

Accelerating Transfers of Interim Finance for REDD+: **Building Absorptive Capacity**

A report for UK DFID

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Summary

The objective of interim finance for REDD+¹ is to reduce emissions and enhance removals of greenhouse gases in relation to forests in the shortest possible timeframe. Therefore, interim finance for REDD+ will only be useful if it can be used efficiently and effectively by Rainforest Nations to achieve this objective. This will be strongly influenced by the capacity of each country to acquire and use any available resources effectively, sometimes termed their absorptive capacity. This in turn has major implications for the design of an interim finance mechanism.

1. **Country-level capacity:** There are significant differences between the capacity of different Rainforest Nations to acquire and use financial resources for REDD+. While some are likely to be able to access funds from a variety of sources, whether public or private sector, relatively easily, others are much less able to do so. Similarly, there are significantly different levels of capacity to implement the measures required to achieve REDD+ (readiness). This means that some countries are likely to be able to move relatively quickly to a point where significant national-level emission reductions can be achieved while for others this will take much longer to achieve. This has two immediate implications for any financing mechanism:

To be effective, the delivery mechanism for interim finance will need to be appropriate for significantly different country situations. This is likely to require a variety of delivery options rather than a single approach.

Many Rainforest Nations are unlikely to be able to benefit from national-level performance-based payments (either as part of an interim finance mechanism or under a longer-term climate agreement) without a period of sustained and effective capacity building. This should therefore be a main pillar of any interim finance strategy.

2. **Multiple drivers:** A further complication is that there are many different drivers which contribute to forest degradation and loss each of which has its own institutions, actors, potential mitigation activities and incentive structures. Some drivers are highly subject to international leakage (eg agricultural commodities, industrial logging), while others are not (eg subsistence agriculture). Some mitigation activities are potentially economically viable in their own right (eg improved forest management) while others are not (eg reduced conversion for agriculture). Those involved in some drivers are well-organised with high levels of capacity to implement changes, while those involved in other drivers are disorganised and lack even basic capacity for implementation. Therefore, each driver requires different policies and measures and will need to involve a different suite of actors in successful mitigation.

¹ REDD+ is used to refer to the full suit of forest activities including not just reduced emissions from deforestation and degradation (REDD) but also conservation of existing stocks (SFM) and enhancement of removals (afforestation/reforestation).

To be effective, the delivery mechanism for interim finance will need to be designed to achieve effective engagement with the whole range of drivers and potential mitigation activities. This has a number of implications discussed below.

3. **Build on experience:** Efforts to reduce forest degradation and loss are not new. Many of the potential activities that will contribute to REDD+ (eg improved governance, better logging practices, increased efficiency of smallholder production, establishment of protected areas) are already being pursued in many countries. Some of these efforts have been successful, but many have not and though lack of financial incentives has been one of the causes, it is not the only one. Other factors, and particularly a lack of capacity, have also played an important role. The design of an interim finance mechanism needs to utilise this experience to avoid repeating failures and to build on successes.

Current REDD+ efforts should build on the experience of what has and what has not worked in the past and the reasons behind this. A rapid, practical and comprehensive review for each major driver could provide an excellent basis to be used in designing the interim finance mechanism.

4. **Involve a wide range of actors:** In order to overcome capacity constraints as efficiently as possible, and to engage with the whole suite of stakeholders involved with the variety of drivers, a wide range of organisations should be involved in implementing REDD+. National governments have an important role to play in co-ordinating national strategy, but implementation of measures and programmes will need to involve, *inter alia*, local governments, non-profit organisations, the private sector, indigenous peoples and forest communities.

Any finance mechanism for REDD+ should be designed to encourage the involvement of the widest possible range of organisations and stakeholder groups in implementing REDD+.

5. **Finance aimed at different scales:** Development and implementation of a national REDD+ strategy must be a cornerstone of the approach for any country. However, for many of the activities required to address particular drivers there are strong international links and it will also be important to have international programmes to encourage networking and collaboration (eg agricultural commodities). At the same time, particularly in countries where there are constraints to rapid progress at a national level, it is important to support activities at a local level which can help to build a critical mass of activities from the bottom up.

REDD+ financing should be provided at a variety of scales. This should include national-level funding mechanisms, support for international programmes and mechanisms to fund local activities (potentially including performance-based payments for local projects or programmes prior to a national system being in place).

6. **Scale up capacity-building at all levels:** Lack of knowledge, understanding and capacity is likely to be a major barrier at many levels for many countries. There is

an urgent need to build capacity rapidly. There are already a variety of efforts to do this, including proactive approaches from the non-profit sector as well as governments and donors.

Training and capacity building should be a major and ongoing component of any interim REDD+ financing mechanism. This should ensure that emerging experience is shared as well as basic information, and is one of the activities where international programmes should run in parallel with national approaches.

7. **Innovation and leadership:** It is extremely unlikely that REDD+ will succeed simply by trying to scale up existing programmes and approaches. While this is important, there will also need to be new and innovative approaches if changes on the scale required are to be achieved. In general, innovation requires imaginative leadership and flexibility. While it is not possible to create leaders, it is crucial to support possible solutions as they emerge.

The interim finance mechanism should include flexible provisions to encourage and support new and innovative approaches and avoid focusing only on existing approaches.

8. **Financing architecture:** The financing architecture can itself become a barrier to progress if it is inappropriate. Firstly, the capacity of institutions within the funding chain to disburse, as well as receive, funding is fundamental. In practice, however, many institutions, both governments and multilateral finance institutions can be very slow and bureaucratic. A realistic assessment needs to be made of the distributive capacity of any entity in the chain. Secondly, the transfer process for funds (application, screening, approval, monitoring etc) can be very onerous and discourage or discriminate against groups (or even countries) lacking capacity. This can be addressed by a focus on the level of materiality which requires the transfer process to be appropriate to the level of risk. For smaller sums, a focus on accountability and transparency of the recipient may be more appropriate than complex bureaucracy. Institutions able to use this approach need to be found and utilised.

Interim REDD+ financing, particularly prior to payment based on national performance, should utilise a range of different institutions to ensure that finance can be efficiently and effectively supplied to a range of different end-users. In addition to multilateral and national development banks this could include private banks, non-governmental organisations and private sector organisations.

9. **Incentives for progress to performance-based payments:** It is clear that some countries will be able to move more quickly towards performance-based payments than others. It is very important that the funding mechanism is designed to provide support to the countries which progress more slowly. However, it may also be useful to consider incentive mechanisms to encourage countries to progress from cost-based to performance-based payments. One approach to doing this, if performance-based payments are made to individual

projects or programmes within a country, is to link the two. For example, there could be a link between the proportion of performance-based and cost-based funding provided with a gradual defined decrease in the proportion of cost-based funds. Alternatively, cost-based funding could be provided as a supplement attached to performance-based payments.

While it is essential to have adequate cost-based funding to support progress in countries with capacity constraints, it may be useful to provide incentives to progress to performance-based payments by linking the proportion of cost and performance based funding which is paid.

Background

In March 2009, a report commissioned by the Government of Norway (referred here as the 'Meridian Report'²) was published to contribute to the policy development process related to the inclusion of a mechanism for reducing emissions from deforestation and forest degradation (REDD) in a post-2012 regime under the UNFCCC (UN Framework Convention on Climate Change).

Using this report as a starting point, a series of practical implementation points have been identified that requires further work. In particular, two of the areas requiring greater attention are the issues of the absorptive capacity of the Rainforest Nations to utilise any additional funding raised, and the issue of opportunities for early market involvement³. This is one of two reports commissioned by the UK's Department for International Development (DFID) to provide further input on these topics⁴.

1. Absorptive capacity

The main objective of interim financing for REDD+ is to begin achieving reductions in emissions and enhancements of removals of GHGs in relation to forests in a timeframe of months and years rather than decades. If this objective is to be achieved, then it is crucial not only to raise adequate financing but also to ensure that it can be effectively utilised.

There are numerous examples of similar attempts by the international community to raise and utilise finance in response to particular issues ranging from poverty alleviation to protection of biodiversity. In some cases this has been very successful, but there are many others examples where it has at best only partially succeeded and at worst failed entirely. There are many reasons for lack of success, but a key one, particularly where the recipient countries are poor (which is the case for many rainforest nations) has been a lack of absorptive capacity. Therefore, it is crucial to understand what implications this is likely to have for the success of interim financing for REDD+.

² Angelsen A., Brown S., Loisel C., Peskett L., Streck C., and Zarin D., 2009. Reducing emissions from deforestation and forest degradation (REDD): An options assessment report. Prepared for The Government of Norway. Meridian Institute, March 2009.

³ It is important to note that there are a number of other implementation issues which are equally important in achieving the objectives of interim finance for REDD+ including environmental and social issues, equity and resource tenure rights. These are being considered in a number of fora and are not the focus of this paper.

⁴ The other report being: "Accelerating transfers of interim finance for REDD+: Options for early market involvement, by Moura Costa P. and Nussbaum R., ProForest report to DFID, August 2009."

The absorptive capacity of a country, an organisation, or a programme is its ability to receive and utilise resources. For financing for REDD+ there are two aspects of absorptive capacity which are important:

- The capacity to plan and implement activities: if there is no capacity to plan and undertake mitigation activities then, however much finance is available, nothing will happen.
- The ability to get available finance to potential end users: if finance does not move from the source of funding to the end users, they will be unable to undertake the activities for which the finance was intended.

For both interim and long term financing for REDD+ to be effective, both of these potential constraints to absorptive capacity must be understood and addressed. Each is discussed in more detail below.

In considering each of these two aspects it is also necessary to consider the implications of the main objective for interim financing – to achieve results quickly. To do this it is necessary to address both of these aspects in a way which is both efficient and effective. Efficiency is essential in order to act quickly. Any delay in disbursing and using funds will seriously undermine the objective. Effectiveness is essential in achieving results. It is not sufficient simply to disburse and use funds rapidly. It is also essential that they are used for activities which contribute to the objective of reducing emissions or enhancing removals of GHGs from forests.

