

Policy Brief: Opportunities for Private Sector Investment in Climate Action in Sub-Saharan Africa

International and domestic private investment flows will be essential to assist African countries fund the transition to a low-carbon, climate-resilient future. However there are no quick-fixes. Investment momentum will be achieved by making the policy environment more receptive to private sector investment. Committed political leadership is required to drive policy reforms coupled with public sector risk finance to build investable project pipelines.

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May 2019

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KEY MESSAGES

- Mitigation efforts in Africa require a different approach to other regions. Widespread landscape degradation is responsible for 43% of CO₂ emissions on the continent, which exceeds emissions from that of the energy sector (Tubiello, 2014).
- Sustainable land management solutions, which are able to address both emissions and support more resilient agricultural practices, are recognised in country Nationally Determined Contributions (NDCs) but in many cases are not translated into effective policies or programmes.
- Meeting current food demand is already a formidable challenge for the agriculture sector and poorly developed infrastructure adds additional risks. Public Private Partnerships have proved successful in unlocking private sector adaptation finance in agriculture. International development agencies and other intermediaries can play an important brokering role.
- Madagascar has secured funding from the Green Climate Fund (GCF) to implement the first GCF-funded adaptation project in Africa, which aims to build a resilient rural economy through distributed renewable energy projects and improved farming techniques.
- Index-based insurance can enhance climate resilience for smallholder farmers. On its own, it represents only part of the overall solution and needs to be implemented alongside support for market access and technology to improve yields.
- The NDCs of 52 out of 54 African countries mention renewable energy, however more than half of the NDC renewable energy targets are conditional on countries receiving climate finance support.
- South Africa's Renewable Energy Independent Power Producer Procurement Programme (REIPPPP) is a good example of what can be achieved with ambitious energy sector reform, coupled with political leadership and an engaged private sector. Government guarantees helped to de-risk the long-term power purchase agreements.
- Energy access for the millions of Africans without clean and reliable supply is a key developmental goal and this is reflected in many country's NDCs. Distributed renewable energy systems with clean and efficient cooking solutions provide the best chance for Sub-Saharan Africa (SSA) to achieve universal access and transition to a low-carbon economy.

Introduction

In the lead up to Conference Of the Parties (COP) 21 in Paris, all SSA countries submitted comprehensive and quantifiable countrywide mitigation and adaptation targets. The targets contained in NDCs are mostly conditional on support, which can be categorized into adaptation finance, mitigation finance, technology transfer and capacity building. The funding gap requires the mobilisation of large amounts of private finance, exceeding current investment flows into African economies.

Research reveals private sector investment barriers to funding climate action in SSA. The barriers have parallels with challenges encountered in the African infrastructure sector and fall into well-documented categories: appropriate policies; institutional arrangements; capacity development; financing and de-risking mechanisms; and importantly, committed leadership. Private sector investment momentum will be achieved by addressing factors that make the policy environment more receptive to foreign investment. The leverage points in this complex system require committed political leadership to drive policy reforms, coupled with public sector risk finance to build investable project pipelines.

This policy brief examines case studies and provides a set of recommendations for policy-makers to incentivise stronger private sector participation in the implementation of NDCs.

Mitigation efforts must address emissions reduction, resilience, food security and rural development

Mitigation efforts in Africa require a different approach to other regions. Globally the AFOLU sector - Agriculture, Forestry, and Other Land Uses - accounts for 24% of anthropogenic emissions. However in Africa, the AFOLU sector accounts for 43% of CO₂ emissions, which exceeds emissions from that of the energy sector on the continent. Climate action in the AFOLU sector is of significant interest and importance to SSA countries.

AFOLU activities, which represent a large portion of national economies, are particularly at risk from climate change, and create opportunities for programmes that link emissions reduction to resilience, food security and rural development goals (Tubiello, 2014). However projects in this sector are both challenging and high risk, and therefore they currently do not attract the level of funding required to build resilience and address productivity. The Case Study discussed below titled 'Sustainable Landscapes in Eastern Madagascar', funded by the GCF, aims to address this important nexus.

Private sector investment in agriculture is essential for food security

Agriculture, especially in Africa where rain-fed agriculture prevails, is extremely vulnerable to climate change. Adaptation projects in the agriculture sector are currently struggling to secure the necessary public or private sector funding to build a climate-resilient sector. In addition, poorly developed infrastructure on the continent adds additional risks to food production, logistics and access to markets. Meeting food demand for a growing population is already a formidable challenge for the sector, and it will be further exacerbated as the effects of climate change escalate and compound.

