INFORMATION NOTE: REDD+ FINANCE

ASIA/PACIFIC REGION

Introduction

More than a decade ago, the Conference of the Parties (COP) to the United Nations Framework Convention on Climate Change (UNFCCC), at its 11th meeting in Montreal in 2005, started discussing approaches to reduce emissions from forests. The initial focus was on deforestation, before the discussion was expanded to include forest degradation, conservation, sustainable management of forests and enhancement of forest carbon stocks – now known as "REDD+". But already, in 2005, the discussions centred on "*policy approaches and positive incentives*".[1]

These two aspects were a constant feature of subsequent REDD+ negotiations, and are what makes REDD+ unique. Reducing deforestation and forest degradation, conservation, sustainable management, and reforestation/restoration (enhancement) have long been central to all national forest programmes. However, the focus on "*policy approaches*" emphasized the need to address underlying threats to forests, and the implication that this requires working at the national scale.

Although "*positive incentives*" does not necessarily refer to financial resources, several subsequent decisions of the COP clearly called on Annex I countries to provide results-based finance, for example, Decision 2/CP.17, paragaph 65:

> *"Agrees that results-based finance provided to developing country Parties that is new, additional and predictable may come from a wide variety of sources, public and private, bilateral and multilateral, including alternative sources"*

Decision 9/CP.19, paragraph 5 provides further guidance on results-based finance:

> *"Encourages entities financing the activities referred to in decision 1/CP.16, paragraph 70, through the wide variety of sources referred to in decision 2/CP.17, paragraph 65, including the Green Climate Fund in a key role, to collectively channel adequate and predictable results-based finance in a fair and balanced manner, taking into account different policy approaches, while working with a view to increasing the number of countries that are in a position to obtain and receive payments for results-based actions"*

The provision of international results-based finance is the key defining feature of REDD+, yet the COP has provided little guidance on what this means in practice. Moreover, finance remains a thorny issue, lagging behind in the wider context of the climate change negotiations. Consequently, many countries are uncertain about REDD+ Finance, and it has been the most-requested topic for knowledge management support from the UN-REDD Programme in Asia/Pacific.

For this reason, the UN-REDD Programme, in partnership with the FCPF, and supported by funding from the REDD+ Partnership, organized an Asia/Pacific knowledge exchange on REDD+ Finance in May 2016, from which the key lessons described below emerged.

[1] *FCCC/CP/2005/5, paragraph 81*

Issue 1: REDD+ Finance is not just results-based payments

Although the provision of international results-based finance[2] is the defining feature of REDD+, it must be remembered that there is also a need for **investment finance** (*see explanation on page 8)* in order to develop and implement the policies and measures (PAMs) needed to generate results. Decision 1/CP.16, paragraph 73, states that REDD+ should be implemented:

> *"in phases, beginning with the development of national strategies or action plans, policies and measures, and capacity-building, followed by the implementation of national policies and measures and national strategies or action plans ..., and evolving into results-based actions that should be fully measured, reported and verified"*

Finance is required for the first two phases (i.e. readiness and implementation) to generate the emission reductions (and/or enhanced removals) that will trigger results-based finance. Since the phases are not rigidly distinct, but tend to overlap, this implies the need for a comprehensive financing plan for REDD+ in each country, covering both investment and results-based finance.

Participants attended at the REDD+ Financing event
Photo Credit: Heang Thy

Country Experience Box 1: Sri Lanka

- Sri Lanka started by identifying candidate policies and measures (PAMs) to address key drivers of deforestation and forest degradation through a highly consultative process. These PAMs were then prioritised through multi-criteria analysis using social and environmental safeguards, various feasibility factors (e.g. institutional acceptability/ownership, likelihood of institutional coordination and private sector engagement, cost of implementation, availability of technical/functional capacity, resource availability, and time frame) and expected carbon and non-carbon impacts as prioritisation criteria.

- In parallel, Sri Lanka defined the country's REDD+ vision – "Forests and beyond, sustaining lives and livelihoods in a greener Sri Lanka". The vision recognises the role of REDD+ within the overall national development process, while pointing to the need for a cross-sectoral framework to anchor the PAMs. The selected priority PAMs were then matched against relevant public sector activities and development partner initiatives to identify existing resources and investment gaps, and develop an integrated financing action plan. The plan will also link each PAM with its expected REDD+ impacts and safeguard status. The plan will form the backbone of Sri Lanka's National REDD+ Strategy.

