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Climate Finance and Carbon Pricing in the Context of Africa's Continental Free Trade Area

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Abstract

Climate change continues to be a critical issue of concern across the globe. In Africa, the vulnerability and exposure to climate risk are very high although African countries do not contribute to emissions as compared with developing countries in other continents. We argued that to effectively achieve the low carbon and climate-resilient development, Africa must use appropriate diversified financial instruments, have a long-term plan, implement a systemic approach and provide support based on each country's needs. We also explore some critical issues on climate finance, carbon pricing and other related issues within a lense of an Africa which is making strides towards a continent-wide free trade area.

Keywords – African Free Trade, Climate Finance, Carbon Pricing, Climate Change, Nationally Determined Contributions, COP21

JEL – F1, F3, G1, Q3, Q54,

1. Introduction

Due to the ongoing alarming climate changes experienced worldwide through temperature changes, precipitation and wind patterns since mid-20th century till now, many initiatives have been adopted and implemented in efforts to sustain the environment, the people and the economies, by all stakeholders. This is led by international institutions like the United Nations, the World Bank and many others. The Paris Agreement under the United Nations Framework Convention on Climate Change (UNFCCC) adopted in 2015 in Paris and ratified by 190 countries is one of those initiatives. It was hatched at the 21st Conference of the Parties (COP21). It aims to reduce the emission of greenhouse gas (GHG) to the levels that would prevent the global temperature from

rising to more than 2°C above the pre-industrial temperature¹ and to build resilience to climate change.

The Nationally Determined Contributions (NDCs) are the fundamental instruments used by states to achieve the COP21 goals. To be able to implement those actions, states need financial resources which they could capture from different sources including the public sector, the private sector and development agencies. Unlike the developed countries, African countries only benefit of 3% of the climate fund that is available worldwide.² Also, many of them cannot tap financial resources from the private sector because first of all there are not sufficient policies in place to price carbon. Secondly, the industrial sector is still embryonic. Thirdly, they face more social and economic challenges which undermine their efforts on climate change.

The World Bank's Vice President for Africa, Hafez Ghanem, notes that Africa is already experiencing some of the devastating impacts of climate change in the form of frequent and long droughts, unpredictable rainfall, floods, ... although Africa may have contributed the least to global warming.³ These impacts threaten the livelihood of many Africans. Also, the release of the Intergovernmental Panel on Climate Change (IPCC) shows the urgency to implement adequate climate change response actions. The above highlights the need for climate finance since most African countries are low-income countries. What instruments can African states use to raise the fund needed and how can the African Continental Free Trade Area (AfCFTA) impact the precedents? This article aims to decipher some of these issues and proffer some suggestions relevant for business, practitioners, policy and the academic community.

2. Climate Finance in Africa

According to the Carbon Pricing Leadership Coalition (CPLC), Africa would require about US\$4 trillion for mitigation and additional US\$488 billion for adaptation by 2030 to implement its

¹ The Editors of Encyclopaedia Britannica. (2021, January 27), "Paris Agreement international treaty [2015]", Retrieved from: <https://www.britannica.com/topic/Paris-Agreement-2015>

² African Development Bank. (2018, December 18), "Africa must not be short-changed by climate finance, says expert panel at COP24", Retrieved from: <https://www.afdb.org/fr/news-and-events/africa-must-not-be-short-changed-by-climate-finance-says-expert-panel-at-cop24-18884>

³ World Bank. (2018), "Accelerating Climate-Resilient and Low-Carbon Development: The Africa Climate Business Plan — Third Implementation Progress Report and Forward Look" World Bank, Washington, DC.

NDCs.⁴ Meanwhile, the intensification of climate change impacts on Africa would increase its vulnerabilities and incapacities, and prevent it from achieving economic growth. Africa would then be unable to help to finance the implementation of its NDCs despite the efforts of the World Bank and its associated institutions like the International Development Association (IDA), the International Bank for Reconstruction and Development (IBRD) and those under the Paris Agreement for constant channeling of fund from developed economies to undeveloped ones to finance climate through existing operating entities like the Global Environment Facility (GEF), the Green Climate Fund (GCF) and special funds, Adaptation Fund (AD), the Least Developed Countries Fund (LDCF) and the Special Climate Change Fund (SCCF).⁵

Interestingly, the efforts consented by those international public climate finance sources to achieve a low-carbon and climate-resilient development also enable modern and efficient technology, growth in expanding sectors, job creation and investment⁶, which are all economic growth and sustainable development indicators. For example, the World Bank uses the Systematic Country Diagnostic (SCD) and the Country Partnership Framework (CPF) to support developing countries to achieve low carbon and climate-resilient development in the course of implementing its Africa Climate Business Plan (ACBP). The World Bank through its ACBP intends to finance development projects providing climate co-benefits through mitigation and adaptation. For instance, the ACBP's release in 2016 focuses on three major clusters:⁷