Climate resilience for smallholder farmers can be enhanced through Index-based insurance. Innovative means to reach farmers include automatic bundling of insurance with agriculture inputs such as seeds, and payouts by mobile phones. Like many finance mechanisms, it represents only part of the overall solution to build climate resilience in the agriculture sector in Africa, as it needs to be implemented alongside other initiatives such as support for market access and technology to improve yields.

Public Private Partnerships (PPPs) are an important mechanism to unlock private sector adaptation finance in agriculture. International development agencies have played an important brokering role to facilitate partnerships between the public sector and international agribusiness. Our research shows how relationships that become established between public and private actors through PPPs often result in further investment. The African Union Commission is exploring ways of supporting the development of agri-PPPs to catalyse private sector investment as part of the Commission's strategy to strengthen the sector.

Case Study: Sustainable Landscapes in Eastern Madagascar funded by the Green Climate Fund (GCF).

Madagascar has secured funding from the GCF to implement the first GCF adaptation project in Africa. This project addresses both mitigation and adaptation climate action. It demonstrates efforts by the Government of Madagascar to stimulate the rural economy through renewable energy projects, and support for agriculture through improved farming practices. A key goal is leveraging private sector finance, enabled through policy reform. The innovative institutional and financial setup includes funding from a \$ 300 million climate bond issued by the European Investment Bank.

Renewable energy in Africa addresses key development goals



The underdeveloped energy sector in SSA creates both opportunities and challenges for future development and future emissions reduction pathways. Energy access for the millions of Africans without clean and reliable supply is a key developmental goal and this is reflected in many countries' NDCs. Distributed renewable energy systems with clean and efficient cooking solutions, provide the best chance for SSA to achieve universal access and move towards a low-carbon economy. The rapid deployment of renewable energy, coupled with energy efficiency, can achieve around 90% of the global emission reductions in the energy sector needed by 2050, while at the same time advancing economic growth and development. The African Union has named energy as a top priority for the first decade of its Agenda 2063 which outlines the strategy for socio-economic transformation of the continent over the next 50 years. There are encouraging signs of growth in the sector, however the contribution of renewable energy (excluding hydroelectric sources) remains very small, representing less than 1% of SSA's installed capacity. Projects to address energy sector reform and improve the enabling environment are underway in a number of SSA countries, creating significant investment opportunities for private sector funders.

Case Study: South Africa's Renewable Energy Programme

Our research finds encouraging signs emerging from the growth in utility scale renewable energy infrastructure. South Africa's renewable energy programme, the Renewable Energy Independent Power Producer Programme (REIPPPP), is a good example of ambitious energy sector reform, largely funded by debt from local commercial banks with equity taken up by national and international project developers. There are success stories of utility scale renewable energy projects in less liquid African economies, supported by multi-lateral development banks and funds, policy reform and targeted application of concessional and non-concessional public financing. The REIPPPP has attracted about ZAR R210Bn (USD \$15Bn) of private capital to renewable energy in South Africa over four bidding rounds, with 20% of this amount coming from foreign investors. (Dept of Energy, S.A 2018). Due to differences in the maturity of financial markets and related barriers, a programme such as the REIPPPP set up in other SSA countries may not lead to a similar success. However key success elements of the REIPPPP, such as the introduction of government guarantees to de-risk the long-term power purchase agreements, will help to build the foundation for renewable energy programmes in other SSA countries.

Recommendations for Policy-makers

Climate change presents an additional risk multiplier to the private sector investment equation. In addition, African policy-makers need to understand how they will compete with other developing regions to secure a meaningful proportion of available private finance for climate action. Below is a list of recommendations that will help policy makers focus their efforts towards addressing the private sector funding challenge.

Integrating NDC commitments into national development strategies will help to build momentum

Countries must ensure that there is strong political backing and broad stakeholder support for NDCs developed through participatory processes to ensure ownership, awareness and credibility. We have learned over the last decade that effective implementation of climate action should not only be driven by ministries of environment. Coordination across several government agencies and ministries is required. There is a need to tackle climate change as a multi-sectoral challenge with the finance ministry playing a key role in driving the response.

Cabinet ministers and senior bureaucrats involvement in the planning processes will build support and create awareness of trade-offs and benefits. NDCs should feature in subnational and sectoral investment plans and these should be developed and framed as investment opportunities for the private sector

Strengthen the investment climate

A constrained investment climate has been demonstrated to limit foreign direct investment. This must be addressed through enforced property rights, a robust framework for PPPs and sound investment policies and incentives. Other criteria include legal and regulatory systems, dispute resolution, intellectual property rights, transparency, performance requirements, effective state-owned enterprises, responsible business conduct, and action against corruption.