Key Lessons

- In order to receive international results-based finance, investment finance is required to implement PAMs leading to results, as well as for capacity building in the development and implementation of the National Strategy/Action Plan (NS/AP), National Forest Monitoring System (NFMS), Safeguards Information System (SIS), etc. in the first two phases of REDD+;
- In order to move towards generating REDD+ results as rapidly and efficiently as possible, countries should develop a comprehensive financing plan, identifying sources of both investment and results-based finance; and
- A high quality integrated financing plan is supported by thorough analyses of drivers, comprehensive financial and economic assessments of potential PAMs, and the preparation of a NS/AP that enjoys broad stakeholder ownership.

[2] *The terms "results-based finance" and "results-based payments" are interchangeable, and both terms are used in COP decisions.*

Issue 2: REDD+ investment finance is not necessarily international

Although COP decisions emphasize the international nature of results-based finance, it does not mean that investment finance will also necessarily come from international sources or only from such sources. Working on the assumption of investment finance being international in origin risks diverting the attention of a country from the development of required capacities and identification of required PAMs. Identifying sources of domestic investment finance will enhance a country's position to attract international investment and results-based finance.

Inntha tribe at Inle Lake, Myanmar, taken in May 2014
Photo credit: Khin Hnin Myint

Country Experience Box 2: Brazil and India

- Every year India's central government collects about USD 200 billion in taxes. From that amount, it then passes on about USD 60 billion to its 29 state governments. In 2015, the Indian Parliament changed the formula for calculating the amounts transferred to include forest cover (7.5% weighting) in addition to other criteria related to factors such as population, area, and income. So a state's share of tax revenue provided by the central government will now depend, in part, on the forest cover it has maintained. This is a powerful, and budget-neutral way to stimulate investment in measures to maintain or expand forest cover, amounting to a USD 6 billion investment in forests each year (adapted from http://www.cgdev.org/blog/indias-big-climate-move).

- Rural credit, which the government subsidised via lower interest rates, is an important source of financing for rural agricultural producers in Brazil. Introduced in mid-2008, Resolution 3,545 placed a condition on rural credit for producers in the Brazilian Amazon Biome. To obtain credit, borrowers had to present proof of compliance with environmental regulations, the legitimacy of their land claims, and the regularity of their rural establishments. To prove credit eligibility, Resolution 3,545 required borrowers to present a series of documents. The resolution induced restriction in credit contributed to contain deforestation in the Amazon Biome, while production of soy and beef increased. Over 2,700 square kilometers of forest would have been cleared between 2009 and 2011 without the resolution. As annual deforestation rates in the late 2000s and early 2010s were around 7,000 square kilometers, the effect attributed to the resolution is quite substantial (adapted from J. Assunção, C. Gandour, R. Rocha, R. Rocha, 2013. Does Credit Affect Deforestation? Evidence from a Rural Credit Policy in the Brazilian Amazon. Climate Policy Institute, Rio de Janeiro).

Key Lessons

- Many PAMs for REDD+ may not be new, since many countries have already established PAMs to address deforestation or forest degradation, or to promote conservation and sustainable management of forests;
- Financing the implementation of existing PAMs may come from government budgets or other domestic sources (e.g. payments for ecosystem services) – these should be considered REDD+ investment finance;
- Existing PAMs should be strengthened and complemented, often through a cross-sectoral vision so as to be transformational, and financed from domestic budgetary sources, building a solid case to request additional gap-filling international investment finance;
- Countries also need to consider financial incentives that stimulate deforestation, and how these can be adjusted to reduce negative impacts (see also below);
- Not all PAMs come at an additional cost – for example, India's transfer payments modification; and
- Focusing only on international sources of investment finance may slow down progress towards results-based finance, and may deflect focus from existing PAMs that may require relatively minor adjustments in order to generate results.

