

Mobilizing Public and Private Resources for the Protection of Tropical Rainforests

The need to create incentives for immediate investments in the reduction of emissions
from deforestation within the international climate change regime

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1. Objective

The objective of this policy brief is to propose a framework aimed at achieving meaningful reductions in greenhouse gas (“GHG”) emissions from deforestation. The authors and supporting organizations call upon the Parties to the UNFCCC and the Kyoto Protocol to adopt a set of mechanisms which allow (i) for an immediate and broad participation by developing countries whilst (ii) facilitating the integration of private investors in such efforts.¹

2. Background

GHG emissions from deforestation in developing countries represent about 20% - 25% of global GHG emissions. Avoiding further deforestation and promoting sustainable forest management is the single largest opportunity for cost effective and immediate climate benefits. It can also provide a “bridge” to the cleaner energy technologies that are needed but which will take decades to develop and deploy. Effectively reducing deforestation is therefore a strategic issue in the climate change agenda for the period post 2012.

However, reducing emissions from deforestation will require a continuous international effort to build the required capacities and to sustain adequate levels of funding. Research carried out for the Stern Review² indicates that “*the opportunity cost of forest protection in 8 countries responsible for 70 per cent of emissions from land use could be around US\$ 5 billion annually, initially, although over time marginal costs would rise*”. Only market instruments can mobilize this level of investment and induce GHG emission reduction activities at a scale that would be adequate for pursuing the ultimate objective of the UNFCCC. It is therefore essential that the international climate regime creates a robust framework and stable incentives for investments in sustainable forestry and forest protection.

3. Cornerstones

Decades of international cooperation for the protection and development of forest resources in developing countries, as well as the recent establishment and rapid growth of the international carbon market, provide the basis for the identification of some basic elements crucial for the success of any mechanism aimed at Reducing Emissions from Deforestation in Developing countries (REDD):

¹ The proposal intends to contribute to the ongoing discussions in the context of the UNFCCC by incorporating the different views and concerns expressed by Parties during the negotiation process started at the 13th Conference of the Parties in Montreal (2005). The proposal builds on a UNFCCC submission by CATIE and BVEK (http://unfccc.int/essential_background/library/items/3599.php?rec=j&priref=500004142#beg).

² Stern Review, Final Report. Part VI, Chapter 27. Cambridge University Press, 2006



- Incentives to undertake REDD measures under the UNFCCC framework should accommodate different national circumstances and levels of capacity, so that countries are able to participate immediately and increase their participation as they enhance their capacities, thus allowing for a growing involvement in global emission reduction efforts.
- Traditional sources of funding will not suffice to achieve a meaningful reduction in emissions from deforestation. Market mechanisms which allow full private sector participation are the most promising tools to create sufficient financial transfers to reduce emissions from deforestation in developing countries. In order to mobilize the necessary investment flows into developing countries, a private-sector driven mechanism allowing for the commercialization of carbon credits is essential. The example of the CDM shows that private investments can dwarf public sector contributions.
- Countries and private actors have earned valuable experience with the implementation of emissions reduction activities in developing countries, i.e. the CDM. Scientific and methodological uncertainties have decreased and capacities have been increased. Consequently, the proposed mechanisms should be consistent with the principles of the carbon market and rely on the technical and institutional infrastructure already in place.
- Any mechanism has to be embedded in a wider participation and deeper GHG emission reduction commitments by Annex I countries.
- Incentives to reduce emissions from deforestation should be complemented by instruments to allow countries to build capacities and enhance the availability and quality of data, as well as to propose and implement effective measures.

