Increasing and Improving climate finance in Africa

Europe and the G20 Can and Should Do More to Support Climate Finance in Africa

Opinion piece

Author:

Ameer Chughtai
Researcher, European Council on Foreign Relations

Institution:

EUROPEAN COUNCIL ON FOREIGN RELATIONS
ecfr.eu

The European Council on Foreign Relations (ECFR) is an award-winning international think-tank that aims to conduct cutting-edge independent research on European foreign and security policy and to provide a safe meeting space for decision-makers, activists and influencers to share ideas. We build coalitions for change at the European level and promote informed debate about Europe's role in the world.

Keywords:
climate finance, World Bank, Africa, Europe

INTRODUCTION

Africa's climate needs are growing in a time of international crisis. 17 of the 20 countries most threatened by climate change are African (UNECA, 2023). The catastrophic effects can be seen now, with the Horn of Africa facing its longest drought in 40 years and desertification fueling conflict in the Sahel (House of Lords, 2023).

African countries cannot avert catastrophe on their own, with significant shortfalls in climate finance playing hampering action. Indeed, the current shortfall in climate funding is enormous. African countries will need 2.8 trillion USD, or 280 billion a year, between 2020 and 2030 to meet their needs for mitigation and adaptation in line with the Paris Agreement (CPI, 2022). It is estimated that African countries will be able to put together 286 billion in this decade, meaning other sources will need to provide 2.5 trillion USD. Any external funding that comes in to support African countries, even if is not explicitly tied to climate, will support them in reaching their climate goals.

Currently, two key problems hold back African countries from reaching their climate finance needs. One is that there is simply not enough money available for African countries to fund, implement, and scale up climate projects vital for their development. European countries and the G20 need to step up the financing available to African countries. To do so, they should focus limited resources where they are needed most and explore innovative financial mechanisms. Secondly, a large amount of climate finance to Africa is currently spent inefficiently. Too many scarce resources flow to projects or countries where they are not as needed or are used in ways that do not maximize their impact. For African countries to meet their climate goals, these scarce resources need to be used as efficiently as possible.

WHY EUROPE AND THE G20?

The G20 has an obvious role in supporting climate finance in Africa. As the world's premier forum for international economic policymaking and cooperation, the G20 should be at the heart of the action.

But European countries, with their extensive presence in the G20, should drive the pursuit to ramp up external financing to Africa. One clear reason for doing so is equality and fairness. The fact that Africa has emitted less than any other continent yet remains the most vulnerable to climate change gives a moral imperative to Europe's climate finance efforts (Al Jazeera, 2023). But there are also geopolitical considerations. The sharp reduction in Chinese lending to Africa offers an opportunity for European countries to reassert and strengthen their role as Africa's premier economic partner. And as significant

»European countries, with their extensive presence in the G20, should drive the pursuit to ramp up external financing to Africa.«

»However, all the potential external funders for climate projects are unlikely to significantly increase their funding in the short-to-medium term.«

shareholders in the World Bank and IMF, European countries also have the means to make it happen.

To be effective in ramping up climate finance, Europe and the G20 need to pick their battles. Currently, policy discussions on climate finance mention a broad array of proposals without recognizing how limited financial resources are. To both increase and maximize climate finance, European countries and the G20 need to select a series of policies to push and agendas to advocate.

Despite all the challenges, the World Bank and International Monetary Fund remain the best mechanisms for Africa to reach its climate finance goals. With their past and proven ability to leverage their paid-in capital to lend to developing countries, the two bodies have the best chance to channel and maximize the financing to African countries.

BARRIER 1: STRAINED BUDGETS

The most obvious solution to filling the funding gap is increasing the amount of financing that goes to African countries. Funding can come in many forms, either in concessional loans from multilateral development banks, subsidies for these loans from wealthy countries, or even direct grants.

However, all the potential external funders for climate projects are unlikely to significantly increase their funding in the short-to-medium term. "Higher-for-longer" interest rates have meant that most African countries find it more expensive than ever to borrow to fund climate projects in Africa. The very same factors, along with the Russian invasion of Ukraine, have meant that national budgets in European countries are strained, leading to a sharp reduction in overseas development assistance (ODA). Indeed, the UK, France, and Germany have all radically slashed their spending on aid in recent years (Quinn, 2023; Bollag, 2024; Bollag, 2024a).

The World Bank is also unlikely to be able to significantly increase its lending in the same timeframe, due to geopolitical competition between US and China. China would likely make any significant capital increase depending on a big increase in Beijing's share. And with ties strained between the two superpowers, the US is unlikely to agree to any change in the shares at the World Bank and IMF.

