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Options for scaling-up near term support

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1. Introduction

The European Union (EU) is a strong supporter of international efforts to reduce greenhouse gas (GHG) emissions in the forest sector. It has declared its commitment to a reduction target for gross tropical deforestation of at least 50 percent by 2020,[1] and it is a vocal advocate of an international policy framework for "reducing emissions from deforestation and forest degradation and the role of conservation, sustainable management of forests and enhancement of forest carbon stocks" (REDD+). At the same time, the EU lacks a coherent strategy on how to mobilize resources for REDD+. The Union and its Member States have so far only committed a small portion of the funds likely to be necessary to reach its stated policy goals, giving rise to important questions regarding their financing. [2] The EU proposal touted in 2008 to make available complementary funding (beyond development aid, bilateral sources and the like) for REDD+ activities through a new financial mechanism, the Global Forest Carbon Mechanism, in the range of 1.5 – 2.5 billion Euro annually by 2020, has not been heard of since.[3]

While expectations remain optimistic that greater financial pledges for the post-2020 period will be made at the 21st Conference of the Parties in Paris in 2015, the urgency of financing REDD+ demands that the finance levels be scaled up in the short term. This paper presents options on how to mobilize REDD+ finance in the EU. Section 2 begins by assessing the current state of play of REDD+ in EU climate policy, with a focus on recent developments. Section 3 provides a brief overview of the options considered in the paper for mobilizing REDD+ finance. Section 4 develops in some detail two options: (i) REDD+ 'compensation credits' and (ii) sustainable supply chains – that stakeholder consultations identified as the most promising options for mobilizing finance in the medium term. Section 5 then describes a range of other options that, while not considered by stakeholders to have as much potential as those in Section 4, may nonetheless have some value in securing financing for REDD+. Finally, Section 6 summarizes and draws conclusions from the analysis.

[1] European Commission, Addressing the challenges of deforestation and forest degradation to tackle climate change and biodiversity loss, Communication COM(2008) 645 final, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0645:FIN:EN:PDF.

[2] According to the latest figures released by the European Union, the total cost of the climate and energy package for 2020 will be around 48 billion euros a year in 2020 (0.32% of projected 2020 GDP). (cf.http://ec.europa.eu/clima/policies/finance/international/faststart/docs/presentation_eu_fast_start_funding_for_dc_en.pdf). For an overview of REDD+ activities sponsored by the European Union including its member states and Norway see the final report of the "2nd EU REDD+ Projects Coordination Meeting 3-4 July 2012", at http://www.euredd.efi.int/files/attachments/euredd/report_-_2nd_eu_redd_projects_coordination_meeting.pdf.

[3] Communication from the Commission to the European Parliament et al., Addressing the challenges of deforestation and forest degradation to tackle climate change and biodiversity loss, COM(2008) 645/3

2. Introduction: REDD+ in the EU

2.1 REDD+ in EU carbon markets

The EU Emission Trading Scheme (EU ETS) continues to be the EU's most prominent instrument for mitigating climate change and has long been the engine of the global carbon market. The Effort Sharing Decision (ESD), meanwhile, sets emissions caps for the non-EU ETS sectors in each EU Member State, addressing Member States rather than the individual emitters. Both schemes allow for the use of certain international offsets to facilitate compliance, though neither permits international REDD+ credits. The ESD does however allow afforestation and reforestation credits generated under the Clean Development Mechanism (CDM) to be used to meet national mitigation targets. Both instruments provide for the possibility to allow credits generated under bilateral agreements between the EU and third countries, though to-date none has been concluded and there are no indications that any are under negotiation.

The exclusion of forestry credits from the EU's emission trading frameworks stems from a number of concerns the EU holds surrounding the sector, particularly regarding the permanence and the monitoring and reporting of emission reductions. It also arises from the large number of offset credits that could potentially feed into the markets, particularly in the context of persistent market oversupply.[4] These dual reasons have been repeatedly cited by the EU Commission as the rationale for excluding REDD+ from the EU ETS, while the ESD explicitly provides for the Commission to make an assessment of the inclusion of REDD+ in the framework of the ESD only in the event of both the conclusion of an international agreement on climate change leading to an EU 2020 emission reduction commitment in excess of 20% and the development of an internationally recognised REDD+ system.[5] The challenge for REDD+ crediting, thus, is two-fold: the market challenge – oversupply of tradable units – on the one hand, and the (perceived or real) technical challenge – liability, non-permanence, and the capacity to monitor emissions –on the other.

The **market challenge** remains acute and currently shows few signs of being overcome prior to 2020. As of May 2014, the EU ETS was oversupplied to the tune of 2.1 billion allowances,[6] and prices as of July

[4] Commission Staff Working Document, Impact Assessment EU ETS (2008), COM(2008) 16 final, pp. 56 et seq.

[5] Decision No 406/2009/EC of the European Parliament and of the Council of 23 April 2009 on the effort of Member States to reduce their greenhouse gas emissions to meet the Community's greenhouse gas emission reduction commitments up to 2020 ("Effort Sharing Decision"), Article 8.

[6] Point Carbon, EU Carbon Permit Surplus Rose to Over 2.1 Bln Allowances in 2013, 14 May 2014.

2014 average around EUR 6.7 Although the approval in 2013 of the European Commission's "backloading proposal" (i.e. to defer the auction of 900 million allowances by a few years and thereby temporarily boosting prices) is likely to provide some reprieve for the market,8 it will hardly create room for allowing additional international credits into the scheme, whether from REDD+ or any other credit category. Adopting deeper cuts in emissions by 2020, a move touted by the EU Commission and supported by a number of key Member States, would have the potential to open up such a space. However, such moves have so far failed to attract sufficient support in the European Council or Parliament, the two law-making institutions at the EU level, to obtain the majority required to move forward. Meanwhile, attention has shifted toward agreeing on targets for 2030, making any change in 2020 targets no longer likely.

Another possibility is the adoption of a Market Stability Reserve for the EU ETS, which would serve to remove a given quantity of allowances from the market during times of oversupply, and release them in times of shorter supply. The Commission has proposed that such a reserve be operationalized by 2021, but has expressed its openness to implementation at an earlier date.[9] Such a move would be subject to negotiations with Member States and the European Parliament, which are due to be concluded by October 2014. Under present proposals for the Market Stability Reserve, however, it is unlikely that even early institution would result in major changes to market supply without the introduction of more stringent emission reduction targets. [10]

The market situation under the Effort Sharing Decision may, to some extent, be less dramatic. Although the oversupply is massive,[11] Member States will be less inclined to offer their surplus for sale, and the underperformers may have a (political) interest in buying international credits rather than over-allocated allowances from their EU partner countries. While it is not likely (as with the EU ETS) that the overall level of ambition under the ESD is lifted before 2020, it may still be politically viable to open the format for international credits allowed into the scheme. That said, any steps in the direction of amending the ESD to include a REDD+ window will require substantial political will and advocacy. So far, no Member State has publically backed such a move, and the countries most supportive of REDD+ within the Union (UK, Germany) have no need to purchase international credits to meet their targets.

Beyond 2020, the prospect, of more ambitious targets creates the possibility for increased demand. In March 2014, the Commission proposed an emission reduction target of 40% for 2030, with a 43% target proposed for the EU ETS sectors. The current proposal, however, does not make any provision for international credits, though it does leave open the possibility that they could be introduced under a more ambitious target [12]

[7] www.pointcarbon.com

[8] Commission Regulation (EU) No 176/2014 of 25 February 2014 amending Regulation (EU) No 1031/2010 in particular to determine the volumes of greenhouse gas emission allowances to be auctioned in 2013-20

[9] Point Carbon, EU Commission Says Open to Carbon Market Reform Before 2021, 20 May 2014.

