

# Mobilizing private finance: Unlocking the potential of Rwanda's businesses to drive climate change adaptation

There is a strong expectation that the private sector will provide a large share of the US\$100 billion per year in climate finance that world leaders have pledged to mobilize by 2020 under the UN Framework Convention on Climate Change (UNFCCC). Globally in 2014, two-thirds of the US\$361 billion in financial flows relevant for mitigation in 2014 came from the private sector.<sup>1</sup> Yet as little as 8% of that was invested outside the country where the finance originated – and only a small fraction reached the Least Developed Countries (LDCs).

It is thus important that we ask whether it is realistic for LDCs to expect significant flows of private climate finance. This policy brief examines that question for Rwanda, focusing mainly on adaptation. It draws on a literature review and on interviews with 25 key stakeholders from ministries, agencies, international organizations, the private sector and civil society.

There are several practical challenges in boosting private-sector investment in Rwanda – in adaptation and overall. Along with the high cost of credit (interest rates up to 20%), there is the fact that the country is landlocked, which increases transportation costs and makes Rwanda dependent on its neighbours to facilitate trade and attract investments. Despite substantial efforts to ramp up power generation, the electricity supply is still inadequate, and exports are mostly limited to a few commodities.

In order to understand how Rwanda could scale up private adaptation finance, we apply an analytical framework that divides the process into three phases: the establishment of an *enabling environment*, and the *mobilization and delivery* of finance.<sup>2</sup>

The enabling environment is the foundation on which the two other phases are built. It is the policies, institutions and incentives set up by the government to mobilize private finance. It may also involve public investments (e.g. in infrastructure) to lay a foundation for private investment, or in specific projects, seed funding, risk mitigation (e.g. loan guarantees), or co-financing. Such efforts are not confined to finance for climate-

## Key findings

- Rwanda has prioritized private-sector investment in development and climate-related activities. It has laid out a clear vision in key policy and planning documents, but it has yet to create a strong enabling environment for private-sector investment in adaptation.
- Little private climate finance for adaptation has been mobilized to date. Greater efforts and tailored incentives are needed to raise private-sector awareness of both climate risks and business opportunities related to adaptation. Development partners can play a key supporting role here.
- Foreign direct investment plays a tiny role in Rwanda's economy, and it is unlikely to make a major impact on adaptation in the country. Increasing FDI may be important to Rwanda from an economic perspective, but to increase private-sector investment in adaptation, the government and development partners should focus on empowering the Rwandan business community – much of it small and medium enterprises.

related investments, but could nonetheless deliver private-sector investments aligned with the country's adaptation priorities.

Yet even if government incentives are in place, they may prove ineffectual, or they may mobilize private finance, but not in a priority sector or location. The resulting investments may also have limited adaptation benefits or cause maladaptation. For example, a business might be incentivized to build a dam, with clear adaptation benefits, such as flood prevention or water storage for irrigation. But it might also increase vulnerability – for instance, by reducing the amount of water available downstream, or to local farmers not connected to the new irrigation system.<sup>3</sup>

## Why donors are drawn to Rwanda

Rwanda is one of the poorest countries in the world, ranked 163th among 188 countries on the 2015 Human Development Index.<sup>4</sup> About 71% of its people experience multidimensional poverty, and another 18% are close to it.

But Rwanda is also widely seen as a model of effective governance for development. The U.S. Agency for International Development (USAID) has noted that “Rwanda's extraordinary recovery from complete political, economic and social collapse after the 1994 genocide represents one of Africa's most dramatic and encouraging success stories.”<sup>5</sup>

The country has well-developed policy documents, such as *Vision 2020*, adopted in 2000, and the *Green Growth and Climate Resilience National Strategy*, approved in 2011.<sup>6</sup> Rwanda's clear development plans, small size and relatively low levels of corruption have helped it attract strong international support and deliver strong results for the aid provided as proven by its strong economic development.



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The US\$3.5 million Akanyaru Watershed Protection Project in Gisagara District aims to increase environmental resilience by preventing soil erosion and landslides.



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On the northeastern shore of Lake Kivu, one of the African Great Lakes, which lies on the border between the Democratic Republic of the Congo and Rwanda.

Rwanda also stands out for its *imihigo*, a performance-based contract rooted in local tradition that holds government agencies accountable to the President of the Republic for reaching key targets on socio-economic development indicators. The goal is to improve the quality and speed of programme implementation, and make public agencies more effective.

Rwanda's economy has grown steadily, by an average of 8% per year in 2001–2015, and the country is on track to become a (lower) middle-income country by 2020.<sup>7</sup> Yet this growth is driven mostly by public investments and aid; official development assistance is a staggering 30–40% of GDP, and has exceeded central government spending in most recent years.

