FINANCING OUR FUTURE: A new paradigm for Africa-Europe

As outlined in the landmark benchmarking *State of Africa Europe 2024*, Sustainable Finance represents a critical domain of cross-continental cooperation, from joint commitments on combatting illicit financial flows and expanding climate-debt clauses in lending agreements to carbon market activation plans, global green bond initiatives, the reallocation of Special Drawing Rights and the overall reform of the international financial architecture.

This Policy Report of the Africa-Europe Foundation (AEF) deep dives into the Finance chapter of State of Africa Europe 2024 and benefits from the preparation of the 'Future Africa-EU' Strategic Roundtable of July 2024, timed against a backdrop of a new EU institutional cycle, the Next Decade of the AU's Agenda 2063 and the UN Summit of the Future. The Report examines the state-of-play on joint commitments on Sustainable Finance, particular those resulting from the last EU-AU Summit, but it also outlines how this domain of cooperation provides an operational blueprint for a new paradigm in international cooperation – moving from an outdated donor-recipient model to a transformative, win-win partnership and real partnership of equals.

1. Setting the scene

Sustainable Finance was one of seven major areas covered by the 6th Summit of African and European Heads of State in February 2022. Financial commitments were made in fields such as improvement to the Common Framework for Debt, reallocation of SDRs, combating Illicit Financial Flows, cooperating on tax transparency and addressing domestic tax base erosion, implementing the EU-Africa Global Gateway Investment Package through a mix of public, private and innovative finance, and boosting regional and continental economic integration.

There is a great deal of activity in the sustainable finance sector, to which African and European countries could make significant contributions by taking the lead and showing political will. Collectively, these actions have the potential to bring about significant improvements in both the volume of funding flows and the ease with which such flows are accessed but much more needs to be done to address current barriers:

- The route to reform is currently lengthy and bureaucratic
- African countries face a very high cost of borrowing on private capital markets in comparison with rates at the World Bank thanks to the rankings provided by three powerful credit rating agencies
- As EU countries slash aid budgets due to competing priorities and many African countries are in high risk of debt distress and a collective rethink is urgently needed to reduce risks of polarisation, multilateral fracture, increased inequalities and acute climate risks
- Several African countries face challenges with ineffective public debt management and governance systems, which lead to heightened risks of debt distress, misallocation of resources, and reduced fiscal transparency

Areas where Europe and Africa could work together include broader Multilateral Development Bank (MDB) reform, imaginative efforts around blended public-private finance, debt relief through swaps, clauses and restructuring, the issuing of bonds, and expansion of carbon finance, innovative funding mechanisms, such as global tax and levies, financial and insurance products, addressing illicit financial flows (IFF), and build debt management capacity across both continents. There are also a number of measures which African governments could pursue such as fiscal reforms, diaspora bonds, and deepening domestic capital markets. Sound public debt management is critical in managing debt risks and increasingly complex debt instruments, and there is a collective need to make sure that international debt management capacity building initiatives are well-resourced and well-coordinated, to deliver sustainable capacity in beneficiary countries.

There is no globally accepted definition of sustainable finance. While the European Union offers a comprehensive description - "finance to support economic growth while reducing pressures on the environment and taking into account social and governance aspects" – Member States of the African Union underline the importance of "the stability, reliability and predictability of financing options, which could help reduce the dependence on developmental finance".

1.1. A snapshot of the climate negotiation process

Sustainable finance plays a pivotal role in advancing climate action by mobilising public and private capital investments in sustainability, resilience, and low-carbon development. Doing so will contribute to the goals of the Paris Agreement and help meet the aspirations of the African and European continents in addressing climate change. However, the issue has become a matter of dispute between historically big emitters such as EU member states and the US and those countries, especially in Africa, which have emitted very little to date but suffer disproportionately from climate disasters.

The impact of climate change, especially on the most climate-vulnerable countries, is growing exponentially. According to the AfDB (2022), Africa loses between $7-$15 billion annually due to climate change, and this figure is expected to rise to around $50 billion per year by 2030. The Global Stocktake, which assesses global efforts to address climate change, reported at COP28 in December 2023 that countries are seriously off-track to meet the Paris commitment, agreed at COP21 in 2015, to keep global heating below 2°C, and as near to 1.5° as possible.

Currently, the focus seems to be on repair rather than mitigation and resilience-building. A Loss and Damage (LED) Fund specifically for countries vulnerable to the effects of climate change was established at COP28 but its resources are paltry, and a focus on LED has drawn attention away from adaptation financing, designed to help communities mitigate risks they face from climate change. A commitment was made at COP26 in 2021 to double adaptation funding by 2025 compared to 2019 but it is unclear if or how that will be met. COP29 in Azerbaijan November 2024 will have a focus on finance, and decisions are expected on the New Collective Quantified Goal for climate finance, scheduled to start operating from 2025, an assessment of the progress of the LED fund and plans for achieving a doubling of adaptation finance by 2025 compared to 2019.

Climate finance has become a major source of dispute between historically big emitters such as EU member states and the US, and those countries, especially in Africa, which have emitted very little to date but have disproportionately suffered from the effects of climate change. Many in African policy circles argue that there is a disconnect between the continent's very small contribution to global greenhouse gas emissions (0.8 metric tons per person vs a global average of 3.9 tons per person) and the stringent conditions often imposed on African countries in order to access the resources that should already be available according to commitments made by the international community but there has often been a failure to meet those commitments exacerbating an atmosphere of distrust and cynicism. The late and incomplete delivery of $100bn promised at COP15 in 2009 has aggravated this skepticism, which is worsened by accusations of hypocrisy about the lack of transparency, double counting, and the absence of new and additional finance.

Meanwhile, industrialised countries including the EU have been arguing that the pool of climate donors must expand to include many high- and middle-income countries, which have seen rapid increases in incomes per head since the 1992 classification of countries under the UN Framework on Climate Change (UNFCCC). These include countries with significant carbon emissions, such as BRICS+ and Gulf petrostates. This makes it all the more important that African leaders play a prominent role in defining and resolving the issues faced by their countries.

1.2. African and European perspectives on climate and development

Africa and Europe approach the climate and development agenda from very different starting points. While everyone can sign-up to a long-term goal of net-zero emissions, it is important to recognise that there are significant divergences in interests. African countries want support to deliver economic growth, increased incomes, better jobs and access to energy for the majority of the population currently without basic amenities such as electricity, water, and sanitation. The solutions exist. Renewable energy sources are now a cheaper means of generating electricity than fossil fuels but an effective rollout requires upfront investment—the re-purposing of grid networks, for example, demand significant amounts of capital. For those countries heavily reliant on exports of fossil fuels, a phased approach is needed to diversify away from oil and gas and some countries have already begun developing energy transition plans to map out such an approach.

Europe has been at the forefront of global climate policy and leadership with an effective carbon compliance market, ambitious Greenhouse Gas emissions targets and the proposed Carbon Border Adjustment Mechanism (CBAM) to encourage trading partners to reduce the carbon intensity of traded goods. In the short-term, CBAM presents a hurdle to African countries wanting to export goods with high carbon intensity but longer-term CBAM could spur the evolution of green industrial sectors in Africa.

While continuing its ambitious leadership on greenhouse gases, Europe must support the implementation of several proposals which could increase both the volume and ease of access to climate finance, especially for poorer African countries. Europe's position in multilateral bodies gives the EU and individual members states considerable weight which could be used to achieve much needed changes to benefit the African continent[1]. Over the past 30 years European countries have been at the heart of negotiations at the climate COPs and leading members of the OECD's Development Assistance Committee (OECD-DAC). Hence, Europe's stance and demonstrated capacity to deliver on climate finance are critical to making progress on this issue.