- i. strengthening resilience (by boosting regional assets both natural and physical assets),
- ii. powering resilience (by contributing to increasing access to energy and mitigating climate change) and lastly,

⁴ Carbon Pricing Leadership Coalition. (2020, October 20), "Carbon Pricing in Africa: Opportunities for action at sub-national level", Retrieved from: <https://www.carbonpricingleadership.org/calendar/2020/6/9/cplc-workshop-carbon-pricing-in-africa>

⁵ United Nations Climate Change. (n.d), "Introduction to Climate Finance", Retrieved from: <https://unfccc.int/topics/climate-finance/the-big-picture/introduction-to-climate-finance>

⁶ World Bank. (2020), "Transformative Climate Finance: A new approach for climate finance to achieve low-carbon resilient development in developing countries", World Bank, Washington, DC.

⁷ World Bank. (2018), "Accelerating Climate-Resilient and Low-Carbon Development: The Africa Climate Business Plan —Second Progress Report on the Implementation", World Bank, Washington, DC.

- iii. enabling resilience (by strengthening the region's hydro-meteorological systems at the regional and country levels and building the capacity to plan and design climate-resilient investments).

Conversely, the Next Generation Africa Climate Business Plan released in 2020 concentrates on five strategic directions which are food security, environment stability, clean energy, resilient green cities and climate shocks.⁸ From 2015 to 2020, the World Bank through IDA and IBRD has implemented 346 projects using US\$33 billion with 29% positive outcomes on the climate.⁹ African developing countries must still look for other means to finance their low-carbon and climate-resilient development because the Multilateral Development Banks (MDB), the African Development Bank (AfDB) and other supporting institutions' contributions are insufficient to meet their NDCs goals, especially with other rising issues like the COVID-19 pandemic.

The COVID-19 pandemic had shifted focus from climate action to health-based issues. International and national finance are being used majorly to respond to those issues and to assure economic resilience throughout the world since the health crisis has induced a worldwide economic crisis. This resulted in the reduction of available fund for climate action. Moreover, even though the current climate financing system has helped in achieving many successful co-benefits projects, it could have certain limitations which prevent it from accessing the full volume and type of financing needed to sustain a widespread transformational change.¹⁰ Climate finance is allocated to projects rather than systemic interventions, without complete consideration of climate objective, and uses a very restrained number of financial instruments.¹¹ Therefore, to be able to effectively achieve the low carbon and climate-resilient development, Africa must use appropriate diversified financial instruments, have a long-term plan, implement a systemic approach and provide support based on each country's needs.

⁸ World Bank. (2020), "The Next Generation Africa Climate Business Plan: Ramping Up Development- Centered Climate Action", World Bank, Washington, DC.

⁹ *Ibid.*

¹⁰ World Bank. (2020), "Transformative Climate Finance: A new approach for climate finance to achieve low-carbon resilient development in developing countries", World Bank, Washington, DC.

¹¹ *Ibid.*

3. Carbon Pricing

Carbon pricing is an instrument used by governments to mitigate the outcomes of greenhouse gases (GHG) emission. It consists of charging a fee for the emission of GHG or offering an incentive when emitting less.¹² The well-known and first adopted forms of carbon pricing are the carbon taxation and the Emissions Trading Scheme (ETS) but due to context diversity, other forms of carbon pricing are being used like fuel taxes, fossil fuel subsidies and the Reducing Emissions from Deforestation and Forest Degradation including sustainable forest management, conservation of forests, and enhancement of carbon sinks (REDD+). To enhance the impacts of carbon pricing in mitigating climate change, different mechanisms and ways are being adopted as well. We can cite the carbon crediting mechanism, the international carbon pricing mechanisms, the clean development mechanisms, the results-based climate finance (RBCF) and the internal carbon pricing. Although Carbon pricing is proven to be relevant for the implementation of the Paris Agreement, out of the 181 countries that submitted their NDCs, only 96 countries mentioned carbon pricing. Up to 2020, only 61 carbon pricing initiatives were implemented in 46 national and 32 subnational jurisdictions covering 12 GtCO₂e (i.e. gigatonnes of equivalent carbon dioxide) representing 22% of global GHG emission.¹³ Not only has carbon pricing helped in controlling GHG emission but also in raising money to finance climate action. For instance, US\$45 billion were raised in 2019 alone.

Factually, carbon pricing helps to finance climate change using the money paid by carbon taxpayers and payers of financial penalties or implicitly attract financial supports. For example, developing countries become eligible for financial support when they implement REDD+. This mechanism is called results-based climate finance. Besides, the money raised from carbon pricing has been allocated to other needs apart from the need to finance climate change. Actually, 40% of the US\$45 billion were redirected to the general budget.¹⁴

Looking at the insufficiency of climate finance available for Africa to implement its low-carbon and climate-resilient development, carbon pricing seems to be an additional perfect way to increase

¹² United Nations Climate Change. (n.d.), “About Carbon Pricing”, Retrieved from: <https://unfccc.int/about-us/regional-collaboration-centres/the-ci-aca-initiative/about-carbon-pricing>

¹³ World Bank. (2020), “State and Trends of Carbon Pricing 2020”, World Bank, Washington, DC.