Despite government outreach efforts and tax incentives, foreign direct investment is low relative to neighbouring countries, just 4% of GDP in 2015, which was the best year in a generation. FDI goes almost entirely into mining, information and communications technology (ICT), and large infrastructure projects.<sup>8</sup>

Meanwhile, climate change, rapid population growth and urbanization are putting a strain on Rwanda and pose serious risks for the future. Already, floods and droughts cause major socio-economic impacts and hinder growth; by 2030, climate change impacts could amount to 1% of GDP. Rwanda needs to invest an estimated US\$50–300 million per year in adaptation – or more than US\$600 million, if social protection and accelerated development are included.<sup>9</sup>

### The private sector and Rwanda's ambitions

Rwanda's institutional and regulatory frameworks are designed to promote investment, including in activities that build resilience to climate change. *Vision 2020* highlights the need to revamp the country's underdeveloped private sector. The *Green Growth and Climate Resilience National Strategy* (GGCR) also aims to boost private investment. It lays out a pathway to a green economy, with targeted programmes for each sector. Related policy documents identify fundable projects as well as technical support and assistance needs.

At the same time, Rwanda has created a national "Green Fund" for climate change, FONERWA, with help from international donors, to serve as the "engine of green growth".<sup>10</sup> It is a nationally driven, cross-sectoral climate and environment investment fund, the largest of its kind in Africa. A key aspect of FONERWA is that it requires projects to show how

they contribute to Rwanda's main policy objectives. Environmental impact assessments (EIAs) are compulsory for the majority of projects, in order to prevent maladaptation and negative outcomes.

The *Economic Development and Poverty Reduction Strategy 2013–2018* (EDPRS2), Rwanda's most important economic strategy document, requires that ministries and agencies identify key private actors in each sector to engage them in their efforts.<sup>11</sup> In the period covered by EDPRS2, the foreword notes, "our private sector is expected to take the driving seat in economic growth and poverty reduction".

Yet although almost all donor agencies interviewed in this study cited Rwanda's goal of encouraging private investment, only GIZ, the German international cooperation agency, has a specific programme targeting private-sector adaptation. It works with the tea and coffee sectors and the Rwanda Association of Manufacturers. GIZ provides technical assistance, and German's development bank, KfW, has extended credit lines to the financial institutions, which in turn lend to small and medium enterprises (SMEs).

Overall, interviews with stakeholders suggest that, despite the public sector's incentives and ambitions, Rwanda's private sector has low awareness of climate risks and adaptation options. Only a few examples were mentioned where the private sector invests in adaptation, be it to reduce a company's own risks, or as a line of business.

Investment costs also remain high, due to high transaction costs and high interest rates for private loans – significant barriers for the SMEs that make up the majority of Rwanda's private sector. There are few large companies, and the most active are partly owned by the government. Indeed, the government is the main formal employer in Rwanda. However, aside from a few corporate social responsibility initiatives, interviewees did not mention any strong ambition from these companies to invest in adaptation activities.

The Rwanda Environmental Management Agency (REMA) has teamed up with the Private Sector Federation (PSF), which promotes the interests of the business community, to hold awareness-raising initiatives and trainings. However, the activities do not focus specifically on climate change, and funding is scarce, so only a fraction of businesses are being reached.

The Rwanda Development Board (RDB), meanwhile, whose stated goal is to fast-track development through private-sector growth, makes almost no mention of climate change on its website.<sup>12</sup> In general, advocates and practitioners do not seem to be on the same page.



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Vincent Biruta, Rwanda's Minister of Natural Resources, visits the site of a Green Fund investment earlier this year.



Still, there is ample potential for the private sector to get involved in climate-related activities in Rwanda, including adaptation. Interviewees mentioned opportunities in several sectors, including energy efficiency, rural energy access, afforestation, climate-smart agriculture, water supply, integrated water resources management, housing, infrastructure, ICT systems, and sustainable tourism.

### Initial experiences with private finance for adaptation

FONERWA is a public fund, and thus biased towards public finance. However, it is required to direct at least 20% of its resources to the private sector. It is mainly providing grants and credit lines. Today, 37% of FONERWA-financed projects are managed by the private sector, but there is very little direct mobilization of private funds. Rather, contributions are in-kind or involve technology transfer. Furthermore, most projects focus on mitigation, not adaptation.

There have been a few public-private partnerships (PPPs) that successfully mobilized private finance. For example, a FONERWA-funded project on rooftop rainwater harvesting in three regions brought together a ministry, a bank and a manufacturer of water storage tanks (see box). Another project, a collaboration between the Ministry of Trade and Industry, REMA and the PSF, set up a resource efficiency and clean production centre. Its objective is to create awareness, build capacity and identify bankable projects. In addition, there have been some small-scale investments in irrigation schemes and rural electrification.

