

[IETA Article 6 Discussion Paper](#)

## How Governments Can Implement NDCs Cooperatively and Encourage Private Sector Investment

### KEY MESSAGE BOX – “INGREDIENTS FOR SUCCESS”

**Intention:**

- Countries should announce whether they intend to directly make use of Article 6 and/or authorise entities in their jurisdictions to participate in Article 6 transactions.
- Countries should determine whether they intend to participate or allow participation in Article 6 either as a seller, a buyer, or both.

**Authorization:**

- Countries should provide a clear strategy and guidelines on which sectors, projects, and vintages of emission reductions and removals will be eligible for Article 6 and how they relate to the national inventory and nationally determined contribution (NDC).
- Countries should specify whether activities are (i) authorised for use towards an NDC, (ii) authorised for use for “other international mitigation purposes,” or (iii) both.

**Transparency:**

- Countries should articulate how Article 6 will help achieve the goals of the Paris Agreement and contribute to sustainable development.
- Host countries should elaborate a policy framework for Article 6 and NDC compliance and determine how it will interact with other countries.

**Interoperability:**

- Countries should establish an effective interaction between voluntary market activity in the country and the compliance markets.
- Countries should support the emergence of a widely accessible traded market for carbon credits.

**Accountability:**

- Countries should ensure that they have a suitable digital registry or other infrastructure for GHG accounting, and that reporting is in place and designed to link to UNFCCC and other registry systems.
- Countries should identify key risks in the transaction lifecycle and identify mechanisms to reduce them.

**Capacity building:**

- Countries should emphasise the areas where capacity building is required and the role of international organisations.

## Introduction

One of the successes of COP26 was the finalisation of the Paris Rulebook through the agreement on Article 6 guidelines. The potential benefits of cooperation in achieving NDCs using Article 6 are significant for all Parties to the Paris Agreement. The potential cost reductions that may be achieved through Article 6 cooperation are estimated to exceed \$300 billion per year in 2030 when compared with the independent implementation of NDCs by countries.<sup>1</sup> There is also the opportunity to build efficiencies from the lessons learned from the CDM.

Since the Article 6 agreements in Glasgow, there has been increasing interest in the use of Article 6 to support cooperative approaches to help countries and sectors decarbonise. Over half of all countries signalled in their first or first updated NDC that they will use or might use international markets to meet their NDC. There is a wealth of information for governments of host and receiving countries to consider through the UNFCCC and COP processes. However, there has been a lack of clarity on how countries intend for their business entities to help develop and support Article 6. To date, it has been unclear whether the UNFCCC will establish guidance for the private sector as part of their capacity building activities or whether national governments and domestic businesses are best placed to tailor guidance to their business-specific circumstances.

The objective of this note is to highlight important elements for the business sector to help maximise the impact and use of Article 6. In discussions with our members and other business organisations, IETA identified the following elements that governments need to consider and address to mobilise private sector resources and investment towards Article 6 mechanisms. We have broadly organised them into 6 key categories: (I) Intention, (II) Authorization, (III) Transparency, (IV) Interoperability, (V) Accountability, and (VI) Capacity Building, and we have provided specific recommendations under each. The hope is that by articulating these elements, this paper can help advance the use of Article 6 across relevant stakeholders.

## I. Intention

**Countries should announce whether and how the country will authorise Article 6 credits and/or accept them towards the achievement of its NDC** – Countries that intend to meet their decarbonisation ambitions solely or predominantly through domestic efforts will adopt different strategies from countries that intend to meet their ambitions through international cooperation. Clarity over whether a country intends to use Article 6 and which approach governments will use is urgent, as prolonged ambiguity and postponing decisions is not conducive to investment and discourages private finance. Each country should publish a list of all countries it plans to cooperate with and the specific approach it intends to use. The details of each cooperative approach should be made publicly available, and the terms of each bilateral agreement should be published.

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<sup>1</sup> Edmonds, J., Yu, S., Mcjeon, H., Forrister, D., Aldy, J., Hultman, N. et al. (2021). How Much Could Article 6 Enhance Nationally Determined Contribution Ambition Toward Paris Agreement Goals Through Economic Efficiency? *Climate Change Economics*, 12(02), 2150007.

