REDD, the last chance for tropical forests ?

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A Policy Brief by Michael Richards

Key insights:

◊ REDD has major potential for rainforest conservation, but is politically and technically complex. It was given the go ahead at Bali, but there is a lot to do to reach an agreement.

◊ Any REDD agreement will have winners and losers. A big problem is how to compensate low deforestation countries - REDD could result in a perverse incentive to increase deforestation in some countries.

◊ REDD could flood the carbon market .... or facilitate aggressive emissions targets in a post-Kyoto agreement.

◊ The private sector needs to be included to make it work, since governments have a poor record in responding to market incentives. This means a 'nested approach' is needed—REDD has to work at the project and national (programme) levels.

Introduction

Tropical deforestation happens mainly because it is more profitable to cut down trees or forests than look after them, and due to the weak rights of local forest users. This is due to a combination of market, policy and governance failures which make alternative land uses more attractive - in other words the opportunity costs of sustainable forest management (SFM) or conservation become too high. A key response to market failure is the development of payments for ecosystem services (PES) mechanisms. Because it's linked to climate change, the most important current PES opportunity is for 'forest carbon'.

Forest carbon payments can occur either for carbon sequestration, deriving from the net absorption of carbon dioxide in planted trees, or by protecting carbon stocks that would otherwise be emitted in natural forests. The latter is known as avoided deforestation (AD) in the voluntary carbon markets, and as Reduced Emissions from Deforestation and forest Degradation (REDD) in the United Nations Framework Climate Change Convention (UNFCCC) context.

Forest carbon trading has been excluded or marginalised in the regulatory carbon trading markets such as the Clean Development Mechanism (CDM) of the Kyoto Protocol and the EU Emissions Trading Scheme, due to market flooding worries (i.e. that major increases in forest carbon offsets would depress prices) and moral hazard concerns (i.e. that offsets will reduce pressures to cut industrial or consumption emissions). But increasingly, it is being realised that the inclusion of AD or REDD mechanisms will be vital for tackling climate change. The momentum for forest carbon has accelerated rapidly since the Stern Review (2006) observed that deforestation contributes about a fifth of man-made carbon dioxide emissions. Stern pointed out that while AD is allowed for industrialised countries in the Kyoto Protocol, it is not permitted for tropical countries where most deforestation occurs. Stern proposed AD or REDD as a "highly cost-effective way of reducing greenhouse gas emissions.... fairly quickly" while recognising that "major institutional and policy challenges" must be overcome.

At the Bali UNFCCC meeting in 2007 "the urgent need to take further meaningful action to reduce emissions from deforestation and forest degradation" was agreed. However the precise mechanism for REDD is not yet agreed, partly since whatever mechanism is decided will result in different 'winners' and 'losers' among tropical or developing countries, due to various methodological and practical complexities. The deadline for reaching agreement on REDD, at least as regards to it being implemented in the short and medium term, is the UNFCCC meeting in Copenhagen in December 2009.

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'Compensated Reduction' REDD

The front-running REDD proposal in the UNFCCC negotiations is 'compensated reduction' in which developing countries could, on a voluntary basis, sell carbon credits gained by reducing their deforestation rates against a baseline or 'business as usual' deforestation rate. A common aspect of REDD proposals is that a national programme and national carbon counting are essential due to the 'leakage' problem.

REDD is not inherently pro-poor and could be anti-poor. Market-based REDD could end up compensating wealthy developers who are threatening to cut down the rainforest rather than communities that have conserved forests for centuries. It will need a lot of donor and NGO support to ensure the poor do not lose out again.

'Leakage' occurs when carbon gains in one place are lost when deforestation pressures are displaced to another forest area. Proponents of the compensated reduction approach argue that:

• it is the only genuinely market driven approach and will ensure the "additionality" of carbon payments;

• it can facilitate more ambitious emission caps in a post-Kyoto regime;

• it will lower global climate change mitigation costs and 'buy time' for technology and policies to cut industrial emissions; and

• it will increase developing country participation in climate change mitigation, and therefore encourage US participation in the Kyoto Protocol (or its successor).

Compensated reduction is, however, vulnerable to various criticisms and faces various challenges, including:

• whether REDD will cause market flooding and suppress carbon prices, seriously reducing the economic viability of renewable energy and other key mitigation options;

• equity concerns, including those associated with additionality (Box 1);

• a perverse incentive for low deforestation countries to increase deforestation in order to gain credits later on. It means that countries like India and Costa Rica which have very low or even negative deforestation rates would have no carbon -based incentive to keep their forests. A similar situation faces indigenous and other communities which have conserved their forests for centuries;

• the highest deforestation rates tend to be in weaker governance countries: it will require high levels of political will and sustained donor support to deliver the necessary policy, governance and tenure reforms for REDD to work;

• the definition of baseline deforestation rates is problematic. The approach likely to be favoured is an average historical deforestation rate which is assumed to continue into the future. But deforestation can slow as forests are depleted or speed up as countries experience faster economic development. An alternative is to predict future deforestation rates, but this is also difficult due to the many unpredictable factors which affect deforestation rates;

• countries could decide on 'anti-poor' REDD strategies (Box 1) or stop their REDD efforts once 'low hanging fruit', like forest fire prevention, have been captured and before the main policy and governance failures are tackled (although this would ultimately mean less success and less REDD payments);

• up-front funding will be needed as carbon payments would not flow until 2017 – the end of the next UNFCCC accounting period. Initial investments will be needed in national 'carbon infrastructures' (e.g., specialised institutions, expertise and technology), for REDD research and planning, and for the policy/legal reform process – known as 'Readiness' activities. The international community will need to take the lead in pre-financing REDD and/or underwriting the risks to forward investors in REDD credits;

• government actions may have little effect on deforestation rates since factors beyond government control like agricultural commodity prices (aggravated by the biofuels boom) can be key drivers of deforestation;

• it is voluntary for tropical countries - if key timber supply countries opt out, international leakage is likely due to the continuing demand for timber and NTFPs.

