Country Focus Report 2023

MALAWI

Mobilizing Private Sector Financing for Climate and Green Growth

AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE DE DÉVELOPPEMENT

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TABLE OF CONTENTS

List of Figures 17 - 32

List of Tables 14 - 33

LIST OF ACRONYMS AND ABBREVIATIONS

AEO2023	African Economic Outlook 2023
AfCFTA	African Continental Free Trade Area
DFIs	Development Finance Institutions
GDP	Gross Domestic Product
GHG	Greenhouse Gas
GGI	Green Growth Index
GNI	Gross National Income
GoM	Government of Malawi
ICT	Information communications technology
IUU	Illegal, Unreported, and Unregulated
MDBs	Multilateral Development Banks
Mkw	Malawi Kwacha
NDC	Nationally Determined Contribution
ND-GAIN	Notre Dame Global Adaptation Index
ODA	Official Development Assistance
PPP	Public-Private Partnerships
US$	United States Dollar

Malawi

KEY MESSAGES

Macroeconomic Performance and Outlook

- ***Malawi is facing structural and systematic weaknesses that have elevated the economy's vulnerability to shocks.*** Malawi is currently experiencing macroeconomic instability coupled with debt distress, both of which require significant reforms if the country is to attract investments that would ensure the objectives of its medium- and long-term strategy are realized.

- ***Investing in climate change actions and green growth is critical to building resilience.*** Existing infrastructure gaps, and climate adaptation and mitigation measures are central to making Malawi an attractive investment destination given its land-locked position and increased vulnerability to climate change.

Private sector financing for climate change and green growth

- ***Climate change poses a significant hurdle to Malawi's ambitious development objectives.*** The country is grappling with substantial developmental issues, which are further exacerbated by the changing climate. With a ranking of 163rd out of 182 countries in 2020 according to the Notre Dame Global Adaptation Index, Malawi is regarded as extremely vulnerable to climate change.

- ***The frequency and intensity of climate-related disasters are on an upward trend, inflicting devastating damage.*** For households living on the edge, a single disaster could drastically raise their chances of descending into poverty. Infrastructure damage, particularly from flooding, not only disrupts electrical services, travel, and commercial activities but also demands substantial financial
- resources for repairs and reconstruction, consequently diverting already limited resources away from other developmental necessities. For example, the estimated damage caused by Tropical Storm Ana equated to around 1.5–2.7% of Malawi's GDP, with notable costs involved in the extensive repair and refurbishment of the Kapichira Dam.

- ***A World Bank analysis shows that climate change will impose large costs on the economy and on already vulnerable households.*** Climate change could reduce Malawi's GDP growth by 3–9% by 2030, 6–20% by 2040, and 8–16 % by 2050.

- ***There is already a strong political commitment towards green growth and climate action in Malawi.*** Real action in implementing the several policies, and legislative and strategic frameworks need to be expedited with support from development partners.

  Strengthening cross-sectoral coordination will contribute towards mobilizing additional private sector finance. Malawi needs to ensure strong horizontal and vertical integration among the critical institutions charged with the implementation of climate actions and green growth. This includes the development of green skills and addressing the existing capacity gaps that limit the development of commercially viable green growth and climate change projects for private sector investments.

  Malawi has thus far only mobilized limited resources from the private sector. Between 2019 and 2020, Malawi mobilized US$ 512 million per year in climate finance, or approximately 23.3% of

its needs as assessed by the AfDB; 61% of these resources came from public sources and 12% from private sources. The gap, estimated at an average of US$ 1.69 billion per year, could partly be bridged through greater private sector mobilization. Assuming public contributions remain stable over the next few years, the current private sector contribution must be increased by at least 28 times to cover the country's entire needs.

There are private sector financing opportunities for green growth and climate change in Malawi and unlocking these opportunities will need concerted action by multiple stakeholders.

- For the private sector, Malawi's young population, urbanization, agricultural diversification and commercialization and adoption of new and existing technologies, provide opportunities for investing in affordable green urban housing, energy and transport, food and waste management services.

- With the integration of numerous innovative financing tools including green bonds, carbon markets, debt-for-nature swaps and blend financing, current developments in the financial markets represent clear opportunities for Malawi to improve the financing needed to implement actions for green, sustainable, and inclusive growth.

- For the government, to encourage greater mobilization of resources from the private sector at national, regional, and international level, Malawi must build the technical capacity of its experts in the technical and financial structuring of climate projects, on the one hand, and improve the business environment by establishing and strengthening an incentive-based regulatory, institutional and governance framework on the other hand. Multilateral banks and development finance institutions can support Malawi in this regard.

- For development partners, assistance with capacity-building activities to enhance the legislative, policy, and regulatory frameworks will increase the private sector investments in climate actions and green growth.

- For regional organizations, the dissemination of information on regional opportunities for value chain development in the context of the African Continental Free Trade Area (AfCFTA) will foster private sector collaborations and investments in climate actions and green growth.

Natural capital for climate finance and green growth

- ***Malawi's non-renewable natural capital is increasing but there is a need for action to reverse the decline in renewable natural capital which is currently under threat.*** The loss of forest ecosystems and marine biodiversity is a present risk which requires active management and harnessing the returns from these systems in a sustainable manner is also required. More can also be done to exploit clean energy resources through an attractive incentives framework to increase investments.

- ***Significant deficiencies in infrastructure and economic policy discrepancies hinder competitiveness and obstruct economic diversification.*** Although Malawi's human capital is showing signs of improvement, it continues to be restricted by factors like low levels of education and gender imbalances. Further, the commercial environment is crippled by weak institutions, corruption, a lack of transparency, and substantial policy ambiguity.

Non-renewable assets are not being fully utilized to their full potential due to limited investments, especially in the mining sector. The investment climate needs to be improved to attract investments that could best exploit mineral endowments and develop associated value chains. This raises the importance of good governance in the managing the returns from natural capital and in bringing together physical and human capital to add value to the country's primary products for enhanced exports.

International agreements provide a prime opportunity for Malawi to benefit from its natural capital. Greater use of international agreements on climate change and biological diversity to finance higher returns from the substantial endowments of natural assets in the country that can serve the global goals need to be taken advantage of.

The analysis is based on World Bank data for major categories of assets but the coverage of some forms of natural capital is incomplete. Work is still needed on estimating the value of renewable energy sources such as sunshine, wind and hydro, as well as that of landscapes and biodiversity.

1. INTRODUCTION

The Malawi Country Focus Report reviews the role and potential of the private sector in financing climate change and green growth. It further explores the scope for harnessing natural capital to finance adaptation and mitigation to climate change and to promote green growth. It builds on the analyses carried out at the continental level in the African Development Bank's main African Economic Outlook (AEO) report.

This Report is structured as follows. Section 2 reviews Malawi's recent macroeconomic performance and outlook. Section 3 discusses the private sector financing for climate and green growth. Section 4 discusses the role of natural capital for climate finance and green growth in Malawi. Section 5 draws some policy recommendations for the government, the donors' community, the domestic and international private sector, and developed country governments.

2. MALAWI'S ECONOMIC PERFORMANCE AND OUTLOOK

2.1 RECENT MACROECONOMIC AND FINANCIAL DEVELOPMENTS

Growth: Despite the reopening of the economy following almost two years of COVID-19 containment measures, GDP growth decelerated to 0.8% in 2022 from 2.2% in 2021 (Table 1.1). The Russia-Ukraine conflict, global logistical challenges and climate shocks dampened growth. The result has been a notable decline in per capita GDP for four consecutive years up to 2022 which negatively impacted efforts on addressing poverty and income inequalities. As noted by the Reserve of Malawi (2023), agriculture remains the largest contributor to 2022 overall GDP growth at about 22.1% followed by wholesale and retail trade (12.6%), and real estate and construction (6.5%). As observed in the Malawi Country Diagnostic Note (2023) there is a clear reversal of the downward trend in the manufacturing sector's contribution to growth at about 12.7% in 2022.

Monetary policy and inflation: Monetary policy was tightened, with the key policy rate adjusted to 18% in October 2022 from 12% in 2021. Inflation jumped from 9.3% in 2021 to 21.0% in 2022 on account of higher food and non-food prices. The local currency was devalued in May 2022, dropping in value from Malawi Kwacha (Mkw) 824.8 to Mkw 1036.2 to the United States Dollar (US$). The banking sector liquidity tightened in 2022, and the non-performing loans ratio rose to 6.1% from 4.5% at the end of 2021 (Table 2.1).

Fiscal and current account balances: In 2022, the fiscal deficit marginally narrowed to an estimated 7.2% from 7.4% of GDP in 2021 due to fiscal consolidation. Malawi continues to face structural balance of payments challenges on account of the COVID-19-induced economic weaknesses in China and the on-going Russia-Ukraine conflict, the country's key tobacco export destinations. Foreign currency shortages have induced import compression leading to an improved current account deficit of 12.9% of GDP in 2022, compared to 13.8% in 2021.

Malawi's external and overall public debt is assessed as "in distress" (IMF DSA, 2022). The ratio of public debt to GDP has increased significantly from 45.3% in 2019 to 76.6% in 2022. Unless the ongoing debt restructuring negotiations are concluded successfully, the public debt to GDP ratio could remain above the 50% sustainability threshold throughout the medium term.

Table 1.1 - Macroeconomic Indicators

	2018	2019	2020	2021	2022(e)	2023(p)	2024(p)
Real GDP growth	4.4	5.7	0.9	2.2	0.8	2.0	3.5
Real GDP per capita growth	1.7	3.0	-1.8	-0.4	-1.8	-0.6	0.9
CPI inflation	9.2	9.4	8.6	9.3	21.0	22.8	15.4
Budget balance % GDP*	-5.5	-4.6	-6.6	-7.4	-7.2	-7.8	-7.7
Current account balance % GDP	-17.1	-12.0	-12.5	-13.8	-12.9	-11.7	-12.3

Source: Data from domestic authorities; estimates (e) and prediction (p) based on authors' calculations.
** Data for fiscal year: Year n refers to July n / June n+1*

2.2 OUTLOOK AND RISKS

Economic Growth: Economic growth is projected to rebound to 2.0% in 2023 and 3.5% in 2024, driven by a recovery in agriculture, tourism and exports, and foreign direct investment. Weather-related shocks and the persistence of the Russia-Ukraine conflict remain as downside risks. Despite the tight monetary policy, inflation is expected to rise to 22.8% in 2023 before falling to 15.4% in 2024. The current account deficit is projected to improve to 11.7% of GDP in 2023 and 12.3% of GDP in 2024, due to weak growth and domestic demand. Fiscal consolidation to achieve medium-term debt sustainability was expected to narrow the fiscal deficits, but a mixed picture is emerging. In 2023, the fiscal deficit will rise to 7.8% of GDP due to the impact of Cyclone Freddy before falling slightly to 7.7% in 2024. Using the IMF DSA (2022) baseline assumptions, the debt-to-GDP ratio is likely to fall to 72.6% by 2026 compared to 76.6% in 2022 as the economy recovers and when most of the debt to Afreximbank, and to Trade and Development Bank will have been paid back.

