VCMI

03

Determining the role for carbon markets in NDC achievement

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Who should be included in these discussions? Government agency or agencies responsible for NDC design and implementation, UNFCCC negotiators, agencies in charge of GHG inventories and NDC accounting, attorney general's office, sectoral ministries with relevant activities in their portfolios.

It is essential that host country governments decide whether – and to what extent – voluntary and regulated carbon market transactions should contribute to their Nationally Determined Contribution (NDC). This decision requires an assessment of the mitigation potential of existing and planned policies, including the identification of potential mitigation gaps.

Voluntary carbon markets (VCMs) – and compliance carbon markets – can help countries to increase their ambition and generate emission reductions and removals that go beyond existing NDCs.

How carbon markets contribute to a country's NDC depends on the decisions a host country makes regarding which types of mitigation activities are approved, and then authorized for international transfer under Article 6 of the Paris Agreement.

3.1 Clarify when emission reductions and removals count towards the host country's NDC achievement

Under the Paris Agreement all Parties must formulate NDCs and report progress towards meeting mitigation objectives. The Paris Agreement, through Article 4.13, establishes the requirement that countries account for emissions under their NDCs. Countries must define a methodology to assess progress against NDC targets and establish suitable data sources.

In accordance with Article 4.13 of the Paris Agreement:

"Parties shall account for their nationally determined contributions. In accounting for anthropogenic emissions and removals corresponding to their nationally determined contributions, Parties shall promote environmental integrity, transparency, accuracy, completeness, comparability and consistency, and ensure the avoidance of double counting (...)"

Carbon market activities under Article 6 of the Paris Agreement influence the NDC accounting of participating Parties. Article 6.2 of the Paris Agreement establishes a mechanism to transfer mitigation outcomes between countries. The transfer of such internationally transferable mitigation outcomes (ITMOs) needs to be reported and accounted for in the context of NDCs to "ensure environmental integrity and transparency, including in governance" and, "inter alia, the avoidance of double counting, consistent with guidance adopted by the Conference of the Parties."

Transfers under Article 6 of the Paris Agreement require robust measurement, reporting, and verification (MRV) of GHG emission reductions and removals. Emission reductions and removals cannot be accounted for under more than one NDC, in most cases either the generating or the receiving country's NDC. If countries transfer a mitigation outcome credited under Article 6.2 or 6.4. of the Paris Agreement and it is being accounted under another Party's NDC or used against another international mitigation goal, the Parties involved need to make a 'corresponding adjustment' to ensure that there is no double counting of the mitigation benefit by multiple countries (see Box 1 and Figure 1).

Host countries have ultimate control over whether GHG emission reductions and removals generated by carbon market projects count towards the achievement of their NDC. Host countries decide whether a GHG emissions reduction or removal will be authorized for trade with a corresponding adjustment, or remain unauthorized meaning the GHG emissions reduction or removal can count towards the host country's NDC. Governments can decide to support activities through cooperative approaches between countries (Article 6.2) or via the UNFCCC centralised mechanism (Article 6.4) with OR without authorizing the transfer of GHG emission reductions and removals with corresponding adjustments:

- When countries approve a corresponding adjustment for a carbon credit traded in VCMs, the associated emissions reduction or removal can no longer be used towards the host country NDC

- When carbon credits issued under Article 6.2 or 6.4 of the Paris Agreement are not authorized to be accounted for against another country's NDC or another international mitigation goal, they can be counted towards the host country's NDC

Box 1: What are corresponding adjustments?

Corresponding adjustments are a national accounting tool agreed by and for countries under Article 6 of the Paris Agreement to avoid double-counting in tracking progress toward implementation of their Nationally Determined Contributions. Corresponding adjustments do not change the quality of the associated emission reductions or removals.
Article 6 rules require corresponding adjustments for internationally transferred carbon credits authorized for use toward a buyer's Nationally Determined Contribution or for other international mitigation purposes (e.g., CORSIA); but host country authorizations may place limits or conditions on such uses or specify authorized users.

