

Reflections of a Summit Organizer

Overview of the Discussion about Forest Carbon Markets

During the six months during our preparation to host the first Forest Carbon Finance Summit, I have had the opportunity to interact with dozens of professionals from many countries and perspectives, who are studying, drafting, debating, negotiating, and in general preparing for inclusion of REDD (or terrestrial carbon) in the comprehensive climate treaty (“Copenhagen”). There is widespread agreement among that group, many of whom are joining the Summit, that REDD must be included in Copenhagen for the world to have a credible chance avoid dangerous climate change, i.e. terrestrial carbon at 18-20% of global emissions is just too large to exclude from the global deal.

What has struck me consistently, however, is that in spite of much agreement on the “inclusion imperative” for REDD, there is still deep disagreement over many important matters which must be resolved to get a deal. We now have only approximately nine months before Copenhagen to bring together all those “similarly interested” parties on the “details” or else Copenhagen may, like Kyoto, fail to include a comprehensive solution for REDD. This Summit is one effort to try to put some good minds together to close some gaps and move the process forward.

Among many issues still remain to be resolved (from scope and scale, to baselines and verification protocols), one of the most central is which funding mechanisms will be adapted for REDD, and whether (or when/how) compliance carbon markets will be embraced. That debate has been characterized so far by two opposing positions. Both have supporting economic theory and impressive advocates among the NGO, consulting and academic communities. The two positions differ most fundamentally over one issue: “the path to full compliance forest carbon.”

One position, is “fast path.” The “fast path” position supports immediate legislation to foster compliance grade offsets, starting from REDD projects at a “sub-national” (project) level. Advocates of “fast path” believe that REDD project offsets will be available at low cost and in large quantities, and thus provide relatively cheap compliance credits for Annex 1 emitters who purchase them. The “fast path” group does not want to make the creation of national or international capacity a prerequisite for compliance offsets as that would take years in many of the tropical forest environments, especially to develop national baselines and technical ability to accurately monitor and verify performance (leakage, etc.). “Fast path” believes that even at a project level there are reliable methods to monitor and verify performance, to estimate and reserve for leakage, to validate quality of the avoided emissions, and to handle permanence and liability. They believe that these methodologies can be applied in a way that will be sufficiently reliable (“not make perfect the enemy of the good”) to justify reliance by investors and protect the integrity of the new climate treaty. While not ignoring social, human rights or other environmental issues, the “fast path” group places primary emphasis fast action on REDD and the climate risks.

At the opposite end of the spectrum from “fast path”, are other NGOs, academics and experts, who have fundamental doubts that a market for compliance offsets should ever be a core mechanism for REDD finance. This “slow path” or “no path to compliance forest carbon” position is more prevalent in Europe than North America. It focuses on the relatively weak level of governance and legal/technical capacity across a wide range of tropical forest geographies, and the high cost and unproven ability in many of those areas to measure, monitor, report and verify emission reductions from REDD, or to verify their additionality or permanence. The “no path” advocates add to this lack of confidence their concern that the drivers of deforestation (and causes of sudden release including climate change itself), will likely threaten much of the “saved” forest at some point later in this century, and thereby undo whatever “success” for REDD may be claimed in the short term. Thus the No Path group concludes that tropical forest carbon cannot be a credible and reliable permanent source of compliance offsets, at least not for many years

Even more pessimistically, the “No Path” group fears that investments REDD offsets counted toward compliance targets would not only be wasted, but would siphon off investment in real permanent emission reductions by Annex 1 countries of their own emissions, and would divert funds away from renewable energy and energy conservation projects in developing countries (and offsets from those projects).

Many in the No Path group also have concerns that the establishment of massive global fund flows to the forest and forest communities purely on the basis of carbon, rather than taking a comprehensive holistic approach (which would weight more highly social, human rights, and environmental services), will distort policy and possibly have negative unintended consequences. They particularly distrust project developers and market intermediaries to adequately consider those broader social issues. For all those reasons, the No Path group generally distrusts carbon markets for REDD and prefers that reduction of tropical forest carbon emissions be funded through (bi-lateral and multi-lateral) public funds coordinated with a central planning mentality and focused on capacity building in early phases. The source of those funds would be not private capital, but rather general public revenues, set-aside portions of emission permit auction proceeds, or levies on particular industries such as marine or airline transportation.

Is A Middle Ground The “Right Path”?

