

Market Mechanisms of the Paris Agreement: Getting to Consensus on Article 6

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SYNOPSIS

At the close of COP21 in Paris in December 2015, Parties adopted a set of decisions pertaining to work needed to be done to develop the Paris Agreement rulebook. However, Article 6—which covers provisions on the role of market mechanisms—remains on the climate negotiations agenda as one of the most difficult issues to get to consensus on at the end of COP24 in Katowice. This policy brief will explore the major points of contention regarding Article 6 focusing on Articles 6.2 concerning provisions on internationally transferred mitigation outcomes, and 6.4 concerning provisions on market mechanisms; by referring to the Presidency's draft text of 14 December 2018 and the 26 June 2019 draft text from the 50th meeting of the Subsidiary Body on Scientific and Technological Advice (SBSTA50). Particular focus will be accorded to the legacy Kyoto Protocol market mechanisms, as well as the upcoming market mechanisms proposed by the International Civil Aviation Organisation (ICAO) for international aviation given its relevance to Article 6.2.

KEY POINTS

- At the Katowice Climate Change Conference held from 2–14 December 2018, countries were unable to reach consensus on matters relating to Article 6 of the Paris Agreement paragraphs 36–40 of decision 1/CP.21. These include market and non-market approaches for international cooperation, which have been pushed to future sessions.
- Article 6 rules are essential in operationalising the Paris Agreement, since more than 80 countries have submitted NDCs that indicate the use of market mechanisms to complement domestic measures to curb greenhouse gas emissions.
- The language on market mechanisms in Article 6 is complex as it reflects a range of concerns and interests.
- To adopt the Article 6 package, concessions to pragmatic realities will have to be made while keeping environmental integrity and support for sustainable development intact.

INTRODUCTION

Market mechanisms are not new to the international climate change regime. The Paris Agreement's predecessor, the Kyoto Protocol, featured mechanisms to help countries with commitments meet their targets by reducing emissions or removing carbon from the atmosphere in other countries in a cost-efficient manner.

The Paris Agreement also acknowledges the role that carbon markets can play in the wider context of climate action. Carbon markets can foster greater climate ambition, and support

sustainable development in developing countries through the application of “common but differentiated responsibilities”. As Parties could not reach agreement to produce a substantive text at the end of COP24, they continued to discuss Article 6 at the recent 50th meeting of the Subsidiary Body on Scientific and Technological Advice (SBSTA50) in June 2019. However, issues previously taken off the table, such as human rights and sustainable development have been put back on, thus requiring more time for Parties to consider the Article 6 package as a whole.

This brief will refer to the Presidency's draft text of 14 December 2018 and the SBSTA50 26 June 2019 draft texts and describe the major points of contention regarding Article 6. On a related note, this brief will also look at how this affects the legacy Kyoto Protocol market mechanisms, and the upcoming market mechanisms proposed by ICAO for international aviation given its relevance to Article 6.2. With over 80 first Nationally Determined Contributions indicating the use of market mechanisms to complement their carbon mitigation measures, it is imperative to get to consensus on these rules. This brief does not intend to prejudge outcomes of Article 6 issues, since it is solely up to the UNFCCC negotiations by all Parties.

ANALYSIS

The Internationally Transferred Mitigation Outcomes (ITMO) Mechanism in Article 6.2

Article 6.2 proposes to create a new mechanism for Parties to transfer their mitigation outcomes between each other. For example, if Party A (presumably a developing country) has exceeded its mitigation pledges in its Nationally Determined Contributions (NDCs), it can “transfer” these gains to Party B (presumably a developed country), which would fall short of its NDCs without the transfer. In exchange, Party B is expected to provide material support for sustainable development in Party A. The transfer of ITMOs is envisaged largely as a bilateral process. However, there may be some role and leverage for the UNFCCC Secretariat to facilitate the transfer process, such as through registration of the ITMO, and the recording and compiling of information related to corresponding adjustments.

An issue which remains is the “value-added” elements of the ITMOs. To ensure the environmental integrity of ITMOs, the draft guidance provides that ITMOs should: (1) Be real, permanent, absolute, and verifiable; (2) have robust, transparent governance; (3) have robust accounting to ensure, inter alia, the avoidance of double counting; (4) not result in environmental harm; (5) address any risks of conflict with other environment-related aspects; (6) are consistent with sustainable development in the host Party; (7) avoid unilateral measures and discriminatory practices; (8) is consistent with the Party's

respective obligations on human rights; and (9) avoid causing negative social or economic impacts to any Party. It remains to be seen which of these will remain in the final text.

