Are countries ready for Article 6? Is Article 6 ready for the countries?

Final results of a research project against COP23 outcomes

Umwelt Bundesamt

DEHSt
Deutsche Emissionshandelsstelle

Editorial information

Publisher
German Emissions Trading Authority (DEHSt)
at the German Environment Agency
Bismarckplatz 1
D-14193 Berlin
Phone: +49 (0) 30 89 03-50 50
Fax: +49 (0) 30 89 03-50 10
emissionstrading@dehst.de
Internet: www.dehst.de/EN

Workshop minutes, 7 December 2017
BMUB, Köthener Straße 2-3, Berlin

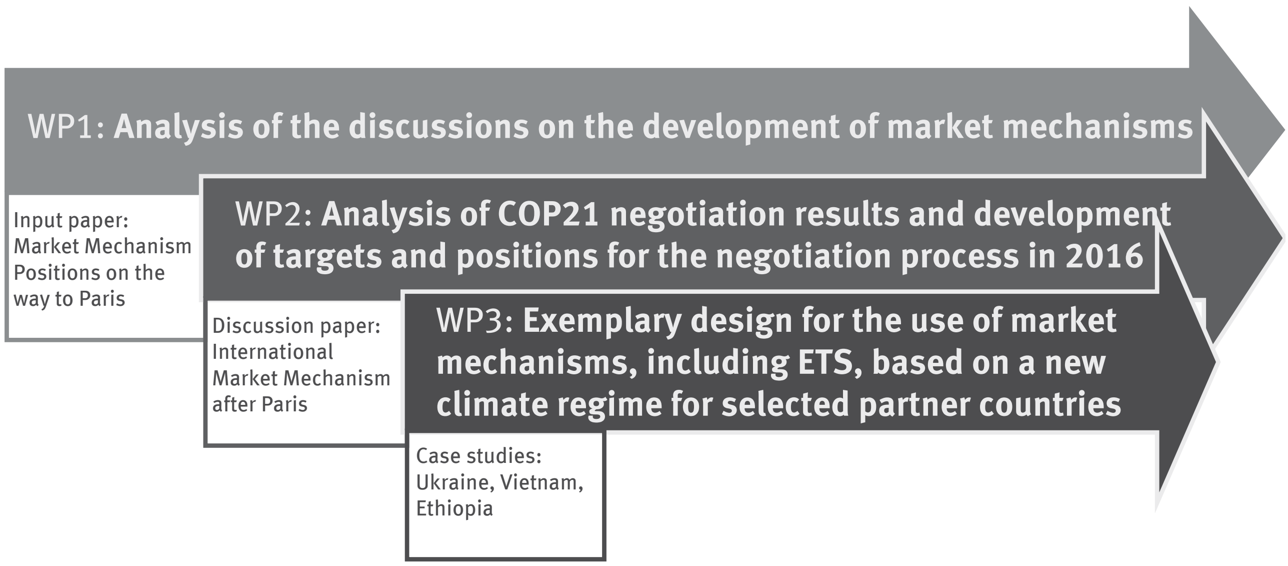
Authors
Julia Groß
Dennis Tänzler

Content

I Introduction and overview of the research project

Dr. Karsten Karschunke from the German Environment Agency (UBA) welcomed the participants and said that the workshop was a concluding part of the research project "Analysis of interactions between new market mechanisms and emissions trading systems" (FKZ: 3714 41 506 0), which was conducted by adelphi, Öko-Institut and NewClimate Institute for the German Environment Agency from 2015 to 2017, and had been following the developments around market mechanisms from before the Paris Agreement until the COP23. He noted that whereas in 2016, Article 6 negotiations made only limited progress, in 2017 discussions on the substance of future market mechanisms were held for the first time, and considerable progress had been made in the months leading to the COP23 in Bonn, with a clear mandate to finalise the rulebook for Article 6 in 2018.

Julia Groß from adelphi said that the project had not only witnessed but also reflected all major milestones in the international climate change policy in the last two years. While first focusing on country positions merging into what is now Article 6 and analysing its provisions, the project then went down from the negotiation level to the in-country level, which is less prominent in the negotiation context, and focused on domestic capacities for Article 6 and means to enhance country readiness through international support. As the Paris Agreement rulebook is not yet finalised, it would be valuable to reassess project results as soon as the rules are agreed upon.



