

Submission to the United Nations Framework Convention on Climate Change
by
The Tropical Agricultural Research and Higher Education Center (CATIE)¹
and the
German Emissions Trading Association (BVEK)²

**Subject: Reducing Emissions from Deforestation in Developing Countries
(FCCC/SBSTA/2006/L.25)**

1. Mandate

The Subsidiary Body for Scientific and Technological Advice (SBSTA), at its twenty-fifth session (Nairobi, 6–14 November 2006) invited Parties and accredited observers to submit to the Secretariat, by 23 February 2007, their views on ongoing and potential policy approaches and positive incentives, and technical and methodological requirements related to their implementation; assessment of results and their reliability; and improving the understanding of reducing greenhouse gas (GHG) emissions from deforestation in developing countries.

CATIE and BVEK welcome this opportunity to provide views and submits the following inputs on these issues.

2. In Brief

The following elements of a mechanism for Reducing Emissions from Deforestation (RED) in developing countries are proposed:

- a) A Fund to create enabling conditions and pilot experiences in non Annex 1 countries, to be established as soon as possible through initial voluntary Annex 1 contributions and replenished by institutionalized mechanisms, such as an X% levy on Emissions Reductions Units issued or Assigned Amounts traded - 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.
- b) A voluntary early action phase, starting prior to 2012 and creditable afterwards.
- c) A voluntary baseline-and-credit system for RED starting after 2012.
- d) Crediting of reductions achieved, but no debits accruing during the early action phase and as long as no credits are issued.
- e) A mandatory X% credit buffer – tradable only among non-Annex I Parties - to make up for future release of forest carbon once protected and to allow issuing permanent and fully fungible RED credits.
- f) A national reference emission level with full country liability, once credits have been brought to the market, adjustable in subsequent crediting periods.
- g) Independent issuance of RED credits for project-level and country-level emission reduction, following accounting rules that integrate country-level and project-based RED activities.

¹ CATIE is an international organization headquartered in Costa Rica and dedicated to research and higher education in agricultural, natural resources and environmental areas. The center was founded in 1973 and has 13 member countries from the Latin American region (www.catie.ac.cr).

² BVEK is an association promoting the principle of emissions trading, headquartered in Berlin, Germany.

3. Basic considerations

The successful evolution of the international climate change regime post-2012 will require the continued leadership by Annex 1 countries - reflected in a wider participation and deeper GHG emission reduction commitments – as well as an increased and equitable participation in such efforts by developing countries following the principle of common but differentiated responsibilities. Likewise, a wider inclusion of sectors and technologies will contribute to maintain the cost-effectiveness of the regime, and therefore its viability.

GHG emissions from deforestation in developing countries, while currently representing an important source of such gases globally, entail mitigation options capable of contributing to many of the goals mentioned above. Therefore, effectively addressing emissions from deforestation can be considered a strategic issue in the future climate change agenda.

Incentives to Reduce Emissions from Deforestation (RED) under the UNFCCC framework should be able to accommodate different national circumstances, so that countries may be able to increase their participation as they enhance their capacities, thus allowing for a growing involvement in global emission reduction efforts.

Forest degradation should also be acknowledged as a concern that requires further attention. Parties should not miss the opportunity of considering positive incentives for activities that reduce emissions from forest degradation (e.g. sustainable forest management).

Considering the variety of circumstances, interests and capacities of developing countries, an appropriate RED mechanism should include a menu of options based on market and non-market instruments designed to be complementary and effectively address the different dynamics of deforestation in developing countries.

4. Proposal for a RED mechanism

4.1 Non-market instruments

In the transition to an increased participation in global emission reduction efforts via market and policy instruments, developing countries must enhance their capacity to generate real emission reductions while pursuing their sustainable development goals. It is essential for these countries to acquire sufficient confidence and internal political support that any measure to reduce emissions from deforestation will be implemented following a sovereign decision, that it will represent an opportunity to foster their social, environmental and economic goals, that it responds to appropriate and endogenous social and economic safeguard policies, and that it will be recognized as part of their contribution to the global effort to address climate change.