3. PRIVATE SECTOR FINANCING FOR CLIMATE AND GREEN GROWTH IN MALAWI

3.1 INTRODUCTION

Malawi needs to build resilience by prioritizing green growth and climate action if it is to achieve its national development objective of attaining upper middle-income status by the year 2030.

The frequency, intensity, and magnitude of extreme weather events in Malawi have increased over the last two decades. Floods, droughts, and strong winds associated with tropical cyclones have elevated the country's vulnerability to climate change, putting at risk the lives of the 50.7% of the population that is already in deep poverty. Malawi was ranked 163 out of 182 countries on the Notre Dame Global Adaptation Index (ND-GAIN) in 2020, which ranks the climate adaptation performance of countries. The high ND-GAIN vulnerability score (53/100) and low readiness score (28/100) underlines the need for investment in improving readiness and urgency for action. The World Bank notes that climate change-induced extreme weather events can raise the country's poverty rate by 8%, which would add another four million poor people by 2040 (World Bank, 2022). Since 2010, Malawi has experienced 16 major floods, two rainfall-related landslides, five storm-related disasters and two severe droughts. Of these weather-related events, three cyclones - Idai (2019), Gombe (2022) and Freddy (2023) in the southern parts combined with drought in the north of the country, and Tropical Storm Ana (2022), have had devastating effects on people's lives and livelihoods.

Heavy reliance on agriculture raises the importance of policies that promote sustainable development. Environmental degradation caused by climate change and the increasing human and livestock population pressures are impacting agricultural productivity as more and more marginal areas are being used. In addition to the agriculture sector suffering the greatest losses because of climate change impacts, most smallholder farmers in Malawi are resource-poor with very limited capacity to respond to more frequent and intense shocks arising from climate change. For example, seasons have become shorter thereby reducing yields and causing food shortages with negative implications for nutrition. Poverty, coupled with overdependence on traditional biomass (wood, charcoal) and other fossil fuels to meet the country's growing energy needs, are also contributing to climate change as forest resources are being depleted. In common with many other developing countries, the country's economic growth prospects are highly threatened by climate change. Estimates from economic modelling indicate that climate change contributes to reducing the country's annual gross domestic product (GDP) growth by at least 5% each year. This makes the transition to green growth more urgent than ever, despite Malawi's minimal contributions to global carbon dioxide emissions (0.0043%) in 2021.

There is a strong demonstration of Malawi's political commitment to green growth and climate actions.

Considering the recurring disasters, the Government ratified the Disaster Preparedness and Relief Act of 1991, that established the Department of Disaster Management Affairs, an agency which is responsible for coordinating and directing the implementation of disaster risk management programmes to improve and safeguard the quality of life of vulnerable

Malawians. A series of sectoral legislative frameworks and strategies to integrate environment and climate change management in socio-economic development activities, including through the country's previous overarching long-term strategy Malawi Vision 2020 (GoM, 1998) have since been in place. In the Nationally Determined Contribution (NDC), the Government sets out its planned mitigation and adaptation measures. The National Adaptation Programmes of Action (NAPA) (GoM, 2006), submitted to the United Nations Framework Convention on Climate Change in 2016, identified those sectors most affected by climate change which include agriculture, human health, energy, fisheries, wildlife, water, and forestry, as well as their differentiated effect on gender. Several other initiatives and processes were also put in place to assist the most vulnerable communities and ecosystems to adapt and mitigate the impacts of climate change by increasing adaptive capacity and resilience, enhancing carbon sinks, reducing greenhouse gas emissions, improving food security and promoting sustainable economic development.

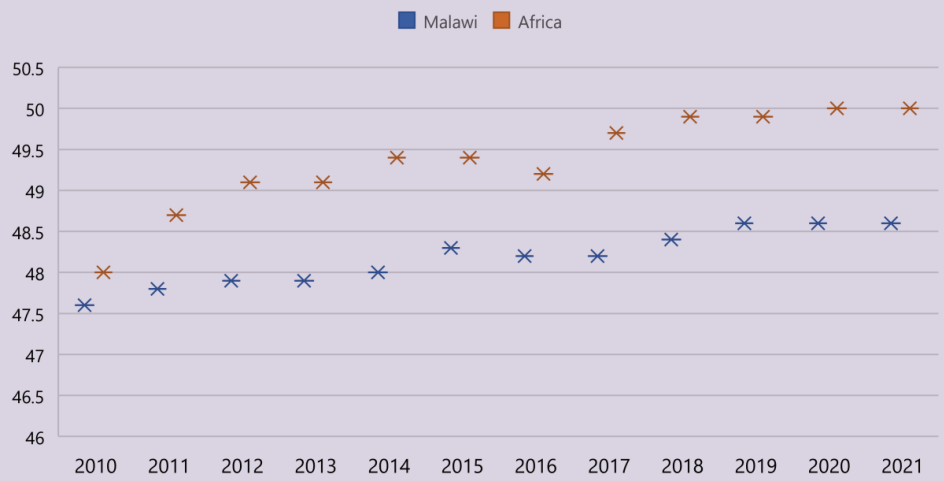
Noting the high level of climate vulnerability and increasing intensity of climate-related events that Malawi has experienced in recent years there is need to enhance its climate actions, especially through attracting increased financing for resilience.

Additionally, in 2016, the Government developed the National Climate Change Management Policy, a key instrument for managing climate change. The policy helped create an enabling policy and legal framework that enabled a pragmatic, coordinated, and harmonized approach to climate change management. It included setting priorities for climate change interventions and an institutional framework for the application and implementation of adaptation, mitigation, technology transfer and capacity-building actions. For example, the Nationally Appropriate Mitigation Actions, National Climate Change Response Framework and National Adaptation Plans were developed. Some of the climate change actions are sector-specific. For example, in the health sector, Malawi conducted vulnerability and adaptation assessments on climate change, and drafted National Adaptation Health Plans. Implementation of Early Warning, Alerts and Response Systems that identify potential risks for climate-sensitive water- or vector-borne diseases is already underway in four selected districts. Malawi also prioritized climate change, environment and natural resources management within the Malawi Growth and Development Strategy III (GoM, 2018). The Health and Climate Change Core Team, comprising several government sectors and partners, has been central in providing oversight and guidance on the implementation of health and climate change actions since 2019. Vision 2063 (2021), which is the basis of the updates to the 2016 NDC, outlines the seven enablers of its three pillars (agricultural productivity and commercialization; industrialization; and urbanization). Under enabler 7 (environmental sustainability) three key actions are specified: ***(i)*** embracing ecosystem-based approaches in managing the environment with harmonized legislation; ***(ii)*** ensuring adequate waste disposal, treatment and recycling; air and water pollution management; and prudent water resource management; and ***(iii)*** mitigating and adapting to the effects of climate change.

Given the various policy, legislative instruments and plans developed over the years, Malawi's performance against the identified green growth actions needs urgent attention.

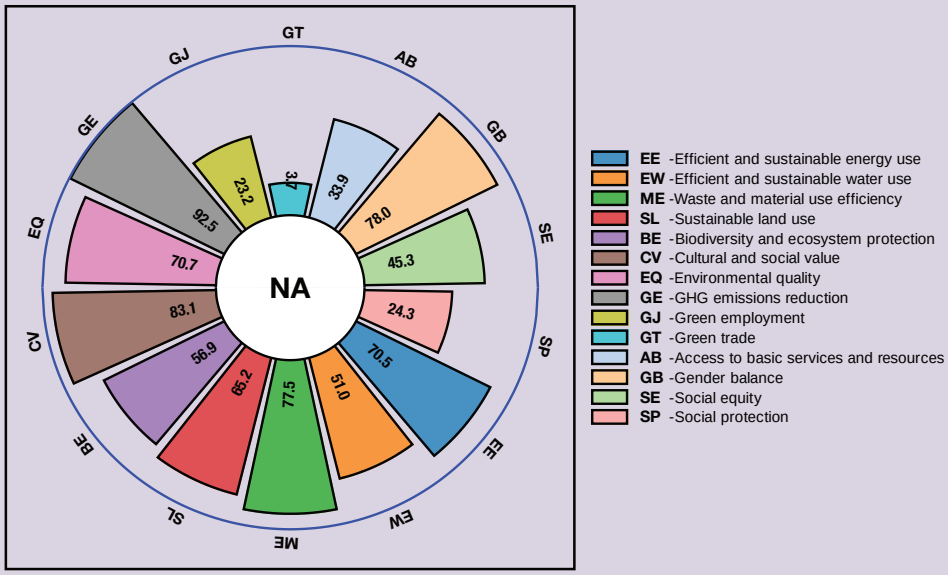
Malawi's green growth performance is below the African average although it is on an upward trend, stable and identical to that of Mozambique and Zimbabwe over the last eleven years. Its mean Green Growth Index (GGI) (Acosta, et al, 2019a) has risen by one point from 47.6 in 2010 to 48.6 in 2021, almost 1.5 points lower than the overall African mean GGI performance in 2021 (Figure 3.1). Noting the high level of climate vulnerability and increasing intensity of climate-related events that Malawi has experienced in recent years there is need to enhance its climate actions, especially through attracting increased financing for resilience. Malawi's GGI is mainly driven by high performance on greenhouse gas emission reduction, waste and material use efficiency, cultural and social value, and gender balance and its worst performance is in both access to basic services and resources and social equity at less than 50%.

Figure 3.1: GGI Performance



Source: Staff computations using World Bank data (2021).

Figure 3.2: Components of Malawi's GGI



Source: Staff computations using World Bank data (2021).

[1]The seven enablers of Vision 2063 are: mindset change; effective governance systems and institutions; enhanced public sector performance; private sector dynamism; ¬human capital development; economic infrastructure; environmental sustainability.

3.2 PRIVATE SECTOR FINANCE FLOWS, GAPS AND NEEDS FOR GREEN GROWTH AND CLIMATE ACTION IN MALAWI

3.2.1 Current Flows of Finance

Accelerating green growth and climate actions requires enhanced mobilization of domestic public and private sector resources to complement international inflows.

