CLIMATE MARKETS AND AFRICA

Geoff Sinclair considers the current role of climate policy and markets in Africa, the effectiveness of initiatives to date and what Paris can do to help

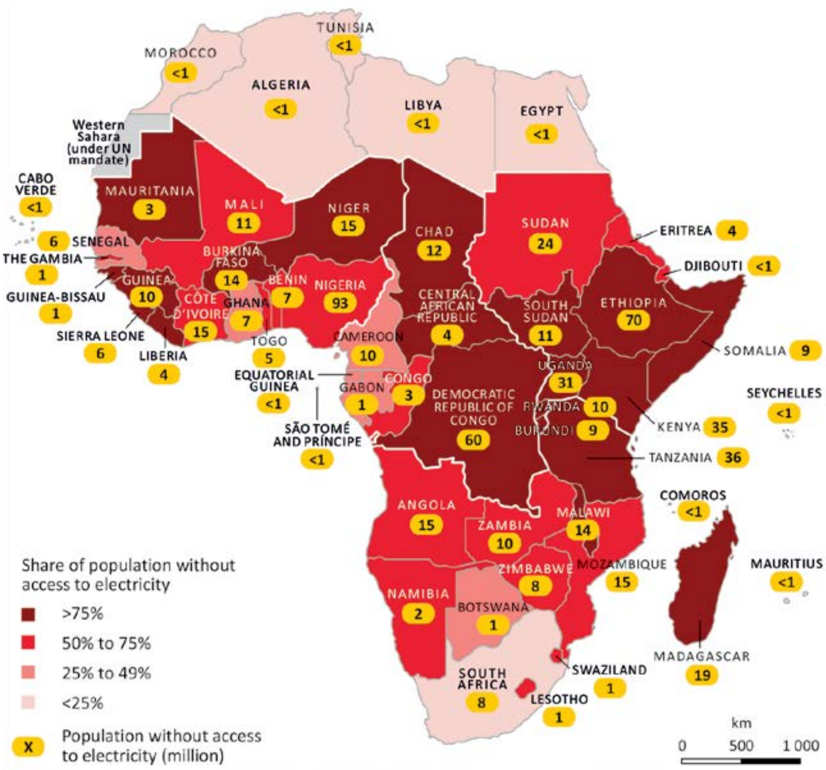
Successful economic development in many African nations relies on building appropriate infrastructure that is resource efficient. Climate policy and markets can help – but any initiative needs to consider the specific local challenges.

AFRICAN DEVELOPMENT CHALLENGES

Africa is the only continent where both the number of people without access to electricity and the number of people in extreme poverty are rising.

In many African countries, there has been a chronic failure to develop and maintain the energy infrastructure that is critical (alongside investment in education and health) to reverse this trend, and much of the existing infrastructure is costly and inefficient. This failure has not been due to a lack of latent demand, but due to other challenges including political complexity and instability, lack of creditworthy grid companies, weak government balance sheets, corruption, and lack of capacity in the public and private sectors. Project and infrastructure development in Africa requires a range of enabling conditions to be in place before it can truly take off. That said, many forms of climate-friendly infrastructure make sense in African countries even without the motivation of climate change mitigation: renewable energy, for example, is isolated from the cost, risk, currency exposure and logistical challenge of long-term fuel supply requirements. And with the dramatic reduction in costs, PV panels and wind turbines in particular, many projects are starting to stack up on unsubsidised economics. Many African households currently use a mix of fuels such as charcoal, kerosene and diesel when they can afford it – renewable energy solutions are already significantly cheaper and more reliable than these.

"Spreadsheet" economics, however, does not mean that projects will happen. Each project has unique challenges, often requiring solutions (such as government or credit guarantees) that appear anathema to developed countries. Technological approaches also need to be adapted to local conditions: for example, given continued failure of centralised generation and transmission in many African countries, it is likely that smaller, decentralised solutions will be more successful.

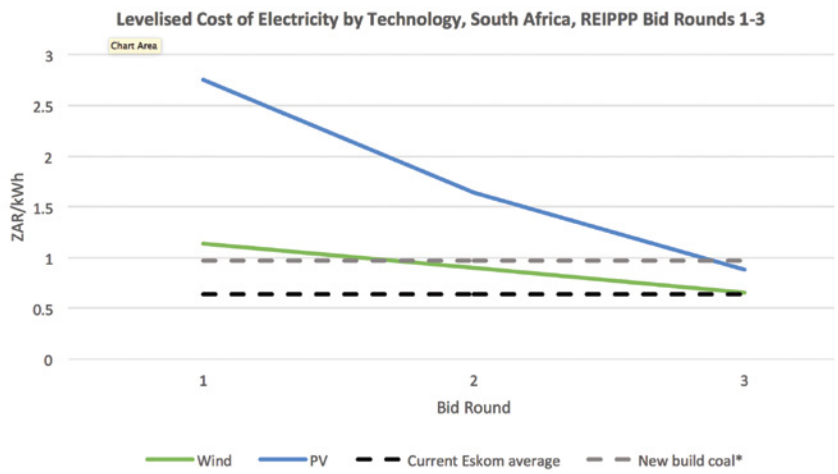


Source: International Energy Agency, Africa Energy Outlook 2014

MARKET APPROACHES TO STIMULATE GREEN DEVELOPMENT

THE CLEAN DEVELOPMENT MECHANISM

Until prices fell, the private sector viewed the Clean Development Mechanism (CDM) as a potential economic incentive to stimulate investment in green development. Most African countries, however, largely missed out, with the vast majority of investment going to Brazil, China and India. It it is clear that there were a number of reasons for this:



