Nested Approaches to REDD+

An Overview of Issues and Options

Executive Summary

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Climate Focus:
Thiago Chagas
Charlotte Streck
Robert O'Sullivan

Forest Trends:
Jacob Olander
Joerg Seifert-Granzin

Forest Trends' mission is to maintain, restore, and enhance forests and connected natural ecosystems, life-sustaining processes, by promoting incentives stemming from a broad range of ecosystem services and products. Specifically, Forest Trends seeks to catalyze the development of integrated carbon, water, and biodiversity incentives that deliver real conservation outcomes and benefits to local communities and other stewards of our natural resources. Forest Trends analyzes strategic market and policy issues, catalyzes connections between producers, communities and investors, and develops new financial tools to help markets work for conservation and people.

Climate Focus is an advisory company committed to the development of policies and projects that reduce greenhouse gas emissions. Our international and multidisciplinary team works closely with companies, governments and non-governmental organizations on reducing emissions in energy, households, industry, agriculture and forestry. Climate Focus is an independent expert in international and national climate law, policies, project design and finance.

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Executive Summary

There is consensus in climate negotiations that efforts associated with Reducing Emissions from Deforestation and Forest Degradation (REDD+) will ultimately be measured and rewarded based on national-level accounting systems. But while developing countries are building capacity to implement and manage these national systems, subnational initiatives are evolving rapidly at the state, provincial, and project levels. Integrating these different accounting scales will be crucial to ensure the environmental integrity of the system as a whole and to mobilize finance.

To ensure appropriate emission accounting and allow the transfer of incentives in the form of carbon credits or payments, rules need to be defined that integrate the various levels of accounting, management, and incentives. Such rules are referred to as "nested systems" that nest project or programs within national- or state-level REDD+ accounting systems. Nesting allows incentives to be placed at the appropriate level of governance. While broader policy reforms may take years to be implemented, REDD+ action can be developed faster at the project level, delivering near-term emission reductions. Projects and programs also offer opportunities for private sector engagement and may provide important options for direct community-level participation in REDD+. Finally, subnational activities can make important contributions to emerging national frameworks for REDD+ management and accounting. Establishing local investment mechanisms as well as measurement, reporting, and verification (MRV) capacity is providing valuable experience to inform broader national policies.

While the focus of this paper is on the nesting and integration of projects into subnational and national systems, the discussion of REDD+ projects and programs should also be understood in the broader context of national REDD+ strategy development. Creating incentives for projects is only one part of a national REDD+ strategy which may include governance reform, fiscal incentives, and other policies that address particular drivers of deforestation. The discussion of accounting, legal and technical issues around the integration of different levels of crediting emission reductions is relevant not only for projects but also for the allocation of emissions and emission reductions among different levels of government (states, provinces, national) and policies (e.g., payments for ecosystem services, other subsidies, protected areas).

Countries and states or provinces may opt to implement nested forms of REDD+ through progressive phases. This step-wise approach is one of the main advantages of nesting and allows governments to move from independent project accounting to projects nested within state/provincial programs, and finally to a full-fledged national accounting system. These phases can be harmonized with the general REDD+ implementation phases acknowledged in the Cancun UNFCCC decision.

Distribution of Incentives

Emission reductions from REDD+ can be rewarded in the form of carbon credits (recognized in voluntary and/or regulated markets) and results-based payments from public sources (e.g., Green Climate Fund, bilateral REDD+ funding). Options to be defined in international negotiations might include direct distribution of incentives from an international REDD+ mechanism to projects (as under the Clean Development Mechanism) or direct distribution to national and/or subnational governments with a subsequent (indirect) distribution to subnational programs or projects. At the national level, governments with the authority to allocate credits or

funds must make a range of policy choices, including (i) deciding whether and how to incentivize project activities (striking a balance between these and use of funding for policies and programs), (ii) opting to allocate tradable credits or distribute benefits/payments; and (iii) defining the criteria or basis for allocating incentives.

Regulatory Aspects

The regulatory and institutional setup for REDD+ will have a considerable impact on the ability of nested approaches to ensure credible emission reductions and to attract private investment. Issues and options that require the attention of international as well as national policymakers include:

- Defining the basic institutional setup, such as the main regulatory entity responsible for overseeing domestic implementation, and the contours of the powers of that entity.
- Establishing approval procedures at international and domestic levels. At the international level, a dedicated system for approving projects and/or subnational programs could be created following the criteria set by the Cancun UNFCCC decision. At the domestic level, countries and states or provinces could determine what is required to approve or endorse project; who proposes and registers subnational reference levels; when independent verification is needed; and what relevant consultation procedures are.
- Creating a registry to support domestic policy options. A registry could function as an electronic database that is designed to evolve over time as domestic MRV capacities grow.

Managing Risk of Government Failure

Risk mitigation mechanisms can be designed at the project level or the government level. At the *project-level*, risk mitigation tools may be needed to address the issues of permanence and project performance. However, when rewards or incentives for subnational project activities are linked to the overall performance of the *government,* additional risks are generated beyond a project's control. Commonly cited risk management tools include: (i) buffer and reserve accounts; (ii) insurance mechanisms for reversal of carbon stocks; (iii) government guarantees; and (iv) penalty fees for sanctioned deforestation. These tools could be applied in many different combinations.

Measurement and Monitoring

Measuring and monitoring emissions from forests and land-use is complex but feasible. Specific parameters will generally be determined at the domestic level in order to ensure that forest cover, forest condition, and carbon stocks are measured consistently at different jurisdictional levels. To obtain consistent results, certain elements and concepts will need to be standardized, while other methodological decisions can be left to developers at the subnational level.

Potential issues and options for countries and states or provinces, and the international REDD+ system include (i) creating a definition of forest that is common and applicable at multiple scales; (ii) defining eligible activities and how to account properly for different land-use and forestry activities taking place at different scales; and (iii) harmonizing accounting periods for REDD+ activities implemented in different time periods.

Reference Levels

Potential methods for establishing baseline deforestation rates (reference levels) discussed under the UNFCCC include using historical average deforestation as well as various mechanisms that take into account projected deforestation and national circumstances. While, in itself, establishing relevant baselines is a difficult task, the technical and political challenges are compounded in nested REDD+ because the multiple baselines needed at different levels must be consistent and coherent. At least as challenging as setting national reference levels is determining how national levels are allocated within national (or subnational) boundaries.

Options to develop and integrate business-as-usual reference levels from subnational activities for nested approaches can be categorized as:

- Disaggregate or bottom-up approaches, in which multiple project-specific baselines are developed largely independently; or
- Consolidated or top-down approaches, where spatially explicit regional baselines are developed and used to zone and stratify the forest landscape to predict the rate, location and timing of future deforestation, or to establish benchmarks.

Leakage

Leakage is a real risk for project-level activities, as activity-shifting, market or other effects, can cause emissions to shift to areas outside their project boundaries. Current approaches to dealing with leakage under project-level accounting standards (e.g., CDM, VCS) include improving design of project activities to minimize leakage risks, accounting for leakage within a monitored "leakage belt" that covers the range of displaced agents and their activities, and making use of discount factors. At the national or state/provincial level, options to deal with leakage include applying these project approaches, using a leakage tax, and/or having governments assume leakage risks in order to spur private investments.

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