## II. Authorization

**Countries should provide a clear strategy and stable guidelines on which sectors, activities, and vintages will be eligible for Article 6 credits** – Each country will have a different set of circumstances and priorities for achieving its NDC. In developing a country’s Article 6 strategy, clear guidance on which sectors, activities and vintages will be eligible to generate credits under Article 6 in the host country will help assist the private sector in identifying opportunities and cooperative approaches between countries. The elaboration of positive lists of sectors or activity types where the private sector is encouraged to engage (often called whitelists) would allow rapid identification of these opportunities and avoid lengthy and complex NDC and policy alignment procedures. Whether authorisations will be granted for use towards an NDC, “other international mitigation purposes,” or both should be made unequivocally clear. Frequent regulatory changes and pending regulations regarding the eligibility of carbon projects are extremely damaging and may lead to forgone mitigation opportunities. A model Letter of Authorisation should also be published to streamline and standardise the process, reducing risk and uncertainty for all parties involved.

## III. Transparency

**Countries should articulate how the use of Article 6 will help achieve the goals of the Paris Agreement** – How Article 6 contributes to increasing a host country’s ambition in its mitigation and adaptation actions will be key. This requirement should be applied in a pragmatic manner, allowing countries to use Article 6 to help finance their NDCs rather than engaging in cooperative mechanisms only for activities above and beyond their NDCs. Likewise, a country that intends to import Internationally Transferable Mitigation Outcomes (ITMOs) faces a similar task in identifying how Article 6 transactions are consistent with its long-term decarbonisation ambition and the goals of the Paris Agreement. Such steps are necessary to strengthen the credibility of cooperative approaches and minimise the risk of perverse incentives that may lead to overselling and lower ambition. The principles around participation, baselines, and other methodological requirements (including additionality) outlined in the Article 6 guidelines are good starting points that need to be rapidly specified and operationalised. Understanding these elements will help the private sector focus resources and capital on opportunities that are amenable to both selling and buying countries.

**Host countries should elaborate what policy framework they will adopt and how it will interact with the receiving country** – Illustrating the policy and procedural framework a country will follow when engaging in Article 6 mechanisms will be integral for the private sector. This will help reduce uncertainties, provide credibility to the process, and encourage investment. The framework may also specify how a country will manage future improvements. This could include, for example:

- framework agreements establishing specific cooperative approaches with other countries;
- required documentation and use of independent standards, if any;
- volume, types, and origin of credits that a country intends to support for sale and/or purchase;
- how the host country will implement authorisations for transfer and/or use;
- how the host country will implement corresponding adjustments;

- how compliance, voluntary markets, and standalone projects will interact;
- applicable taxation related to transfers and any other levy or mechanisms that may impact the project's economics.

Furthermore, countries should make clear how Article 6 transfers relate to their carbon pricing mechanisms and broader decarbonisation strategies. For example, they should be encouraged to state:

- how the registries of the two countries will link together securely to assure the integrity of the transfer, tracking, and reporting infrastructure;
- how the transfer will help assure that NDCs are achieved by participating countries;
- how the countries intend to integrate transfers into their carbon pricing systems.

This will help cooperating countries ensure that the transfers are rooted in high integrity and transparency. How countries will apply corresponding adjustments will be integral, particularly to provide more clarity for the Global Stocktake in 2023.

#### IV. Interoperability

**Countries should establish an effective interaction between compliance instruments and the voluntary carbon market (VCM)** – While Article 6 guidelines do not directly regulate the voluntary carbon market, addressing how Article 6 mechanisms and credits are expected to interact with the voluntary carbon market could encourage greater investment. Article 6 is designed to deal with carbon transfers between countries – obligations may be delegated down to private sector actors through mandatory schemes, but the reporting and accounting of emissions remain at the national level. Hence, the voluntary trade of carbon credits between private actors should have no bearing on the Article 6 market as long as those credits are not used for obligations related to the achievement of an NDC outside the host country. If project developers or buyers would like the host country to authorise carbon credits issued by independent private standards and apply a corresponding adjustment when these credits are transferred internationally, they ought to have the option to make such a request to the host country. However, the international transfer of credits without host country authorisation and corresponding adjustment is permitted, and countries should ensure that the emission reductions associated with those credits remain in the host country's GHG emissions inventory and count towards the NDC of the host country. In this manner, the voluntary carbon market would catalyse private capital to deliver significant carbon projects, avoiding double counting and other perverse incentives.