In many cases there is likely to be a significant tension between efficiency and effectiveness. For example, it would be easy to establish a mechanism where funds could be very quickly disbursed and spent if there were minimal requirements on how it was used, but the application of such funds would be unlikely to generate very effective results. On the other hand, an approach which seeks to ensure that every funded activity is highly effective may be very slow, complex and inefficient. The optimum balance between effectiveness and efficiency needs to be found for each country and at each stage in the process which will almost certainly mean finding appropriate compromises.

1.1. Factors influencing ability to implement measures

In identifying factors likely to influence the ability of countries to implement the measures required for REDD+, information was drawn from the literature on absorptive capacity for development aid, together with experiences from existing programmes and projects which impact on forests. This analysis suggests that a number of factors are likely constraints for effective and efficient use of interim and longer-term financing for REDD+.

These include constraints at both the national level and at the level of implementation of specific activities on the ground. The latter is particularly important to consider in the case of REDD+ because of the range of different drivers which are involved in forest degradation and loss as discussed in Section 2.2.

Institutional constraints: At a national level, lack of effective institutions to develop coordinated strategies, poor transparency and efficiency of budget systems, patterns

of public expenditure, the degree of decentralisation of resources and responsibilities, mechanisms to define policy priorities and accountability systems to hold governments responsible for performance have all been identified as influencing absorptive capacity. Lack of institutional capacity can range from a complete lack of important institutions to poor functioning of existing institutions

due to inadequate resources or to inadequate institutional culture. Problems can be compounded if there are also competing external demands to commit the limited available resources to different policy areas (see Box).

At the level of implementation on the ground, experience from forestry, agriculture and rural livelihoods projects indicate that lack of capable local institutions and organisations to run or support programmes or initiatives are a key constraint.

Human capital: Lack of technical and managerial personnel is a major barrier to absorptive capacity. Everything from developing government policy to managing funds to implementing projects and programmes requires competent staff. At a national level the governments of poor countries often have problems recruiting, training and retaining qualified staff.

At a field level, it is often difficult to attract competent, well-trained people, who generally have a choice of jobs, to choose to live and work in forests, or on forest-agriculture frontiers which are almost always remote and lack basic infrastructure such as schools, hospitals and cultural activities.

At the other end of the spectrum, particular successes can often be attributed, at least in part, to good and effective leadership where the efforts and vision of a particular individual or organisation (or a combination) are crucial in making progress.

Political will: Lack of political will or political coherence is a serious constraint to effective and efficient implementation. It may exist for a number of reasons ranging from active opposition to a particular measure to lack of capacity to engage.

In many cases the situation is very complex with support at some levels or from some parts of government and opposition or lack of engagement from others. In practice, experience over the last

Example: Competing objectives and lack of personnel – an example from FLEGT

There is a widespread consensus that improving forest governance is a key issue for effective REDD+ strategies in many countries. Yet there is growing anecdotal evidence from people involved in the FLEGT process, both within the EU (EC and various MS governments) and from partner countries, that the current focus on REDD+ is, in some cases, reducing both the political commitment and the availability of key personnel to work on forest governance issues.

Example: Importance of political will

In Brazil political will at both state level (eg Amazonas) and at national level has resulted in a significant decrease in rates of forest loss. Conversely in Indonesia, lack of political at the sub-national level in some provinces and districts has resulted in continued forest loss even with support at a national level.

three decades with a series of development aid-funded programmes and initiatives aimed at improving forest management and reducing forest loss indicates that progress is much less efficient and effective if political will is lacking, whereas rapid progress can be made where there is genuine political will.

Levels of finance received: in the case of development aid there is a growing body of research which indicates that if aid exceeds a certain level in relation to GDP, it ceases to be effective and can even be counter-productive (see Box 1.1 below). One aspect of this discussion, which has immediate relevance, is that the way in which aid is delivered (budgetary support, technical support, project support) and the institution via which it is delivered (government, private sector, NGO) has been shown to impact on its effectiveness.

The implications of absorptive capacity and ability to implement the measures required to achieve REDD+ are discussed in Section 2.

Box 1.1: Development aid, resource rents and absorptive capacity

There have been a number of studies which looked at the level at which increasing the flow of resources from development aid ceases to be effective in contributing to further growth. Different studies have estimated that this occurs when aid reaches anywhere between 15% and 45% of GDP^{5,6} and suggest that beyond this level, aid may not only be less effective, but can in fact be harmful, undermining the national economy and resulting in declining levels of governance.

Undermining economy: This may occur because significant levels of aid in the form of foreign currency could provoke a 'Dutch disease' effect; because aid flows are often unpredictable and volatile, and so can negatively influence macroeconomic stability, by triggering inflation and interest-rate and exchange-rate volatility; because aid increases can cause labour market pressures, by increasing demand for skilled labour and driving up wages.

Impact on governance: This may occur because high (and increasing) levels of aid dependency can provide negative incentives for much needed reforms, and shift government accountability from domestic to international actors.

By comparison, an analysis of the impacts of resource rents from oil on growth in poor countries suggests that they cease to be effective at an even lower level, i.e. 8% of GDP. The study suggests that this is because, in addition to the factors discussed above, rents are likely to be entirely captured by elite government and business interests and have negative effects on governance, while aid can be targeted in diverse ways, including towards technical assistance, projects, conditional funding packages and debt relief².

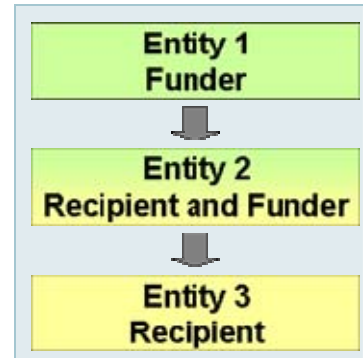
⁵ From ODI (2005) *Scaling up versus absorptive capacity: Challenges and opportunities for meeting the MDGs in Africa*. <http://www.odi.org.uk/resources/download/1369.pdf>

⁶ Cited in Collier (2005) *Is Aid Oil?* <http://users.ox.ac.uk/~econpco/research/pdfs/Is-Aid-Oil.pdf>

1.2. Factors influencing flow of finance to end-users

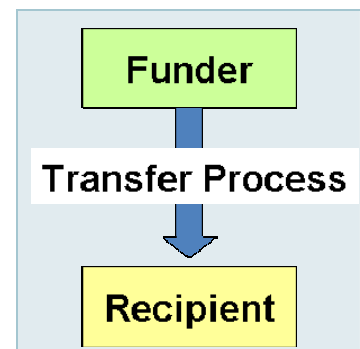
The second aspect of absorptive capacity is the efficiency and effectiveness of the funding architecture used, in particular;

Distributive capacity: Absorptive capacity is likely to be directly linked to distributive capacity. In general, the receipt and distribution of funding involves a chain so that the entity that receives funds will itself have to reallocate resources to the next stage down the chain thus becoming a distributor. Therefore, it is not only the ability of an entity to receive funding which is crucial, but also its ability to redistribute efficiently and effectively.



This in turn has important consequences for the model used to channel funding from the original donors through to the final recipients. In particular it is crucial to consider not just the ability of any entity in the chain to receive funding, but also its ability to redistribute effectively – the two together make up the overall absorptive capacity. This is the case whether the entity in question is a government department reallocating resources to various programmes and agencies, a regional or national development bank acting as a central point for funding, or an NGO providing payments to communities. Therefore, it is very important to understand the full suite of a country's existing funding mechanisms in order to identify the most appropriate agency(ies) to handle any particular type of task.

Transfer process: The ability of a recipient, whether a country or an institution, to 'absorb' funds is highly dependent on the interaction with the entity that distributes funds and, in particular, on the interface between the two. This transfer process, including the procedures for application, screening, approval or rejection and disbursement of funding, needs to be accessible, efficient and as straightforward as possible.



In ensuring that any early REDD+ financing mechanism is both efficient and effective it will be crucial to develop appropriate transfer processes at each stage in the financing chain. If it is too onerous or bureaucratic, it can become a major barrier to entry and create very high transaction costs. This not only creates inefficiency but may also exclude many relevant actors from involvement reducing effectiveness. Conversely, if it is too weak, there is a risk that money is disbursed ineffectively thus undermining the objectives of the funding. In developing appropriate transfer processes, it is important that there is consideration of the **level of materiality** of the requirements based on the level of funding being requested and provided (see Box 1.2).

In many cases, it has proved much more effective, particularly for smaller amounts of money, to focus on requiring accountability and transparency as the funds are spent, rather than onerous requirements at the application stage and this may be appropriate for interim finance.

Box 1.2: Level of materiality

It is very important to apply the right level of conditions to different levels of risk. Where sums are large and thus the risk associated with the funding not being used effectively is significant, it is appropriate to have correspondingly serious conditions of transfer for funds. On the other hand, where sums are small the risk associated with ineffective use of the funds is also small and it is appropriate to have correspondingly less onerous conditions.

For example, if a government department is applying for several million € to build its technical capacity for MRV it is perfectly appropriate to require substantive information justifying the need for funding and elaborating how it will be spent and to have detailed and legally binding conditions associated with its disbursement. An organisation which cannot respond to these requirements is unlikely to be able to use large sums of money effectively. On the other hand, if a small community organisation or NGO is seeking funding of a few thousand € to pay a salary for a year or organise some training, it could be a serious barrier to entry to require exhaustive information or demand complex contracts – particularly in initial phases when such organisations are likely to lack capacity. Therefore, it is important to design a process which is as simple as possible to encourage a wide range of organisations to become involved since the risk, even if the funding is not used effectively by several of the recipients, is small and accept that in a few cases funds will be used ineffectively – but that this is likely to be more effective than not using funds at all.

2. Capacity to implement REDD+ measures

There are significant differences between the relative abilities of different rainforest countries to engage with REDD+ which have implications for the design and implementation of the interim finance mechanism. This section addresses:

- The generic absorptive capacity of rainforest countries to obtain & use funding;
- The potential readiness of different countries to engage with REDD+ activities (and different phases of proposed REDD+ strategy – see Box 2.1);
- The potential for different countries to contribute their own resources to tackle REDD+.