[10] Proposal for a Decision of the European Parliament and of the Council concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and amending Directive 2003/87/EC, COM(2014) 20 /2.

[11] Over 20 member states including all bigger ones (except perhaps Italy and France) will overachieve their targets. See European Environment Agency, Progress to Greenhouse Gas Emissions Targets (October 2012 Assessment), http://www.eea.europa.eu/data-and-maps/figures/projected-gaps-between-2020-ghg-1.

[12] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: A policy framework for climate and energy in the period from 2020 to 2030, COM(2014) 15 final.

By contrast, the **technical challenge** appears at least more surmountable. In 2013, the European Parliament and Council approved new rules to improve the monitoring and reporting of greenhouse gas emissions, including those from forestry and agriculture.[13] This represents a promising step towards the inclusion of the agriculture and forestry sectors in the EU policy framework. The Commission only intends to consider including LULUCF within the EU targets once the accounting rules have been proven, however, which is likely to take some years.[14] At the international level, meanwhile, the development of a crediting system for REDD+ under the UNFCCC remains elusive, with Parties at the 19th Conference of the Parties in Warsaw excluding any crediting option from their decisions on modalities for financing REDD+. The possibility remains that REDD+ crediting could take place within the framework of the New Market Mechanism; nonetheless, negotiations on that topic remain unlikely to make much progress prior to the end of 2015. In the absence of such a mechanism, it would appear unlikely that the EU will open either the EU ETS or the ESD to REDD+.

2.2 FLEGT

The EU Forest Law Enforcement, Governance and Trade (FLEGT) Action Plan and the related Timber Regulation together comprise perhaps the most important EU initiative on international forestry. In recent years, the EU has continued to expand the negotiation of Voluntary Partnership Agreements (VPAs) with partner countries: six countries have concluded and are implementing VPAs, while nine are in VPA negotiations and a further eleven are in the pre-negotiation phase.[15] Meanwhile, the EU Timber Regulation came into force in 2013, requiring all importers to establish due diligence systems to ensure the legality of all timber exports.[16]

The EU is increasingly interested in creating synergies between REDD+ and FLEGT. The recently established EU REDD+ Facility covers at present five countries (Democratic Republic of Congo, Guyana, Indonesia, Republic of Congo and Vietnam).[17] Nevertheless, the coordination effort remains modest and has not gone beyond complementary action in the framework of institutional and regulatory 'readiness' exercises. While the Facility has been provided with a budget of EUR 4.3 million so far, it is worth mentioning that FLEGT or the Timber Regulation do not otherwise foresee direct investments or payments for efforts or results; rather, their impact on forest protection and conservation activities remains indirect in that they aim at strengthening governance capacity and setting timber demand incentives, the broad assumption being that this will also eventually benefit REDD+ (specifically by reducing forest degradation).

[13] Decision No 529/2013/EU of the European Parliament and of the Council of 21 May 2013 on accounting rules on greenhouse gas emissions and removals resulting from activities relating to land use, land-use change and forestry and on information concerning actions relating to those activities.

[14] See http://ec.europa.eu/clima/policies/forests/lulucf/index_en.htm.

[15] See list provided by the EU FLEGT Facility: http://www.euflegt.efi.int/portal/home/vpa_countries/.

[16] Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010 laying down the obligations of operators who place timber and timber products on the market.

[17] EuropeAid's Environment and Natural Resources Thematic Programme (ENRTP), has, for example earmarked EUR 40 million for REDD+ with a further EUR 55 million and EUR 73 million allocated to related areas of FLEGT and biodiversity, respectively. European Forest Institute, Fact Sheet on EU REDD Facility, 2012, available at: http://www.euredd.efi.int/files/attachments/euredd/7_-_eu_redd_facility_efi.pdf.

2.3 Today's Funding Channels for REDD+: Europe Aid and Member State Public Finances

The EU and its Member States are important REDD+ donors. They committed EUR 1.44 billion in fast-start finance for REDD+ during 2010-2012,[18] with over two-thirds flowing through bilateral arrangements and the remainder being channelled through multilateral channels.[19] What proportion of the EU's EUR 5.5 billion in post-2012 climate finance will flow to REDD+ remains unclear,[20] though the EU's biggest donor, Germany, allocated EUR 542 million of its total climate finance of EUR 1.9 billion for 2013 to REDD+ and confirmed its goal to allocate EUR 500m per year to international forestry and biodiversity from 2013.[21] The UK, the Union's second biggest REDD+ donor, aims to divert 20% of its GBP 2.9 billion International Climate Fund to REDD+ and other forestry initiatives.[22]

The origins of the funds made available are diverse. The EU mainly uses its development and aid programme ("Europe Aid"), while some of the Member States (though not the UK) have made use of a provision in the EU ETS Directive to earmark at least 50% of revenue generated for environmental purposes, including REDD+.[23] Germany, in particular, has allocated between EUR 335-440 million per year from auction revenues during 2013-2016 for international climate financing, a substantial part of which is expected to go to REDD+ activities.[24]

Funding has been under pressure lately. The economic crisis and austerity policies throughout Europe have left their mark, and auction revenues have diminished rapidly with the depression of allowance prices in the EU ETS. Not all Member States saw themselves in the position to compensate for auction revenue shortfalls with funds from the state budget although Germany, having weathered the financial crisis much better than most, did.

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[18] Figure based on levels of "Fast-start arrangements" reported by the EU and its Member States to the Voluntary REDD+ Database. See http://reddplusdatabase.org/by/funders#fsf_report.

[19] Specifically, the World Bank's Forest Carbon Partnership Facility and Forest Investment Programme, and the UN-REDD Programme. See Valérie Merckx and Christophe Van Orshoven, EU Tools to support REDD+, presentation at Asia-Pacific FLEGT-REDD Seminar for EU Delegations and EU Member States Kuala Lumpur, 16 November 2011.

[20] Council of the European Union, Council conclusions on climate finance – fast start finance, 3238th Economic and Financial Affairs Council meeting Brussels, 14 May 2013.

[21] Add reference

[22] International Climate Fund (ICF) Implementation Plan 2011/12 – 2014/15 Technical Paper.

[23] The UK Treasury Department have explicitly prohibited earmarking and therefore setting aside funds from EU ETS would not be possible in the UK.

[24] For the overall figures see Sven Harmeling et al., The German Fast-Start Finance Contribution, World Resources Institute, Overseas Development Institute and GermanWatch Working Paper, April 2013, available at: http://www.odi.org.uk/sites/odi.org.uk/files/odi-assets/publications-opinion-files/8348.pdf;. Note that Germany's REDD+ and other international biodiversity funding in 2012 amounted to about EUR100 million, according to the Report of the Ministry of Finance, see

http://www.bundesfinanzministerium.de/Content/DE/Standardartikel/Themen/Oeffentliche_Finanzen/Bundeshaushalt/2013-04-25-ekf-anlage3.pdf?__blob=publicationFile&v=3 (page 30).

3. Overview of Options

Table 1 provides an overview of the options identified for mobilizing REDD+ finance in the EU in the short to medium term. These options provided the basis for expert consultations conducted for this paper.

