



The Post-Durban Policy and Market Environment for REDD

An Updated Policy Assessment for the MCDI REDD Project

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Overview

The international policy and market environment for REDD continued to evolve during 2011 in manifold ways. Carbon markets had a difficult year, with the price of CERS sold under the European Union Emission Trading Scheme (EU ETS) collapsing to less than a third of their peak value (the EU ETS does not include REDD offsets) and, with a major sovereign debt crisis threatening the European Union itself, in some danger of folding entirely. Voluntary markets, which make up less than 1% of total carbon markets, were less buffeted by wider market problems and voluntary trade continued to expand from 2010 to 2011, supported by a growing portfolio of approved verification/validation standards and approved projects.

At the international policy level, the 17th UNFCCC Conference of Parties (CoP) was held in Durban, South Africa in December, 2011. The CoP effectively served to keep the UNFCCC process alive, and even experienced a minor breakthrough in obtaining tacit agreement from China and other developing countries to accede to a new post-Kyoto regulatory regime by 2015 (this post-Kyoto agreement to be negotiated over the next several years). With no prospects for a global climate regime to come into effect before around 2020, any larger compliance market for carbon offsets involving REDD will not exist before then. The EU ETS, suffering from over-supply of credits, will also not incorporate REDD until 2020 at the earliest.

Despite the fact that a global compliance market for REDD, as originally envisioned, will not exist for another eight years or so, there were a number of more promising compliance market developments at national or sub-national scale that may create enhanced demand for REDD offsets, at least in some places. The most significant of these is California, which moved forward with its cap-and-trade scheme and is including a limited volume of international REDD offsets. Other countries including Australia and Quebec also moved forward with their own domestic climate regulations or trading schemes.

This state of affairs is generally one that will likely continue for the next 5-10 years; action on climate issues, including overall emissions caps and reduction targets and provisions for including REDD in cap and trade programs, will continue at national or provincial levels where there is political will to take action. This will continue to create increased market demand- but on a modest and somewhat constrained scale- for REDD offsets where cap and trade programs allow inclusion of international REDD offsets. With at least some patchwork progress within these national and regional compliance markets, and potentially a gradual global economic recovery from the recurrent difficulties of 2008-2011, private sector demand for compliance-worthy REDD offsets through the voluntary market should continue to increase. There is, however, the potential for oversupply of REDD offsets, with many projects undergoing validation under VCS and thus bringing offsets to market all around the same time.

International Policy Developments

Global Climate Policy: COP 17, Durban

The general perception of the 17th UNFCCC CoP held in Durban, South Africa, in December, 2011, is that there was some continued progress on technical issues and agreement to continue negotiations (using a timeline that has receded into the future considerably over the past two years) on a post-Kyoto agreement. There was potentially a breakthrough on the latter front in obtaining agreement from developing countries such as China to be included in that post-Kyoto binding climate regime, although no specifics have been agreed to at this stage.

REDD continues to be among the more uniformly accepted elements of global climate negotiations, although in the absence of an overall binding treaty regime and global compliance market it is not clear what that means for actual REDD projects. Discussions focused on Monitoring, Reporting and Verification (MRV), Safeguards, Reference Levels, and Financing. Some tightening up and clarity of procedures for MRV and for countries to set Reference Levels emerged from the negotiations, though no major decisions on financing. The decision on safeguards provides a reporting system but no clear criteria and no remedial measures (penalties) in case safeguards are not adhered to.

With regards to financing, there was discussion of both non-market and market sources of financing but any decision, as on a number of other key issues, was deferred to the next CoP in Qatar in 2012. There was generally agreement coming out of the CoP that there will be no global REDD market until 2020 at the earliest.

Overall REDD negotiations continue to make progress on technical issues, with gradual convergence around nuts-and-bolts aspects, but continuing broad uncertainty about financing as well as agreement on key safeguard issues. The lead scientist for CIFOR characterized the outcome from Durban as follows:

“We are now seeing the technical obstacles to REDD fall by the wayside and the decisions made on REDD in Durban are a vote of confidence in the progress that the scientific community has made over the last few years. However, we do not have progress on the ‘politics behind the money’ and without this we cannot talk about sustainability of REDD” (Kovacevic, 2011).

National and Regional Policy and Market Developments

Outside of the UNFCCC process, international policy developments that may have implications for REDD progressed in both positive and negative ways.

The EU ETS- by far the largest formal carbon market in existence- had a particularly shaky year, as a result of both the deteriorating economic conditions in Europe and an oversupply of credits. The price of an EU ETS carbon credit fell during 2011 from highs in April of €17.31 to all-time lows of €6.90 by December 2011 contract. The latter prices mean that the EU credits were down more than 75% from their all-time highs of more than €32 in July 2008. (Marco, 2011). This collapse in prices is largely due to oversupply, which results from too many credits being issued during the first phase of cap-and-trade, with emissions declining since then due to decreased production of electricity as a result of Europe’s recessionary economic conditions.

Since the EU ETS does not allow REDD offsets, and will not consider adding REDD until around 2020, these price changes do not impact the direct demand for REDD offsets. However, since the EU ETS dominates the overall carbon market in terms of transaction value and volume,

developments there do have important overall implications for the carbon market as a whole, including investor appetite for future investments in offsets.

