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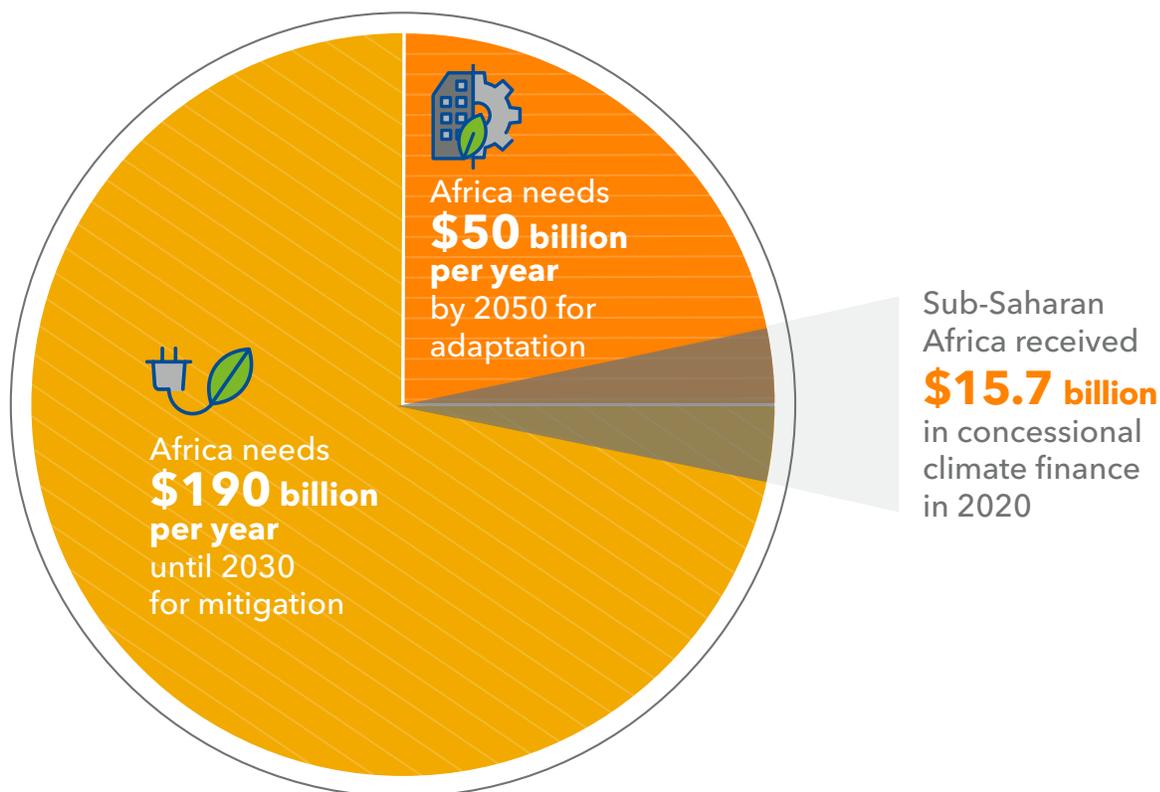
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Closing the Gap: Concessional Climate Finance and Sub-Saharan Africa

Although sub-Saharan Africa is the world's smallest contributor to global greenhouse gas emissions, it is the most vulnerable to climate-related shocks. Addressing climate change will be costly, and few sub-Saharan African countries have the resources or fiscal space to tackle this challenge without assistance from the international community. Concessional finance should be scaled up to strengthen the region's resilience to climate change and to help speed the green energy transition. This note explores some available options, highlighting the untapped resources currently available from multilateral climate funds, and noting in particular the demand for new ways of connecting public, private, and concessional finance to lift investment and close the gap between resources and needs. Part of the effort to scale up climate finance will entail steps to address existing bottlenecks—including on the part of recipient countries—in order to ensure that committed funds are used swiftly and effectively.



