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Private financing of adaptation to climate change in poor countries?

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Bonn, 26 November 2012. During recent UN climate conferences developed countries pledged to mobilise USD 30 billion for the period 2010-2012, and USD 100 billion per annum from 2020 onwards for climate change mitigation and adaptation in developing countries. Developing countries want the polluter to pay and therefore prefer climate finance to come from public budgets as grants. Yet the final decision of the 2009 UN climate conference was that the private sector would be one of the sources of climate finance. And why not? Approximately 86% of all investments worldwide are made by the private sector, and 90% of the population in developing countries depends on the private sector for their income, as small as it may be. Yet one reason of why some developing countries are so poor, is that their private sector is underdeveloped and that investment conditions are unfavourable. Why would climate change adaptation in the Least Developed Countries (LDCs) offer business opportunities?

Motives of private sector adaptation

Private sector investment might have adaptation and mitigation benefits, but profit-making is its main objective. In line with this objective, private firms can invest in adaptation for three reasons. First, to address potential impacts of climate change on their operations. Second, to participate in an emerging market for new products and services. And third, to address adaptation as part of their 'corporate social responsibility'. The questions are: do these motives also apply to private sector operations in developing countries? Can private investment in adaptation contribute to broader social objectives? Early research from the United Nations Environment Programme and the Stockholm Environment Institute (SEI) gives a rather sceptical answer: important sectors for adaptation such as coastal protection and ecosystem conservation are not attractive for private investment. Other sectors, like water and agriculture, have either been relatively unattractive, or have seen investment in large-scale export-oriented activities but not in the small-scale production that sustains local populations. How can the private sector be relevant for tackling adaptation if it has, as SEI concludes, "failed to alleviate poverty and livelihood threats in many of the poorest parts of the world"?

Private Sector in LDCs

The private sector in poor countries typically comprises a huge number of micro enterprises but only few large companies. Their share of medium-sized enterprises is even smaller than in rich countries. There are many reasons for this, including a lack of economic infrastructure (e.g. roads, ports, energy), low-skilled work force, and an inadequate financing system. This means that the private sector has low capacities for growth on its own. This is mirrored in external ratings of business environments: In World Bank and World Economic Forum rankings LDCs score very low on average.

As a consequence, only around 1% of global foreign direct investment flows into LDCs. This share would be even lower if it weren't for LDCs with large extractive industries such as Angola and Zambia. The underdeveloped private sector also manifests itself in the number of Clean Development Mechanism (CDM) projects under the Kyoto Protocol. Only 1% of the 4945 CDM projects so far are carried out in LDCs.

These structural weaknesses are therefore also likely to severely constrain the private sector's capacities to adapt to climate change on its own. It might make private enterprises dependent on public investment to adapt its business operations against climate change. It is also unlikely that foreign firms will play a major role in this area, unless their direct investments in climate-sensitive sectors in LDCs grow considerably.

Private Sector in LDCs' adaptation strategies

Despite this uncomfortable starting position, it is important to understand how LDCs consider the idea of private sector adaptation and adaptation finance. At the UN Climate Summit in 2001, LDCs were invited to formulate National Adaptation Programmes of Action (NAPAs). Although the guidelines for these reports do not request LDCs to describe the role of the private sector, there are good reasons for doing so. The NAPAs are supposed to integrate the adaptation needs of the most relevant sectors and stakeholders. Within these plans, private sector participation could foster awareness, innovation and change, lower the costs of adaptation and increase the rate at which adaptation funding is put to use. Yet the private sector has a limited role in the current 47 NAPAs. For example, the private sector was only represented in 43% of the teams that formulated the NAPAs. Only 22 countries explicitly state that the private sector has a role in adaptation, of which 18 mention a sector, and only 14 include a (very) brief description of the activities. Nine NAPAs do not mention the private sector at all. And whilst 92% of the LDCs state that a lack of financial resources is a barrier for adaptation, Mali is the only LDC stating that the private sector has to co-finance adaptation, in this case the country's energy transition.

Steps forward

To conclude, the private sector is an important player, but its potential for adaptation financing in LDCs is unknown. LDCs should take the lead in identifying this potential, as they know their countries' conditions best. We think of three steps forward:

First, a definition of 'private sector' within the climate negotiations is necessary. For now, a subsistence farmer is as much private sector as a multinational corporation. The former are poor but abundant in LDCs, the latter can invest but are scarce in LDCs.

Second, the NAPAs will soon be followed up by the National Adaptation Plans (NAPs) to identify longer-term adaptation needs and to develop strategies and programmes to address those needs. The formulation of the NAPs would be a good opportunity for LDCs to think more pro-actively about the needs and possible contributions of their private sectors. The potential is likely to be very limited in many sectors and LDCs – but then at least we know.

However, LDCs will be very uncomfortable to commence this analysis, knowing that it might reduce international public adaptation finance. Therefore, developed countries have to guarantee that they will mobilise public finance for adaptation of the most vulnerable people and in those sectors that seem to offer limited opportunities for private sector finance.

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