4. Problems of Relying on National Baselines Only

Many UNFCCC negotiators appear to favor a REDD mechanism exclusively built on the adoption of national baselines. Such baselines would go hand in hand with the establishment of a national baseline-and-credit system and require the definition of a national reference emission level. Credits would be issued only for emission reductions below the reference emission level. Such a system would *only be successful in those countries that are able to successfully implement effective policy, legal and institutional reforms nation wide, including appropriate social and economic safeguards*. The time requirement, political cost, and failure risk of such reforms are likely to be high, as history shows, given the complexity of the deforestation problem and the cost and barriers of such a wide-scope activity. *Any failure to reduce emissions below the reference scenario would prevent a country from getting the carbon revenues it needs to sustain and improve its efforts to reduce emissions in the long run, thus making subsequent actions more difficult to justify politically.*

A consequence of such a mechanism is that *countries with little capacity to implement forest protection measures, and thus most in need for international support, would not be able to participate in a system which rewards the nation wide lowering of deforestation rates only*. It is further unlikely that private investors would be willing to share the risk of potential policy failure by directly supporting government programs. *It is generally unlikely that the private sector would participate in a REDD mechanism which links investment risk to government performance*. In a system in which the allocation of funds and potential carbon credits takes place through host country governments, the political and legal risk of the mechanism will be considered as too high as to attract private finance. Therefore, *it is important to assure that successful project-based activities implemented by private and public entities will be credited regardless of possible over-emissions and no-credits at the national-level.*

5. Main Design Features of a REDD Mechanism

Based on the assumptions laid out above, we propose a double baseline-and-credit mechanism which rewards government as well as private efforts for lowering deforestation rates. The mechanism consists of the following elements:

- A country-wide scheme based on the following principles:
 - i. Internationally negotiated and agreed reference level of deforestation, which rewards the lowering of national levels of deforestation.
 - ii. The creation of fungible carbon credits which can be used to comply with GHG targets.
 - iii. Countries may allocate these credits to private entities and authorize them to trade the issued credits.
 - iv. A mechanism ensuring permanence of the achieved emission reduction.
- A project based mechanism for REDD based on the following principles:
 - i. The authorization of private or public entities to implement REDD activities at the project level, regardless if the host country has a negotiated a national emission reference level.
 - ii. Credits for these project activities would be issued directly to the project entities through an international and independent mechanism, regardless of national emissions from deforestation (CDM type of mechanism).
 - iii. Mechanisms addressing leakage and ensuring permanence of the achieved emission reduction.
 - iv. The creation of fungible carbon credits which can be used to comply with GHG targets.
- A voluntary early action phase, starting prior to 2012, rewarding private and public activities in REDD activities.
- A Fund to create enabling conditions and pilot experiences in non Annex I countries complementing the market based mechanisms which should be established as soon as possible to encourage and enable early action.

6. Proposal for a REDD Mechanism

National and sub-national policies and measures should be envisioned as creating an enabling environment for forest carbon conservation and preservation project activities carried out by local actors and to complement private and public efforts at the project level (e.g. CDM-like projects). Success will depend on these two elements.

A mechanism is proposed to encourage developing countries to start emission reductions at the national level as soon as possible. However, due to different national circumstances and levels of international assistance, some countries will not be able to account for emission reductions immediately. We therefore propose a “*nested approach*”, whereby project activities can start independently and sooner in a context where national level emission reductions are progressively implemented by a larger number of countries. Developing countries would be able to decide their initial level of participation in this mechanism. However, in the case of implementation at the sub-national level, once the total area of a participating country reaches XX% of its forested territory or YY ha (an amount that could entail significant leakage at the national level and which would have to be negotiated), such country would have to adopt a national emission reduction goal. Developing countries could, at any time before reaching the limit proposed above, decide voluntarily to implement a national scheme.

6.1 National Approach

Non-Annex I countries are encouraged to negotiate target levels of emission reduction. That level may be above or below the objective deforestation level of the base-year or base reference period. As exact deforestation levels and future land use trends are often unknown, developing countries should be given enough time (and assistance) to assess these issues. Moreover, to be realistic and achievable, the emission reduction level to be pursued by each country should first be discussed and agreed internally by each host-country, taking into account institutional barriers, agents and drivers of land-use change, growth projections, contrasting interests of different economic agents, and the multiple views on national sustainable development. The success of reducing emissions from deforestation depends on developing countries being able to conclude this process with sufficient technical and financial assistance. This takes time. We therefore envision a roadmap with clearly defined milestones to reach the goal.