II Are countries ready for article 6? Presentation of the final case study results

Ritika Tewari, NewClimate Institue, summarised the results of the project with regard to the capacities of countries to engage in Article 6 and potential ways to support them through enhanced international collaboration:

- How ready are countries to generate high-quality mitigation outcomes?
- Are countries ready to be able to transfer outcomes in a way to avoid double counting?

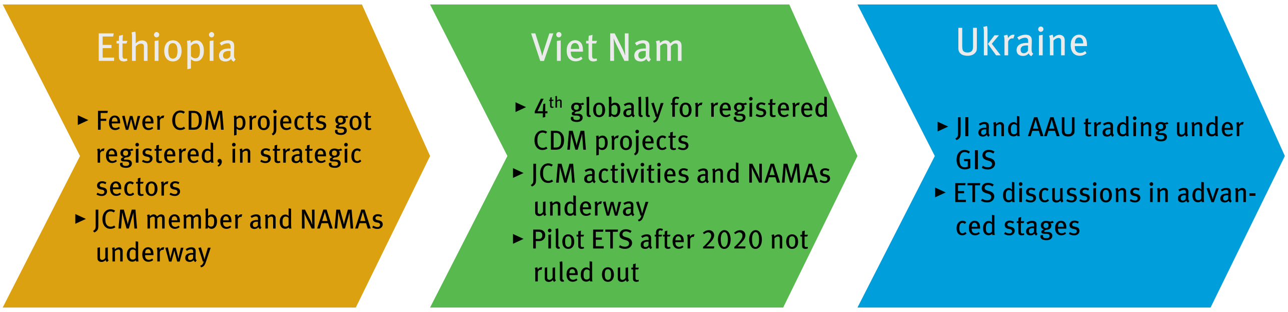
While readiness will to a large extent depend on the guidance and rules to be agreed upon multilaterally, three key elements have been identified for analysing the countries' capacity to engage with Article 6:

- **Enabling conditions:** the elements that play a facilitative role in the uptake of instruments that would generate mitigation outcomes;
- **Feasibility of maintaining robust MRV and accounting:** the strength of domestic systems to ensure the generation of high-quality ITMOs, track transfers and undertake corresponding adjustments;
- **Compatibility of NDC:** the type and content of NDC obligations, which affect the transparency of what is considered an ITMO and its quality.

The project team has conducted specific case studies, to analyse these key elements for three countries: Ukraine, Vietnam and Ethiopia.

(1) Enabling conditions

While all three countries have expressed their willingness to participate in the post-2020 markets in their NDCs, the starting points to engage in market instruments vary and motivations to participate differ substantially (see graph below).



(2) Feasibility of maintaining robust MRV and accounting

With regard to accounting, MRV systems, implementation capabilities, and registry experience, various levels of capacities have been observed:

- Ukraine is at a relatively advanced stage considering the infrastructure it has created being a Kyoto Protocol Annex B Party (with more substantive experience with MRV procedures, accounting and national registry), although implementation capacities at the installation level still need to be improved.
- Although the MRV and accounting capacities of Vietnam and Ethiopia are rather limited, they are being developed in a few priority sectors covered by the NDCs with the support from international donors. Kyoto Protocol activities and Nationally Appropriate Mitigation Actions (NAMAs) have been the major catalysers of these developments. Main barriers for these countries are the financial, technical and institutional resource constraints that limit the capacity to independently develop inventories and the full scale MRV system. There is limited discussion on how single-standing sectoral MRV structures fit in the overall policy and institutional framework required for the NDC.
- In all three countries a need for broadening and deepening institutional capacities to implement market mechanisms has been identified. Currently, they are limited to a few champions or institutional bodies, while the subnational and private sector capacities (especially for the installation-level MRV) tend to be limited.

(3) Compatibility of NDC

There are some similarities and differences in NDCs put forward by the three countries:

- All three countries have economy-wide, absolute emission reduction targets. And all have single-year targets with the target year 2030.
- Ethiopia's target is conditional; Vietnam's target includes conditional elements; and Ukraine has an unconditional target.

Last but not least, it is necessary to address the interlinkages between Article 6 and other Paris Agreement provisions:

- Article 13.7 (b): information necessary to track progress towards NDC implementation;, which would include information on ITMO transfers;
- Article 9: Distinction between support for conditional NDCs through market mechanisms and climate finance commitments under Article 9;
- Article 13.10: reporting on support needed and provided.

