

## Filling the REDD Basket: Complementary Financing Approaches

**T**he set of policies known as REDD (Reducing Emissions from Deforestation and forest degradation in Developing countries) offers significant potential for reducing global warming emissions, but financing approaches for REDD are an issue of active debate. Often the discussion of financing approaches is seen as “market versus fund,” but here we identify and discuss three major categories of potential funding for REDD: direct carbon market, market-linked, and voluntary sources. All three sources have advantages, and all should have a role in reducing emissions from deforestation.

With many such financing options emerging, there is a growing consensus on the “Basket of Approaches” idea,<sup>1</sup> which would combine different sources of financing for different aspects of REDD in different time periods. Below is a discussion of what can go into the “REDD Basket.”

### REDD Financing Approaches

**Direct carbon market.** In direct carbon market funding, companies in industrialized countries purchase REDD credits for use as emissions allowances in their national cap-and-trade systems. Through REDD, they purchase the right to emit more domestically than their caps allow, and in turn prevent emissions from deforestation in developing countries. Direct carbon market funding has included such programs such as the Clean Development Mechanism (CDM) forestry projects, and would likely also include national-baseline REDD credits if they were accepted into the post-2012 carbon market.

**Market-linked.** Market-linked approaches generate funding by using auction revenues or allocated allowances for REDD from cap-and-trade systems, or by establishing dual market systems in which REDD credits are not fungible with industrial country allowances. In these systems, funding increases as cap-and-trade markets grow but the REDD credits are not offsets. Examples of market-linked financing proposals include Germany’s proposed use of auction revenues, the U.S. Lieberman-Warner Climate Security Act’s proposed use of allowance allocations, the Center for Clean Air Policy’s “Dual Market” proposal for a separate

REDD market, or required purchases of REDD-specific units as in Greenpeace’s TDERM.<sup>2</sup>

**Voluntary.** Finally, voluntary funding may be provided by countries or individuals but not connected to their cap-and-trade markets. Voluntary contributions can be made at all levels. Official development assistance (ODA), such as Norway’s \$2.6 billion commitment announced at Bali, is an example of national-scale voluntary action. Companies and consumers can also purchase credits that, once purchased, are no longer used for emissions compliance in carbon markets.

### Advantages and Disadvantages of Each Approach

Direct carbon market credits lower the cost of reductions globally, and likely have the largest potential to generate funding for REDD—many tens of billions of U.S. dollars per year. On the other hand, these REDD offsets purchased from developing countries allow higher levels of emissions in industrialized countries. The net effect is zero, unless industrialized countries have agreed to make further reductions. Because of this zero-sum nature of offset credits, it is critical to ensure that the REDD credits correspond entirely to real and verifiable reductions—those that are fully additional and not reduced by leakage. If reductions are not real, selling the credits in the carbon market actually risks a net increase in heat-trapping emissions.

Market-linked mechanisms could generate funding in the range of tens of billions of dollars annually. Unlike direct carbon market offsets, they are not likely to significantly lower compliance costs in developed countries. However, the reductions funded are in addition to those made by developed nations. Therefore, problems such as leakage and additionality do not risk increasing net global emissions. Furthermore, they can finance REDD-related costs such as capacity building, measuring and monitoring, or stabilization of low deforestation rates in areas such as the Congo Basin. These qualities can help ensure the success of REDD overall.

Voluntary approaches have the least potential for generating substantial and reliable funding. They



## Characteristics of REDD Financing Methods

Characteristic	Direct Carbon Market	Market-linked	Voluntary
Examples	REDD credits purchased by developed-country emitters	Auction revenues, allowance allocations, dual markets	Official development assistance, voluntary offset purchases
Potential funding	<b>Large</b> (many \$10s of billions/year)*	Medium (\$10s of billions/year)	Small (\$100s of millions/year)
Annex 1 compliance costs	<b>Lowered</b>	Same	Same
Reliable funding	<b>Yes</b>	<b>Yes</b>	No
Effect on emissions	Offset	<b>Additional reduction</b>	<b>Additional reduction</b>
Funding for stabilization	No	<b>Yes</b>	<b>Yes</b>
Funding for capacity building	No	<b>Yes</b>	<b>Yes</b>
Mobilizes voluntary efforts	No	No	<b>Yes</b>
Availability	After reductions are made	When cap-and-trade starts	<b>Immediately</b>

\* **Boldface** indicates particularly desirable properties of each of the three approaches.

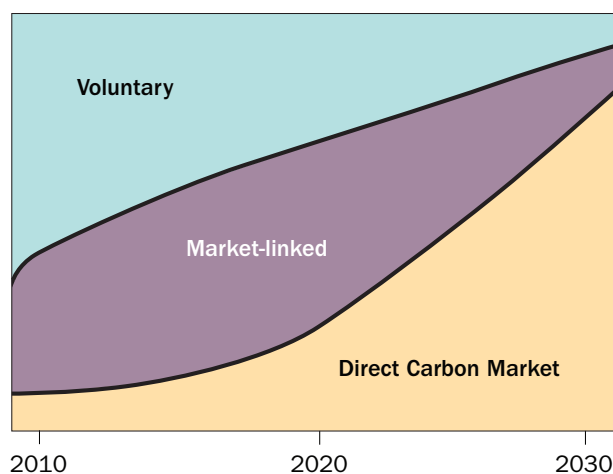
**All three approaches to REDD have desirable qualities; therefore using all three financing mechanisms provides the greatest benefit.**

are likely to be limited to hundreds of millions of dollars per year, and are subject to the fluctuations of government budgets in donating countries. Like market-linked mechanisms, voluntary approaches are in addition to those made by developed countries, and offer the flexibility to fund capacity building, stabilization, and other REDD-related activities. They also help mobilize the willingness of countries, companies, and individuals to reduce deforestation, beyond what they might do for solely economic reasons. While the level of available funding does not automatically grow as cap-and-trade markets expand, voluntary approaches can provide a funding path for countries that have not yet implemented carbon market systems.

### Matching Financing Timing to Needs

In the near term, the flexibility of voluntary approaches presents the quickest way to build up capacity. Because deforestation reductions take several years to verify, the need for funding to purchase credits in initial years is low. Approaching 2020, more funding will be needed, but limited capacity to ensure high offset quality will constrain how much can come directly

### Expected Evolution of Funding Needs



**In the near term, the flexibility of voluntary approaches presents the quickest way to build up capacity. However, during the 2020s direct carbon market financing could become the largest source of funding for REDD.**

from the carbon market. During this time period the market-linked approaches can provide an increasing share of financing both directly to reduce deforestation and to help avoid leakage and non-additionality. Finally, in the 2020s—with built-up capacity, a broad experience base, and near-global participation—the direct carbon market could become the largest source of funding for REDD.

REDD financing must address the unique objectives of different time periods.

Each method—direct carbon market, market-linked, and voluntary funding—plays an important role at different times. All three REDD financing approaches should go in the basket, to create a system able to grow and develop as the REDD process evolves.

- 1 Discussed by the Coalition for Rainforest Nations and the World Resources Institute, among others.
- 2 Tropical Deforestation Emissions Reduction Mechanism



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