

DISCUSSION DRAFT

Governors' Climate & Forests Task Force (GCF)

TASK 1 REPORT: GCF Design Recommendations for Subnational REDD Frameworks

APPENDIX 2

MAKING GCF/ARB REDD FEASIBLE FOR PRIVATE SECTOR INVESTMENT

Tobias Garritt, GCF Representative, Province of Papua, Indonesia

July 21, 2010

Introduction

Reducing Emissions from Deforestation and Degradation (REDD) represents a compelling opportunity for achieving certain goals associated with California's climate legislation (AB 32), including cost-effectively reducing global greenhouse gas emissions while catalyzing sustainable development in developing countries.

California Air Resources Board (ARB) is considering approving international forest-based offsets generated on a sectoral basis by member states and provinces of the Governors' Climate & Forests Task Force (GCF). However, Recognizing that few such states and provinces will be ready in the near term to account for emission reductions on a jurisdiction-wide (i.e. sectoral) basis and given the importance of private-sector REDD in supporting public initiatives and encouraging early movers, California regulators would be advised to consider alternative crediting options for REDD during the early years of regulation. The benefit of a staged or scaled approach is to help build needed experience, technical capacity and institutional arrangements for host states/provinces to establish robust REDD sectoral programs for generating longer term offset supply for California regulated entities.

States and provinces in a position to establish robust jurisdiction-wide REDD accounting and crediting systems should be encouraged to participate in California's offset compliance market through a sectoral crediting pathway. However, by allowing GCF states and provinces making progress towards establishing sectoral systems to generate offset credits from a small number of pilot REDD projects, this would ensure that sufficient volumes of high-quality international forestry offsets are available to regulated entities, and would reduce the risk of allowance price volatility and negative economic impacts to California. Furthermore this approach builds confidence and public buy-in within host states/provinces that REDD is real and scaled-up government effort is warranted while providing ARB with appropriate scale for low-risk learning by doing during early years of regulation.

However, in order to achieve these benefits and even consider participation in a sectoral-based crediting scheme, a flow of funds and expertise to support technical and institutional capacity development is at once a necessity and urgent, with (currently the experience in Indonesian Papua) funding desperately lacking for states/ provinces to engage in the steps necessary to understand and take advantage of the ARB process to protect their forests, let alone generate the multi-tiered political will necessary to demonstrate REDD as a real alternative to oil palm investment. This political will to engage in REDD is dependent on realization of investment/ forest protection on the ground, and counterparties that state/ provincial governments, and importantly local governments who play a key role in the decision making process re: land conversion activities such as oil palm, can have exposure to and engage with, to determine that REDD is actually a real option for their economic development. To date (in Indonesian

Papua), this is to a large extent happening with private-sector investment – early movers with real funds for conservation activities offering real alternatives to local communities whose traditional forest lands are threatened with conversion today. However, in order for these private-sector initiatives to continue and expand, the appropriate mechanisms and in particular commercial safeguards need to be in place to support the realization these investments in place of their alternatives.

An Enabling Environment to Leverage Public Funds with Private-Sector Capital

Private-sector capital is playing an important part in early action in developing countries, protecting forest resources now that would otherwise be lost while national and state/provincial regulations and accounting systems are being developed in conjunction with public funding and programs. In Indonesia, many private-sector investments are already providing site-level (i.e. project) interventions which are providing targeted and tangible biodiversity and livelihood benefits while supporting and providing important input into state/ provincial and national processes which include developing benefit sharing and development of monitoring and accounting systems.

Furthermore private sector capital will be necessary to adequately reduce GHG emissions from deforestation. Agents with private capital will not invest in REDD if return on investment is contingent upon large-scale collective action (regional/national emissions performance), especially if such large-scale collective action either at an ARB or state/ province level remains under development without a clear monitoring and reporting mechanisms, agreement on baseline scenarios and a staged pathway to achieve these cornerstones of successful REDD.

Compensation for REDD projects can either be linked to regional/national emissions performance or not. If not linked, Pedroni et al. propose a workable model via the nested REDD approach. If linked, projects will need to be compensated in situations of regional/national non-performance through buffer reserves, sovereign guarantees, or mitigation payments. Given a linked, sectoral scenario, buffer reserves, sovereign guarantees and/ or mitigation payments will be critical in providing commercial safeguards for private-sector REDD, which even given the substantive contributions from the public sector, will play an important role in the success or failure of REDD programs and the subsequent markets for REDD based credits.

Transitional period of project-level REDD:

This would involve crediting a number of VCS projects per province for a 2-3 years transitional period. A suggested transitional period would encompass two stages. Stage one would include the creation of regionally or nationally explicit REDD plans in which areas where governments will accomplish REDD will be distinguished from areas in which are open to the private-sector. During the first stage state/ provincial baselines/

REL's and business as usual scenarios would be agreed upon and established, together with MRV and accounting systems which would also be able to distinguish between private-sector and government REDD initiatives.

These stage one projects would essentially be 'de-linked' and able to achieve direct crediting. Such projects would not necessarily only be private-sector – this framework would be equally effective in supporting public sector and governmental initiatives in the early stages.

The second stage would be for linked or nested REDD projects in which private sector and governmental credit issuance is based on regional/ national performance against agreed REL's. Under the linked approach, should REL's be exceeded due to emissions on a governmental level, private-sector REDD initiatives which achieve emissions reductions would need to be compensated with saleable credits from a buffer reserve, sovereign guarantees and/ or mitigation payment.

