Briefing

Policy and planning

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Climate change financing in Kenya

Kenya has adopted a climate-resilient green economy pathway to achieve sustainable development by 2030. Financing its Climate Change Action Plan will cost US$2.75 billion per year, but so far demand for climate change finance exceeds supply. To realise its bold ambitions, Kenya will need to tap all sources of climate finance available. Currently, it is estimated that both public and private sectors from international and domestic sources have invested cumulatively around US$3.2 billion in projects and programmes. The lack of a climate-specific budget code makes generating time series data a difficult task, but Kenya has been able to mobilise close to US$1 billion per year. This is good, but more needs to be done if the $2.75 billion a year target is to be achieved.

Policy pointers

Through Vision 2030, Kenya has committed itself to a climate-resilient green pathway to sustainable development. The government has made a good start on this journey, but now needs to scale up climate funding to meet the task.

By operationalising the proposed National Climate Fund, the government could increase the efficiency of resource mobilisation and disbursement to low-carbon resilient development (LCRD) investments.

With public finance likely to remain the primary source of climate finance in the near future, the government should aim at leveraging additional public sources in the short and medium term. At the same time it should introduce additional economic and financial instruments to incentivise private sector investments into LCRD.

The Treasury should assign a specific climate change budget code, to help policymakers integrate and track climate-sensitive expenditure within the national budget.

Kenya's determination to achieve sustainable development by 2030 via a climate-resilient green economy pathway is evident from its National Climate Change Response Strategy and National Climate Change Action Plan.[1] However, financing the action plan will cost KES 235 billion (US$2.75 billion) a year, split roughly equally between adaptation and mitigation. So far Kenya has been able to mobilise less than US$1 billion per year. It is clear that demand for climate change finance has exceeded supply.[2]

To meet its climate change targets, Kenya will need to tap all sources of climate finance available — international and domestic, public and private.

To discuss how Kenya can scale up climate change financing, we will first examine the country's current 'financial landscape' for climate change in terms of the sources, the intermediaries, economic and financial instruments, financial planning systems and the uses and users of climate finance (see Table 1, overleaf).

Sources and investment areas

To date, Kenya has relied on various sources of climate finance, including international public and private sources, domestic public and private sources and carbon finance. Public sources of international finance come from bilateral development partners and multilateral agencies.

The Scaling-up Renewable Energy Programme is an example of a climate fund that Kenya is using to transit to a climate-resilient green economy. Approximately US$25 million have been disbursed to this programme to date. The Special Climate Change Fund, the Global Environment Facility Trust Fund and the Forest Carbon Partnership Facility Readiness Fund have all disbursed resources to Kenyan projects.

Domestic sources of climate finance are funding not less than 35 government-run projects, valued at US$450 million. The Kenyan private sector had invested close to US$150 million in renewable energy projects alone by April 2012,[3] a figure that has probably risen since. The private sector is investing heavily in geothermal activity, biomass and small hydroelectric projects.

Kenya has relied on carbon markets to incentivise international private sector investment in mitigation activities. By April 2012, seven clean development mechanism projects had been registered in Kenya. Carbon Africa estimates that by 2020, the clean development mechanism may facilitate more than US$1.5 billion in project financing in Kenya, with voluntary market activity additional to this. Kenya's voluntary carbon market has also been expanding: to date there are at least ten voluntary gold standard projects in operation, delivering emission reductions of more than two million tonnes a year. Many of these are cookstove projects to improve household energy efficiency. Kenya also boasts seven voluntary forestry sector projects, including the Rukinga REDD+ Phase I.[4]

To meet its climate change targets, Kenya will need to tap all sources of climate finance available

But Kenya will face a lot of challenges if it is to keep up this performance.[2] In April 2012, one tonne of carbon dioxide emission was trading at less than US$5. This challenge, coupled with changes to credit eligibility rules in the European Union Energy Transmission Scheme, has demotivated private investors in the area.

Uses and users of climate finance

A Ministry of Environment survey in April 2012 revealed that 43 per cent of total climate finance is spent on mitigation, 48 per cent on adaptation and the remaining nine per cent on projects with both adaptation and mitigation components. Figures 1 and 2 summarise sectoral usage and who is implementing projects.

Intermediaries

The most important intermediaries in Kenya are multilateral development partners, who have invested US$0.9 billion in various projects. These partners include the World Bank and the African Development Bank.

The leading bilateral development partners are Agence Française de Développement (AFD) which has invested more than US$400m, the Danish International Development Agency, the Swedish International Development Cooperation Agency and the UK Department for International Development.