Box 2.1: Proposed phases of REDD+

It is being proposed that progress on REDD+ in each rainforest country will involve three phases:

Phase 1: Initial REDD+ readiness, comprising REDD+ strategy preparation through an inclusive multi-stakeholder consultation process, and initial investments in MRV capabilities;

Phase 2: Implementation of enabling policies and measures according to the REDD+ strategy leading to emissions reductions verifiable through proxy-based indicators. This would include two different but complementary aspects of strategy implementation:

- **Phase 2a:** Payment on the basis of budgetary cost for enabling policies and measures (eg institution and capability building, development of legal frameworks and law enforcement capabilities, land tenure and forest governance reforms and MRV capacity);
- **Phase 2b:** Payments for performance against proxies (simplified methodologies) for implementation of policies and measures which deliver substantive emission reductions.

Phase 3: Participation in the UNFCCC compliance system (whether offsets, funds or other mechanism) enabled by IPCC-compliant MRV systems.

2.1. National level factors

It is clear that there are major differences in the absorptive capacity of different rainforest nations and also in their ability to attract different types of finance. In order to examine this further, a brief review was carried out based on two sets of factors that are likely to impact the ability to attract and utilise finance:

- Macroeconomic circumstances (eg FDI, ODA as % of GDP, DFID fiduciary risk assessment, sovereign/capital risk ratings);
- Governance indicators including both generic indices and forest-specific indicators (eg World Bank Governance Indicators, Transparency International Corruption Perception Index (CI CPI), forest governance capacity, historical and recent levels of forest loss).

There are other issues which may have an impact on the ability of countries to engage quickly and effectively with REDD+, such as the need to address land tenure (see Case Study 1). However, the analysis provided a basis for making some broad generalisations. It indicated that four groups of countries can be identified summarised in the table and discussed further below.

Group	Description
A	Countries which have access to international finance or substantial domestic investment, reasonable institutional capacity to absorb (manage and utilise) funds and have demonstrated the capacity and/or political will and coherence to make progress on achieving emission reductions or enhanced removals.
B	Countries which have access to international finance or substantial domestic investment, reasonable capacity to absorb funds at the national level, but face substantial institutional or cultural challenges to changing behaviour in the forest sector, and have not demonstrated the capacity and/or political coherence to make progress on emission reductions.
C	Countries which do not currently have access to international finance or domestic investment for the forest or agricultural sectors, but do have some capacity to absorb (manage and disburse) public funds, and have demonstrated some capacity and/or political will to address issues related to forest loss.
D	Countries which do not currently have access to international finance or domestic investment for the forest or agricultural sectors, do not appear to have the capacity to absorb (manage or disburse) funds, and have not demonstrated the capacity and/or political will to address issues related to forest loss.

While there are significant variations between countries even within one group, nevertheless it is possible to make some broad assumptions about each of the four groups:

Group A countries already have a considerable capacity to obtain and use funding through existing institutions and programmes, though these may need to be strengthened or scaled up to deliver emission reductions on the scale required. These countries have mostly already begun to achieve reductions in emissions or enhancement of removals (either directly in response to the current climate debate or due to other factors) and are likely to move quickly through Phases 1 and 2a of the proposed REDD+ strategy. Most will have the capacity to invest their own resources at an early stage provided that they see a reason for doing so.

Group B countries have capacity to obtain and utilise funding through existing institutions and programmes, but have not yet begun to achieve emission reductions or enhancement of removals, perhaps due to policy inconsistencies or lack of political will at some level. These countries are likely to remain in Phase 2a longer than necessary unless strategies are found to overcome the barriers to progress. They may have the capacity to invest their own resources at an early stage, but again political will is crucial.

Group C countries have less capacity to obtain and utilise funding through existing institutions and programmes but have demonstrated political commitment to make

progress. These countries are likely to remain in Phases 1 and 2a for a considerable period unless implementation capacity can be improved rapidly. This may require a combination of providing support to existing institutions, creating new organisations and programmes and identifying innovative ways to rapidly increase capacity. These countries are less likely to have their own resources available to contribute in the early stages, though this may vary between sectors (discussed further in Section 2.2).

Group D countries have neither the capacity to attract and utilise funds nor the capacity to engage very actively with the REDD+ process in the short term. In these countries it will take time to develop capacity both within and outside government. For those which currently have high forest cover and low rates of forest loss, in order to avoid international leakage, it may be necessary to consider novel mechanisms for providing incentives not to accelerate rates of forest loss while greater capacity is developed.

In summary, the analysis indicates that there will be significant differences between different rainforest countries with relation to generic absorptive capacity, readiness to engage and make progress and ability to contribute their own resources.

- **Generic absorptive capacity to obtain and use finance:** Group A and B countries have reasonable absorptive capacity to both attract and use finance, whether from the public or private sector, which may need only minimal additional support. Group C countries are likely to have limited capacity which will require substantial additional support if these countries are to be able to obtain and use finance. In particular, these countries are much less likely to be able to access private sector finance if it becomes available unless they are provided with specific support for doing this. Group D countries have little or no capacity so it will largely have to be developed from scratch and innovative approaches may be needed;
- **The potential readiness of different countries to engage with REDD+ activities (and different phases of proposed REDD+ strategy):** Countries in groups A, B and C are all likely to be able to engage actively with Phase 1 of REDD+ and move into Phase 2a. Countries in groups A and B also have the capacity to transition from Phase 2a to Phase 2b relatively quickly, though for countries in group B lack of political coherence may slow this process at a national level. For group C countries, the lack of capacity to implement activities has the potential to be a significant barrier to the transition from Phase 2a to 2b (and therefore to be ready for Phase 3) and should be a major focus of interim finance. Group D countries are unlikely to have the internal capacity to engage very actively in the short term.
- **The potential for different countries to contribute their own resources to tackle REDD:** As with readiness, Group A countries are likely to be able to contribute their own resources to tackle REDD+ based on the availability of reliable *ex-post* payments quickly (or are already doing so as in the case of countries like Brazil and Ecuador). Group B countries probably also have the potential but may not yet have the political will or coherence to do this. Group C countries are less likely to be able to accelerate activities based on their own

resources in the short term, though this may vary by sector (this is discussed further in Section 2.2)

It is clear from the discussion above that the strategy developed for interim REDD+ financing will need to vary depending on the country. However, there is a further issue which is also important and needs to be considered relating to the range of drivers of forest loss. This is discussed in the next section.

2.2. Different drivers of forest loss

It is not only national differences between rainforest countries which will impact absorptive capacity, but also complexity within each country because of the diversity of activities or drivers which contribute to forest degradation and loss⁷. These drivers, several of which are likely to be relevant in any country, can be grouped into five main types:

- Commercial forest exploitation – harvesting of products from the forest, both legally and illegally, for sale, either domestically or internationally. This can range in scale from individuals harvesting firewood or single trees to large-scale industrial logging.
- Conversion to commercial agriculture – transformation of forest, both legally and illegally, for production of agricultural products to be sold domestically or internationally. This can range in scale from small-scale family farms to large plantations or agri-business.
- Subsistence use – harvesting or conversion of forest for subsistence use by poor rural communities. The impact of subsistence use on the forest can range from negligible where population pressure is low and/or uses have a low impact on the forest to very significant where population pressure is high and/or activities have a major impact on the forest.
- Infrastructure development – replacement of forest by infrastructure such as roads, settlements, mining or pipelines.
- Natural disasters and accidents – particularly loss of forest due to fire (many other natural disasters cannot be controlled).

The type and combination of drivers varies both geographically within the country and over time. For instance, while expansion of subsistence agriculture may be a

⁷ Meridian Institute (2009) Reducing Emissions for Deforestation and Forest Degradation (REDD): An Options Assessment Report. Prepared for the Government of Norway. Available from www.redd-oar.org;

Chomitz, Buys, De Luca, Thomas and Wertz-Kamounnikoff (2007) At Loggerheads? Agricultural Expansion, Poverty Reduction and Environment in Tropical Forests. World Bank.

Hoare, Legge, Nussbaum and Saunders (2008) Estimating the cost of building capacity in rainforest nations to allow them to participate in a global REDD+ mechanism. Chatham House and ProForest. Available from www.proforest.net.

major driver in one region of a country, conversion of forests for commercial agriculture may be the most important driver in the neighbouring region. Furthermore, while commercial logging may be the most significant driver currently, next year it could have been replaced by subsistence farming or conversion to commercial agriculture.

Each type of driver has different impacts on the forest, involves different actors (government departments, companies, communities, NGOs, research organisation, markets etc.) and will need to be addressed by different mitigation strategies, each of which in turn has different potential to attract finance and different costs. Furthermore, while some are not particularly prone to international leakage (eg subsistence use), others can and do migrate rapidly between countries and continents (industrial logging, large-scale agriculture, mining etc)

As with the differences between countries, the differences between drivers has significant implications for strategies for achieving REDD+.

- **Driver-specific absorptive capacity to obtain and use finance:** there are two related issues which need to be considered:
 - There are likely to be significant differences in the capacity of different types of driver to obtain funding and to use funding. Thus, even in group A and B countries, some drivers may have weak capacity to attract or use funds (for example subsistence users) and may not make progress unless this is recognised and addressed. Conversely, in group C countries there may be some drivers which already have significant potential both to attract and use funds.
 - Closely related to the ability to obtain and use finance is the interest in doing so. Different drivers probably require different levels and types of incentive over different time periods in order to change behaviour. For example, there are unlikely to be significant cultural or economic barriers to persuading commercial timber concession-holders to change from destructive to sustainable logging practices on the basis of modest additional payments. However, there may be significant cultural resistance from rural subsistence farmers to changing their behaviour requiring time to achieve significant progress, while there may be significant economic barriers to engaging agribusiness on the basis of modest payments.
- **The potential readiness within a country to engage with REDD+ activities (and different phases of proposed REDD+ strategy):** The complexity of different drivers has a number of implications:
 - The large number of drivers means that a corresponding large number of national and local government departments and national and local policies and programmes impact on or are impacted by REDD+. As a result, there is great potential for a lack of policy cohesion between different parts of government dealing with different sectors, either due to lack of capacity in government or due to differing levels of political will in different departments. As a result, there may be good progress in some sectors and

little or none in others. This has very clear implications for making progress to the proposed Phase 2b where it is envisaged that payments will be made based on national emissions reductions. This is probably the main challenge in group B countries and may become an issue in other countries as well.