Meeting green growth and climate action ambitions will require significant investments, especially from domestic public and private sector players. The average climate finance flows for the period 2019 and 2020 was US$ 512 million and for 2020 alone was US$ 583.8 million, indicating a 16.3% increase over that in 2019. Of this amount, US$ 453 million was public financing of which 61% was foreign public financing and 27% came from the government. The private sector contributed only 12% of the total financing (Table 2.1), with commercial banks and other financial institutions contributing nothing. Regarding the origin of public financing, only 31% is domestic financing and the rest is foreign sourced.

Also notable is that agriculture, forestry, other land uses and fisheries, energy systems and multiple sectors make up the greatest share in the financing allocations, while industry and ICT received no financing. This outcome could reflect the small size of the industrial sector, where manufacturing value-added is less than 10% of GDP and/or the lack of institutional arrangements/frameworks for private sector participation in climate financing in the country. In terms of the use of the available financing, adaptation takes the lion's share at 61% followed by mitigation and multiple objectives at 34% and 5%, respectively. The use of climate financing resources clearly indicates an effort to build resilience to climate change.

Table 2.1: Climate Financing by Source, Sector and Use (average for 2019 & 2020)

TOTAL FINANCING			US$ 512 MILLION
	INSTITUTION TYPE		
Private	**$**	**59**	**12%**
Commercial bank	$	-	0%
Commercial FI	$	-	0%
Corporation	$	7	1%
Funds	$	-	0%
Households individuals	$	-	0%
Institutional investors	$	9	2%
Unknown	$	44	9%
Public	**$**	**453**	**88%**
Bilateral DFI	$	63	12%
Export Credit Agency ECA	$	-	0%
Government	$	141	27%
Multilateral climate funds	$	14	3%
Multilateral DFI	$	236	46%
National DFI	$	-	0%
Unknown	$	-	0%
SOE SOFI	$	-	0%

TOTAL FINANCING			US$ 512 MILLION
SECTOR			
Private	$	59	12%
Agriculture, forestry, other land uses and fisheries	$	86	17%
Buildings & infrastructure	$	42	8%
Energy systems	$	120	23%
Industry	$	-	0%
Information and communications technology	$	-	0%
Others & cross sectoral	$	175	34%
Transport	$	47	9%
Water, wastewater and waste	$	42	8%
USE			
Adaptation	$	312	61%
Mitigation	$	176	34%
Multiple objectives	$	24	5%
Unknown	$	-	0%

Source: AfDB Staff calculation based on Africa Landscape data

3.2.2 Private sector finance needs for the future

Malawi will need more than US $2.21 billion annually up to 2040 to meet its climate change and green growth objectives.

To illustrate the importance of scaling up private financing for climate change actions, reviewing Malawi's financing needs for mitigation up to 2040 is salutary. The Nationally Determined Contribution (NDC) estimates that Malawi's adaptation and mitigation financing needs are about US$ 46.33 billion for the period 2020 to 2040, thereby giving annual financing needs of about US$ 2.21 billion. Assuming the current average annual financing flows (US$ 512 million) hold for the NDC period, more than four times as much financing as is available today is required to meet the country's mitigation needs (Table 3.1). Therefore, scaling up financing for climate actions is an urgent reality and this must be partly addressed by scaling up private sector financing as public financing is insufficient to ameliorate the risks posed by climate change.

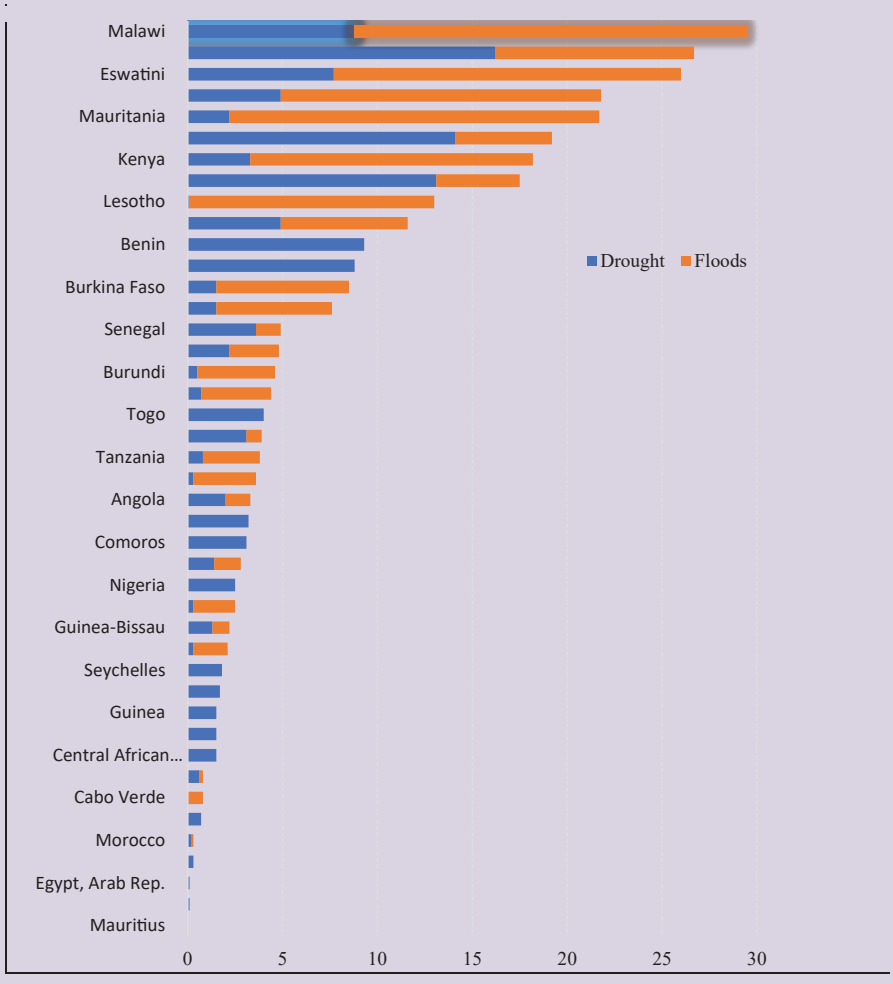
Malawi's combined unconditional and conditional contribution reduction target of GHG emissions is 51% by 2040. To achieve this, current total financing flows need to be raised substantially to a minimum of 15.8% of GDP compared to about the 4.1% of GDP in 2021. The private sector contributes only 0.47% of GDP or 3% of total financing requirements for climate actions, which suggests the sector is punching below its potential. Estimates of opportunities for private sector investments for adaptation to droughts and floods add up to about 29.5% of Malawi's GDP, the greatest untapped potential of most African countries while Mauritius has the least opportunities (Figure 3.3). There is also a mismatch between financing needs and current financing flows, with the latter more focused on adaptation compared to current needs that are more biased towards mitigation.

Table 3.1: Funding requirements for climate change adaptation and mitigation measures (US$ million) to 2040

	2020-2025	2025-2030	2031-2040	Total
Mitigation measures				
Unconditional contribution	1,664	1,949	5,362	8,974
Conditional contribution	2,550	5,393	24,866	32,808
Total	**4,213**	**7,341**	**30,228**	**41,782**
Adaptation Measures				
Unconditional contribution	573	738	817	2,128
Conditional contribution	656	818	945	2,419
Total	**1,230**	**1,556**	**1,762**	**4,547**
Combined total	**5,443**	**8,897**	**31,990**	**46,329**

Source: Government of Malawi, NDC 2021

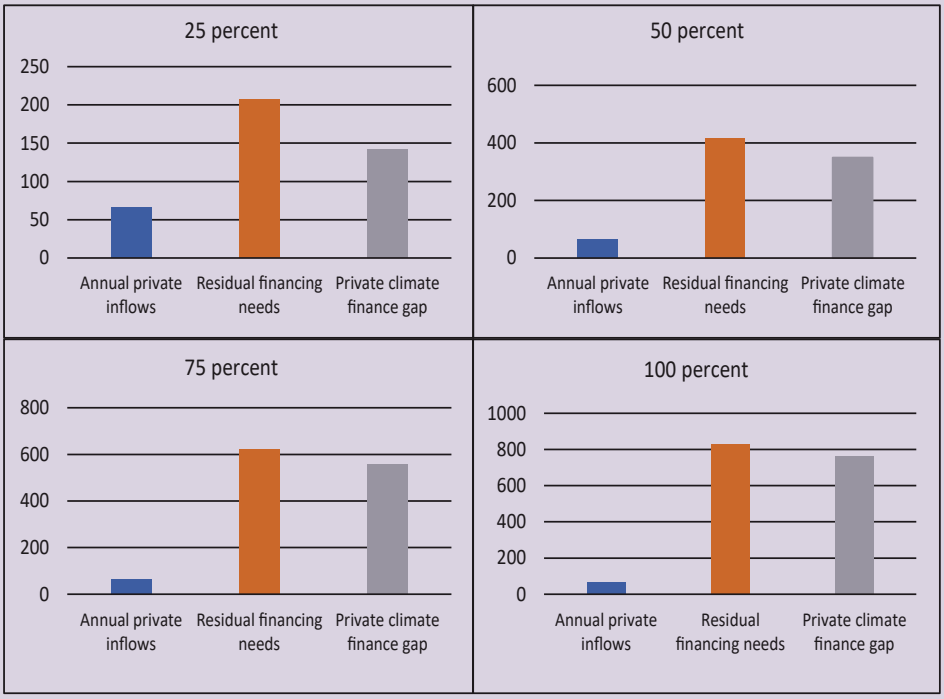
Figure 3.3: Upfront private investment opportunities to adapt to droughts and floods in Africa between 2021 and 2040 (% of GDP)



Source: https://www.ifc.org/wps/wcm/connect/775d1c2f-a9f3-4b7d-b0d7-72738b42e3b8/Working-Paper-Adapting-to-Natural-Disasters-in-Africa.pdf?MOD=AJPERES&CVID=ohpHufW

Based on recent trends in global private climate finance flows, Malawi holds the greatest opportunities for the private sector to contribute up to 30% of GDP to climate financing needs (Figure 3.4). For a conservative scenario of a 25% contribution to climate financing needs, the private sector residual financing need will be US$ 207 million annually, with a financing gap of about US$ 141.8 million. For a 100% contribution to climate finance, which is an optimistic scenario, the private sector residual financing need will be about US$ 830 million annually, with a financing gap of about US$ 763.9 million (Figure 3.4).