Key takeaways

As we will enter into an international market mechanism regime without a strict distinction between buyer and seller countries, and all Parties have to take adequate effort towards global mitigation, the approach on markets also needs to be modified:

1. Differing readiness may present countries with different entry-points for participation in Article 6 options (see Table 1 below).
2. Countries interested in Article 6 need to realise what role market mechanisms are going to play in their NDC achievement.
3. Readiness for using markets is closely linked to the readiness for implementing the NDC.
4. Unpacking NDC targets will be important to facilitate environmental integrity objectives of Article 6:
   - Single year targets increase the risk of hot air ▸ to avoid it, it is recommended to define trajectories leading to the target year.
   - Conditional NDC elements have a risk of double counting of mitigation outcomes (and support) and lowering global mitigation ambition ▸ it is important to address this issue through specific reporting and accounting requirements.
5. Operationalising environmental integrity principles under Article 6 would benefit from a discussion across agenda items [Art. 13.7(b), Art. 13.10 and Art. 9]

Role of international support in Article 6 readiness

Ritika Tewari also addressed the question of how international cooperation can support Parties in their engagement with Article 6. She said that immediate support for NDC implementation readiness would benefit respective countries' readiness for engaging in market mechanisms. Raising awareness and mobilising the engagement of the private sector and subnational actors as well as providing support for strengthening institutional capacities are of great importance. Moreover, supporting or developing platforms for learning and sharing experience, and piloting market instruments could also be beneficial. Progress can also be achieved by simply enhancing the understanding of what future markets would look like and what capacities are required to participate in them. It is necessary to distinguish between country-specific and overarching support needs.

Tabelle 1: Different entry-points for participation in Article 6 options

Options for ITMO transfers under Article 6.2 and Article 6.4	Potential engagement options for countries in different stages of readiness		
	Ukraine (Advanced)	Viet Nam (Medium)	Ethiopia (Low)
ITMO transfers between **linked Emission Trading Schemes**			
Direct transfers of ITMOs between countries			
Tranfers of ITMOs generated **from bilateral baseline and crediting instruments** (e.g. JCM)			
Transfers of ITMOs generated **from international baseline and crediting instruments**			

Article 6.2 and **Article 6.4**

Brief summary of specific outcomes from case study countries

1 Ethiopia (presented by Ritika Tewari, NewClimate Institue)

Options for use of Article 6 market mechanisms

There is better readiness for generating transfers via less complexly structured instruments in the immediate future (approaches based on baseline and crediting instruments developed at project/programmatic scales are the most immediate entry-point). It is necessary to carefully consider the role of carbon markets (and climate finance) in NDC achievement and risks of overlaps.

Entry-points for international support

- *Focussed technical support on linkages between Article 6 and NDC implementation:*
    - Developing a multi-level MRV system to administer mitigation activities at the national, sectoral and intervention levels.
- *Furthering in-country sectoral MRV capacities for market mechanisms:*
    - Supporting technical readiness of public, private and sub-national actors in key sectors;
    - Awareness raising on Article 6 developments.
- *Access to platforms for sharing experiences and lessons learnt, especially by developed countries.*

2 Vietnam (presented by Sean Healy, Öko-Institut)

Options for use of Article 6 market mechanisms

Crediting instruments seem to be the most feasible in the short term. In the longer term, the linking of the proposed small scale emissions trading systems (ETS) for the iron and steel sector may be a future option for Vietnam. Allocating more personnel resources to the development of market mechanisms could support the country's engagement with Article 6 options. Raising the level of NDC ambition is crucial to avoid the risks of potential restrictions from the use of market mechanisms (in case there are any).

Entry-points for international support

- *Furthering in-country MRV capacities for market mechanisms:*
    - International support necessary to develop tools for streamlined, common emissions reporting and training for actors reporting and administering MRV systems.
- *Technical support on linkages between Article 6 and NDC implementation:*
    - If Vietnam's current participation in the JCM is to evolve into a cooperative approach with Japan, will be necessary to agree upon how the ITMOs generated would be distributed amongst the two countries.
    - Technical support for the design of a future ETS and possible linkage with other countries.
- *Sharing experiences and learning lessons:*
    - International technical guidelines as well as case studies from developed countries on how to establish market mechanisms could be extremely helpful for Vietnam to learn from this experience.

3 Ukraine (presented by Julia Groß, adelphi)

Options for use of Article 6 market mechanisms

In the future, the whole range of preliminary options could be used. As ETS establishment and linking are time-consuming and effort-intensive processes, crediting instruments and direct transfers are more feasible in the near future.