- The culture and ability to change practices varies both between types of driver and within each group of drivers. One example is agricultural intensification where large-scale agricultural producers in many rainforest nations have already begun adopting measures to increase productivity, whereas the smallholder agricultural sector changes more slowly. As a result, the point at which these different drivers begin to contribute to achievement of the overall REDD+ strategy for a country is likely to be very variable even if efforts to address them begin simultaneously.
- The proposed phased approach includes, as part of Phase 1 'the development of a national REDD+ strategy through a comprehensive, transparent, multi-stakeholder consultation process that includes indigenous and forest peoples ...'. In practice, however, the sheer number of organisations, institutions and individuals associated with the range of drivers means that there are a very large number of stakeholders who have an interest in or need to be involved in REDD+, many of whom have extremely limited capacity to engage meaningfully with any kind of consultation process at this stage. Therefore, there needs to be an ongoing process to a) build the capacity to engage and b) to have mechanisms for ongoing consultation as more stakeholders are able to engage (Box 2.2).

Box 2.2: Stakeholder consultation: lessons from FLEGT

Stakeholder consultation in developing legality assurance systems is an important ambition of the FLEGT process. However, in most countries it has taken time for many stakeholder groups to develop sufficient understanding of, and engagement with the process to become fully involved. However, meaningful involvement of civil society has been greatly accelerated by providing ongoing training and capacity building for NGOs (provided by organisations such as Fern and IUCN). Several commentators have suggested that creating a process which fosters genuine engagement of a wide range of different stakeholder groups, while still functioning imperfectly, has nevertheless been one of the early successes of FLEGT VPAs, and that this was achieved by keeping a constant focus on the issue, and providing ongoing capacity building.

- **The potential for different sectors to contribute their own resources to tackle REDD:** Even in countries which make rapid progress to Phase 2b nationally, there may be some sectors where there is limited interest or ability from either government or the actors involved in implementing activities. In this case, the payments being made would be for emission reductions achieved by tackling other drivers. The potential implications of this situation – where progress is made based on tackling some drivers but not others – needs to be further analysed to understand the long-term implications for REDD+. Conversely, even in countries which are not ready to move to Phase 2b

nationally, there may be some drivers where government is already investing its own money (or development aid money) for other reasons such as poverty alleviation, improved governance or a more efficient agriculture sector or where there is significant potential for private sector investment (eg sustainable management of forests).

2.3. Discussion and recommendations

The discussion above raises some key points relevant to an interim financing strategy.

Raising funds versus using funds: so far initiatives focused on urgent short-term actions have focused mainly on how to raise finance quickly, together with some consideration of the financial architecture for disbursement (discussed in the next section). However, the analysis above indicates that even if finance is raised, it may fail to make an impact in many rainforest countries because there is inadequate absorptive capacity to access and use funds quickly and effectively. This needs to be urgently addressed through building on experience from existing programmes and initiatives and developing new and novel approaches.

Urgent consideration must be given (on at least the scale of the current consideration of how to raise finance) on the question of how to ensure that all rainforest nations are able to access and use the finance effectively.

Avoiding international leakage: There is a serious risk of both interim and longer-term finance resulting in international leakage if progress with REDD+ is made unevenly. There are two situations where this may occur. Firstly, if some countries make progress and others do not then mobile drivers are likely to move to the countries where there is less progress. This reinforces the importance of finding strategies that ensure that progress is made in all countries. Secondly, it may still occur even if all countries are engaged if several only address some drivers initially. This is particularly important because at least one of the drivers most likely to move between countries – conversion to large-scale commodity agriculture – is also a driver with high opportunity costs which may not respond to low level financial incentives and so may be ignored by a country while other, cheaper options are pursued.

In considering financing options it is crucial to ensure that there is enough flexibility to ensure that all countries are engaged and all drivers are understood and monitored even if not actively addressed. This requires a reasonable understanding of the complexity being dealt with.

Channelling payments to projects and programmes as well as countries: The core of the interim REDD+ strategy being proposed is to encourage countries to move as quickly as possible through phases 1 and 2a where payment is made based on budgetary support for undertaking specific activities to phase 2b where payments are made to countries *ex post* for emission reductions achieved (probably measured using a simplified methodology relative to the final full IPCC requirements).

However, it is clear from the analysis of countries and drivers that some countries are much more likely to be successful at achieving overall emission reductions than others. For group A countries, guaranteed payment for carbon may be sufficient incentive to make progress nationally. However, in group B and group C countries there are likely to be significant barriers to national progress due to various absorptive capacity constraints, but there may be considerable sub-national variation with some drivers and some projects and programmes able to make progress. In this case, providing Phase 2b funding directly to individual projects or programmes (using appropriate methodologies to account for displacement and leakage) may be a very effective way to build capacity which can then gradually scale-up to a point where national progress is being made (this point also relates to the discussion of early market involvement and attracting risk or debt capital discussed further in Section 4).

Adopting an approach where performance-based payments (Phase 2b) are paid only on achievement of national emission reductions may be a serious barrier to progress for some countries. Allowing project or programme based payments initially may result in quicker overall progress nationally.

3. Financial architecture and disbursement capacity

In Section 1 the constraints to absorptive capacity related to the financial architecture itself were identified. The implications of this for any interim REDD+ financing mechanism are discussed in this section.

There are a number of possible ways to design a financial architecture for interim REDD+ payments. The analysis in Section 2 highlighted that there are significant differences both between countries and between different drivers within each country. This also has significance for the design of the architecture adopted by the interim finance mechanism. Whatever is adopted needs to recognise the variation both between and within countries and will need to be able to deliver financing efficiently and effectively to the entire spectrum of situations.

In order to be effective and efficient, as discussed in Section 1, there are two key considerations in relation to the organisations involved in the financing architecture:

- **Distributive capacity of organisations:** the ability of the fund-holder to distribute funds efficiently and effectively to users.
- **Transfer process required:** The appropriateness of the procedures for application, screening, approval or rejection and disbursement of funding.

Distributive capacity: For the interim finance mechanism it is particularly important that the institutions involved in disbursing funds are efficient as well as effective. Therefore, this should be a primary consideration in designing the architecture.

However, there are many examples of constraints in the distributive capacity of fund holders. This has applied to a variety of institutions ranging from the UN (the Global Environment Fund (GEF) was so inefficient at disbursing funds that it was broken into three funds) to governments themselves – both donors and recipients (see Box 3.1). There are many reasons for this, but important ones are the institutional culture and capacity of the organisation itself. This has the potential to be a significant barrier to the effective use of any interim finance if these issues are not considered.

In addition to the generic issue of poor distributive capacity there is an added complication for interim REDD+ finance. As discussed in Section 2, financing REDD+ will mean providing funds to a wide range of different countries and to a wide variety of different drivers in different sectors. Some financial institutions may be better at dealing with one type of country or one type of driver than others. This suggests that over-reliance on individual institutions, unless they have a proven track record of efficient and effective distributive capacity to a range of countries or, at country level, a range of drivers, is very risky.

It is also important that in designing the financial model there is an element of caution when drawing on examples of programmes which had a narrower focus and so had to deal with less variation in fund recipients.

Box 3.1. Case study: Inadequate distributive capacity

Small-scale mining in Ghana makes a significant contribution to national gold and diamond production and employs approximately 80,000 people. However, much of this activity is illegal and the environmental impact of mining causes serious land degradation and water pollution.

The Minerals Commission (MC) developed a strategy to regularise the sector and to reduce its negative environmental impacts. This included work to identify those areas suitable for small-scale mining, promotion of the creation of mining cooperatives, provision of technical and financial support to these cooperatives, and the promotion of alternative livelihood projects. However, the Ministry's performance reports for 2006 show that there was limited release of funds for this work (see table).

Table (from "Table 11: Implementation of Mineral's Commission programme of work, first quarter, 2006)

Programmed Activities	Budget Performance	
Identify & Investigate Areas for Small Scale Mining: Undertake geological investigation of areas identified for small scale mining	Planned	9,000,000,000
	Approved	9,000,000,000
	Released	23,010,750
	Expended	23,010,750
Alternative Livelihood Projects in Mining communities: Create alternative livelihood projects (Oil Palm pilot project)	Planned	14,961,573,000
	Approved	14,961,573,000
	Released	0
	Expended	0

Constraints on the release of these funds were reported as follows:

- Significant delays were experienced in trying to access funding from the Mineral Development Fund due to the complexities of tracking multiple funding sources combined with poor tracking capacity and lack of transparency within environmental agencies.
- The Ministry of Finance's practice of releasing funds on a monthly basis did not allow for effective planning, and was administratively cumbersome.
- Decisions over the release of funds by the Ministry of Finance appeared to be discretionary and further oversight on the release of approved budgets was identified as being needed.

The report's primary conclusion was that the top priority of development partners should be the promotion of improved governance structures, including removal of conflicting agency mandates and the funding of regulatory activities through an existing government-wide Consolidated Fund rather than internally generated funds (e.g. from external donors, etc.)

Source: Bird and Avoka (2007) Budget support, aid instruments and the environment: The country context. Ghana Case Study. ODI and CDD-Ghana. (http://www.odi.org.uk/cccf/resources/reports/s0166_ghana2.pdf)

Transfer process: To be efficient and effective it will be necessary to design a transfer process which delivers an acceptable level of effective utilisation of funds being spent while still being efficient.