A Global Problem

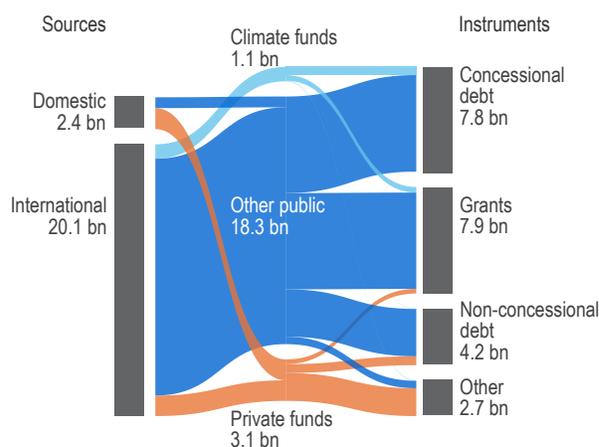
Worldwide, climate change is an increasingly urgent threat to the lives and livelihoods of millions. **This challenge is particularly pressing for sub-Saharan Africa**, which has a highly vulnerable population, and where climate shocks often amplify existing social tensions and food-security concerns—out of the world’s 10 most vulnerable countries, 8 are in sub-Saharan Africa (ND-GAIN 2023). Moreover, **energy demand in sub-Saharan Africa is set to expand dramatically over the next few decades**. Adopting the same carbon-intensive path taken by other economies would potentially undermine the global effort to contain global warming (IMF 2021).

Clearly, any viable global solution to climate change will need to consider the region’s concerns and interests. And it must ensure that sub-Saharan Africa gets the resources it needs to both protect its people and secure a swift energy transition. **Africa cannot and should not be expected to shoulder this burden alone.**

This note draws on recent climate-related research in the IMF, focusing on options to scale up climate finance in sub-Saharan Africa (Belianska and others 2022). In particular it highlights the importance of concessional climate finance—defined here as below-market-rate funding from grants, loans, or other instruments aimed at supporting climate-related development objectives.

The case for concessional climate funding is relatively straightforward. On simple equity grounds, Africa has contributed little to the accumulation of greenhouse gases but is nonetheless the **world’s most vulnerable region** to global warming. On efficiency grounds, climate action is a clear example of a **global public good**, whereby concessional funding can narrow the gap between the private costs faced by the region and the social benefits enjoyed by the rest of the world, especially on mitigation. And in practical terms, concessional finance still dominates the flow of climate finance to the region (Figure 1), making it the most **promising funding source in the immediate term.**

Figure 1. Climate Finance Flows to Sub-Saharan Africa, 2020



Source: Climate Policy Initiative.

Concessional Finance Should Be Scaled Up to Build the Region’s Resilience

Addressing climate change, through both adaptation and mitigation, will be costly. Estimates of these costs vary but are generally daunting. For the African continent alone, adaptation costs could reach \$50 billion per year by 2050—equivalent to 1.6 percent of current GDP—even in a two-degree Celsius scenario (GCA 2021). And mitigation costs for a clean energy transition in Africa have been estimated at about \$190 billion per year until 2030 (IEA 2022).

In current circumstances few, if any, countries in sub-Saharan Africa have the resources to meet these needs. **Local public resources are limited**, given practical limits on domestic revenue mobilization, elevated debt levels, tighter global financial conditions, and rising borrowing costs. Moreover, these constraints are not equally distributed across countries. In sub-Saharan Africa, the countries that are most at risk—through either their vulnerability to climate shocks or constraints on their ability to adapt quickly (readiness)—also tend to be countries with little remaining fiscal space (Figure 2). So, for public authorities at least, there is often **little scope to tackle climate change by taking on further debt**, especially not at market rates. The region will need concessional financial support.

