

Submission to SBSTA on Article 6 (2,4, and 8) of the Paris Agreement

September 2016

Executive Summary

- Article 6 of the Paris Agreement offers the opportunity to build a global carbon market to assist in accelerating the energy transition and in delivering a net zero emissions outcome at lowest cost to society. Early analysis by the World Bank Group shows that financial savings by countries working collectively through Article 6 can be 30% lower than countries working on their own to meet their respective mitigation targets. This is consistent with prior economic studies, all of which suggest that market cooperation can deliver a significant savings.
- The use of the internationally transferred mitigation outcomes (ITMO, Article 6.2) in conjunction with an emissions mitigation mechanism (EMM, Article 6.4) can embed carbon pricing rapidly and effectively into the global economy. Scenario analysis (Shell: [Pathways to Net Zero Emissions](#)) indicates that carbon pricing must start soon and become widespread and meaningful by the 2030s to deliver the goals of the Paris Agreement.
- Article 6 provides the opportunity to expand the reach of carbon pricing to enable full implementation of Nationally Determined Contributions (NDCs) and possibly to help raise ambition amongst NDCs in order to deliver on the overall goal of the Paris Agreement.
- Accounting for transfer of mitigation outcomes and the use of the EMM will build on the experiences of the CDM of the Kyoto Protocol, but must apply in a new context where every country is implementing its own NDC. That is why it will be a departure from the scope of the CDM, and why it could support even greater mitigation outcomes. The Article 6 guidelines should provide robust accounting of transfers to provide greater confidence, scalability and reliance on the international carbon market.
- Articles 6.8-6.9 can usefully support the development of approaches to manage the broad range of non-CO₂ greenhouse gases, with a view to mitigation, sustainable development and the important co-benefit of supporting more robust development of CO₂-based market mechanisms.

Section I: Thinking Big on Article 6

Getting to the scale we need to meet the goals of the Paris Agreement

IETA set out its vision for Article 6 ahead of the Bonn UNFCCC climate negotiations earlier this year. In [A Vision for the Market Provisions of the Paris Agreement](#), IETA notes the long-term durability of the Paris Agreement, making it especially crucial that its implementation incentivises the maximum level of emissions reductions – including via harmonised carbon pricing systems. This can be achieved through cooperative action, which in turn enables the transfer of emissions units between various national carbon pricing systems. Such transfers are described in Article 6 of the Paris Agreement, with paragraph

2 establishing internationally transferable mitigation outcomes (ITMOs) as means of accounting for such linkages.

The system of transfers must be sufficiently robust to support large-scale mitigation investments in a wide range of jurisdictions. The system must promote confidence not only for the Parties involved and their constituents, but also for the international community. To deliver that confidence, the Article 6 accounting guidelines should focus on solid fundamentals of clarity, consistency and accuracy. These fundamentals are described more fully below.

Linking carbon pricing systems can help drive costs down and create the economic conditions for greater emissions cuts in the future. If national systems operate in isolation, they can end up costing more – which can discourage ambition. Linkages allow governments to go beyond the minimums proposed in their INDCs in the months leading up to COP 21 in Paris. Taking steps to forge these connections now can provide a boost to the formation of rules guiding ITMO exchanges, including on accounting and transparency.

Ninety governments state in their INDCs that access to markets is essential to fulfil their plan, if not to go further, according to our recent [analysis](#)¹ with the Environmental Defense Fund. The ITMO provision in the agreement could see carbon market coalitions or clubs form, as governments seek to raise their ambitions.

Our Vision for Article 6 also highlights the role of the Emissions Mitigation Mechanism (EMM), as established by paragraph 4 of article 6. This mechanism can cut emissions in countries which are currently not in a position to establish a carbon pricing system, yet which need the climate finance that the EMM can bring. Robust accounting and governance provisions are again crucial to ensuring the environmental integrity of any resulting reductions that are counted towards a country's Paris Agreement goal.

The EMM and the ITMO process have great potential to involve all countries and to target whole sectors, rather than the project-by-project approach with the CDM and JI under the Kyoto Protocol. This can help governments meet the ultimate objective of the Paris Agreement of limiting the temperature increase to well below 2 degrees. The EMM can also be a catalyst for more carbon pricing systems and build upon the experiences of the CDM, if flexibility remains at its core and it allows for private sector participation.

In [A Vision for the Market Provisions of the Paris Agreement](#), IETA offered a 'straw man' proposal that shows a potential implementation of cooperative approaches, using Article 6 and the NDC structure of the Paris Agreement to insert carbon pricing into national economies. We hope that policymakers will refer back to that 'straw man' as they embark on negotiations over accounting under Article 6 of the Paris Agreement at COP 22 in Marrakech.