Table 1: Overview of options for mobilizing REDD+ finance in the EU

OPTION	DESCRIPTION
REDD+ Compensation Credits	REDD+ credits could be used to create flexibility in meeting targets under various instruments under the climate and energy package or beyond, for example the Renewable Energy and Energy Efficiency Directive. This could serve as a transition strategy until mandatory domestic standards (e.g. on fuel, energy efficiency, eco-agriculture etc.) can be met. They should provide equivalence in results and be used to strengthen, rather than weaken, existing targets.
Sustainable Supply Chains	Regulators could stimulate private sector investment in reducing the deforestation impact of products through using regulation to strengthen existing voluntary initiatives in this area. Such regulations would build upon existing EU regulatory initiatives to reduce the deforestation impact of products, such as FLEGT and the Renewable Energy Directive. Potential strategies could include banning or providing differentiated import tariffs for imports linked to deforestation.
Ring-Fencing Public Finance	The EU and/or its Member States could dedicate a portion of certain public finance streams to REDD+. Potential sources could include EU ETS auction revenues, national carbon taxes, and any potential future EU-level taxes, such as an EU carbon tax or financial transactions tax.
Stimulating results-based payments for REDD+	REDD+ credits could trigger payments in the context of public 'performance-based funding', fulfil compensation functions under regulatory regimes, mobilize funding in voluntary carbon markets, and be used as tradable units between emissions-trading systems. Potential options include: - Establishing a fund to increase investment leverage, reduce risks and make advance payments; - Dedicated cooperation networks at the jurisdictional level to strengthen REDD+ activities; - Enhanced voluntary carbon neutrality obligations across public and private sectors.
Coordinating EU Results-based Financing	Greater coordination of results-based funding between EU Member States can serve to exploit synergies and efficiencies. Potential strategies for results-based payments in this context include: - Direct results-based payments for the achievement of emission reduction measures against subnational or national reference levels.; - Advance Market Commitments (AMCs), such as an underwriting facility for REDD+ credits in advance of (and for a limited time in parallel with) regulatory steps to create genuine demand. ; - REDD+ Emission Reductions Tenders that allow procuring entities to acquire credits on the best possible terms.

Member State Incentives	Several Member States have adopted national targets that are substantially more ambitious than EU targets and establish penalties or ,buy-out fees for non-compliance. The option to buy REDD+ credits rather than paying a buy-out fee could reduce costs and ensure stringent targets are established and achieved.
Public-Private Partnerships	Agreements between public agencies and the private sector could be concluded to undertake sustainable forestry actions that may not be otherwise feasible. This could encourage sustainable investments by sharing risks and rewards, providing loans and credit, or providing needed capacity building. Ideally they would be embedded in a political cooperation to reduce investment risk.

4. Two Promising Options

REDD+ Compensation Credits and Sustainable Supply Chains

Consultations with key EU policy makers and experts on the options outlined in Section 3 identified two options – REDD+ 'compensation credits' and sustainable supply chains – as holding particular promise for stimulating short to medium term financing for REDD+ in the EU. While all experts agreed that a number of challenges exist to realizing either option in practice, there was significant interest in seeing them being developed in more detail. This section therefore describes each option as follows: firstly, its underlying rationale; secondly, general issues surrounding its application; and, thirdly, potential options for its application in the EU.

4.1 REDD+ Compensation Credits

4.1.1 Rationale

The focus on market demand from emissions trading proper – EU ETS and ESD – seems unnecessarily restrictive and narrow. REDD+ actions, if robustly developed, are capable of accurately measuring effort and impact. As such, they may serve as a tool for complementary action to domestic (intra-EU) efforts in a range of policy frameworks. The provision for the use of 'super credits' from the sale of (climate friendly) electric cars by the car industry to compensate for higher gasoline ratios (CO2/km) illustrates the potential the 'crediting approach' holds outside emissions trading.[25] In fact, a 'REDD+ super credit' may have a number of advantages over super credits generated from the sale of electric cars, such as environmental integrity and transparency of effects.[26]

Compensation credits essentially provide regulatory flexibility together with equivalence in results. Applying regulatory flexibility means ensuring a higher level of autonomy and a lower level of State control, even though procedures and transaction costs can come as a considerable burden to stakeholders concerned. A flexibility instrument allows the regulatory authority to channel activities, technologies and/or funding outside the (domestic) regulatory system. This is of particular importance in the context of international climate finance meant to stimulate the transfer of technologies that are essential for low-carbon development in developing countries.

[25] Regulation (EU) No 333/2014 of the European Parliament and of the Council of 11 March 2014 amending Regulation (EC) No 443/2009 to define the modalities for reaching the 2020 target to reduce CO 2 emissions from new passenger cars.

[26] That the concept of super credits as defined in the Commission proposal is weak on both issues is recognized by the Impact Assessment, see footnote before.

The concept of Compensation Credits (CCs) is not new to climate policy and has been employed in a range of regulatory systems over the past decades, including the Joint Implementation and Clean Development Mechanisms of the Kyoto Protocol. At the national level, most modern environmental and planning regulations contain certain forms of compensation measures or credits, where equivalence is the central requirement. Measuring equivalence, however, is rarely as straightforward as in the case of emissions trading, which has the advantage of being structured on a numerical system.[27]

4.1.2 General issues surrounding application

Compensation credits would link sectoral EU climate regulations to the aforementioned principles of regulatory flexibility and equivalence in results. A 'primary legislative system' (in theory, virtually any climate change-related EU legislation) is linked to a 'secondary legislative system' (in this case EU-approved REDD+ crediting) in order to increase the cost-efficient output for the former and to create financial leverage for the latter system. Any such linkage should be built on a number of components.

The two regulatory systems should have a common objective: climate change mitigation, in general, and the achievement of GHG emission reductions, in particular. The regulatory system could have additional objectives, as long as they are consistent with the common objective.

The linkage between the two regulatory systems should ensure they are commensurate, i.e. the benefit generated under one system should materialize in a benefit in the other system, and this benefit must be quantifiable and congruent. This concept would allow REDD+ CC to be used as a type of exact additional currency for compliance in any primary legislation. The application of REDD+ CC would allow those market participants who fall under primary legislation to gradually adapt to the new standard. Simultaneously, these market participants would contribute to the financing of the secondary system (REDD+), which would enable it to function.

1. REDD+ CCs should meet a strict equivalency standard, i.e. the environmental benefits represented by compensation credits must be at least equivalent to those that would have been achieved through meeting obligations under the primary legislation. This requires, on the one hand, the accurate calculation of the expected GHG emissions resulting from compliance with primary legislation and, on the other hand, a strong Measurement, Reporting and Verification (MRV) standard for the REDD+ CC, including safeguards to secure permanence and good governance, and avoid leakage. It also requires the establishment of a transparent accounting and basic registry system for those who will use REDD+ CCs. Deviation in the compensation should only be permitted on the upper end of the spectrum – for instance, if use of REDD+ CCs would result in a higher level of GHG emission reductions compared to full compliance with the primary legislation.
2. Clear limitations should be set to the applicability of CCs. These would be primarily manifested as percentage limits for specific targets, and compensation may be limited in time to ensure its character as a regulatory stopgap measure. Any undermining of actual (primary) legislation must be avoided. Ultimately, the mechanism is only intended to enhance the flexibility and not the need for the private sector to achieve the required emission reductions in the long run. It is therefore paramount to secure the stringency of the overall commitment or target (or to impose a sanction on a non-compliant entity).

