Paying Africa's Climate Bill

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A GLOBAL APPROACH TO CLIMATE CHANGE REQUIRES PRIVATE SECTOR FINANCIAL FIREPOWER

The world's poorest countries, especially those in Africa, are struggling to pay for investment to stave off a climate crisis they did not create.

More public debt is not the answer: climate investment needs exceed the lending capacity of multilateral finance institutions, and many African countries are already in a funding squeeze. What's needed are novel solutions—chiefly, stepped-up private sector investment for climate action in poor countries. And these efforts cannot be simply country-based. They must be geared to achieve global goals for net zero greenhouse gas emissions.

The stakes in Africa are heightened because the continent will contribute the most to human population growth in coming decades. This will increase the need for funds to mitigate climate-warming emissions. At the same time, a greater share of the region's agriculture will be exposed to climate-linked productivity losses. Millions of families in Mali, Niger, and Senegal understand from experience the horror of desertification, which is set to worsen without climate action. On the other hand, Africa's large coastal cities—including Lagos, its most populous metropolis—have no meaningful defense against rising oceans.

Based on the size of their economies, African countries face a disproportionate burden to avoid the worst of climate change. For example, while China needs to raise its annual climate mitigation spending by 2 percent of GDP through 2030, Cameroon needs to increase spending by 9 percent of GDP, according to the World Bank's 2023 Country Climate and Development Reports. The five countries of the West African Sahel—Burkina Faso, Chad, Mali, Mauritania, and Niger—some of the poorest in the world, need to increase spending by about 8 percent of GDP on average.

The continent's required climate funding comes on top of the existing need for development financing, in addition to resources for COVID crisis recovery. Inadequate and missing public services in health, transportation, and education in many African countries hold back economic growth—and some have resorted to debt to address development financing gaps.

Additional borrowing to pay for climate mitigation is not a good option, for at least three reasons.

First, poor countries have limited ability to borrow. They must either pay above-market rates to borrow in international debt markets (Olabisi and Stein 2015) or must accept burdensome conditions from multilateral and development lending institutions. With rising debt, the ratios of service payments to revenues are troubling for many governments. Among the continent's largest economies, South Africa's had debt of nearly 70 percent of GDP in 2021; Nigeria's was about 40 percent. The pressure to spend on climate mitigation and governments' inability to do so have the makings of a crisis that is not entirely of the countries' making.

Second, investment needs are beyond the capacity of the world's multilateral lending and development institutions. The global need for investment to address the worst of climate change exceeds $1.3 trillion a year for the next decade. This amount will not address all climate issues; it will only avoid the worst effects. The African Development Bank estimates that Africa needs to spend $3 trillion by 2030. For context, all sub-Saharan Africa combined had a GDP of $2 trillion in 2022. Even if you added the entire $1 trillion lending capacity of the IMF to the $400 billion lending portfolio of the World Bank, it is clear that the global financial institutions do not have the lending capacity to address climate change at the speed and scale needed. If the lending capacity of the regional development banks is added to the mix, we would come close to the scale of financing needed. But in that case banks would do little else over the next decades but finance the green transition and urgently needed climate adaptation.

Third, public debt may not be the most effective financing mechanism for some of the most promising climate interventions. Debt may not always work as a means to deploy relatively recent technologies at scale, often in settings where such technologies are untested. Some of the principal technologies for climate mitigation or adaptation—such as solar- or wind-powered irrigation for farmland or retrofitting residences and industrial sites—do not fit the mold of typical debt-funded public projects. Much of the necessary climate funding is to prevent severe human and economic losses. The auxiliary goal of climate financing is to boost the adaptive capacity of local economies. Neither boosting adaptive capacity nor avoiding asset losses looks, in principle, like a bankable venture that can produce a steady cashflow stream.

Climate-friendly finance

In exploring new ideas, one possibility is the supplementation of debt with other financing arrangements that meet the challenge of climate change.

Africa is a prime location to create opportunity from this crisis. The need for energy fits with the abundant renewable energy potential of the continent. Africa's solar potential greatly exceeds its fossil fuel resources. If high-income countries are looking for markets, Africa is poised to have 2 billion consumers of food, energy, and water by 2050.

A man walks by a car covered by sand in the village of Boumdeid, near Kiffa, in Mauritania.

GEORGES GOBET/AFP VIA GETTY IMAGES

The Benban Solar Park in Benban, Egypt.

UTE GRABOWSKY/PHOTOTHEK VIA GETTY IMAGES

If the need is for labor and new ideas, the youthful population of the region is seeking opportunities for work. The world can choose to leapfrog the impending multiple crises of climate and development financing by setting the conditions for a rapid transition to sustainable energy and responsible natural resource consumption for the region, while it is still a continent of 1.2 billion.

