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Accessing Money for REDD: Public Finance or Market?

by

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Summary

Of the two possibilities of Public Finance and Market Mechanism for funding REDD activities the former would mean contribution by developed countries into a REDD Multilateral Fund requiring approval by national parliaments that might pose insurmountable difficulties in these times of recession. On the other hand the fact that money in market for REDD credits would come from business entities, and not from the exchequers, would makes it a politically attractive option. It is often argued that market mechanism would be efficient, effective and enhance equity while reducing governance risks and keeping costs low. But in a market where producers abound and buyers dominate it would not lead to greater equity as the two externalities of biodiversity and the concern for indigenous people, both critical for equity, remain stubbornly outside. Nor would the market be effective in meeting the REDD objectives as the credibility of the carbon credits generated would suffer from high uncertainties of leakage and fears of impermanence. The market will discount low credibility reducing economic returns particularly in poor and poorly governed countries further hurting equity. Also the market mechanism does not reduce overall global emissions and is merely a translocation of green house gas emissions from the poor countries to the rich.

Settling on interim solutions when final solutions prove elusive could be a good strategy. One such interim solution could be the setting up of a public financing for REDD confined only to Least developed countries (LDCs). This would be politically acceptable in the developed countries provided the LDCs agree to a dominant role for the donor countries in the planning as well as monitoring, reporting and verification (MRV) processes in the initial phase of REDD which could taper as the governance and the technical capabilities of the LDCs improve. In the case of the emerging economies like China, Brazil, Indonesia, Malaysia and India, an interim step could be a market

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mechanism for REDD that takes the shape of an enlarged CDM in which additional activities of forest management, conservation and enhancement of carbon stock are also included beside the existing afforestation and reforestation activities and making it mandatory that 20 percent of emission reduction requirements should be met from forest based mitigation activities. There is a great need of making compromises on all sides in order to move forward quickly.

Among the many issues that are blocking the early implementation of REDD one of the most contentious is whether its funding should come from public source like a Multilateral Fund with financial contribution from rich countries in accordance with their historical emission levels and their current stage of development or should it access money through a new market mechanism where developed countries, that need carbon credits to meet their GHG emission reduction targets, pay for REDD credits.

Developed countries supporting market mechanism for REDD financing claim that it would be efficient, effective and enhance equity while having lower administrative cost and providing protection against the risks of policy and governance failures that often have devastating impacts on government led programs in developing countries.

There is no doubt that market mechanism are more efficient than Government administered programs and will have lower administrative cost as well as limited risk of policy failures impacting the REDD objectives. But it is difficult to accept their claim that market would either lead to greater equity or effectiveness. Markets can lead to greater equity when it is perfect market with very large number of producers and consumers and a free flow of information among them. In other words, markets enhance equity when market is founded in equity.

But in the case of REDD none of these conditions are met at present nor is their much likelihood of it happening in the foreseeable future. The buyers are very few while producers abound and market, when it does come into existence, would be tilted against the producers in the developing world from the beginning because it is essentially the developed world, the buyers, who would set the market rules. Also the REDD market has too many externalities that could stubbornly remain unvalued in economic terms. Two of the large externalities are the biodiversity and the indigenous people both of which are critically important for equity. Societies that take care of these two critical aspects well would have less to offer in terms of carbon and thus generate less economic returns whereas the ones which care little would earn far more. The REDD market is, therefore, loaded against equity by its very nature.

One could argue that as these two externalities of care for indigenous people and biodiversity are factored in the economics of REDD credits through better and more effective regulations the markets would become more equity oriented. There is definitely a possibility that this could happen in the years ahead. But the implementation of such regulatory mechanisms would require good governance in the REDD host countries which can only come through higher investments in governance in these countries, the source of which can only be public funding since the REDD market cannot be expected to take on the burden of improving the governance.

The claim of REDD markets being more effective in meeting the REDD objectives is even weaker. A process would be called effective if it resulted in better quality of the output, cost remaining the same. But in the REDD market mechanism the quality of the output, intricately linked to the credibility of the carbon credits, would always be suspect because the single greatest difficulty in REDD is the assessment and accounting of leakage. Leakage, which is the loss of carbon at a different site caused by a climate change mitigation activity undertaken somewhere else, is a serious enough problem in any mitigation project but assumes a special significance in REDD that is expected to cover vast nations with a very large number of individuals and market forces capable of causing leakage making monitoring a near impossible task. The impermanence of the REDD, for reasons within and without the control of man, is another factor that would always cast a question mark over the credibility of the REDD credits. The markets would discount the loss of credibility heavily thus reducing returns from REDD sharply in poorer and poorly governed countries because it is there that the reversal of REDD is more likely to occur.