BARRIER 2: INEFFICIENCY

Given the limited nature of resources available, international policymakers need to maximize the financing available and allocate funds efficiently. This is particularly important for concessional finance. Concessional finance refers to grants or lending below market rates. This is typically done by multilateral development banks and other financial institutions. The most significant example is the International Development Association (IDA), the World Bank's concessional lending arm. This concessional lending is particularly important as it is often the only source of financing, climate or otherwise, for the poorest countries in the world.

However, as MDBs need to pay back their own creditors at market rates, they require additional funding to supply below-market-rate loans. As a result, donors from developed countries pay subsidies to make up the difference. However, as subsidies are limited, MDBs cannot lend concessionally unlimitedly. Ideally, all African countries could receive concessional lending and grants to fund their climate projects, but there are not enough resources to make that possible.

However, development banks and financial institutions allocate concessional financing inefficiently in two key ways. One layer of inefficiency is that concessional financing flows largely to relatively wealthy and high-emitting middle-income countries. Indeed, 10 countries attract over half of climate finance in Africa (CPI, 2023). While these countries all have significant climate needs, the overfocus of climate finance in these countries means that other countries invariably lose out. Another layer is thematic. Too much concessional financing goes toward mitigation, rather than adaptation. Indeed, even in low-income countries in Africa with few emissions to mitigate, not enough attention and resources are paid towards adaptation projects (Dimond, 2023).

This is important as adaptation projects are much more difficult to finance from private sources. This is primarily because most adaptation projects do not produce any revenue, complicating their bankability (Arcanjo, 2023). A typical adaptation project, such as the use of floodwalls, cannot produce any money to repay a private creditor. As a result, adaptation projects typically rely more on public money. This is not to say, however, that adaptation projects do not provide significant value for money. Indeed, modeling suggests that adaptation projects provide strong economic benefits for an economy (Ijjasz-Vasquez and Saghir, 2023). Indeed, the principal reason for a lack of investment in adaptation is that these benefits are accrued publicly, rather than privately, deterring investors.

»Given the limited nature of resources available, international policymakers need to maximise the financing available and allocate funds efficiently.«

The need for adaptation projects is also most acute in the lowest-income African countries, meaning that these countries face a double shortfall in climate financing. Data from the Notre Dame Global Adaptation Initiative show that African countries make up 8 of the 10 countries most vulnerable to climate change and that a significant factor in this vulnerability is that these countries have limited state capacity to respond to climate shocks (ND-GAIN, 2023).

THE DECISIVE YEAR FOR CLIMATE FINANCE.

2024 can be the decisive year for climate finance. With Brazil hosting the G20 summit in November, the African Union in its first full year as a G20 member, the IDA21 replenishment, and COP29 in Baku due to focus on climate finance, the time has come for G20 member states to increase and improve climate finance flows to Africa.

There should be three key policy foci. The first is for European countries and the G20 to commit the required resources to the upcoming IDA replenishment. IDA remains a lifeline to many of the most climate-vulnerable countries in Africa, but it depends on subsidies from developed countries to finance its below-market interest rates. This financing occurs in a "replenishment cycle" every 3 years, which falls in 2024. However, despite World Bank President Banga calling for a "record" replenishment, waning development financing may lead to smaller-than-normal funding for IDA (Lawder, 2023). The G20, which makes up the bulk of the largest donors to IDA, should resist this temptation.

»2024 can still prove to be the decisive year for climate finance.«

IDA provides exceptional value for money, and with its ability to leverage 4 dollars in lending for every dollar committed, there are not many better places for development financing available (Songwe and Aboneaaj, 2023).

Second, European and G20 policymakers can increase climate finance in Africa through the use of innovative financial instruments and mechanisms. The most prominent of these has been Special Drawing Rights (SDRs), a type of reserve currency issued by the IMF. Following the COVID-19 pandemic and the issuing of 650 billion USD in SDRs, the G20 committed to rechanneling 100 billion in SDRs to developing countries, many of which are in Africa. To do so, the IMF set up the Resilience and Sustainability Trust, with a specific climate focus, to complement the pre-existing Poverty Reduction and Growth Trust. However, since the initial drive to use SDRs to support developing countries, less than 1 billion USD of the original 100 billion has reached its intended recipients.

The proximate reasons for SDRs not living up to their original promise are technical, but the underlying reasons are political. The changes required to rechannel SDRs are difficult, complicated, and expensive, but they are not insurmountable to a motivated G20. Proposals such as SDR-linked bonds and hybrid capital show potential pathways that European countries and the G20 should support and implement (Setser and Paduano, 2023; Paduano, 2024). Doing so will ramp up climate financing to Africa in the time that it needs it most.