Plans are under way to establish a national climate fund in Kenya: the design was completed in 2012. The aim is for the fund to become the main recipient of Kenya's external multilateral and bilateral climate finance and to contribute significantly to scaling up these climate finance flows.

Several international banks with Kenyan operations — Barclays, Standard Bank and Bank of Africa — have already established climate finance expertise. Some banks have built partnerships with international organisations (such as International Finance Cooperation and AFD) and NGOs (such as Global Village Energy Partnership International) that facilitate loans by acting as middlemen between firms that want to borrow, and the international organisations.

Economic and financial instruments

The Kenyan government is considering working with the World Bank to provide guarantees to local and international private investors, mostly for power purchase agreements (PPAs). For

Table 1: Kenya's 'financial landscape' for climate change

Sources of climate finance	Intermediaries	Economic and financial instruments	Financial planning systems and institutional arrangements	Uses and users of climate finance
International and national public finance International and national private finance Carbon finance Voluntary climate finance	Multilateral banks Bilateral agencies National agencies National financial institutions	Power purchase agreements Warranties Guarantees Insurance Carbon offset flows Grants Concessional loans Capital: equity, debt financing	Expenditure and budgetary frameworks, without budget code Ministry of Environment, Water and Natural Resources (coordinating agency)	Adaptation Mitigation Government Development partners Private sector Non-governmental organisations (NGOs)

Figure 1. Climate finance spending by sector

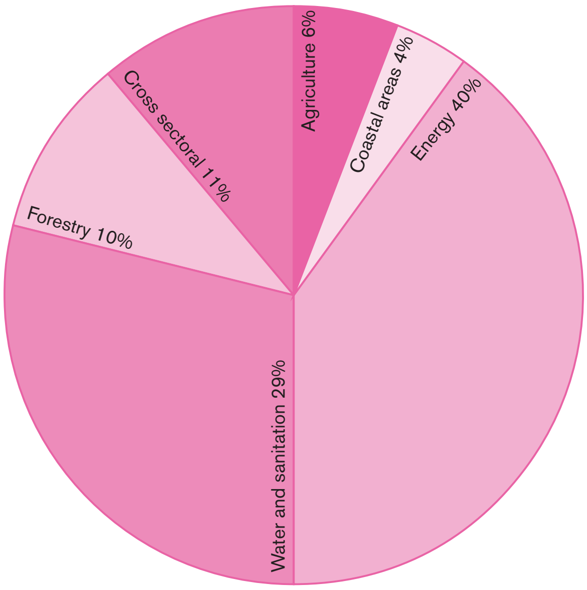
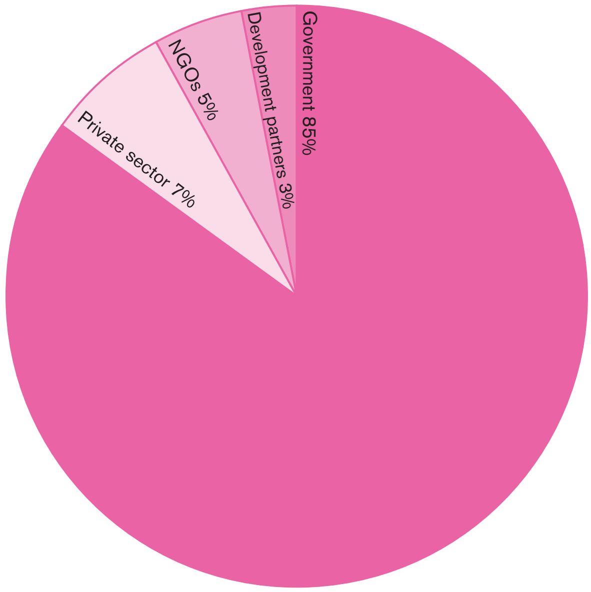


Figure 2. Organisations implementing climate change projects



some time, green energy investors have not been comfortable with the bankability of PPAs signed by the Kenya Power and Lighting Company. Uncertainty arises because, as the country's sole bulk power purchaser, the company enjoys a monopoly. International and Kenyan financers, reluctant to invest in capital-intensive projects without more security of regulation and purchase, often ask the government to act as guarantor for Kenya Power, even when a PPA is signed. It should be noted that foreign investors with financial strength can also use the Africa Trade Insurance Agency and the Multilateral Investment Guarantee Agency to insure their investments. Small or weaker firms may not be able to afford this insurance, and as such the government should consider guaranteeing investments for these.

