

ISSUE BRIEF

Managing Climate-Related International Forest Programs

A Proposal to Create the International Forest Conservation Corporation

Forest Carbon: An Initiative of the Climate Policy Program at RFF

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Resources for the Future

The Climate Policy Program at Resources for the Future (RFF) provides a framework for policymakers and stakeholders to better understand and address one of the most complex environmental issues of our time: climate change. The program has two core objectives: to develop domestic policies that are politically and economically viable and to articulate a new architecture for a global climate policy regime. Program scholars work to both support current policy efforts as well as foster the evolution of these policies over time.

Forest Carbon is one of four initiatives of the Climate Program. Its objective is to speed the development of large-scale global markets for forest carbon by conducting world-class, interdisciplinary research that helps create strong policy frameworks and accelerates private action, primarily through direct outreach to U.S. and international decisionmakers.

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Summary

As a result of new climate change policies, by 2015 the U.S. government and U.S. companies may be spending up to a combined \$11.5 billion per year to help developing nations reduce tropical deforestation. Existing federal agencies are ill-equipped to manage new programs in ways that produce genuine climate change benefits, reduce the cost of climate action for the United States, and advance other foreign policy objectives, including poverty alleviation and economic development. As part of new climate change legislation, Congress and the Obama administration should create the International Forest Conservation Corporation (IFCC), a specialized agency with the unique mandate, authority, and expertise needed to effectively manage this funding.

Why International Forests?

International forests are emerging as a central focus of U.S. climate legislation and diplomacy for several reasons. Approximately 20 percent of global greenhouse gas emissions results from tropical deforestation and other changes in land use, mainly in tropical developing nations. Reducing emissions from tropical deforestation will cost less than many other climate solutions and can be done immediately without new, unproven technologies. Done right, moreover, tropical forest conservation could produce many ancillary benefits, including new livelihoods for the rural poor, international security dividends and social reconciliation through reduced environmental degradation, less vulnerability to the adverse impacts of climate change, support for indigenous communities, and conservation of natural places and the biodiversity they contain.

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An accumulation of supporting evidence and the widespread distribution of benefits is helping to create a coalition of governments, corporations, environmental groups, international development organizations, and local communities—in developed and developing countries alike—pressing for forest-friendly climate policies. Momentum is building to create new economic incentives and market mechanisms to assist developing nations in reducing forest sector emissions, through not only U.S. domestic climate legislation but also new international climate change agreements. Within the next decade, tens of billions of dollars could be flowing from public and private U.S. sources—and more from other developed nations—to new programs to reduce emissions from forests worldwide.

Here we examine the institutions and authorities the Executive Branch needs to help the United States lead a global effort to reduce deforestation in ways that help stabilize the Earth’s climate, control the cost of climate action, and advance other important foreign policy objectives.

U.S. Climate Legislation

The American Clean Energy and Security Act of 2009 (also known as H.R. 2454 or the Waxman-Markey bill)—passed by the United States House of Representatives’ Energy and Commerce Committee on May 21, 2009—provides two central mechanisms for promoting tropical forest conservation. First, the bill would set aside five percent of the allowance value of emissions permits in a cap-and-trade system from 2012 through 2025 to fund new U.S. programs to conserve and manage international forests. Second, the bill would permit U.S. companies to offset up to 1.5 billion tons of their domestic carbon dioxide emissions by investing in international activities, including in the forest sector, that will reduce emissions by at least 125 percent of any offset claimed starting in 2018. Estimates by the Environmental Protection Agency (EPA) and McKinsey and Company (2008) suggest that 60 to 80 percent of these international offsets would come from the forest sector.

EPA also estimates that, combined, these provisions could generate about \$11.5 billion annually by 2015 in additional U.S. public and private funding for tropical forest conservation, which could be used to purchase about 1.4 billion tons of verified emissions reductions, thereby protecting millions of hectares of tropical forest.² About \$8.5 billion and 1.05 billion tons would come from the private sector through carbon markets. EPA estimates that overall international offsets—which again are expected to come primarily from the forest sector—would reduce the cost of domestic cap-and-trade allowances by half³. About \$3 billion and 330 million tons would come from the five percent allowance set-aside. These emissions reductions achieved via the set-aside would be above and beyond the obligation of U.S. companies within the cap-and-trade program to reduce their emissions 17 percent below 2005 levels by 2020.

These figures illustrate two central conclusions. First, new international forest funding would dwarf the approximately \$125 million currently allocated annually by the U.S. government for forest conservation in

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² There is significant uncertainty involved in projecting the costs and timeline of building market-readiness and delivering verified emissions reductions from tropical forest conservation in developing nations. Some have argued that traditional estimates do not adequately account for these transaction costs and thus overestimate the availability and underestimate the cost of greenhouse gas emissions reductions from tropical forests. Using a conservative estimate prepared by the Congressional Budget Office, in 2015 the Waxman-Markey bill would still generate about \$4.4 billion in additional forest conservation funding for developing nations, likely delivering 200 to 400 million tons of verified emissions reductions.