In very simple terms, effectiveness requires that all those that should be receiving funds (because they will use them to enhance progress to REDD) are able to access them and all those that should not be receiving funds (because they won't use them to enhance progress to REDD) are not able to access them. In practice, the main focus of funders is often too much focused on the second of these with the result that funds are either not disbursed at all, or are disbursed only to the type of organisations able to go through complex application procedures and meet complex conditions.

For REDD+ interim financing it is important to make the transfer process sufficiently robust that there is not widespread misuse of funds received, but also to design mechanisms which are appropriate to the use envisaged and which treat the degree

of materiality appropriately. One way of doing this that is being increasingly widely adopted, particularly for smaller-scale funding is to have a relatively simple process and set of conditions, and to focus instead on accountability and transparency in the use of funding (see Box 3.2).

Box 3.2. Case Study: Using accountability and transparency instead of conditions

In 2006 two organisations – the Dutch Doen Foundation’s Oils programme and the GEF-IFC Biodiversity in Agricultural Commodities (BACP) programme – both announced funding for projects (in the \$50 – 200K range) to support greater sustainability in the soy and oil palm sectors

Doen developed an extremely simple set of objectives (1 side) and invited short applications in the applicant’s own format – but not to exceed 3-4 pages (plus a budget). However, they included quite strict requirements for provision of information on implementation and an independent financial audit of spending. The funding has now been used successfully for a whole range of projects and is widely recognised in the sector as having been very effective in supporting early activities and making a valuable contribution to progress over the last three years.

The BACP programme spent over a year developing a strategy document of about 50 pages and finally opened a first call for proposals 18 months late. The application forms are complex and require detailed information on links to the strategy document, breakdown of spending, indicators of success and other factors. To date the number of proposals received is less than anticipated, few projects have been approved, even fewer received funding and there has not yet been much impact on the ground.

Annex 1: Case Studies

This annex contains case studies compiled by the team to inform the content of the report.

- Case Study 1. Land and forest tenure: the need to balance urgency with legitimacy and effective process; 41
- Case Study 2. Agricultural intensification for subsistence producers: lessons from a successful approach in Africa 45
- Case Study 3. FLEGT Voluntary Partnership Agreements: An existing international programme addressing legality and governance issues in the forest sector. 47
- Case Study 4. Costa Rica: A case-study of an early REDD+ programme 51
- Case Study 5. The Montreal Fund: an example of a successful international fund to address an environmental issue (ozone depleting substances) 54
- Case Study 6. Demand for the products of deforestation: the importance of policy coherence between REDD+ and international demand-side drivers 58

Case Study 1: Land and Forest Resource Tenure (Connie McDermott)

The Meridian Report identifies land tenure and forest governance reforms as Phase II activities key to enabling countries to move to Phase III. This section begins by highlighting core issues related to forest and forest carbon tenure that are of relevance throughout Phases I-III. It then provides three regionally distinct case studies as illustrations relevant to the “absorptive capacity” of countries to implement tenure arrangements for REDD/+. A summary of lessons learned highlights implications regarding time frames, scales, and distribution of benefits.

Core issues

- Clear rights to land and forest resources, including forest carbon, are widely recognized as of central importance for incentivizing REDD+ or REDD+.
- Tenure rights determine who holds the power, and incentive, to protect forest carbon reserves, and who benefits from REDD/+.
- Tenure rights across the majority of the world’s tropical forests lack the clarity and legitimacy necessary to facilitate REDD/+
- Worldwide, the clearing and/or planting of trees is often both legally and customarily of central significance to land claims and, where rights are contested, a core driver of political and ethnic conflict.
- Governments have developed a wide diversity of legal frameworks that shape options for negotiating land tenure in any given country, but often lack both the capacity and the legitimacy to implement these frameworks.
- Various and dynamic ‘customary’ tenures overlap this formal law. Such rights are negotiated among local groups and individuals, in many cases along ethnic lines, involving a mix of local residents, migrants, and commercial interests.
- Customary law is often better understood by forest users than formal law, and carries greater legitimacy. It is key in shaping forest use.
- The introduction, via carbon markets, of new value to forest resources could quickly and dramatically change the current forest tenure dynamics and, without timely and appropriate action, inflame existing disputes.
- Tenure is intimately tied to overall governance and enforcement capacity. Tenure rights can be established “on paper” with relative ease, but the key to REDD+ performance objectives is its translation into practice.

Three Case Studies in Forest Tenure

The following three case studies highlight some key challenges and opportunities in each of the three major tropical forested regions. They illustrate how high capacity (e.g. Type A in

this report's typology) countries still face substantial hurdles to rapid tenure "fixes" (e.g. Brazil) while Type B & C countries (e.g. Indonesia, Tanzania) have some promising success stories but face substantial barriers in scaling up.

Southern Pará, Brazil

In Brazil, the state of Pará is second only to Mato Grosso in annual forest cover loss. Southern Pará covers roughly 49 million hectares, and has been a center of Amazonian land tenure disputes and violence. Speculation over land - including land already privately titled - and over agricultural credit, have been substantial drivers and enablers of deforestation. While registered land titling has favored large-scale land owners, politically well-organized and impoverished migrants -- sometimes with support from indebted land owners, mining companies, banks, and other actors—have utilized existing legal and customary avenues for land and credit speculation by clearing patches in public and/or privately owned forests.⁸ Should carbon markets become available and large landowners gain further incentive to 1) acquire large areas of land as quickly as possible and 2) exclude small-scale settlers, this could exacerbate political tensions, as well as displace migrants into further reaches of the Amazon. While legal policies and customary practices have often encouraged forest clearance, they also create major barriers for those seeking legal permission for sustainable forest management.⁹

Brazil's recent Emergency Measure 458/June 2009 has further influenced incentive structures by promising rapid transfer of tenure to an estimated 1 million forest settlers.¹⁰ While this approach matches the time-frame and scale necessary for rapid development of carbon markets, it runs the risk of accelerating land speculation and conflict. Major and sustained efforts to strengthen and sustain forest governance and policy will be critical to counter such perverse incentives.

Handei Village Forest Reserve, Tanzania

The majority of forest area in Tanzania is (on paper) publicly owned, and (in practice) characterized by insecure and disputed tenure arrangements, high incidence of fire, and competing pressure for resource extraction and development. As of the 2002 Forest Act, and in an effort to clarify tenure rights, Tanzania has codified two types of community tenure regimes: 1) community-government co-management agreements (Joint Forest Management (JFM)) and 2) village ownership (Community-based Forest Management (CBFM))

⁸ Fearnside, Philip. 2001. "Land-tenure issues as factors in environmental destruction in Brazilian Amazonia: The case of Southern Pará." *World Development* 29 (8):1361-71.

⁹ ITTO. 2006. "Status of Tropical Forest Management 2005." International Tropical Timber Organization.

¹⁰ Sabaja, Marco. 2009. "Brazil approves controversial land tenure law." Associated Press, June 26. <http://www.wtop.com/?nid=389&sid=1705660>

which are generally demarcated as part of general village land. According to a 2006 report, CBFM currently cover about 3 million hectares, or about 14% of the total forest area.¹¹

The *Kyoto: Think Global, Act Local* Project has supported members of the CBFM Handei Village Forest Reserve in monitoring the forest carbon impacts of village ownership. The 156 ha Handei Village Forest Reserve, established in 1996, serves as a buffer zone to a neighboring protected area, and allows timber harvest and other extractive activities subject to village by-laws. The village-based monitoring efforts have succeeded in quantifying positive carbon impacts of communal management (totaling 780 tons CO₂/yr) in a manner believed to be suitable for future carbon credit compensation.¹² While such evidence is encouraging for the inclusion of communal tenure in carbon finance, there are caveats to consider. These include: 1) how such success stories might translate to relatively remote areas where village customary rights are less clear, and 2) the impacts of monetizing carbon on the village social structure, as well as its potential to stir up disputes competing land/carbon claims from governments or neighboring villages and ethnic groups is not yet known and will require attention.

Sidrap Community Reforestation, Southern Sulawesi, Indonesia

In 1967 Haji Abunawas, an award-winner in martial arts, was granted land-use rights to 382 ha of degraded grasslands (i.e. non-treed lands dominated by persistent, fire-adapted *Imperata* grasses). Mr. Abunawas invited 100 households to share the land grant, giving them full tenure rights in exchange for the establishment of tree-farming systems. As of a 2006 study, 300 hectares have thus been successfully reforested, at an average rate of 8 ha/year. While admittedly small-scale and slow moving from a climate/carbon perspective, this project has generated considerable government and stakeholder support for scaling up.¹³

Along such lines, a CDM project (ADB TA No. 4137-INO) has targeted 650 hectares of 'unoccupied' degraded grasslands for the establishment of small-holder fruit and timber systems. The granting of clear tenure rights is a core component of the program. Start up capital and access to tenure will be facilitated by project collaborators and the carbon revenues are to be shared as follows: District Government 15%, Lestari Foundation 40%, Farmers 45%. The anticipated carbon sink is 5,922 tons of CO₂ per year. There appears to be

¹¹ Zahabu, Eliakimu. 2006. "Handei Village Forest Reserve, Tanzania." In *Community Forest Management as a Carbon Mitigation Option: Case Studies*, ed. D. Murdiyarso and M. Skutsch. Bogor, Indonesia: Centre for International Forestry Research (CIFOR). www.communitycarbonforestry.org/Case%20study%20bookWeb.pdf

¹² Ibid.

¹³ Roshetko, James M., Rizaldi Boer, Hardjanto, Lala Lolopaking, Andri Akbar, Upik Rosalina Wasrin, Bambang Dwi Dasanto, and Sri Rahayu. 2006. "Sidrap Community Reforestation of Unproductive Grassland, Indonesia." In *Community Forest Management as a Carbon Mitigation Option: Case Studies*, ed. D. Murdiyarso and M. Skutsch. Bogor, Indonesia: Centre for International Forestry Research (CIFOR). www.communitycarbonforestry.org/Case%20study%20bookWeb.pdf

broad levels of support, and high expectations, for this project at the national, district and local levels, involving a wide range of stakeholders.¹⁴ This project's focus on unoccupied, low value *Imperata* grasslands on the one hand 1) means that the methodologies clearly cannot be simply transferred to the more high value forested lands that are the source of the majority of forest carbon emissions; however on the other hand 2) such projects may be critical as mechanisms to realistically foster forest carbon benefit-sharing among smallholders and create legitimacy for global carbon markets.