Figure 3.4: Private financing inflows, residual financing needs and financing gap (US$ million)



Source: AfDB Staff calculation based on Africa Landscape data

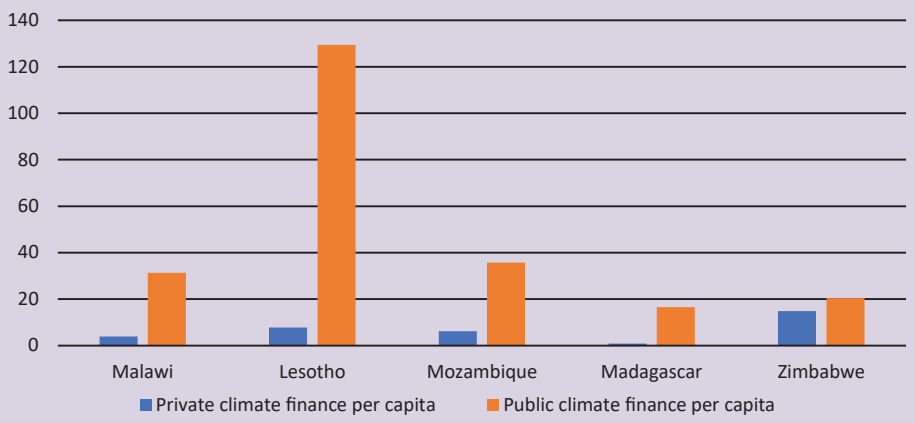
Despite the emergence of innovative instruments for mobilizing private sector financing towards green growth and climate action, they remain largely untapped in Malawi.

3.2.3 Emerging innovative private sector financing mechanisms for green growth and climate action

Despite the emergence of innovative instruments for mobilizing private sector financing towards green growth and climate action, they remain largely untapped in Malawi.

Malawi's performance in mobilizing both private and public climate financing among similar low-income countries in the Southern Africa region is dismal. It lags all the four countries except Madagascar in terms of private financing and only does better than Madagascar and Zimbabwe in term of public financing (Figure 3.5). Not many countries in Africa have benefitted from the emerging financing instruments for green growth and climate action. The continent's share in global green bonds issuance is only 0.1%, with only nine countries involved, of which three (Kenya, Rwanda, and Gabon) account for over 90% of issuances (Figure 3.3).

Figure 3.5: Private and Public Climate Finance Per Capita US$



Source: AfDB Staff calculation based on Africa Landscape data

Table 3.2: Instruments for Green Growth and Climate Actions Financing in Malawi

Type of Instruments	Green bonds, sustainable debt financing e.g. sustainable bonds, sustainability-linked loans/bonds, social bonds	Debt for Swaps e.g. Debt-for Climate/Nature Swaps	Blended Financing Instruments	Carbon Markets
Definition	Debt instruments where proceeds are allocated to eligible environmental and social projects or a combination of both.	Debt forgiveness on the condition that debt repayments are invested in climate change adaptation and mitigation.	Instruments that use public/donor finance to de-risk and scale up private climate investments.	Finance generated through investment in projects that reduce GHG emissions. Purchased by corporates or international actors to reduce or offset their CO_2 footprint.
Current Performance	0.1% of global green bond issuance. Issued in 9 countries with 3 countries accounting for over 90%. Others green finance instruments account for less than 1% of global issuance.	Few investments in the last 3 decades (typically less than $10 million per year).	Leading globally (Avg. $1.5 billion) per year. Most transactions concentrated in just 5 countries.	11% of total carbon credits generated originate from Africa (Global market $2 billion).
Use Case	AfDB Green Bond program. ADF Guaranteed Benin SDG Bond.	Portugal $150 million debt for nature swap to Cabo Verde.	Africa Go Green Fund, Acumen Fund, African Green Bank Initiative.	Africa Carbon Markets Initiative.
Estimated Potential	$3 trillion over the period 2020-2030 [i].	More than $500 million for every deal.	High leverage ratios (5-10 times public finance).	Up to $50 billion [ii].

Type of Instruments	Green bonds, sustainable debt financing e.g. sustainable bonds, sustainability-linked loans/bonds, social bonds	Debt for Swaps e.g. Debt-for Climate/Nature Swaps	Blended Financing Instruments	Carbon Markets
Challenges to Scaling	-Market conditions, policy. -Insufficient regulation and governance. -Smaller ticket size project opportunities. -Limited technical capacity. -Greenwashing.	-High transaction costs & lengthy negotiation times. -Challenges in freeing up national resources. -Additionality-swaps substituting already planned government expenditure.	-Several actors hence ineffective coordination and at time, unclear impact. -Dependent on public/donor funding.	-Unregulated, highly volatile market. -Integrity of credits. -Challenges in freeing up national resources. -High capital intensity for project development & certification.
Key Success Factors	-Broader sets of investors. - Quality climate data/climate tagging. -Attractive, bankable low-carbon projects. -Bonus/penalty if sustainable target is achieved/or not. -Technical assistance for governments, local & national financial institutions, and projects.	-Reduction of complexity and time. -Need to be significant enough to relieve debt burden. -An effective monitoring, Reporting and verification framework.	-De-risking/First loss fund, guarantee from public/international actors. -Technical Assistance/Capacity building - Clear impact and additionality.	-Increased carbon pricing. -Strengthening VCM market strategy -Build capacity and capabilities of developers to scale up projects including technical assistance for monitoring, reporting and verification.

3.3 OPPORTUNITIES AND BARRIERS FOR MOBILIZING PRIVATE SECTOR FINANCE FOR GREEN GROWTH AND CLIMATE ACTION

3.3.1 Opportunities for private sector investments

Private sector financing for climate actions and green growth in Malawi is still at its infancy.

Malawi has just started to use market-based instruments to mobilize climate financing. The growing importance for financial institutions to adhere to environmental, social, and governance standards through such instruments as green/sustainability bonds, carbon credits, public-private partnerships (PPPs) provide opportunities for the country to enhance climate financing. So far, the PPP instrument has been applied to the Nacala railway project (US$100 million), Liwonde and Nkhotakota National Parks Project (US$18 million), student accommodation (US$47 million), and six other projects are under consideration. The government is also seeking opportunities for blended financing and de-risking instruments to attract private investment.

Opportunities for private sector investments in green growth and climate action in Malawi cut across many sectors.

Different sectors offer opportunities for investments in green growth, including agriculture, industry, health, education, transport, energy, water, and other resource management. Several factors drive private sector investment opportunities. First, Malawi's population size is expected to rise to 38.15 million by 2050 from 19.13 million in 2020. Given that most of this population is projected to be composed of young and middle-aged persons (median age of 24 years) living in urban areas (35% up from 18.5% in 2020), investment opportunities for the private sector to invest in the provision of affordable and green urban housing, energy and transport, food and waste management services will grow. For inclusivity, as stated in Vision 2063, these goods and services will also need to be provided in the rural areas to reduce the urban-rural gap. Already, digital technology has contributed to strengthen financial inclusion, but more investments in other sectors as well as the financial sector are needed to meet the projected increased demand. Such investments will also need to respond to climate change imperatives.

Given an increased focus on agricultural diversification and commercialization, opportunities for enhancing green growth are emerging, especially the efficient use of water, biogas production and use. For the forestry subsector, efforts to replant trees, introduce better environmental management and minimize deforestation will enhance carbon capture and open new opportunities for tapping into the carbon market. For the transport and energy sectors, a move towards the use of renewable energy will also contribute positively to climate actions and green growth. Adoption of new technologies is already emerging, with a private company Raiply Malawi implementing a woodchip project in Mzimba to save Malawi's forests in 2021. About 33,000 hectares of forests are destroyed each year in Malawi and the government supported Raiply's efforts to produce briquettes for cooking from wood waste. In the energy sector, PressCane Ltd, invested in an ethanol distillery based in Chikhawa and uses molasses from Ilovo Sugar. Complementary to the ethanol plant, a biodigester plant was established to treat effluent from the site which generates biogas which is used as renewable fuel for the biogas engines.

3.3.2 Barriers to private sector investments

(a) High level cost of capital leading to accumulation of unsustainable debt

Malawi is suffering under the weight of unaffordable capital offered by international lenders including Multilateral Development Banks (MDBs) and Development Finance Institutions (DFIs) as well as other private sector lenders.

Limited fiscal space, on the back of high fiscal deficits and debt distress make public financing more challenging. Malawi has been facing rising costs of debt and lopsided credit allocation on the domestic market due to the public sector crowding-out the private sector. Only about 30% of credit is available to the private sector at a high cost, especially as the policy rate was increased from 18% to 22% in April 2023. Malawi is also in debt distress, which makes access to external financing limited. Based on the Malawi authorities' and IMF's calculations, the debt servicing costs of multilateral debt accounted for 19.5% of total debt service obligations in 2022 compared to 72.1% for commercial creditors. The average interest cost for concessional debt is 0.73% per annum compared to 10.52%, 10.73% and 15.32% for commercial debt, Treasury Bills and Treasury Notes, respectively. Faced with unaffordable capital costs, public financing capacity has fallen, thereby reducing the country's ability to use blended finance for green growth and climate action or increase the allocation of existing public resources towards green growth and climate action priorities in alignment with NDC commitments.

Not only the public sector, but private climate financing in Malawi also faces significant challenges due to multiple factors including:

- Private sector financing frameworks and mechanisms for climate financing and green growth are not yet developed;
- There are inadequate institutional and technical capacities to develop bankable project proposals as required to access climate financing;
- The private sector is small and lacks the mechanisms to enable it to finance climate actions;
- Low awareness on how to access climate finance; and,
- Inadequate evidence or data to support and promote the projects needing climate financing.

In addition, the absence of reporting requirements for private sector and non-state actors to provide financial data on their investment projects with climate actions make the assessment of private sector climate financing a daunting task. Knowledge on existing green climate facilities - Access to Energy Fund, the InfraCo Africa, the Interact Climate Change Facility, the IFC Canada Climate Change Program, the Climate Investment Funds' Clean Technology Fund, the Energy and Environment Partnership in Southern and East Africa, and the Green Bonds Program - needs to be enhanced with technical support.

(b) Low levels of skills within the country to meet green growth and climate action needs

Malawi lacks adequate green skills across all sectors, with existing skills mostly concentrated in the renewable energy sector.