³ “The capped sector uses all of international offsets allowed in all years of the policy (1.25 billion tCO₂e offsetting 1 billion tCO₂e of capped sector emissions annually). Without international offsets, the allowance price would increase 96 percent.” (U.S. EPA 2009, 3).



developing nations.⁴ Second, the emissions reductions achieved by the United States through these new international forestry programs would be a major component of U.S. climate policy—roughly equal to the annual emissions of Germany or 20 percent of expected U.S. emissions in 2015.

Important Concerns

The Waxman-Markey bill outlines an innovative, large scale, and balanced set of policies and mechanisms to reduce emissions from tropical forests. Unfortunately, the institutions and authorities the bill puts forward to manage international forest programs are unsuited for such a major, specialized international undertaking. Its approach—delegating responsibility to EPA, in consultation with the U.S. Department of State—gives rise to several major concerns, many of which have already been expressed by key policymakers and stakeholders, including members of Congress and their staff.⁵

U.S. INSTITUTIONAL CAPACITY

No existing U.S. entity has the requisite capacity to successfully administer a multi-billion dollar international forest conservation program like that proposed in and funded by new climate legislation. The State Department and U.S. Agency for International Development (USAID) lack experience with environmental markets. EPA has that market regulation experience but lacks (1) expertise in forests, (2) sufficient knowledge of on-the-ground political, economic, and social conditions in developing nations, and (3) experience negotiating complex, legally binding international agreements with geopolitical ramifications.

READINESS OF DEVELOPING NATIONS

Many tropical forest countries do not possess the institutions and governance systems necessary to participate in U.S. emissions-reduction programs, and the United States will need to invest in building the capacity of these nations to participate in forest carbon markets. Unless the U.S. has well-managed capacity building programs with the appropriate expertise, developing countries will not produce enough low-cost verified emissions reductions to contain the costs of U.S. climate action. While the Waxman-Markey bill envisions the United States providing this assistance, the institutions it assigns responsibility to are not well organized to provide it as quickly and effectively as the programs demand.

WEALTH TRANSFERS

Absent an innovative financial mechanism, developed nations and their regulated companies will pay full market prices for forest carbon—reflecting the high marginal costs of domestic reductions. Avoiding deforestation in the tropics may cost developing nations less than \$5 per ton, but U.S. companies are likely to pay \$11 to \$14 per ton in 2015 according to EPA. Without a mechanism to help U.S. entities negotiate better terms, new forest conservation programs will result in larger than necessary income transfers to developing nations and produce fewer emissions reductions.

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⁴ United States Agency for International Development (2008)

⁵ See Leonard et al. 2009.



MARKET INTEGRITY

As EPA lacks expertise in developing-country forest conservation and developing nations themselves lack the governance institutions needed to verify emissions reductions, forest carbon projects may not meet high environmental standards and may pose a risk to the integrity of the larger U.S. carbon market.

ALLOWANCE FLOODING

Large volumes of low-cost international forest credits entering the U.S. carbon market could drive the price of allowances down to levels that provide insufficient incentives for efficiency improvements and technological development. If this is the case, short-run savings could be outstripped by far higher costs down the road when emissions reductions from forestry are no longer available and needed energy technologies fail to materialize as a result of underinvestment due to low carbon market prices.

These are important concerns, even if sometimes overstated, and they are strongly held by many influential players in the U.S. policy process. Failing to address them increases the risk that forest conservation provisions will be substantially weakened or removed as climate legislation moves through Congress. Precisely because the general thrust of the Waxman-Markey international forest provisions are sound, the additional effort needed to deal with these issues should be spent to ensure new tropical forest conservation programs are successful.

International Forest Conservation Corporation

One potential solution to address the concerns summarized above and ensure that international forests remain a central part of U.S. climate policy is suggested here. The United States should create a new, specialized government agency—the International Forest Conservation Corporation (IFCC)—to manage tropical forest-related elements of climate legislation. The IFCC would be modeled most closely on the Millennium Challenge Corporation (MCC), which enjoys broad bipartisan support in Congress, but also the Overseas Private Investment Corporation (OPIC) and the Export-Import Bank of the United States (EX-IM). More specifically, the IFCC would be an independent government corporation, with the same legal status and governance structure as the MCC. The IFCC would be chaired by the Secretary of State and governed by a board that includes cabinet and other senior officials from only the most relevant agencies, which in this case would be the Secretary of the Treasury, the Secretary of Agriculture, and the administrators of USAID and EPA. The IFCC would serve the following important functions.

NEGOTIATE AND MONITOR BILATERAL AGREEMENTS

Like the MCC, the IFCC would be fully integrated into U.S. foreign policy agencies, and would have the mandate to negotiate and monitor specialized bilateral assistance agreements with developing nations. These agreements would lay out the terms of cooperation, including the expectations and obligations of both parties. By giving the responsibility for negotiating these agreements to the IFCC, rather than to EPA as the Waxman-Markey bill currently does, Congress would build on the expertise of the State Department in conducting international negotiations while also helping to ensure full coordination with U.S. climate



diplomacy and other foreign policy objectives. Close integration with U.S. foreign policy agencies would also ensure U.S. forest conservation programs support the development of a coherent global climate change framework with strong standards that build on U.S. practices. These agreements, importantly, would give the IFCC the opportunity to set the terms and conditions for when nations would receive funding from the United States. The IFCC, for example, could condition eligibility on whether a nation has made an international commitment on climate change or developed a sound strategy for reducing its emissions in line with its international responsibilities. The IFCC would also institute a pay-for-performance approach—compensating nations only after emissions reductions are actually verified by the United States.