Entry-points for international support

- *Ensuring compatibility of MRV system with Article 6 requirements as soon as they are set (effective legislation, piloting, trained operators, increased transparency, high-quality verification, additionality assessments, etc.);*
- *Raising awareness of more actors and engaging them in the dialogue on potential incentives for using Article 6 (e.g. other relevant ministries and the private sector; cooperation with Ukrainian NGOs);*
- *Providing support for the creation of a separate national authority on climate policy issues, which could bring multiple co-benefits (e.g. enhance institutional coordination);*
- *Conducting studies on the opportunities for raising NDC ambition;*
- *Organising demand-driven technical dialogues (e.g. on specific ETS design/ linking issues).*

III Q&A

The presentations were followed by a discussion of selected key themes:

Risks of regarding NDCs as "emissions budgets"/using NDCs for baseline setting

INDCs were put forward in a different context (fulfilled mainly a signal function before the Paris Agreement) and the targets as well as the conditional and unconditional shares were often not based on scientific data. For this reason, taking the NDC targets for baseline setting might be misleading. This could, however, change in the context of the future NDCs, if those are based on careful scientific assessments. Some of the current NDCs might also be too ambitious for the same reason of lacking/limited initial scientific basis. One way of dealing with the issue of hot air is supporting the development of the sound data basis the NDCs should be based on.

Integration of market mechanisms in NDC implementation and long-term climate strategies

Many developing countries still think from an offsetting perspective without taking into consideration the new context of the Paris Agreement (the value of reductions for every country). Ideally, to understand how ITMOs should be used, it is very importance to consider this question in the context of an NDC implementation strategy and in an even longer-term perspective, because every NDC should be embedded in a long-term climate strategy.

At the current stage, many developing states would welcome any kind of support to implement their NDCs. At the same time, is important to be realistic what the country can achieve with national efforts and what is really wants to achieve. International cooperation cannot support all efforts without judging about how realistic they are.

Other issues

- Developing countries face domestic pressures and need to balance support for measures against climate change against other national priorities.
- It is important to closely coordinate international donor activities (e.g. Vietnam is already working closely with the Japanese government) to avoid the duplication of effort.
- Should climate finance be considered as a means of raising NDC ambition? What is raising ambition? A unified international view on ambition raising is needed.
- The definitions of "economy-wide NDC" differ across countries (e.g. Vietnam does not include industry in its NDC but refers to it as "economy-wide"). One participant assumed that putting certain sectors outside of the NDC scope might sometimes even be a strategy to benefit from the market.
- Risks of double-counting from conditional NDCs as compared to unconditional NDCs should be further clarified.

IV Prospects for german international cooperation on carbon markets against the backdrop of COP 23 outcomes: Input statements

Ambachew Admassie (Carbon market expert and negotiator, Ethiopia)

The readiness assessment should take into consideration whether the analysed countries fall under Article 4.2 or 4.6 of the Paris Agreement (e.g. least developed countries (LDCs) and small island developing States (SIDS) "may prepare and communicate strategies, plans and actions for low greenhouse gas emissions development reflecting their special circumstances"). This distinction has an impact on double counting issues and the technical side of Article 6.

In particular, LDCs in general have very insignificant overall emissions. Most of them include high-emission sectors in their NDCs. The sectors not included in the scope of their NDCs would be too insignificant to pose a threat to environmental integrity. Ethiopia's NDC includes all IPCC sectors and all major economic sectors. The emissions from the sub sectors not included in the scope of the NDC are too insignificant compared to the total national and global emissions. Therefore, the debate on the scope of Article 6 (only the scope of NDC or also beyond the scope of NDC) is not really relevant in the LDC context.

Although Ethiopia has communicated a single year target, in reality, the target is linear from the base year to the target year. Simple mathematics can thus deliver the interpolated annual target for Ethiopia.

All LDCs, against the backdrop of their special circumstances, focus on low emission development plans through various support / financing options and combinations. For Ethiopia, it will be easier to identify specific areas for potential support for the engagement with Article 6 once the Paris rulebook is finalised. Currently, Ethiopia goes beyond its Paris Agreement commitment and undertakes unsupported mitigation action from large hydropower plants connected to the grid.

Malin Ahlberg (BMUB)

Malin Ahlberg summarised the areas, which are of special relevance for the international and German support activities related to market instruments in the near future:

(1) There are certain technical issues where support is required (MRV, avoiding double counting).

(2) Overarching issues such as NDC implementation should be supported; countries should be brought in a position to put forward clearer, more thought through NDCs in the future.