While the volume of finance is often the focus of negotiation and argument, other factors cannot be ignored if funds are to achieve their purpose. These include:

- An enabling framework of policy and regulation which provides a stable long-term context for investment in energy, cities, land, forests and oceans,
- A pipeline of investible projects and expertise to construct both technical and financial structures for project delivery,
- A platform able to broker deals and mediate between domestic and international funders, matching projects and finance providers. Mutual collaboration would be very fruitful between Europe and Africa on the technical expertise needed to make progress in these areas.

1.3. The shifting geopolitics of 2024

In 2024 a majority of the world's population go to the polls including one-third of African countries and EU-wide elections for the European parliament in June 2024,[2] the results of which will shape the appetite and direction for the EU's position on climate and development issues.[3]

Geopolitical issues are exacerbating differences between global blocs and re-framing Africa-Europe relations. Europe, as a central part of the "West", is finding its role challenged on multiple fronts, and the stability of long-standing alliances is under threat. With the forthcoming elections, Europe risks turning inwards if populism and nationalist political forces become stronger. Making the case for long-term partnerships between Europe and Africa has never been more important.

The recent AU Summit and the joint article, published in *The Economist,* by Presidents Akufo-Addo of Ghana, Ruto of Kenya, and Hichilema of Zambia demonstrate very clearly that African leaders want a very different global system—one in which their voice counts.[4] In their statement, the three presidents emphasise the importance of speaking with one voice, to advocate a collective African agenda for global financial reform. They are looking for solutions through investment in growth and prosperity, ensuring that borrowing generates jobs rather than being used for consumption. The Ghanaian president, for example, proposes that each country invest a minimum of 30% of its sovereign reserves in African multilateral institutions rather than being held in assets abroad.

Our geopolitics are fractured and the world is on the edge of a new more uncertain era, which may be significantly different from the period of stability that much of Europe has enjoyed since 1945. This increasing fragmentation and polarisation make tracking the Africa-Europe partnership particularly urgent if we are to ensure commitments entered into on both sides are monitored and reported. Doing so could enable a stronger more confident relationship to emerge in this era of profound and rapid change. Throwing light on areas for improvement in relations between our two continents will enable corrective action to be taken early on. The next 24 months, leading to COP30 in Belem and the G21 under South African leadership—both in 2025—offer a brief but valuable opportunity to design a new sustainable finance model that, while recognising past mistakes, addresses future needs.

1 AEF (2023)
2 2024-elections-research-brief.pdf (ibrahim.foundation)
3 Ursula von der Leyen's campaign for re-election has so far omitted mention of climate and development, in favour of economic competitiveness and defence, which gives a sense of the shift in politics over the past 5 years.
4 "Three presidents on how to make global finance work better for Africa", The Economist, March 6th, 2024

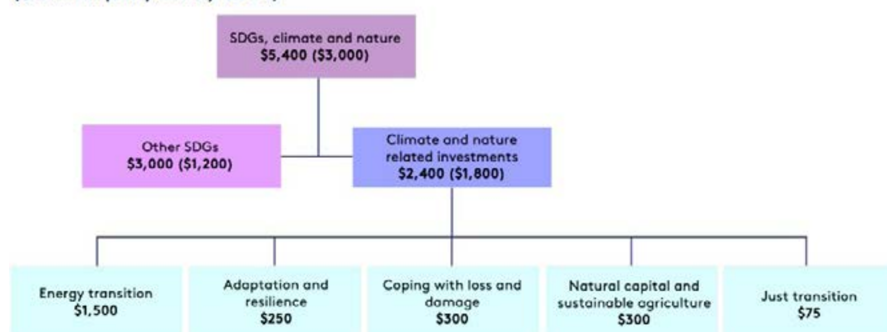
2. Closing the funding gap

A range of recent reports provides an assessment of funding needs, by sector, geography, and Sustainable Development Goals (SDGs)[5] in order to deliver a series of national plans and strategies such as:

- Just Energy Transition Plans (JETPs)
- Nationally Determined Contributions (NDCs)
- National Adaptation Plans (NAPs)
- Agri-food transformation plans
- National Biodiversity Action Plans

One assessment of investment needs for all emerging market and developing economies (EMDEs—except China) is shown in Figure 1 below[6]:

Figure 1. Investment/spending requirements for climate and sustainable development ($ billion per year by 2030)



Note to Figure: Incremental investment from current levels in brackets.

Finance to Africa for climate actions has been shrinking and represents only 12% of the amount needed.[7] It will cost a total of $2.8-3 trillion between 2020 and 2030 to implement Africa's nationally defined contributions (NDCs). However, annual climate finance flows in Africa for 2020 (domestic and international) were only $30 billion, or one-eighth of the need.[8] Closing the energy access gap will require an estimated annual investment of over $25 billion up to 2030. The need is urgent: in 2022 alone, African countries lost close to $9 billion as a result of loss and damage due to climate change and in a 2 °C warming scenario, the annual costs of loss and damage in Africa are projected to reach at least $290 billion.

There are a wide variety of projections for the finance needed to address climate change and a range of associated sectors, as seen in Figure 1 above.

The spectrum of estimates depends on the sectors, region and time frame but overall, the projections demonstrate a very large and growing funding gap, as shown below:[9]

- $250 billion investment is needed between now and 2030 in Africa's natural resources, environmental and agricultural development to align with the Paris agreement
- Africa's infrastructure requirements to address climate change mitigation and adaption require $68-108 billion/year
- An estimated $2.8trn is needed by 2030 to implement climate commitments as expressed in African countries' NDCs submitted in April 2023, equivalent to annual flows of $250 billion[10]

5 AUC/OECD (2023); Bhattacharya A, et al (2023) ; Songwe, V. et al (2022) ; NGFS (2023) ; AEEP (2023).
6 Bhattacharya A, Songwe V, Soubeyran E and Stern N (2023) A climate finance framework: decisive action to deliver on the Paris Agreement – Summary. London: Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science.
7 Songwe V, Stern N, Bhattacharya A (2022) Finance for climate action: Scaling up investment for climate and development. London: Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science.
8 Songwe et al (2024).
9 Further projections and estimates are presented in Appendix 1.
10 African Economic Outlook 2023 - Highlights

- Of the $29.5 billion in total climate finance flows received by African countries in 2019–20, private finance, of
- $4.2 billion, represented only 14%, the lowest proportion among the world's main regions
- The annual sustainable financing gap is equivalent to 7% of Africa's GDP and 34% of its investments in 2021.