REDD credits shall be issued for any voluntary emission reduction below the agreed national reference emission level. Such credits would be *permanent* and *fungible* with any other emission allowances. A *mandatory reserve account* of XX% of the REDD credits issued from a country would guarantee the permanence of the emission reductions traded in the carbon market. Issuance of REDD credits would be overseen by a UNFCCC body according to the following principles:

- A reference emission level would be defined for each crediting period, which may include one or several Annex I commitment periods and several verification periods of one or more years.
- If emissions from deforestation were above the reference emission level in a verification period, no credits would be issued.
- In case emissions from deforestation remained below the reference emission level, and REDD credits are issued, the implementing country would remain liable for the permanence of the emission reductions. Consequently, in case of future emissions above the reference emission level, the implementing country might either:
 - i. Offset the excess emissions by transferring REDD credits from its reserve account, or by acquiring REDD credits from other implementing countries' reserve accounts; or
 - ii. Over-comply in the subsequent verification period by an amount of emission reductions equivalent to the excess deforestation emissions; or
 - iii. Request an adjustment of its reference emission level for the subsequent verification period, arguing justifiable reasons of force majeure (such as large-scale forest destruction due to extreme climatic events and their consequences) or improvements in the availability of data and methods. Any adjustment of the reference emission level would be subject to either review and approval by the Parties, or independent validation and certification by an accredited body following transparent and agreed procedures.

6.2 Project Based Mechanism

To avoid delaying the urgent emission reductions that climate change mitigation requires, it is necessary to allow and encourage project level activities and the participation of the private sector. *Project level activities can start sooner and in all countries, independently from activities at the national level and international support.* Successful project-level activities will further encourage governments to take action and will increase the speed of the learning curve, since the private sector does not only bring finance but also human resources. Some countries may be able to speed-up their national process and disclose internationally a voluntary national emission reduction goal already for the post-2012 period. Any country

may authorize private or public entities to develop and implement REDD activities at sub-national, local or project levels.

- Such project activities would have their own emission reference level and may be registered prior to reporting of the national reference emission level.
- REDD credits from project activities shall be real, measurable and additional to any that would occur in their absence. They would be issued directly to the authorized project participants by the competent UNFCCC body, even in the case of excess deforestation emissions at the national level.
- Issuance of REDD credits for project activities would require that the activities be subject to an independent (third party) validation, verification and certification procedure by an independent accredited body.
- Project leakages detected and independently verified would be:
 - i. Deduced in the calculation of emission reductions attributable to the project activity; and
 - ii. Added to that national reference emission level, once this level will have been negotiated and registered.
- Non-permanence would be addressed using a flexible approach:
 - i. Temporary credits with no project and no host-country liability (similar to tCERs).
 - ii. Permanent credits with host-country liability (governments may request a share of the credits to be transferred to the national reserve account).

In our view, the REDD crediting system described above is able to attract private capital in REDD activities because successful project-based activities would be credited even in the case of excess deforestation emissions at the national level. Without such a system, credits would only be issued to governments, and governments would eventually redistribute the proceeds from REDD credits to local actors. This would make the future REDD regime less attractive for private investment and delay field-level activities by several years, as countries would have to agree internally on their national emission reference levels before being able to trade emission reductions, which is likely to be a time-consuming process.

6.3 Supporting Instruments

A new *Fund* could finance activities aimed at creating enabling conditions, including institutional and technical capacities. The Fund may include an enabling window and an activity window. The *enabling window* of the Fund shall be disbursed on a grant basis. Part of its tasks shall be to develop reliable forest inventory data. An *activity window* of the Fund may enable *early action activities* implemented prior to 2012 and any *posterior pilot activity* designed to test the effectiveness of capacities and measures to reduce emissions from deforestation.

To achieve the abovementioned goals a fund would require *identifying sources of sufficient, continued and predictable replenishment* from Annex I countries. Therefore, in addition to voluntary contributions to kick-start capacity building and early action activities in developing countries, any new fund shall be fed by institutionalized mechanisms such as *inter alia*:

- an X% levy on Assigned Amounts first traded in the carbon market, similar to the one imposed on CERs, and/or
- fees on carbon intensive commodities and services in Annex I countries, and/or
- a levy on international transport emissions.