

Article 6 Strategy: Identifying Opportunities and Managing Risks

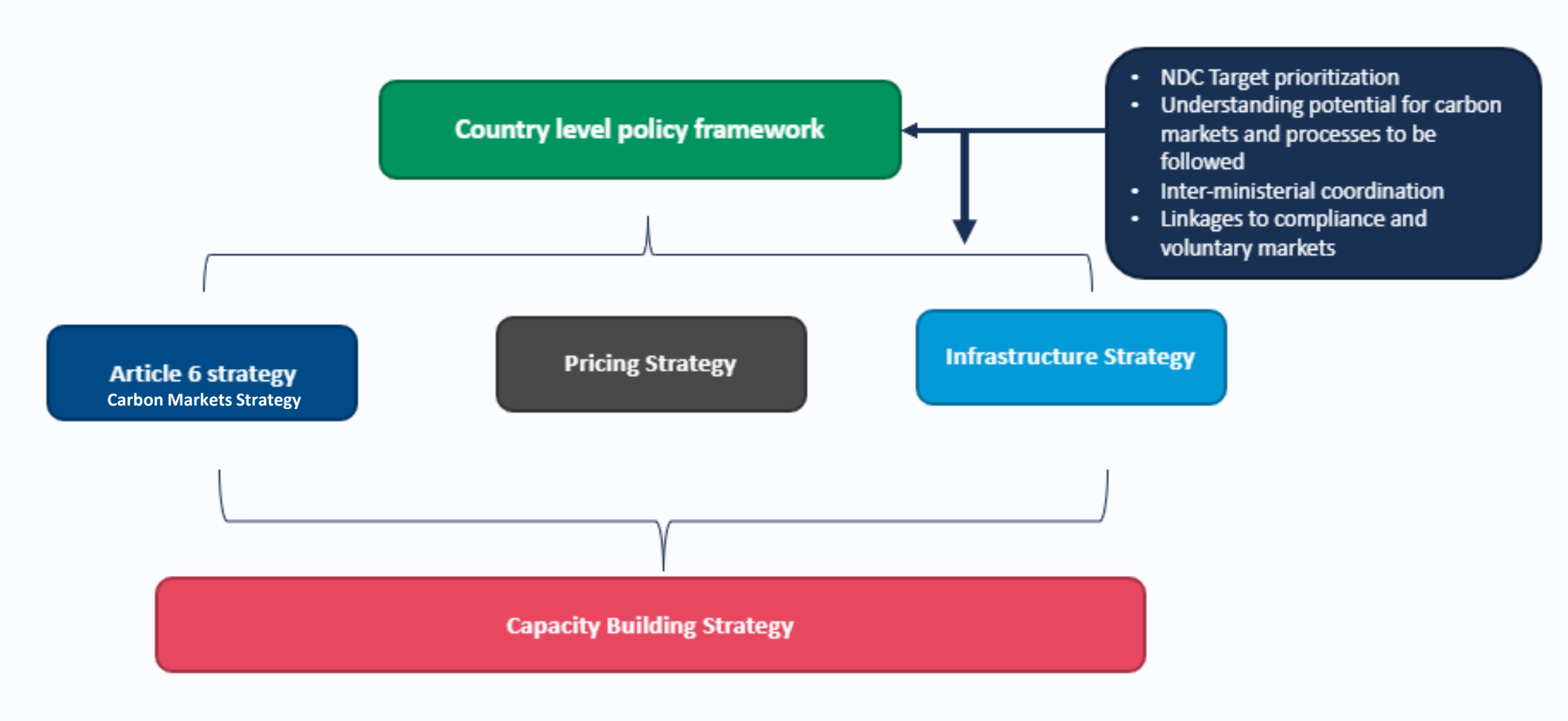
Hari Gadde, World Bank
Sept 25, 2024



Context

- Increasing role for host countries under Article 6 of the Paris Agreement
- Understanding the differences between Article 6 and CDM is important
- Challenges with adoption of national regulations and struggle to understand the interplay between different national and international market mechanisms
- Countries are looking at different strategies to put in place (A6 strategy, pricing strategy, infra strategy, capacity building strategy etc)
- Capacity building needs are enormous
- Several initiatives trying to bring clarity and trust to the market
 - World Bank approach papers, VCMi Access Strategy Toolkit, SPAR6C guidebooks, OECD report etc
- Clear guidance/decision framework is needed
- WB, along with partners like VCMi, ICVCM, GGGI etc, aiming to develop the simplified and practical country guidance note