Clearly there is potential. Both public and private sectors can increase investment in climate-related activities. But some barriers need to be overcome to scale up private-sector investment. The needs most commonly mentioned in interviews were reducing investment risk, increasing awareness, and reducing red tape. Risk-sharing and co-financing were also mentioned as successful strategies. When there is co-financing, risks are reduced and there is also co-ownership, which creates strong incentives for efficient project implementation and management.

A more difficult challenge is that many benefits of adaptation measures are difficult to measure in economic terms and are perceived as part of the public realm. Conservation, ecosystems restoration, capacity-building and education, for example, do not produce immediate profits. This issue is not only relevant to the private sector: even within ministries, a few interviewees said it was a problem to constantly have to show how a project contributed to GDP to get a budget allocation.

### Can investments be delivered in a way that supports adaptation?

As noted above, the small amounts of private finance for climate activities that are being mobilized rarely focus on adaptation. However, the interviews also revealed that some activities that contribute to adaptation are already taking place, but they are often not recognized as such.

The restoration of the Rugezi watershed is an example. Hydropower is crucial to Rwanda's power supply, but climate change is expected to shift rainfall patterns. One of the main power stations, Ntaruka, had seen a steep decline in generation capacity, due in part to poor management of the upstream wetlands and degradation of the surrounding watershed.<sup>13</sup> A major

### A public-private partnership on rainwater harvesting

The FONERWA-funded project Rooftop Rainwater Harvesting in High Density Areas of Nyarugenge, Gasabo, Kicukiro, Musanze, Nyabihu and Rubavu Districts (RWH), launched in January 2014, brings together a public agency, the Rwanda Natural Resources Authority (RNRA), a financial institution, the GT Bank, and a water tank supplier, Aqua-San.<sup>14</sup>



The project's objective is to expand access to water in local communities, and in the process, improve livelihoods and reduce poverty. It involves four main types of interventions: strengthening an existing loan scheme for rainwater harvesting facilities; supporting a subsidy and loan system; disseminating very low-cost rainwater harvesting techniques for poor rural households; and building rainwater harvesting systems for selected public buildings and integrated collective household systems.

GT Bank provided finance, while the RNRA issued guarantees to lower interest costs. The terms of reference for the project were easily negotiated, and communities appreciated the results. However, a bank representative said for GT this was seen as a corporate social responsibility project, and added: "If we are going to continue to be involved in these kinds of projects, they need to have a bigger business focus. It has to be more attractive for financial institutions in terms of balancing the operating costs associated with the project."

watershed restoration project not only brought substantial environmental benefits, but also restored Ntaruka's generation capacity, and made the facility more resilient to future changes in rainfall. Several interviewees mentioned this as a case where a development project had clear adaptation benefits, and also illustrates the value of an adaptation focus to decrease the risk of projects leading to maladaptation and increasing local people's vulnerability.

Shifting towards a private sector-driven economy is challenging, and the international community has an important role to play in helping Rwanda achieve its goal – and in the process, promote private-sector investment in adaptation-related activities. Bilateral and multilateral donors are already involved in sector working groups in order to pool resources and coordinate investments. Now they need to increase their emphasis on private-sector implementation and financing of adaptation activities.

In order to mobilize private-sector finance both within Rwanda and abroad, greater efforts also need to be made to operationalize existing policies to create an enabling environment, and to raise awareness of both climate risks, and investment opportunities in adaptation.

## Policy recommendations

- While there are strong ambitions for private-sector climate finance, the policies in place in Rwanda have not translated into an enabling environment for private investments in adaptation activities. There are further policy needs before the government's vision can be turned into enabling mechanisms.
- Corporate social responsibility initiatives are a good first step to mobilize additional private finance and scale up private investments. However, there is a need for a systematic approach to move beyond that step and prove the business case for investing in adaptation. There is a need for more awareness-raising, capacity-building and information-sharing between the public and private sectors.
- International donors and the Rwandan government should make adaptation part of a broader development agenda, using scarce funds for larger initiatives as a way to entice the private sector to contribute to adaptation as a co-benefit of development projects.
- Readiness support is a good way for international partners to help advance domestic efforts, but more is needed. It is important to pool international resources and include different stakeholders and actors, to focus on capacity-building, technology transfer and finance. The GCF is a key actor in this regard.

Rwanda has recently been awarded readiness support from the Green Climate Fund (GCF) to help enable its agencies to better communicate and coordinate and build capacity, aiming to attract more international climate finance. Realistically, however, Rwanda is unlikely to be able to attract large amounts of FDI to support adaptation. This means that to solve the two issues of aid dependence and adaptation deficits, Rwanda needs to unlock the potential of its own private sector.

## Endnotes

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