Modalities and procedures for financing results-based actions on REDD+
Views submitted by the World Bank Group

Introduction

The World Bank Group appreciates the opportunity to contribute to Parties' important work under decision -/CP.17 on the Outcome of the work of the Ad Hoc Working Group on Long-term Cooperative Action under the Convention, matters referred to in paragraph 69 inviting views on modalities and procedures for financing results-based actions and considering activities related to decision 1/CP.16, paragraphs 68-70 and 72.

This submission draws from insights and lessons derived from the World Bank Group's carbon finance experience across many different types of projects, programs and sectors around the world over the past decade including in the land use sector. It is hoped that this submission will be constructive input to Parties' deliberations. The World Bank Group would be pleased to elaborate further and contribute to this important work as needed.

The submission is divided into two parts: (i) our key insights from experience with financing results-based actions; and (ii) recommendations for the Parties' consideration.

I. Some key insights from experience with financing results-based actions

Performance-based payments for emission reductions produce powerful incentives. Such payments are provided after results have been verified, i.e., emissions reduced, relative to a reference level. This is in contrast to what has generally been the case for investment lending where financing is provided ex ante. As such this method of finance is recognized as a means to incentivize positive action on a sustained and recurrent basis. In the REDD+ context, performance-based payments are primarily designed to value and reward measurable and verifiable greenhouse gas emission reductions quantified in tonnes of carbon dioxide equivalent, and thus to value forests standing more than felled.

Investment finance and performance-based payments go hand in hand. The potential impact of results-based payments has been limited to date due to the lack of connection to investment finance. A significant obstacle is that REDD+ programs face upfront financing needs that have to be met before results are produced that in turn unlock results-based payments. Upfront financing needs vary according to program types but are likely to be substantial. Ultimately, it is necessary to secure enough financing to invest in activities or policies that will reduce emissions. Once a stream of results-based payments can commence after the start of the implementation of activities, these payments can be re-invested into the program enabling it to be sustained and expanded.

Performance-based payments could be made available upfront. Payments that are purely based on performance (i.e., after emission reductions have been verified) do not alleviate the upfront financing needs unless they can be advanced in the form of pre-payments or monetized. Because pre-payment increases risks to buyers/investors, various forms of guarantees or insurance may be needed. Insurance institutions are needed to provide coverage for a range of commercial and political risks. There is also a role for financial institutions as they are able to monetize the future streams of payments for expected emission reductions on the basis of off-take agreements that serve as collateral for loans to finance the upfront investments in programs. If necessary, multilateral and bilateral finance could provide guarantees to allow local banks to monetize these streams of payments.

Performance-based payments come from a variety of sources. Whether they are motivated by objectives of development aid effectiveness, corporate social responsibility, or trade in emission reductions, the rigor inherent to and incentive created by performance-based payments is attractive to both the public and private sectors.

II. Recommendations for the Parties' consideration

Blend traditional and innovative financing. Carbon finance is primarily a stream of on-delivery payments, and yet the upfront investments needed for REDD+ and other land-use activities are significant and economies of scale are not easily attained. The investments that are needed to address the drivers of deforestation and forest degradation are long-term and deemed risky, particularly, though not exclusively, in many developing countries. The following is needed to help achieve the desired results: institutional arrangements for financial intermediation and insurance, an understanding by financial institutions, including those in developing countries, of the opportunity for carbon finance to help in financing rural development, upfront payments based on meeting performance benchmarks and frameworks that incentivize the private sector to engage. Concessionary resources and grant financing seem necessary at the initial stage in order to reduce risk to private capital and mobilize significant flows of private sector financing at a later point. Securing timely and predictable financing through innovative strategies can also catalyze additional financing investment, creating a magnifying effect.

Secure a regulatory framework that fosters the effectiveness of results-based payments. Regulatory requirements such as ex ante and ex post assessments of programs and how permanence is addressed have direct implications on revenue flows. The CDM validation and verification requirements for projects have imposed high transaction costs on A/R CDM, thus eroding the potential of results-based payments. Assessment of REDD+ programs should rely on more streamlined or better calibrated approaches. In the UNFCCC decisions on REDD+ the preferred approach is national. Decision 1/CP.16 provides that "actions to address the risks of reversals" should be promoted and supported when undertaking REDD+ activities. It is therefore likely that the permanence treatment could be less demanding in REDD+ than for traditional projects, which is positive and needs to be secured. Permanent crediting, the use of buffers and/or insurance products should be considered.

Determine whether and how additional benefits could be recognized. Activities that improve land use, such as REDD+, have the potential of encompassing climate mitigation, as they remove carbon from the atmosphere, as well as adaptation, as they build up the resilience of the environment and communities to the poorer environmental conditions that would result from deforestation and degradation. Improving both living and environmental conditions can add significant environmental and social benefits (besides carbon) that are currently not recognized or rewarded. Given that additional benefits are a strong incentive for local participation and for improving program performance and maintain permanence, reward options (including finance) should be considered. At the same time this recognition may impose monitoring needs, so the technical and resource implications of monitoring these benefits have to be assessed.

February 28, 2012