Research has shown that achieving a green economy not only requires innovative solutions, but also the knowledge and wisdom of local people, backed by scientific understanding and technological foundations. Major constraints in achieving green economies include economic development that relies on labour-intensive primary industries, inadequate investment in

renewables and other alternatives, the lack of appropriate skills and adequate policies to develop and commercialize green technologies, and overreliance on primary production. The transition to green growth and the implementation of climate change adaptation and mitigation requires green skills and capacities within key sectors. Malawi needs skills that would contribute to reducing environmental impacts and support economic transformation by attracting cleaner, more climate-resilient and efficient production systems that preserve environmental sustainability and provide decent work conditions. According to recent research, a transition to a green economy requires upgrading skills and adjusting qualification requirements across occupations and industries and re-skilling labour in declining economic activities. For a country like Malawi which already faces skills challenges, this transition presents even greater problems. Moreover, climate financing largely depends on donor financing, which in many cases the government has been unable to sustain once the projects close. This is particularly the case where external providers were relied upon. Such arrangements do not ensure a sustained flow of financing and do not guarantee continuity once the external skills exit. Malawi, therefore, needs to develop a deliberate plan for developing skills through establishing appropriate institutions to train its citizens in the skills required for a green economy.

(c) Lack of meaningful coordination by government ministries and agencies on green growth and climate action

Malawi has a climate change policy framework, but there are gaps in coordination, particularly across different levels of government, hence the lack of an integrated approach to the mobilization and use of private sector finance.

Despite an array of legislative and sectoral frameworks that integrate environment and climate change management [Vision 2020; the Malawi Growth and Development Strategies; National Environmental Policy, 2004; NAPA 2007; National Climate Change Investment Plan, 2013; Malawi Energy Policy (2003); Food Security Policy, 2006; Disaster Preparedness and Relief Act, 1991; Environment Management Act, 1996 and the Disaster Risk Management Policy, 2015] most of them do not explicitly focus on climate change adaptation and mitigation. The NDC and National Climate Change Management Policy, however, clearly articulates Malawi's efforts to address climate change under the national and international climate change framework, given the multi-dimensional and cross-cutting nature of climate change. The Malawi Country Climate Risk Assessment Report (2018) by Irish Aid notes that Malawi's capacity limitations stem from the high levels of poverty and limited financial resources to address the challenges effectively. This is exacerbated by a lack of institutional coordination and weak community participation in environmental and natural resources management and climate change action. In addition, overreliance on agriculture, lack of alternative affordable and reliable energy sources, and inadequate budgetary allocations all contribute to the lack of significant progress on climate actions. Lack of clarity on roles and responsibilities amongst the various agencies (the Ministry of Development Planning and Cooperation, and Environmental Affairs Department; and the Department of Climate Change and Meteorological Services) and weak decentralization structures affect the mainstreaming of climate change action at different levels. Given the weak link between the national policies and actions and the planning processes at local government level, the top-down approaches have not worked as climate actions happen at local levels.

Moreover, mobilizing public financing has been a challenge in an environment characterized by high fiscal deficits and debt distress. In the absence of mechanisms for the private sector to finance green growth and climate action, limited private sector resources have been made available and where such resources have been used it

is isolated and not necessarily coordinated.

3.3.3 Pathways to mobilizing private sector finance for green growth and climate action in Malawi

There are several pathways that Malawi can use to unlock private sector finance for green growth and climate action. These are discussed below.

(a) Deepening domestic financial markets to mobilize domestic finance for green growth.

Malawi's domestic financial sector development is at its infancy which limits its potential contribution to mobilizing private sector finance for targeted green growth and climate action projects.

The financial sector comprises commercial banks, pension, insurance, capital markets and microfinance institutions. The sector is small and access to financial services remains a challenge, but a digital transformation has taken place and has increased access to finance – increasing the percentage of adults using financial institutions from 19% in 2011 to 40% in 2018. Current estimates indicate that the proportion of adults with a mobile money account in Malawi increased to 57.6% in 2019. However, the formal credit market is highly concentrated, with four out of the eight commercial banks, (National Bank of Malawi, FDH Bank, Standard Bank Malawi and NBS Bank) supplying 75% or more of the financial sector infrastructure. In terms of credit distribution, although there has been an increase in private sector credit – from MK427.6 billion in 2017 to MK871.6 billion in 2021 - community, social and personal services; wholesale and retail trade; and agriculture, forestry, fishing and hunting account for 67.5% of total credit. Key sectors such as energy, manufacturing and mining do not feature highly in credit allocations. The low allocations of credit to the productive sectors, except for agriculture, forestry, fishing and hunting coupled with the absence of a framework of private sector financing for climate actions raises the need for concerted efforts to improve the flow of financing for green growth and climate action. Financial sector deepening, including diversifying the financial instruments on offer to ensure competition and a larger pool of available resources, will certainly help in increasing financing for green growth and climate action.

(b) Sustainable and green finance frameworks and policies for the private sector urgently need to be put in place

Since 2001, Malawi has not developed any new regulations despite the establishment of institutions needed to access sustainable finance, hence the limited private sector role in financing climate actions.

The National Climate Change Management Policy provided the institutional framework for climate change management in Malawi. These include the National Steering Committee on Climate Change, the National Technical Committee on Climate Change, Expert Working Groups (Adaptation, Mitigation, Climate Finance) and Climate Change and Disaster Risk and Reduction Committees. However, since 2001, no new regulations for climate financing have been developed, hence private sector financing remains extremely low (less than 3% of total climate financing). This situation holds despite the low public expenditure levels on climate financing at 1% of GDP. The sectors that have been prioritized for climate financing include agriculture (e.g., irrigation, development of drought-tolerant seeds); energy (renewable energy and energy efficiency), forestry (resilient landscapes, afforestation, and natural regeneration), water, waste, transport, construction, and fisheries, all of which provide private financing opportunities. The establishment of the National Climate Change Fund provides avenues by which the private sector could play its role in financing climate action which so far, has been through PPP arrangements worth about US$165 million.

(c) Ramping up the use of blended finance instruments for financing green growth

Blending finance across sectors will need frameworks that are informed by the nature of markets in those sectors.

Malawi created the National Climate Change Fund (2022) as a dedicated vehicle through which public and private sector investments into green growth and climate action would be channelled. Its operationalization remains to be realized. Moreover, scaling the mobilization of private sector finance through blended finance instruments requires the development of sectoral regulatory frameworks. Malawi's capacity in this area remains patchy, hence the need to provide technical assistance for structuring blended finance projects.

The implementation of a conducive operating framework for blended finance in different sectors is based on a contextual understanding of financing needs as well as the nature of the market. The level of risk that is encountered by private sector investors determines the extent to which public finance is used to de-risk investments. However, those levels of risk will vary by sector and region given the different regional levels of physical risk. In addition, different sectors have varying levels of willingness to pay for goods and services provided by the private sector. Malawi needs sector-specific frameworks to guide the development of blended finance instruments, while also maintaining flexibility to allow cross-sectoral blending of finance. There is also potential for integrated climate investments across sectors, as illustrated by the examples of PressCane Limited and Ilovo that cuts across agriculture and energy sectors.

(d) Skills and capacity development is required for micro-, small- and medium-scale enterprises and the informal sector to increase innovation and engagement with key private sector partners.

The development of green skills and capacities needs to be integrated into existing education and innovation institutions.

The skills required to ensure effective implementation of green growth and climate actions are largely multi-disciplinary, including science, social science, law, engineering. As such, the scope for developing such skills is also broad. Malawi has been observed to lack sufficient skills and capacities to realize its green growth and climate action plans. Existing skills and capacities are limited to large firms and mostly related to renewable energy. This means Malawi needs to focus on deepening and expanding its skills and capacities across multiple sectors, while at the same time promoting innovation in other sectors to attract private sector investors. The private sector in Malawi is made up of a few large firms and many micro and small businesses while medium-scale enterprises are largely missing.

Addressing the skills and capacity gaps requires an initial stage of identifying gaps and designing an approach that would include various forms of skills development including technical assistance, shadowing, and upgrading knowledge through higher education. Institutions created under the National Climate Change Management Policy could be assessed first, followed by private firms and technical capacities of higher and tertiary education institutions that may have capacity train local personnel by mainstreaming green growth and climate change in their curriculum.

(e) Adoption of fiscal incentives to attract private sector investments to sectors that generate soft infrastructure outcomes.

Policies on fiscal incentives to attract investments to support industrialization and export growth are already in place and a similar approach could be adopted to take advantage of the global momentum on green growth and climate action.

Malawi is already implementing fiscal incentives to attract green growth or climate-related investments while penalizing activities that negatively impact the environment or generate GHGs. A good example of climate action incentives was the removal of import duties and excise tax on imports of spare parts for the renewable energy equipment, as well as electric vehicles. Similarly, import duty and value added tax on imported solar panels and inverters into the country is waived. Given the managed exchange rate regime currently operational in Malawi and the resultant exchange rate misalignment, there is an implicit subsidy on fossil fuel use. While cognizant of the potential effect on inflation in the country, the authorities need to consider a differential approach to fuel pricing as part of its climate actions.

A comprehensive Green Fiscal Incentives Policy Framework whose goal is to provide guiding principles for the provision of fiscal incentives to investments in green growth should be considered. The framework will also present Malawi's plan to use tools such as carbon tax, rebates, subsidies, concessional loans and guarantees to attract investments towards specific priority sectors and projects. It should be acknowledged that the benefits of these incentives can only be achieved if the framework reflect the needs of all stakeholders, particularly the domestic and international private sector and are implemented across multiple sectors.

(f) The Role of MDBs and DFIs

Malawi needs more affordable capital from multilateral and bilateral development finance institutions.

Malawi is one of the highest recipients of donor financing on the continent, receiving an average of 10.7% of gross national income (GNI) or an average of US$ 1.3 billion during the period 2019 – 2021. For example, in 2021, Malawi received US$ 1.15 billion of Official Development Aid (ODA) and was the 18th largest recipient in sub-Saharan Africa, accounting for approximately 1.8% of total flows to the sub-region. Private sector inflows, in the form of foreign direct investment remain low, at US$ 93 million in 2021. Of the ODA receipts, only 16% is allocated to production and infrastructure. As indicated above, foreign public resources make the largest share of climate financing (61%) of total, with the Development Finance Institutions (DFIs) contribute 46% of the total.