[27] Even this numerical system does not equate efforts, although it does provide at least a quantitative basis for commensuration.

4.1.3 Practical application in the EU

Exemplary implementation options for the REDD+ CC concept can link it with two statutes from the EU climate and energy package of 2009: the Renewable Energy and the Energy Efficiency Directive. While both directives have been praised for their high level of ambition, they have all the same proved exceptional for the high level of non-compliance from Member States and the opposition from business and environmental pressure groups alike.[28] The proposed integration of both directives with the concept of REDD+ CC has the capacity of reasonably addressing the key arguments raised with respect to the directives, namely environmental integrity, on the one hand, and short-term economic and political feasibility, on the other.

Renewable Energy Directive (RED)

The European Union Directive on the promotion of the use of energy from renewable sources (EC 28/2009) outlines the methodology for reaching a Union-wide target to source 20% of its energy from renewable sources and to achieve an all Member States minimum share of 10% biofuels in transport petrol and diesel consumption. The European Commission recently proposed to freeze the share of '1st generation biofuels' (i.e. biofuels from food crops) at 2011 levels (5% of the energy consumption in the transport sector).[29] In addition, fuel suppliers will be under the obligation to report on the entire biofuel lifecycle "including the estimated indirect land-use change emissions" in accordance with pre-established reporting guidelines and emission factors per crop.[30] However, accounting for indirect emissions is only a partial solution (and an obvious example of political compromise). Indirect emissions continue to be disregarded for the comparative greenhouse gas analysis with fossil fuels, which needs to prove minimum emission reduction outputs ("carbon savings") in order to be eligible under the directive.

In this situation, the integration of REDD+ CC offers opportunities. The first two requirements for a REDD+ CC linkage – identity in purpose and commensurability – are certainly met. The RED's explicit aim is "to reduce greenhouse gas emissions and comply with the Kyoto Protocol" (Recital No. 1). Furthermore, the biofuel target translates into quantifiable amounts of emission reductions,[31] just as indirect emissions from land-changes are measured in tones of CO2eq. On this basis, we see two distinct options to implement a REDD+ CC pilot.

Option 1: REDD+ CC for Sustainability in EU Biofuel Targets

Option 1 would directly address the issue of indirect GHG emissions resulting from land conversion for biofuel production and thereby strengthen the impact of the directive's sustainability requirements. The entry-point

[28] In 2013 alone, the European Commission has conducted 20 infringement proceedings urging EU Member States to comply with the renewable energy and energy efficiency targets (see EC infringement decisions: http://ec.europa.eu/energy/infringements/index_en.htm; see also for a critical assessment Hohnen (2010) "The 2009 EU Renewables Directive – how binding is 'binding'?", *The Energy Policy Blog*, available at http://www.energypolicyblog.com/2010/09/13/the-2009-eu-renewables-directive-%E2%80%93-how-binding-is-%E2%80%98binding%E2%80%99/).

[29] EC (2012) *Proposal for amending Directive 98/70/EC relating to the quality of petrol and diesel fuels and amending Directive 2009/28/EC on the promotion of the use of energy from renewable sources*, European Commission, available at: http://ec.europa.eu/energy/renewables/biofuels/doc/biofuels/com_2012_0595_en.pdf. The EU Parliament, in its first reading resolution, proposed to increase the 1st generation biofuel target to 6% of total transport fuels, see Resolution of 11 September 2013, http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-TA-2013-357.

[30] Ibid.

[31] The Member States have to calculate the greenhouse gas emission saving from the use of biofuels and bio liquids and report to the European Commission, see Article 19 of the Renewable Energy Directive.

would be the reports of indirect emissions: fuel suppliers would be put under the obligation to compensate for the indirect emissions that they report – which would need to be verified in an adequate way – with REDD+ CC. This would provide in the short term that all indirect emissions are fully addressed. It would also provide in the mid and long term – through the stimulation of enhanced REDD+ intervention – that indirect emissions and damages to tropical forests be significantly reduced.

The introduction of REDD+ CC would also respond to the scientific critique, which has focused on the uncertainties of indirect emissions calculations. While scientific progress seems to be closing the knowledge gap quickly,[32] the introduction of a REDD+ CC sustainability window would not aim at the concrete calculation of *de facto* indirect emissions, but rather act as a standardized hedging instrument against any potential losses. This would then result in more robust climate change mitigation achievements in the biofuel sector of the EU, and the third requirement for the applicability of compensation credits – output equivalence or overachievement – would be easily met.

The fourth requirement – the installation of a robust MRV system for the use of REDD+ CC – could be addressed at the central level (EU) or, alternatively, at the Member State level with the European Commission retaining a supervisory role. REDD+ CC would only be allowed as a hedging instrument, if generated under a bilateral agreement (crediting scheme) with a third country, this agreement also establishing an ambitious framework of control and oversight. The fifth requirement – the restrictive use of compensatory elements – would translate into a strong reconfirmation of all sustainability criteria defined by the directive and verified by the respective institutions. The use of REDD+ CC must not be understood as replacing (or watering down) any of the sustainability procedures for biofuels, but rather as complementing them.

Option 2: REDD+ CC for Missing EU Biofuel Targets

Alternatively, the concept could be used to address the notion of regulatory flexibility by allowing EU Member States to compensate for a certain share in the country biofuel targets or, indeed, any of the other renewable energy targets of the directive with the purchase of REDD+ CC. This approach would also be oriented along the principle of equivalence, i.e. the applicable REDD+ CC quota should be based on a robust measurement of avoided emissions from the switch to biofuel usage. In terms of the biofuel targets and relative to the ratios discussed for option 1, it is suggested that those for option 2 should satisfy an even stronger requirement for equivalence, as under-achievement of primary EU legislation on climate change must be avoided at any rate. Given the high-end abatement costs for biofuel blending[33] as opposed to the low-end costs for REDD+, overachievement through REDD+ CC will not pose any major challenges. Indeed, a REDD+ CC window will reduce the cost exposure for industry and consumers significantly, while meeting stricter emission reduction targets. Yet, in line with earlier elaborations, REDD+ crediting should not be allowed in unlimited numbers. The RED notably aims at more than just cost efficiency in climate mitigation, even though this remains an important goal.

[32] See Gnansounou *et al.* (2008) Accounting for indirect land-use changes in GHG balances of biofuels: Review of Current Approaches, *LASEN - Laboratoire de Systèmes Energétiques - Working Paper: Lausanne.*

[33] For a recent country study see Rob Bailey (2013) *The Trouble with Biofuels: Costs and Consequences of Expanding Biofuel Use in the United Kingdom*, EER PP (Chatham).

Energy Efficiency Directive

The second area in which we see a potential for a REDD+ CC pilot scheme is the Energy Efficiency Directive.[34] The Directive establishes a framework for achieving a 20% energy efficiency EU-wide target for 2020.[35] It further outlines specific regulations such as efficiency in energy use (chapter 2) and efficiency in energy supply (chapter 3). As with the options for RED, we see two distinct implementation options for a REDD+ CC mechanism at an industry and country level.

Option 1: REDD+ CC for Flexibility in Meeting EU Energy Efficiency Targets

Article 7 of the Energy Efficiency Directive specifies the requirement for EU Member States to set up a detailed obligation scheme for their energy distribution and sale companies. It dictates that annual energy savings from January 2014 should be at least 1.5% of the annual energy sales to final customers (see Article 7(1) for details). This obligation provides an opportunity for a flexibility mechanism built on REDD+ CC.