Notes: Price fully indexed, average ZAR/kWh base April 2011. Source: South Africa Department of Energy

- On the whole, CDM project activity was driven by economic development, rather than driving it;
- The general impediments to economic development in many African countries continued to exist; and
- The complexity and transaction costs of the CDM, particularly the measurement, reporting and verification of emissions, biased it towards large projects – whereas the greatest potential in Africa continues to be in smaller, distributed technologies. Programmatic CDM overcame this just as prices collapsed.

CLIMATE FINANCE

'Climate finance' is seen by many as a solution. There has been a rush of public funding available, to the point where public and quasi-public providers find themselves aggressively competing to finance a small pool of bankable projects. The problem is a need to get potential projects to the point where they become truly investable.

THE DEFINITION OF CLIMATE FINANCE APPEARS TO INCLUDE A NUMBER OF KEY COMPONENTS:

Grants and capacity building, which are a valuable source of support (and equity) for many developers, but have historically been restricted to a narrow range of external costs and have tended to be biased towards donors' political agendas;

Provision of loans and/or equity investment have traditionally been disbursed through multilateral and bilateral development banks, although donors are using an increasing number of innovative structures such as Green Africa Power. These provide up-front finance but are often restricted to projects that are large and/or already bankable. Most public funds of this nature require a minimum ratio of private to public funds.

Results-based finance *(RBF),* alternatively called pay-for-performance. Entering into a long term purchase of certified emission reductions (CERs) is one example, and the World Bank's Pilot Auction Facility is continuing innovation in this context, but other "results" such as certain social and health outcomes may also be purchased. Despite the name, RBF does not typically involve up-front finance, requiring investors to take the project development, implementation, financing and performance risk.

RBF initiatives are being developed with reference to local needs and conditions; the South African Renewable Energy Independent Power Provider Programme (REIPPP) is good example. The REIPPP consists of a series of tender rounds in which prospective developers compete based on the electricity tariff that their project would require, and has yielded remarkable results, including solar PV tariffs that are lower than those of competing thermal generation. The success of the REIPPP, however, also rests on government backing for the power offtake, a well-developed legal and regulatory framework and a grid capable of absorbing significant new (and intermittent) generation.

A number of African countries are now considering implementation of a similar mechanism, with Nigeria having recently tendered for related advice. Likewise, other initiatives such as Uganda's GET-FiT, a combination of subsidised renewable energy tariffs and standardised documentation, are planning geographical expansion.

PARIS AND BEYOND

It is easy to think of 'African' development in simplistic, top-down terms from a developed country perspective. Given the size and complexity of the continent, and the policy and development environment, initiatives to develop climate-friendly infrastructure can only be useful if they meet local priorities and intelligently apply a broad range of tools to have maximum impact. Helping developers to generate bankable projects is key.

Intended Nationally Determined Contributions (INDCs) reflect local priorities, thus can form the basis of a broad range of tailored engagements to assist development. In this scenario, African countries would direct their own development, while donor countries would work with them, applying a wide range of tools including guarantees, risk mitigation,

"SPREADSHEET" ECONOMICS DOES NOT MEAN THAT PROJECTS WILL HAPPEN

early stage project development assistance, grants, advice, loans, investments and RBF. This approach would also involve working with markets to facilitate projects.

A complex ecosystem of initiatives is already beginning to develop along these lines, and will continue to do so into 2016 – although there is possibility of donor competition and lack of coordination. As in financial markets more generally, however, the answer is in encouraging coordination, innovation and information disclosure. The Green Climate Fund may also play a significant role by providing both tools and people to apply them.

Paris can play an important catalytic role in aiding these developments:

- by stimulating the implementation, in a timely manner, of a well-considered set of INDCs that reflect local conditions and priorities (but nevertheless involve as much regional coordination as possible);
- by encouraging climate finance providers to support initiatives that work with local stakeholders and developers, using a broad range of tools with maximum flexibility and in a nuanced way to boost the number of bankable sustainable development projects and get them financed; and
- by explicitly acknowledging that African countries should be able to develop their own policies using the broadest range of tools and providing a means to link domestic tools to international mechanisms and standards, for example through tradeable instruments.

With the right framework of policies and financial support, the African continent can develop the infrastructure it needs to stimulate economic development that is consistent with the 2°C target and become an important contributor to global economic growth. The performance of individual countries in Africa will always vary, but Paris can play an important role in helping them to get there.

Geoff Sinclair *is Managing Director of Additional Energy, which specialises in renewable energy and innovative climate finance solutions for sub-Saharan Africa. He was previously head of climate finance at Standard Bank.*

ADDITIONAL ENERGY