Economic difficulties in Europe- both in terms of sovereign and private debt holdings- and the challenges this has created for the continued existence of the Euro and the EU itself have further shaken the carbon markets over the past year and will continue to have major implications for REDD in the near future.

While the EU ETS experienced perhaps its most difficult year in the marketplace and in the media, more promising developments for REDD were witnessed in California. The western US state, which is itself the world's ninth-largest economy and accounts for 2% of global carbon emissions, has moved to the forefront of leadership on climate and carbon market development within North America. The key to California's vanguard position are the following events during the past five years:

- 2006 passage under then-Republican Governor Arnold Schwarzenegger of the Global Warming Solutions Act (Assembly Bill 32- AB 32), which obliges the state to reduce emissions to 1990 levels by 2020 and then cut emissions 80% by 2050.
- In November 2010, AB 32 survived a referendum challenge, financed by the oil lobby, that would have put off implementation of AB 32 until certain state-wide employment and economic criteria were first reached. This referendum proposal to delay implementation of AB 32 was defeated by a 61% to 39% margin at the polls.
- Since those events, a Democratic Governor (Jerry Brown) has been elected to succeed Schwarzenegger and has reinforced the state's commitments to implementing its emission reductions and implementing a cap-and-trade program to be overseen by the state Air Resources Board, which has moved forward with the necessary institutional framework to be formally launched in 2013.

California has also played a leadership role in the state/province level Governor's Climate and Forests Task Force (GCF) which includes leadership at the state and provincial level from about 15 countries around the world, including Indonesia, Nigeria, Mexico, and Brazil. California has worked to include some international REDD offsets within its cap-and-trade program, and by 2015 this may represent the first major source of compliance offsets from REDD to be traded globally. The GCF is continuing to work out the details of this REDD offset trade through the REDD Offset Working Group, which partners with Acre state in Brazil and Chiapas state in Mexico, which initially will generate the REDD offsets to be traded.

GCF is being looked to as one source of leadership in the rather more decentralized, pluralistic climate and carbon policy arena that has taken shape since the failure of Copenhagen (CoP 15) two years ago. While hopes for a post-Kyoto global climate regime have faded, and the UNFCCC process itself teetered on the brink of dissolution, national and regional leadership continues to create both policy-level dynamism and some level of market demand, or at least hope for future market demand.

Other countries continue to also move forward with their own carbon regulatory regimes, including Australia's approval of a carbon tax after a narrow parliamentary vote and extensive debate. South Africa also recently announced plans to institute a carbon tax on a limited basis. Even in the US discussion has revived recently around using a carbon tax to address the dual objectives of reducing carbon emissions and generating tax revenue for debt and deficit reduction. None of these other schemes creates a cap-and-trade compliance market for REDD offsets, but these national and regional initiatives are nevertheless essential for

maintaining continued momentum towards increased aggregate climate regulation, and thus hope for future REDD markets and financing.

REDD Market Trends

Global forest carbon markets have continued to expand, with total transactions totalling about 30 million metric tonnes of CO₂e (MtCO₂e) in 2010, worth about \$178 million in total value (Diaz et al., 2011). Overall, carbon forestry offsets now make up more than 40% of the total Over the Counter voluntary carbon market. In addition, within the overall carbon forestry market, REDD surpassed the volume supplied by any other project type, supplying 19.5 MtCO₂e out of the total 29.0 MtCO₂e from the primary market (Diaz et al., 2011).

It is difficult to provide a clear picture on pricing of offsets from the voluntary market due to the diversity of standards, often embodying different products (e.g. co-benefits) and variation amongst prices. However, the average price for offsets across the primary forest carbon markets rose from \$3.8/tCO₂e in 2008, to \$4.5/tCO₂e in 2009, and up to \$5.5/tCO₂e in 2010 (Diaz et al., 2011). Some niche markets, such as Plan Vivo Certificates, sold a lower volume of offsets at consistently higher prices e.g. \$8-\$10/tCO₂e. Thus despite all the volatility in the overall carbon markets (e.g. collapse of prices in EU ETS), voluntary offsets continue to rise in value according to some representative market measures and premium products with co-benefits still are routinely earning in the vicinity of \$10/tCO₂e.

East Africa was in the international spotlight as a result of the Wildlife Works Carbon (WWC) project in Rukinga, between Tsavo East and Tsavo West National Parks, which became the first REDD project anywhere to achieve validation under the Verified Carbon Standard (VCS). WWC also entered into a \$50 million sourcing and project development financing deal with BNP Paribas in September 2010, which has enabled it to invest in project development elsewhere in Africa.¹ These private sector developments have helped Africa continue some momentum within global carbon forestry markets, as noted:

Africa remains a relatively small player in terms of global supply, providing the fewest credits of any region with a voluntary OTC focus. African volumes were down from their peak at 5.1 MtCO₂e contracted in 2009, producing just 1.9 MtCO₂e contracted in 2010 from 14 projects. Nevertheless, the region is expected to follow its longer-term historical growth trend with a growing pipeline of large projects such as those begun by Wildlife Works in Kenya, and new deals, such as from ERA Ecosystem Restoration Associates in the Democratic Republic of Congo, which appear set to contribute a future boost in African supply beyond historical levels. (Diaz et al., 2011).

¹ <http://www.wildlifeworks.com/WWCarbon/WWCarbon/BNP.pdf>

References

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