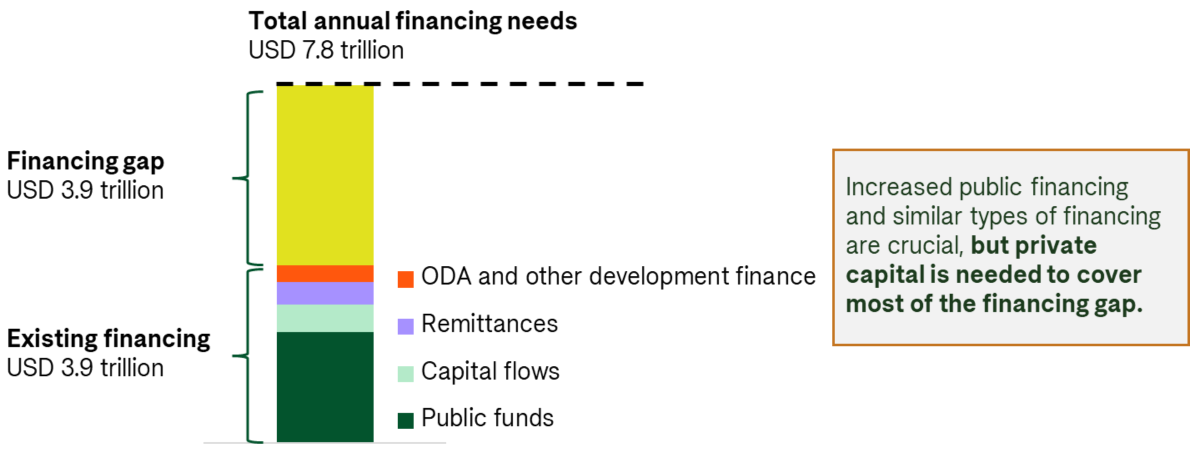
Norway's new guarantee scheme for renewable energy investments in developing countries

1. Introduction

If the world is to successfully deliver on the Sustainable Development Goals (SDGs), there must be a rapid and substantial increase in our collective investments (public and private). The financing needs for emerging markets and developing countries are just under USD 4 trillion annually. According to Tracking SDG 7: The Energy Progress Report, IEA estimates that an average annual investment of around USD 3 trillion in the energy sector is needed to achieve SDG 7. This is a significant increase compared to current investment levels.[1]The investment gap cannot be closed without increased large-scale, private capital mobilisation. To obtain this financing either a) the enabling environment for investment must be significantly improved, or b) risk mitigation must be made available on a much larger scale, or both.

Annual financing needs to achieve SDGs in developing countries



Source: OECD (2024), OECD Contributions to the 2030 Agenda and Beyond: Shaping a Sustainable Future for All, OECD Publishing, Paris, https://doi.org/10.1787/69c94bd4-en.

The Norwegian Government already supports private sector focused financing at scale for the SDGs through various channels, including the Multilateral Development Banks (MDBs), the Norwegian Investment Fund for Developing Countries (Norfund) and the Climate Investment Funds. Norway also provides support to the Norwegian Agency for Development Cooperation (Norad) for its early phase project incubation scheme, which has given rise to large-scale investment projects, including the Mocuba solar power plant in Mozambique and the Sukkur solar power plant in Pakistan. Norway also cooperates closely with partners such as the Nordic Development Fund (NDF), the Nordic Green Bank (NEFCO), and the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) on the Global Energy Transformation Programme (GET.pro), Mobilising Renewable Energy Investments Programme (GET.invest) and Transforming Energy Sectors Globally Programme (GET.transform).