Moreover, different Parties have reported different types of NDCs. They can largely be classified into three types—absolute emission reductions with reference to a base year; emission reductions relative to “business as usual” (BAU) projected emissions; and emission intensity improvements. It is not clear how the ITMOs, which are likely to be reported as absolute emissions reductions, will translate accurately to the latter two types of NDCs, or indeed NDCs that feature alternative units of measurements to carbon dioxide equivalent (CO₂eq) such as megawatts of renewable energy capacity or gigawatt-hours of electricity saved.

Finally, Parties remain divided on whether ITMOs can be authorised for a purpose other than towards an NDC, and whether Parties can participate in Article 6.2 if they do not submit required information as part of its biennial transparency report (BTR) under the Enhanced Transparency Framework pursuant to Article 13, paragraph 7. As it stands, the ITMO mechanism simply provides a “value-added” certification process for transfers of mitigation outcomes. Even without a finalised guidance text, Parties can still undertake bilateral agreements outside the ambit of the UNFCCC, though these transfers may be looked at with circumspect during the Article 13 transparency and reporting processes.

The Market Mechanism in Article 6.4

The mechanism established by Article 6.4 is said to represent a successor to the Clean Development Mechanism (CDM), which is the market mechanism for emissions reductions in the Kyoto Protocol. The Article 6.4 mechanism has been called the “Sustainable Development Mechanism” (SDM) in some quarters, seeing as Article 6.4 itself calls for the mechanism to “contribute to the mitigation of greenhouse gas emissions and support sustainable development”. It retains elements of the CDM, including voluntary participation authorised by Parties involved; the need for real, measurable, and long-term benefits related to the mitigation of climate change; reductions in emissions that are additional to those that

would otherwise occur; the need for verification and certification of emissions reductions; supervision by a body under the authority of the Conference of Parties to the UN Framework Convention on Climate Change (COP); and for a share of the proceeds for the administrative expenses and adaptation.

As a market mechanism, some of the usual issues in setting up a market apply, and are in contention. Parties have at least reached agreement on the accounting basis of the market mechanism. An Article 6.4 emission reduction unit (A6.4ER) is measured in CO₂eq and equal to 1tCO₂eq calculated in accordance with the methodologies and common metrics assessed by the Intergovernmental Panel on Climate Change (IPCC) and adopted by the CMA and in other metrics that the CMA adopts. The main issues are whether CDM projects approved and credits issued under the aegis of the Kyoto Protocol can be carried forward into the Article 6.4 market mechanism, and under what circumstances should this be allowed. A6.4ERs do not currently have an expiry date, and Parties need to determine if they should be renewable beyond the timeframe of a given NDC. Parties are also negotiating if “compulsory cancellation” should be applied to transfers of A6.4ERs to enforce achieve overall mitigation in global emissions (OMGE). A proposal from the Alliance of Small Island States (AOSIS) suggests this should be set at 20 per cent of issued A6.4ERs at the point of issuance to guarantee OMGE.

From Clean Development Mechanism to Sustainable Development Mechanism

Parties fall into three camps on whether CDM credits and projects can be carried forward into the Article 6.4 market mechanism. On the one hand, large developing countries with significant involvement and investments in the CDM system, such as Brazil, China, and India, would like to see all CDM projects and credits being directly deemed as equivalent to their Article 6.4 counterparts. This stance is opposed by the European Union, which has raised issues as to the actual emissions reductions achieved by the CDM. A 2016 Öko Institute report produced for the European Commission estimated that only 15 per cent of all CDM credits are likely to meet the criteria of additionality, i.e. the emission reductions claimed would *not* happen without the

existence of the market. Added to this are the various claimed failure to uphold the other Sustainable Development Goals and various human rights issues. This has led the EU to demand that the CDM and its related projects should not be allowed to continue. CDM credits would thus expire when the Paris Agreement comes into legal effect in 2020. Somewhere in the middle is the Environmental Integrity Group (EIG), which is not completely opposed to CDM projects, but would require existing CDM projects to re-register under Article 6.4 if they meet the rules, modalities and procedures of the new mechanism under Article 6.4. Mali, on behalf of the African Group, said that the Article 6 mechanisms should “build on the achievements of flexible mechanisms under the Kyoto Protocol, particularly the CDM, and not lose mitigation activities on the ground and their scaling up potential due to the regime change.