Country's participation in carbon markets depends on clear understanding of requirements and establishing clear strategies supported by a national framework

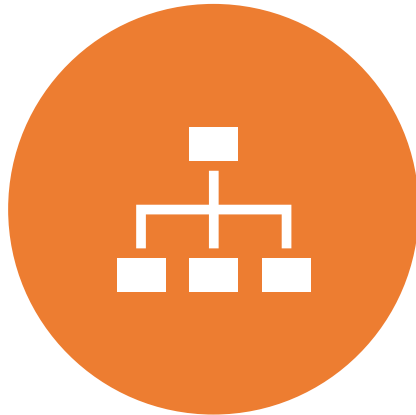


Host countries are beginning to establish policy frameworks for Article 6 carbon markets, with some also incorporating voluntary carbon markets.

Clear policy frameworks governing market activity have been emerging, with varying degrees of market coverage and policy breadth.

Element	Description	Policy Approaches	Country Examples
Activities	Activities eligible to generate carbon credits (countries may also specify which sectors are eligible to receive Authorization to generate Internationally Transferred Mitigation Outcomes (ITMOs))	Whitelist/positive list to be included in the country policy framework	Ghana, Thailand, Rwanda, Kenya, South Africa*, India, Zambia**, Cambodia, Indonesia, Malaysia, Paraguay, Tanzania, and Zimbabwe
Methodologies & Mechanisms	Eligible methodologies and crediting mechanisms to quantify and generate carbon credits	Eligibility of methodology(ies) specified in the policy framework, for instance use of Gold Standard/Verra etc.	Ghana, Rwanda, South Africa, Singapore, Indonesia, Malaysia, and Zambia
Issuance	Processes for credit issuance, including the country process and relevant overseeing institutions. This element may also specify the registry to be used.	Institutional arrangements, processes and responsibilities to be included in the policy framework.	Ghana, Kenya, Indonesia, Cambodia, Zambia, Paraguay, Peru, Tanzania and Malaysia, Bhutan
Authorization Procedures	Process by which authorization is granted; this element may include the Letter of Authorization template to be used/its content and specify the relevant institutions that manage and grant authorization.	Publishing the process for securing authorization; identifying relevant institutions and specifying conditions, if any. Include revocation conditions, if applicable.	Ghana, Rwanda, Zambia, Peru, Bhutan and Cambodi
Reporting Process	Outlining how the country will follow and meet reporting requirements under Article 6	Reporting template consistent with the UNFCCC guidance, and identification of relevant institutional arrangement	Ghana, Tanzania, Thailand, Kenya, Singapore, Cambodia, Zambia, Indonesia, Peru, South Africa and Malaysia
Pricing Strategy	Country's approach to pricing credits that come with corresponding adjustment and/or its plan to use the carbon revenues collected from a corresponding adjustment fee or levy, if any.	Linked to priority investment areas for decarbonization, transaction costs and reflect the opportunity costs for meeting NDC for adjusted credits	Ghana, Bhutan
Eligible Uses	Mitigation purposes for which generated credits can be used	Specifying criteria and eligibility for approvals and Authorization. Eligibility of use of the credits determined by the buyer.	Ghana, Rwanda, and South Africa

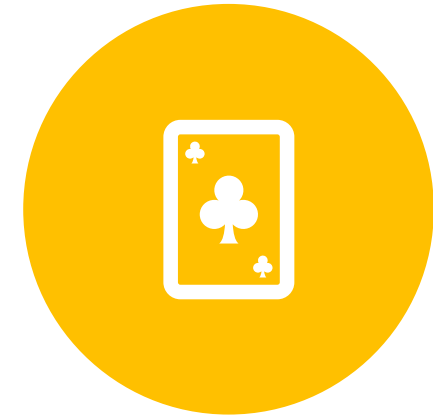
Decisions for host countries on Article 6 engagement happen at three levels