With the emissions factor per generalized energy output calculated for each country, a compensation exchange ratio similar to those previously suggested could be implemented to allow companies to adapt smoothly to the new energy efficiency standards. A ratio that favours compliance to the primary legislation (i.e. 1:2 or higher) and an absolute ceiling for compensation (e.g. 10%) would guarantee that the energy efficiency target is not hollowed out substantially. Nonetheless, the option to choose between two ways to comply does represent a flexibility asset for the energy sector.

Option 2: REDD+ CC as a Sanctioning Tool in Meeting EU Energy Efficiency Targets

Option 2 addresses the compliance to the energy efficiency target on a country level. If a country is not willing or not able to comply with its self-assigned target, it could reconcile its under-achievement by purchasing REDD+ CC that are, in terms of their emission reductions, at least equivalent to the hypothetical emission reductions that would have been achieved through complete compliance with the energy efficiency target.

The hybrid integration of REDD+ credits in EU climate change sensitive regulations offers the opportunity to give flexibility to market participants, while lowering transformation costs and strengthening the environmental integrity and climate output of the regulations in question. The outlined options leave significant room for regulatory flexibility both at the EU level and for Member States. The use of REDD+ compensation credits, in both examples, may help overcome challenges the directives are currently facing. REDD+ activities in turn would see a significant rise in credit demand and a long-term source of funding.

[34] Directive 2012/27/EU of the European Parliament and of the Council of 25 October 2012 on energy efficiency, amending Directives 2009/125/EC and 2010/30/EU and repealing Directives 2004/8/EC and 2006/32/EC.

[35] Reported energy efficiency target by country can be found here: http://ec.europa.eu/energy/efficiency/eed/reporting_en.htm .

4.2 Sustainable Supply Chains

4.2.1 Rationale

Mobilizing finance for REDD+ during a time of tightened public expenditure and little demand from global or regional carbon markets necessitates exploring alternative options to direct private financial flows to tackling deforestation. Re-directing a portion of the large amounts of private sector finance that already flows to commodities associated with deforestation such as soy, beef and palm oil towards investments that reduce deforestation provides one of the most promising opportunities in this regard. EU consumption is responsible for some 10% of deforestation embodied in global consumption, though its share in relation to internationally traded products is far higher.

Redirecting this demand toward products originating from sustainable practices can therefore provide important incentives for EU importers and retailers to invest in reducing the deforestation impacts of their products. At the same time, there is increasing awareness and interest from both consumers and the private sector in the sustainability of products, as evidenced by a multitude of private sector initiatives such as the Forest Stewardship Council (FSC) certification for timber and the Roundtable for Sustainable Palm Oil (RSPO). By harnessing and building upon this momentum, EU and its Member States have the potential to mobilize significant streams of private finance towards avoided deforestation.

4.2.2 General issues surrounding application

Defining 'sustainability' criteria

Though sustainability criteria can be interpreted broadly to include a range of social, environmental and economic factors, here the term is used to refer to criteria whose primary focus is addressing the impact of products on deforestation and forest degradation. The complex relationship between specific commodities and deforestation means that defining workable criteria to identify products with low deforestation impacts is a challenging task. While a detailed consideration of this issue is beyond this paper's scope, looking at existing criteria in EU legislation can help conceptualize how this can be done in practice.

Of particular relevance in this respect are the criteria set out in the EU RED, which sets out sustainability criteria for biofuels used to meet Member State targets under the directive.36 Among others, RED sets out several criteria directly aimed at avoiding the reduction of carbon stocks in forests. Two approaches are used. In the first approach, products originating from land that, in January 2008 was of very high carbon value – namely wetland, peatland (that has subsequently been drained) and "continuously forested" areas – are banned outright.37 In the second approach, products (or ingredients from products) originating from land that has moderate forest cover38 are permitted only where evidence can be provided to show that any carbon stock change arising from the extraction of materials does not

[36] Directive 2009/28/EC of the European Parliament and of the Council of 23 April 2009 on the promotion of the use of energy from renewable sources and amending and subsequently repealing Directives 2001/77/EC and 2003/30/EC.

[37] This is defined as land spanning more than one hectare with trees higher than five metres and a canopy cover of more than 30 %, or trees able to reach those thresholds *in situ*. See RED, *ibid* Article 17 (4)(b).

[38] This is defined as land spanning more than one hectare with trees higher than five metres and a canopy cover of between 10 % and 30 %, or trees able to reach those thresholds *in situ*. See RED, *ibid* Article 17 (4)(c).

exceed certain defined levels.39 The directive further defines the methodologies that must be used to calculate these changes in carbon stocks.

These two approaches offer broad and potentially workable models for distinguishing products with a high deforestation footprint. Several variations may be possible depending on the type of scheme in which they are applied and the specific objectives it seeks to achieve. These may include defining additional types of lands from which materials are banned outright, defining multiple categories based on the net carbon loss resulting from the conversion of the land and applying different criteria to different products. In each case, the development of criteria should be based on thorough research and consultation to ensure the ability to achieve their objectives and accurately reflect the situation on the ground.

Prioritising commodities to regulate

The complexity of regulating the sustainability of commodity imports means that, while in the longer term regulating all EU imports with major deforestation impacts may be the goal, beginning with the regulation of one or perhaps two commodities can make the task more manageable and provide a valuable learning experience that can later be applied to regulating other commodities. In determining which commodity to prioritise, several factors are relevant to consider.

1. **The relevance of the commodity in the EU market and its impact on deforestation**. A recent study prepared for the EU Commission calculated that, of total deforestation embedded in crop products imported by the EU of 7.4 million hectares (Mha), 70% is attributed to oil crops,40 predominantly soy (82%) and palm oil (17%). Other important crop product groups are stimulants like coffee and cocoa (12%) and industrial crops like rubber (6%). Deforestation embedded in ruminant livestock products, meanwhile, amounts to 1.3 Mha.41 These products therefore represent the most promising options for achieving maximum avoided deforestation.
2. **The complexity of regulating a given product.** The composition of the actors in the supply chain of each commodity varies, which can affect which policy measure will be most effective. Feasibility studies of policy measures on the different commodity supply chains is therefore a crucial first step in determining which products are most viable to begin with.
3. **Whether to regulate only raw materials or also processed or semi-processed goods.** The more processed a good, the more actors are likely to have been involved in its journey from forest to import, making tracing its origins and assessing compliance with sustainability criteria more difficult. Since the EU produces a large share of the final goods and services it consumes using raw and semi-processed agricultural and forestry commodities imported from other regions,[42] it may be logical to (at least at first) confine regulations to raw and certain semi-processed materials.

[39] In the context of RED, which aims to reduce emissions by replacing conventional fuels with biofuels, this carbon stock change is measured by comparing the emissions from the carbon stock change to the emissions savings from the replacement of conventional fuels with biofuels. While the specifics of this approach are clearly particular to the context of RED, the basic principle of keeping carbon stock changes below a certain threshold is applicable to a broader range of approaches.

[40] Report on EU Consumption and Deforestation.

[41] Ibid, at 24.

[42] Ibid, at 27.