Currently, concessional climate finance in sub-Saharan Africa comes in the form of grants or concessional loans, mainly from **major bilateral donors, multilateral development banks (MDBs), and multilateral climate funds**. In 2020, concessional climate flows received by the region totaled \$15.7 billion, well short of the region's needs but amounting up to 70 percent of total climate flows (Figure 1) and almost a fourfold increase from a decade ago.

These resources are most welcome. But, while concessional climate flows are rising, this comes against an overall decline in official development assistance (ODA)—as a larger share of a shrinking envelope; therefore, climate financing may risk crowding out funding for other important development goals. Over the past few decades, for example, total ODA flows into sub-Saharan Africa have fallen from more than 6 percent of recipient GDP in the early 1990s, to about 2½ percent currently. And going forward, despite the temporary surge in ODA during the COVID-19 pandemic, tighter global financial conditions suggest that official aid flows will likely shrink further over the near term. Indeed, some major donors have already announced significant cuts in their foreign-aid budgets. This potentially puts recipients in an impossible situation, where actions to address the longer-term climate needs of the planet come at the expense of the immediate development needs of their people. **Concessional climate finance should be additive, coming on top of current aid flows, rather than replacing them.**

It should be noted that concessional finance is by itself unlikely to meet the region's transition and adaptation needs, as the amounts required to fund adaptation and mitigation are immense. Still, concessional funding can nonetheless play a critical role in **expanding access to private sector capital**—for example, by accelerating high-priority projects that can help unlock follow-on private investment or by allowing for risk-sharing arrangements that address the most pressing concerns of risk-averse investors.

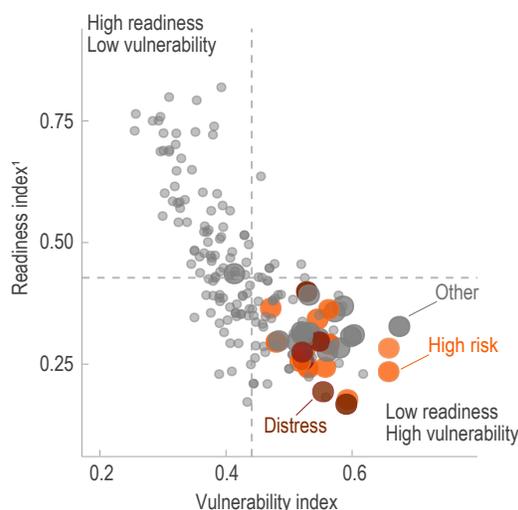
In this context, sub-Saharan Africa urgently needs new ways of connecting public, private, and concessional finance to lift investment and close the gap between resources and needs. This is an often-complex issue, and will require **increased cooperation and innovation** across the broader international community, including: donors, private investors, development finance institutions, MDBs, and international financial institutions.

MDBs in particular will likely play an essential part in helping boost climate funding to sub-Saharan Africa, as they already serve as a key source of long-term and concessional funding. On climate and other global public goods the role of these institutions is evolving rapidly. **Climate finance committed by MDBs in sub-Saharan Africa has more than tripled since the 2010s**, and they have valuable experience in financial structures that include guarantees, insurance, risk mitigating features, or other capital-market instruments to help address barriers to investment.

Further, MDBs can also have a key role in **leveraging their existing climate expertise**—improving data and information on climate projects for the private sector, through local capacity development and enhanced project identification and monitoring.

Figure 2. World: Climate Vulnerability Indicators, 2020

Index, 0-1, large circles are sub-Saharan African countries; colored circles are IMF debt risk ratings for PRGT-eligible countries)



Sources: ND-Gain; and IMF staff calculations.

Note: PRGT = Poverty Reduction and Growth Trust.

¹ Readiness index includes measures of social and governance readiness only.