HIGH-LEVEL (“STRATEGIC”): WHETHER
THE RISKS AND OPPORTUNITIES THAT INFLUENCE
THE OVERALL DECISION TO PARTICIPATE



MID-LEVEL (“TACTICAL”): HOW
KEY CONSIDERATIONS ONCE COUNTRIES HAVE
DECIDED TO PARTICIPATE



LOW-LEVEL (“OPERATIONAL”): WHAT
CHOICES ON IMPLEMENTING THE VARIOUS
STRATEGIC AND TACTICAL DECISIONS

Please read “Developing an Article 6 Strategy for Host Countries” paper

<https://www.theclimatewarehouse.org/knowledge/papers/developing-an-article-6-strategy-for-host-countries>

Strategic issues: assessing risks and opportunities

Managing Risks

- Overselling risks and links to NDC
- Overselling risks and pricing considerations

Capturing opportunities

- Opportunities to support long term climate goals
- Opportunities for co-benefits
- Opportunities for market positioning – “branding”

Overselling risks and links to NDC

- Key issue is how to ensure that export of mitigation outcomes not only supports long-term climate ambition but also **does not compromise current NDC goals**
 - First need to understand what mitigation options the host country would like to use for their NDC, based on costs, policy alignment, co-benefits
- Several different strategies to address this risk, which might also be used in combination
 - Carefully **choosing sectors, project types, technologies and investments** used for A6, to not interfere with the interventions selected by the host country to meet its NDC.
 - Setting **prices for ITMOs** high enough that, even if the host country must replace the underlying mitigation intervention with a more expensive option to still meet its NDC, there is sufficient revenue to cover these mitigation costs
 - **Keeping some of the mitigation outcomes** from a cooperative activity in the host country rather than exporting them
- Strategies may be reflected in eligibility criteria, other regulations related to A6, or pricing considerations for ITMOs

Overselling risks and pricing considerations

- Host country government **may or may not have a direct role in the financial flows** of A6 activities
 - Financial flows unlikely to be governed by UNFCCC guidance, but may be from different contractual arrangements, some of which may include the government
- Factors that may influence pricing include **abatement costs, marginal cost of meeting NDC**, international market prices (if they exist), and potential premiums for activities with high co-benefit
 - Will evolve over time as international carbon market matures
- As one strategy to address overselling risks, host country could **consider a pricing strategy** that sets an ITMO price high enough to replace any A6 activity with another alternative outside of the “NDC package” of measures.

Impact of Corresponding Adjustment for MOs transfer for host countries

- In pre-2020 carbon markets, the emission reduction purchase agreements were between the buyer and seller (project developer), there was limited role nor any share of most host government;
 - China, for instance, was an exception and collected substantial tax on low-cost mitigation activities coupled with a minimum price for CERs.
- In context of mitigation activities under Art 6 seeking transfer of mitigation outcomes outside, the role of the host government is enhanced:
 - Ensure current NDC commitments are met;
 - To perform corresponding adjustment (present);
 - Seek avenues for further mitigation to enhance ambition for (future) NDC update; and
 - Additionally, identify investment needs climate resilience among other activities (present and future).
- To perform these roles, the host government could charge a fee/ cess/ levy /tax to finance set of activities for the additional mitigation activities that have to be undertaken due to corresponding adjustment.
- For mitigation outcomes (MOs) with corresponding adjustment, there may be a need for a two-part payment with the market price (\$m) being paid to the seller and an additional share (\$+) to the host government.

Opportunity: carbon pricing supporting long term climate goals

- LT-LEDS should identify technology and financing needs in comparison to current situation in order to identify gaps, so tasks in the A6 strategy process should include:
 - Review any discussion about carbon markets in the LT-LEDS or similar on domestic carbon pricing and/or international cooperation
 - Identify as *priorities* for A6 cooperation any technology areas that are important for long term but for which there is no domestic capacity or knowledge
- Identify as potential *exclusions* from A6 cooperation any low-cost options (but which might face other barriers) that are important for long term goals and have some domestic capacity
 - but this may not be needed if the host country has other strategies for managing overselling risks