FUND CAPACITY BUILDING AND MARKET-READINESS

Also like the MCC, the IFCC would be responsible for funding on-the-ground capacity building and market-readiness programs in developing nations, drawing heavily on the expertise of the State Department and USAID. Using the funding set aside from a cap-and-trade program (five percent of the allowance value of emissions permits, as outlined above), these programs would prepare developing nations to participate in U.S. and global carbon markets. This is vital, because the countries with the ecological and economic conditions most conducive to forest conservation are often those with the most limited institutional capacity and weakest national governance. Necessary activities might include governance, land-tenure, and judicial reforms; the development of national forest management plans; support systems for the measurement, reporting, and verification of reductions; efforts to combat illegal logging; pilot and experimental activities for forest conservation; and upfront financing for policy reform in the poorest or most high-risk countries.

VERIFY ENVIRONMENTAL INTEGRITY AND LOCAL BENEFITS

The IFCC would develop the specialized expertise needed to ensure the environmental integrity and local benefits of forest conservation activities, drawing on the regulatory authority and market experience of the EPA and the on-the-ground experience of U.S. foreign policy agencies. With a specialized mandate, the IFCC would have the opportunity to develop the capacity needed to ensure for U.S. policymakers and stakeholders that international forest emissions reductions are real and that U.S. forest conservation programs benefit local people, including indigenous communities and the rural poor.

SOLE PURCHASING AUTHORITY

The expertise of EPA and the Treasury Department would be helpful for the IFCC in serving as a financial intermediary that would negotiate prices and purchase verified emissions reductions from international forests. This could be accomplished both through bilateral agreements with developing nations and by serving as a market-maker for verified emissions reductions from private-sector project developers. As the sole purchaser of international forest carbon offsets for all U.S. entities, the IFCC would use the full purchasing power of the U.S. carbon markets to negotiate the best possible price. The United States would be able to negotiate prices for itself and for U.S. companies far closer to the marginal cost of reducing forest emissions in developing nations than would be the case in a pure market. The IFCC would then resell offsets to U.S. companies, passing on the cost savings to shareholders and consumers. This financial intermediary



function would also insulate U.S. companies from the burdens and risks of being associated with specific international forestry projects about which they have little knowledge but that nevertheless carry reputational risks regarding environmental practices and the treatment of local people.

MANAGING AUCTIONS AND ALLOWANCE PRICES

In its role as financial intermediary, the IFCC would also control the volume of forest carbon assets entering U.S. compliance markets, reducing price volatility and maintaining the optimal price signal needed to drive innovation. To accomplish these goals, credits purchased by the IFCC could be introduced into the allowance market through a minimum price auction. The Waxman-Markey bill contains limits on the quantity of international offsets a regulated entity can use to meet its compliance obligations. Limits are needed if the integrity of the offsets is in question or there is fear that low price offsets will flood the market—issues directly addressed by the IFCC. Importantly, the IFCC would be self-financing as it could use a portion of revenues from these auctions to fund operations. Although the IFCC would be created to manage international forest carbon offsets, it could also be authorized to manage all international offsets under a U.S. cap-and-trade program.

Conclusion

The creation of the International Forest Conservation Corporation as a new government entity mandated to manage international forests offsets and set-asides under U.S. climate policy would produce the following benefits.

- Forest conservation activities would be more closely integrated with broader climate change diplomacy as well as other foreign policy objectives;
- a specialized agency would be best situated to develop the unique capacity needed to manage funding for international forests in ways that maintain high U.S. standards and achieve real results;
- a pay-for-performance system would not be confused with foreign aid and thus would be more defensible and popular with the American people;
- a governing board structure would bring all agencies with expertise and interests to the table to ensure interagency cooperation;
- using a similar institutional structure to the MCC may help win over conservatives and moderates who view that Bush administration initiative as a successful model for international cooperation;
- U.S. regulated entities would pay less for forest carbon assets as the IFCC could pass on cost savings;
- EPA would have a partner with expertise in forest carbon to ensure the entire U.S. carbon market is managed appropriately;



- private sector forest carbon investments would achieve greater emissions reductions for every dollar invested;
- price volatility would be managed, and the ideal carbon price would be maintained to drive innovation; and
- U.S. companies could invest in verified emissions reductions approved by the United States rather than having to work with project developers directly, which would reduce costs and help insulate U.S. companies from charges that they are violating the rights and interests of local people.

From an environmental, financial, and political perspective, the IFCC would address many of the important concerns being raised by policymakers and stakeholders about the approach to international forests taken in the Waxman-Markey bill. Introducing the IFCC into that bill would not require a major rewrite but would advance important U.S. interests.

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