AADFI WORKING GROUP ON CLIMATE CHANGE

Concept Note

ABSTRACT

The Association of African Development Finance Institutions (AADFI) has set up a Working Group on Climate Change (WGCC) to sustain its commitment to addressing the challenges of climate change and achieving the Paris Agreement.

Olympus Manthata

WG Coordinator

Concept Note for the Establishment of the AADFI Working Group on Climate Change

1. Background

The Association of African Development Finance Institutions (AADFI) is an international organization created in 1975 with a membership of over 80 Development Finance Institutions (DFIs), spreading across the five sub-regions of the African continent. The AADFI Headquarters is in Abidjan, Republic of Cote d'Ivoire.

The broad objectives of the Association include promoting cooperation for the financing of economic and social development in Africa; accelerating the process of economic integration in Africa; establishing among DFIs a systematic exchange of technical assistance; encouraging the implementation of studies on DFI issues and establishing a framework for successful operation of DFIs in Africa.

To achieve its objectives, AADFI implements projects and activities to nurture cooperation among DFIs, carry out regular capacity-building for professional skill development in development banking and finance operations, and institutional reforms to strengthen DFIs in Africa. The Association promotes advocacy and development policy advice to ensure that DFIs are strengthened and operate in line with best practices and is an efficient partner in delivering impact development in the key priority sectors of African economies.

2. Climate Change Working Group

To sustain its commitment to addressing the challenges of climate change and achieving the Paris Agreement, AADFI has set up a Working Group on Climate Change. The Working Group was launched on November 9, 2023, during the Joint International CEO Forum of AADFI and its Asian counterpart, the Association of Development Financing Institutions (ADFIAP), held from November 8 to 10, 2023, in Abuja, Nigeria.

During the launch, the AADFI Chairman, Mr. Thabo Thamane, highlighted that the need for AADFI members to be involved in providing solutions to address the climate challenges made it imperative for the Association to be strategically engaged.

Consequently, the Working Group was created to lead the AADFI's agenda on climate change and generate ideas and actions that will enable the member DFIs to contribute effectively to achieving the objectives of the Paris Agreement.

The responsibilities and objectives of the Working Group are:

i. Supporting efforts to create a road map for African DFIs to accelerate their involvement in addressing climate challenges.
ii. Leading the effort in attracting technical assistance and support to build the skills and capacity of member DFIs on climate change, guiding African national DFIs in mobilizing finance, identifying

funding opportunities for green projects (connecting finance to green projects, raising Green Bonds), and hand-hold other national DFIs in their climate finance journey.

iii. Collaborating with the African Financial Alliance on Climate Change (AFAC).

iv. Leveraging other support from the African Development Bank (AfDB), the Global Center on Adaptation, the Green Climate Fund (GCF), the Global Environment Facility, and other partners to support member DFIs' actions on climate change.

The Association aims to drive meaningful change and accelerate Africa's energy transition by collaborating with various stakeholders and partners.

2.1 Rationale for the Climate Change Working Group

While African nations have contributed negligibly to the changing climate, with just about two to three percent of global emissions, it stands out disproportionately as the most vulnerable region in the world. As a continent, Africa faces exponential collateral damage, posing systemic risks to its economies, infrastructure investments, water and food systems, public health, agriculture, and livelihoods, threatening to undo its modest development gains and slip into higher levels of extreme poverty. United Nations Environment Programme (UNEP) research estimates that the cost of adapting to climate change across Africa could reach $50 billion a year by 2050 if the global temperature increase is kept within 2°C above preindustrial levels.

A recent IMF paper found evidence that climate change indeed inflicts more lasting macroeconomic costs in fragile countries. Cumulative losses in gross domestic product reach about 4 percent in fragile states three years after extreme weather events. That compares with around 1 percent in other countries. Droughts in fragile states are expected to cut about 0.2 percentage points from their per-capita GDP growth yearly. This means that incomes in fragile states will be falling further behind those in other countries.

Climate finance remains a major constraint to Africa's aspirations of a sustainable and resilient economy. With the traditional financing avenues offering limited access to funds for African countries, innovative ways of climate financing, especially those courting the private sector, have become essential.