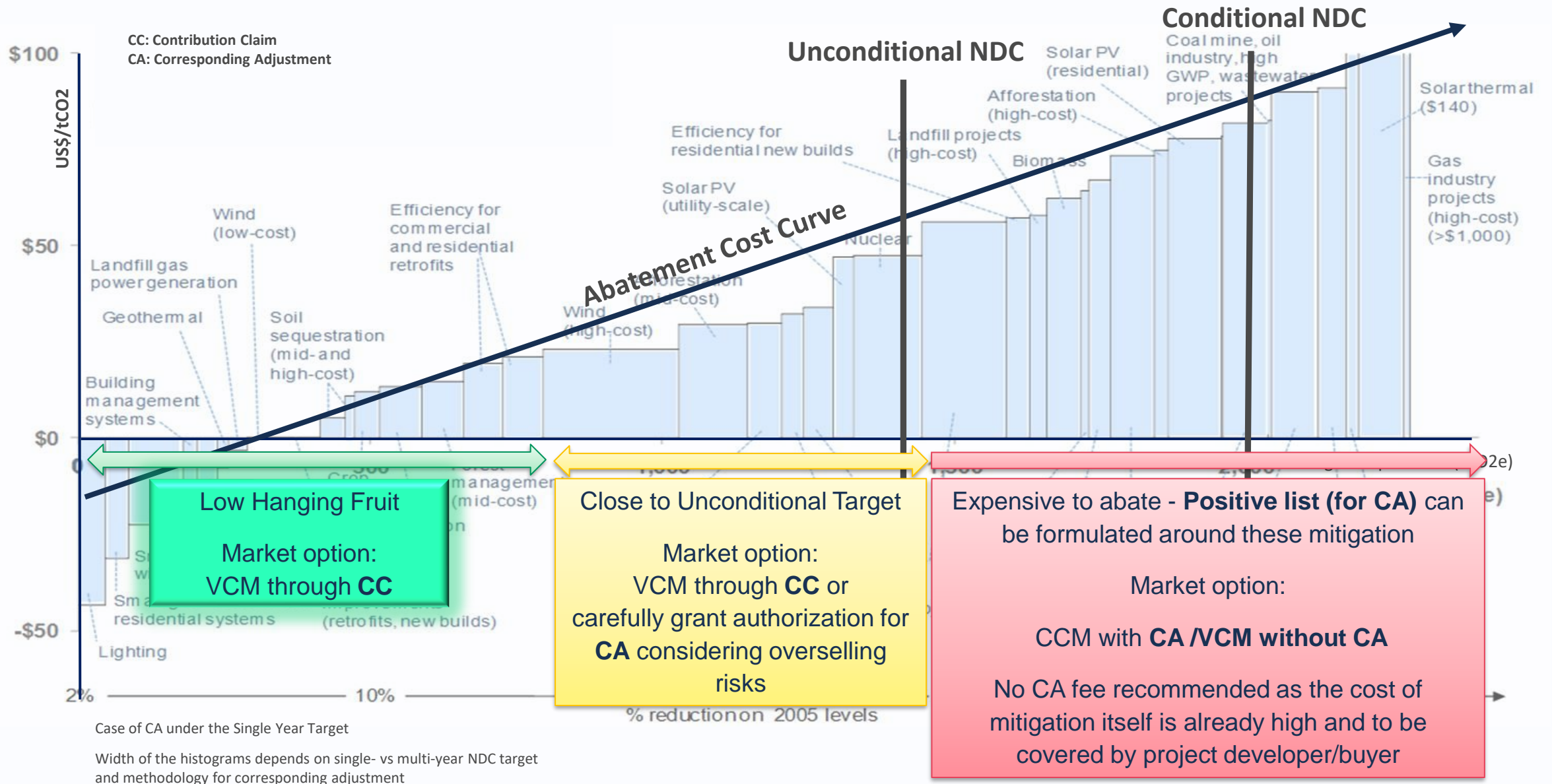
Opportunity: capturing co-benefits

- Mitigation can also **lead to significant of co-benefits** >> take this into account when choosing the strategy for participation in Article 6.
- Co-benefits can cover many of the SDGs, including health, gender, adaptation, economic diversification and just transition.
- Taking a holistic view will not only ensure a better outcome for the country and society but will also help address other issues that are a priority for different host countries.

