How the Green Climate Fund Could Promote REDD+ through a Cash on Delivery Instrument: Issues and Options

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Abstract

Climate change will have profound effects on development, poverty, health, and wellbeing in coming years. Rejuvenated by the recent Paris agreements, efforts to channel the international funding commitments need channels for cost-effective mitigation. The Green Climate Fund (GCF) represents the best current opportunity to address climate change effectively with international funding. Unlike other institutions, the GCF is relatively new and is still developing its policies and procedures. Thus, its Board has the flexibility to approve a performance payment approach which emphasizes much greater recipient autonomy, simplicity, and transparency than other climate funds have been willing to permit. In this way, the GCF can build on lessons from other performance programs and break from the restrictions of conventional aid that have delayed and sometimes interfered with progress. This paper concludes with a specific proposal for the GCF to pilot a pay for results agreement – using a Cash on Delivery (COD) approach – to slow climate change through reductions in deforestation.

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1. Introduction

The Green Climate Fund (GCF) has US$10 billion of pledges to "promote the paradigm shift towards low-emission and climate-resilient development pathways by providing support to developing countries to limit or reduce their greenhouse gas emissions and to adapt to the impacts of climate change…" As a result of agreements signed during the Paris meetings in December 2015, the GCF now has about US$6.5 billion of these pledges available as usable commitments. The GCF Governing Instrument has provisions that support the use of performance payments to allocate resources, incentivize mitigation, and pay for verified results. Furthermore, it explicitly addresses efforts to reduce deforestation and preserve forests, making such efforts eligible for funding. Therefore, the GCF has a rare opportunity to accelerate progress on protecting forests and slowing climate change by introducing a performance instrument that differs from existing initiatives in its scope and logic. In particular, the GCF could pay for results in line with the Cash on Delivery model which emphasizes much greater recipient autonomy, simplicity, and transparency than existing approaches. This could complement existing funding for forests by addressing policy levels not currently covered by existing bilateral and multilateral initiatives.

The international community has learned a great deal about performance payments in the last two decades but they are still hampered by procedures that were designed for conventional aid programs. The legitimate aims of these conditions need to be addressed differently in performance payment agreements if these new approaches are going to realize their potential. REDD+ programs are among those which have pioneered the uses of payments for results but even these are facing delays and problems associated with unnecessary encumbrances.

GCF already has the mandate, governance, and procedures in place that would allow it to finance agreements that pay accredited entities for results that correspond to inputs, processes or outputs, including an approved logic model for REDD+ performance payments. As a relatively new organization, its policies and procedures are still being elaborated. So far, however, GCF policies are exhibiting a strong tendency to replicate the constraints in other international organizations that make innovative results payment programs difficult to implement. Many of the GCF's initial policy documents address organizational accreditation and fiduciary controls that could constrain it from achieving real, rapid and broad sustainable development goals through results payments. For example, the GCF has adopted procedures to review proposals that require detailed plans, negotiations and approval by the board, taking into consideration financial viability and institutional capacity (GCF 2014). While such provisions might make sense for investment projects, they are antithetical to the logic of *ex post* results payments. Similarly, the GCF has adopted standards for choosing between concessional and other financial instruments on the basis of how funds are used – distinguishing, for example, between identifiable investment costs and reducing costs of capital. But the list does not encompass the use of funds to simply purchase averted tons of carbon emissions (GCF 2013, Section 2.2). Fortunately, the GCF still has room to adopt procedures for results payments because the very same section that fails to mention purchasing emission reductions is followed by a section noting the value of results-based payments to generate incentives (GCF 2013, Section 2.3). In other words, the GCF is adopting restrictive policies that may undermine its ability to pay for results, but it has not yet locked itself in.

Therefore, this note is offered to clarify how the GCF could apply a performance payment approach that breaks from the restrictions of conventional aid mechanisms that are delaying progress and inconsistent with current understandings of development. After discussing the design, benefits, issues and responses that arise from such applying a pure results based model like COD, it extracts lessons from other performance programs. It concludes with a specific proposal for the GCF to pilot a COD agreement to slow climate change through reductions in deforestation.

