COUNTERING TRANSNATIONAL CORRUPTION GRAND CHALLENGE FOR DEVELOPMENT:

SAFEGUARDING CARBON MARKETS CO-DESIGN SESSIONS

May 2024

EXECUTIVE SUMMARY

The United States Agency for International Development (USAID) held five co-design sessions and completed a comprehensive literature review between January and May 2024 to determine the key elements of a call for innovations through the Safeguarding Carbon Markets Challenge (SCM Challenge). The SCM Challenge is the latest activity under the Countering Transnational Corruption Grand Challenge for Development (CTC Grand Challenge). Through this literature review and the co-design sessions, the CTC Grand Challenge team engaged diverse global and local perspectives to determine where innovation might be needed in climate finance and carbon markets and how to incentivize it.

The team focused the first co-design session on climate finance with carbon markets as one potential area of interest. As a result of the insights gained in that session, the following four sessions focused exclusively on carbon markets, from a recommendation to narrow the scope within climate finance and that carbon markets present a unique opportunity to innovate to preserve the benefits of critical finance for global climate mitigation efforts.

The co-design sessions and literature review provided the CTC Grand Challenge team with an understanding of both potential areas of innovation and challenges in the carbon markets space. Key results underscored that:

- In the last three years, average annual climate finance flows reached approximately $1.3 trillion as mitigation efforts accelerate to achieve net zero greenhouse gas emissions by 2050.[1] Addressing corruption has the potential to maximize the impact of these investments and raise additional future funds for climate finance.
- High-integrity carbon markets represent a promising channel to unlock capital and demand for lasting and independently verified emissions reductions, with a myriad of additional benefits for local communities. However, corruption risks can undermine the trust in and effectiveness of carbon markets because they are difficult to measure, regulate, and monitor, and they still lack strong governance, reporting, monitoring, and auditing systems.
- Carbon markets are at varying stages of development across individual countries, as some countries have more advanced markets, regulatory systems, and the capacity to trade in carbon credits, while others do not. Regardless of where they are in their development process, all markets present opportunities for corruption that warrant attention.
- While the literature on concrete cases of high-level corruption in carbon markets is still limited, most focus on opportunities for embezzlement, rent-seeking, fraud, and land grabbing.
- It is essential to work with local leaders, communities, and civil society organizations to define the problem, determine the opportunities for corruption in country or regional contexts, and identify potential solutions grounded in the realities of the local context.

These discussions helped to form the foundation of the SCM Challenge, which launched in June 2024.

[1] See the Global Landscape of Climate Finance, Climate Policy Initiative, 2023.

CLIMATE FINANCE BROADER CO-DESIGN SESSION

The CTC Grand Challenge held the first co-design session focused on climate finance on January 17, 2024. This co-design session was a hybrid event, with some participants attending in person in Washington, DC, and some attending virtually. Through this initial session, the CTC Grand Challenge team aimed to collect information to frame the scope of the CTC Grand Challenge's work on transnational corruption in climate finance, identify where USAID could have the greatest impact, clarify common themes, and determine if there were additional stakeholders to engage through co-design.

The session highlighted the growing investment in climate finance ($1.3 trillion in average annual flows from 2021-2022) to achieve net zero greenhouse gas emissions by 2050 through adaptation and mitigation efforts in renewable energy, transportation, land, and other infrastructure. The session also emphasized that the top ten recipient countries of climate finance score below average on the corruption indices, yet they receive 42 percent of funding, and seven to 15 percent of these transfers are lost to corruption. Addressing existing corruption risks is crucial to enhancing trust in and protecting future funds for climate finance.[2]

During the session, the participants split into breakout groups, where facilitators asked them to define the problem and describe the state of innovation, including the types of solutions that might have an impact and potential barriers. The co-design group discussion resulted in the following key takeaways:

- There is significant pressure to disburse funds quickly to address climate change. In addition, climate funds are likely supporting corrupt and illegal mining, logging, or other land use practices, particularly in remote locations where it is difficult to monitor.
- Funds are moving across a growing suite of both highly diverse and technical industries (including mining, energy, forestry, infrastructure, and construction) that involve traditional and non-traditional financiers from the private and public sectors, bilateral and multilateral donors.
- Climate finance often involves unclear or evolving laws and regulations for governments with limited capacity to monitor, audit, and certify the process.
- Land use and access that supports local communities' livelihoods are an integral part of the work in climate finance, particularly related to carbon markets.
- High-integrity carbon markets are a potentially promising solution to support lasting, and independently verified emissions reductions that benefit local communities. However, there is a lack of regulation of carbon credit registries; measurement, reporting, and verification systems; and overall commodity supply chain certifications.
- While investors want reliable data and information on carbon markets, they are at varying stages of development around the globe. Greater data transparency presents one potential solution to corruption challenges. Its success is dependent on the ability of local leaders, communities, and civil society to utilize the data.

