




Filling the REDD Basket: Complementary Financing Approaches





The 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 have become 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 their particular advantages, and all have a role to play in reducing emissions from deforestation.

With many such financing options emerging, there is a growing consensus on the “Basket of Approaches” idea,¹ 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.²

Voluntary. Finally, voluntary funding provided by countries or individuals is 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.

The 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 lead to higher levels of emissions in industrialized countries. Thus, the net effect on global emissions is zero, at best. Because of the 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, verification 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 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 are likely to be limited to hundreds of millions of dollars per year, and are subject to the fluctuations

Characteristics of REDD Financing Methods

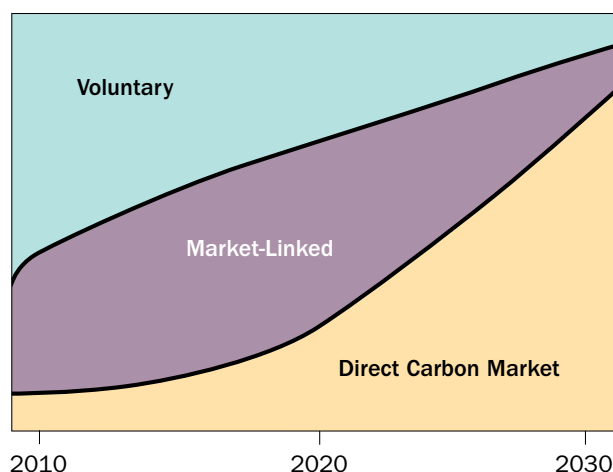
	Direct Carbon Market	Market-linked	Voluntary
Examples	REDD credits sold as offsets to developed-country emitters	Auction revenues, allowance allocations, dual markets	Official development assistance, voluntary offset purchases
Potential funding	Large (many \$10s of billions/year)*	Medium (\$10s of billions/year)	Small (\$100s of millions/year)
Effect on Annex 1 costs	Lowered	None	None
Reliable funding	Yes	Yes	No
Effect on net global emissions	Zero	Additional reduction	Additional reduction
Funding for stabilization	No	Yes	Yes
Funding for capacity building	No	Yes	Yes
Mobilizes voluntary efforts	No	No	Yes
Availability	After reductions are made	When cap-and-trade starts	Immediately

* **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.

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.

Expected Evolution of Funding Needs



In the short-run, 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.

Matching Financing Timing to Needs

In the short-run, 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 risks of leakage, non-additionality, and monitoring errors will constrain how much can come directly from the carbon market. During this time period the market-linked approaches can provide an increasing

share of financing to both directly reduce deforestation and help avoid the leakage and non-additionality. Finally, in the 2020s—with built-up capacity, a broad experience base, and near-global participation—the direct carbon market should 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, providing smaller

or larger amounts of funding for countries with varying needs that change as the REDD process evolves. All three REDD financing approaches should go in the basket, producing a system best able to grow and develop as the world's needs change.

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



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