Addressing climate change through both adaptation and mitigation will be costly. Estimates of these costs vary but are generally daunting. The G20 2023 policy brief indicates that current climate finance flows to Africa pale in comparison to what is needed to adapt to climate change. Between 2016 and 2020, Africa obtained only $19.5 billion in climate funding, although annual adaptation costs needed for the continent are estimated at $30-50 billion until 2030, indicating significant financing gaps.[1] And mitigation costs for a clean energy transition in Africa have been estimated at about $190 billion per year until 2030 (IEA, 2022). Much of the past funding has come from Development Finance Institutions and national governments with private investors playing at the margins.

Mitigation accounts for the largest share of reported needs in 2020-2030, at 66% of total climate finance needs. Adaptation accounted for only 24% of total climate finance needs identified, despite Africa being highly vulnerable to climate change, which calls for a better balance of finance between mitigation and adaptation.

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. However, 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 *et al*, 2021).

Climate funds need to streamline their accreditation processes and requirements, noting the high compliance costs for sub-Saharan African countries, particularly for small and fragile states. The 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 (IMF, 2023).

The private sector has significant potential to meet Africa's climate finance needs, but NDCs rarely discuss its role. Public funding alone will not be sufficient, given the magnitude of investments needed, and current and future constraints on public domestic resources in Africa. However, most current climate financing in Africa is from public actors (87%, USD 20 billion) with limited finance from private actors (CPI, 2021).

It is against this backdrop that the AADFI working group on climate change seeks to have a sharp focus on improving access to climate finance for member institutions. The working group further seeks to develop innovative financing instruments that would use the limited public resources to leverage significant private sector resources to fund climate projects and programmes.

2.2 Proposed actions of the Climate Change Working Group

The working group aims to enhance the coordination of member institutions with national and international climate finance actors through the following actions:

i) Creating clear processes to design member climate strategies, leading to robust climate investment plans
ii) Member institutions to jointly prepare project pipelines with bankable mitigation and adaptation projects and
iii) Enhancing cooperation among member institutions and multilateral and bilateral donors
iv) Encouraging the dialogue between national policymakers and member institutions to promote the active role of DFIs in projects that aligned to country NDCs
v) Delivering international climate finance, including:
    - Using member institutions as a mechanism to manage and channel financial resources.
    - Considering member institution experiences and advice in the design of new and innovative financing instruments that can be funded by mechanisms such as the GCF and
    - Supporting readiness strategies and internal capacity building efforts for member institutions.
vi) Building knowledge about best practices of member institutions
vii) Encouraging member institutions to develop readiness strategies for international climate finance mobilisation and intermediation including:
    - Building internal capacities and knowledge about international climate funds and
    - Strengthening their capacities to monitoring and reporting of the impacts of interventions.

2.3 Proposed Functions of the Climate Change Working Group

2.3.1 Access to Climate Finance

a. Accreditation to Climate and Environmental Finance mechanisms (e.g., GCF, GEF, and Adaptation Fund)

i) Conducting gap analysis of the candidate DFIs.
ii) Developing policy frameworks to address gaps identified (e.g., through GCF readiness support).
iii) Lessons sharing to help expedite the process.
iv) Information sharing, including various frameworks and strategies for accreditation where allowable.

b. Building capacity within DFIs to effectively take advantage of the accreditations

i) Building DFI capacity to deliver on accreditation expectations.
ii) Secondments between DFIs to facilitate expedited knowledge exchange/transfer.
iii) Exploring co-financing opportunities (between accredited and non-accredited DFIs).

c. Building pipeline of climate and environmental projects

i) Pipeline development knowledge sharing.

ii) Sharing pipeline information.

iii) Customising existing programmes/projects from one country to the others to expedite climate finance access.

2.3.2 Developing Net Zero and Paris alignment strategies

a) Sharing information regarding existing strategies and frameworks

b) Comparing notes regarding strategy development

2.3.3 Just Energy transition pathways

a) Partnering with academia regarding the proposed capacity building/research initiatives

2.3.4 Financing Biodiversity and Nature Based projects and programmes

a) Enhancing understanding of the "nature based"/biodiversity space

b) Integrating "nature based" solutions into infrastructure development

2.3.5 Monitoring and reporting

a) Developing and sharing knowledge on monitoring and reporting frameworks

b) Sharing tools, systems, and processes (e.g., Paris alignment tools)

c) Capacity building

2.3.6 Key Partnerships to enhance delivery of the programme

a) African Development Bank's African Financial Alliance on Climate Change (AFAC)
b) International Development Finance Club (IDFC)
c) United Nations Development Programme (UNDP)
d) Green Climate Fund (GCF)
e) Global Environment Facility (GEF)
f) Adaptation Fund (AF)

3. Bibliography

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