Other international mitigation purposes are not defined in Article 6, but many view that these could include transfers in voluntary carbon markets. As such, Article 6 creates a path—but not an obligation— for host countries to authorize and apply corresponding adjustments for the use of carbon credits in voluntary carbon markets (See Figure 8).

The Article 6 guidance does not require carbon credits that are used for voluntary purposes by companies to be authorized by host countries. Despite this, host country governments may choose to authorize carbon credits for voluntary purposes. Having been authorized, these credits would then require corresponding adjustments to be made once transferred. At the time of writing, most countries are not ready to implement corresponding adjustments because they are still developing and refining administrative, transparency, and accounting practices.

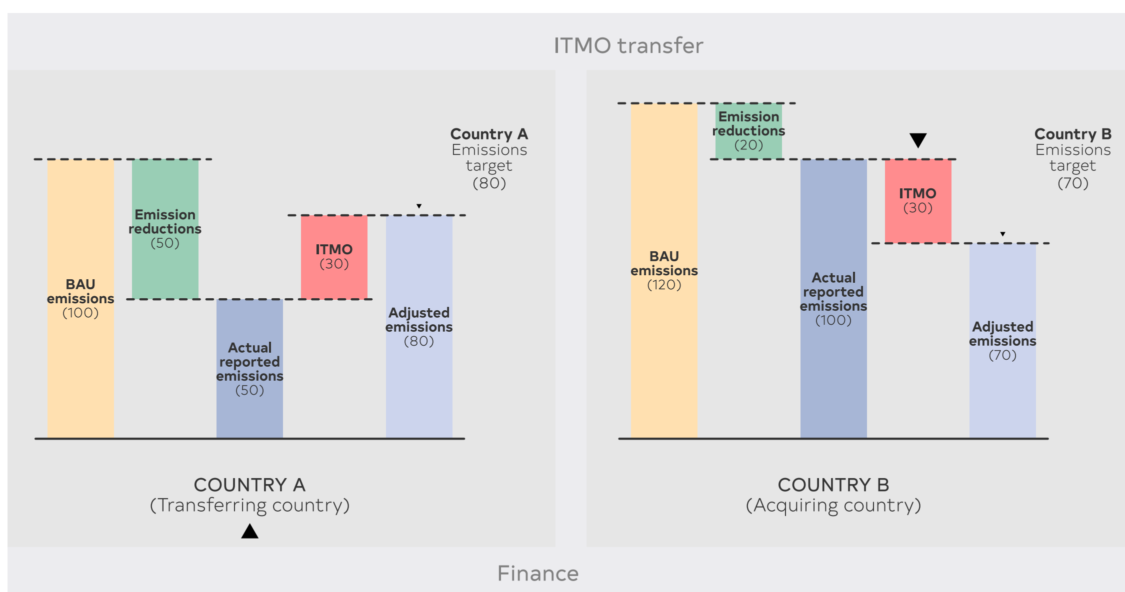

Figure 1: Under the Article 6 rules, when Internationally Transferable Mitigation Outcomes (ITMOs) are exchanged between countries, they must be backed by corresponding adjustments. The corresponding adjustment means that the emission reductions or removals represented by the ITMO are counted toward the NDC of the country that acquired the ITMO and not towards the NDC of the country that generated the ITMO.

To complement domestic policy instruments and voluntary action, governments may consider engaging in Paris Agreement Article 6.2 cooperative approaches or Article 6.4[1] activities directly to achieve NDC targets. Governments can sponsor Article 6.2 cooperative approaches, develop larger aggregated or jurisdictional programs, and prioritize VCM projects from certain sectors for Article 6.2./6.4 approvals and authorizations. If VCM projects seek corresponding adjustments, they must comply with Article 6.2 of the Paris Agreement.

