Aligning Kenya's Financial System with Inclusive Green Investment

Current Practice and Future Potential to Mobilize Investment in a Sustainable Economy

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Inquiry: Design of a Sustainable Financial System

IFC International Finance Corporation WORLD BANK GROUP

About the Report

This report was developed through a partnership between the International Finance Corporation (IFC) and the UNEP Inquiry into the Design of a Sustainable Financial System (UNEP Inquiry).

IFC's engagement in this initiative has been in partnership with Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) on behalf of the German Ministry for Economic Cooperation and Development (BMZ).

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Comments are welcome and should be sent to Aditi Maheshwari (amaheshwari@ifc.org).

ABOUT IFC

IFC, a member of the World Bank Group, is the largest global development institution focused exclusively on the private sector. Working with private enterprises in about 100 countries, we use our capital, expertise, and influence to help eliminate extreme poverty and boost shared prosperity. In FY14, we provided more than $22 billion in financing to improve lives in developing countries and tackle the most urgent challenges of development. For more information, visit www.ifc.org.

ABOUT UNEP INQUIRY

The Inquiry into the Design of a Sustainable Financial System has been initiated by the United Nations Environment Programme to advance policy options to improve the financial system's effectiveness in mobilizing capital towards a green and inclusive economy—in other words, sustainable development. Established in January 2014, it published its final report in October 2015. More information on the Inquiry is at: www.unepinquiry.org.

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ACRONYMS

BMZ	German Ministry for Economic Cooperation and Development
ESG	Environmental, social, and governance
FDI	Foreign direct investment
GDP	Gross domestic product
G20	Group of 20
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
IFC	International Finance Corporation
MTP2	Second Medium Term Plan
MW	Megawatt
PPP	Public-private partnership
UN	United Nations
UNEP	United Nations Environment Programme

Executive Summary

ABOUT THIS REPORT

This report aims to promote inclusive green investment in Kenya. It focuses on policy, structural, and investment innovations across the economy and financial sector that would increase capital flows that support sustainable development.

Inclusive green investment forms an important part of the broad environmental, social, and governance (ESG) considerations that underpin sustainable investment. "Green" investment supports economic growth in a clean, resilient, and sustainable manner – such as initiatives to encourage more efficient use of resources, reduce pollution, and mitigate environmental damage. "Inclusive" investment serves not only investors, but the broad interests of society, particularly low-income segments of the population.

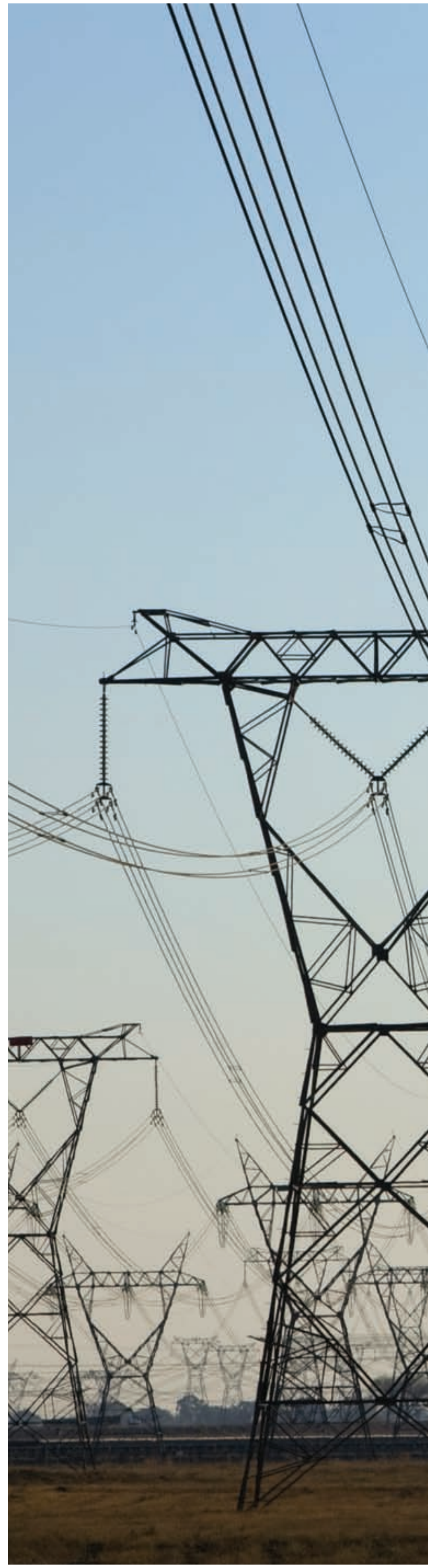
The report is a product of a global collaboration involving the International Finance Corporation (IFC) and the United Nations Environment Programme Inquiry into the Design of a Sustainable Financial System (UNEP Inquiry), with support from the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) on behalf of the German Ministry for Economic Cooperation and Development (BMZ). It is based on broad-based research, which included extensive interviews and dialogues with stakeholders across Kenya's investment value chain.

MAIN FINDINGS

Kenya's fast-growing economy is the largest in East Africa, and serves as a trade and investment hub for East and Central Africa. While the economy is diversifying, it remains largely dependent on natural resources. Agriculture and tourism account for nearly half of gross domestic product (GDP).

> Kenya is highly vulnerable to the effects of climate change, environmental shifts, and associated social effects.

According to the Kenya National Climate Change Action Plan 2013-2017, extreme climatic events could cost the economy as much as $500 million a year, equivalent to about 2.6 percent of the country's GDP in 2013.[1] Aggregate models project that these economic costs will increase in the future, with some sources suggesting they could reach the equivalent of 7 percent of GDP by 2020. Such losses could result from lower crop and livestock yields, forest fires, damage to fisheries, reduced hydropower generation, lower industrial production, and reduced water supply. In addition to the effects of climate change, Kenya also faces costs from environmental pollution, which adversely affects human health and raises the risk of epidemics.



To counter these trends, Kenya requires increased investment in areas such as sustainable agriculture, and green resilient infrastructure for transport, water, and waste management. Green resilience refers to the ability of a system to continue operating as external conditions change, and to adapt to changes in temperature, precipitation, and other variables. In the context of climate change, green resilient infrastructure would be able to operate at its design capacity despite sharply changed climatic conditions. This means making a conscious shift away from a business-as-usual approach, in which capital flows to non-sustainable polluting industries, practices, and technologies.

Kenya has a wealth of potential green investment opportunities, particularly in infrastructure, agribusiness, tourism, and manufacturing.

The country is also home to some of Africa's largest private sector-funded renewable energy projects, such as the $870 million Lake Turkana wind power project and the $620 million OrPower 4 (Olkaria III) geothermal power plants. To date, however, domestic financial sector participation in these investments has been limited.

The Kenyan government articulates a strong high-level policy commitment to inclusive green economic growth and investment. This is expressed clearly in the country's Constitution, its Vision 2030, and the Second Medium Term Plan (MTP2). But the necessary links to sectoral strategies, including those of the domestic financial sector, are a work in progress.

Kenya's aspiration to become a middle-income country based on sustainable development is premised on strong investment growth. The government targets investment growing from 24.7 percent of GDP in 2013-2014 to 30.9 percent of GDP by 2017-2018.[2] The current level of public sector investment of between 8 percent and 10 percent is expected to be sustained throughout the period, with the bulk of the increase in overall investment expected from the private sector. Policy