This first co-design session indicated that the overall area of climate finance was likely too broad for an individual open innovation competition and that the CTC Grand Challenge may want to focus on carbon

---

[2] See Corruption and Climate Finance, U4 Anti-Corruption Resource Centre, 2020.

markets. The breakout groups determined that carbon markets are an area that is less explored for countering corruption and particularly ripe for innovation, despite the challenges that exist around data measurement and utilization in the space. The importance of engaging local voices was noted, which led the CTC Grand Challenge team to plan subsequent sessions focused on targeted regions around the globe that are impacted by carbon markets.

REGIONAL DISCUSSIONS ON CARBON MARKETS

The CTC Grand Challenge team held four additional co-design sessions. The first was in-person, on the margins of a HackCorruption boot camp in Malaysia, on February 23, 2024. The other three were virtual sessions that included participants from West and Central Africa (in April 2024), South Asia (in May 2024), and Latin America and the Caribbean (in May 2024). The team held these conversations to understand what issues in carbon markets matter most to participants from each region, as well as to learn about any promising solutions that can serve as a model.

These regional discussions emphasized that carbon credits are demand driven and involve the purchase and sale of carbon credits or allowances under voluntary, compliance, and Article 6 markets.[3] Participants noted that because carbon credits are intangible commodities, they are difficult to regulate, can be poorly designed with non-standard evaluation criteria, and face limited oversight and transparency, resulting in significant outcome variability. This creates opportunities for embezzlement, rent-seeking, fraud, and land grabbing and ultimately leads to large-scale corruption by government officials siphoning off wealth from land deals, natural resources, and local, indigenous, and marginalized communities.

The co-design participants shared their personal experiences and technical insights, which included the following:

- **Southeast Asia**: According to some participants, the regulatory landscape in Southeast Asia is not ready for carbon offsets. There is confusion and even skepticism in the region about how to sell, receive funding for, or participate in, carbon offset activities. Land considerations are key to carbon offset activities and climate finance, particularly in Indonesia, which receives a significant amount of climate funds and carbon offset investments. Carbon market activities must use local language and engage local communities to build an understanding of the potentially positive or negative impacts on local communities. Any anti-corruption work in this space should empower local communities, including women and youth, to push for greater transparency and integrity in carbon markets.

---

[3] Article 6, of the Paris Agreement (an international treaty on climate change that was adopted in 2015), sets out how countries pursue voluntary cooperation to meet their climate targets, tackling climate change through financial support for developing countries. Additional to being a source of financing, they provide the tools, including the Paris Agreement Carbon Crediting Mechanism (PACM) that enable countries to transfer carbon credits earned for the reduction in greenhouse gas emissions. Under this mechanism, a company can reduce emissions in a given country, and trade or credit those reductions for sale to a company in another country to offset their emissions.

- **Africa:** Participants stated that the lack of policies and clear regulations around carbon markets, the large number of actors involved, and the overall politicization of the carbon markets sector have led to a lack of trust in these markets. The participants discussed specific corruption cases, including one in Liberia where the president attempted to sell about ten percent of a community's land to a Dubai-based company for carbon offsets with no revenue for the people living there. Protests eventually halted this project. Participants also discussed a case in Zimbabwe's Hurungwe District, which resulted in significant revenue for issuers and traders of carbon credits and government officials, while offering limited returns for the local Kariba community. Many carbon projects do not benefit local communities, and politicians and government administrators often lack an understanding of how carbon markets are supposed to function or who they are meant to benefit. Participants suggested that a vibrant civil society is critical for taking governments to task on corrupt deals and issues surrounding transparency, asking hard questions, and acting as a watchdog. They also emphasized that ensuring land tenure and administration, for local communities living on land involved in carbon market deals, are central to the conversation.
- **South Asia:** Participants reported a high degree of investment in the just energy transition, particularly in India where there is limited due diligence on carbon projects. This is an especially large challenge in areas categorized as "wastelands," which are deemed as non-productive land. While not owned by local communities that use them, approximately 1.3 billion people depend on them to graze cattle and grow subsistence crops. Participants explained that there is a focus on how developers and private investors use this wasteland, but limited emphasis on the ways in which corruption in carbon markets impacts communities. This session made clear the importance of revisiting how carbon markets are quantified, credited, and verified to tackle the enabling environment and broader corruption risks within carbon markets.
- **Latin America and the Caribbean:** Although carbon markets may not be as advanced in Latin America and the Caribbean as they are in parts of Africa or Asia, they are of growing importance for the region. Participants noted the potential impact they may have on the lives and livelihoods of indigenous and other local communities. Within this context, participants noted that investigative journalism can play an important role in shedding light on corruption and holding officials accountable for guaranteeing the benefits of carbon transfers for local communities.