

Using International Carbon Credits to Achieve National Mitigation Targets of EU Member States – Options for Accounting under Article 6 of the Paris Agreement

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1 Introduction

The European Union (EU) has communicated in its nationally determined contribution (NDC) a target of reducing greenhouse gas (GHG) emissions by 55% until 2030 compared to 1990 levels. This target will be achieved through various policies implemented under the European Green Deal. In its NDC, the EU clarified that it will not use international carbon credits to achieve its NDC. Article 6 of the Paris Agreement will only be used to account for the exchange of emission trading system (ETS) allowances with non-EU countries, such as Norway, Liechtenstein and Switzerland.

Several member states have also established national mitigation targets. Some of these member states may wish to purchase international carbon credits to achieve these targets. Sweden, for example, has established a goal of reducing emission in 2030 by 63% compared to 1990 levels, which provides for the possibility of using Article 6 of the Paris Agreement and purchasing internationally transferred mitigation outcomes (ITMOs) to achieve this goal. This raises the question how the use of ITMOs can be accounted towards national mitigation targets of EU member states.

This paper explores how the purchase of ITMOs by EU member states can be accounted for under Article 6 of the Paris Agreement, in particular the method and timing for applying any corresponding adjustments. Towards this end, the paper analyses the decisions from COP26 in Glasgow and COP27 in Sharm El-Sheik in the specific context of the EU and its member states. The paper also briefly highlights implications for the establishment of an EU ITMO registry and potential implications of Article 6 decisions on the accounting for single-year national mitigation targets.

2 Analysis of decisions under the Paris Agreement in relation to the use of ITMOs towards national mitigation targets

Article 6.2 of the Paris Agreement establishes a framework for accounting for internationally transferred mitigation outcomes (ITMOs). Decision 2/CMA.3, adopted at COP26 in Glasgow, establishes detailed rules for accounting for ITMOs. This decision is complemented by decision 5/CMA.3, which provides further guidance for operationalizing the modalities, procedures and guidelines for the enhanced transparency framework referred to in Article 13 of the Paris Agreement. At COP27 in Sharm El-Sheikh, Parties also adopted two decision that further operationalizes Article 6.2 ("Matters relating to cooperative approaches referred to in Article 6, paragraph 2, of the Paris Agreement", hereinafter referred to as COP27 Article 6.2 decision) and provide further guidance on the Article 6.4 mechanisms ("Guidance on the mechanism established by Article 6, paragraph 4, of the Paris Agreement", hereinafter referred to as COP27 Article 6.4 decision). These decisions are analysed with respect to the specific questions introduced above.

Under what type of provisions does the use of ITMOs towards national mitigation targets fall?

Paragraphs 1 and 2 of the Annex to decision 2/CMA.3, hereinafter referred to as "Article 6.2 guidance", establish that ITMOs may not only be used towards achieving NDCs but also towards "other international mitigation purposes" (OIMP). The latter includes the use towards "international mitigation purposes", such as the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) established under the International Civil Aviation Organization (ICAO), or "other purposes", such as voluntary goals by private or public entities.

The EU NDC excludes the use of international carbon credits towards its NDC. This also means that any ITMOs purchased by EU member states should not be accounted towards the EU NDC. This further implies that any use of ITMOs by EU member states must represent a use towards OIMP, and not a use towards the EU NDC. As the term "other purposes" under OIMP is not further specified,

it is reasonable to assume that it may cover the use of ITMOs by EU member states towards national mitigation targets, similar to the use of ITMOs by private or public entities to achieve voluntary goals.

Does the EU member state using ITMOs towards its national mitigation target need to apply corresponding adjustments?

The decisions under the Paris Agreement imply that, in the case of using ITMOs towards OIMP, corresponding adjustments shall only be applied by the first transferring country (i.e., the country where the emission reductions or removals occur) but not by the entity using the ITMO.

Paragraphs 7, 8 and 23 of the Article 6.2 guidance and the table on the structured summary in the annex to decision 5/CMA.3, establish the main basis for how additions and subtractions of corresponding adjustments shall be made in the structured summary.

Paragraphs 8(a) and 23(c) of the Article 6.2 guidance, and the table on the structured summary in decision 5/CMA.3, specify that transferring countries need to apply corresponding adjustments, in the form of additions to their emissions, for all ITMOs that were first transferred. According to paragraph 2 of the Article 6.2 guidance, first transfer includes also ITMOs that are used for OIMP. This implies that the country where the ITMOs are generated must apply corresponding adjustments for any ITMOs transferred, regardless of whether such ITMOs are used towards NDCs or OIMP.