Ensuring compatibility with international trade law

Whenever tariffs or other fiscal incentives or disincentives are adopted, these must be carefully designed to ensure they are compatible with the General Agreement on Tariffs and Trade and related instruments adopted under the auspices of the World Trade Organization. What is important is that the EU design measures in good faith and in a non-discriminatory manner, including ensuring that comparable measures are applied to products originating within the EU, providing a certain degree of flexibility and support so that exporting countries can realistically comply with the measures and engaging with exporting countries in the design of the measures.[43]

4.2.3 Practical application in the EU

There are two broad policy options available to the EU to mobilize finance for sustainable commodities associated with deforestation and, where relevant, breaking these down into further sub-options. The measures presented are not mutually exclusive, and many are indeed mutually reinforcing, providing the basis for a holistic EU approach to a complex issue that builds on the multi-pronged approach adopted to address the legality of timber under the FLEGT Action Plan.

EU sustainability criteria for commodities associated with deforestation

Under this option, sustainability criteria for a defined set of commodities associated with deforestation would be introduced into EU legislation. Criteria could be applied in one of two ways. Under the first sub-option, EU importers would be subject to absolute requirement to ensure that the products they import, or a certain portion of them, meet the sustainability criteria. Under the second sub-option, EU importers or retailers could be provided with incentives to import or sell products meeting the sustainability criteria.

This policy option builds upon existing EU initiatives addressing deforestation, most notably the EU Timber Regulation and FLEGT Action Plan,[44] which work to restrict the import of illegally harvested timber and facilitate the generation of systems to ensure legality, and the RED, as discussed above. The present policy option would move beyond the specific focus on legality or a specific product type, however, to address the overall deforestation impact of a broader range of products.

The two initiatives serve as models from which policy elements can be distilled for the application of sustainability criteria for the import of commodities associated with deforestation. Drawing on these initiatives, potential strategies are presented below for addressing two key elements of this option: (i) whether sustainability criteria should be applied as requirements or incentives; and (ii) how to ensure that sustainability criteria are met. The strategies presented for elements (i) and (ii) are independent of one another, and hence all combinations of strategies in principle are possible.

[43] See United States — Import Prohibition of Certain Shrimp and Shrimp Products, WTO case Nos. 58 (and 61). Ruling adopted on 6 November 1998.

[44] 'Forest Law Enforcement, Governance and Trade (FLEGT), Proposal for an EU Action Plan', Communication from the Commission to the Council and the European Parliament, 21 May 2003, COM (2003) 251 final.

Element A. Sustainability criteria as requirement or incentive

Sustainability criteria can be set as a requirement to enter the EU market or as an incentive to be met in order to fulfil obligations or gain financial advantages. The FLEGT and the RED provide illustrations of these different approaches.

FLEGT Model - The most stringent measure, and in the same vein as the FLEGT, would be to adopt EU legislation prohibiting or limiting the import or sale of commodities unless they meet the sustainability criteria adopted. Such restrictions could apply to all or part of the commodities imported or sold by a given business, and a phased approach could also be envisaged under which the proportion of products that must meet the criteria is increased over time. As with the approach under the FLEGT Action Plan, demand-side measures to restrict imports of unsustainable products could be complemented with supply side measures to ensure that producers are able to provide products that meet the criteria.

RED Model - The approach embodied under the RED incentivizes the use of sustainable biofuels. Under the RED, the production or import of biofuels that do not meet the sustainability criteria are not blocked from the EU market per se, but at the same time, they are not subject to any incentives such as accounting towards national targets or eligibility for financial support, thereby becoming less attractive than their sustainably produced counterparts. While commodities such as palm oil or soy will not become subject to minimum national targets in the same way as biofuels are, alternative incentives could be envisaged for encouraging the import of products meeting the sustainability criteria, such as differentiated import tariffs or other fiscal incentives. This approach has the advantage of creating flexibility for market participants, though its effectiveness would be subject to the significance of the incentive provided.

Element B. Ensuring compliance with sustainability criteria

Under either model suggested, the establishment of systems capable of verifying that criteria have been met is crucial. Given that raw products frequently go through a number of hands before reaching the consumer, or even the importer, adequately providing for the traceability of products is a common challenge faced in addressing product sustainability. The FLEGT and RED models again offer two distinct approaches in addressing this challenge.

FLEGT Model - Under the EU Timber Regulation, one of the measures under the FLEGT Action Plan, operators who place timber and timber products on the EU market for the first time are obliged to exercise due diligence to ensure that such products originate from legal sources. This is achieved through the requirement to establish due diligence systems that include keeping track of the origin of the timber and assessing the risk that the timber is of illegal harvest. Due diligence systems are subject to regular checks by accredited monitoring bodies, who are themselves subject to inspection by Member States. Operators who are found not to be in compliance with their obligations are subject to sanctions, which may include seizure of products or prohibition to trade. Timber and timber products that originate from countries that have signed VPAs with the EU are automatically considered to be legally harvested.

RED Model - The verification of compliance with the sustainability criteria under the RED is performed either by independent auditing of the information submitted by economic operators, which is checked by Member

States, or through voluntary certification schemes approved by the European Commission. Currently, 14 voluntary schemes have been approved by the European Commission. The RED, similar to the VPAs under FLEGT, allows for voluntary agreements to be concluded with third countries that regulate the compliance with the sustainability criteria.

Sustainability criteria in public procurement

While some Member States have already taken steps to reduce deforestation through public procurement,[45] there may be scope for a more prominent role for the EU in this area. One option would be the adoption of voluntary standards that address deforestation for public procurement of key commodities, which could comprise a first step towards the introduction of requirements for a gradually increasing proportion of commodities to meet such standards. Such an approach could help to harmonize existing criteria for public procurement in different Member States, thereby reducing confusion and reducing the burden for entities supplying multiple governments. The required proportions regulations could be differentiated per Member State based on capacities and existing progress, similar to the renewable energy targets under the RED.

Voluntary standards at the EU level could draw on the design of existing schemes in Member States. Among the most developed in this regard is the Dutch 'Timber Procurement Assessment System' (TPAS), which is the key tool toward achieving the Netherlands Government's goal of sourcing 100% sustainable timber.[46] The TPAS assesses timber certification systems against sustainable forest management standards set by the Government. The standards were developed through a consultative process with stakeholders over a period of 5 years. Currently, two timber certification systems meet the standards as set by the Dutch government – FSC International and the Programme for the Endorsement of Forest Certification (PEFC), except for the PEFC in Malaysia.

[45] Several Member States, such as the United Kingdom, have already committed to sourcing 100% of products such as palm oil from zero-deforestation sources within the short term (in the case of the UK up to 2015).

[46] http://www.tpac.smk.nl.

5. Other Options

5.1 Ring-fencing Public Finance

Particularly in times of budgetary uncertainty, ring-fencing public finance offers an opportunity to create reliable and (relatively) predictable sources of financing for REDD+. Increasing moves in several European countries to introduce climate-related taxes or levies or apply penalties to entities which fail to comply with climate regulations all create potential sources of (diversified) revenue that could be ear-marked for REDD+. At the same time, it is important to note that laws in some EU Member States (e.g. the UK) prohibit ring-fencing, and so these options will not be applicable in all cases. The following sections describe several potential options for ring-fencing public finance.

5.1.1 EU ETS Auction Revenues

Revenue from auctions under the EU ETS provides a stark example of the need for ring-fencing. Projected proceeds have shrunk dramatically from EUR 30–50 billion (in 2008)[47] to EUR 5-11 billion per year from 2013-2015 (in 2013).[48] As a consequence, channelling proceeds into REDD+ funding may be taken off the agenda altogether in several Member States.

