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Submission of information concerning innovative financial mechanisms, pursuant to decision X/3, A, paragraph 8(c)

The CBD resource mobilization strategy aims to assist Parties and relevant organizations in exploring new and innovative financial mechanisms at all levels with a view to significantly increasing the source of funding to support the achievement of the Convention's three objectives. The strategy considers a wide range of possible funding sources, both public and private, and is geared towards implementation during an initial period up to 2015, coinciding with the development planning cycle, including the Millennium Development Goals. As with Climate Change financing, funding for biodiversity will need to come from a wide variety of sources, including alternative sources of finance, the scaling up of existing sources and increased private flows. Experiences form Climate Change financing is highly relevant for biodiversity financing, both for lessons learned and as joint resource streams e.g. REDD, LULUCF and ecosystem based adaptation.

The high-level advisory group on climate change financing[1] points out that new public instruments based on carbon pricing are important for mobilizing both public and private climate financing. While 50% of the funding identified by the group to reach the goal of USD 100 billion was market based, the recently released TEEB for Business Report [2] assess the emerging markets for biodiversity and ecosystem services to add up to USD 480 billion a year by 2020. With such promising numbers it might be argued that biodiversity finance could be left to the market alone. However, the market opportunities outlined in the TEEB report are not yet fully developed. The national follow up of TEEB- activities may also increase resources to support the achievement of the Convention's three objectives. To explore further some of the opportunities and potential pitfalls of the innovative market based mechanisms

[1] Report of the Secretary-General's High-level Advisory Group on Climate Change Financing, November 2010

[2] The Economics of Ecosystems and Biodiversity (TEEB) for Business: Executive Summary, 2010, page 11, Chapter 5, page 33, see: http:/teebweb.org/.

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for biodiversity, Norwegian Agency for Development Cooperation (Norad) commissioned a study to examine the most discussed market-based instruments and financial mechanisms within the conservation debate.
The study is used as a basis for the Norwegian response to CBD Decision COP X/3, A, paragraph 8(c), inviting parties, relevant organizations and initiatives such as the World People's Conference on Climate Change and the Right of Mother Earth, to submit information concerning innovative financial mechanisms that have potential to generate new and additional financial resources as well as possible problems that could undermine achievement of the Convention's three objectives; conservation, sustainable use and benefit sharing of genetic resources.

An international team, headed by Professor Arild Vatn at the Norwegian University of Life Sciences was selected for the study. The aim of the study has been to examine the opportunities and limitations of the most discusses marked-based instruments and financial mechanisms within the conservation debate. The report is divided into three parts: 1) general evaluation of market-based mechanism, their foundations and demands, 2) an analysis of experiences, with some key examples, mainly payment for ecosystem services (PES) and the associated system of conservation trust funds, and 3) other mechanisms that may be considered more experimental such as PES procurement auctions, habitat banking and ecological fiscal transfers. The potential to reform subsidies is also included in the analysis. The study does not cover payments for bio-prospecting and biodiversity based commodities such as eco-certified products and ecotourism. It does however track experiences of PES and other market based mechanisms for finances in both developed and developing countries. In this respect it goes outside of the innovative development finance discourse, which focuses on the search for "innovative " or alternative sources of Official Development Assistance to help finance achievement of the Millennium Development Goals.

Innovative development finance involves nontraditional applications of solidarity, Private Public Partnerships (PPP), and catalytic mechanisms that (i) support fundraising by tapping new sources and engaging investors beyond the financial dimension of transactions, as partners and stakeholders in development; or (ii) deliver financial solutions to development problems on the ground. Even though the scopes are different, the report comes to the same conclusions on lessons learned as the World Bank study on innovating development finance [3]:

- Success depends on robust regulatory regimes and clear agreement of roles and responsibilities;
- High start up and running costs of certain schemes have been noted and more in-debt evaluation will be required to determine the value-added and net benefits of fund-raising efforts and financial solutions.