Issue 3: Working with the Green Climate Fund (GCF)

As noted above, Decision 9/CP.19, paragraph 5, anticipates that the GCF will play a key role in delivering results-based finance, so it is important to understand what this role might be. However, the GCF is not expected to finalise its guidelines on the provision of REDD+ results-based finance until at least late 2016. The GCF Board has already decided that "*The Fund's REDD+ RBP mechanism will seek to avoid double-counting for emission reductions. The determination of whether emission reductions have already been supported by ex-ante financing should be made* ***ex-ante*** *(see explanation on page 8)*", although how such a determination will be made is not yet clear. As the GCF is continually evolving and adapting based on UNFCCC COP decisions, lessons learnt, needs and requirements, it is essential before making decisions related to the GCF to check the latest Board documents available on www.gcfund.net

Ecuadorian Amazon rain forest, taken in June 2011
Photo credit: Dallas Krentsel

Country Experience Box 3: Ecuador

- By the end of 2016, Ecuador will have fulfilled the requirements as set out by the Warsaw Framework for REDD+, including completion of a National REDD+ Strategy or Action Plan. In order to contribute to its implementation, the Ministry of Environment (National Designated Authority of the GCF) is preparing a proposal for a grant to the GCF through the Forestry and Land Use window. With the National REDD+ Action Plan ensuring a strong alignment of national policies and strict convergence of international contributions to REDD+, this proposal benefits from substantial co-financing from both domestic and international sources.

- Considering the cross-sectoral nature of the National REDD+ Action Plan, this proposal will be led by both the Ministry of Environment and Ministry of Agriculture, and implemented by these ministries as well as various other institutions that will be key for facilitating a shift of the economic base towards greater sustainability, such as the ministries of Foreign Trade and Finance, the Planning Secretariat, and public banks.

- The ongoing GCF proposal review process is demanding, consisting of multiple rounds of review by the GCF Secretariat that will be followed by an assessment by a technical panel that will make recommendations to the GCF Board (for approval or otherwise). Consequently, it is necessary to dedicate staff to manage the process, and it is important to have a detailed understanding of UNFCCC requirements and a clear long-term vision for REDD+ in the country.

Key Lessons

- In order to adequately address the demanding requirements of a GCF proposal for investment finance, it is critical to use and build on processes and analytical work from the REDD+ Readiness phase. These requirements include a detailed budget and work plan, a robust analysis of drivers with a market overview of the agricultural commodities driving deforestation (where this is the case), a very detailed financial and economic evaluation, and documented consultations with national stakeholders.
- It is also essential to have the key components of the Warsaw Framework for REDD+ in place. This includes a strong and comprehensive National REDD+ Strategy (or Action Plan).
- Work on developing a GCF proposal is demanding and time-consuming, meaning that adequate human resources need to be dedicated to the process. As it is a long process (1.5 year expected for Ecuador while building on the readiness work), countries should start submitting quality concepts for investment finance so as to enter the pipeline.
- The accreditation process for direct access to the GCF is demanding. Countries aiming for a national Accredited Entity (AE) should target achievable type and levels of accreditation while building capacity over time. In the meantime, countries should use existing international AEs to avoid the risk of delaying access to finance unnecessarily.
- There are already many AEs that may submit proposals to the GCF, each with different capacity and types of accreditation. Countries should choose the most relevant (volume of funding, type of services, etc.) to achieve the objectives of their specific project.

Issue 4: Other international sources of investment and results-based finance

Besides the GCF, there are a number of other potential sources of international investment and results-based finance. These include climate funds administered by the World Bank and bilateral donors. A number of countries in Asia/Pacific are receiving support through the FCPF's Carbon-Fund (C-Fund), the Forest Investment Program (FIP), or bilateral agreements.

Both the FCPF C-Fund and the BioCarbon Fund Initiative for Sustainable Forest Landscapes (BioCF-ISFL) support readiness and piloting of results-based actions to operationalize REDD+ and sustainable management of landscapes at sub-national and national levels. The Forest Investment Program (FIP) supports readiness and investment activities through both grant and concessional finance for institutional capacity building, improving governance, and investments in REDD+. It emphasizes co-benefits – biodiversity conservation, rights of indigenous peoples and local communities, poverty reduction, and rural livelihood enhancements.