Non-market instruments under the UNFCCC should primarily help developing countries in enhancing their capacities to address emissions from deforestation while pursuing their sustainable development goals. A new *Fund* could finance activities aimed at creating enabling conditions, including institutional and technical capacities. This *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 support *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. Real, anthropogenic, and verifiable emission reductions achieved by early action and pilot activities should be eligible for *ex post* crediting (once a reference emission level has been agreed upon) to provide sufficient incentives to stimulate them and sustain them over time.

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*:

- (i) an X% levy on Emissions Reductions Units issued or Assigned Amounts first traded in the carbon market, similar to the one imposed on CERs, and/or
- (ii) fees on carbon intensive commodities and services in Annex I countries, and/or
- (iii) a levy on international transport emissions.

Voluntary Annex 1 contributions to the activity window of the Fund may be disbursed as a loan repayable by proceeds from RED credits on the country level in order to increase the size of these contributions. However, contributions to the activity window arising from the proposed institutionalized mechanisms shall be disbursed on a grant base (polluter pays principle).

4.2 Market instruments

Critical issues

Research carried out for the Stern Review³ 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 could be adequate for pursuing the ultimate objective of the UNFCCC.

Even though stopping deforestation can be expensive, RED is perhaps amongst the most cost-effective mitigation options (on a US\$/tonCO₂e basis), which makes the use of market instruments for RED particularly appealing. However, credits for RED should not undermine existing mechanisms (e.g. the CDM) and emission reduction efforts in Annex I countries. Therefore, before implementing a crediting system for RED, as well as for any other GHG emission reduction technology that can supply large amounts of emission reductions at competitive costs, global emission reduction commitments should be increased substantially.

It has often been suggested that deforestation should be addressed at the national level to control leakage among other reasons. Actions to reduce emissions from deforestation at the national level would imply that developing countries’ governments should engage either in a cap-and-trade or in a baseline-and-credit system. Both regimes have very different potential implications that must be fully analyzed.

Under the cap-and-trade approach, similar to the one used by Annex I Parties, developing countries would negotiate a cap on their emissions from deforestation and would be able to use flexibility mechanisms to comply with their commitments. This approach would not be acceptable to most developing countries at this point, and to some extent it would contradict the principle of common but differentiated responsibilities. The risk of being obliged to invest in emission allowances or other fungible units in case of non-compliance is politically unacceptable for many non Annex I Parties. Moreover, capacities would have to be enhanced, or created in some cases, to support a reliable carbon tracking system at the national level, which implies that – at least in the short-term - the participation in this scheme would be reduced to a handful of countries, possibly those that represent a small contribution to global emissions from deforestation. Timely emissions reductions would be thus limited as well as non Annex I participation.

Under a baseline-and-credit system, a national reference emission level would have to be technically defined and either approved by the Parties, or independently validated and certified, and credits would be issued only for emission reductions below the reference

³ *Stern Review, Final Report*. Part VI, Chapter 27. Cambridge University Press, 2006

emission level. A baseline-and-credit system is more likely to be accepted by a larger number of developing countries, due to its similarities with the CDM (e.g. lack of penalties if targets are not met, contribution to sustainable development, etc.). However, such a system would only work if developing countries would be 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, 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.

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 efforts at the project level (e.g. CDM-like projects). Success will depend on these two elements and the participation of the private sector is undoubtedly critical.

It is essential for developing countries to be able to rely on a system that is capable of attracting sufficient national and foreign capital – both public and private - to activities that reduce emissions from deforestation and forest degradation. Such a system would efficiently complement public and private efforts carried out nationally or at the state level while reducing the costs and risks for developing countries governments.

It is unlikely that private investors would be willing to share the risk of potential policy failure by directly supporting government programs, although public-private partnerships should not be excluded. Competitive carbon prices combined with low delivery risk are needed to attract private investors to RED. 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.*

The permanence of RED credits is also an important attribute to attract investments in RED activities. Expiring credits requiring replacement at subsequent commitment periods are not fully fungible with other compliance units and have therefore limited acceptance in the carbon market (such as tCERs and ICERs issued from afforestation and reforestation activities under the CDM). Therefore, *RED credits should be fully fungible, bankable towards future commitment periods, and permanent.*

Finally, the inclusion of RED under future climate change agreements needs to account for early action. This is so for two reasons:

1. As mentioned in the Stern Review, *“the scale of the problem is daunting. Without prompt action emissions from deforestation between 2008 and 2012 are expected to total 40Gt CO₂, which alone will raise atmospheric levels of CO₂ by ~2 ppm, greater than the cumulative total of aviation emissions from the invention of the flying machine until at least 2025⁴. Taking action to protect forests is therefore too important to wait until the next commitment period. This means that immediate pilot schemes outside the Kyoto Protocol are necessary”.*
2. If current forest conservation is not accounted for, this will constitute a negative incentive for governments against forest protection policies and measures, as these could spoil the country’s reference emission level.