While multilateral development banks (MDBs) provide significant financing to Malawi, the private sector has not benefitted much. Increased financing to the private sector is needed at low interest rates and longer repayment periods to support their investment projects. Additionally, MDBs and DFIs funding interventions should be targeted during capacity development of national and local public and private sector institutions to enable them to mobilize more private sector finance. Capacity development activities should also be directed at the macro-level to enhance the country's credit rating, which will enable government and the private sector to acquire more affordable capital from other lenders.

(g) Enhancing stakeholder collaboration

Collaborations across different stakeholders are important, particularly between governments and the domestic and international private sector to identify and address primary risks to investments in green growth and climate action.

Multistakeholder partnerships are important to strengthen collaboration about the mobilization and use of private sector finance to enable green growth. The Malawi Government, through the Public-Private Development framework, is already working with international partners to enhance private sector access to finance. While these efforts are still at their infancy stage, all stakeholders are exploring mechanisms that would increase private sector dynamism and its

participation in climate actions and green growth initiatives. Efforts to strengthen the engagement between the international private sector, and MDBs and DFIs to generate a deeper understanding of financing needs, capacities and existing mechanisms for green growth and climate action are ongoing.

4. NATURAL CAPITAL FOR CLIMATE FINANCE AND GREEN GROWTH

4.1 THE EVOLUTION OF NATURAL CAPITAL

Natural capital is tracked in three groups: (a) renewable capital, consisting of forest timber, forest non-timber, mangroves, fisheries, protected areas, cropland, and pastureland; (b) non-renewable assets, separated into oil, natural gas, coal, and minerals. In addition, unmeasured forms of natural wealth, such as renewable energy potential from solar, wind and hydro-resources, landscapes, and marine assets are also reviewed but qualitatively . The data for (a) and (b) is from the World Bank, covering the period 1995-2018. The findings for Southern Africa are summarized in Table 4.1 with a special section for Malawi. Compared to the whole of Africa, the following observations can be made.

(a) In total, Southern Africa is the third richest region in natural capital on the continent – after North Africa, West Africa, but ahead of East Africa and Central Africa.

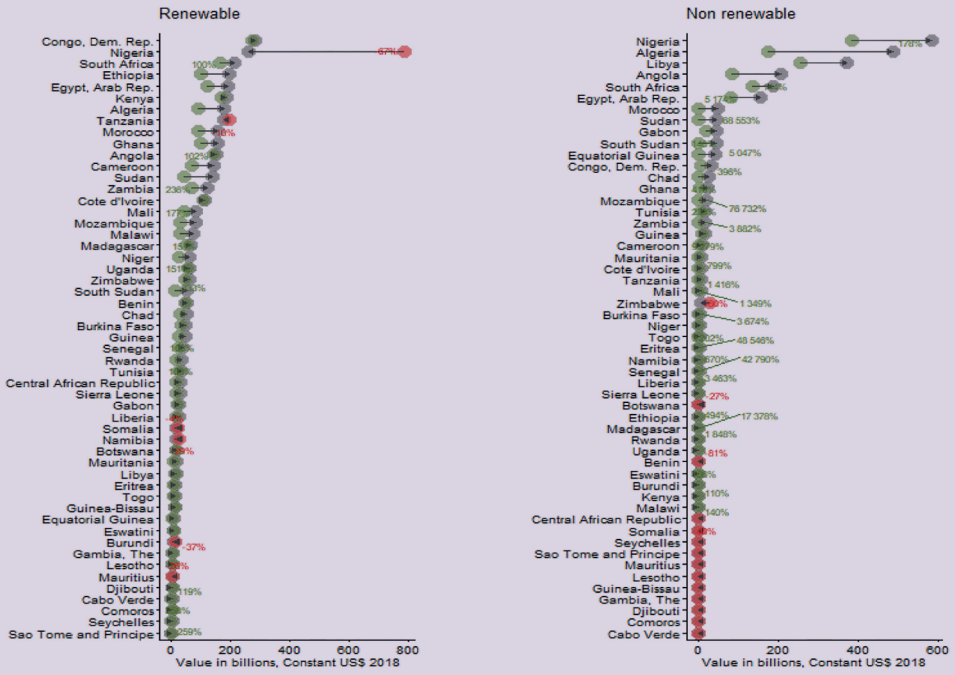
(b) Southern Africa is also the third most endowed with non-renewable capital on the continent, after North and West Africa. Overall, Malawi has had a decline in per capita natural capital, dropping from US$ 3.191 in 1997 to US$ 2.051 in 2006. Its per capita natural capital has since been increasing to a maximum value of US$ 4.272 in 2017 before a slight drop in 2018. The increase in natural capital in Malawi is mainly driven by discoveries of non-renewable capital assets, as renewable capital has declined.

(c) Southern Africa's share of natural assets in Africa has increased from 18.87% in 1995 to 20.3% in 2018, with its share of renewable assets increasing from 5.72% to 7.1% over the same period. Malawi had an increase in the value of renewable resources over the 1995-2018 period of 146.4% compared to the decreases recorded in Mauritius, Namibia, Botswana, and Lesotho (Figure 4.1). In per capita terms, Malawi experienced a decline in renewable assets of 4%, while its non-renewable assets increased by 231% over the 1995-2018 period. Compared to other countries in the Southern Africa sub-region, Zambia, Namibia and Eswatini had losses of more than 40% of the value of renewables in per capita terms, indicating the negative impact of climate change and other environmental challenges. For non-renewables, Lesotho, Mauritius, Eswatini, Botswana, Zimbabwe, South Africa and Angola all suffered losses in per capita terms.

(b) An indicator of sustainable growth proposed in the AEO report is to have an increase in natural capital in per capita terms. In this respect, Malawi has met that condition. Its per capita natural capital has increased by about 36.4% between the 1995 and 2018 period (Table 4.1).

[2] The World Bank data can be accessed at: Explore data (worldbank.org). The study covers 146 countries but excludes those with no data, mainly small island states. In Africa Djibouti is the only country excluded from the list.

Figure 4.1: Changes in the Value of Natural Capital for African Countries, 1995-2018



Source: AfDB Staff calculation based on Africa Landscape data

Further investigations into the reasons for the decline in renewable natural capital have focused on forests, cropland, and pastureland. Except for Mauritius and Namibia, agricultural land and forest area combined make up more than 70% of the land area in the remaining countries. Forest area is significantly high in Angola (53.4%), São Tomé and Príncipe (54.1%), Zambia (60.3%), and Zimbabwe (45.1%). There are three trends to consider: a change in the areas of land that are under each category, the unit income that these lands provide and the sustainability of these rents (measured in terms of the lifetime of the return). This analysis is important because it directs the policymakers on where action is needed to increase the value of natural capital. Forests play an essential role in providing environmental benefits such as climate regulation, soil formation, nutrient cycling, erosion control, and water catchment protection. They are vital for rural livelihoods and provide sources of energy yet the rate of depletion is very high.

In the case of Malawi, the area of agricultural land (cropland and pasture) went up from 40,700km2 in 1995 to 56,500km2 in 2018, which is an increase of 38.8% . At the same time, the value of land per capita based on the wealth accounts decreased by 40% from US$1.767 in 1995 to US$2.216 in 2018. On the other hand, whereas the value of forests (timber) in per capita terms has gone up by 2.5% the value for non-timber has decreased by 59%, resulting in an overall net loss for forest wealth. However, considering the per capita value of renewable natural wealth in general, there is an increase of 36.3% despite the non-availability of data on mangroves and fisheries (Table 4.1).

[3] https://data.worldbank.org/indicator/AG.LND.AGRI.K2?end=2018&locations=MW&start=1961&view=chart

The other category of capital that is undervalued is forests. As noted in the AEO2023 report, the efficiency of sequestering carbon in terrestrial ecosystems (particularly forest) can be increased. By choosing more selective land use and land management methods to increase GHG storage without compromising the use of forests for productive purposes, the amount that is stored can be increased globally around 20%.

Table 4.1: Evolution of Natural Capital in Southern Africa and Malawi: 1995-2018

	Total US$ 2018 Constant (million)			Per capita US$ 2018 Constant		
SOUTHERN AFRICA	**1995**	**2018**	**% Change**	**1995**	**2018**	**% Change**
Renewable Natural Resources	1693273	578185	-66	5458	4290	-21
Forest, Timber	230921	81668	-65	915	1149	26
Forests, Non-Timber	223623	85965	-62	1298	900	-31
Mangroves	240122	85530	-64	1	3	112
Fisheries	269157	85130	-68	573	23	-96
Protected Areas	273096	80765	-70	455	448	-2
Cropland	240051	74986	-69	986	954	-3
Pastureland	216304	84141	-61	1230	813	-34
Sub-soil Assets	206034	87852	-57	617	558	-10
Oil	204788	92816	-55	9	7	-20
Natural Gas	203091	123759	-39	0	35	9186
Coal	218270	142399	-35	222	237	7
Metal and Mineral	224080	148400	-34	387	279	-28
Total	**1899307**	**666037**	**-65**	**6076**	**4848**	**-20**

	Total US$ 2018 Constant (million)			Per capita US$ 2018 Constant		
MALAWI	**1995**	**2018**	**% Change**	**1995**	**2018**	**% Change**
Renewable Natural Resources	29536	74207	151	3000	4090	36
Forest, Timber	6692	12638	9	680	697	2
Forests, Non-Timber	2986	2261	-24	303	125	-59
Mangroves	0	0	n/a	0	0	n/a
Fisheries	0	0	n/a	0	0	n/a
Protected Areas	1049	5573	431	107	307	188
Cropland	17515	48953	179	1779	2698	52
Pastureland	1293	4782	270	131	264	101
Sub-soil Assets	15	36	140	0	1	n/a
Oil	0	0	n/a	0	0	n/a
Natural Gas	0	0	n/a	0	0	n/a
Coal	15	21	38	0	0	n/a
Metal and Mineral	0	15	n/a	0	1	n/a
Total	**29551**	**74243**	**291**	**3000**	**4091**	**36**

Source: World Bank 2021.

The AEO2023 report noted that the categories of natural capital evaluated do not cover all sources of such capital on the continent. The climate, together with the landscape, fauna and flora form a strong basis for tourism. For Malawi, the lake and national parks provide a significant opportunity for the development of tourism destinations while benefitting from the other offerings that South Africa provides. The contribution of natural capital to the flows of goods and services from all these sources of natural wealth, however, is not estimated, which then underestimates their contribution to the economy. Furthermore, given the countries' exceptional landscapes, fauna and flora, an increase in the share of GDP from tourism can be an objective.