Fair and Reasonable Sectoral Crediting Baselines:

Sectoral crediting baselines should not be set below business-as-usual (BAU) reference emissions level. Furthermore baselines/ REL's should properly reflect the level of threat to a given state/ province, which may not have high levels of historical deforestation but by virtue of this fact combined with strong market and economic forces which clearly support conversion, be one of the final vestiges of intact forest (alternatively read 'timber/ mineral resource' or 'available agricultural land') in its home nation.

At present, ARB and GCF are planning on requiring states/provinces to reduce emissions by 20-50% below a defined reference emissions level before any crediting happens. There is no plan for how states/provinces would be compensated for this; rather, it is seen as a political imperative for the GCF partner jurisdictions to have 'skin in the game'.

Assuming such a process could achieve the political will to be implemented at a state/ province level, which is extremely unlikely, many if not all GCF partners will not be able to finance and effectively implement the governmental activities necessary to achieve that level of emissions reductions, while private sector investment will be deterred even if nested REDD is allowed as the private sector waits to see if governments are on track to achieve such significant emissions reductions on their own. From all tiers of government, the opportunity cost alone of having to reduce emissions by 20-50% below a defined reference emissions level before crediting would effectively disable any ability of GCF member states to implement REDD.

Possible points for consideration could be to set the crediting baseline **at** the BAU reference emissions level; or, in the alternative make the 20-50% governmental

emissions reduction target (the 'skin in the game') able to be demarcated geographically rather than requiring it to be achieved prior to any crediting. i.e. with a spatially explicit land use plan state that X GCF Partner jurisdiction will achieve REDD in xyz areas which will accomplish XX% emissions reductions below the reference emissions level. At the same time private sector REDD could proceed in other geographic areas that are open for REDD licensing (nested REDD), and the government's share of the private sector revenues/royalties would help finance the government's efforts in the other areas, and after the governments achieve those emissions reductions they can receive credits themselves for further emissions reductions. Note that this option would still require significant political capital if it were possible to proceed, notably from state/ provincial legislators who are elected from their regions, and in the case of economically disadvantaged areas within Papua, provided a mandate from their constituents to develop jobs and investment in their home regions.

Concerning the relationship of the crediting baseline in a sectoral system and the 'reference emission level', it is critical for the success of REDD in GCF member states/ provinces that the establishment of baseline emissions levels reflect the real level of threat on a member state/ province's forest. In some instances this is relatively straightforward to calculate using historical data. In other instances, it is incredibly complex and enters a matrix of demands on a nation's land where such states/ provinces may be the 'final frontier' (or indeed 'golden goose') for land based development/ exploitation in their country. In the case of Papua, crediting only after reductions below a REL based purely historical deforestation would effectively disincentivize private-sector investment in REDD while creating a challenging political environment in general. The need to closely study the conditions within each member state and develop alternatives for REL determination will prove to be a critical point for the GCF/ARB process and REDD in general.

Conclusion

California Air Resources Board's (ARB) consideration of including international forest-based offsets represents a significant opportunity for GCF member states and provinces to become early-movers in international REDD credit markets. California is to be commended for these steps which will play an increasingly important role in protecting the world's biodiversity and putting a commercial value on intact natural forests - one which the forests' inhabitants and traditional owners can enjoy while protecting their customary lands which provide an important environmental service to the world. As with any commodity, the integration and support of the private sector will play a pivotal role in the early development and continued success of REDD, which combined with the market mechanisms being developed as part of the California initiative now, and the political will both within California and in GCF member states, will play a strong part in determining the formation, feasibility and subsequent success of the implementation of REDD and REDD offsets in GCF member states/ provinces and California respectively.

The challenges faced by the private-sector investing in REDD are inherent in the challenges faced by member states and provinces in that it is one of the functions of government to attract investment and develop economic opportunity for its citizens. REDD, and the GCF process, provide members with the opportunity to attract not just investment, but a socially and environmentally sustainable form of investment that can help establish and protect the rights of communities and their forests while providing economic opportunity. A new paradigm that could be made reality in the near future by the private and public sector pilot projects that are being initiated now across member states. These pioneer projects are being initiated in an environment of sufficient uncertainty as to make the California process an important milestone through which to gauge the relevance of these initiatives in an international context. Combined with the political will that support these projects and the opportunity cost of the investments that they replace, careful consideration needs to be applied to creating an enabling environment to leverage public fund together with private capital to progress REDD.

Inherent in the success of REDD development are sufficient commercial safeguards to provide surety to private-sector investors. Such safeguards should be developed in conjunction with the private sector and would best be achieved through a joint learning approach, of 'learning by doing', fostered by a transitional period of project-level REDD. A transitional period will not only establish surety for private-sector investors in REDD, but also generate significant political capital for state and provincial governments and officials who are favouring REDD development in place of traditional land based investment – potentially at great political risk should a suitable pathway for REDD not be established, or a pathway that does not take into account the true risk of deforestation in a given state/ provinces and by doing so undervalue the protection of a state/ provinces forests through REDD. However, with the input of GCF member states which represent a broad spectrum of existing forest and historical deforestation, it is the hope that together we can support the establish of a mechanism that will provide the appropriate safeguards not just for private-sector, but for GCF members, ARB and the ultimate consumers of REDD-based forestry credits.