Ring-fencing in this context could mean encouraging Member States to commit a significant portion of revenues to REDD+, irrespective of auction price depressions. To a certain extent, this has already been done through providing in the EU ETS Directive that Member States *should* dedicate 50% of their auction revenue toward climate change (including REDD+). It is worth noting that the aviation section of the EU ETS directive specifically mentions avoiding deforestation as a possible use of auctioning revenues from the aviation sector. Arguably, however, more could be done to encourage that these revenues are formally earmarked for REDD+. Alternatively, a dedicated EU-wide fund could be established, with Member States encouraged to earmark a significant portion of their auction revenues for the fund. The fund could be used to finance demonstration and early-mover results-based payments in REDD+ countries, while revenues directed to the fund could be counted toward Member States' climate finance commitments.

[47] European Commission, footnote 3 above.

[48] The adoption of further policy measures such as the EU Commission's current proposals to "backload" a certain number of emission allowances could have significant impacts on allowance prices, thus increasing the revenue available from auctioning. See CDC Climat, Auction Revenues in EU ETS Phase 3: A New Public Resource, Climate Brief N°25, January 2013.

Ring-fencing EU ETS revenues has the advantage of offering a significant source of revenue. Fewer legal changes would be required to integrate REDD+ into existing EU mechanisms and some member states have already committed significant portions of revenue to REDD+. However, the revenue produced is subject to high fluctuations and it is unclear as to whether the EU has a mandate to firmly regulate the use of auction revenues. In addition, REDD+ will need to compete with other climate actions seeking to earmark revenue.

5.1.2 National carbon taxes

Carbon taxes and levies represent another potential source of revenue that could be ring-fenced for REDD+. Such taxes and levies currently exist in Denmark, Finland, Norway, Sweden, Ireland, Switzerland and the United Kingdom (the Climate Change Levy), while a tax has also been proposed in Italy.[49] In most cases, revenue has to be directed to government budgets, though in certain cases a portion of revenues is directed to green energy programs.[50] Member States implementing such taxes could therefore be encouraged to earmark a certain portion of revenues for bilateral or multilateral REDD+ funding. In the event of the creation of an EU-wide fund for REDD+, a strong case could be made to encourage Member States operating carbon taxes to earmark a significant portion of revenues to such a fund.

National carbon taxes and levies have the potential to raise large amounts of revenue and could more easily achieve popular support if channelled towards rainforest preservation. At the same time, it is recognised that the feasibility of new taxes and levies in the immediate future are low, given the current state of continued economic weakness in the EU.

5.1.3 EU Taxes

An EU-wide carbon tax could ultimately provide a major source of financing for REDD+ if momentum on the issue can be regained. Initial efforts in the 1990s failed, and renewed efforts to bring the issue back on the table in 2010 made little progress. The issue has recently surfaced in some quarters once more,[51] though it is not yet being officially considered. Nonetheless, an established common approach to tax certain economic activities according to their carbon output could be combined with an earmarked REDD+ window and would be a conclusive and comprehensive measure to curb greenhouse gases. Indeed, an EU-wide carbon tax would balance still ubiquitous fossil fuel subsidies and incentives, while avoiding competition between member states. However, unanimity amongst Member States would be required and wide uncertainties as to the administration of such a tax and its constitutionality remain.

An alternative option may be the Financial Transactions Tax that has been agreed to by 11 participating Member States. Primarily designed with the aim of rebuilding and strengthening the EU economies, annual revenues are predicted to be around EUR 30-35 billion (0.4 to 0.5% of the GDP of

[49] Reuters, Italy to Introduce Carbon Tax to Fund Green Energy, Online 17 April 2012, available at: http://www.reuters.com/article/2012/04/17/italy-carbontax-idUSL6E8FHALR20120417.

[50] Jacqueline Cottrell, Carbon taxes, Presentation at UNEP-IMF-GIZ Workshop Fiscal Policies Towards an Inclusive Green Economy, available at: http://www.unep.org/greeneconomy/Portals/88/documents/research_products/Fiscal%20Policies/2_Cottrell_CarbonTax_IMF_UNEP_GIZ_2012_FINAL.pdf.

[51] See Euractiv, Carbon taxation: An old-new idea whose time may soon come?, 19 February 2013, available at: http://www.euractiv.com/climate-environment/carbon-taxation-old-new-idea-tim-news-517925.

participating Member States).52 The tax is expected to be implemented from 2016.53 While there is, as yet, no official discussion on the use of revenues from the tax, a wide range of civil society organizations have called for a significant portion to be set aside for climate change finance, a move that has the backing of at least one leading Member State.54 In such an event, Member States could agree that a significant portion of this be earmarked for REDD+.

Similar considerations could apply to possible future levies of bunker fuels set at an international level, though these discussions remain in the early stages.

5.2 Stimulating results-based payments for REDD+

Strategies based on REDD+ crediting remain a constructive way to serve a number of purposes. REDD+ credits may trigger payments in the context of public 'performance-based funding', fulfil a compensation function under specific regulatory regimes, mobilize funding in the voluntary carbon markets and eventually be used as tradable units between linked emissions trading systems. Furthermore, by stimulating voluntary carbon markets, increasing momentum around private sector CSR could be harnessed and existing standards and intervention formats proven to be solid and robust could be utilised. In addition, as a voluntary intervention, the political resistance will be minimal. However, the level and size of the commitment may be modest and the predictability of funding would be hard to achieve.

Voluntary carbon markets could be stimulated by a range of measures involving public-private partnership engagements. One particular option would be to establish a fund to increase investment leverage, reduce risks and make advance payments. In addition, dedicated cooperation networks at the jurisdictional level could be developed to strengthen REDD+ activities. Furthermore, enhanced voluntary carbon neutrality obligations across the public and private sectors would increase the popularity and security of this option and therefore make it more feasible.

5.3 Greater coordination of EU results-based financing

While the EU and its Member States remain relatively major contributors to public financing for REDD+, this financing is channelled through a wide variety of bilateral and multilateral channels and without any coherent strategy. Greater coordination could help the EU and its Member States support synergistic and complementary REDD+ activities. Stakeholders consulted recognized that, while the establishment of a centralized EU financing facility is not likely other options, such as the adoption of an EU REDD+ financing strategy or establishing formal or informal mechanisms for greater coordination of REDD+ finance, may be more feasible.

Results-based finance following from this greater coordination could be implemented through a number of mechanisms, for example:

[52] See EU Commission Webpage at: http://ec.europa.eu/taxation_customs/taxation/other_taxes/financial_sector/index_en.htm#prop.

[53] EurActive, UK, Sweden attack FTT statement by euro nations, 06 May 2014, available at: http://www.euractiv.com/sections/euro-finance/uk-sweden-attack-ftt-statement-euro-nations-301953.

[54] EurActive, Fresh FTT cash needed for development, climate policies: French minister, 18 December 2013, available at: http://www.euractiv.com/development-policy/french-minister-calls-european-f-news-532402.

- Direct results-based payments for the achievement of emission reduction measures against subnational or national reference levels. This option is the most common at present and in line with UNFCCC guidance, though it requires a relatively high level of REDD+ readiness and can make leveraging private finance challenging;
- Advance Market Commitments (AMCs), such as an underwriting facility for REDD+ credits in advance of (and for a limited time in parallel with) regulatory steps to create genuine demand. This would ensure stable demand and predictable investment flows for a REDD+ mechanism, though it is premised on the ultimate introduction of a carbon market for REDD+, something that remains uncertain;
- REDD+ Emission Reductions Tenders that allow procuring entities to acquire credits on the best possible terms. This option builds on successful models developed under the Kyoto Protocol mechanisms and has the advantage of creating market price signals. However, it presumes some future REDD+ demand, which has yet to be established.