Costa Rica taken in March 2015
Photo credit: UN-REDD Programme

Country Experience Box 4: Viet Nam

- Viet Nam's Emission Reduction Program Idea Note (ER-PIN) was accepted by the C-Fund in June 2014. Subsequently, an Emission Reduction Program Document (ER-PD) was prepared and a Letter of Intent signed in January 2015. Viet Nam expects to present its R-Package to the Participants' Committee meeting in September 2016, and to conduct Emission Reduction Program Agreement (ERPA) negotiations between January and June 2017;

- The R-Package preparation has involved a participatory self-assessment and consultations. Five sub-national consultation workshops have been held followed by a national workshop for approval of the R-Package; and

- Carrying out the Social and Environmental Strategic Assessment (SESA) involved visits to forest-dependent villages in six provinces; facilitated consultations with stakeholders at the commune, district, provincial and national levels (including private sector entities and civil society groups); and robust quantitative socio-economic surveys of forest-dependent households.

Key Lessons

- In preparing for the FCPF C-Fund, the SESA process may take longer than expected because of the need to mobilize experts, and the need for broad stakeholder consultations and engagement; and
- Mobilizing international support is easier if all existing initiatives, funded through Official Development Assistance (ODA) and other sources, are coordinated. Good coordination among stakeholders at the national level is also essential.

Issue 5: The role of the private sector

The private sector is a very diverse stakeholder group. It includes entities that may be driving deforestation or forest degradation, companies seeking to demonstrate corporate social responsibility, carbon project developers, international and domestic banks and others. This diversity may confuse “engagement with the private sector”, but ultimately the scale of finance required for implementing REDD+ and reversing the trend of forest loss caused by companies mean that any national REDD+ programme will need to engage with the private sector.[3]

Bird Sanctuary at Prek Toal, Ream Reap province, Cambodia, taken in May 2014
Photo credit: Forestry Administration

Country Experience Box 5: Indonesia

- An analysis of fiscal incentives promoting oil palm production in Indonesia revealed that many current fiscal policies and instruments undercut the country’s GHG emission reduction goals by providing direct incentives to levels in the supply chain that are already highly profitable, and do not focus enough on the most important actors—smallholder producers— who need support to improve yields and livelihoods, while decreasing expansion into forests and peat lands.
- It is possible to bring greater coherence between policy objectives and public incentives, without strong negative side effects. In fact, some steps could increase yields, improve production standards, and provide stronger signals for sub-national governments to make decisions that support livelihoods and sound forest and peat land management simultaneously.
- Recently, several major palm oil companies have made a commitment to move towards producing zero-deforestation palm oil. This development follows a long period of engagement, through initiatives such as the Roundtable on Sustainable *Palm Oil* (*RSPO*) and the development of the *Indonesian Sustainable Palm Oil* Standard (*ISPO*).

Country Experience Box 6: Cambodia

- Cambodia has worked with the private sector through voluntary market projects since 2008. Based on their experiences, it is estimated that the process from project scoping to the issuance of verified credits takes four to five years, and costs from USD 1 to 1.2 million per project. This does not include legal service fees and other transaction costs. The Royal Government of Cambodia has had to rely on the assistance of NGOs and development partners to navigate through the process.

- Only 1.5% of available carbon credits yielded from the Oddar Meanchey project have been sold since market entry in 2010. Revenues from the sales currently remain in an **escrow account** *(see explanation on page 8)* in a US bank, in part because the Ministry of Economy and Finance is unsure whether to categorize carbon revenues as ODA, a grant, or some other type of revenue, and whether they are therefore subject to tax, or exempt.

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[3] http://www.unredd.net/index.php?view=document&alias=14584-un-redd-policy-brief-qfiscal-incentives-for-agricultural-commodity-production-options-to-forge-compatibility-with-reddq&category_slug=policy-brief-series-3154&layout=default&option=com_docman&Itemid=134

