THE ROLE OF DEVELOPMENT FINANCE INSTITUTIONS (DFIS) IN PROMOTING THE CLEAN DEVELOPMENT MECHANISM (CDM) IN AFRICA

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Abstract. This article outlines some of the latest developments and opportunities for development finance institutions (DFIs) to become directly supportive of the Clean Development Mechanism (CDM) in Africa. In striving to make development financing more environmentally friendly and sustainable, DFIs can play a key role in promoting the CDM on the African continent by providing monetary incentives through their project financing activities; encouraging and facilitating partnerships in support of sustainable development, particularly with reference to the CDM, and; providing technical advice and support to clients with regard to project design, planning and implementation.

DFIs have traditionally focused on financing infrastructure and poverty alleviation projects. However, the emergence of the CDM has brought about a shift towards investments in services and products that reduce carbon dioxide emissions and encourage investments in environmentally friendly technologies. This can be ascribed in part to the development of a “carbon market” under the auspices of the Kyoto Protocol that took effect in February 2005. The carbon market and emerging carbon funds are some of the main drivers enabling DFIs to play an increasingly important role in promoting the CDM in Africa.

Key words: clean development mechanism, development financial institutions, environment, innovative environmental markets, investments, sustainability.


1. Introduction

This article aims to highlight the role Development Finance Institutions (DFIs) can play in promoting implementation of the Clean Development Mechanism (CDM) in Africa. The approach taken is to demonstrate innovation by a DFI in promoting CDM in Africa and to extract some of the lessons learnt.
The CDM is a new, market-oriented, innovative, and flexible financing instrument articulated by the 1997 Kyoto Protocol that came into force in February 2005. Its purpose is to enhance the implementation of investment strategies for adapting to or mitigating the adverse effects of climate change and promoting sustainable development. The effects of climate change are measured in carbon dioxide (CO\textsubscript{2}) equivalent units (1992, United Nations Framework Convention on Climate Change and 1997 Kyoto Protocol) and assigned monetary values for possible exchange and trade. This process of valuing CO\textsubscript{2} equivalent into monetary units is complex for both DFIs and policy-makers (Gowdy and O’hora, 1995).

Despite the complex process, DFIs are willing to promote CDM in Africa with the objective of adding value to development impact (Cocker and Richards, 1992). The value of CO\textsubscript{2} equivalent units are largely generated by development projects—for example, energy produced from coal has high emissions due to high carbon content and can effectively be reduced by the CDM initiative. Other sources of emissions include industry, construction, transport, agriculture, residences and fugitive emissions from fuels including solid fuels, oil and natural gas. Also, improperly managed landfills produce methane (CH\textsubscript{4}). Note that CH\textsubscript{4} has a higher global warming potential than CO\textsubscript{2} but a life span of only about 20 years in the atmosphere while CO\textsubscript{2} lasts up to 100 years, hence a better climate change measure (Karani, 2002). In addition, DFIs can support financing moveable assets utilized in managing waste management. For example efficient trucks required to move waste from source to landfills could contribute to effectiveness in capturing methane gas. Therefore, the CDM’s leveraging potential creates an enabling environment for DFI participation.

The evolution of DFIs regarding the CDM as pioneered by the World Bank Carbon Finance Instrument goes back to the establishment of the Bretton Woods Institutions (the World Bank and International Monetary Fund) in the 1940s. The World Bank and IMF evolved as DFIs to assist in financing development that would otherwise be unaffordable to the borrower. Further, evolution and economic and political pressures in the 1960s, led to the emergence of regional DFIs including the African Development Bank, the Latin American Development Bank and the Asian Development Bank. Musasike et al. (2004), in a paper on the role of DFIs and lessons from Southern Africa of best practice for their effective management, argue that sub-regional and national DFIs have emerged and gained prominence with the support of the Bretton Woods institutions.

Regional DFIs have proved useful in public financing but their dependence on continually diminishing Overseas Development Assistance (ODA) and increasing demands for low-interest capital by developing countries constrain their lending ability (Todaro and Smith, 2003). This constitutes one of the major barriers to achieving sustainable development in Africa. With respect to the emergence of the CDM, analysis shows that Africa still lags behind. Although, the World Bank head of Carbon Finance, Odin Knudsen argues that Africa is a priority region for the World Bank’s investments and is no longer a least significant region in terms of carbon projects development that require CDM financing. Review of carbon financed projects by the World Bank indicates that in the year 2004 Africa’s share