¹⁴ *Ibid.*

and diversify the climate finance available. Unfortunately, even though 30 African countries have committed by referencing in their NDCs to implement this instrument, only one African country has made it a reality, which is South-Africa. On the other hand, the reasons nourishing this desert are the inadequacy with African developing countries context and the use of traditional carbon pricing (carbon tax and ETS) because industrial emissions in Africa are almost inexistent. But they do have other potential carbon pricing instruments like fossil fuel to price, or forest sequestration to retain value from. Either way, carbon pricing implementation is very essential for Africa, because it helps to identify possible sources of valuable emissions, mitigating its high climate change vulnerability and augmenting financing to implement adaptation.

4. Africa Continental Free Trade Area (AfCFTA)

Opened for signature on 21 March 2018, the agreement establishing the AfCFTA has been signed by 54 African countries and ratified by 36 countries at the end of 2020.¹⁵ It was entered into force on 30 May 2019, was operationally launched on 7 July 2019, and its secretariat was inaugurated in August 2020 but due to the COVID-19 pandemic, trade begun in January 2021.¹⁶ This initiative aims to connect 1.3 billion people across the continent and creates the largest free trade area by membership in the world established under the World Trade Organization rules. The AfCFTA is expected to boost both intra-Africa trade and exports, facilitate intra-Africa investment, intellectual property and competition, and enable e-commerce. Boosting Intra-Trade implies trade costs lowering, productivity augmentation, job creation, wage increase, reducing gender inequality, industrialization, development, export diversification and impacts on services, agriculture and e-commerce.

Even though some of these gains are expected to be captured from the reduction of non-tariff barriers and trade facilitation, to fully meet the AfCFTA goals, the parties must firstly ratify, domesticate, implement and comply with its commitments despite their respective regional or national challenges. Secondly, they must use complementary policy enablers like better

¹⁵ UNCTAD. (2021), “AfCFTA support programme to eliminate non-tariff barriers, increase regulatory transparency and promote industrial diversification”, Retrieved from: <https://unctad.org/project/afcfta-support-programme-eliminate-non-tariff-barriers-increase-regulatory-transparency-and>

¹⁶ Apiko, P., Woolfrey, S., & Byiers, B. (2020), “The promise of the African Continental Free Trade Area (AfCFTA)”, (Discussion Paper No.287). European Centre for Development Policy Management: Maastricht, Netherlands.

infrastructure, freer movement of goods, people and capital, improved digital connectivity, access to finance, supportive business environment, and investment and trade facilitation.¹⁷ Only the effective implementation of all these measures can trigger the expected change.

Africa will become highly industrialized under the implementation of this agreement and high GHG emission may accompany this economic growth factor. But with the momentum toward achieving a green economy, therefore, a low-carbon and climate-resilient development across the world, the AfCFTA parties are also making efforts to promote green industries through the trade-related policies, resource-pricing policies, industrial policies, different partnerships like the European Green Deal and environmental based initiatives. Ghana has created the AKOBEN special audit programme, an environmental performance rating and disclosure initiative which makes companies use the green process in manufacturing and mining activities.¹⁸ The above shows that climate finance will be supported by the projected inclusive economic growth and will be effectively allocated to green economy projects.

Effectiveness and efficiency in implementing this green economy will mitigate all potential carbon risks and their impacts. But if Africa fails to do that, we would also contribute towards a high GHG emission coupled with ineffective carbon pricing policies.

5. Conclusion

Finally, with climate finance source being few, Africa is in so much need of climate finance and related policies to mitigate climate change and achieve climate-resilience. The non-diversity and non-implementation of carbon pricing in many African countries seem to contribute to this shortage of funds. Fortunately, there is hope to achieve the low-carbon and climate-resilient development goals thanks to many initiatives like the AfCFTA which envisions a context with healthy and preserved environment and ecosystems, and climate-resilient economies and communities.¹⁹

To make sure that low-carbon and climate-resilient development is achieved, policymakers must ensure that all the parties' incentives and interests are taken into consideration while designing

¹⁷ *Ibid.*

¹⁸ *Ibid.*

¹⁹ AU (2015), "Agenda 2063", Addis Ababa: African Union

policies and implementing them to gain full participation and support from all stakeholders. Again, governments and law-enforcement institutions must put in place regulations and punitive laws to guarantee the effective implementations of policies. This can only be possible if African countries have put in place the appropriate policy enablers. Finally, transparency through all the processes is highly needed and there is the need to ensure that the canker of corruption does not find its way into the climate-related finance issues in Africa.

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