

## Key Questions in Nested REDD Policy Design

Scientists have estimated that “leakage” can be quite high for project-level REDD activities. In other words, it is generally accepted that a project to reduce deforestation in one area might not actually contribute to reduced deforestation across a broader geographic area – rather, the deforestation that would have happened in the project area simply shifts to another area in the region, in the nation or internationally, and the net reduction in deforestation is therefore quite low. For this reason, policymakers in many countries have focused on measurement and accounting for REDD at the province or national level: reductions in deforestation emissions as measured against a provincial or national baseline are less likely to be subject to leakage and therefore more likely to represent real emissions reductions.

While REDD policy has moved towards a consensus around measurement and accounting at the jurisdictional level (“sector-based REDD”), most policymakers also aim to encourage project-level REDD activities in order to effectively address the many local causes of deforestation, provide a sound basis for determining REDD revenue distribution, and ensure that environmental and social safeguards are applied at the local level, among other reasons. This has led to the emergence of the concept of “nested REDD”, in which accounting of emissions reductions by project-level activities is reconciled with jurisdiction-level accounting of deforestation emission reductions. California, for example, has adopted regulations for its cap and trade program that allow for the acceptance of sector-based offset credits from reducing deforestation emissions. The regulation explicitly notes that a nested approach to such sector-based REDD that includes project-level activities reconciled against jurisdictional accounts is potentially acceptable.

Many questions remain as to how a nested REDD system would operate. Some of these questions are only appropriate for government-to-government dialogues, such as the MOU process established recently by the governments of California, Chiapas and Acre. Others could appropriately be managed through the CAR Mexico Forest Project Protocol committee. The jurisdictional and nested REDD subcommittee met in November 2010 to discuss some of the issues; at that meeting it was decided that we needed a review of the key policy design decisions involved in establishing a nested REDD system. This document aims to provide that review.

Key decision points include: (1) whether a nested system is adopted in the first place and whether project-level activities are credited directly within that system; (2) whether jurisdictional governments are credited for reduced deforestation within their territory that is not the result of a geographically-specific project activity; (3) whether accounting systems focus only on avoided deforestation or include reforestation and sustainable forest management; (4) the scale of reference baselines and how they are set; (5) how project-level crediting is affected if the jurisdiction as a whole fails to reduce deforestation or increases deforestation emissions; (6) what permanence requirements apply, how they are met and how reversals are measured; (7) how verification and reporting will be managed, and how to integrate carbon stock data sets that are of varying quality; (8) which legal mechanisms will ensure enforcement of the protocol and adjudicate disputes; (9) what environmental and social safeguards will apply, and at what level (jurisdiction, project or both?) they will be applied.

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The outline below provides more detail on the key questions policymakers face in designing a nested REDD system. An accompanying document notes which questions will be addressed by this committee.

## Credit issuance generally

- *Jurisdictional only or nested.* Are credits issued: (1) only to governments for emissions reductions against a jurisdictional baseline; (2) to both the jurisdiction and to project-level activities within the jurisdiction, with accounting reconciled against jurisdictional emissions reductions; or (3) only to project-level activities within the jurisdiction, provided that project-level activities are only eligible for crediting in the event of jurisdictional emission reduction performance and after the development of jurisdictional MRV systems.
  - If credits are issued only to the jurisdiction:
    - Are credits issued based on any emissions reductions below the crediting baseline, or are credits issued only for governmental actions that are focused on specific geographic areas?
      - If credits are issued based on any emissions reductions below the crediting baseline, are governmental actions that reduce emissions distinguished from emissions reductions from other causes (e.g. commodity market cycles)? If so, how?
      - If credits are issued only for governmental actions that target specific geographic areas, are important government actions that are not geographically explicit (e.g. land titling and land reform, an export tax on commodities linked to deforestation, improved law enforcement) incentivized? If so, how?
    - Is the jurisdiction required or encouraged to distribute credits to regional or local REDD activities?
  - If credits are issued both to the jurisdiction and nested project-level activities:
    - Are credits issued to the government: (a) the difference between jurisdictional and project-level emissions reductions, or (b) restricted to government actions that target specific geographic areas?
      - If option (a), does the government have an incentive to minimize project-level activities? (Should take into account any licensing fees, royalties and taxes applied to project-level activities). Would that decrease achievement of REDD, or would it not be problematic?
      - If option (b), are important government actions that are not geographically explicit (e.g. land titling and land reform, an export tax on commodities linked to deforestation, improved law enforcement) incentivized? If so, how?
  - If credits are issued only to project-level activities in the jurisdiction, provided that jurisdictional MRV is in place and project-level and jurisdictional accounting is reconciled:
    - Is there an adequate incentive for jurisdictional governments to develop MRV systems and REDD regulations if the governments don't derive revenue directly from the carbon market? (They could derive revenue indirectly through licensing fees, taxes on carbon sales etc.)
    - Are important government policies to reduce deforestation outside of project areas incentivized? If so, how?

- Would the jurisdictional government be able to initiate and be issued credits for successful project-level activities?
- Is there a transitional crediting phase for pilot projects?
  - If so, are emissions reductions achieved by pilot projects eventually accounted for within jurisdictional accounts?
  - What are the criteria for pilot project eligibility?