The most surprising finding in the report is that in all the PES systems for biodiversity studied, the state plays a key role, not only in defining rights/caps, but also as a buyer. As much as 99 per cent of payments derive from public sources, while this percentage is 97 for developing countries. In all the PES cases studied, payments go to land-owners, implying that they are implicitly granted the right to existing practices. As most of the PES examples

[3] CFP Working Paper series no. 1, Innovating Development Finance. From Financing Sources to Financial Solutions, by Navin Girishankar, 2009.

studied have been in operation for more than 10 – 20 years, the dominating role of government funding cannot be explained by high start up costs. High transaction costs seem to be a core explanation for the extensive involvement of public authorities.

The report emphasizes that establishing markets requires government actions and interventions. The most fundamental action is the definition of rights, as it is crucial for creating financial flows for biodiversity. Hence, public authorities have to specify if rights should rest with traditional right holders and land-owners or with those benefiting from biodiversity and ecosystem services, i.e., whether the 'provider gets' or the 'polluter pays' should take precedence. In this regard it might be relevant to draw the attention to target fourteen of the CBD Strategic Plan 2010-2020.

Establishing rights to facilitate market trades demands that the goods or services involved are well defined and demarcated. The report points out that this is particularly demanding in the case of biodiversity and ecosystem services. Such goods and services are the result of complex processes that are interlinked and difficult to demarcate. Moreover, they have different values and meanings for each individual and also for each country. Information costs are very high. Hence, where payments are used, they are typically linked to proxies in the form of e.g., certain practices or management options, rather than the services themselves. In this respect biodiversity finance do not differ from climate finance. Together with the multidimensional nature of the values involved in biodiversity, this implies limitations to using markets for biodiversity protection.

The systems studied in the report are evaluated using a common set of criteria:

- Legitimacy of process
- Legitimacy of outcomes:
  - o Effectiveness (delivery of services; additionality; permanence; leakage issues)
  - o Efficiency (cost-effectiveness; opportunity and transaction costs)
  - o Equity (distributional effects)

The choice of system implies a choice between different governance structures where the legitimacy of the actual processes – how various groups are involved – is often as important as the outcomes themselves. With respect to the increased use of markets, the question is as much about whether this is a legitimate way to treat environmental values, as it is about whether the markets may work well from a purely functional perspective.

New varieties of financial mechanisms, such as PES procurement auctions, ecological fiscal transfers and habitat banking, may potentially play a greater role in the future mix of instruments used to increase financing for conservation, and potentially create more appropriate incentives.

The report concludes that market based instruments for biodiversity is to a large extent experimental and that several challenges are emerging. The main concern is the very legitimacy of using markets to ensure biodiversity protection in the first place. While trading is thought to have the capacity to reduce costs and increase effectiveness, the report points out that there are several uncertainties and problems involved. These concern not least aspects of quality. The report observes several challenges here. Markets can capture only a subset of the values involved. In fact, markets do not provide the best conditions to trade environmental values and goods. They are, moreover, best at handling well demarcated and discrete assets.

The High-level Advisory Group on Climate Change Financing points out that instruments based on carbon pricing are particularly attractive because they both raise revenue and provide incentives for mitigation actions. The same cannot be said for biodiversity. A common biodiversity currency does not exist and none of the innovative financing schemes for biodiversity is close to defining such a currency. Tradable assets linked to new instruments such as habitat banking can be used in relation to development rights in a region but not as a tradable global asset. On the other hand the rich experiences of different government PES schemes for biodiversity in developed countries should be a good basis for developing similar PES schemes in developing countries. Tax and subsidy reforms are at the core of these systems and needs to be looked into more closely.

The report covers only a limited number of the market opportunities outlined in the TEEB report. Certified agricultural products, voluntary biodiversity offsets and bio-prospecting contracts are assumed to generate more than USD 300 billion per year. The general conclusions of the report regarding legitimacy is, however as valid for these markets, as for the selected markets studied in the report. The report documents that governments need to play a major role in creating and regulating markets. To realize the full economic potential of innovative financing for biodiversity, public and private investments to improve the knowledgebase and management of biodiversity is needed. Hence, the issue is not only about 'how much market', but also about the role of governments in forming and regulating markets.

Please find attached the report "Can markets protect biodiversity- an evaluation of different financial mechanism". The report does not reflect official positions or policies of the Norwegian government, but is meant as an input to address CBD decision X/3, A, paragraph 8(c).

Yours sincerely,

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