2. What is COD and how does it differ from current practice?

The essence of a Cash on Delivery based approach is that it constitutes an agreement between a funder and a recipient to pay *ex post* for the desired *outcome* rather than to pay for *inputs*, procedures or activities (Birdsall and Savedoff 2010). The core elements of such a COD approach are to:

- Agree on the desired outcome
- Identify an indicator which measures the outcome
- Establish a procedure for independently verifying the indicator; and
- Set a price per unit of outcome delivered.

For a number of reasons, it is desirable for the agreement to also be simple and transparent, in the sense of being open to public review.

The key advantage of such a COD approach is that it is consistent with our current understanding of how development happens: through domestic accountability, ownership, innovation, and adaptation. Recipients can still seek technical assistance and external ideas for their programs and policies, but the agreement itself does not constrain the recipient to follow preordained blueprints which tend to interfere with real development and real progress.

Other advantages of such a COD approach are that it:

- Aligns incentives to achieve outcomes rather than buy inputs
- Shifts resources and staff time away from monitoring processes and towards measuring progress (and providing technical assistance only when there's demand)
- Creates space for learning, innovation, and sustainable impact
- Increases the ability of citizens to hold their governments accountable for results
- Reduces waste because the funder pays only for results that are delivered
- Limits corruption by paying for results that recipients can only achieve by reducing fraud

In practice, international agencies have encumbered their performance payment agreements with a number of procedures and preconditions which unnecessarily compromise these advantages (Perakis and Savedoff 2015). In particular, they tend to establish preconditions and require detailed plans which inadvertently:

- delay program initiation and lose opportunities to start learning;[1]
- delay payments after results are achieved by placing additional constraints on how funds are used;[2]
- weaken stakeholder interest in the agreement as prospective payments move ever farther into the future;[3]
- keep funding tied to planned activities after more effective approaches are discovered;[4] and
- generate transaction costs associated with unproven methods for reducing risks at the cost of achieving desired outcomes.[5]

3. How could GCF finance reductions in deforestation through COD agreements?

The core of a COD agreement is the choice of outcome and the indicator that triggers payments. Fortunately, the forest sector already has a rich body of scientific literature, technical tools, and political negotiations to inform this choice. Pioneering work – including Norway's bilateral agreements with tropical forest countries, the Warsaw Framework agreed in the UNFCCC negotiations, and the Methodological Framework of the FCPF Carbon Fund – provide the basis for a multilateral organization like the GCF to choose indicators that are internationally acceptable, technically feasible, and independently verifiable. Focusing on averted tons of carbon emissions estimated through satellite-measurements of changing forest cover is a proven, acceptable and verifiable outcome measure.

The choice of indicator is crucial because it needs to be a good measure of the desired outcome. The indicator also needs to measure something which the government (or service provider) can influence by achieving the desired result. In the case of deforestation, most conventional aid and readiness programs are unable to reach the national policy levels that influence the political-economy of controlling deforestation. This is why a results payment at the national level, triggered solely by changes in forest cover, could complement existing programs.

Perhaps the biggest difficulty in operationally defining this indicator is to establish the reference level or baseline against which progress would be measured and paid. Fortunately, experts have been grappling with the technical and political challenges of defining reference levels and the GCF could rely on them to choose an appropriate baseline.[6] For example:

- A 10-year historical average rate of deforestation which is updated every five years (as in the Amazon Fund)

- An average trajectory toward zero deforestation at a particular level of GDP as estimated from a cross-country sample,[7]
- Separate baselines for different country categories (e.g., low deforestation, high deforestation).