5.4 Member State Incentives

While EU climate policy often moves glacially, action at Member State level frequently outpaces EU developments. Member States, such as the United Kingdom and Germany, have already adopted more stringent national mitigation targets than those assumed at the EU level, creating potential opportunities for mobilizing private sector financing for REDD+ at the national level.

In addition to its EU obligations, the United Kingdom has adopted a nationally binding emission reduction target of 50% below 1990 levels by 2027[55] and has implemented a range of additional measures to achieve these targets. One key set of measures is the Climate Change Levy (CCL) and the associated Climate Change Agreements (CCAs). The CCL operates as a tax on fuel consumption (lighting, heating and power) for business consumers; covered entities can receive a reduction on the levy, however, where they enter into binding CCA under which they agree to an energy-efficiency or emission reduction plan. Previously, participants in CCAs who missed their targets were obliged to purchase allowances from the UK Emissions Trading Scheme. Since this scheme has become defunct, participants who miss targets must pay a 'buy-out' fee of GDP12/tonne of CO2.[56]

Adding an option for participants to purchase REDD+ credits instead of paying a buy-out fee could reduce costs for participants and potentially enable more stringent targets to be agreed when the agreements come up for review.

Other member states could integrate a REDD+ credit linkage in their own systems. The European Commission has recently opened proceedings against Germany's Grid Charges Ordinance for privileging the energy-intensive industry by exempting them from grid charges at the cost of non-energy intensive industries and consumers.57 Under European state aid law, any such privilege needs to be justified by an objective of common

[55] The Carbon Plan: Delivering our low carbon future, HM Government December 2011.

[56] UK Environment Agency, Climate Change Agreements Operations Manual, Version 1 March 2013.

[57] European Commission, IP/13/191, http://europa.eu/rapid/press-release_IP-13-191_en.htm.

interest and prove proportionate in its negative impact on competition. In similar cases, the Commission has argued that the competitive advantage or disadvantage of the energy-intensive industry does not meet the test of proportionality, and it may well decide against Germany in this case. A balanced approach that would address both the interest of the Member State, here Germany, to keep the costs for the energy-intensive industry at sustainable levels and the requirements of EU competition law may indeed lie in a combination of exemption in exchange for compensation measures that would directly benefit the environment.58 Allowing the energy-intensive industry to buy REDD+ credits instead of sharing full network charges may prove a constructive way forward.

5.5 Public-private Partnerships

Public-private Partnerships (PPP) can encourage sustainable investments through sharing risks and rewards, providing loans and credit, or providing necessary training. PPPs are based on agreements between a public agency and one or several companies to share skills and finance in delivering a service for the general public. They are also a tool to encourage the private sector to undertake an activity that it would not do otherwise, either because of high risk or low returns on investment. Public agencies in the agricultural and forestry sectors generally see PPPs as a means to attract investment, while private entities often benefit from a reduced investment risk. Farmers and small forest management companies benefit through training, modernization, or access to capital.

Public funding could support PPPs and leverage private funding in the following areas:

- Forestry projects, including those that support sustainable forest management and sustainable afforestation;
- Agricultural projects, including those that support sustainable intensification in combination with forest protection and agroforestry;
- Community development projects that remove pressure from forests, such as cook-stove, sustainable charcoal or tourism projects;
- Governments could facilitate investments into such activities through the removal of disincentives (risks and barriers) and the creation of financial incentives combined with regulatory measures. Such measures could include:
    - removing or introducing subsidies and tax breaks
    - providing investment security, e.g. by introducing and enforcing penalties
    - combating illegal activities that undermine legal, sustainable activities
    - providing preferential loans
    - starting the process of land titling.

Within such PPPs host governments would support private activities through access to public land, risk sharing, providing revenue or purchase of a particular service or product (sustainable procurement). A number of exemplary project activities are included in the section on ICI project level recommendations.

[58] It is important to note in this respect that measures aimed at environmental protection are recognized by a specific regime under EU state aid law, see the Community Guidelines on State Aid for Environmental Protection, 2008/c82/01, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:082:0001:0033:EN:PDF.

Ideally, the PPPs are embedded in a political cooperation that further reduces private sector investment risk. There are various fora to support such political cooperation on the national level. At the subnational level, the Governors' Climate and Forest Taskforce (GCF) has promoted the creation of jurisdiction-wide approaches to REDD+ and the integration of REDD+ into greenhouse gas compliance systems and voluntary results-based payment schemes. It addresses specifically both sub-national Governments as well as private actors worldwide to mobilize targeted REDD+ action with a high level of visibility and to provide a platform for close public and private coordination, planning and investment.

The GCF invites devolved national administrations, states and cities in developed nations to explore the opportunities offered by GCF membership. REDD+ partnerships offer a framework for environmental and economic cooperation for effective climate change mitigation and international forest protection. In addition to facilitating the sharing of valuable know-how and experience between governments, they offer potential for building lasting economic links, creating new sustainable business opportunities and testing innovative strategies for forest protection.

Advocating such PPPs as well as subnational engagement – as stand-alone options, but also in combination with supply chain options discussed before – will raise momentum among business, civil society and among Governments at the central, the regional and the district level.

6. Conclusions

A structurally weak EU ETS adds new challenges to policy efforts aimed at integrating a window for REDD+ credits into the scheme and boosting the amount of funds made available from EU ETS auction proceeds. Persistent economic weakness across the Union has, meanwhile, led to public finances being strained, putting pressure on public allocations for REDD+. Yet with every challenge comes an opportunity. As European policy makers begin to realize that the current system is not providing the levels of funding that are needed, attention is beginning to shift to new and innovative funding streams that could provide a much needed source of revenue to support REDD+ efforts in the short to medium term.

Options identified in this paper to leverage increased financial support include both REDD+ crediting and non-credit based instruments. Based on consultations with key European stakeholders, there are two options offered in this paper that are considered to hold particular promise for stimulating REDD+ finance – namely incentivizing sustainable supply chains and the use of Compensation Credits to secure financing for REDD+. Other options – including ring-fencing public finance streams, the establishment of Voluntary Carbon Markets, greater coordination of results-based payments, separate member state incentives and the establishment of public-private partnerships – may also retain promise, though stakeholders identified a number of barriers to their realization.

Ultimately, there is likely to be no silver bullet that will serve to fill the major gap in REDD+ financing – from the EU or elsewhere. Ensuring a steady stream of finance in the short-term and further on is likely to require a diverse range of strategies that tap into multiple finance streams, both public and private. This can both increase finance levels and ensure greater stability by reducing exposure to ebbs in any particular finance stream, a necessity laid bare by the severe reductions in (projected) EU ETS auction revenues in recent years. The options presented in this paper should therefore be seen as complementary, rather than mutually exclusive alternatives. That said, reliance on multiple sources should not prevent governments from making firm, long-term funding commitments, which will be essential to provide the predictability needed to stimulate REDD+ action at scale.

Finally, increased and diversified engagement with REDD+ should be accompanied by both more work and knowledge sharing at the technical level. The progress regarding the technical understanding of REDD+ among EU policy makers is remarkably slow, and this needs to be remedied if the EU is to be able to position itself as a leading supporter of REDD+.