Third, it is also necessary for the G20 to support the World Bank's development arms to drive resources to where they are needed most. This means that a greater share of financial resources for climate projects needs to flow to low-income countries, who have few means to fund their projects. Grants need to be more focused on adaptation projects, and inevitably, a smaller proportion of financing should be allocated to middle-income countries.

CONCLUSION

In many ways, the current economic backdrop makes funding climate projects in Africa harder than ever. Increased geopolitical competition, a financial shift toward military budgets, and tight monetary policies globally make finding money for climate in Africa extremely difficult. But in the African Union's first full year as a member of the G20, Africa's climate needs will continue to rise in the international agenda.

Despite the difficulties, Africa can meet its climate needs, but it requires European countries and the G20 to support its efforts. To do so, European countries should focus their resources where they are needed most and where they can have the most impact. This should include the pooling of resources on the IDA replenishment and using innovative financial mechanisms to increase the amount of financing that the World Bank and IMF can lend. Efficiency will also play an important role. Concessional financing has to flow where it is needed most, namely to fragile, low-income countries and adaptation projects.

2024 may prove to be the decisive year for climate finance. However, European countries and the G20 are in danger of missing the chance to secure more and better climate finance for Africa. Forgoing this opportunity will endanger the lives and livelihoods of Africans across the continent and weaken Europe's role as Africa's premier economic and political partner.

REFERENCES

Arcanjo, M. (2023, April 13). The adaptation finance gap: Why is it lagging? Eco. https://www.ecoltdgroup.com/adaptation-finance-gap/

Bollag, B. (2024a, February 19). How Germany is cutting billions from foreign aid. Devex. Retrieved from https://www.devex.com/news/how-germany-is-cutting-billions-from-foreign-aid-107055.

Bollag, B. (2024, March 6). French government criticized over $806m cut to aid criticized over $806m cut to aid. Devex. Retrieved from https://www.devex.com/news/french-government-criticized-over-806m-cut-to-aid-107193#:~:text=This%20year's%20public%20development%20aid,million)%2C%20or%2012.5%25.

Climate Policy Initiative. (2022). (rep.). Landscape of Climate Finance in Africa. Retrieved from https://www.climatepolicyinitiative.org/publication/landscape-of-climate-finance-in-africa/.

Dimond, V. (2023, October 31). Who Gets World Bank Climate Money? An Exploration of Adaptation Financing to Lower-Income Countries. Center for Global Development. https://www.cgdev.org/blog/who-gets-world-bank-climate-money-exploration-adaptation-financing-lower-income-countries

House of Lords, Horn of Africa: Projections of a famine in 2023 (2023). House of Lords. Retrieved from https://lordslibrary.parliament.uk/horn-of-africa-projections-of-a-famine-in-2023/.

How much does Africa contribute to global carbon emissions? (2023, September 4). Al Jazeera. Retrieved from https://www.aljazeera.com/news/2023/9/4/how-much-does-africa-contribute-to-global-carbon-emissions#:~:text=On%20a%20per%20capita%20basis,North%20America%20(10.3%20tonnes).

Ijjasz-Vasquez, E., & Saghir, J. (2023, August 18). Climate adaptation finance in Africa. Brookings. https://www.brookings.edu/articles/climate-adaptation-finance-in-africa/

Lawder, D. (2023, December 6). World Bank's Banga calls for record replenishment of funds for poorest countries. Reuters. Retrieved from https://www.reuters.com/world/africa/world-banks-banga-calls-record-replenishment-fund-poorest-countries-2023-12-06/.

Notre-Dame Global Adaptation Initiative Index (ND-GAIN). (2023) Retrieved from https://gain.nd.edu/our-work/country-index/.

Paduano, S. (2024, January 23). A State of Play on SDRs. Finance for Development Lab. https://findevlab.org/a-state-of-play-on-sdrs/

Paduano, S., & Setser, B. (2023, March 16). How an SDR-Denominated Bond Could Work. Council on Foreign Relations. https://www.cfr.org/blog/how-sdr-denominated-bond-could-work

Quinn, B. (2023, August 2). UK aid budget cuts are a 'death sentence' for the world's most vulnerable children. The Guardian. Retrieved from https://www.theguardian.com/world/2023/aug/02/uk-aid-budget-cuts-are-death-sentence-for-worlds-most-vulnerable-children.

Songwe, V., & Aboneaaj, R. (2023). (rep.). Center for Global Development. Retrieved from https://www.cgdev.org/publication/ambitious-ida-decade-crisis.

United Nations Economic Commission for Africa (UNECA). (2023, November 2). 17 out of the 20 countries most threatened by climate change are in Africa, but there are still solutions to this crisis. Retrieved from https://www.uneca.org/stories/17-out-of-the-20-countries-most-threatened-by-climate-change-are-in-africa%2C-but-there-are.