In each case, the <u>result has to be verified</u> independently to assure the credibility of the agreement for both parties. This requires contracting firms to conduct independent surveys or utilizing remote sensing data. This process, referred to as Measurement, Reporting and Verification (MRV) in REDD+, only has to be precise enough for making accurate payments and independent enough for credibility. One added benefit of such independent verification is that it gives recipient governments information that is crucial for public policy and which can help them improve their normal administrative information systems. Another benefit is that such verification makes it possible for the change in indicator to be legally recognized as a "deliverable" from the perspective of the inspector general or equivalent fiduciary control agent for both funders and recipients. Finally, the independent verification removes the discretion of funders when making payments so that recipients can be assured of payments being made when they are due rather than worrying about other factors influencing funder compliance (e.g. domestic political changes, geopolitical shifts, parallel negotiations in other spheres).

Finally, <u>the amount</u> has to be large enough to be of interest to the recipient and no more than the value of the result to the funder or the cost of alternative approaches for achieving the same goal.[8]

4. Performance payments make funding more effective and less costly

A number of features of such proposals would make GCF funding more effective, less vulnerable to waste and more efficient by making some common conventional aid requirements unnecessary.

<u>Paying for results eliminates the need for detailed planning</u>. Since payments are made *ex post* when results are achieved, it is not necessary to have pre-approved plans. The agreement can be signed as soon as the indicator, reference level, verification process and per-unit amounts are settled. GCF *can* work with the recipient on implementing a program but the recipient can also seek technical assistance from other public or private agencies. This allows GCF to remain lean and avoid hiring specialized technical staff. It also strengthens country ownership by putting the recipient in charge of obtaining the assistance they want.

<u>Paying for results eliminates the need to track funds</u>. Since payments are made *ex post* when outcomes are achieved, there is no need to track the use of funds. To the extent that the recipient had spent money to achieve results, the GCF payments would help the recipient cover those costs. To the extent that the recipient had achieved results without spending money, the GCF payments would be a reward for achieving those results, to be spent as the

recipient saw fit. Since GCF payments would be *ex post* and only paid out in proportion to verified outcomes, any funds that were wasted or lost to fraud *ex ante* would not have produced results and would not be compensated by design.

Paying *ex post* for results and dispensing with fund tracking reduces the transaction costs associated with detailed fund tracking in two ways. First, GCF does not have to track the application of funds spent by the recipient to achieve results. Second, GCF does not have to monitor the subsequent use of payments which reimbursed earlier expenditures. This avoids both "double paying" and "double demanding".[9]

Paying for results strengthens international accords on environmental and social concerns. Since the GCF is not agreeing to a detailed plan, the appropriate way to assure that environmental and social concerns are addressed is through adherence to existing international standards and laws. Without specific plans, it is unnecessary to establish new and duplicative monitoring procedures. Most agencies have intended to follow this path but end up introducing so many *ex ante* conditions to approval that they slow programs without demonstrably improving environmental outcomes or reducing risks. Concerns with hypothetical risks overwhelm the concerns with proven climate change risks. So, for example, the Forest Carbon Partnership Facility (FCPF) Carbon Fund has been operating since 2011, yet only 11 countries have completed the first of 8 steps needed to begin receiving results payments.

GCF agreements would be advised not to impose additional conditions for the kinds of planning or activities that countries have already committed to under the UNFCCC. Instead, the GCF would reserve the right to suspend the agreement if existing mechanisms for judging violations of existing environmental and social standards should occur. This allows GCF to rely on and strengthen existing international agreements, protocols, standards and institutions. Examples of legal language for such "light touch" provisions can be found in the Memorandum of Understanding for results based payments from the United Kingdom to Ethiopia (United Kingdom/Ethiopia 2012)) and in the model contract appendix to Birdsall and Savedoff (2010).

Paying for results leverages other funding sources. Payments are made after achieving progress. Sometimes recipients will be able to deliver results at very low cost. This can happen when simple legal, regulatory or managerial changes effectively mobilize existing public or private resources to generate results. Other times, recipients will need funds for initial investments. In these cases, the recipient can either finance these investments out of their own domestic budget or seek funds from public or private entities in the form of loans or development impact bonds. The existence of a performance agreement makes the possibility of mobilizing other funds more likely. Remember that if GCF is paying for results, recipients still have access to a wide range of conventional funding sources which are complemented by the innovative results-based funding.