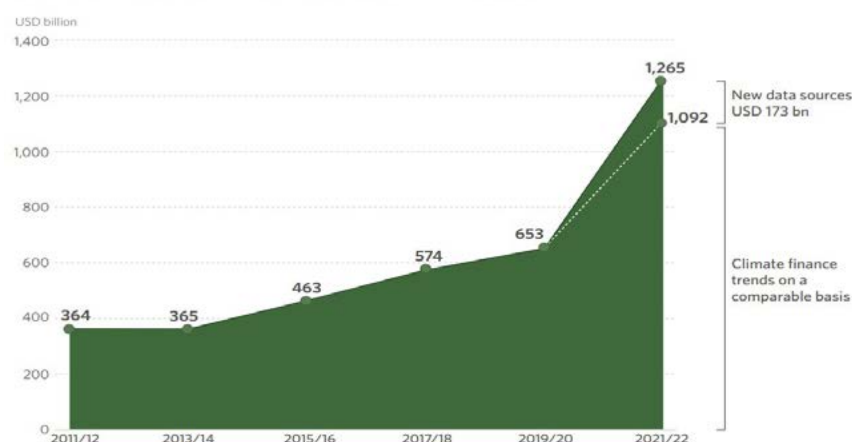
The amount appears small relative to capital available: the annual gap equals less than 0.2% of the global and 10.5% of the African-held stock of financial assets[11]

Regardless of the exact estimates, the funding gap is very big and demonstrates the totally inadequate scale of finance currently available. Clearly, much more needs to be done to not only galvanise existing commitments but to explore a range of new actions. While no single source will provide what is needed, a collective effort that pursues several avenues stands a better chance of bridging the enormous gap in funding, confidence and trust which has opened up between historic emitters of greenhouse gases and those now bearing the brunt.

3. Easing the flow of sustainable finance funds

Just as estimates of the size of the funding gap vary so does evidence for the amounts of climate finance delivered in recent years. On the one hand, the Global Landscape of Climate Finance (GLCF) report estimates total funding at $1.3 trillion for 2021/22, which represents a near doubling over the previous year[12]. As Figure ES2 shows below, part of this increase can be attributed to improved data collection. However, as GLCF recognises, total climate finance still only represents around 1% of global GDP and will need to climb very rapidly if the target of $9 trillion a year is to be reached by 2030.

Figure ES2: Global climate finance in 2011-2022, biennial averages

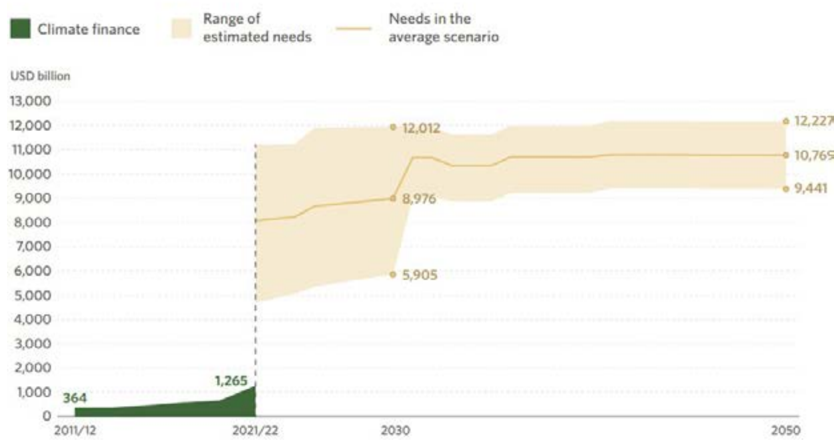


Note: Climate finance flows are reported as biennial averages to smooth out annual fluctuations in data and expressed in nominal USD. This means that annual figures do not account for the effects of inflation and exchange rate volatility over time.

While the growth in recent years looks impressive, the gap between current finance and future need is enormous, as shown in Figure ES3 below. In fact, the amounts currently deployed are significantly short of what is needed[13].

11 https://www.oecd-ilibrary.org/development/africa-s-development-dynamics-2023_3269532b-en
12 https://www.climatepolicyinitiative.org/publication/global-landscape-of-climate-finance-2023/
13 https://datacommons.one.org/climate-finance-files

Figure ES3: Global tracked climate finance and average estimated annual needs through 2050[3]



Note: Climate finance needs estimates for 2023-2050 include direct investments in climate-specific physical assets and excludes transition-related unabated fossil fuel finance. Estimates are based on secondary data collected from over 15 sectoral scenarios (see Methodology document for detail). Climate finance needs for 2023-2050 are expressed in 2022 USD to ensure comparability of estimates from several different scenarios.

On the other hand, the problem is not simply down to gaps in funding. Recent analysis by the ONE Campaign presents a damning critique of climate finance delivery. Its research reveals that nearly two-thirds of climate finance commitments counted by the OECD between 2013 and 2021– equivalent to $343 billion - either never materialised or had little to do with climate change. ONE's Climate Finance Files report shows that due to the use of different methodologies, revised classification systems, and a big gap between funds committed and those actually disbursed, the amounts of finance actually received by climate vulnerable countries are only a small share of what is needed.[14] As a consequence, it reckons that in 2021, the world's 20 most climate-vulnerable countries received only 6.5% of the climate finance they need each year to address climate change. At the same time, ONE found the reporting process is "confusing, slow and imprecise", despite the role of OECD-DAC to establish clear methodologies for tracking Official Development Assistance.

Both the GLCF and the ONE Campaign make the urgent case for a significant increase in climate-related funding to bridge the gap between need and disbursement. At the same time, improvements are needed in the reporting system to provide more transparency and accountability about the amounts actually disbursed rather than the larger sums promised.

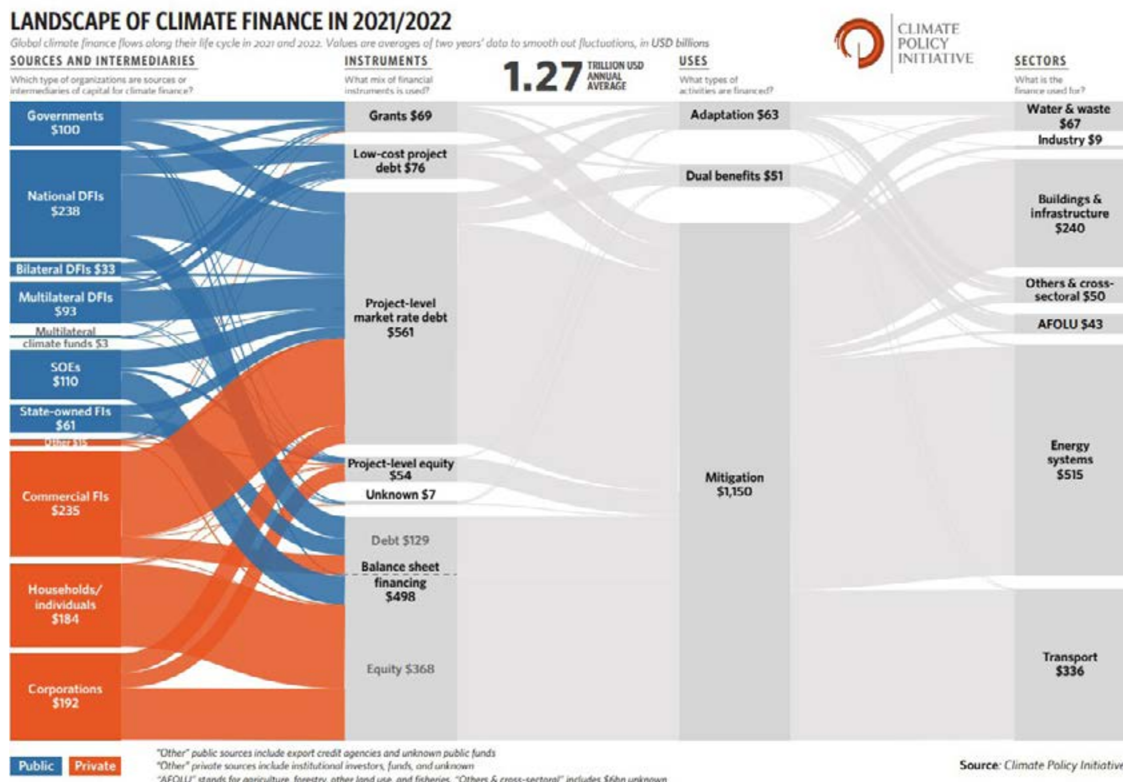
At the very least, European countries should step up delivery of climate finance by pledging to pay their 'fair share' by 2025, and commit to the doubling of adaptation finance by 2025 compared to 2019. Only four developed countries have made climate finance commitments commensurate with their 'fair share': Sweden, France, Norway, and Japan[14]. At COP26, developed countries were urged to double adaptation finance by 2025 from 2019 levels, yet measures to ensure such delivery are not clearly visible. At COP28, it was announced that a ministerial dialogue for doubling adaptation finance would take place in 2024, at which it is hoped European countries can make substantial pledges.