Recently, I have begun to see a third position emerging, bringing together the hopes of “Fast Path” and concerns of the “No Path” advocates. The “Right Path” calls for meeting the objectives of REDD with carbon integrity while respecting and achieving social and environmental values. At the same time, this path fears being overly dependent on public funding for REDD, and fears that it will be unsustainable, especially as western democracies struggle with the huge fiscal burden of supporting their aging populations, now compounded by the financial crisis. While recognizing a role for the voluntary (\$2-5/t) carbon markets, especially for innovation, the right path sees the importance of REDD carbon being able to aspire to become **at some point** compliance carbon (\$10-30/t) in order to attract capital market participants to undertake risky investments at the early phases of REDD.

As this middle ground is still ultimately “pro-markets’, however, in order to attract the support of the “no path’ group I see five principles as key:

(1) RULES AND STANDARDS: getting to compliance carbon requires strong standards and rules to ensure that the carbon is MRVAP*¹. One of the basic elements of bridge building in this area is the insistence on national baselines rather than reliance on sub-national/project approaches.

(2) ADEQUATE NATIONAL CAPACITY: There must be legal and social infrastructure within tropical forest countries sufficiently to make REDD-specific investments reliable and permanent. The “right path” requires public financing, or public-private partnerships for the foreseeable to build that capacity.

(3) INTERNATIONAL FRAMEWORK AND INSTITUTIONS: There must be an enforceable international framework and credible institution(s) to deal with the application and verification of the MRVAP standards, and to handle emergencies.

(4) PHASING: Recognition that “Rome wasn’t built in a day” and neither will REDD be. So a phased approach will be needed to move from planning through full scale implementation. The climate framework should treat REDD carbon differently depending on the phase that its source country has reached in its capacity. And

(5) INTEGRATED PERSPECTIVE (fancy words for “wisdom”) For an intergenerational commitment to permanence to be credible, the REDD sector plans of countries must be thoroughly vetted and tested against the long term projections of drivers of deforestation (population, economy, land use needs, and especially food).

Let me briefly touch on the last three of those areas, as the first two are covered in great depth in numerous excellent articles.

Phasing: hurdles and the path to compliance carbon

The debate between the extremes about a path to compliance carbon really hinges on the credibility that the carbon will be real, additional and permanently sequestered. Naturally, no country can spring from a standing start to being REDD-ready instantly. It will take time for a forest country to establish a REDD sector transformation plan and possess all the elements of readiness (the legal frameworks, land tenure, regulatory policies and enforcement capability, ways of ensuring adequate participation and involvement of communities and indigenous peoples, etc.). It will then take time for that plan to be demonstrated, and then implemented broadly, and then shown to be reliable. During that time there will need to be independent verification of the plan's assumptions and its durability.

There have been various proposals to solve the concern that the world not rely on REDD carbon as compliance carbon before it is proven reliable. "Discounting", "parallel markets", and "buffers/pooling" are several ideas that have been advanced. Regardless of the method chosen to prevent the counting of "hot air", it would seem productive to grade REDD carbon according to the stage of the country's progress along a phased continuum: from the REDD planning and design, through demonstration, early implementation and then mature implementation. Presumably as a country and its REDD efforts progress along that continuum, the reliability of its carbon being MRVAP increases.

One could envisage a sliding scale with various checkpoints along the way. At the early stages of the continuum perhaps none of the REDD carbon would be counted as compliance grade. Further, a small percentage would be sold while most would be held in reserve as a buffer in case it were later shown that leakage or poor data require that carbon to be "retired" (removed from a registry). Finally, after reaching the final stage and establishing credible risk levels (actuarially determined risks of sudden release for example due to fire or drought---see the section below) most of the carbon would be available for sale in the global cap and trade regime.

Formally establishing objective criteria and clarifying the process for “graduation” from one phase to the next and the positive incentives for doing so would accomplish several desirable goals:

---signal to the doubters of REDD carbon that “hot air” would not reach the market and thus not interfere with the other climate mitigation efforts

---signal to countries and their leaders a clear path and positive reason to take the difficult decisions to adjust plans and practices, and stay the course against domestic opposition to change (“if we are willing to do x, we can sell 15% of our carbon, but if we can do x, y, and z, we can get to full compliance status and sell up to 85%...”)

---encourage the participation of private capital as there would be a transparent path for investors who could see that investments today in REDD would eventually have the prospect of producing significant carbon revenue;

---align the interests of all parties (national, local, international, and private) to assist the country and its communities to establishing high quality, sustainable REDD/forestry strategies, as all stand to gain from “graduation” to successively higher grades.

International Framework and Institutions: including a facility for insurance and emergency relief.