GHG emission reductions and removals generated through VCM projects in a host country can be counted towards the country's NDC, unless the associated carbon credits have been authorized for corresponding adjustments. GHG emission reductions and removals generated by a VCM project or program are included in the GHG inventory of the host country. If the GHG emission reductions and removals are issued as carbon credits and transferred to another entity without corresponding adjustments, they do not show in the inventory or accounting system of the country where the issued carbon credits are used.

[1] At the time of writing Article 6.4 is not yet operable. The Article 6.4 Supervisory Body is responsible for determining outstanding key aspects of the 6.4 mechanism via UNFCCC negotiations before the first Article 6.4 carbon credits can be traded.

3.2 Consider double counting and double claiming

Avoiding "double counting" is a widely accepted integrity requirement for carbon markets. Double counting is when the same GHG emission reduction or removal is counted by more than one Party toward achieving its NDC.

A related concept often conflated with "double counting" is that of "double claiming." There are situations in which both a host country and a purchasing company use the same GHG emission reduction or removal represented by a carbon credit. Double claiming does not result in double counting of emission reductions or removals under the Paris Agreement provided only one country counts the GHG emission reductions or removals at any given time, including after any international transfer. Double claiming can occur between different accounting systems (e.g., where corporate accounting overlaps with government accounting) or within a system (e.g., different carbon projects under the same crediting program account for the same GHG emission reductions and removals more than once).

Instances of "double claiming" are common between government and corporate accounts. This occurs when a corporate actor claims the achievement of a mitigation outcome and a government counts the mitigation outcome and associated GHG emission reductions and removals in their NDC accounting.

Double claiming by a country and by a corporate is not prohibited by the Paris Agreement accounting rules. Host countries are not obliged to make corresponding adjustments for carbon credits transacted in VCMs. However, host countries may offer corresponding adjustments for certain projects, under certain conditions.

Some actors in VCMs consider corresponding adjustments necessary to mitigate the risk of double claiming GHG emission reductions and removals. Some corporate buyers seek corresponding adjustments to mitigate the market risk of double claiming. Corresponding adjustments would be necessary for a corporate buyer to use GHG emission reductions and removals that are not also used toward achievement of the host country's NDC. If corresponding adjustments are made in the context of VCMs, GHG emission reductions and removals are communicated to the UNFCCC without being accounted towards an NDC.

3.3 Develop a policy on corresponding adjustments

Host country governments should carefully consider offering corresponding adjustments. Offering corresponding adjustments could have both positive and negative impacts on the country's ability to achieve its NDC.

Positively, putting in place the institutions and regulations needed to make corresponding adjustments prepares countries for participating in Article 6 transfers, and enhances the transparency of carbon market and NDC accounting. Offering corresponding adjustments may help host countries attract additional finance and enhance their reputation. An increasing number of VCM buyers are looking for carbon credits that are backed by an authorization of the host country and the promise of future corresponding adjustments. Host countries that offer such authorizations may position themselves as an attractive place for VCM investments.

However, making a corresponding adjustment for the transfer of a carbon credit also comes with costs to the host country:

1. There are financial and other resources required to build up the institutional and technical capacities needed to make a corresponding adjustment

2. Making a corresponding adjustment means the host country cannot count the GHG emission reduction or removal toward its NDC achievement

3. A host country needs to make a corresponding adjustment for an ITMO regardless of whether the activity that generated this mitigation outcome was within or outside the NDC. The host country will need to achieve an extra GHG emission reduction or removal from the sectors and activities covered by its NDC for each corresponding adjustment made.

The choice of whether to offer corresponding adjustments for the transfer of carbon credits belongs uniquely to host countries and is not a decision made by the carbon standard or the buyer. A host country needs to carefully evaluate when and under which conditions it authorizes corresponding adjustments for carbon credits traded in VCMs. Considerations include:

1. Whether or not the underlying project or program is covered by the country's NDC

2. Whether the mitigation action could be achieved more cost-efficiently without carbon market finance

3. Whether the projects or programs come with significant sustainable development or technology transfer benefits.

In most countries, the agreement to make corresponding adjustments needs to be backed by a legal act. Offering corresponding adjustments to a VCM project results in an enhanced market value of resulting GHG emissions reductions or removals. This means that a decision on corresponding adjustments involves the granting of a valuable service that amounts to a subsidy. Consequently, governments must consider this decision in the context of local competition laws.