14 Based on historic emissions, GDP per capita, and the $100bn target

3.1. Getting more money into the system

According to the Climate Policy Institute, in 2021/22 roughly equal amounts of climate finance came from public and private sources, and at the global level, mitigation expenditure represented more than 90% of all funding (see chart ES1). As the chart also shows, there are a large number of finance sources, all of which need a radical increase in their scale and speed of operation.

Figure ES1: Global climate finance flows in 2021/2022



To help achieve this, there is a clear agenda for Europe and Africa to work together through various actions including:

- **Multilateral Development Bank reform:** Increasing the efficiency with which development banks use their capital assets could greatly increase their lending opportunities. An ODI review of the capital adequacy framework presented recommendations which need to be put into effect[15]. Doing so could free up several hundred billion dollars to invest in climate and development. Equally, if the World Bank is to live up to its name and play a full role in funding the investments needed to ensure a sustainable planet for all the capital base needs to be substantially enlarged. This will demand an increase in shareholdings from high- and middle-income countries like China, India, Indonesia, Brazil and Gulf states. European countries as major shareholders need to encourage such an expansion. Doing so will bring under-represented voices to the table and with it new approaches to intractable issues, which can accelerate progress. A more regular issue of SDRs and their allocation to climate vulnerable nations should also be on the agenda alongside ensuring these countries have a stronger voice in global forums including African board representation on MDB boards and in tax treaty negotiations. The announcement in September 2023 that the African Union has been made a member of the G20 is a start but more is needed to revise frameworks around what voting shares that membership holds.
- **Speeding up the re-allocation of existing Special Drawing Rights:** In 2021, the International Monetary Fund (IMF) allocated $650 billion of new SDRs—over 57% went to advanced economies while Africa received just 5%, totalling $33 billion, the smallest share among all regions. The G20 committed to re-channel $100 billion in SDRs back in 2021. Major IMF shareholders have pledged $87 billion for reallocation, primarily through the IMF's Poverty Reduction and Growth Trust (PRGT) and the Resilience and Sustainability Trust (RST) but the capacity of these channels is

15 Reforming capital adequacy at MDBs: How to prudently unlock more financial resources to face the world's development challenges | ODI: Think change

limited and additional channels and avenues for reallocation are needed. More IMF shareholders are also needed to reallocate at least 20% of their SDRs to surpass the $100 billion target. European regulations currently hinder the direct allocation of existing SDRs to MDBs for onward lending aiming to preserve SDRs as a stable reserve asset and impose constraints on their use in monetary financing. A clear path forward must be established if institutions like the AfDB are to effectively use SDRs as lending instruments for African governments.

The AfDB, in collaboration with the Inter-American Development Bank, has formulated a proposal for rechannelling SDRs through MDBs. Their hybrid capital model for SDR reallocation is the most advanced among existing proposals, both technically and politically, with other MDBs considering similar arrangements. However, for this proposal to materialise, a minimum of five SDR donors must contribute to the hybrid capital instrument, and five additional countries need to provide financial guarantees for a Liquidity Support Agreement. Some progress on this is being made: in May 2024 the IMF approved hybrid capital instruments for the channelling of SDRs. The African Development Bank (ADB) has welcomed this move and expects it to unlock new and more cost-efficient lending by MDBs for sustainable development projects. But the onus will be on the international community to make use of this new approach if it is to meet its potential.

- **Blended public-private finance:** Given the scarcity of public funds for climate and development the focus of much discussion is shifting to ways to leverage large pools of private capital for investment in both mitigation and adaptation actions. Blended climate finance is defined as "the strategic use of a limited amount of concessional resources to mobilise financing from public and private financial institutions to achieve climate impacts" (see box)[16]. The Network for Greening the Financial System (NGFS) emphasises the need to deploy a diverse range of concessional finance from philanthropy, donors and other sources, to bring in more actors to this space. NGFS also recognises that blended finance is not the only way to bridge the climate finance gap but, rather, argues it can act as a valuable means to change market perceptions by showing strong returns from a range of investments, which demonstrate the positive economic fundamentals found in many EMDEs[17].
- **Debt relief on a case-by-case basis through swaps, clauses and restructuring:** If the current debt crisis isn't addressed through initiatives like debt swaps aimed at climate action, which exchange debt relief for commitments to invest in sustainable development, and mechanisms such as debt clauses (DSCs) that allow countries to temporarily suspend debt repayments following natural disasters, progress on climate action in EMDEs will fail18. The slow, bureaucratic, painful process of debt relief through the G20's Common Framework has discouraged many debt-stressed countries from following this route. Taking more than two years, it causes major disruptions in financial flows and a successful outcome is by no means assured, given the range of different creditor nations involved, as well as private bondholders.
- As Diwan et al note, efforts to invest in the 'green transition' will be futile if EMDEs are still burdened with debt and would have to use much of the new investment to service their existing debt. Insolvent countries need debt reduction but it is a difficult process and needs to be significantly improved. However, as the authors report, most of those debt-burdened countries that are facing financial stress are suffering from illiquidity, rather than insolvency[19]. Diwan et al propose a "bridging programme" that unlocks net positive flows for countries facing liquidity constraints. The programme proposes a three-point plan: Multilateral development banks increase their financing for new investments, including those linked to climate objectives; creditors agree to reschedule their claims in the future; and countries commit to stabilise their economy and engage in efforts to promote recovery.

  There is some movement in the right direction. In December 2023, Colombia, France and Kenya launched an expert review on debt, climate and nature, which is due to report by late 2024. The review will be looking at what reforms need to take place to increase the scale and range of debt-relief initiatives which promise action on climate and nature conservation in exchange for reducing and re-scheduling debt.