The idea of phased certification of higher grades of REDD carbon readiness depends greatly on the existence of a strong and credible global governance architecture for the climate and for REDD. Institutions are needed that will set standards, establish the rules for monitoring, reporting and verification, and also provide credible methods of independent verification and certification of results. There are also needs for a variety of functions for funding of capacity building, as well as providing technical assistance to forest country governments in those efforts. These mechanisms could take many forms. One example of a proposal can be found in WWF’s recent discussion paper “New Mechanisms for Financing Mitigation: Transforming Economies Sector by Sector” (Reed et al, March 2009). In addition to the mechanisms proposed in that paper, more thorough consideration is needed to handle the issue of “reversibility” or “sudden release” of carbon stocks due to drought, fire, pests, or disease.

Particularly if national or “nested” approaches are used, a cloud of uncertainty will hang over the forest carbon market that could impede investment in REDD if carbon from perfectly good forest projects could be de-certified due to a sudden release, perhaps unrelated to that project, that puts the country in excess of its baseline. Frequent use is made of the term “insurance” to handle such events. Of course there could theoretically be private or public insurance solutions to this problem. But there are practical difficulties for private insurers to handle low probability unpredictable events with huge financial consequences (akin to earthquake or terrorism risks, which present particular challenges that in part are sometimes met with public assistance). Another way to handle risks of “sudden release” would be for the public sector to provide performance guarantees that could be underwritten by national, multilateral or global institutions. However, in order to aggregate accurate data to allow appropriate pricing and management of the risks, and not create moral hazards, it would be preferable to integrate the sudden release “insurance” function with the certification and verification functions mentioned above.

Perhaps a productive approach to providing the “insurance” function would be to explore the creation of a global or regional Forest Carbon Emergency Facility (FCEF). This facility would be linked to the body under the UNFCCC that will be in charge of certifying the status (and phase) of each country’s REDD sector plan (see “phasing” above), and thus would be playing a role in deciding the percentage of each country’s carbon to be sold vs the percentage to be held back in reserve. The FCEF would hold back a portion of the certified forest carbon according to the phase (level of risk) associated with that country and/or project. If the facility were global or regional (vs national) it would have the advantage of holding a diversified pool of unsold credits, and in the event of an emergency such as a major fire or drought could dip into the “pool” to provide the country in need a “loan” of credits. This “emergency relief” loan would allow that country to continue to meet the reasonable expectations of the complying projects and the forest communities that depend on them. Without this relief, one could imagine immediate financial pressure in the local forest communities to revert to old patterns of behavior, including deforestation, and thus in turn further compounding the country’s excess emissions.

Thus the facility would provide both “insurance” and “emergency relief” functions, akin to the IMF, for carbon. In the case of an extreme event, one could even envisage a multi-year rescue package being constructed between the FCEF and the country whereby there would be a large loan to the country, disbursed over several years, accompanied by an agreed plan to reforest the damaged areas or apply REDD to new areas. The country would agree to follow the plan that would bring it back under the emissions baseline. To repay the loan and to replenish the pool the country would agree that a higher percentage of its REDD credits would be reserved by the FCEF for a period. This example illustrates the obvious advantage of this “Carbon IMF” having a global or large regional scale in order to have geographic diversification of risk and sufficient size to handle large events. It may also need backstop financing and credit lines from the World Bank or other regional agencies, especially in the early years while the credit the pool is in the accumulation phase.

The need for Integrated Plans: Let’s Not forget the Wisdom Factor

People do not clear forests for fun. There are real needs being met for food, fiber, and fuel that are driving deforestation. Population growth in many tropical forest countries, projected to the late 21st century, may create extreme pressures on the need for land for food. If that happens, three generations from now, if land is scarce, will the REDD commitments made in the early 2000s be sustainable?

Commitments for REDD made today, however well intentioned, must be based on sound and realistic plans for how the needs for food, fiber and fuel will be met by alternative lands, or different agricultural or forestry strategies, not only for the next decade but for the balance of the century. Otherwise, the forests that are “saved” today will be “un-saved” decades later. So while we focus a great deal of our energies on solving the technical problems of REDD (MRVAP, scope, scale, baselines, insurance, etc.) we should not lose site of this ultimate point: whatever plans for REDD are made, they must be held up to the light of a long term land use plan for the country and that country’s population and economic development objectives. In the end it will be wisdom to judge

the consistency of the REDD sector plans with the long term land needs of the people that will determine the reliability and permanence of REDD carbon.

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