(3) Linking market instruments with long-term climate strategies:
   a. Providing support for the development of long-term low-emission development strategies;
   b. Defining the role of domestic carbon pricing instruments in the long-term perspective.

(4) Enabling countries to raise their ambition:
Although all countries have to comply with Article 6, the question remains how Art 6.1 will be interpreted and implemented. The use of cost-effective instruments per se does not automatically lead to raising ambition. Possible ways forward could be:
   a. Establishing an international dialogue and explore on the potential of market instruments to raise ambition;
   b. Reaching agreement on the rules for promoting ambition raising.

(5) Supporting countries if they want to coordinate carbon market efforts regionally:
This does not necessarily mean linking ETS. In the first place, it is good when the global carbon market gradually emerges through numerous spots worldwide. Linking carbon pricing instruments with NDC implementation is crucial.

Currently, the second phase of the Partnership for Market Readiness (PMR) is being discussed. It is supposed to be different from the first phase, which was mainly aimed at work to explore on market readiness and to pilot various carbon pricing instruments. This time, the focus should primarily be on implementation. Stronger commitment from the countries is required. The name of the initiative might need to be changed to reflect the new circumstances.

V Prospects for german international cooperation on carbon markets against the backdrop of COP 23 outcomes: Plenary discussion

During the plenary discussion, the following selected questions were discussed:

Whom to support?

While a political framework for climate action is established in some countries (like Vietnam), major gaps include private sector engagement and financial support. In the case of scarcity of financial support, how should the countries be prioritised (providing more support to major emitters or countries that are more ambitious)? On the one hand, special support needs of LDCs and SIDS have to be considered. On the other hand, middle-income countries are also short of resources to finance climate action. An ultimate goal should be to enable all countries to make a contribution to the global mitigation efforts.

How to link carbon pricing instruments and NDC implementation? How to incorporate Article 6 activities within current and future NDCs with the possibility of raising ambition?

One of the outcomes of the case studies was that all support provided for NDC implementation could indirectly also strengthen the readiness of the countries to use market mechanisms. Future support should thus focus on embedding Article 6 and domestic carbon pricing instruments in the broader context of NDC implementation. While previous support was mainly targeted at the development of domestic carbon pricing instruments, now the main area would be to help develop these instruments in the NDC context to make them contribute to NDC implementation and integrate them in the low-emission development strategies. One participant noted that a similarly broad-based approach is taken by some climate finance institutions, which support "transformational change" in the countries (building an investment framework, supporting policy reforms, developing legislation on energy efficiency and renewable energy, etc.). Putting money in policy reforms (e.g. MRV) alone does not work unless there is a clear goal and vision (e.g. ETS establishment).

To clearly understand the role of Article 6 within the long-term mitigation strategy in a country, there should be sufficient information on which parts of the NDCs can be realised through own country effort. If certain project or policy types are not possible to realise with domestic effort ("high-hanging fruit"), these need to be supported.

Currently, a certain fragmentation between the debate on Article 6 and the discussions on NDC implementation can be observed (e.g. the NDC Partnership is almost not involved in Article 6 discussions). Ideally, initiatives like the NDC Partnership should be increasingly utilised to support market mechanisms. Another participant responded that little engagement of the NDC Partnership with market mechanisms so far had to do with the absence of the rulebook for market mechanisms and the resulting lack of clarity regarding their usage to implement NDCs.

Finally, one participant wondered how market mechanisms could be integrated in a long-term climate strategy in light of the diversity of NDCs (e.g. what do intensity-based NDC targets mean for the use of market mechanisms under Article 6). Further research needs to be conducted on this issue.

Where will the demand for market mechanisms come from?

The EU will have no demand for international mitigation outcomes until 2030 and probably also beyond. There are very few countries that intend to buy mitigation outcomes according to the current (I)NDCs (Japan, New Zealand, Switzerland, and South Korea); a certain demand from CORSIA is expected. The demand thus seems to be very low, also given that some countries will be struggling to prolong the CDM. At the same time, a certain demand at a lower level (subnational or even private actors and institutions) and also regional demand hotspots (e.g. in Latin America or Asia) can be observed. Moreover, additional potential demand (though not explicitly mentioned in the NDCs) could come from the Northern countries that have climate neutrality targets (e.g. Sweden, Norway). Other neutrality targets might follow from other countries shortly. In the second round of NDCs countries should strengthen their targets, which could mean additional demand.

Why to support?