An even more serious argument against the market mechanism is that it does not reduce overall emissions because each ton of CO_2 that is prevented from emission due to REDD in a developing country is matched by an equal increase in emissions by the purchaser of the REDD credit in a developed country. So there is no real mitigation of climate change, it is merely a translocation of green house gas emissions from the poor to the rich.

One of the strongest critics of market mechanism is Bolivia whose President Evo Morales has been forcefully articulating his opposition on moral grounds. He says that an acceptable architecture of REDD should recognize that the earth and forests have inherent rights of their own, that management of forests is a sovereign function of the concerned countries, that the rights of indigenous people in all its dimensions ought to take precedence and that carbon sink function could only be treated as one of the many values of forests and not allowed to undermine the wealth contained in the biodiversity fo the forests. This would be possible only if the REDD funding comes in the form of fulfillment of environmental debt that the rich nations own to the earth and its natural ecosystems of which indigenous people are an integral part.

The moral force of this argument is undeniable but the practicability of such a principle being accepted is hugely doubtful. This is far beyond the existing international agreements on climate change. The founding principle of the UNFCCC that all countries “should protect the climate system for the benefit of present and future generations of humankind, on the basis of equity and in accordance with their common but differentiated responsibilities and respective capabilities” implies that all countries share responsibility for global warming in varying degrees and also that all are expected to protect the climate system while recognizing that they have varying capabilities for contributing to the mitigation of warming as also for dealing with the consequences of the warming. This treaty architecture does not permit enforcement of environmental debt for global warming only on the developed countries.

There is a clear North-South divide and, as expected, the developed countries favor a market mechanism which does not place any burden on them beyond what was agreed in Kyoto and the expected agreement for a post Kyoto climate regime. Market is essentially a ‘User Pays’ mechanism where only those entities in developed countries that exceed their emission caps alone would need to purchase carbon credits from REDD. And since REDD credits for each ton of CO2 are expected to be cheaper than non-REDD carbon credits one can easily understand their keenness to rush into a REDD market as early as possible. Also, the money for procuring the REDD credit would mostly come from their business entities and not from the governments which makes it politically far easier to manage.

On the other hand, public financing for REDD would mean contribution by developed countries into a REDD Multilateral Fund as a duty cast on them owing to their primary responsibility for having caused the problem of global warming in the first place, a kind of ‘Polluter Pays’ principle. This money would have to be paid by country governments requiring budget approval by national parliaments, a difficult task at the best of the times but one that might pose insurmountable difficulties in these times of recession.

It is difficult to see how the US Congress would approve transfer of billions of dollars to China, Brazil, India and Indonesia, among others, for protecting and enlarging the size of their forests. Perhaps the prospective recipients also realize it and that is why the willingness of India and China to agree to a REDD financing system where public finance would be complemented by a market mechanism that evolves as lessons are learnt from public funding based REDD approaches.

But this offer of compromise by India and China, which has been on table for some time now, is unlikely to compel the developed countries move ahead on REDD for being too little. Everybody recognizes the enormous urgency of addressing climate change if catastrophic consequences of global warming is to be avoided, and the significant role that REDD can play in it, but the progress is held up for lack of meeting ground between important countries. There is a perhaps a need to look for interim solutions to the many complex problems that REDD poses. And one such interim solution could be the setting up of a public financing system for REDD that is confined only to Least developed countries (LDCs). This would be politically acceptable within the developed countries as there is no real opposition domestically in these countries for helping the LDCs. The only sticking point could be the demand of the donor countries to ensure that the money is well spent. To this end the LDCs could agree to accede to a dominant role for the donor countries in the planning as well as monitoring, reporting and verification (MRV) processes in the initial phase of REDD which could taper as the governance and the technical capabilities of the LDCs improve. As this could also provide significant employment opportunities within the donor countries it would help in enhancing acceptance domestically.

In the case of the emerging economies like China, Brazil, Indonesia, Malaysia and India, an interim solution could be a market mechanism for REDD that takes the shape of an enlarged CDM in which additional activities of forest management, conservation and enhancement of carbon stock are also included beside the existing afforestation and reforestation activities. And this enlargement may also make it mandatory that countries that are not able to confine their emissions within their emission caps should meet 20 percent of their emission reduction requirements from forest based mitigation activities. This assurance of demand would impart a degree of depth to this market encouraging investments. And in order to enrich biodiversity, and enhance equity in relation to indigenous people, these REDD carbon credits should come from processes that have stringent regulations in this regard.

Action on REDD ought to begin at Cancun. The world has already waited for too long. There is a great need of making compromises on all sides in order to go forward quickly. Settling on interim solutions when final solutions prove elusive is nearly always a good strategy.

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