We propose a RED crediting system that in our view is able to address the concerns mentioned above.

⁴ *Stern Review, Final Report.* Cambridge University Press, 2006

Proposed RED crediting system

Any real, anthropogenic, and verifiable emission reductions achieved by *early action activities* implemented prior to 2012 and any *posterior pilot activity* designed to test the effectiveness of voluntary measures to reduce emissions from deforestation should be eligible for *ex post* crediting in subsequent commitment periods (once reference emission levels have been agreed upon).

An early action phase of voluntary emission reductions would help test-driving adequate policies and measures and at the same time fix a realistic deforestation reference level. This initial phase would consist in voluntary emission reductions and shall not bring about any negative consequences for the implementing country, in case it fails to bring down deforestation levels.

As exact deforestation levels are often unknown, a preliminary estimation of actual deforestation levels shall be reported initially and subsequently adjusted, registered and substantiated in terms of GHG emissions, once forest area and carbon inventory data have become available and have been either reviewed and approved by the Parties or validated and certified independently by an accredited body.

After 2012, RED credits shall be issued for any voluntary emissions reductions below national or project-level reference emission scenarios. Such credits would be *permanent*, *fungible* with any other emission allowances, and *bankable* toward subsequent commitment periods, given that a *mandatory reserve account* of X% of the RED credits issued from a country would guarantee the permanence of the emission reductions traded in the carbon market. Issuance of RED credits would be overseen by a UNFCCC body according to the following principles:

- a. A reference emission level would be defined for each crediting period, which may include one or several Annex-1 commitment periods and several verification periods of one or more years.
- b. If emissions from deforestation were *above* the reference emission level in a verification period, no credits would be issued, but no penalties would be applied in the subsequent verification period.
- c. In case emissions from deforestation remained *below* the reference emission level, and RED 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 RED credits from its reserve account, or by acquiring RED 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.
- d. To attract additional capital for RED activities and complement governmental efforts, an implementing country may authorize private or public entities to develop and implement RED activities at sub-national, local or project levels.

- e. Such project activities would have their own emission reference level and may be registered prior to reporting of the national reference emission level. The resulting emissions reductions would be deducted from those achieved by the national scheme in order to avoid double counting.
- f. RED 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.
- g. Issuance of RED credits for project activities would require that the activities have been subject to an independent (third party) validation, verification and certification procedure by an independent accredited body.

In our view, the RED crediting system described above is able to attract private capitals in RED activities because successful project-based activities would be credited even in the case of excess deforestation emissions at the national level. At the same time, implementing countries would be encouraged to develop appropriate safeguard policies to control the project activities and avoid national leakage. As most project activities are likely to produce more emission reductions than leakage, nation-wide emission reductions would be achieved faster than without the authorized and supervised project activities. Moreover, the implementing countries would benefit from international and national private capitals investing in RED activities, which will reduce the cost of government programs and the risk of policy failure, while generating important co-benefits for sustainable development.

Without such a system, credits would only be issued to governments, and governments would eventually redistribute the proceeds from RED credits to local actors. This would make the future RED 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.

Acknowledgments

CATIE and BVEK acknowledge Mr. Michael Dutschke⁽¹⁾ and Mr. Axel Michaelowa⁽²⁾ for their important contributions to this submission.

(1) BioCarbon Consult
Badstr. 41, 77652 Offenburg, Germany
Phone: +49 (781) 970 5749
Mobile +49 (178) 335 5749
Fax: +49 (89) 1488 297 047
www.BioCarbon.net

(2) Perspectives GmbH
Bei der Apostelkirche 24
20257 Hamburg, Germany
Phone: +41 43 355 0073
Mobile: +41 76 232 4004
Fax: +49 89 14 88 28 08 22
www.perspectives.cc