Don't compete with the private sector

Crowding out can occur when government-funded development projects discourage private enterprise from taking place in the same area of the market. This is especially true for economies with underdeveloped private sectors. Public finance must rather support innovative early movers, and take the risks that the private sector is not ready to take. Examples include public spending that de-risks projects using guarantees to underpin credit worthiness, funding incentive mechanisms such as price guarantees, and concessional finance to complement early-stage risk. Our case study on 'PPPs for Agriculture in Ethiopia' illustrates the developmental benefits of collaboration between public and private actors in attracting private sector funding to the agriculture sector.



Use public finance to catalyse private sector investment

Public sector finance needs to be used in innovative ways to de-risk investments or improve returns. Aggregating and catalysing investments, strengthening capital markets and supporting early stage project development, may achieve these goals. Guarantees and insurance provided by DFIs and Export Credit Agencies (ECAs) are the most obvious example of explicit risk mitigation available to support infrastructure projects across the region. A number of African countries have successfully employed tax rebates, VAT relief and reduced import tariffs to encourage the growth of the renewable energy sector. The sovereign guarantees provided to Independent Power Producers in South Africa's REIPPPP, played a key role in de-risking private sector participation.

Look for sources of readiness funding to address capacity constraints

Climate finance readiness aims to develop the capacities of countries to plan for, access, deliver, and monitor and report on climate finance in ways that are catalytic and fully integrated with national development priorities. Readiness strategies should look at various sectors and assess climate change risks, ability to attract private sector project developers, and attractiveness of investment cases as criteria to assess where to focus efforts.

Ensure optimum institutional arrangements

Cross-cutting bodies have proven effective in driving forward, supporting and monitoring climate-related policies. These bodies may assist government departments to respond effectively, maximise opportunities and skills, and avoid overlap. Committed leadership of these institutions is key to achieving the desired impact. An example is South Africa's Independent Power Producers (IPP) Office, which involves Treasury and Ministry of Energy and has been a key part of the success achieved by the REIPPPP.

Public Private Partnerships (PPP) create opportunities in the agriculture sector

The involvement of agents or brokers to initiate PPPs in the agriculture sector is relatively common practice in SSA and well described in the literature. In our research in Ethiopia, we found that international development agencies have played a key role in linking up international agribusiness directly with public sector institutions. This has allowed relationships to develop that have played a critical role in promoting changes in policies and regulations affecting the sector. For large multi-national corporations, complying with corporate level sustainability statements or global commitments is a critical driver and PPPs that fulfil these criteria are likely to get traction.

Address the enabling environment through policy reforms

National and sub-national governments have a crucial role to play in creating the policy and institutional environment that will incentivise private sector investments in low-carbon programmes. The enabling environment should address policy frameworks to support technologies or solutions that are economically viable to reach commercialization and scale up. Through policies, governments should look to address the business environment, financing barriers, transaction costs and risk perceptions.

Stable macro-economic environments support private sector investment

An 'investment grade' given to countries indicates that they have a relatively low risk of default. This encourages the possibilities of traditional project financed deals, particularly in the power sector in SSA (Eberhard et al., 2017). Whilst investment grades may take years to turn around, policy regimes that are clear, stable and predictable will find traction amongst investors.



Identify and support champions to drive programmes

Local government actors need to fill the leadership void by accepting the challenge of building resilience in a world impacted by a changing climate. This is especially true of major cities in SSA that are rapidly urbanising. Champions within the public sector at local level should access available support and harness opportunities that will prepare their communities, build resilience, create jobs and secure political capital that will enhance their ability for further action.

Innovate and learn from success and failures

Public sector actors need to promote new processes and technologies, and support research that may provide breakthroughs. Support for pilot projects encourages learning-by-doing. Partnerships with developed country businesses and institutions promotes knowledge and skills transfer to move pilot projects into replication and upscaling. Successful innovation applies to processes as well as products and is often incremental rather than transformational.

Engage the private sector in implementing NDC targets

Addressing the impacts of climate change in Africa will require significant investment in multiple sectors to build a climate-resilient future. This represents an investment opportunity for the private sector with varying levels of returns based on the sector, project type, and a number of other factors. Governments should actively host roundtable discussions to understand investment barriers and to develop responses to stimulate private sector participation in implementing NDC-related projects.

In conclusion

Encouragingly, the international investor community with trillions of dollars under management is starting to face up to the challenges and opportunities associated with climate change. It is estimated that at least \$4.2 trillion of assets globally are at risk of being stranded as a result of climate change – roughly the size of the world's third largest economy, Japan. Fund managers are beginning to take notice of the widespread risks and opportunities to financial markets. African public sector actors should engage with the investment community to build trust and understand areas of concern particularly related to transparency and governance to ensure that their countries secure a meaningful proportion of private finance for climate action. Understanding the requirements of private sector, particular at sector level, will help policy-makers craft strategies and programmes that are investment ready.



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