Key Lessons

The need for rapid resolution of land tenure must be balanced with the equally urgent need for appropriate solutions that are socially, culturally and politically tenable.

- Rapid, large-scale land titling programs best match the time-frame and scale needed to attract substantial short-term private investment in markets for REDD+.
- However rapid approaches are likely to lack procedural legitimacy, to be highly inequitable and contested, and could be politically explosive.

Concurrent, more holistic work to improve forest governance and implementation is crucial, including under Phase 3.

- Ground up, incremental land tenure reform may be the only feasible option in many countries, and could greatly benefit political legitimacy and improved benefit distribution.
- However, rapid introduction of market-based approaches that outpace legitimate tenure reform run the risk of major leakage, net carbon loss, and political turmoil.

Interim financing must be guaranteed for a time period adequate to allow legitimate land tenure reform, lest it foster "quick fix" solutions that create major perverse incentives. The latter could accelerate forest loss and undermine political stability.

- Historical legal and customary land tenure frameworks vary substantially, requiring solutions that tailored to specific regional, national, and local contexts.

¹⁴ *Ibid.*

Case Study 2: Agriculture and intensification (Connie McDermott)

Agricultural expansion is one of the primary drivers of deforestation in all tropical regions, and its forest impacts are projected to grow. In some countries, large-scale commercial agriculture linked with global commodity markets is a leading cause of deforestation. Demand size measures and carbon market mechanisms together could be relatively effective at altering the financial incentives for such producers.

Subsistence farmers and/or local market economies, however, are also important drivers of deforestation and degradation, and often as a direct result of displacement by commercial producers. The creation of high value markets for forest carbon could be a further driver of this displacement, if forest carbon rights are captured by high capacity business interests and benefits do not adequately accrue to small-holder communities. This highlights the importance of the "absorptive capacity" of local communities, i.e. the capacity of local stakeholders to capture benefits from REDD+ legal frameworks. Unless REDD+ strategies can reach such actors, the net environmental and social impacts may be negative.

In Africa, local food production is thus far the primary driver of deforestation. An estimated 66% of increased African food production is derived from the expansion of harvested area, compared to 22% globally.¹⁵ Much of this expansion occurs in woodland savannah and along the forest edges. In this context, agricultural intensification has been identified as a key and necessary measure to slow deforestation. At the same time, the complexity of factors affecting small farmer land use choices (e.g. land tenure (see box below), labor markets, price fluctuations, risk sensitivity, soil productivity, social inequities, etc.) is such that a focus on intensification alone may yield negative results.¹⁶

REDD+ strategies have a lot to learn in this regard from existing broader scale development efforts.

Key concepts highlighted in the following case study of a rural development project are cross-sectoral integrated approaches that consider the legitimacy of strategic interventions at local to national levels, and the challenges of scaling up from the project to national-level over the short to long term.

¹⁵ World Agroforestry Centre (2009) The Case for Investing in Africa's Biocarbon Potential. Policy Brief 4. Available at: <http://www.asb.cgiar.org/PDFwebdocs/ICRAFPB04-InvestingInAfricasBiocarbonPotential.pdf>

¹⁶ Lee, David R., Paul J. Ferraro, and Christopher B. Barrett. 2001. "Introduction: Changing perspectives on agricultural intensification, economic development and the environment." In Trade offs or synergies? Agricultural intensification, economic development and the environment, ed. D. R. Lee and C. B. Barrett. Wallingford, UK: CAB International.

The Earth Institute's Millennium Villages Project (Ethiopia, Ghana, Kenya, Malawi, Mali, Nigeria, Rwanda, Senegal, Tanzania, and Uganda)¹⁷

The Millennium Villages Project, launched in 2006, covers 80 villages in ten "relatively peaceful and well governed" African countries. Key features include: an explicit linkage to Millennium Development Goals; a holistic, multi-sectoral approach; an intensive five-year investment; a commitment to universal access to project services; a focus on community participation in decision-making and implementation to ensure local ownership; use of new technologies; and support from high profile celebrities and politicians in the North and South.

The planned budget allocation is 15% to agriculture and nutrition, 15% to water, sanitation and environment, 20% to education, 20% to infrastructure, and 30% to health. The funds were managed by the Earth Institute and disbursed directly at the village level.

In 2008, ODI conducted a performance review across five case study countries: Ethiopia, Ghana, Malawi, and Uganda. The positive results are striking. Yields of key crops increased 85-350%, along with equally large improvements across several health indicators. The key challenges are equally striking: i.e. 1) how to achieve long-term sustainability and 2) how to scale up beyond the village level.

The review identified wider lessons to address these challenges. These include: the need for longer term, sustainable sources of funding (along with a continued emphasis on low-cost methodologies); flexibility of budget allocations across sectors and at multiple-scales (e.g. regional level infrastructure development); scaling up and the integration of planning and financial management into government systems (e.g. direct village-level payments enable efficient and effective results over the short term, but government integration may be necessary over the longer term).

The issue of legitimacy, at multiple-scales, is also key. Village buy-in is enhanced if village-level goals (e.g. education, health) are integrated into larger-scale or international environmental concerns (e.g. carbon storage). Likewise, the MVP reviewers emphasized the importance of obtaining government support at multiple levels as key the goals of scaling up and long-term sustainability.

¹⁷ The data for this summary was drawn from: Buse, Kent, Eva Ludi, and Marcella Vigneri. 2008. "Can project-funded investments in rural development be scaled up? Lessons from the Millennium Villages Project." In *Natural Resources Perspectives*, ed. ODI: Overseas Development Institute (ODI).

Case Study 3: Financing FLEGT Voluntary Partnership Agreements – Lessons for REDD+ financing (Jade Saunders)

In 2003 the European Commission published the FLEGT Action Plan recognizing that as major consumers of timber from countries with high levels of illegal logging, European Consumers were responsible for driving damaging deforestation in many poor tropical countries, and simultaneously undermining the business case for sustainable forest management (SFM) by providing profitable export markets for cheap illegal wood.

The plan set out to reduce the European demand for high risk timber and included a number of policy options including one which would aim to ensure that poor developing countries were not excluded from valuable export market by the proposed hike in environmental standards for traded wood products: the negotiation of a series of bilateral agreements covering timber and forest products, with producer country governments who wished to tackle the illegal logging within their forest sectors. The agreements, which are an innovative attempt to link trade in timber and forest products with development priorities, are entered into voluntarily by both parties, but once agreed they become legally-binding, committing each country to ensure that all timber products traded between them would be independently verified as legal.

To date agreements have been signed with Ghana and Republic of Congo (Brazzaville), concluded but not yet signed with Cameroon and are in negotiation with Indonesia, Malaysia, Vietnam, Liberia, Central African Republic, and Gabon. Commercial timber extraction is responsible for relatively large numbers of jobs in these countries and timber exports to the EU are significant export earners. As a result, governments are under increasing domestic and international pressure to ensure that the benefits of the trade are shared appropriately through the effective collection and spending of taxes.

Table: value of EU export markets for timber for VPA countries in 2007 (Liberian data unavailable due to UN sanctions)

Country	Total value of national timber exports to EU 2007 (US\$m)
Vietnam	6,333
Indonesia	1,856
Malaysia	1,239
Cameroon	609
Gabon	392
Ghana	139
Congo Brazzaville	120
CAR	34

The independent verification systems in each country, which, once functional, will ensure that the legal timber traded is credible, have been designed by the partner governments, and national stakeholder, to reflect national circumstances and legal codes, while meeting the criteria for credible verification established by the EC. The systems are known

generically as FLEGT Legality Assurance Schemes (LASs) and include the following five elements:

- A clear national definition of legal timber
- A mechanism to control timber as it moves around the partner country
- A government endorsed institution to verify that laws have been complied with and the control system is being applied with sufficient rigour
- A licensing authority for exports
- An independent institution to monitor the functioning of the whole system

In each country, the first element, the national definition of legality, has been designed through an inclusive stakeholder process over an appropriate time period – from one to five years – allowing for effective and informed participation. The aim of the national definition processes is to clarify conflicting or unclear laws affecting forestry practices and identify areas for potential reform.

In order to ensure that VPA partner countries efforts to enforce forest law are not undermined by unfair competition from cheap illegal timber, the European Commission and Member States are also in the process of establishing a series of demand-side measures for FLEGT licensed and other responsible timber products. These include a requirement for companies importing timber into the EU to have due diligence systems in place¹⁸ and public procurement policies at the national and regional level, which require public contracts to be met with verified legal wood as a minimum criterion. Preliminary analysis of market impacts has shown that premium prices are now available for verified and certified tropical hardwoods in the UK particularly, where the policy is relatively well established. It is hoped that as these policies are developed and implemented, the business case for legal and sustainable forest management will become better established.

In parallel with their trade commitments, the European Commission and Member States have provided up front funding for the development or improvement of LASs in each partner country, with a view to longer term financing coming from improved revenue collection in the sector. In both country cases to date, funds are being made available through Sector Budget Support mechanism, which were established before the VPAs were negotiated, to achieve a variety of aims in relevant sectors.

Donors supported this Sector Budget approach proposed by both countries, in line with broad ODA trends, in order to increase effectiveness and impact through:

- Local ownership of activities
- Coordination of finance from multiple donors in order to (MDBs and bilateral ODA from a number of sources)
- Reduction of transaction costs for donor and recipient countries

¹⁸ Legislation is under development so the exact nature of requirement is as yet unclear.