Considering the costs associated with corresponding adjustments, host country governments can attach a fee to the authorization to convert a GHG emissions reduction or removal into an ITMO backed by a corresponding adjustment. Such fee should reflect the costs of corresponding adjustments for host countries, which are made of:

1. Administrative costs to put in place and maintain the infrastructure to engage in Article 6, issue authorizations and approvals, meet reporting and accounting requirements, and eventually make corresponding adjustments;

2. Opportunity costs of replacing the 'exported' GHG emission reduction or removal with another domestic GHG emissions reduction or removal that can be used to achieve the host country's NDC.

The fees can be set in reference to the cost of other mitigation actions to ensure that the government has funds to generate these other GHG emission reductions or removals to replace the exported mitigation outcomes. If the host country government wishes to incentivize certain mitigation action, the country can also offer corresponding adjustments for prioritized mitigation for a reduced or waived fee.

Host countries can deploy different strategies to avoid "overselling" GHG emission reductions and removals. Overselling refers to a scenario in which a host country authorizes the transfer of GHG emission reductions and removals (including corresponding adjustments) that later makes it harder for the host country to achieve its NDC. Avoiding overselling is important to ensure that offering corresponding adjustments in VCMs does not jeopardize the host country's NDC achievement.

For example, host countries could consider offering corresponding adjustments on a specific percentage of GHG emission reductions or removals generated by a project. Offering corresponding adjustments to, for example, 10-50 percent of the generated GHG emission reductions or removals can ensure that most of the mitigation benefits can still be counted towards the host country's NDC. The exact percentage of carbon credits that a host country authorizes for corresponding adjustments may depend on how well-aligned the mitigation action is with host country priorities or on the co-benefits that the projects or programs generate.

Other strategies include pricing to fund a 'reserve' for additional mitigation, and excluding certain activities that a host country intends to use for its NDC achievement from carbon crediting mechanisms that require corresponding adjustments[2] (e.g. a negative list, such as the 'red list' described in Ghana's framework on international carbon markets and non-market approaches[3]).

[2] Carbon Limits (2020). *Practical Strategies to Avoid Overselling.* Available at: https://www.infras.ch/media/filer_public/32/71/3271ad9a-ff27-43b2-bd46-7ce719b8222f/practical-strategies-to-avoid-overselling-final-report.pdf (Accessed 4th April 2023)

[3] Ghana (2022). *Ghana's framework on international carbon markets and non-market approaches.* Available at: https://cmo.epa.gov.gh/wp-content/uploads/2022/12/Ghana-Carbon-Market-Framework-For-Public-Release_15122022.pdf (Accessed 4th April 2023)

3.4 Avoid risks related to carbon market engagement

As carbon markets develop, many governments are increasingly concerned about associated risks and liabilities. For example, governments worry that:

- Poorly implemented projects may cause harm to local communities or negatively affect biodiversity
- Projects lack proper benefit-sharing provisions
- Projects may not be aligned with host country policies and priorities
- International export of GHG emission reductions and removals may affect their ability to achieve their NDCs, and / or that corporates or third-party countries may take legal action to compel host countries to deliver corresponding adjustments, thereby creating significant NDC-compliance risks.

Host country governments may create regulations that guide how VCM project developers and investors operate in their country. For example, this can include:

- Requirements related to benefit-sharing, land concessions, and reporting to national registries
- Additional safeguards and reporting requirements that enhance the quality and transparency of local carbon markets
- Guidance and data for setting conservative reference levels and baselines, to ensure the integrity of projects and GHG emission reductions and removals generated.

The Voluntary Carbon Markets Integrity Initiative is a multistakeholder platform to drive credible, net zero-aligned participation in voluntary carbon markets.

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