

## **Climate Regulation Series -- Market-Based Mechanisms to Protect Forests**

By Kenneth Markowitz, *Akin Gump Strauss Hauer & Feld LLP*, on 19 March 2008

Forests play a vital and complex role in the global climate system. Trees and plants are our best absorber of carbon dioxide, one of the principal greenhouse gases (GHG), and can play a crucial role in moderating the earth's temperature. Deforestation and land use changes, on the other hand, are often cited to cause 20 percent of the world's anthropogenic GHG emissions. Well-designed regulatory frameworks are critical to preventing deforestation, forest degradation and GHG intensive land use changes, while not stifling economic growth. One approach is through market-based programs which provide economic incentives and regulatory flexibility to achieve sustainable development objectives. While some of these programs offer great promise, they have been met with significant opposition and have yet to yield measurable, reportable and verifiable results.

Delegates at the December 2007 United Nations Framework Convention on Climate Change (UNFCCC) meetings in Bali, Indonesia felt it important to highlight the need for "policy approaches and positive incentives on issues relating to reducing emissions from deforestation and forest degradation in developing countries." The concept of "reduced emissions from deforestation and degradation" (REDD) demonstrates a major shift in how the global climate framework would treat forests. A formal decision document from Bali states that "forest degradation also leads to emissions" and calls for the Subsidiary Body for Scientific and Technological Advice to research "methodological issues related to a range of policy approaches and positive incentives" for REDD. The goal of the REDD process is to find an adequate way to account for the emissions absorbed by forests, with a final goal of including credits to developing countries for forest protection either in a post-2012 climate agreement or by developing a parallel financial mechanism for trading these credits.

REDD attempts to realign economic incentives so that the value of the ecosystem goods and services flowing from an intact forest is greater than the market value of the timber and other non-replenishing natural resources. Two main obstacles must be overcome for REDD to succeed. First, there needs to be a reliable verification method for quantifying the emissions reductions from forests and monitoring mechanisms to assure there are real, permanent, additional, and verifiable emission reductions that do not lead to deforestation elsewhere. Assuring compliance has been a major hindrance to wider recognition of forest projects in the carbon markets. Second, the price of carbon must be high enough to provide economic incentive for local communities to forego logging and development.

The World Bank announced a major effort to support REDD endeavors at the Bali meetings. The Forest Carbon Partnership Facility (FCPF) will have two components. The first would assist developing countries in their efforts by providing performance-based incentive payments for reducing land and forest-based emissions. The second component of the FCPF would help

developing countries determine the carbon capacity of their forests and current and future emission rates. The World Bank hopes to raise \$200 million in capital to operate the FCPF on a pilot basis.

In January 2008, the European Commission (EC) published proposed Directives to govern the next compliance phase of the European Union Emissions Trading System (EU-ETS) – which will run from 2013 until 2020. This proposal dealt a significant blow to proponents of market based approaches to forest protection. The proposal would continue the current policy of prohibiting emissions credits derived from forestry projects to be used for compliance in the EU-ETS. Citing the lack of consistent reliability, the Commission believed that the integrity of the trading system would be put at risk by including credits from forestry projects. The Directive will not be finalized until the beginning of 2009 at the earliest, so there may be a small window for reconsideration.

In the United States, California is leading efforts to create a market-based approach for forests in mitigating climate change. The California Climate Action Registry published, and the California Air Resources Board adopted, a set of Forest Sector Protocols in October 2007. These Protocols detail the steps for determining the amount of carbon that can be stored in a forest and how to quantify the emissions reductions from forestry projects. Credits generated pursuant to the Protocols currently are used only in the voluntary markets, though they could be integrated into a compliance system if California adopts a cap-and-trade program under the 2006 Global Warming Solutions Act (known as AB32). In the voluntary markets, the Protocols have already led to a transaction to preserve a section of forest in northern California that will generate 60,000 tons of marketable emissions credits.

If proven successful, California's Forest Sector Protocols will provide a significant boost to both forestry projects and the voluntary markets, and could serve as a model for other regulatory regimes, including the EU-ETS, to embrace a market-based approach to forest protection.

If market-based approaches are to play a significant role in preserving our forests and reducing GHG emissions, certain design elements must be present. Suggestions include, but are not limited to, internationally recognized, nationally appropriate standards for monitoring, reporting and verifying baseline emissions and actual emission reductions; recognition of projects aimed at afforestation (planting trees to cover clear area) and deforestation avoidance (protecting existing area); inclusion of large and small scale projects - the market will decide which projects are economically feasible; and utilization of technologies such as remote sensing for monitoring to help regulators respond to the challenges associated with assuring compliance.

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