- **Carbon finance and green and blue bonds:** Carbon markets have the potential to generate significant sums for African land-users, green energy providers and governments. The African continent has extensive natural assets with an enormous capacity to sequester carbon, and the adoption of clean cooking technology should also generate significant carbon credits. The challenge is to establish a carbon market in African countries that shows its potential to deliver significant revenue, in ways which maintain high integrity and ensure fair revenue distribution. There is movement in this direction—some European countries have developed bilateral arrangements with African countries to establish a carbon market, and to purchase assets. Kenya, Ghana and

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16 The NGFS (2023) report Scaling Up Blended Finance for Climate Mitigation and Adaptation in Emerging Market and Developing Economies
17 ibid.
18 Diwan, I, Kessler, M. and Songwe, V. (2024). A bridge to climate action. A tripartite deal for times of illiquidity. Policy Note 14. Finance for Development Lab.
19 Ibid

Rwanda, for example, have been putting in place the regulatory framework for carbon market governance, and are expecting to generate significant revenue. European and African countries, by following a learning by doing approach, should put in place the regulation and governance needed, and support the preparation of carbon projects, leading to a high integrity carbon credit ecosystem in Africa which would be attractive to many other investors. At COP28, the negotiations over Article 6, the key to unlocking financial support to tackle climate change in Africa, collapsed, jeopardising the timeframe for establishing an international market in carbon credits as well as generating frustration at the delays to rolling out a carbon revenue stream. A group of European countries have launched a set of recommendations to restore trust within the voluntary market and the World Bank is supporting DRC, Ghana, Madagascar, Mozambique and Republic of Congo to develop high-integrity markets through certification of their environmental and social contributions. There is uncertainty around the distribution of revenue between local land-users, local and national governments, and organisations brokering the transaction. There are also concerns that the monetisation of Africa's natural capital will lead to a land- grab—the announcement in 2023 of the UAE's purchase of carbon credits encompassing 10% of Liberia's land has done nothing to curb such anxiety. However, by putting in place the regulation and governance needed, and supporting the preparation of carbon projects African and European countries could support a high integrity carbon credit ecosystem in Africa which would be attractive to investors.

The Africa-Europe Working Group on Carbon Markets
The AEF launched an Africa-Europe Working Group on Carbon Markets in 2023, to bring togetherexpertise and foster cooperation to encourage investment in carbon sinks and low-carbon growth. The purpose is to ensure convergent approaches to market-building, in which Africa can activate its carbon credit opportunities, joint innovation can accelerate green industrial development, and low-emission products can serve both African and EU demand. This should connect carbon markets with implementation of the CBAM and re-frame the latter as a catalyst for innovation and growth. The Carbon Market Working Group provides a space for tackling several contentious areas in this field, and offers an opportunity for strengthening bilateral approaches to show what can be achieved.

- Advancing global tax fairness: OECD countries are taking the lead as global decision-makers on tax, but tax havens continue to cost nations hundreds of billions of dollars in lost tax income each year. On behalf of the Africa Group at the United Nations, Nigeria has proposed a draft resolution for negotiating a comprehensive UN Convention on Tax in September 2023. This initiative aims to address gaps and weaknesses in current international tax cooperation efforts and improve the fairness, transparency, efficiency, and effectiveness of tax systems to eliminate tax evasion, tax base erosion, and profit shifting. The terms of reference for these negotiations will be discussed from July 29 to August 16, 2024, and the outcomes will be submitted to the General Assembly at its seventy-ninth session in December 2024 and it will guide negotiations on the Convention over the coming years.

  Additionally, preparations are underway for the 4th International Conference on Financing for Development, set for 2025, as per resolution 78/231 adopted by the General Assembly on December 22, 2023, which will assess progress on the Monterrey Consensus, Doha Declaration, and Addis Ababa Action Agenda, and address new and emerging issues to accelerate the implementation of the 2030 Agenda and the Sustainable Development Goals.

  While support for such adjustments has not been secured easily, improvements are underway. With political backing, these reforms will enable developing countries to discuss global tax rules on an equal footing.

  Innovative funding mechanisms: There is urgent need for new money flows in the international system given fiscal constraints in both industrial countries and EMDEs. One obvious source is to establish a system of global taxation that builds on the principle that the polluter pays *higher rates of tax*. Such tax systems have been discussed for many years but have made little or no headway in terms of implementation. The newly established Global Taskforce on Tax, initiated at the Paris Summit in June 2023, has a two-year mandate to explore a range of "innovative finance" mechanisms. It will focus on fostering political will and advancing various options which have the potential to mobilise finance at scale while bringing more climate justice and fairness to our current financial system and ensuring the most polluting industries and people contribute to financing the fight against climate change and inequalities. The taskforce believes that the principle of common but differentiated

responsibility should not only be applied to states but also to individuals and corporate entities. Early estimates suggest, for example:

- Financial Transaction Tax: A 0.1% tax on the trading of stocks and bonds could deliver up to $418 billion per year on a global level.
- Aviation: An aviation levy could raise up to $150 billion per year on a global scale
- Maritime shipping: A levy of $150/ton C02 would raise up to $80 billion per year.
- Fossil fuels: A fossil fuel extraction levy of $5/ton C02 would raise $210 billion per year rising to an average of $300 billion per year by 2050—assuming significant reduction in demand and an increase in the tax rate of $10 per ton annually to reach $250 a ton by 2050. A tax on windfall profits of 10% would have raised $300 billion in 2022 as net income for fossil fuel producers in 2022 was $4 trillion with an implied windfall profit of $3 trillion globally.

While there will be attempts to block such tax proposals, the taskforce needs to work with some urgency. With political support it would be possible to set up very quickly a trial amongst, say, ten large airlines to generate revenue through a levy on business-class tickets. Such a pilot could provide valuable practical insights to feed into the work of the taskforce.

- **Addressing illicit financial flows:** The AU has been highlighting the risks of Illicit Financial Flows (IFFs)—money illegally earned, transferred or used— for a decade, building on the work of the 2015 Mbeki Report, which estimated the annual illicit capital flight at $88.6 billion from Africa, equivalent to half of the continent's SDG financing gap[20]. The report made a series of recommendations to address the commercial component (such as trade mispricing, transfer pricing, and profit shifting), the criminal component, and the corrupt component. Elements essential to achieving these goals include stronger governance structures within Africa, greater political will, and the successful return of stolen assets. However, to date, few of the report's recommendations have been put into effect.

  The 6th Africa-Europe Summit recognised that IFFs must be treated as a problem for both continents, taking advantage of the financial administrations in Europe that have the capacity to move further and faster. EU initiatives have traditionally focused on the origin of transactions in Africa, however, efforts are now underway to address Europe, a major destination for IFFs. The AEF Working Group on IFFs has established a platform for African and European discussions from which to build practical solutions to address IFFs. Effective tax policies such as stringent offshore enquiries, and the exchange of information between different tax jurisdictions are at the centre of the conversation. The OECD's *2023 Tax Transparency in Africa* report shows how measures implemented between 2009-2022 resulted in many African countries gaining a substantial boost to tax revenues, interest payments, and penalties[21]. In 2024, at the Pan-African Conference on Illicit Financial Flows and Taxation held in Tunis from June 26th to June 28th, the EU launched a Team Europe Initiative on Combatting IFFs and Transnational Organised Crime, which aims to significantly reduce IFFs and arms flows, strengthen the recovery and return of stolen assets, and combat all forms of organised crime[22].

  Both the Mbeki Report and the Working Group on IFFs identified politics as the biggest constraint in tackling IFFs. The rapid strengthening of measures in the OECD to combat IFFs after the February 2022 invasion of Ukraine only highlights how sluggish the implementation of IFF regulations has been so far. This political failure to tackle IFFs is even more damaging than existing administrative and technical weaknesses, which, even if solved, allow IFFs to thrive.

- In Europe there is political will to tackle IFFs not just to sanction Russia but also to confront terrorist and state finance directed towards undermining democracy, while in Africa the debt crisis and declining development aid spending have placed a premium on domestic resource mobilisation, making dealing with IFFs even more urgent. An increasing proportion of IFFs are destined for other jurisdictions in Africa and elsewhere, such as the Gulf states. Establishing greater control over such flows is thus of special relevance to African governments. In addition to addressing IFFs within the Anti-Money Laundering and Counter-Terrorism Financing framework, the EU is also tackling these issues within the Domestic Resource Mobilization agenda, aiming to strengthen financial governance and tax systems. Given the issue is a priority in both continents this is the moment to confront IFFs.