Other contributions of natural wealth, such as solar or hydro for generating electricity have not been assessed either and it is something that should be done as a matter of urgency. Africa benefits particularly from sunshine, wind and hydro resources that can generate clean energy. Malawi has good wind and solar power generation potential, which can contribute to enhancing the energy mix and transitioning to a low carbon pathway, especially as 90% of power generation is already hydro based. Currently the Mzimba Wind Farm is under development and is expected to feed 50 megawatts into the national grid once completed by end of 2023. For solar energy, most of the country has an annual average of 7.5 hours of sunshine daily.

An important component of the natural capital of Southern Africa, and Malawi in particular, is its marine wealth, which has been absent in the wealth accounts prepared so far. As the AEO 2023 notes fisheries provides protein, minerals, and micronutrients for over 400 million people on the continent and employ around 13 million people. There is concern, however, regarding over-exploitation of the wild stocks, which are decreasing. Key factors contributing to overfishing in Africa are overcapacity; illegal, unreported, and unregulated (IUU) fishing activities; poor resource governance; insufficient knowledge and misperception. Water and wetlands in Malawi cover 26.5% of the total land area, providing a diverse aquatic system for fish production and fish provides about 70% of the total animal protein intake. Inland fishing is practiced and the self-renewable character of fish is important, but sustainable fishing practices need to be implemented and enforced.

4.2 OPPORTUNITIES TO ENHANCE THE CONTRIBUTION OF NATURAL CAPITAL IN MALAWI

The importance of good governance in managing the returns from natural capital and in bringing together physical and human capital to add value to exports wherever possible needs no emphasis. It contributes to increasing the returns from natural capital without damaging the core base that provides these returns. Given that some natural resources are of a transboundary nature, international agreements on climate change and biological diversity are critical to finance higher returns from natural assets in Malawi, the region and indeed globally.

The review has shown that natural capital has declined sharply (21.4%) in Southern Africa in per capita terms over the last quarter of a century. For Malawi, it is a little difficult to be conclusive due to the lack of comprehensive data although there are indications of an overall increase in natural capital, improving by 36.4% over the 1995 to 2018 period. Measures to improve this trend are divided into those pertaining to non-renewable natural capital and those pertaining to renewable natural capital.

4.2.1 Non-Renewable Resources

In considering non-renewable natural capital, the AEO 2023 report notes that revenues from the extractive sector contribute a lot to the private and public finances of many African countries. Malawi is endowed with coal, lime, limestone, graphite, black granite, aquamarine, tourmaline, ruby, sapphire, bauxite, and marble. Of these resources, those currently being exploited are sold in raw form in both domestic and international markets as is also the case with uranium, bentonite, gemstones, and ornamental stones. Most recently, oil deposits have been discovered around Lake Malawi but are not reflected yet. Resource rents, especially negotiated royalty rates are often too low, limiting the "fair share" of the revenue from non-renewable resources to guarantee economic development. Moreover, the revenues are not well spent due to corruption and weak institutions in mineral-rich countries so that low growth and high poverty rates remain prevalent.

For Southern Africa, these issues are more important than for other regions on the continent, where the value of the stocks of such assets are much smaller. Except for Mauritius, extractive resources contribute high values to natural per capita incomes. For example in South Africa it represented US$7,000 at its peak in 2011. For Malawi, non-renewable capital contributed only about US$2 in per capita terms in 2018, suggesting its potential has not been fully explored. The recommendations from the AEO 2023 report propose ensuring a fair share of rents for the state and urging transparency, efficiency, and good governance in managing them as being important for the extractive resource-dependent economies in the region. For other states, with small but nevertheless important amounts of minerals, the same recommendations apply.

In addition to improving transparency and accountability in resource rents, Malawi should better align its industrial policies to the future potential of its extractive sector. Moreover, its energy transition should be geared to the future supply and demand dynamics to ensure it makes the maximum contribution to sustainable development. A regional approach could also benefit the country as it takes advantage of the local content regulation and allow Malawi to exploit regional industrial linkages that can enhance job creation.

4.2.2 Non-Renewable Resources

Renewable resources lie at the heart of sustainable development across the whole of Africa. Southern Africa has experienced a large expansion of cropland and pastureland over the last quarter century, but its value and per capita income levels have deteriorated. In other words, land has become less productive. Sustainable land management practices, therefore, need to be put in place. In addition, sustainable forest, and the management of other renewable assets, including arresting deforestation and environmental degradation will add to the stock of land that can generate long-term income flows. At the forefront will be raising the unit value of land through increased productivity and change of use, especially through developing agricultural value chains.

Malawi's forests cover 23.8% of its land area. The major tree species in Malawi's forests include conifers, baobab, miombo, and acacia and the wood from these forests supports the large wood carving and furniture industry in the country. However, forest cover is declining at the rate of about 36% annually leading to a decline in forest rents from 5.9% of GDP in 2016 to 4.0% of GDP in 2020. Fishing remains a key economic activity and source of food in Malawi. Lake Malawi, Africa's third largest lake, is one of the major sources of fish in the country and is home to hundreds of fish species. The many national parks and other protected areas of Malawi are major tourist attractions in the country as Malawi has a rich biodiversity. Data from the Food and Agriculture Organization reveals that between 1990 and 2020, the depletion of

forest area was 16% in Angola, 18.9% in Botswana, 36% in Malawi, 15.3% in Mozambique, and 24.3% in Namibia. The major reasons for this include expansion of agriculture, the unsustainable exploitation of fuelwood, infrastructural developments (dams, power lines, urban expansion, irrigation) illegal settlements, change of land use, mining, invasive alien species, pests, and veld fires. Countries where there has been a decline will need to reverse it through deliberate conservation measures as well as replanting and recovery where appropriate.

The World Economic Outlook 2023 report proposes several measures to achieve recovery of forests, some of which are relevant for Malawi. Malawi is experiencing deforestation at the steep rate of 36% annually due to charcoal production and clearing land for agriculture use, which has become a major challenge. Governments should promote and enforce policies and regulations protecting forests, including protecting reserved areas and preventing illegal logging through increased enforcement and greater penalties. Sustainable forestry practices such as selective logging practices and reforestation should also be promoted by governments using instruments such as performance bonds for forest lessees. Indeed, there is evidence that some countries in the sub-region have begun to successfully reforest in the last few years. Policies for green growth in countries can raise revenue from forests by both increasing the efficiency of carbon capture (as discussed earlier) as well as raising the price received for carbon sequestered, through accessing international agreements on carbon. The African Economic Outlook 2023 (AEO2023) report noted an important channel for doing this is the creation of a single market for the trade of emissions credits (under Article 6 of the Paris International Agreement).

In addition, countries could increase their participation in the voluntary market, where new opportunities are arising. Among these is an ambitious new Post-2020 Global Biodiversity Framework, to scale up ecosystem restoration, reduce the extinction risk of species, and protect 30% of land, freshwater and marine areas by 2030. The AEO2023 report notes that for Africa to benefit from such arrangements, there may be need for the establishment of an Africa Biodiversity Fund to attract private capital. To service this demand, many project developers offering a range of greenhouse gas emission offsets have emerged. Many of these are Nature-based Solutions related to forestry and land use, agriculture and soil sequestration, as well as blue carbon. These credits would expand the voluntary market greatly, so the countries in East Africa should prepare themselves to be part of the growth by developing new offsets and ensuring the integrity of certification of voluntary carbon markets.

To exploit landscapes more effectively for tourism, countries are looking to develop ecotourism further. As the AEO2023 report notes, the potential for ecotourism is significant but not fully realized. Before COVID-19, the tourism sector employed about 525,000 people and this could grow with additional investments. If properly utilized, they could yield considerable economic and social benefits for local communities while simultaneously safeguarding natural resources. While specific data on the revenue generated by ecotourism in Africa is not readily available, there is evidence that ecotourism is growing in Africa. Ecotourism's potential in Malawi and the region includes onshore and offshore sites including national parks and historical sites.

5. CONCLUSION AND POLICY RECOMMENDATIONS

5.1 CONCLUSION

Striving to achieve the goals articulated in Malawi 2063 will not only spur economic growth and alleviate poverty, but also bolster the nation's resilience against the impacts of climate change. However, to also harness possible synergies, it is crucial to weave climate targets into Malawi's development strategies and policies and to guarantee that all investments are climate-resilient. This may necessitate altering current practices, as well as adopting new and different approaches.

Given that the investment needs far exceed what the government can handle as it endeavours to bring debt back to manageable levels, Malawi must actively explore sources of financing that avoid further public debt increases, specifically for climate-related activities. There is an immediate need for grant and highly concessional financing from public sources to cater to the substantial investment requirements anticipated in the coming years to ensure better results in both the medium- and long- term. Present and future development aid should seek to attract climate finance from public sources and should stimulate private sector investment for viable opportunities.

In fact, mobilizing finance for green growth and climate action in Malawi require that both the international community and the private sector play a major role by investing and creating value through innovation and local value addition. Actions should be taken to leverage the opportunities for private sector investments in adapting to and mitigating the effects of climate change, while also reducing the existing barriers to private sector investments. This will involve tapping into emerging innovative private sector financing mechanisms for green growth and climate action and will require enhancing public financing as well.

Natural capital also plays a major role in climate finance. Renewable natural capital is critical to the economies of Southern Africa. However, the analysis been based on data collected by the World Bank for major categories of natural assets but where the coverage of forms of natural capital is incomplete. Work is still needed on estimating the value of renewable energy sources such as sunshine, wind and hydro, as well as that of landscapes and biodiversity.

Natural capital has not grown over the last quarter century to keep pace with population and therefore the per capita level of such wealth has declined. If this is to be reversed in the coming years action will have to be taken to prevent the loss of forest ecosystems and marine biodiversity as well as harnessing the returns from these systems in a sustainable manner. Much more can also be done to exploit clean energy resources.

The role of non-renewable assets is larger in Southern Africa than other parts of Africa and care in managing such assets to the benefit of the region and Malawi as mentioned above will be important.

For cropland and pastureland more goods and services can be generated in value terms by investing in new technologies, as well as extending the value chains. This may require bringing in foreign partnerships in some cases. For forests, there are several incentives that can be swiftly introduced to reduce loss or damage to the

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Striving to achieve the goals articulated in Malawi 2063 will not only spur economic growth and alleviate poverty, but also bolster the nation's resilience against the impacts of climate change.