Lessons for REDD+ financing

- The FLEGT family of measures aims to create an incentive for legal and sustainable forest management by combining protected markets for verified products with increased rate of detection and likelihood of sanction for illegal operators. It recognizes that voluntary improvements in social and environmental standards are unlikely to happen without an appropriate regulatory/market framework.
- Donors are still learning lessons about the most effective way to finance the enforcement of forest law. The experience outlined in the text box above suggests that even relatively new and innovative financing mechanisms which rely on government capacity can be inefficient, slow and subject to political interference and competition.

The countries with high levels of illegality generally face capacity/institutional challenges which are not likely to be overcome in the immediate term. VPA negotiations have taken between one and three years merely to establish a clear legal code and design a system for verifying the legality of timber. Expected implementation schedules also vary, with some countries likely to move from legal agreement to licensing in around one year, while others are expected to take significantly longer due to poor government capacity. In addition, the level of stakeholder participation in a number of VPA countries has been, while widely praised, time consuming and subject to relatively high transaction costs as international NGOs have been required to take on extensive capacity building projects.

Case Study 4: The Costa Rican system of direct payment for environmental services (Pedro Moura Costa)

In 1997, in anticipation of the UNFCCC Kyoto meeting and prior to the creation of the CDM, Costa Rica launched two complementary national level carbon sequestration programmes based on sustainable forest management and forest conservation, respectively. In spite of the efforts of Costa Rica and the support of other forested countries, the forestry activities included in these programmes were denied eligibility for participation in the CDM. As discussions on the role of forestry and forest conservation gains momentum again, it is appropriate that the very pioneering and sophisticated aspects of the Costa Rican initiatives are analysed in the context of proposals for any future REDD+ regime.

The Costa Rican national programme involved two complementary sub-programmes based on forest conservation and sustainable forest management, respectively. The Protected Areas Programme (PAP) had the objective of reducing deforestation rates by consolidation of the national parks network through the purchase of privately-owned land inside the parks. The programme aimed at consolidating 570,000 ha within 28 national parks, and claiming the carbon savings derived from avoided deforestation, which historically averaged 3% per year. Costa Rica expected to avoid the release of about 18 million tonnes of carbon (66 m t CO₂) through the implementation of the PAP. These savings were initially independently verified by the international certification company SGS Forestry, and carbon credits issued accordingly.

Commercialisation of CO₂ reduction credits would be done through the system of Certified Tradable Offsets (CTOs) issued by the Costa Rican Office on Joint Implementation (OCIC - Executive Decree N. 25066 Minae, 1996). These CTOs were carbon credits based on the amount of CO₂ fixed in forests similar to the CERs that were subsequently created by the CDM, and were to be sold with the assistance of international carbon brokers. The first batch of CTOs (200,000 tons of carbon) was sold to a Norwegian consortium at US\$ 10/tonne C (US\$ 2.70/t CO₂), for a total of US\$ 2,000,000. At a projected price of US\$ 10 per tonne of carbon, Costa Rica expected to raise US\$ 180 million through the Protected Areas Programme.

In order to complement the PAP, Costa Rica also worked on a second national level land use project, the Private Forestry Programme (PFP). The PFP encouraged land owners to opt for forestry-related land uses by providing direct payment for environmental services. Environmental services included CO₂ fixation, water quality, biodiversity, and landscape beauty [Forestry Law N. 7575, April 1996; La Gaceta (1996)]¹⁹. These monetary incentives aimed at increasing the attractiveness of forestry compared to higher-impact forms of land use. Incentives were to be paid to land owners over a period of 5 years following the signing of a contract to keep their land under a specified type of utilisation for a minimum period of 20 years. Farmers who received these incentives assigned the rights of to the environmental

¹⁹ La Gaceta (1996), Ley Forestal 7575, April 16 1996. Alcance n. 21 a La Gaceta, Diario Oficial, N. 72. 8 pp.

services of the government, who bundled them for potential sale. The resources for initiating the PFP programme were raised by a domestic 15 % tax on fossil fuels, which was expected to raise US\$ 21 million per year (Franz Tattenbach, pers. comm). It was hoped that future payments to farmers would be based on the sales of resultant CTOs.

The value of PFP incentives varied. There were three main areas of interest: conservation of existing forests, selective harvesting for sustainable wood production, and reforestation or natural regeneration of degraded pasture or agricultural land. In the case of private forest conservation, farmers would receive a total of US\$ 280/ha, through a series of annual payments. They were also waived payment of land tax. Those opting for natural forest management would receive US\$ 47/ha/year, to a total of US\$ 235/ha, in addition to the revenue derived from timber harvesting. In order to enforce compliance with low impact logging guidelines, the law required that any harvesting operation must be supervised by a trained forester. Farmers who chose to reforest part of their agricultural land would receive a series of payments related to the costs of plantation establishment, to a total of US\$ 558/ha. An additional benefit of the PFP is that it served as a leakage mitigation measure for the PAP. By providing an alternative set of incentives for those landowners that were displaced by the PAP, the PFP would prevent a significant increase in un-sustainable land use from the other programme.

The institution co-ordinating the administration of the incentives was called Fonafifo (Fondo Nacional de Financiamiento Forestal - Forestry Financing Fund), an office created by the MINAE (Ministerio del Ambiente y Energia - Ministry of Energy and Environment). Fonafifo had the role of receiving and analysing applications, conducting field verifications, carrying out the payments, and monitoring field implementation of forestry projects.

Beyond CTOs, Costa Rica also worked on ways to charge the economic sectors which most benefit from these services. One example is the creation of a system to charge hydroelectric plants for the conservation of their water catchments, at a rate of US\$10/ha/year. A similar mechanism was being created for remunerating farmers in eco-tourism regions. In the case of biodiversity, genetic prospecting contracts were firmed between INBio (the Costa Rica institute of genetic resources) and international chemical companies. The first of such contracts was signed with Merck, the large Swiss company, and stipulated that Merck pay to Costa Rica 10 % of the profits from any product derived from their forests.

In addition to these national programmes, Costa Rica also hosted independent private sector carbon forestry projects given the country's positive environment for investment in this type of activity. Furthermore, the combination of national level monitoring and the role that the PFP had in reducing potential leakage enhanced the effectiveness of the independent land use carbon projects.

The Costa Rican system of payment for environmental services provides a useful case study of how developing countries can engage in REDD+ in a well-planned and controlled manner. Many of the issues addressed by the project are currently back in the agenda with relation to REDD+ systems, such as national versus sub-national projects, integration of public and private-sector participants, leakage control, approaches for engagement of small holders,

and mechanisms for the disbursement of financial resources. Furthermore, this programme also demonstrates how carbon finance can be channelled by developing countries into their national priorities. The programmes were entirely conceived by the Costa Rican government and, consequently, totally conformed to their sustainable development objectives. As international interest in REDD+ grows, this is a model that can be adapted to the circumstances of other developing countries.

Case Study 5: The Montreal Fund – lessons for REDD+ financing (Jade Saunders)

The Montreal Multilateral Fund (MMF) was set up by a decision of the Second Meeting of the Parties to the Montreal Protocol (London, June 1990) to assist developing countries to meet their Montreal Protocol requirements. The MMF has provided finance for various activities including industrial conversion, technical assistance, information dissemination, training and capacity building aimed at phasing out the ODS used in refrigeration, foam blowing, industrial cleaning, fire extinguishing, soil fumigation and cosmetic and pharmaceutical products.

The MMF is a publicly-funded financing mechanism, not an implementing body, responsible for disbursing US\$2.2 billion over 17 years. Contributions to the fund are paid by industrialized countries, or non-Article 5 countries, and are assessed according to the United Nations scale of assessment. Financing is performance-based with independent verification of activities and results, flexibility in the use of funding to promote national ownership, and provision of penalties for non-achievement.

In addition to monitoring impact, a performance assessment of national implementing agencies is carried out each year, based on a range of indicators developed to measure the performance against national commitments. Assessments have been used as a reference for future resource allocation, creating a competitive environment among Parties and improved implementation.

Responsibility for overseeing the operation of the Fund rests with a 14 member Executive Committee comprised of seven representatives each from developed and developing countries. Although theoretically the countries can vote on decisions, to date management has been achieved almost universally by consensus. The Chair and Vice-chair of the Executive Committee alternate annually between the developing and developed countries. By embedding a close partnership between developing and industrialized nations in its management structure, the Fund is felt to have fostered partnerships based on equality, not dependence leading to more effective outcomes.

Since the inception of the Multilateral Fund, the Executive Committee has allocated a total of US \$2.11 billion to implement more than 5,500 projects and activities. Total funding of US \$3.72 billion was initially sought for these projects. The savings of US \$1.61 billion represents costs that were found to be outside the Executive Committee's funding guidelines or which did not meet the fundamental Multilateral Fund requirement of being "incremental costs".

The Parties to the Montreal Protocol also decided that contributing Parties could use up to 20 percent of their annual contribution to carry out activities with developing countries on a bilateral basis. Currently 12 contributing Parties engage in a range of bilateral activities such as training, technical assistance and the introduction of up-to-date ozone-friendly technologies. Their participation diversifies the implementation process and broadens the impact of the Multilateral Fund.

Implementing the Montreal Protocol is ultimately the responsibility of national governments. Recognizing this, the Multilateral Fund has provided funding to establish national ozone units within the governments of each recipient developing country. The funding is intended to enable the provision of at least one full-time staff member and to cover basic office and communication costs even for the smallest country.

Establishment of national ozone units has helped 140 countries to take ownership of their national ozone protection programme by providing a continuous link to the assistance under the Multilateral Fund, as well as a channel of communication to the agencies implementing Multilateral Fund projects. One of the benefits of the creation of national ozone units has been the steady improvement by developing countries in the mandatory annual reporting of data on national consumption and production of ODS. By 2004, the rate of reporting by recipient developing countries had reached 96 %.

