

UN-REDD PROGRAMME POLICY BRIEF



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Fiscal incentives for agricultural commodity production: Options to forge compatibility with REDD+

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KEY MESSAGES

1. Fiscal policies and incentives are often key underlying drivers of forest change that influence land use behavior in sectors that encroach on forests, although the understanding of their impacts on forests is often lacking. Fiscal policies have not been systematically examined as part of REDD+ readiness.
2. Public policy and related fiscal policy and incentives must seek coherence across sectors, in order to overcome inherent conflicts between sectors and competing land uses, and to send the right signals.
3. REDD+ provides an entry to rethink fiscal incentives for agricultural commodities as part of Actions Plans National REDD+ Strategies.

I. Introduction

Fiscal policies and incentives are often key underlying drivers of forest change that influence land use behaviour in sectors that encroach on forests, although the understanding of their impacts on forests is often lacking. Developing countries that are pursuing REDD+¹ seek to reduce greenhouse gas (GHG) emissions from the clearing and degradation of forests. Agriculture is estimated to be the direct driver for around 80 per cent of deforestation worldwide, and yet in order for countries to reverse this pressure, they must influence the underlying or indirect drivers associated with the production of agricultural commodities in an increasingly globalized economy.² The future pressures on forests are enormous. More than 80 per cent of growth in global demand over the next 15 years for field crops, fibre and beverage crops, meat, timber and forest products, will be in developing countries, and yet the options to overcome crop and pasture yield constraints present huge technical, social and economic challenges.³ To avoid crop expansion and just meet projected crop needs by increasing production, it is predicted that crop yields would need to increase by an estimated 32 per cent more from 2006 to 2050 than they did from 1962 to 2006 during the height of the 'green revolution'.⁴ Reaching such increases in yields is highly unlikely. With global population rising to at least nine billion people by 2050, it is commonly accepted that the resource degradation and increasingly marginal food production circumstances risk the economic and ecological stability we have come to rely on in the past.^{5,6} Our agricultural systems are reaching a productivity plateau, and often depend on spatial expansion, rather than increases in yield per hectare, for production increases.

Our natural capital - forests, agricultural lands, water - are increasingly being understood in the context of building social capital and stable economies. The Aichi Biodiversity Target number 3 calls for the elimination and reformation of incentives and subsidies harmful to biodiversity by 2020.⁷ The post-2015 sustainable development goals (SDGs)⁸ identify a range of economic, social and environmental goals that countries agree should form the basis for sustainable development moving forward. Halting and reversing land degradation and biodiversity loss, sustainably managing forests, ensuring sustainable production and consumption patterns, and promoting inclusive and sustainable economic growth are key goals.⁹ One sustainable development target specifically calls for the phasing out of inefficient fossil fuel subsidies that encourages

wasteful consumption and market distortions.¹⁰ Income inequality and economic efficiency are important indicators for how far countries are along the pathway towards inclusive economic growth. The UN report, *Inequality Matters*, finds that economic inefficiency traces back to highly unequal land distribution in a significant number of developing countries, and enhancing land equity and productivity crucially must underpin broader rural development strategies.¹¹ The report finds that while some Latin American and African countries have reduced economic inequalities over the last two decades, income disparities have increased within many countries, and risk development futures. Further, the unequal distribution of public and private assets is an important determinant of spatial disparities, and this is visible in the enduring urban-rural divide. **For REDD+ countries, this requires decoupling economic growth from deforestation and forest and land degradation, and finding greater compatibility between rural development, commodity production and REDD+, for solutions towards low-carbon growth.** The redesign of fiscal incentives can help enable that transition, and this paper explores examples of and pathways for how this can work.

While decoupling economic growth from deforestation and degradation sounds simple, operationalizing the concept requires rethinking the fiscal incentive frameworks promoting agriculture and the opening of the forest frontier. The recent *New Climate Economy* report notes that many countries subsidize key agricultural inputs, such as irrigation water and fertilizer, in order to boost productivity, but evidence suggests these subsidies can also lead to waste and environmental damage. There is an urgent need to identify how policy changes can increase the efficiency of agricultural production and reduce GHG emissions.¹² Fiscal and policy incentives that support agricultural development were usually not designed with REDD+ in mind, and thus need to be better understood and revised to identify the complementarities and conflicts between such fiscal policies and REDD+. This should include assessing how social, economic and environmental impacts and benefits associated with fiscal policies and measures can be better understood and balanced.

A. Definitions

Box 1 below provides a set of working definitions for the full range of subsidies and fiscal incentives that

Endnotes

1. The 'Cancun Safeguards' were agreed at the UNFCCC COP 16 in Cancun, Mexico, in 2010 with the aim to ensure that social and environmental risks are minimized and benefits enhanced when implementing REDD+. More information is provided in Box IV.
2. FAO estimates that greenhouse gas emissions from agriculture were 5.3 Gt CO₂-eq per year in 2010 with another 4.0-5.0 Gt CO₂-eq per year from the forestry and other land use activities such as deforestation, biomass fires and peat degradation (FAOSTAT, 2013)
3. Soft commodities generally refer to commodities that are grown, rather than those extracted such as metals, minerals and fossil fuels.
4. The NCD has been signed by more than 40 CEOs of financial institutions and is supported by more than 30 non-financial organisations. The initiative is managed by UNEP FI and Global Canopy Programme.
5. The framework builds on previous work by WWF, including key performance indicators used in a Bank Policy Benchmarking Tool developed in 2012 to anonymously assess banks' environmental and social policies for high-risk sectors.
6. There is not one uniform definition of corporate social responsibility (CSR), but one way to define it is 'a company's sense of responsibility towards the community and environment (both ecological and social) in which it operates' (Business Dictionary). Depending on the definition that one uses for CSR it can be criticised for being disconnected from a company's main activities. In order to deal with ecosystem degradation, including deforestation, a better model might be to focus on how impacts and dependencies by a company on the natural environment, and the resulting exposure to risks and opportunities, can affect its operations in a financially material way. Linking ecosystem degradation directly to a company's business operations brings greater clarity to the fact that it is in the company's self-interest to deal with impacts and dependencies on a continuous basis through operations and supply chains.
7. <http://www.theconsumergoodsforum.com/strategic-focus/sustainability/board-resolution-on-deforestation> (viewed in May 2015)
8. <http://www.theconsumergoodsforum.com/the-consumer-goods-forum-statement-in-response-to-greenpeace%E2%80%99s-campaign-on-palm-oil> (viewed July 2015)
9. In the context of this report natural capital is defined as 'the stock of ecosystems that yields a renewable flow of goods and services' (such as timber, other forest products, water regulation, carbon sequestration, etc). This definition of natural capital excludes non-renewable natural resources such as metals, minerals and fossil fuels (Mulder et al., 2013)
10. <http://www.nbim.no/en/the-fund/> (viewed in July 2015)
11. Although preferential terms by large or universal financial institutions are an interesting financial incentive for borrowers to produce more sustainably, the cost of capital provided by domestic financial institutions or other sources of finance (often without specific environmental and social conditions tied to loans) may still be cheaper and therefore more financially attractive.
12. It is important to note that it is typical of national and regional banks to only make information available in the local language, which was a constraint for this study.
13. It is important to note that not all finance is provided by the formal banking sector. A study on Riau in Indonesia showed that for independent smallholders which are responsible for 60% of forest clearing, 90% of their finance needs are self-financed or provided through family networks.