Opportunity: Overall “branding” or market positioning

- Asses options for the country’s ”brand” in markets (e.g., low-cost supplier, high quality/high ambition supplier, high SD impact supplier)
- Identify how this affects later tactical decisions (e.g. could include issues such as contribution to OMGE, contribution to adaptation, how ITMO proceeds are used/re-invested, alignment with San Jose Principles or other coalition)

Use of international carbon markets to achieve a country's NDC



4. Tactical issues

- Key considerations for host countries once they have decided to participate in Article 6, to minimize risks and maximize opportunities.
- Decisions on which specific sectors, technologies and activities will form part of the country's Article 6 portfolio
- How the national criteria, procedures and financing structures support implementation

Consider:

- Domestic carbon pricing and A6
- Eligibility criteria for A6
- Standards and programs
- Opportunities as a trading hub
- Partnerships and types of cooperation
- Setting up a mitigation fund

The starting point can be analysis of the country's current capacity and the existing institutional setup

Eligibility criteria for Article 6 – links to risks and opportunities

Risk

- Eligibility criteria to address risk (overselling) and opportunities
- Analysis could include: NDC & LTS
- Important for private sector engagement
- Avoidance of overselling risk: a) qualitative restrictions; b) quantitative restrictions; c) pricing ITMOs

Opportunity

- Positive list : technologies or sectors
- Opportunity approaches may require revisiting as technology costs, ambition, etc. changes over time

Domestic CPIs and Article 6

- There needs to be coordination and synergy between Art 6 participation and domestic CPI
- Art 6 cooperation can involve domestic CPIs (e.g., linking ETS)
- Art 6 ITMO can originate outside domestic CPIs and can be used for compliance with domestic CPI or for Art 6 cooperation
- Examination on where is the best use of mitigation outcome opportunities – domestically or externally

Standards and programs

• Three segments

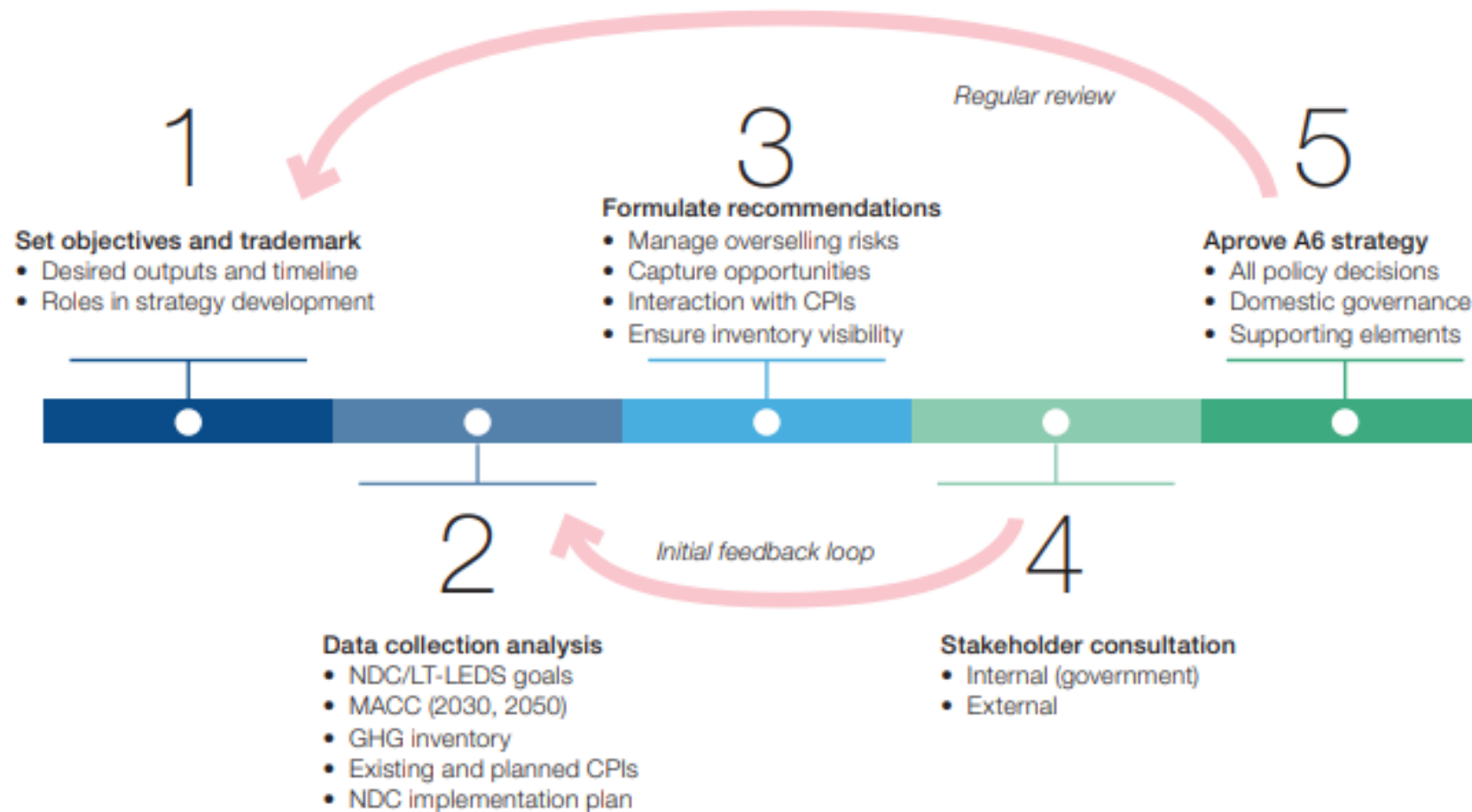
- Approval of projects/policies with mitigation outcomes
- Protocols for validation, measurement, verification
- International transfer and corresponding adjustments