This challenge calls for novel approaches to financing. Spending to address climate change is not optional, given the severe human and economic losses that accompany unmitigated greenhouse gas emissions. For many African countries, there is no fiscal policy wiggle room for structural adjustment.

Engaging private markets

The private sector has enough to support the $1.3 trillion a year needed for climate adaptation. Starting with some ballpark figures, the top 500 global corporations earned more than $2.9 trillion in profits in the fiscal year ended March 2023, on revenues of about $41 trillion. For the United States alone, gross private domestic investment was about $5 trillion in the third quarter of 2023. If the corporations making these investments converged uniformly on climate action the US private sector alone could, in principle, fund a global renewable energy transition 15 times over.

If most companies saw the renewable energy transition as their primary business opportunity and were offered incentives that encouraged investment without national barriers, climate action would get a much-needed boost. This pathway could complement other efforts toward a global carbon pricing mechanism if such mechanisms had robust revenue-sharing commitments to developing economies.

The burning question is, How can governments and international institutions nudge corporations to protect the global commons by investing in the low-income countries with the greatest need for climate financing?

Broadly speaking, governments can pressure corporations to invest in a green transition through any combination of approaches: regulation, taxes matched with direct public investments, or cap and trade. New-energy vehicle requirements in China and zero-emission vehicle mandates in California, as an example of a regulatory approach, have led corporations to invest massively in new production systems. The regulatory steps seem to work, but more is needed. A global carbon pricing mechanism is one example of a tax, while a global cap-and-trade mechanism can be defined to set limits on fossil-fuel-based economic production, matched with tradable points for renewable-en-

ergy-based production, among other possibilities. The most meaningful approach will depend on the type of investment needed, and the effectiveness of each approach will depend on the political economy of the context. Regardless of each country's specific approach, however, effective climate action could benefit from tapping the private sector's financial resources when public resources are limited.

Public incentives to spur private investment seem particularly appealing for some of the challenges that need timely action in low-income countries, and especially for African economies with little fiscal space. However, current public incentive programs are typically designed to spur spending for country-specific climate goals. The mismatch in policy efforts here is that climate action should be based on optimization at a global scale.

It is a failure of policy if the governments of northern European countries such as Germany and the United Kingdom pay billions to support the in-country installation of solar panels that could produce 40 percent more energy in a tropical setting such as Côte d'Ivoire or Ghana. Spending billions on additional wind farms in California that yield less energy per dollar than a comparable investment in Kenya suffers from the same flaw. If the vast renewable energy potential of areas near the equator can be hooked into global value chains through trade—yielding climate gains, as well as profits that feed back to the German, British, or Californian sources of the investments—it may be the policy win of the century.

Win-win solution

Speeding the renewable energy transition in African countries is needed for the sake of the world. It can be a win-win, if done right. Local economies win, as the investment drives local development, while the global economy wins from the combination of sustained profits and climate losses avoided. The reason policy holds back this win-win scenario is that the global accord for climate action has no teeth, and the rewards to private actors spending on climate action are limited by national boundaries.

The current pattern of energy investment in Africa highlights both the opportunity to do better and the failure of a system without coordinated incentives (Olabisi, Richardson, and Adelaja 2022). Public and private energy financing from Group of Twenty countries and multilateral development banks to African countries averaged about $35 billion a year between 2012 and 2021. The private sector provided just over 40 percent of the funds. The largest chunk of financing—$83.5 billion—went to gas and liquefied natural gas projects (Moses 2023). Spending on other energy sources, including renewable options such as solar, hydro, and wind, lagged sorely behind. Corporations are open to spending to meet energy demand in Africa, so the burden of investment is not purely public, but their efforts follow the short-term gains—such as those from fossil fuels. Just imagine the impact of a global climate fund paying the marginal incentives that would boost private sector returns on solar and wind in Africa above the gains from gas projects.

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At some point, policymakers and the private sector will have to agree that the better way to profit from private enterprise must be ecologically sustainable. Or better yet, the approach should remediate the planet to improve the quality of life for future generations. The private sector and its linked equity markets can, with the right policy guidance, channel resources to finance a green transition faster than governments can raise debt for a purely public approach to salvaging the global commons.

Today, we have private corporations with significant global reach in the renewable energy business that were nonexistent or barely existent three decades ago. A growing number of billion-dollar companies in the renewable energy business have room to grow further with the right public policy postures. The speed necessary for effective climate action, especially in many African countries, calls for private sector initiatives, along with astute global governance. Can we imagine a future when most corporations pursue global ecological sustainability because their economic sustainability depends on it? F&D

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