However, we recognise that more is needed. As part of a wider ambition to support the efforts of

[1] Tracking SDG 7: The Energy Progress Report 2024: [sdg7-report2024-0611-v9-highresforweb.pdf (esmap.org)]

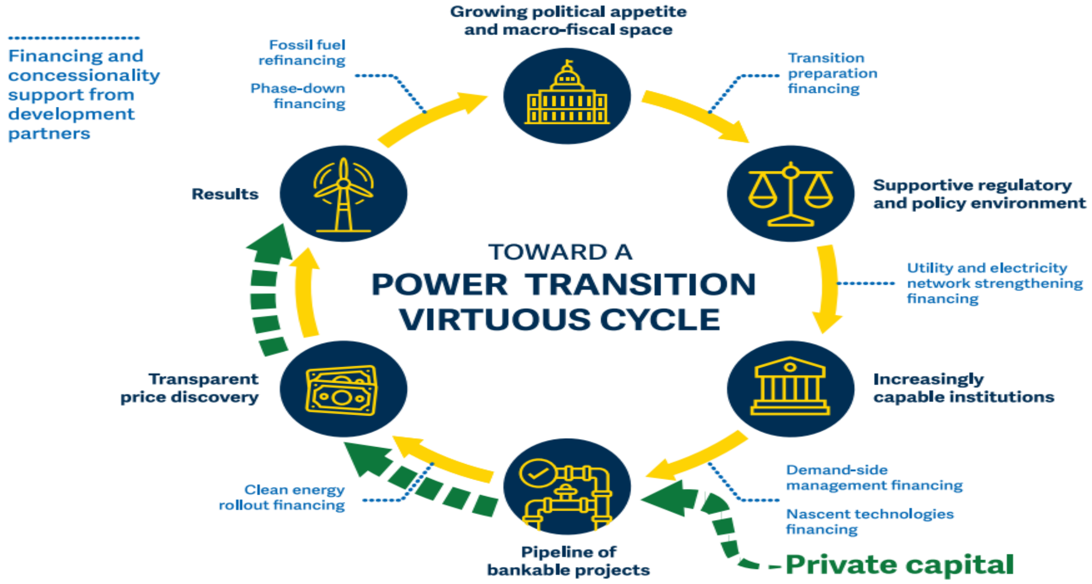
low- and middle-income countries to increase energy access and deliver on the green energy transition, the Storting (Norwegian parliament) decided last year to establish a 5-year (pilot) unfunded state guarantee facility of approximately USD 500 million for renewable energy. This includes, but is not necessarily limited to, renewable energy production and infrastructure, off-grid power production, and energy efficiency. The guarantee scheme aims to mobilise large-scale private and public capital for renewable energy systems by reducing risks, thus driving down the cost of capital. The scheme will be administered by Norad and supported by Norfund (see section 3 below).

The objectives of the Norwegian State Guarantee Scheme for renewable Energy investments in developing countries are threefold:

- Development and poverty alleviation through increased renewable energy access
- Reduction in greenhouse gas emissions
- Supporting national policy agendas towards increased renewable energy

The guarantee scheme is primarily focused on SDG 7 (affordable and clean energy) and SDG 13 (climate action), but will indirectly support a broad range of SDGs. Access to energy is a precondition for poverty alleviation and economic growth. There is a strong correlation between countries that have the highest poverty rate, the lowest energy access rates, and the least developed financial markets. Dependable and affordable energy improves productivity, enables communication and trade, and improves social conditions. [2] Increased energy access can be particularly transformative in rural areas, where electrification can lead to higher agricultural yields and access to markets, thereby also driving sustainable job creation.[3]

Figure 1: A virtuous cycle to propel the power sector transition, with financing approaches that can help to overcome barriers at each stage



Comment: 'Fossil fuel refinancing' is used here to mean the refinancing of expensive, outstanding debt of younger fossil fuel assets to incentivise early retirement. The figure is included as an example of how various financing approaches can drive the power transition. However, the guarantee scheme might choose not to be involved in certain approaches.
Source: 'Scaling up to phase down – Financing energy transitions in the power sector', The World Bank April 2023, Report NO: AUS0003306, p.6.