Paragraphs 8(b) and 23(e) of the Article 6.2 guidance, and the table on the structured summary in decision 5/CMA.3, specify, however, that the Party using the ITMOs must apply corresponding adjustments, in the form of a subtraction, only for the use of ITMOs towards NDCs. This means that no corresponding adjustments are applied for the use of ITMOs towards OIMP.

It should be noted that some paragraphs of the Article 6.2 guidance only refer to the "use" of ITMOs, rather than "use towards the NDC", when speaking to the application of corresponding adjustments. The intent of the decisions is, however, clear. Applying corresponding adjustments for the use of ITMOs towards OIMP would indeed counter the purpose for which OIMP was introduced. If a corresponding adjustment in the form of a subtraction would be applied for use of ITMOs towards OIMP, the ITMOs would be automatically accounted for use towards the NDC, since the country would report lower adjusted emissions. This would imply that all ITMOs used for OIMP are also used towards the NDC. The concept of OIMP was, however, introduced as an alternative approach, and not as a sub-form of using ITMOs towards NDCs. This issue has been further clarified in decision 5/CMA.3, where the structured summary table – i.e., the emissions balance of the country – specifies a row for reporting the "annual quantity of ITMOs used towards achievement of the NDC (para. 23(e), annex to decision 2/CMA.3) (para. 77(d)(ii) of the MPGs)", but not for the annual quantity of ITMOs used towards OIMP. The use of ITMOs towards NDCs is thus not included in the total balance of adjusted emissions.

What are the implications for the method for using ITMOs towards single-year targets?

Paragraph 7 of the Article 6.2 guidance establishes two approaches to account ITMOs towards single-year targets: averaging or establishing multi-year trajectories or budgets. These provisions, however, only hold for the transferring country and for countries using ITMOs towards NDCs. As the use of ITMOs for OIMP is not subject to corresponding adjustments, the provisions of paragraph 7 also do not apply. This means that these provisions also do not apply to EU member states using ITMOs towards their national mitigation targets.

Nevertheless, robust accounting towards single-year targets is also important in the context of national mitigation targets. If ITMOs were used to fill a mitigation gap in the target year only, for example, this could lead to higher emissions over the period 2021 to 2030 compared to a situation

in which the EU member state achieved its target domestically (Lazarus et al. 2014; Siemons and Schneider 2022). Although the provisions of paragraph 7 of the Article 6.2 guidance do not apply for ITMO uses towards OIMP, it is thus important to adopt similar provisions at domestic level to ensure environmental integrity. Member states could, for example, apply the approaches set out in paragraph 7 of the Article 6.2 guidance *mutatis mutandis*, by using one of the following two approaches at *national* level (noting that this not required under Article 6 rules of the Paris Agreement):

1. **Establishing a trajectory or budget:** EU member States could establish a linear emissions trajectory or budget for the period 2021 to 2030, based on their 2020 and 2030 targets, and purchase ITMOs corresponding to the cumulative mitigation shortfall against that trajectory or budget, consistent with the approach set out in paragraph 7, subparagraph (a)(i).
2. **Averaging:** EU member states could account in 2030 for the average amount of ITMOs purchased over the period 2021 to 2030, consistent with the approach set out in paragraph 7, subparagraph (a)(ii). This means that only one tenth of the ITMOs purchase over the period 2021 to 2030 can be used to meet the target in 2030.

What are the implications for the timing of using ITMOs?

The Article 6.2 guidance includes a number of provisions with regard to timing of using ITMOs and the application of corresponding adjustments. For example, paragraph 8(b) of the Article 6.2 guidance specifies that the mitigation outcomes shall be used within the same NDC implementation period as when they occurred. This provision, however, can be interpreted to only apply to the use of ITMOs towards NDCs, and may not necessarily apply to ITMOs used for OIMP. Since the use of ITMOs towards OIMP does not imply any corresponding adjustments on the side of the user, also the issues related to the timing of application of corresponding adjustments by countries using ITMOs towards NDCs are not applicable.

A restriction on the timing of the use of ITMOs towards OIMP may arise if the first transferring country has defined the trigger for corresponding adjustments to be the “use or cancellation” of ITMOs. In this case, a corresponding adjustment by the seller country is only applied after the ITMOs have been used towards OIMP. Given that countries should report the final structured summary in the first biennial transparency report following the single target year, it would be important that by that time the corresponding adjustments by the transferring countries have been applied and the accounting for the NDC can be closed. In these cases, it would be important that ITMOs be used towards NDCs before the country reports its BTR in which it accounts for its NDC, so that the relevant corresponding adjustments can be included in the structured summary.