20 "United Nations. Economic Commission for Africa (2015). Illicit financial flows: report of the High-Level Panel on illicit financial flows from Africa. Addis Ababa. UN.ECA. https://hdl.handle.net/10855/22695"

21 OECD (2023), Tax Transparency in Africa 2023: Africa Initiative Progress Report, Global Forum on Transparency and Exchange of Information for Tax Purposes, OECD, Paris, https://www.oecd.org/tax/transparency/documents/tax-transparency-in-africa-2023.pdf

22 AEF (2024), p55

Improving the methodologies of credit rating agencies: In 2021, the average cost of capital for energy projects was about seven times higher in Africa than in Europe and North America. While experienced investors see higher average returns in Africa than in other world regions, the lack of reliable information and data on investment performance has been an important barrier to new investment and has maintained the dominance of credit rating agencies in the market.

Three global credit rating agencies dominate the market: Moody's, Fitch and SEP. Their assessments of sovereign risk determine the cost of capital not only for sovereign states but also for institutions such as MDBs. African countries argue that their ratings are not based on accurate data and, in fact, are largely subjective. The EU could provide expertise and support for those countries that need to improve data reporting in national statistical offices and central banks in order to minimise questions of transparency and improve reliability of risk assessments. EU and African countries could jointly convene a dialogue with the major Credit Rating Agencies to discuss the criteria and processes used to assess risk and challenge their methods. Within any discussion of MDB reforms, attention must also be paid to the credit rating agencies who need to change their approach to assessing the balance sheets of development banks, to maintain top credit ratings while putting into effect the recommendations from the Capital Adequacy Framework.

There could also be benefits from opening up the Global Emerging Markets Risk Database Consortium (GEMs) database to public scrutiny. Established in 2009 as a joint initiative between the European Investment Bank and the International Finance Corporation, the GEMs consortium has grown to include 24 MDBs and Development Finance Institutions and is one of the world's largest credit risk databases for the emerging markets operations of its members. It pools data on credit defaults on the loans extended by consortium members, shifts in their clients' credit rating and recoveries on defaulted projects. Each Consortium member contributes anonymised data from their credit experience in emerging markets and developing economies. In return, members gain access to aggregate GEMs statistics on observed default rates, recovery rates by geography, sector, time-period and various other dimensions. GEMs statistics thus provide members with an insight into countries which are otherwise relatively poorly served in terms of data on credit and loan performance[23].

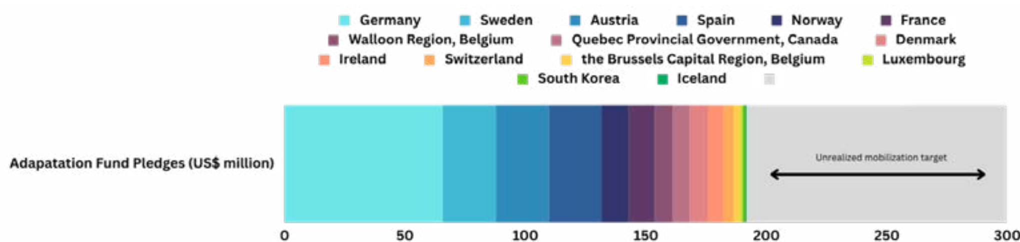
- **Adaptation finance:** Adaptation finance is funding that helps communities reduce the risks posed by climate change. According to a recent UN Environment Programme report, the updated costs of adaptation for developing countries are estimated to range from U$215 billion to $387 billion per year this decade[24]. Adaptation finance requirements are 10-18 times as great as current international public adaptation finance flows—at least 50% higher than previously estimated. Consequently, the global adaptation finance gap is widening and now stands at between $194 billion and $366 billion per year.

  The economic and social benefits from investing in adaptation finance are all too clear. Recent estimates by UNEP [?] found that:

  - Every billion invested in adaptation against coastal flooding leads to a $14 billion reduction in economic damages
  - $16 billion per year invested in agriculture would prevent approximately 78 million people from starving or chronic hunger because of climate impacts

In 2021 at COP26 in Glasgow, developed nations were urged to double their adaptation finance to reach approximately $40 billion by 2025[25]. However, even at twice the current amount the adaptation finance on offer falls woefully short of requirements. The UN Environment Programme Gap Reports found that doubling adaptation finance would narrow the adaptation financing gap (noted above) by only 5% to 10%. COP28 recognised the need for adaptation finance by highlighting how the gap of adaptation finance is widening, and why there is a need to go beyond the doubling of adaptation finance proposed in the New Collective Quantified Goal on Climate Finance to be agreed at COP29. Since COP26, developing countries have argued for increased adaptation finance noting the unfulfilled $100 billion pledge and low levels of adaptation funding. In response, COP27 mandated the Standing Committee on Finance (SCF) to evaluate progress toward this goal. However, the SCF's report, released before COP28, highlighted significant challenges in tracking adaptation finance, which include difficulties distinguishing funds allocated for dual-purpose activities (both mitigation and adaptation) and inconsistencies in the official reporting of climate finance within the UNFCCC, complicating the accurate assessment of progress in meeting the goal to double adaptation finance.

23 AEF (2024), p55
24 https://www.unep.org/resources/adaptation-gap-report-2023
25 https://unfccc.int/sites/default/files/resource/cma3_auv_2_cover%20decision.pdf



Adaptation Fund Pledges at COP28

Is Blending the answer?

The NGFS (2023) report Scaling Up Blended Finance for Climate Mitigation and Adaptation in Emerging Market and Developing Economies highlights a number of practical blended finance examples from around the world, such as in Nigeria, Egypt, Indonesia, Mexico and Uruguay. A number of lessons can be drawn from these illustrations which include:

- Each deal is quite complex and needs to be tailored to the specific location, sector, government, commercial structures, and funding sources involved.
- Blending requires significant time—often 3-5 years—to explore, negotiate and establish a viable deal, with the need for upfront development funds to draft a technical and financial prospectus for the project, prepare a project pipeline, and so on.
- Different funders have different expectations regarding risks and returns, with certain investors wanting higher and more assured short-term returns, while others can take a longer-term perspective. Hence, each deal is composed of senior and junior debt holders, with grant or concessional funders covering technical assistance and other forms of expertise.
- Blended funds can represent as much as 10-15% of total capital, providing guarantees to private investors for such as breach of contract, political risk, and problems with non-convertibility of currency which hinder repatriation of returns. The idea is that over time, these projects will demonstrate a stable and secure investment environment able to attract future private investment flows without the need for further guarantees.

One particularly interesting example concerns the SDG Indonesia ONE Platform, which provides a means for domestic and international sources of funding to connect, identifies priority infrastructure needs, and can mobilise technical assistance and funding to support new projects seeking finance. Overall, such blended finance approaches seem best suited to middle-income countries such as Indonesia, Egypt, Uruguay rather than small, low-income nations in Africa.

3.2. Improving quality and access to finance.

While funding must increase significantly there are also serious problems with the delivery of finance with many complaints that it is very slow, bureaucratic and expensive to access certain global funds. For example, governments must create a National Implementing Entity (NIE) as the structure able to give and receive the funds. Before funds can be transferred, NIEs must be assessed to establish their financial management skills but many African countries have not had their NIEs approved and so they have to rely on the UN or other international agencies to act as the conduit for funding, adding to lengthy procedures and costs of management. There are also frequent complaints about the lengthy process involved in getting finance from organisations such as the Green Climate Fund because of overly cumbersome and complex application procedures.