Key Lessons

- Establishing an effective partnership with private sector entities which may be driving deforestation or forest degradation (e.g. palm oil in Indonesia) can be a lengthy process. Therefore processes to build trust and engagement should begin early;
- Incentive systems for agricultural crops established by line ministries (e.g. agriculture) may have negative impacts on forests, and modification of such incentives could deliver substantial results while still delivering on their intended objectives. However, line ministries may defend their own programmes, so adequate engagement strategies and analytical work are required;
- Global banks (such as Credit Suisse) can play a positive role in a number of ways:[4]
    - ⇒ Reputational risk policies guide investments, and loans and other transactions can be declined, terminated or approved (with or without conditions);
    - ⇒ Sustainability risk management may determine, for example, that no financial services will be provided for operations in High Conservation Value (HCV) areas; and
    - ⇒ Green bonds may stimulate green investment, but these are only effective for relatively large-scale investment opportunities.
- Currently, producers of commodities entering supply chains, particularly in emerging markets, are not sufficiently incentivised (or not sufficiently dis-incentivised) by public policy to focus on increasing output by raising productivity, rather than by clearing more forest. Part of the problem is lack of strategic planning and capacity, leading to conflicting industry development and land conservation policies;
- Market mechanisms might evolve (e.g. higher oil palm sustainability standards from Europe), but overall commodity demand is not going to diminish pressure on forest ecosystems (e.g. higher palm oil demand in China, India, and other emerging economies). Therefore, we need clear and effective public policy and public expenditures that can leverage substantial private sector/corporate finance to move markets towards more sustainable operating models; and
- Voluntary market projects can be expensive and time-consuming to develop. Whether they can be integrated into national REDD+ programmes, e.g. as arrangements for “internationally transferred mitigation outcomes” (ITMO), remains to be seen as many countries currently struggle with the “nesting”[5].

Issue 6: Managing REDD+ Finance

The main financial management options are budget support, fund-based or project/market-based models. If transactions involving public financial resources are not subject to the same legislative approval process as the annual budget, they are outside the public budget and are therefore fund-based approaches or market-based approaches. To date, no REDD+ country has opted for budget support but created independent REDD+ funds or integrated REDD+ into existing funds.

Fund-based approaches have several advantages and disadvantages compared to other solutions. They allow the earmarking of REDD+ payments from other streams of funding and centralize fund raising, disbursement and monitoring and evaluation procedures. If a fund-based approach is selected, there are several options such as independent trust funds or funds managed by **public entities, sinking, revolving, endowment funds** *(see explanations of these terms on page 8)* or a combination of these. In the case of REDD+, where results-based payments are expected to be generated on a regular basis, a revolving fund modality could be envisaged with a first capitalization for investments in the form of a sinking fund.

Another decision is whether existing funds are suitable or new structures should be created. Issues that need to be considered are how to ensure coordination with relevant national policies and institutions, disbursement capacities, efficiency of procedures, and how effective the modalities are (e.g. earmarking, carry-overs, multi-year budgets, **ring-fencing,** *see explanation on page 8*). It also needs to be considered whether there is a sufficient legislative basis to incorporate REDD+ funds into existing funds (e.g. a protected-areas fund may only fund activities within protected areas; forest funds may not be able to fund large-scale reform processes in the broader land use sector).

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[4] *This information was based on a presentation made by Ben Ridley of Credit Suisse.*
[5] *“Nesting” is a term used to describe a process by which interventions at multiple levels (local, sub-national and/or national scales) are integrated, such that carbon accounting at each sub-national level “adds up” to provide a coherent national carbon account.*

Country Experience Box 7: Viet Nam

- Viet Nam began piloting Payment for forest environmental services (called "PFES" in Viet Nam) in two provinces in 2008. In 2010, the Government mandated the nationwide implementation of PFES. As part of the PFES process, the Vietnam Forest Protection and Development (VNFF) was established at national level under the Ministry of Agriculture and Rural Development and the Forest Protection and Development Funds (FPDF) were established at provincial level under the Provincial Department of Agriculture and Rural Development or the Provincial People's Committee. The National REDD+ Fund Scheme was approved by the MARD Minister as a sub-fund of the VNFF; and

- The National REDD+ Fund is initially expected to be managed by an international trustee while institutional capacities will be developed to nationalize the fund.