Paying for results improves coordination of public and private funding. Once a generalizable program is established, with clear rules, payments and verification mechanisms, then it becomes possible for any funder – public or private – to participate. For this to happen, two key parameters will have to be address: what portion of the averted carbon will be considered transferable and whether the payment is treated as a partial subsidy or a full payment. For example, in the Amazon Fund agreement, Norwegian contributions cannot be counted as offsets and the amount – at US$5 per ton – is more like a subsidy than full compensation for the costs of averting carbon emissions. The GCF has greater latitude to negotiate agreements that relax one or both of these restrictions. Once agreements are in place to pay for results, private contributions could be mobilized to complement and expand the funding for the performance payments.

5. Practical problems (and solutions) for GCF

Despite all these advantages over conventional aid, experience with performance programs at bilateral and multilateral agencies has demonstrated four particular issues that require practical solutions.

Uncertainty. To be credible, performance agreements have to pay for a *result* which is measured with enough precision so that funders, recipients and the public are confident that real achievements have been made.

Solutions: choose good indicators; establish credible reference levels; set up verification with adequate precision; make programs long-term so that errors one year are offset by errors in the other direction the next year.

Windfalls (and shortfalls). When funders pay for an outcome (especially in the forestry sector, as deforestation rates tend to vary widely from year to year), some of the variation in outcomes will be due to factors beyond the control of the recipient. Sometimes other factors will be favorable and lead to windfalls. Other times, complementary factors are not favorable and shortfalls will occur. This is also true of conventional aid; however, in conventional aid the effects of these other factors is rarely measured and has no impact on the flow of funds.

Solutions: choose outcomes that are directly responsive to policies (i.e., other factors have little impact); choose indicators that control for other factors (without increasing complexity too much); use reference levels with moving averages against a plausible counterfactual to minimize annual variance; use long-term programs so that windfalls one year are offset by shortfalls the next.

Budgeting and allocation. Funders and recipients alike prefer predictable funding. However, aid is never predictable. Conventional aid programs are notoriously volatile, often because of policy changes or bureaucratic procedures in the funding agency which are outside the recipient's control (Kharas 2008). Performance payments are no different in this regard but there are a number of ways that funders and recipients can explicitly make contingency plans to handle the expected fluctuations of performance funding.

Solutions: establish performance agreements for a pool of countries – so that higher payments to one country are offset by lower payments to another; think long-term so that disbursements that are lower than expected can be banked to cover higher than expected payments in later years; establish fixed total annual disbursements which are shared among countries based on proportional progress, thereby creating a positive competition among participants; create agreements with minimum and maximum payouts. Remember that if all GCF funding were based on results, recipients still have access to other conventional sources of funding.

6. GCF can learn from experiences at other agencies to do a better job with performance payments

Other agencies have financed a range of performance payment programs from which GCF can learn a few important lessons.

Plan Nacer. The World Bank (WB) approved a loan to Argentina to expand provincial health insurance to pregnant women and children before approval of its current Program for Results modality. The loan defined "health insurance coverage" as the deliverable for disbursing funds which created a problem in the approval process when legal advisors said they would need to also provide receipts for the health care services provided to the beneficiaries. This was antithetical to the notion of health *insurance* which gives someone access to care only when they need it. The WB team successfully negotiated terms for defining "insurance coverage" based on verifying (1) who was enrolled and (2) that services were indeed available to those with coverage. As a result, the legal process for auditing the program dispensed with typical requirements for documenting expenses (e.g., salaries, supplies) and replaced it with a system that requires documentation of *coverage*.

The lesson for the GCF is that engagement with legal advisors to define an appropriate deliverable (e.g., tons of carbon averted) is extremely useful to assure that *any audits hold the performance program accountable for its deliverables* and *not* for the recipient's expenses.

Results-Based Aid for Secondary Education in Ethiopia. In 2012, the UK signed an agreement with Ethiopia to improve secondary education. The agreement rewards the government for increases in the number of students above a baseline that take or pass a national exam at the end of lower secondary school (grade 10). Funds are transferred directly to the Ethiopian Ministry of Education, and are additional to existing support that DFID provides to the education sector.