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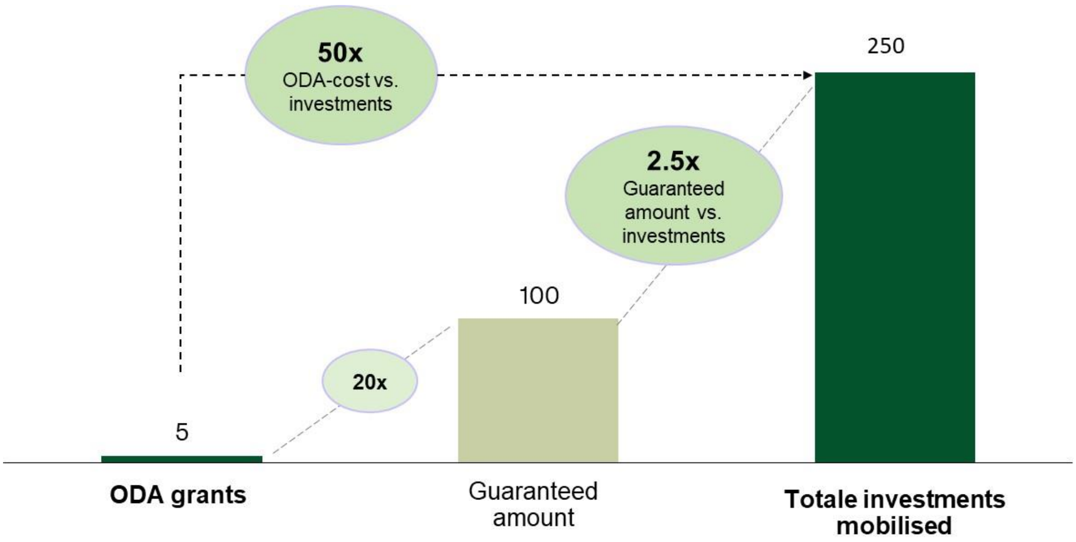
[2] Eberhard, A., & Dyson, G. (2020). What is the impact of investing in power. British International Investment, Burke, P., Stern, D., & Bruns, S. (2018). The Impact of Electricity on Economic Development: A Macroeconomic Perspective. International Review of Environmental and Resource Economics, 85-127., Andersen, T., & Dalgaard, C.-J. (2013). Power outages and economic growth in Africa. Energy Economics.
[3] Falchetta, G. (2021). Energy access investment, agricultural profitability, and rural development: time for an integrated approach. Environmental Research.

2. Key features of the scheme

The Norwegian sovereign guarantee is AAA rated, which reduces the risk for the beneficiary. As illustrated below, the mobilisation rate relative to the size of the guarantee is estimated to be 2.5x, based on experience from similar arrangements. However, as opposed to grants, equity and loans, an unfunded guarantee does not require on-budget capital expenditures, except where ODA grants are used to subsidise the risk premium (estimated in the figure below to about 5 per cent of total guaranteed amount).[4] Relative to on-budget appropriations, the leverage ratio is thus exceptionally high – a crucial point given budget constraints and the size of the investment gap.



Source: Example based on numbers from Sida's guarantee scheme. The guarantee scheme from 2012–2021 had a portfolio with an average of 5 % subsidies (grants) of total guarantee exposure. Their mobilisation rate was 2.5x (mobilised capital to guaranteed volume). The Norwegian state guarantee scheme is to a large degree comparable with the Swedish scheme, although there are some differences

The guarantee scheme will make an initial loss provision of 15 per cent of the total facility of approximately USD 500 million, but over time the scheme is to be self-financed through the payment of guarantee premiums (the price that those benefitting from the guarantee will pay for the service).

2.1 Guarantee offers

The guarantee scheme will drive investment and capital mobilisation by reducing risk (and thus cost of capital) for its beneficiaries. The scheme will be flexible and can cover both portfolios and individual projects, as well as a wide variety of risks, including commercial, political and currency risks.

In the short-term, it is likely that credit guarantees will account for many of the guarantees, as the demand for these is high and it is a well-known financial instrument.

2.2 Guarantee beneficiaries

As approved by the Storting (Norwegian Parliament), 65 per cent of the guarantee facility will be issued in cooperation with multilateral development banks. MDB involvement will promote manageable risk exposure due to the various comparative advantages of MDBs, including in-house experience and expertise as well as the ability to access and influence national and key decision-makers. Guarantees

[4] It is expected that potential losses and cost of administration will be covered by guarantee fees in the long-term. Potential cost of subsidies will come in addition.

with MDBs can be developed in direct dialogue with individual MDBs, through a call for proposal or a combination of both.