## Accounting

- Is only deforestation accounted for, or are afforestation/reforestation or sustainable forest management accounted for as well (i.e. total forest carbon stock as compared to the crediting baseline)?
  - If afforestation/reforestation or sustainable forest management are included, is conversion from natural forest to timber plantations discouraged? If so, how?
- What registry will be used to record and track transfers of REDD credits? Selected by whom?
- If a jurisdiction develops a nested REDD system with credit sales to foreign entities, is that jurisdiction precluded from participating in bilateral or multilateral ‘pay for performance’ schemes? Are emissions reductions represented by credits sold by a sub-national jurisdiction accounted for within a national pay for performance scheme?
  - If a bilateral or multilateral ‘pay for performance’ scheme accounting is based on reducing the rate of deforestation while a sub-national system accounting is based on reducing emitted tonnes, how is the accounting reconciled?
- If a nation or sub-national jurisdiction has acceded to a “Nationally Appropriate Mitigation Action” (NAMA) through the UNFCCC process or otherwise, how is that NAMA accounted for in a nested REDD scheme? [e.g. through a distinction between crediting baseline and reference emission level? Or otherwise?]

## Baselines

- What is the geographic scale of the baseline (province, group of provinces, nation)?
  - Will there be a single baseline or multiple, nested baselines (i.e. nation, then regional baselines based on varying deforestation rates and drivers, then project-level baselines)?
- How is the reference emission level (REL, i.e. “business as usual”) determined – by historical emissions, forecast emissions or an ‘adjustment factor’ on historical emissions?
  - If the REL is set strictly by historical emissions, areas on the frontier of deforestation, which have experienced low historical deforestation but are likely to experience significant deforestation in the near future, will not be able to earn significant income from REDD credits until deforestation is well advanced. How will REDD be incentivized in such regions?
  - If the REL is based on forecast emissions, how is the forecast done? If an adjustment factor is incorporated into a REL based on historical emissions, how is that adjustment factor derived?
- Is there a difference between the crediting baseline and the reference emission level?
  - If so, are any credits issued for emissions reductions between the reference emission level and crediting baseline? At full rate or discounted rate? If a discounted rate, does the discount change as emissions approach the crediting baseline?

## Risk mitigation

- If project-level activities (whether private or government financed) are nested within jurisdictional accounting, are project-level activities compensated if they successfully reduce deforestation emissions but the jurisdiction doesn't? If so, how?
  - Options: (a) a "risk management" reserve of credits; (b) a leakage discount that varies with jurisdictional performance; (c) financial insurance; (d) governmental guarantee; (e) payments from agents causing deforestation emissions.

## Additionality

- At the jurisdictional level, are any emissions reductions below the crediting baseline deemed additional, or will there be other criteria for additionality?

## Permanence

- What are the permanence requirements for obligated reductions at the nested project level and the jurisdictional level?
  - 100 years? If less, how will rough emissions balancing be achieved to ensure atmospheric integrity?
- What is the liability for reversals?
  - Options: (a) retirement of equivalent quantity of credits, (b) specific performance (i.e. replanting), (c) monetary penalty
  - Are there different liabilities for intentional versus unintentional reversals? How are the two distinguished?
- If a nested system is in place, which baseline will reversals be measured against? Jurisdiction, sub-region, and/or project?
  - If jurisdictional, will project-level activities be penalized at all for reversals if the jurisdiction as whole has not reversed any obligated reductions?
  - If a mix of project-level and jurisdictional-level activities are credited, or if only nested projects are credited, how will compensation for reversals at the level of a project activity be accounted for in the jurisdictional accounts?
- Who will have liability for reversals?
  - If a jurisdiction reverses, do project-level activities have any liability for that reversal? (See "risk mitigation" section for related issues).
  - If a project reverses but the project-level proponent (community, landowner, investor) defaults on its reversal liability, does the jurisdiction have a contingent liability for that reversal (even if there is no reversal at the jurisdictional level)?

## Measurement, reporting & verification

- Measurement
  - The resolution on forest carbon data will likely vary significantly by area and scale. How will high resolution and low resolution carbon stock/deforestation data sets be integrated in jurisdictional accounting? What happens if a project area has much higher resolution carbon data than the jurisdiction as a whole?

- Reporting
  - What data will be required in reports? How frequent will the reports be?
- Verification
  - What verification will be required? At what intervals? Will this be accomplished by remote sensing, ground surveys or a combination? Who will be licensed to perform the verification?
- Miscellaneous
  - What is the definition of forest used? Does it include agroforestry crops (e.g. palm oil) or plantation forestry? If so, are there any restrictions on the conversion of native forest to agroforestry or plantation forests?

## Legal

- What legal mechanisms will be in place to create liability and ensure enforcement? What system will adjudicate disputes?
  - Options: (a) jurisdictional credits held in corporate entity that is a wholly-owned subsidiary of government, and the corporation contractually accedes to personal jurisdiction in the buy-side jurisdiction (i.e. the jurisdiction with the emissions trading system); (b) [?]
    - Offshore escrow accounts may be necessary to ensure payment of damages/retirement of credits in the event of reversal.

## Environmental and Social Safeguards

- Environmental:
  - See discussions above on whether there are restrictions on conversion of native forest to plantation or agroforestry and whether forest degradation is accounted for.
- Social:
  - What standard is used for Free Prior Informed Consent (FPIC)? At what level is FPIC applied (e.g. at the jurisdictional or local/project level or both)?
    - How is the FPIC process carried out in areas of unclear or contested land tenure?
  - What standard is used for benefit sharing? Is it a bright-line rule (e.g. X% of revenue to local stakeholders, no exceptions) or a standard?
- How are social and environmental safeguards monitored and enforced?
  - Part of jurisdictional and/or project reporting? Third-party verification? What entity has the standing to enforce application of safeguards and impose penalties for breach?