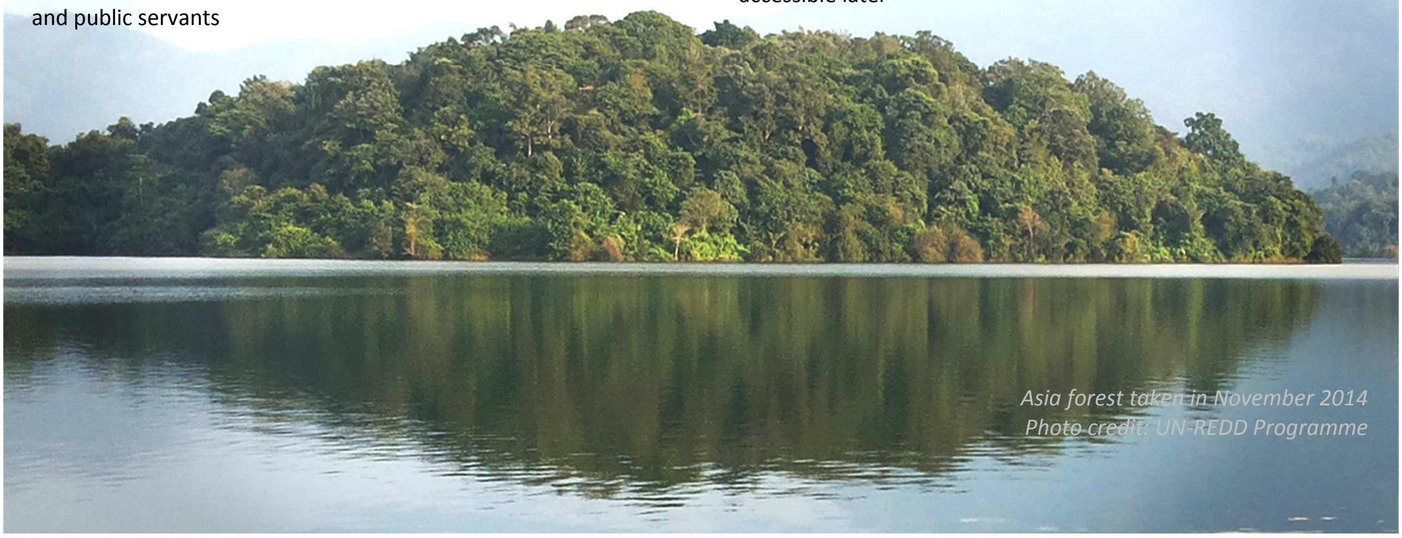
Key Lessons

- "Form follows function", so before developing any fund management model, countries must understand what PAMs they will be implementing and how they will be implemented (a strategy or investment plan is required). Several countries have embarked on fund design without understanding what kind of activities they will be implementing and without plans for capitalizing the fund. A robust theory of change behind the fund convinces donors to invest and the fund has to be robust for donors to use for their investments.
- In considering whether to establish a national REDD+ fund, broad consultations with line ministries and other stakeholders from an early stage are absolutely necessary. It may be valuable to establish a taskforce or similar body to manage this process. Support from NGOs and international organizations is also essential; and
- By engaging with line ministries at an early stage, it is easier to secure **seed funds** *(see explanation below)* from the national budget to cover costs during the initial years of operations.

Terms related to Finance

http://www.conservationfinance.org/guide/guide/index338.htm

- **Investment finance:** Finance that is used in order to generate some benefit – in this instance, results-based finance – in the future
- **Ex-ante:** Latin term, meaning "before the event". Used to imply payments before results are known
- **Escrow account:** A bank account held by a third party on behalf of the other two parties in a transaction. Its purpose is to confirm that the finances are in place, but to prevent use of the funds until certain conditions are met
- **Public entity:** An organisation that is established to serve a public function, but which operates with some autonomy from ministers and public servants
- **Sinking funds:** A fund established in which the initial capital investment is not replenished, so that as expenditures are made, the amount of capital in the fund decreases
- **Revolving funds:** A fund in which there are periodic re-investments of capital which approximately match expenditures, so that the total amount of capital in the fund remains stable
- **Endowment funds:** A fund in which expenditures are limited to the amounts generated by investments of the capital
- **Ring-fencing:** A process by which incoming funds from one source are financially separated from other sources, and managed separately
- **Seed funds:** Small amount of funding intended to be used to create conditions under which much more funding will become accessible later



Asia forest taken in November 2014
Photo credit: UN-REDD Programme

UN-REDD PROGRAMME

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