• Approval of projects is a domestic, national matter to determine what the country allows for export

• MRV and project flow protocols – CHOICE: this can be developed and operationalize domestically or use an international standard. This may include some infrastructure requirements such as registries

• International transfers and corresponding adjustments – undertaking by the country

Key steps in the development of an Article 6 strategy



Some lessons learned..

- **Awareness:** Countries understanding of Article 6 rules, reporting requirements and their roles is quickly evolving and there is a huge gap with understanding what is needed to put in place at domestic level
 - Countries with ongoing Article 6.2 transactions are more advanced with their understanding and what needs to happen and put in place at domestic level
- **Understanding needs:** Needs assessment and gap analysis through World Bank's Mitigation Action Assessment Protocol – international market readiness (MAAP-ITR) is found to be very useful
 - Availability of data and information for such assessment is a challenge
- **A6 Strategy:** Countries are prioritizing identification of sectors and mitigation activities that can be eligible to participate in international carbon markets without jeopardizing meeting the NDC targets
 - Uncertainty over these is making any cooperation and involving in Article 6 pilots slow
 - Coordination between different and relevant ministries and agencies is critical
- **Infrastructure and capacity building:** Domestic level infrastructure (mainly registry) and capacity building are top priorities of many countries. The capacity building needs in countries even with experience with Kyoto markets are huge.
 - Coordinated efforts between different development partners and initiatives is needed
- **Policy frameworks:** Many countries aim to establish institutional and policy framework to support the country's participation in markets, but require a lot of capacity building and support
 - Support with assessing the existing policies/frameworks, institutional arrangements is needed

Thank You!

Program links & resources:

- Partnership for Market Implementation (PMI) - <https://pmiclimate.org/>
- Partnership for Market Readiness (PMR) – <https://thepmr.org/>
- Carbon Pricing Leadership Coalition (CPLC) - <https://www.carbonpricingleadership.org/>
- Climate Warehouse - <https://www.theclimatewarehouse.org/>
- Networked Carbon Markets - <https://www.worldbank.org/en/topic/climatechange/brief/globally-networked-carbon-markets>
- Innovate4Climate - <https://www.innovate4climate.com/>
- Pilot Auction Facility - <https://www.pilotauctionfacility.org/>

Operational issues

- Detailed governance decisions for different Art 6 functions
- Authorization/transfer criteria
- Stakeholder participation - where and how
- 6.2 contributions to adaption or OMGE
- Fulfilling rules on authorization of ITMOs for purpose other than NDC
- Other specific 6.2 participation requirements (e.g., submitting GHG inventory report, quantifying NDC and goals, etc.)
- Accounting and CA approach - use existing one (e.g., averaging vs trajectory for single year targets) or propose a new one
- Registry design if country uses its own; whether registry for Party use or for participation in secondary markets; Links to A6 database
- Legislative and regulatory needs to make Art 6 operational in the country
- Rules for accreditation of DOEs (only needed if country does not simply refer to an external standard)
- Defining sustainable development requirements
- More detailed pricing issues (e.g., price floor)