In which Party account could the use towards OIMP occur?

The use of ITMOs towards OIMP could occur within the accounts of any Party to the Paris Agreement. This opens the possibility of two potential ways for EU member states to use ITMOs towards national mitigation targets:

1. **Use within the EU accounts:** The EU member state could acquire ITMOs from the transferring country and use these ITMOs towards OIMP within EU accounts. A possible advantage is that this may give EU member states greater certainty that the use of ITMOs is accounted correctly for. It may also help ensure that the use purpose (e.g., “Use towards Sweden’s domestic climate goal”) is appropriately specified.
2. **Use within the accounts of the transferring country:** The EU member state could also use the ITMOs within the accounts of the transferring country. This could occur in different ways. One

way is that the EU member state would be authorized by the transferring country to open an account in the transferring country. The ITMOs could then be transferred from the project developer's account to the EU member state's account and subsequently be used by the EU member state towards OIMP. Another way could be that a third party (e.g., the project developer) uses the ITMOs towards OIMP on behalf of the EU member state, indicating the use purpose clearly in the related transaction. These approaches require respective authorizations by the transferring countries or contractual agreements with the project developer.

How exactly are ITMOs used towards OIMP?

The decisions under the Paris Agreement do not yet clearly define how ITMOs are used towards OIMP. The terminology in this context is not fully consistent, in particular whether the associated transaction is a "cancellation" or a "use". Paragraph 2, subparagraph (b), of the Article 6.2 guidance indicates that a first international transfer in the context of OIMP may be either the "cancellation" or "use" of the ITMO. The COP27 Article 6.2 guidance does not yet specify the account and transactions in the context of the international ITMO registry. The COP27 Article 6.4 decision specifies the accounts of the Article 6.4 mechanism registry. This includes an "Account for cancellation of A6.4ERs for other international mitigation purposes" (paragraph 32, sub-paragraph g). This indicates that the use of ITMOs towards OIMP may be implemented through a "cancellation" in that registry. However, different provisions may apply for the international registry under Article 6.2, and provisions for the Article 6.4 mechanism registry could be updated, once further guidance has been finalized under Article 6.2.

3 Implications for establishing EU ITMO registries

The Article 6.2 guidance establishes that each Party to the Paris Agreement shall have, or have access to, a registry. The COP27 Article 6.2 decision further specifies the requirements for such registries. The EU will thus need to establish an ITMO registry, given that it is a Party to the Paris Agreement. This registry will also account for the ETS links to non-EU countries.

Given that the EU has a single NDC, and EU member states do not have their own NDC, the EU and its member states will need to clarify whether the EU will establish one single ITMO registry only, or whether member states will have their own ITMO registries.

If the EU establishes a single ITMO registry, this EU registry would need to have provisions to enable EU member states to use ITMOs towards national mitigation targets, such as:

- Establishing provisions for enabling EU member states (and possibly other entities) to:
 - a) open and manage holding accounts of ITMOs;
 - b) acquire ITMOs from non-EU countries;
 - c) use ITMOs towards OIMP;
- Establishing provisions that forbid or prevent ITMOs from international carbon credits to be used towards the EU's NDC;
- Establishing registry functionalities that require account holders using ITMOs towards OIMP (or cancelling ITMOs) to clearly document the purpose (e.g., "Sweden's domestic climate target), in order to avoid any potential double use of ITMOs.

4 Conclusions

This paper outlined options for how EU member states can use ITMOs towards achieving national climate targets. Given that the EU has a single NDC for all 27 member states and given that the EU NDC excludes the use of international carbon credits towards its NDC, the use of ITMOs by EU member states to achieve national mitigation targets should constitute an OIMP. The use of ITMOs towards OIMP does not require any corresponding adjustments to be applied by EU member states and thus also provides flexibility how and when ITMOs are accounted for. EU member states may nevertheless wish to ensure that the use of ITMOs for national single-year mitigation targets is robustly accounted for, in order to ensure that aggregate emissions are not higher compared to the situation that the EU member state achieves its national climate target domestically. Lastly, the transaction of using ITMOs towards OIMP could either occur in the first transferring country or within the EU accounts. If the EU establishes a single ITMO registry, the latter should enable EU member states to use ITMOs towards OIMP.

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