Building a national-level country-led platform

National leadership is crucial to bring stakeholders together. Establishing platforms at the national level is proposed by Bhattacharya et al (2023) and Diwan et al (2024) as the best way to make progress with mobilising climate investment and for addressing immediate problems of debt[26]. As they note, “the first task is to act to unlock investment at scale through tackling impediments and buttressing institutional structures that can create

26 Bhattacharya et al (2023). Diwan et al (2024)?

investable pipelines of projects, anchored in a strategy of transformational change[27]." This involves "co-creation of investment opportunities and tackling obstacles with the combined involvement of countries, the private sector and development finance institutions".

Decentralised funding for adaptation and resilience

Currently, when funds are received at the national government level it may take a considerable time to reach those local government or community organisations best able to implement resilience building on the ground. For this reason, the concept of Locally-Led Adaptation has been developed, and innovative funding mechanisms designed and tested to get adaptation funds down to the local level where community priorities can shape the allocation of funds in the most effective way for this locality.

One example is the Developed Climate Finance (DCF) Alliance mechanism piloted in Kenya, Tanzania, Senegal and Mali. Funding between 2011-19 was channelled to create a total of 284 investments identified as priorities by the local community, across the four countries[28]. In Mali and Senegal, villagers chose to invest the DCF finance in projects rooted in local needs, such as digging out ponds to store more water, and accommodate fish farming, developing and enclosing an irrigated market garden; marking out a route for livestock to pass through farmed areas, setting up a vaccination centre for livestock, closing off an area for natural regeneration, and investing in solar lights for public spaces, and mills to alleviate women's daily chores.

Figure 5 presents a visual interpretation of the DCF, with its focus on developing the institutional and financial "plumbing" to ensure climate finance is delivered effectively to meet local requirements. The figure below uses an analogy with "plumbing" to highlight the need to assess overall funding inputs coming into the system, the various "leakages" to intermediaries, including project developers, international and national agencies, and consequently what proportion of funds actually reach the intended recipients. Thus, it is important to focus international negotiations not only on the volume of finance available from different sources, but also design of delivery mechanisms best suited to achieve their purpose.

The current system features high costs as finance flows through intermediaries, along with increasing compliance requirements, compared to financing climate actions/responses directly through local funds via the DCF mechanism.

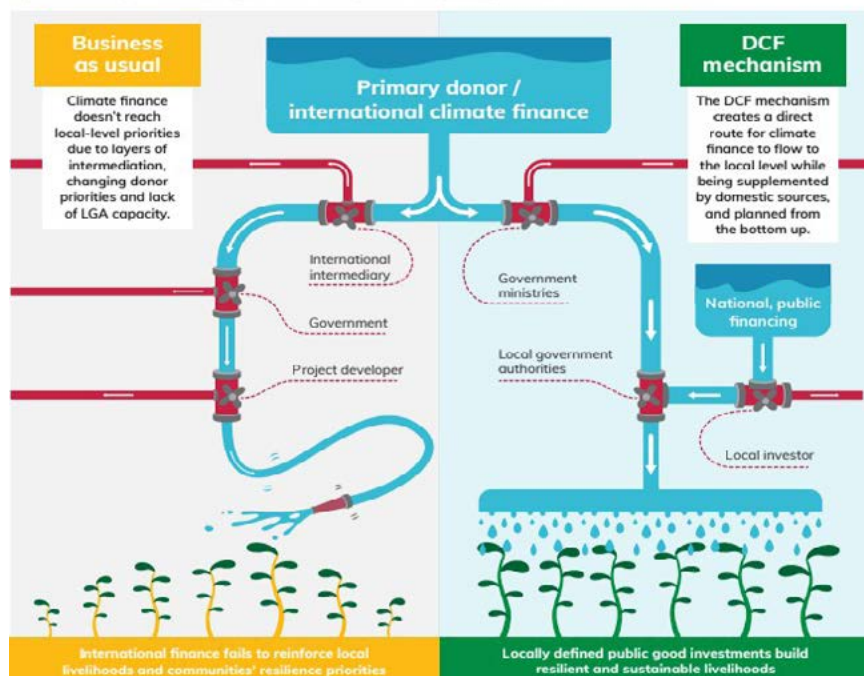


Figure 5: The Decentralised Climate Finance Mechanism (DCF Alliance, 2019).

In June 2020, the Government of Kenya formally endorsed this decentralised approach, and launched the multi-stakeholder Government Financing Locally-led Climate Action (G-FLLOCA) programme, led by the National Treasury.

27 Ibid
28 DCF Alliance (2019

Domestic resource mobilisation

According to the AU in 2013, and reiterated at the last AU Summit in February 2024, financing Agenda 2063 is generated from two categories: Domestic Resource Mobilisation and External Financing Mechanisms. Domestic Resource Mobilisation is meant to contribute 75-90% of the financing of Agenda 2063 on average per country. As Amit Jain (2024) notes, African countries could do well by emulating successful examples from countries like South Korea, by reducing reliance on external sources of finance and mobilising domestic capital, such as by unlocking the $2.3 trillion of investment, pension and sovereign wealth funds that are currently locked-up overseas[29]. Establishing a well-regulated capital market would facilitate such transactions and unlock domestic savings to fund investment in local projects large and small. Governments could also consider broadening their tax base to increase their tax revenue-to-GDP ratio above 15% by, for example, instituting a property tax on land, commercial and residential buildings—and making their fiscal systems more efficient. Comelli *et al* argue that many African countries could follow the examples of Rwanda, Senegal, and Uganda, which have seen large increases in their tax revenues by eliminating tax exemptions or digitising filing and payment systems.[30] Phasing out fossil fuel related subsidies would also greatly improve the public finances.

Leveraging African institutional sources, such as pension and sovereign funds, represents another important source of domestic capital. Currently, most of those pension funds and sovereign wealth funds are invested outside Africa. However, the NEPAD-AUDA 5% Agenda, an institutional infrastructure investment initiative between African Heads of State and Africa Pension and Sovereign Wealth Fund leaders launched in 2017, promised to invest 5% of Assets Under Management into African infrastructure investment projects developed through Institutional Investor-Public Partnerships[31].

Next steps

From this review of current and proposed climate finance measures, it is clear that no single solution can fill the huge gap between the demand for and supply of sustainable finance but collectively, the successful implementation of the range of actions outlined in this report could constitute a significant increase in the availability of funds for investment in climate action and to build more resilient economies. Some actions have already been taken such as the agreement by the World Bank that SDRs can be allocated directly to MDBs, such as the African Development Bank, followed by a direct re-allocation by European countries. Other areas in this broad and complex agenda such as the work of the Global Tax Taskforce will take more time. Nevertheless, launching initiatives on airline levies, in just one example, would show political will and a commitment to making change happen.

The AEF must consider where best to focus its efforts within this broad landscape of finance for climate and development in order to achieve maximum impact in 2024-25. To do so effectively the AEF must draw on its strengths, networks, and founding partners. This means facilitating a frank dialogue about where the blockages lie, how Europe and Africa can work together on lifting such blockages, and those essential next steps that recognise the importance of both domestic and international contributions needed for effective climate action and development delivery. Potential areas of focus include:

- Reform of the financial architecture including debt suspension, reform of MDBs, SDR allocation, the cost of capital, the subjectivity of credit rating agencies and the risk premiums charged to African countries.
- Domestic resource mobilisation including the broadening of tax bases, tackling IFFs and leveraging African institutional sources such as the private sector, pension funds, sovereign funds.
- International public climate finance including improving the quality, quantity of and access to finance primarily for adaptation from the large global funds, and making good on promises of climate finance in the context of ongoing climate negotiations.