Market Flooding

The key to the market flooding concern is how much the demand for carbon offsets will increase. If the industrialised country emission targets remain weak, then the concerns are justified. However, it is being increasingly recognised that aggressive emission reduction targets are vital for tackling climate change, and to ensure that the first priority is to cut emissions at source. In fact the proponents of compensated reduction think that REDD would facilitate the setting of stringent emissions targets; without a big increase in the supply of carbon offsets, the price of carbon could rise beyond 'willingness to pay' prices.

Alternative 'non-market' REDD proposals

There are various alternative REDD proposals to the market-based 'compensated reduction' approach. Some of these propose a global fund rather than carbon trading, although a weaknesses of this are that it is less likely to result in 'real' carbon benefits, or to deliver financial sustainability. It may also be more prone to corruption. Other proposals revolve around compensating the maintenance of carbon stocks in standing forests. Such approaches would make it easier to reward community conservation, but at the sacrifice of carbon 'additionality'. This reflects a wider tension with PES mechanisms—there is often a trade-off between environmental and equity benefits.

Box 1: Additionality and equity issues of REDD

REDD is not inherently 'pro-poor' and could prove anti-poor. Carbon offsets must show 'additionality' - this means that they have to show that the carbon gains would not have happened without a carbon payment,. For example, carbon storage would not be additional if forest management is economically viable for timber or other products, or if there is no threat to the forest. In practice, therefore, REDD actions must target threatened forests. Thus the main 'winners' could turn out to be would-be developers or degraders, e.g. wealthier farmers planting oil palm, rather than forest conserving communities.

A related ethical issue is that these developers are often politically well-placed individuals who tend to break 'paper' laws, e.g. encroachment on state or community tenure land. Therefore REDD payments could end up compensating them for the opportunity costs of obeying the law. Clearly the 'correct' solution is legal compliance, but governments may find REDD payments politically expedient. Other equity concerns are that governments could adopt a 'fences and fines' approach to REDD, possibly involving the eviction of indigenous or other poor groups from protected areas and/or ignoring customary tenure and other property rights. Use of a credible standard like the Climate, Community and Biodiversity (CCB) standard, used in the recently designed Aceh, Indonesia, REDD Programme, would greatly help, but it will be difficult to oblige governments to use such standards. Other factors determining equity outcomes are the level of transaction costs, how project contracts are structured and compliance regimes.

1 The World Bank Forest Carbon Partnership Facility has earmarked $300 million for national REDD 'readiness' programmes and pilot projects. DFID and Norway have announced a £100 million Congo Rainforest Fund; and the Norwegian Government has pledged $550 million per annum (for five years) for tackling deforestation.

Unresolved REDD issues

Some key unresolved technical issues to be addressed at the next UNFCCC meeting are:

• whether REDD credits should be fully 'fungible', i.e. tradable across all carbon markets, or whether they should be limited to a REDD or AFOLU (Agriculture, Forestry and Land Use) market – this links to market flooding concerns;

• how to set baselines. Some countries prefer a historical baseline (with various options of reference period), and others a predicted baseline with an 'adjustment factor' for future development. The choice has major implications for determining the winners and losers;

• how to avoid or reduce the 'leakage' problem;

• how to combine a national REDD strategy and accounting system with a project-based incentives, known as the 'nested' approach – this is needed for the involvement of the private sector, given the poor record of governments in market-based approaches;

• methodological and measurement questions about how to account for forest degradation—the second D of REDD; and

• whether to credit 'early action' or pilot REDD projects until the next UNFCCC accounting period (2013-2017).

Conclusions

Deforestation is caused by a combination of market failures and policy and governance failures. REDD is undoubtedly a major opportunity as it brings together the demand and supply sides of the problem by making SFM and conservation more attractive (tackling the market failure problem) and reducing its opportunity costs (driven by policy and governance failures). It can also deliver major biodiversity and hydrological benefits, and has strong synergies with climate change adaptation strategies.

Success is not certain, however, as REDD also faces significant challenges. There are concerns about carbon market flooding, equity impacts, and high transaction costs for communities. A compensated reduction REDD mechanism could be anti-poor depending on how a country pursues REDD. Moreover any national REDD strategy must tackle tough policy and governance issues, including insecure property rights of forest communities, weak governance and the illegal logging of timber.

2008 and 2009 are key for the architects of REDD. Critical issues will be:

- Structuring of national incentive systems, including appropriate, accountable institutions for managing REDD funds, so that the incentives reach forest managers and communities;
- Avoiding perverse outcomes, for example from compensated reduction approaches. (One option could be a complementary non-market mechanism which compensates the standing carbon value of forests, with industrialized country contributions mandated by UNFCCC, alongside a market-based REDD strategy);
- Identifying the minimum set of public policy reforms that must be achieved if REDD is to realise the hopes placed on it.

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