Kenya's Energy Act (2006) and Renewable Energy Feed-in Tariff Policy (2008, revised 2010) provide various fiscal incentives including tax exemptions, tax holidays and subsidies. For example, importing, constructing and selling photovoltaic cells are exempted from duty and tax, and the government has given ten-year tax holidays for small-scale solar projects.

The government is using public-private dialogue to unlock private sector investments by creating awareness in the private sector of regulatory requirements for climate change projects and opportunities available for climate change financing. The Ministry of Energy also engages the private sector through a biannual national energy conference. Although these are both good tools for unlocking private sector investments, the government should consider using more instruments to incentivise the sector. For instance, Kenya's low-carbon sectors find it difficult to access financing for two reasons. First, small and medium-sized enterprises often struggle to secure debt and equity investment from Kenya's financial institutions because the latter favour short-term projects with high returns and low-carbon projects are long term in nature. Second, firms need to put up a large amount of collateral to secure their loan, which many do not have.

Planning systems

The Ministry of Environment has played the main coordinating role in ensuring Kenya's low-carbon climate-resilient trajectory. Under the leadership of technocrats within the ministry, Kenya prepared its Climate Change Response Strategy in 2010, to be implemented through five-year action plans. The current Kenyan Climate Change Action Plan for 2013–2017 runs concurrently with the second medium-term plan of Vision 2030. Climate change adaptation and mitigation has been integrated in the 2013–2017 plans.

Although this is a good start, the national government should now consider incentivising county governments to integrate climate change financing into their development plans. This is important because it will guide and incentivise investment into low-carbon resilient development (LCRD). Furthermore, the integrated financial management information system used by the National Treasury to manage public resources does not have a specific code to track and report climate change budgets and expenditures. Funds meant for climate change projects and programmes are therefore bundled up into overall ministerial expenditures, creating a number of accounting and reporting challenges.

Recommendations

We recommend that the Kenyan government consider taking the following steps to scale up climate financial resources within the country, and thus reach sustainable development via a green pathway by 2030.

1. Make the proposed National Climate Fund operational so Kenya can mobilise and disburse resources to LCRD investments more efficiently. National Climate Funds can be designed to draw down and pool multiple sources of international and national finance, thereby enhancing resource mobilisation strategies. They also have the potential to minimise transaction costs, fragmentation and duplication associated with project-based funding.
2. Introduce additional economic and financial instruments to leverage private sector investments into LCRD. These include guarantees to enable small- and medium-sized enterprises to access funds from financial institutions and guarantees, insurance and concessional loans to address the barriers associated with risky investments and up-front investment costs. At the same time, the government should continue to draw down on public sources and focus on making existing public investments work better.
3. Assign a climate change budget code to integrate and track climate-sensitive expenditure within the national budget. This would support effective financial management for LCRD investments in three potential ways:
   - Allowing climate-sensitive expenditure to be tracked within the national budget, enabling policymakers to assess both the cost of addressing climate change and the effectiveness of targeted investments.
   - Integrating LCRD interventions into a broader portfolio of investment, thereby un-locking other sources of capital.
   - Shifting to longer-term financial planning. Because a budget code reflects a country's strategic priority, it would make ministries plan for LCRD every year and the government allocate resources to implement priorities.

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Knowledge Products

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Notes

[1] Government of Kenya. 2010. The national climate change response strategy. http://cdkn.org/wp-content/uploads/2012/04/National-Climate-Change-Response-Strategy_April-2010.pdf and Government of Kenya. 2013.The national climate change action plan. http://cdkn.org/wp-content/uploads/2013/03/Kenya-National-Climate-Change-Action-Plan.pdf / [2] Ministry of Environment and Mineral Resources. 2012. Climate change financing in Kenya / [3] Kenya Institute for Public Policy Research and Analysis. 2011. Government of Kenya climate change activities. Annex C of National Climate Change Action Plan. / [4] Vivid Economics, Adam Smith International, Kenya Institute for Public Policy Research and Analysis, 2011. Current and future international climate finance architecture — implications for Kenya's financing mechanism. Annex A in the National Climate Change Action Plan: Finance, final reports and annexes. http://tinyurl.com/pnvzfok / [5] Buchner, B et al. 2013. The global landscape of climate finance. Climate Policy Initiative. http://climatepolicyinitiative.org/wp-content/uploads/2013/10/The-Global-Landscape-of-Climate-Finance-2013.pdf