



# **Financing Mechanisms to Reduce Emissions from Deforestation: Issues in Design and Implementation**

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# Overview

- Stocktaking
  - ◆ Financing needs and flows to forest sector
  - ◆ Existing monitoring framework
- Features for an effective environmental financing mechanism for RED(D)
- Design Issues
  - ◆ Monitoring, baselines/reference rate, leakage, and permanence
  - ◆ Issue of payments and addressing potential price uncertainty
- Conclusions

# Forest Financing: Needs and Flows

- Problem: significant emissions from deforestation and forest degradation
- Financial needs assessment
  - ◆ Mitigation cost estimates vary (USD 5-12 billion)
  - ◆ Capacity building cost estimates are limited
- Financial flows to the forestry sector
  - ◆ Estimates vary (ODA = USD 528 million)
  - ◆ FDI > ODA
- Need further comparable studies on mitigation costs
  - ◆ e.g., similar assumptions on carbon accounting, costs, land areas, baselines and other major parameters

# Monitoring Emissions: Current Status

- Monitoring RED(D) is crucial to ensure environmental objectives of any financing mechanism are met
- Requires time series data on changes in forest area and changes in carbon stocks
  - ◆ Forest area data are available
  - ◆ Data are lacking on changes in carbon stocks
- National inventories in developing countries are limited: no historical trends, high uncertainty
- Insufficient data and institutional capacity under FCCC or in-country to support monitoring of RED(D)

# Key features of effective environmental financing mechanisms

- Clear goals and objectives
- Sufficient and long-term sources of funding
- Eligibility criteria and prioritisation
- Monitoring and performance evaluation

# RED financing proposals

- Voluntary RED fund (Brazil)
- Stabilisation fund (COMIFAC)
- Nested Approach + Multilateral fund (Paraguay et al.)
- N24 (Belize et al.)
- Colombian proposal (Colombia)
- Compensated Conservation (India)
- Dual Markets (CCAP)

- Proposals vary in terms of
  - ◆ goals: capacity building vs. RED(D)
  - ◆ scope: deforestation and degradation
  - ◆ type of mechanism: fund or market-based; national or project level

# Monitoring

- Proposals recognise the challenges but few highlight concrete methods
  - ◆ Voluntary RED Fund: proposes monitoring by biome; uncertainty estimates and conservative accounting
  - ◆ Nested approach: Tier I and II for national and project accounting respectively
- Further work: what is necessary?
  - ◆ International system for monitoring, reporting and review
  - ◆ National systems and inventories

# Baselines / reference rates

- Essential to assess additionality and performance of financing mechanism
- Proposals focus on historical reference points ... but projections are also relevant
- Proposals suggest national and/or project level baselines ....but national approach more effective to limit leakage and would lower transaction costs



# Leakage

- Leakage likely to be a key problem
- Large estimates of national leakage (5-93%)
  - ◆ Need national level accounting for good environmental performance
- Few studies but indicate large estimates of international leakage
  - ◆ Possible option is to introduce minimum country threshold for entry into force (similar to Kyoto Protocol)

# Permanence

- Can manage (lack of) permanence
  - ◆ Temporary credits
  - ◆ Insurance mechanisms
  - ◆ Debit systems
- Need to ensure consistent methods and approaches across countries
- Further work required

# Payments to governments vs. forest owners/users

- Payments made directly to individual forest owners/users can influence land use decisions
  - ◆ Requires adequate monitoring at “project” level i.e., medium to fine spatial resolution
- Payments to government could provide incentives to correct other market and government imperfections
- Tiered-approach for international payments based on monitoring capacities in developing countries

# Addressing potential flooding in integrated RED(D) market mechanism

- Any increase in potential supply of credits should be matched by increase in demand i.e. stringency of emission reduction commitments
  - >> Aim is to reduce emissions at minimum economic cost
- Methods available to address unexpectedly low prices:
  - ◆ Impose constraint on volume of RED(D) credits to enter international carbon market
    - can revise over time as information improves
  - ◆ Minimum bid price auctions (price floor)
    - administratively cumbersome
  - ◆ Offset safety valves
    - constraint on volume of RED(D) credits to enter market to depend on international price of allowances

# Main conclusions

- The 4 key features identified apply to both fund and market based mechanisms. Building blocks are the same under each and would be similar for any alternative options for RED(D)
- Market based mechanism is better able to address financing issue and has potential to engage private sector funds
- High uncertainty surrounding available emissions estimates from deforestation in developing countries. Creation of RED(D) market would require significant more effort to establish reliable systems for monitoring, review and verification of performance
- National scale accounting required to ensure higher level of environmental performance than project level

# Further work needed on:

- ◆ Decision on scope & type of mechanism
  - ◆ Deforestation vs degradation
  - ◆ Avoiding perverse incentives
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- Monitoring needs and capacities to support the financing mechanisms
  - Minimum eligibility requirements for participation
  - Early action is essential for capacity building