On 27 June 2018, ICAO introduced its Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA) mechanism, which requires airlines to purchase carbon offsets for emissions from international flights above the sectoral average, with a gradual transition towards metrics based on individual airline’s emissions growth over time. This is based on ICAO’s commitment to pursue “carbon-neutral growth” by growing the aviation sector without increasing sectoral emissions past 2020. Where CDM is involved is that some ICAO members have broached the possibility of using CORSIA to soak up excess credits generated by CDM. Carsten Warnecke and his co-authors writing in *Nature Climate Change* journal published this February said that this is expected to absorb only 3.7 billion tCO₂e, out of the 4.6 billion tCO₂e available in the CDM. How remaining CDM liquidity is to be soaked up remains unclear.

Market Stability

On the question of when and how A6.4ERs should expire, Ethiopia, on behalf of the Least Developed Countries, proposed that the crediting period should mirror the Paris Agreement’s NDC cycles and be limited to five years with no renewal to take into account technological advances and changes in additionality. Brazil proposed that up to 2.5 per cent of Kyoto Protocol credits should be allowed to be carried forward into the Article

6.4 market mechanism. In the same vein, up to 2.5 per cent of A6.4ERs should be allowed to be carried forward from one credit period to the next. These carried-forward credits, however, would not be eligible for trading. Further questions remain as to whether there should be other measures to avoid significant fluctuations in prices, quantities, and speculative transfers of A6.4ERs through restrictions on the number of times they can be transferred, how many can be transferred, and implementation of reserve prices / A6.4ER reserves. However, these are matters which will likely be left to the Article 6.4 market mechanism supervisory body, which can make decisions on a flexible basis as and when necessary.

Share of Proceeds

The draft Katowice Text envisaged that 5 per cent of the A6.4ERs issued to projects should be withheld and transferred to the Adaptation Fund. This is to assist developing countries that are particularly vulnerable to the adverse effects of climate change to meet the costs of adaptation. While the principle of withholding credits for adaptation is not controversial – the CDM already does this—the increase from the CDM’s 2 per cent to the proposed 5 per cent may be questioned by some Parties.

Non-Market Approaches under Article 6.8

Parties recognise the importance of integrated, holistic and balanced non-market approaches to assist in the implementation of nationally determined contributions. The draft Katowice Text describes the work programme under the framework for non-market approaches under Article 6.8. This points to a focus on activities such as joint mitigation and adaptation for the integral and sustainable management of forests, social ecological resilience, avoidance of GHG emissions, ecosystem-based adaptation, integrated water management, and energy efficiency schemes. The modalities of the work programme may include workshops, regular meetings with public and private sector participants, submissions, technical papers and synthesis reports by the UNFCCC Secretariat.

CONCLUSION

Article 6 is a key tool for international cooperation under the Paris Agreement. Although Parties were not able to reach

consensus in Katowice, or Bonn, they would have been able to take stock of progress on this complex issue. The authors remain confident that the Article 6 package will eventually be delivered. It is expected that many countries, including Singapore, will not be able to achieve a Paris-compliant emissions trajectory based solely on their own efforts. The ITMO and SDM provisions will allow for Parties to support climate action in other Parties while also serving as a foundation for more climate ambition.

The completion of the Article 6 package would serve to encourage Parties to submit more ambitious NDCs at COP26 in 2020. However, expectations should be tempered at this stage. The three parts of the Article 6 package form a whole. For Parties to adopt the package, some concessions to pragmatic realities must be made in order to get the buy-in of Parties with significant investment and involvement in the Kyoto-era mechanisms. The challenge now is to do so while keeping environmental integrity and support for sustainable development intact.

WHAT TO LOOK OUT FOR

The 25th Conference of Parties (COP25) in Chile from 2–13 December 2019, where Article 6 rules are scheduled to be presented to the CMA for consideration.

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