**Countries should support the emergence of a widely accessible traded market for carbon credits** – The private sector can mobilise capital towards mitigation projects by either investing in assets or committing to offtake agreements in return for the supply of carbon credits that can be used to discharge compliance obligations (such as an ETS or a carbon tax liability) or to offset hard-to-abate emissions. Hence, clarity and transparency on the eligibility of various types of credits for compliance purposes and/or offsetting claims are necessary to incentivise sustained investment in mitigation. Efforts to create standardised and fungible credits abiding to a minimum

standard will allow the emergence of a liquid asset class and enable the deployment of streamlined trading and risk management that will reduce transaction costs, further mobilise capital, and increase investment flows.

#### V. Accountability

**Countries should ensure a suitable digital registry or other infrastructure for GHG accounting and reporting is in place** – The effectiveness and credibility of Article 6 mechanisms must be underpinned by an infrastructure enabling the comprehensive accounting and reporting of GHG emissions by sources and removals by sinks. The requirement to apply a corresponding adjustment to account for all net transfers points to the need to properly quantify activities, policies, and measures, both inside and outside the NDC of a country. Recording, tracking, and reporting provisions in the Article 6 guidelines should be interpreted as basic requirements. Draft and final Annual Information, Biennial Transparency Reports, and NDC commitment period reports should be fully published. A list of all pending and completed corresponding adjustments should also be made publicly available. Greater data availability and transparency are necessary to enhance the environmental integrity of cooperative approaches, avoid double counting and protect private sector actors committing significant resources in carbon projects.

**Countries should address key risks in the activity cycle and identify mechanisms to reduce them** – Project developers and private sector players engaging in Article 6 transactions are exposed to a series of risks throughout the lifecycle of the trade, which may extend several years in the case of forward emission reduction purchase agreements (ERPAs) and even decades in the case of removal projects. While host government involvement was limited in Clean Development Mechanism and voluntary market transactions, the need for authorisation and application of a corresponding adjustment in Article 6 exposes both sellers and buyers to significant sovereign risk. Examples of such risks are:

- host government delays or denies the issuance of letters of authorisation;
- host government declines to honour previously issued letters of authorisation;
- host government does not issue ITMOs for verified emissions reductions from authorised projects;
- host government changes the scope of sectors eligible for Article 6 credits;
- host government does not apply corresponding adjustments or does not do so correctly;
- host government favours ‘ex post’ authorisation of ITMOs.

It is crucial for the private sector and investors to know what recourse they would have in such instances and where liabilities lie. The involvement of international institutions and multilateral development banks may help create incentives and penalties that would encourage positive behaviour by host governments. Mechanisms to reconcile the need for environmental integrity with investor protection should be developed. The provision of sovereign political risk insurance may be necessary.

#### VI. Capacity building

**Countries should emphasise the areas where capacity building is required and the role of international organisations** – All parties can benefit from the use of Article 6, but this is an innovative process that requires an

integrated effort across governments, the private sector, and civil society initiatives. Areas identified by governments already include policy support for decarbonisation pathways, clarity on environmental integrity criteria, reporting and accounting, authorisation frameworks, and others. The private sector will need a voice at the table to share areas on where opportunities can be explored and where tensions exist, especially in light of the need for private sector financing to achieve NDC goals. Mechanisms that allow for businesses to illustrate these points through a consultation process (whether for a tax, offset, ETS, or otherwise) will allow all parties to progress forward on which areas need capacity building. Over time, these insights can be shared with the relevant communities to assist decarbonisation efforts.