  Global Taxes and Innovative financing mechanisms including leveraging additional revenues, carbon markets, bonds, debt for nature/climate swaps, financial and insurance products and SDRs for climate action. The content of global tax treaties needs to be examined and revised as does the composition of decision-making boards on this issue. Any discussion around taxation must incorporate the role of the informal sector, which makes up over 50%

29 Amit Jain et al in Foresight Africa: Top Priorities for the Continent In 2024. The Africa Growth Initiative at The Brookings Institution (2024).
30 Fabio Comelli et al (2024) in Foresight Africa 2024.
31 https://regulationinnovation.org/team/hubert-danso

of Africa's GDP. It is critical that systems be put in place to bolster and grow this sector, which could eventually become a means to creating simpler and less burdensome tax systems.

- Fostering bilateral partnerships and calling for climate investment statesmanship: finance and investment match-making across Africa and Europe, in critical sectors of cooperation including energy, agri-food systems, the 'blue economy' and project pipeline preparation.

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Appendix 1

i. Finance processes underway:

- Taskforce Global Taxation (co-chair Laurence Tubiana) reports COP30
- UNCC process to COP29, including New Collective Quantified Goal.
- UN Summit for the Future, September UNGA79.
- OECD Aligning Investment Contracts with Paris Agreement. March 2024. Paris.
- Carbon Markets – resolving difficulties with Article 6.1.
- Establishing LED fund - rules and regulations.
- WLN sub-group focus on finance.

ii. Additional assessments of funding gaps by sector.

Health

- While Africa accounts for just 15% of the world's population it bears 24% of the global disease burden and experiences 50% of global deaths from communicable diseases. Government health expenditures represent only 1.9% of GDP in Sub-Saharan Africa, far below the target of 5% suggested by UNECA and low compared to East Asia and the Pacific (4.4%) and Latin America and the Caribbean (4.1%).
- The combination of underinvestment, high population growth, and the increasing disease burden means that infrastructure shortages are acute. The $4.5 billion in annual capital expenditure on health currently made by African governments is far below the estimated $26 billion in annual investment needed to meet evolving health needs over the next decade.

Source: African Development Bank Group, "Strategy for Quality Health Infrastructure in Africa - 2022-2030", 18.05.2022

Energy

- Climate Policy Initiative estimates that $277 billion is needed annually between 2020 and 2030 for African countries to fully implement their NDCs to reduce greenhouse gas emissions and adapt to climate impacts.
- African governments have committed 10 percent to this amount through domestic financing, leaving about
- $250 billion needed from external sources.
- The AfDB estimates that Africa's annual finance gap for energy and power projects ranges from $35 billion to $50 billion, which will be needed to reach SDG7: access to affordable and clean energy for all.

Source: Moses, Oyintarelado, "Who Finances Energy Projects in Africa?", Carnegie Endowment for International Peace, 27.11.2023

However, the distribution of investment in energy is highly uneven:

- Public financing institutions and corporations in G20 countries and MDBs committed $345.76 billion in energy finance to Africa from 2012 to 2021. The overall amount averages to $35 billion per year, seemingly addressing the annual gap. However, analysis shows this finance is predominantly for fossil fuel production.
- Egypt, Mozambique, Nigeria, Angola, South Africa, Morocco, Ghana, Uganda, Kenya, and Ethiopia received 77 percent of all energy finance between 2012 and 2021, leaving 23 percent of finance for Africa's remaining forty-four countries.
- In fact, the top five recipient countries received a majority (61 percent) of the finance, leaving the rest of Africa's forty-nine countries with just 39 percent.

Adaptation

- There are wide variations in the gap between the needs and existing supply of adaptation funding
- The countries with the highest gaps tend to combine both high needs and low existing adaptation expenditure and include: Benin, Burkina Faso, Cameroon, Central African Republic, Democratic Republic of the Congo, Liberia, Niger and Somalia.

Source: Nicholson, Kit, Broermann, Shanaz, Folscher, Alta, Mutimba, Stephen Mutimba, Tchané, Yacine Bio and Zaky, Mohamed, "Planning Africa's Adaptation Finance: Estimating and Reducing country Level Adaptation Gaps," United Nations Development Programme, 11.2023

- Global adaptation finance gap is widening and now stands at between US$194 billion and US$366 billion per year. Adaptation finance needs are 10–18 times as great as current international public adaptation finance flows – at least 50% higher than previously estimated.
- The updated costs of adaptation for developing countries are estimated to be in a plausible central range of US$215 billion to US$387 billion per year this decade.

Source: United Nations Environment Programme, "Adaptation gap report, 2023", 02.11.2023

Agri-food

- The enormous hidden costs of the global agrifood system, estimated at about $12 trillion/year, are a strong indication that it is no longer fit for purpose.
- the cost to transform the global agrifood system to make it more resilient, nutritious, inclusive, and net-zero is estimated at about $500 billion/year for the next 10 years.

Sources: United Nations Interdepartmental Task Force on African Affairs, "Building Africa's Food Sovereignty and Resilience through Sustainable Investments", 25.07.2023 and Nieuwkoop, Martien van, "Financing the agrifood system transformation – There is no lack of money to do it", World Bank Blogs, 22.02.2024

- About $76 billion annually is estimated to be needed until 2030 to transform African food systems ($614 billion in total).
- The Malabo Declaration reaffirms the need to allocate 10% of public resources to agriculture.
- Africa is still well below the 10% level. In 2019, Africa spent around $12 billion on agriculture which was three times the level of 2001.
- From 2001-2019, Africa's share of agriculture expenditures declined slightly from 2.93% to 2.32%
- Three out of four agri-small and mid-size enterprises (SMEs) in sub-Saharan Africa lack sufficient access to finance

Source: World Economic Forum, "Bridging the Gap: Financing Africa's Agricultural Growth," Podcast, 21.09.2023

- Three out of four agri-SMEs can't access formal bank financing, and are too large for microfinance, creating an estimated $100 billion gap in unmet demand for financing.

Source: Galbiati, Giulia Maria, Yoshida, Makie, Benni, Niclas and Bernoux, Martial, "Climate-related development finance to agrifood systems: Global and regional trends between 2000 and 2021", Food and Agricultural Organization of the United Nations, 2023

- Sub-Saharan Africa emerged as the primary beneficiary of financial support directed towards climate-related initiatives in agrifood systems. The region received a substantial 53 percent of these funds from bilateral donors, with contributions coming mainly from Germany and EU institutions.
- The growth rate of climate-related development finance towards agrifood systems falls short of the average growth rate observed in climate related development finance overall. Consequently, there is an overarching decrease in the proportion of finance allocated to agrifood systems in comparison to global flows.

Source: fi-Compass, "Financing Gap in the Agriculture and Agri-food Sectors in the EU", 10.2023

- In 2022, the financing gap for the EU-24 agriculture sector was EUR 62.3 billion, surpassing the 2017 figure by 33%.

Source: African Development Bank Group, "African Development Bank, UN Environment Programme, partner to drive implementation of Kunming-Montreal Global Biodiversity Framework in Africa", 28.07.2023

Biodiversity

- Annual gap in biodiversity finance of $700 billion

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