The British government is concerned that the Ethiopian government should abide by appropriate fiduciary, environmental and social standards. Consequently, the Memorandum of Understanding (MoU) references "Partnership Commitments" which establish basic principles along with simple procedures for dealing with any eventual breach of these commitments. This approach has eliminated the need for costly pre-planning and monitoring of activities under the MoU while upholding legitimate principles and establishing the opportunity to end the agreement if serious breaches of the commitments were to occur.

The lesson for the GCF is that performance payment agreements can manage environmental and social concerns by cross-referencing established international standards, establishing *ex post* procedures for addressing breaches of commitments if they occur, and reserving the right to halt or suspend programs only in the ultimate instance.

The Amazon Fund. The Amazon Fund was proposed initially by Brazil and the Norwegian government promptly responded with interest in piloting an agreement. The subsequent agreement transferred official development assistance from Norway to Brazil on the basis of verified reductions in carbon emissions from slowing the rate of deforestation. It quickly became a model for international financing to reduce emissions from deforestation and an early example of a national performance payment program.

This program has been successful in terms of supporting Brazil's reduced emissions from deforestation, increasing leverage for environmental policies, and transferring a large amount of performance funding to Brazil (about $750 million as of 2014). However, the program also demonstrates quite clearly the disadvantages of establishing additional conditions on the use of the performance payments (i.e., "double demanding"). Brazil's initial proposal to Norway established that contributions would be based on averted emissions but earmarked to a special fund (the Amazon Fund) managed by Brazil's national development bank (BNDES). Because the Amazon Fund itself established detailed criteria for approving specific environmental projects, and transfers from Norway were to be made based on "need" for financing such projects, disbursements were delayed and the distribution of Norwegian payments was delayed. This attenuated the link between payments and performance at the national level.

The lesson for the GCF is that it (and recipients) should avoid attaching extra conditions to performance payments which unnecessarily delay disbursement and undermine the linkage between performance and funding.

7. If GCF follows existing approaches at other agencies, it will be less effective

Even the best performance payment approaches today are unnecessarily burdened by procedures and standards which apply to conventional aid, to the detriment of development goals.

The typical strategy followed by bilateral and multilateral agencies when they introduce new performance payment modalities:

- aims lower in the results chain so as to get attribution,
- establishes extensive diagnostic and planning processes to "guarantee" success,

- introduces too many indicators, diluting the focus on results,
- agrees to weak verification so as not to spend too much money on information gathering, and
- creates special monitoring and grievance systems to forestall violations of environmental or social standards.

These approaches undermine the basic premise of performance programs and explain, in part, how "aid-ification" has diverted REDD+ programs from their initial conception (Seymour and Angelsen 2012). The great irony is that none of these approaches can deliver on their promises. Attribution is always elusive, no amount of planning can guarantee success, weak verification undermines credibility, special monitoring systems have not protected agencies from criticism, and safeguards have not demonstrably mitigated social and environmental risks. Consequently, agencies have addressed their perceived risks by setting up procedures that have mostly slowed progress and run counter to the way real development happens – through domestic political processes.

8. A proposal for GCF to make an open offer

GCF could implement a performance payment program that rewarded countries for averted greenhouse gas emissions under its existing investment framework. However, it is likely that making the performance payment approach conform to GCF's investment framework will generate the same compromises implemented by other organizations. To avoid this, GCF can design a pay for results approach that preserves the autonomy, flexibility, and adaptability of recipients if, at a minimum, it:

- defines deliverables (indicators) that legal advisors recognize as "auditable,"
- defines Logic Models that work with *ex post* payments, explicitly recognizing the value of experimentation and adaptation and the value of saving funds which are not disbursed when outcomes are not achieved, and
- obtains acceptance from the Board for applying *ex post* checks on environmental and social issues for programs that use *ex post* payments.