The remaining 35 per cent of the guarantee facility may be deployed through other institutions or, in certain circumstances, channelled directly to companies. These guarantees will be awarded under a call for proposal, followed by discussion and negotiation. Calls for proposals will be open to both Norwegian and international institutions, including funds and financial institutions managing portfolios of relevant projects, specialised entities focusing on guarantees, and individual projects and/or companies that meet defined criteria.

For all potential partners, Norad will attach importance to effectiveness, impact, and alignment with the criteria of the scheme. Contributions to increasing available capital, building new markets and commercial sustainability of renewable development are also important elements. For MDBs, Norad will give additional focus to strengthening lending and investment capacity to ensure more renewable energy development.

2.3 Geographic distribution

The guarantee scheme is open to all ODA countries, with a limit of 30 per cent to low-income countries. However, Norad will prioritise countries where there is potential for significant outcomes in reducing energy poverty and future greenhouse gas emissions, increasing future growth and renewable energy development, and where a green agenda (such as JET-P or other ambitious investment plans, ideally linked to countries' Nationally Determined Contributions (NDCs)) is being implemented, or where the deployment of guarantees can support such an agenda. The presence of infrastructure investors and relevant financial institutions and the impact of a guarantee on a country's overall debt will also be considered.

2.4 Risks and additionality

The guarantee scheme aims to be additional according to the OECD definition, which includes both financial-, value-, and developmental additionality. A guarantee will normally have the greatest development additionality in the poorest countries where the risks are greater but will mobilise more capital in middle-income countries where the investment climate is more favourable.

The additionality criteria is applied to avoid market distortions. The aim is to support and develop sustainable financial markets, and not to substitute or out-compete existing market participants. For a private sector activity to qualify as ODA it needs to exhibit either value- or financial additionality and development additionality.

Norad will assess the level of additionality through its own and/or partners' criteria and estimates.

3. How the guarantee scheme works

Norad will design and structure a process for cooperation with guarantee recipients that is effective and impact-driven in order to limit workload, provide partners with a sense of security and predictability, and deliver results.

First, this will entail identifying a strong pipeline of guarantee opportunities through dialogue with relevant partners, MDBs, and calls for proposals. Norad will publish its first call for proposals in Q4 2024.

Second, Norad, in cooperation with the relevant partner, will develop the conditions of the deal and transaction. Importance will be attached to cross-cutting concerns such as human rights (including but not limited to indigenous peoples' rights), gender equality, anti-corruption and climate and environment. This will help to ensure that the scheme has a positive effect across the SDGs.

Guarantee premiums can be subsidised by Norad using its ODA-funded grant budget. Subsidies will be granted on an application basis, based on an evaluation of additionality, need and potential impact. Further details on criteria will be outlined in the application process. The purpose of subsidies is to catalyse more projects with greater development effect.

Third, Norad will monitor and evaluate the outputs and outcomes of the guarantee scheme using project-specific and real-world KPIs and other appropriate follow-up and evaluation tools. The aim will be to monitor, evaluate and learn on an ongoing basis in order to assess the impacts, improve the scheme over time, and share insights with the broader development finance and climate community.

Finally, Norad will implement appropriate risk mitigation measures both to ensure the effectiveness of the scheme and to adhere to national regulations on risk management.[5] Norfund is a key partner of the scheme and will provide expertise on due diligence and risk assessment processes. Other external partners may be asked to provide additional risk management support at a later date.

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4. Contact us

More information can be found on our website www.norad.no.

Responses to frequently asked questions (FAQs) will be posted on our website.

Meetings will be held in conjunction with all calls for proposals in order to respond to any outstanding questions. Information about meetings will be posted on our website.

[5] This means that Norad will develop a risk matrix for the guarantee scheme, clearly outlining level of risks along with mitigation measures