Although most national ozone units were up and running by 1994, maintaining a national programme to phase out ODS constantly presents new technical and managerial challenges. The Multilateral Fund supported two initiatives to support the fledgling units as they assumed an increasing level of national responsibility. In 1993, the Government of Sweden initiated and funded a regional network for South-East Asia and the Pacific to enable national ozone officers from that region to meet twice a year, together with representatives from developed countries and implementing agencies, so providing a forum to discuss regional issues, disseminate information on and gather feedback on the policies of the Multilateral Fund. This peer support system proved successful and was quickly adopted by the Multilateral Fund. Today, there are nine regional or sub-regional networks, which form the backbone of a global ozone network, for 139 national ozone units.

As a second initiative, since 2000 the Multilateral Fund has funded UNEP's Compliance Assistance Programme (CAP), which has enabled UNEP to relocate staff to the regions and deliver more timely advice and assistance to both individual countries and the regional networks.

In 1986, one year prior to the adoption of the Montreal Protocol, the total consumption of the most important ODS, chlorofluorocarbons (CFCs) and halons, in developing countries was about 188,000 ODP tonnes. Using the prevailing average annual ODS growth rate, this consumption would have reached about 570,000 ODP tonnes by 1999. Such growth would have raised the phase-out costs by up to 300% and increased substantially the complexity of the overall phase-out task. The effective intervention of the Multilateral Fund between 1991 and 1999 contributed significantly to containing this growth and as a result in 1999 the total baseline consumption of the two ODS in developing countries was about 212,000 ODP tonnes. In this way consumption of around 358,000 ODP tonnes of the two harmful chemicals was avoided.

In addition to providing funding, the Protocol also allows for restrictions on trade in products controlled by the agreement as a non-compliance sanction. These were built into the regime from the outset, as measures designed to be employed against nonparties, but they are now recognized as an important potential tool for use against non-complying parties. There is direct evidence from some countries that the trade provisions were important in persuading them to accede to the treaty; a good example is the Republic of

Korea, which initially expanded its domestic production, but realising the disadvantages of being shut out of Western markets, became a party.

Since 2000, the Multilateral Fund has put less emphasis on the funding of stand-alone projects to replace technologies using ODS. Instead, it has encouraged the development of national ODS phase-out plans that map out a detailed plan of action to eliminate the remaining consumption of the most common ODS in a country. Each plan is governed by an agreement between the Executive Committee and the government concerned which specifies:

- The annual reduction target to be achieved by the government, at a minimum consistent with the reduction schedule for ODS under the Montreal Protocol;
- the total funding level from the Multilateral Fund agreed in principle;
- schedule for the disbursement of funds;
- an independent verification of achievement of the annual reduction target, as a condition for fund disbursement;
- the flexibility to reallocate funds within programmes; and
- provision for penalties such as a reduction or suspension of grants if the reduction target for ODS is not met.

Tight deadlines have been established for the return of unused funds from completed or cancelled projects. Fund returns are continually monitored, to maximise reprogramming for future use.

The Montreal Protocol's compliance system is frequently considered as a model worthy of emulation. Suggestions have been made at various times by parties to the 1973 Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) for an implementation or compliance committee analogous to the protocol's Implementation Committee. The 1993 Lucerne Conference of European Environment Ministers called for the development of non-confrontational compliance procedures (à la Montreal) for all Parties. Conversely, in other fora, for example in the negotiations over the 1992 United Nations Framework Convention on Climate Change and the 1997 Kyoto Protocol, the regime has been regarded as too effective to be copied, mainly given its potential recourse to trade measures as an enforcement mechanism.

Lessons for REDD+ interim finance

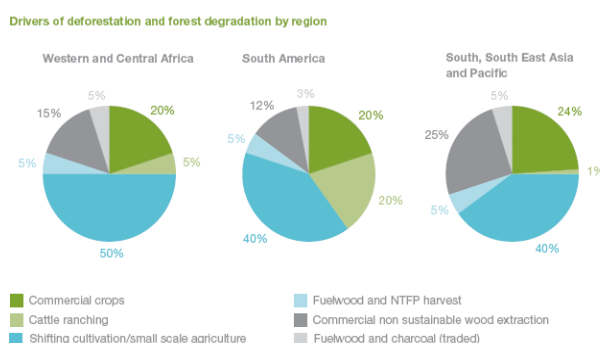
- Funding is performance-based but performance is not simply measured by tonnes of ODS. Allows for, and judges, MRV of pragmatic proxies and capacity building, requiring demonstrable progress towards national commitments.
- Funding shifts that are positive anyway but wouldn't be entirely profitable: moving companies to high-tech coolants is an interesting parallel with agricultural intensification or SFM where 'good' activities are recognised as positive by companies but don't necessarily make financial sense in the short to medium term. Further research? It might be interesting to see how private finance interacts with MMF funds in both large scale and SME companies in different regions/types of country.

- Funding marginal cost only: recognition that responsibilities are shared, activities have a national benefit to the implementing company/country, therefore funding does not all need to be 'additional'
- Consistent funding for national contact points: spending monitored, reported and verified although not strictly relating to units of ODS. Thought to have developed leadership and can be compared with GEF, which took on responsibility for supporting compliance in former Soviet countries on a strictly 'project' basis. The 'project' approach was seen to be significantly less effective with almost all countries slipping into non-compliance, compared with high levels of compliance among developing countries which arguably faced more severe capacity constraints to start with.
- Allowing for 20% bilateral funding which fosters innovation (eg Swedish pilot of regional network) and direct technical assistance.
- MMF has been effective in administering funds for one-off investment but markedly less so in reducing use of Methyl Bromide, which is used annually in agricultural cycles and as such would require a much more complex MRV regime and capacity to move money quickly. Significantly more complex /diffuse / risk-averse stakeholder groupings are also considered a challenge to reducing use of MB.
- The benefit of speedy intervention: between 1991 and 1999 the Fund contributed significantly to containing the growth in ODS use in developing countries, and as a result by 1999 had avoided the use of around 358,000 ODP tonnes of CFCs and Halons compared with the projected BAU trajectory of use, putting rapidly growing economies on a less damaging path.
- Use of trade measures as a sanction for non-compliance with Parties' commitments could be considered a precedent for demand-side policies relating to illegally-produced timber, or agricultural commodities produced on converted forest land etc.

Case Study 6: Policy coherence – international demand for timber and agricultural commodities (Jade Saunders)

As stated elsewhere in this paper, while some options for slowing deforestation can be considered ‘no regret’ measures (such as tackling forest fires), many of the drivers of deforestation relate to profitable alternative uses for forest land, and often have a significant international dimension, for example global demand for timber, palm oil, beef or leather.

Figure: Deforestation is driven by the needs of growing populations for timber, energy and food



Source: Blaser J. and C. Robledo (2007). Initial Analysis on the Mitigation Potential in the Forestry Sector. Report prepared for the Secretariat of the UNFCCC. August 2007

The table above suggests that by region 40, 52 and 50% of deforestation serves a demand which is either currently linked in with a global market, or may be relatively easily if domestic production was significantly reduced by a REDD+ strategy.

This has two fundamental implications for the financing and permanence of REDD:

- **Financing:** The opportunity costs of REDD+ will be substantially higher if global demand for timber and agricultural products is not subject to a coherent policy framework – one which aims to reduce the potential profit to be gained from alternative land uses.

Given that many alternative uses are inherently good things (for example producing food) this coherence could most usefully be implemented through policies which reduce demand for illegal or unsustainable forest products or food which comes from illegal land conversion.

- **Permanence:** Given the reach and maturity of global commodity markets, it is highly likely that demand for products that have been displaced by REDD+ activities will ‘leak’ into forest countries which are not actively pursuing a REDD+ strategy or have not, to date, been subject to high levels of deforestation.

If the question of demand for land based commodities is not tackled in parallel with attempts to create an incentive for REDD+, then the net impact of any REDD+ incentive is likely to be significantly reduced.

'Demand-side' flanking measures – existing options

A number of policies for are currently in place at the international, national and company level to ensure that international demand for key commodities is met responsibly.

International recognition that demand for tropical timber was resulting in illegal and unsustainable logging and deforestation has resulted in three types of policy response over the last decade:

- Systems to identify 'responsible' wood through standard setting and chain of custody schemes. This includes the development of private sector certification schemes such as FSC and MTCC and government to government verification systems under FLEGT VPAs (see case study 3)
- Legislation to ensure that either illegal forest products are excluded from trade at point of import. This includes the 2007 US Lacey Act revision and the EU FLEGT Due Diligence Regulation which is currently under development.
- Policies to favour demonstrably legal and sustainable products either voluntarily or through government regulation. This includes responsible purchasing policies at the federation or individual business level, inclusion of relevant criteria in building standards and mandatory government procurement policies for wood and products including paper and furniture.

More recent recognition that hugely increasing global demand for agricultural products such as palm oil, driven by increasing population, wealth and the need for low carbon transport options (biofuels) is resulting in illegal and unsustainable conversion of forest land has resulted in:

- The negotiation of international standards for responsible production of palm oil, including relevant safeguards relating to conversion of high conservation value forest. The best example of this is the Roundtable On Sustainable Palm Oil certification scheme.
- Voluntary commitments by companies which are sensitive to reputational risk (eg those with retail brands) to avoid purchasing palm oil which is not independently certified as meeting these standards.

However a number of policy instruments are in place to increase global demand for biofuels, without any attempt to rule out those which come from converted forest, most notably at the European level.

Very recent NGO publicity about the relationship between global demand for beef and shoe leather and deforestation in Brazil has resulted in public commitments to removing these products from relevant supply chains from a number of companies with brands to protect. These have included Nike, Timberland shoes and Marks and Spencer but without regulation to ensure that these 'market leaders' are not undercut by companies without reputational sensitivity (brand, retail, shareholders), the impact is likely to be little more than symbolic.

Given their unique role in parallel with the UNFCCC process, and relationship with G8, which has historically called for action to reduce the trade in illegally-logged wood, the UK should consider making explicit proposals that those country wishing to support reductions in tropical deforestation as a global climate mitigation strategy could do so most effectively by combining financial support for REDD+ with effective and coordinated demand-side measures for products which are often highly profitable 'drivers' of deforestation.