One participant wondered why Germany was putting so much effort on supporting markets. Another participant mentioned that the EU has long-term experience with emissions trading, and it is important to share the accumulated knowledge with other countries to help them avoid the same mistakes at the beginning of the ETS establishment. Moreover, while there is currently a rise of political willingness towards climate neutrality, market mechanisms could help support these efforts (e.g. through voluntary compensations).

How to effectively use support? Are there certain limits to support?

In many cases, market instruments recommended by external actors are too complicated for countries to implement and effectively manage. Careful consideration is required to decide whether market mechanisms should be substituted with alternative measures in certain countries (results-based finance; regulatory measures; promotion of energy efficiency and renewable energy). On the other hand, carbon pricing instruments are cost-effective, which makes them a needed solution. Carbon taxes are easier to implement than ETS.

One participant wondered if focusing on domestic market instruments (e.g. with PMR support) should be complemented with specific Article 6 related support. Other participants regarded this as not necessarily required.

One participant expressed an opinion that the Paris Agreement has certain limits in terms of the ability to set up rules to ensure environmental integrity (there are no visible viable solutions for single-year targets, environmental integrity of units, etc.).

VI Concluding remarks

Frank Wolke from the German Environment Agency summarised the results of the discussion. The readiness of the countries for Article 6 varies a lot because the countries have different circumstances and infrastructure. However, it is clear that many countries face a lot of challenges, which can be classified as the project team suggested (enabling factors; technical capacities e.g. MRV and accounting; compatibility of NDCs).

How can the countries be supported and how can their readiness be enhanced? First, it is necessary to reduce the uncertainty: Many countries do not have substantial understanding why Article 6 could be valuable for them. Second, technical support plays a key role. Establishing robust in-country systems based on data and scientific information that can guarantee robust accounting, and sharing technical expertise on the ground would enable the countries to use all kinds of market mechanisms in the future. Third, focusing the efforts on further developing NDCs is crucial: While they were initially developed politically and not always have a sound scientific basis, it is highly important to identify the real mitigation potential to understand how to utilise it with the help of market mechanisms or results-based finance. Market mechanisms should support the countries in activities that they are not capable of implementing on their own. It is thus key to have clarity regarding the question where exactly the mitigation potential lies.

Dr. Karsten Karschunke from the German Environment Agency and **Carsten Warnecke** from NewClimate Institute thanked the participants and formally closed the workshop.

Annex I: Agenda

Workshop Agenda

9:45-10:00	**Registration and welcome**
10:00-10:15	**Introduction and overview of the research project** Dr Karsten Karschunke, German Environment Agency (UBA/DEHSt) Ms Julia Groß, adelphi
10:15-11:30	**Are countries ready for Article 6? Presentation of the final case study results** Ms Ritika Tewari, NewClimate Institute Mr Sean Healy, Öko-Institut e.V. Ms Julia Groß, adelphi Q&A
11:30-11:45	**Coffee break**
11:45-13:00	**Prospects for German international cooperation on carbon markets against the backdrop of COP 23 outcomes: Plenary discussion** Moderated by Dr Constanze Haug, adelphi Input Statement by Mr Ambachew Fekadeneh Admassie, Ethiopia Input Statement by Ms Malin Ahlberg, BMUB ▸ How can German international cooperation support the uptake of market mechanisms under Article 6? ▸ How to ensure high quality of the future market mechanisms?
13:00-13:15	**Concluding remarks** Mr Frank Wolke, German Environment Agency (UBA/DEHSt) Dr Karsten Karschunke, German Environment Agency (UBA/DEHSt) Mr Carsten Warnecke, NewClimate Institute
13:15-14:00	**Lunch**

Annex II: List Of Participants

List of Participants

Last Name	First Name	Organisation
Admassie	Ambachew Fekadeneh	Carbon Market Negotiator for Ethiopia
Ahlberg	Malin	BMUB
de Grandpré	Juliette	WWF
Groß	Julia	adelphi
Haug	Constanze	adelphi
Healy	Sean	Öko-Institut e.V.
Karschunke	Karsten	German Environment Agency (UBA/DEHSt)
Kollmuss	Anja	SEI Associate
Tewari	Ritika	NewClimate Institute
van de Ven	Jan-Willem	EBRD
Warnecke	Carsten	NewClimate Institute
Wolke	Frank	German Environment Agency (UBA/DEHSt)

German Emissions Trading Authority (DEHSt) at the German Environment Agency
Bismarckplatz 1
D-14193 Berlin

www.dehst.de/EN | emissionstrading@dehst.de