[4] Ecotourism refers to nature-based forms of tourism in which the main motivation of the tourists is the observation and appreciation of nature as well as the traditional cultures prevailing in natural areas.

forests and to increase the efficiency with which carbon can be captured. These should be pursued vigorously. In addition, accessing international mechanisms to market carbon credits at higher prices will increase unit rents a great deal. For fisheries, Malawi needs to implement sustainable fisheries management practices, while countries with ocean coasts will need to do more to stop IUU fishing and to sign access agreements for distant water fleets to prevent overexploitation of wild stocks while generating fair revenues for local communities. For tourism the aim should be to increase total income, with an emphasis on ecotourism. South Africa has become a major tourist destination through ecotourism and Malawi can benefit from such activities given its natural parks and unique cultural disposition in the region.

Below is a set of recommendations for different sets of stakeholders with indications of whether these should be implemented in the short term [S], medium term [M] or long term [L].

5.2 POLICY RECOMMENDATIONS FOR PRIVATE SECTOR FINANCING FOR CLIMATE CHANGE AND GREEN GROWTH IN MALAWI

5.2.1 National Government

-[S] Ensure vertical coordination by national-level institutions responsible for facilitating the implementation of green growth and climate action frameworks.

-[S] Develop sustainable financing frameworks including modalities for private sector investment in climate action through fiscal incentives like waiving customs duties.

-[M, L] Mainstream green skills development into education institutions to ensure that there is a continuous supply of green skills to enable the transition to green growth.

-[M] Develop multistakeholder platforms that link the domestic private sector with other international actors such as MDBs, DFIs and the international private sector that are major sources of private sector finance.

5.2.2 MDBs and DFIs

-[S] Share risk by further engaging with the Malawi Government to identify ways to provide affordable capital for green growth and climate change investments.

-[M, L] Use innovative financing instruments that de-risk private sector investments such as partial risk guarantee and political risk insurance, particularly in non-energy sectors such as water and health infrastructure development.

-[M, L] Support the establishment of innovation hubs to promote local innovations for industrial development based on the natural capital of the country.

5.2.3 Domestic and international private sector

-[M, L] Collaborate with governments, MDBs and DFIs and other private sector actors to identify key risks to investments and propose ways of addressing these investment risks.

5.2.4 Developed country governments

-[S] As shareholders of MDBs and DFIs, developed country governments can encourage these institutions to be less risk averse when financing green growth in Malawi and the region and provide additional capital to these institutions based on concrete actions proposed for climate action.

5.3 POLICY RECOMMENDATIONS FOR INCREASING THE CONTRIBUTION OF NATURAL CAPITAL TO CLIMATE FINANCE AND GREEN GROWTH

5.3.1 National Government

-[M, L] Implement spatial development, which is part of the Malawi Vision 2063, especially as it relates to the development of ecotourism.

-[S, M, L] Increase investment and improve efficiency to enhance rents on cropland and pastureland, taking account of mitigating climate change impacts.

-[S, M] Promote and enforce stricter policies and regulations protecting forests and preventing illegal logging. Sustainable forestry practices such as selective logging practices and reforestation should also be promoted through instruments such as performance bonds for forest lessees.

-[M, L] Exploit the potential in renewable energy through the development of capital markets as part of the energy transition.

-[S, M] Expedite the implementation of sustainable fisheries on Lake Malawi and other lakes in the country while also developing the fisheries value chain.

5.3.2 MDBs and DFIs

-[S, M] Assist the Government of Malawi to explore opportunities in international agreements that could benefit the country. These include the creation of a single market for emissions credits to raise the price of carbon credits in the forests; and increased participation in the voluntary market through the Post-2020 Global Biodiversity Framework.

-[S] Support the Government of Malawi in preparing to be part of the growth in carbon sequestration from nature-based solutions related to forestry and land use, agriculture and soil sequestration, and blue carbon. They can do this by developing new offsets and ensuring the integrity of certification of voluntary carbon markets.

5.3.3 Regional Organizations

-[S, M] Assist Malawi to explore opportunities for making natural capital more productive across the region through strategic partnerships with state-owned enterprises and foreign investors in the context of the AfCFTA. This should include opportunities offered by franchising to boost continental trade.

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Annex 1: Malawi Selected Indicators

Indicators	Unit	2010	2015	2018	2019	2020	2021	2022 (e)	2023 (p)	2024 (p)
National Accounts										
GNI at Current Prices	Million US $	6,476	5,929	7,898	10,377	11,239	12,332	...	...	...
GNI per Capita	US$	440	350	430	550	580	620	...	...	...
GDP at Current Prices	Million US $	6,960	8,903	9,881	11,057	11,855	12,435	11,946	10,880	11,074
GDP at 2010 Constant prices	Million US $	6,960	8,571	9,668	10,219	10,312	10,539	10,627	10,839	11,219
Real GDP Growth Rate	%	6.9	3.3	4.4	5.7	0.9	2.2	0.8	2.0	3.5
Real per Capita GDP Growth Rate	%	3.8	0.5	1.6	2.9	-1.7	-0.4	-1.7	-0.6	0.9
Value Added: Mining and quarrying	Million US $	70	59	73	81	84	97	90	...	...
Value Added: Mining and quarrying	% GDP	0.7	0.7	0.7	0.7	0.7	0.8	0.8	...	...
Value Added: Fishing	Million US $	...	...	...	...	...	...	...	...	...
Value Added: Fishing	% GDP	...	...	...	...	...	...	...	...	...
Prices and Money										
Inflation (CPI)	%	7.4	21.9	9.2	9.4	8.6	9.3	21.0	22.8	15.4
Exchange Rate (Annual Average)	local currency/US$	150.5	499.6	732.2	745.2	744.1	799.6	963.8	1,320.1	1,543.5
Government Finance										
Total Revenue and Grants	% GDP	26.8	15.3	14.6	14.6	14.8	14.5	10.8	11.6	11.1
Total Expenditure and Net Lending	% GDP	26.6	20.0	20.1	19.2	21.4	21.9	18.0	19.4	18.9
Overall Deficit (-) / Surplus (+)	% GDP	0.2	-4.6	-5.5	-4.6	-6.6	-7.4	-7.2	-7.8	-7.7
External Sector										
Terms of Trade Growth	%	5.8	0.4	-10.9	-0.4	4.2	-21.7	-8.7	6.9	-2.6
Current Account Balance	Million US $	-969	-1,101	-1,693	-1,322	-1,477	-1,715	-1,538	-1,276	-1,363
Current Account Balance	% GDP	-13.9	-12.4	-17.1	-12.0	-12.5	-13.8	-12.9	-11.7	-12.3
Debt and Financial Flows										
Debt Service	% exports	0.2	3.1	5.7	5.5	7.2	14.0	35.3	24.9	20.9
External Debt	% GDP	8.8	17.9	24.9	28.0	31.8	30.9	29.9	33.2	34.4
Net Total Financial Flows	Million US $	1,049	1,071	1,762	1,134	1,576	811	...	...	...
Net Official Development Assistance	Million US $	1,017	1,050	1,279	1,168	1,454	1,155	...	...	...
Net Foreign Direct Investment	Million US $	46	510	959	55	45	50	...	...	...
Demography										
Total Population	Millions	14.7	16.9	18.4	18.9	19.4	19.9	20.4	20.9	21.5
Population Growth Rate	%	2.9	2.8	2.7	2.7	2.7	2.6	2.6	2.6	2.6
Urban population	% of total	16.0	16.9	17.7	17.9	18.2	18.6	18.9	19.3	19.6
Life Expectancy at Birth	Years	56.4	61.4	63.3	64.1	63.7	62.9	62.9	63.7	65.4
Fertility Rate	births per woman	5.3	4.5	4.1	4.1	4.0	3.9	3.8	3.8	3.7
Poverty and Income Distribution										
Pop. living below national poverty line	% of total population	50.7	...	...	50.7	...	...	...	...	...
Population living below $2.15 a day	% of total population	68.4	...	...	70.1	...	...	...	...	...
Gini Index	%	45.5	...	...	38.5	...	...	...	...	...
Labor Indicators										
Labor Force participation (total)	%	74.7	69.6	67.5	67.4	68.3	67.6	67.6	67.5	...
Labour Force participation (youth)	%	61.3	55.7	53.0	52.4	56.9	55.0	54.9	54.8	...
Unemployment rate (total)	%	4.9	5.0	4.9	4.9	5.7	5.7	5.6	5.6	5.6
Unemployment rate (youth)	%	6.8	6.9	6.9	7.0	8.1	7.7	7.7	7.8	7.7
Natural Resources rents										
Total natural resources rents	% GDP	5.9	8.9	5.0	4.2	4.0	...	...	...	...
Oil rents	% GDP	...	...	...	...	...	...	...	...	...
Natural gas rents	% GDP	...	...	...	...	...	...	...	...	...
Mineral rents	% GDP	...	0.0	0.0	0.0	0.0	...	...	...	...
Forest rents	% GDP	5.9	8.8	5.0	4.2	4.0	...	...	...	...
Coal rents	% GDP	0.1	0.0	0.0	0.0	0.0	...	...	...	...
Natural Capital Renewable Resources										
Arable land	1000 hectare	3,700.0	3,600.0	3,600.0	3,600.0	3,600.0	...	...	...	...
Agricultural land	1000 hectare	5,685.0	5,650.0	5,650.0	5,650.0	5,650.0	...	...	...	...
Other land	1000 hectare	1,081.3	1,326.3	1,452.3	1,494.3	1,536.3	...	...	...	...
Forest land	1000 hectare	2,661.7	2,451.7	2,325.7	2,283.7	2,241.7	...	...	...	...
Planted Forest	1000 hectare	96.8	86.2	79.9	77.8	75.7	...			
Annual freshwater withdrawals, total	% of internal resources	8.4	8.4	8.4	8.4	...	...	...	...	...
Total Fisheries Production	metric tons	100,929.0	146,617.0	230,863.0	163,184.0	180,508.2	...	...	...	...
Climate Finance and Green Growth										
Total Climate Finance*	Million US $	...	...	...	...	583.8	...	...	...	...
Green Growth Index**	%	...	...	...	...	29.4	...	...	...	...

Last Update: June 2023

Source: AfDB Statistics Department: African; IMF: World Economic Outlook,April 2023 and International Financial Statistics, April 2023; AfDB Statistics Department: Development Data Portal Database, April 2023. United Nations: OECD, Reporting System Division.
Notes: … Data Not Available (e) Estimations (p) Projections

** Source: Climate Policy Initiative (www.climatepolicyinitiative.org)*
***Source: Global Green Growth Institute (GGGI). The scores for the Green Growth Index range from 1 to 100, with 1 having the lowest or very low performance and 100 having the highest or very high performance*

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