Alternatively, GCF could propose a new modality that would be fully Cash on Delivery. This modality would establish criteria for outcomes, indicators, verification procedures, reference levels and *ex post* safeguard standards and procedures. It would permit the board to approve programs which are fully consistent with performance payments.

The following idea is proposed as an illustration for how the GCF could fully embrace what we know about the complexity of development and climate change policy by piloting a new modality. The particulars of defining the baseline, setting prices, etc. could be changed without altering the core idea. The details are offered only to make the idea more tangible.

Imagine if the GCF established a pilot program consisting of:

- An *open offer* to the first 10 tropical forest countries who were willing to come forward and sign up for a 5-year program with option to mutually renew for another five years.
- The program would establish a *baseline* for each country based on a simple process of incorporating recent rates of deforestation and a path toward zero deforestation by the time the country reaches an income level of $10,150.[10]
- The GCF would set aside *$1 billion annually for disbursement* to these 10 countries based on averted tons of carbon emissions at a rate of $25/ton.
- The GCF would commit to pay each country for *up to 4 million averted tons of carbon emissions* verified through satellite monitoring.
- Any funds remaining from the $1 billion annual allocation after disbursing these amounts would be paid out to countries who exceeded the 4 million averted tons level.
- The GCF would reserve the right to suspend payments for any participating country which was found to violate international agreements on human rights, social protections and environmental conditions by a pre-agreed and existing international organization, panel or tribunal.

By making such an open offer,

- GCF would begin paying out performance rewards for averted emissions within one year of signing the agreement with the first 10 countries.
- It would be assured of regular annual disbursements so long as the 10 countries, in aggregate, averted 40 million tons of carbon emissions.
- It would bring immediate regular attention to the rate of deforestation in these 10 countries both domestically and internationally.
- It would provide flexible funding to the recipient countries to make more progress in the ways they deem most effective.
- And it would provide international support in a way that works with, rather than against, the process by which real complex social and political development occurs.

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End Notes

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[1] For example, hopes for the Fast Track Initiative to accelerate universalizing education were dampened by World Bank insistence that countries undertake new appraisals rather than rely on existing diagnostics (Bermingham 2009 and 2011). More generally, researchers have demonstrated ways in which conventional project planning interferes with local institutional development by interfering with local processes of iterative adaptation (see for example Easterly 2006 and Andrews et al. 2012).

[2] Consider, for example, delays in Guyana's REDD+ program caused by channeling funds through the World Bank (Busch and Birdsall 2014).

[3] Consider for example Indonesian attitudes toward Norway's pay for results agreement described in Seymour et al. 2015 and Dharmasaputra and Wahyudi 2015.

[4] Arguments about the inflexibility and problems caused by planning are presented in Easterly (2006) and inform the call for more flexible programming of funds in the Paris Declaration and Accra Agenda for Action (http://www.oecd.org/dac/effectiveness/parisdeclarationandaccraagendaforaction.htm).

[5] Kenny and Savedoff 2013 discuss evidence that World Bank procurement rules and other control mechanisms generate transaction costs without materially reducing risks. For example, "red flags" denoting corruption risks were ubiquitous in water and sanitation programs and their appearance correlated with project complexity but not corruption indicators. Furthermore, the number of bidders on World Bank programs has declined over the same period that countries have been encouraged to improve procurement integrity through competitive bidding.

[6] For further discussion of reference levels see, for example, Herold et al. 2012 and Wheeler et al. 2011.

[7] See, for example, Wheeler et al. 2011.

[8] An analytical discussion that shows the bounds for setting the amount are related to the funders willingness to pay and the recipients willingness to accept can be found in ESMAP 2015.

[9] See William Savedoff "Funders Worry About 'Double Counting' – but What About 'Double Demanding'?" http://www.cgdev.org/blog/funders-worry-about-double-counting-%E2%80%93-what-about-double-demanding.

[10] This proposal is based on Wheeler et al 2011. op. cit. but is only used to illustrate the concept of a baseline which is relatively simple, incorporates major concerns about differences across contexts, and can be easily illustrated in charts.