Money on the Table: Climate Funds Are an Untapped Funding Source

Multilateral climate funds have existed since the 1990s. But in 2009, when advanced economies committed to provide \$100 billion per year in climate finance by 2020, these funds gained greater prominence. Viewed by donors as a **convenient, purpose-built mechanism of channeling assistance for climate goals**, climate funds source their financing from bilateral donors or multilateral financial institutions and then allocate these resources to recipients—which may include governments, national development banks, nongovernmental organizations, or the private sector (including commercial banks). In some cases, climate funds provide concessional resources through simple grants. In other cases, concessionality is provided through subsidized interest rates, extended loan tenors, or other enhancements that lower the cost of climate-related investment.

Climate funds are only a small part of sub-Saharan Africa’s overall funding mix. But they nonetheless represent a **largely unused pool of finance at a time when spending and investment needs are increasingly urgent**.

To date, climate funds have taken in much more than they have disbursed. Since their inception, worldwide deposits in climate funds have totaled \$35 billion (from \$43 billion in pledges). Of that amount, only \$28 billion has been set aside for approved projects, and less than \$11 billion has actually been disbursed. Moreover, sub-Saharan Africa is arguably underrepresented in these outflows, with \$7 billion approved and disbursements of less than \$3 billion (CFU 2022). Thus, a significant backlog of unused deposited funds remains. These deposits cannot be repurposed or withdrawn and are simply **waiting to be matched with appropriate projects**.

Heterogeneity across climate funds remains a key bottleneck. The operations of these funds differ significantly. Some provide project financing directly to accredited recipient governments or subnational entities. But about 90 percent of disbursements from climate funds in sub-Saharan Africa are provided indirectly, through regional or international implementing partners. For individual countries, meeting the requirements for direct financing can be onerous, and vary from fund to fund. In addition, project selection and evaluation criteria also differ. This can prevent a country from directly interacting with more than one climate fund at a time. The Green Climate Fund (GCF), for example, is the largest climate fund worldwide, but it has relatively low accreditation rates and slow disbursements, reflecting lengthy and often complex processes (Fouad and others 2021).

Addressing Bottlenecks to Take Full Advantage of New Funding Sources

Sub-Saharan Africa’s need for climate funding—especially concessional climate funding—is urgent. The international community can certainly do more. But part of the effort to scale up climate finance for the region should also include **steps to ensure that committed funds are being used swiftly and effectively**.

Country authorities can play a powerful role in addressing key bottlenecks in the identification and funding of suitable projects. In the short term, this can help them directly access already-deposited funds that are sitting unused in the climate funds. Looking forward, a pipeline of credible, climate-related, “bankable” projects is key to unlocking private investment (for examples, see Belianska and others 2022). Authorities should enhance their governance and legal frameworks, promote the development of local financial institutions that can identify green projects, and work with partners toward the accreditation of implementing entities who meet the varying requirements of the climate funds.

Climate funds should further streamline their accreditation processes and requirements, noting the high compliance costs for sub-Saharan African countries, particularly for small and fragile states. Focus should be on areas where strong local capacity can translate into strengthened financial safeguards, with the aim of channeling funds more swiftly and efficiently to economies in greatest need.

Development partners (bilateral agencies and international organizations, such as the IMF) have a critical role in supporting countries to strengthening and build capacity, which would raise their access to all sources of concessional climate finance. Priority areas include governance and public financial management, the development of adequate data and climate strategies, and broader policies to enhance macroeconomic stability.

In this context, the IMF's new **Resilience and Sustainability Facility (RSF)** is an important new financing instrument that will help sub-Saharan Africa address longer-term structural challenges such as climate change, as well as act as a catalyst for climate finance (IMF 2022a). It provides affordable long-term financing to support adaptation, mitigation, and transition efforts, while also providing a framework of transparency, credibility, and stability that is essential in incentivizing investments in climate resilient infrastructure and renewable energy projects. Rwanda is the first country in the region to have received funds from the RSF, which will strengthen monitoring of climate-related spending, integrate climate risks into fiscal planning, include climate-related issues into public investment management, strengthen climate-related risk management for financial institutions, and reinforce disaster risk reduction and management (IMF 2022b).

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