Section II: Accounting in the Paris Agreement

Toward principles to guide market development

Introduction

The design of the Kyoto Protocol resulted in a particular emissions accounting architecture that has seen widespread adoption, even within jurisdictions not covered by the Protocol itself. That architecture is a mixture of allowance allocation appearing in cap-and-trade systems, combined with a provision for project-based credits originating outside these caps. Project-based credits effectively raise the amount of supply in the market when they are imported into the covered system. Under the Kyoto Protocol, allowance allocation is handled through the issuance of Assigned Amount Units to Annex 1 Parties. The project based systems, known as the Clean Development Mechanism (CDM) and the Joint Implementation (JI) program, produce the credit supplies from developing countries and economies in transition.

Similarly in California and Quebec, which are not covered by the Kyoto Protocol, allocation is handled through the distribution or sale of allowances, and external projects produce credits through the state's/province's compliance offset protocol and issuance system. The Regional Greenhouse Gas Initiative in the United States, which is primarily an allowance trading model, uses a similar system.

A feature of these systems is that the accounting normally focuses first on the allowance allocations to entities within the cap, and second to the projects that are awarded credits for reductions achieved outside the cap.

Since none of these systems cover the entirety of global emissions, they alone cannot account for the total greenhouse gas impacts on the atmosphere. There is an implicit assumption that the sum of the various parts adds up, such that the overall outcome is better than not having conducted the exercise at all. This happens because only a small percentage of the global economy sits under a cap, so there is no accounting mechanism available to account for the total global impact.

A further issue related to the current structure is the macro accounting of the external credit. Projects vary in type, ranging from clearly measurable emission reductions (e.g. capturing landfill methane) to notional reductions (e.g. a wind turbine is built, but the alternative might have been more coal use). Particularly in the case of the latter example which is an energy mix question, in some countries there may not be a resolution between the local project and the overall carbon emissions of the host country: the project may reduce emissions, but new fossil generation could still increase the overall emissions of the country.

Accounting Provisions in the Paris Agreement

The Agreement is built on the concept of Nationally Determined Contributions (NDCs) and includes several explicit references to reporting of obligations, emissions reductions, and emissions transfers. These are summarised below:

1. Article 13 of the Paris Agreement includes a transparency framework which describes **reporting obligations** of Parties and includes national reports and emissions inventories. Different reporting obligations depend on different capabilities: large, industrialised Parties currently have higher reporting obligations than smaller, less industrialised Parties.
2. Article 6 of the Paris Agreement provides the **guidelines on reporting of international transfers of mitigation outcomes** will be agreed at the first meeting of its COP/MOP – but each Party will decide how it comports with the guidelines. A new mitigation **mechanism**, to which all Parties have access, is also bolstered with a **strong provision against double counting**.

3. A strong theme of **environmental integrity** appears throughout, with numerous references to “no double counting” (Articles 4 and 6). But the Agreement sets no firm consequence of poor accounting, though Parties have made clear that it could result in lack of market access. Similarly, most results-based finance initiatives in the field of climate finance also require accounting of emissions reductions.

IETA believes that particular **goals for accounting guidance** should be set for Parties as they implement their NDCs and they prepare for COP decisions on guidance for both the transparency framework under Article 13 and accounting under Article 6.

The goals of the accounting guidance are to:

1. Promote public confidence in the environmental results achieved in NDCs, including:
 - Confidence amongst trading partners that transfers are of high integrity;
 - Confidence in comparable treatment amongst peers; and
 - Ease of understanding by the general public and the private sector.
2. Promote integrity in tracking actions or investments to reduce emissions;
3. Inspire Parties to do more through international partnerships rather than “going it alone” from a government-to-government perspective, as well as by enabling private sector participation. This will allow for NDCs to be met at lower cost, and in turn, promote conditions for raising ambition. A recent paper published by IETA and the Environmental Defense Fund, [Doubling Down on Carbon Pricing](#), shows that countries can raise ambition by connecting national carbon pricing systems, such as by linking carbon markets.

Basic principles drawn from financial accounting

Commercial participants **rely on strong accounting principles** for making any major investment or market transactions in the climate change arena, just as in other areas of commerce. The public accounting profession also can offer **insights from experience** in other areas of governance and commerce.

IETA encourages policymakers to incorporate **best practice accounting concepts** which are outlined below with both transactional and governance elements. These will boost public confidence and prompt greater investment in climate mitigation by both public and private actors. The first group of principles involve four core **transactional** elements:

1. **The Principle of Completeness:** All assets, liabilities, and equity interest that should have been recorded, have been recorded. In a carbon market context this means debits and credits should match for all transfers recorded for a specified accounting period; clear reports of assets and liabilities by accounting period (e.g. banking or borrowing of units);
2. **The Principle of Existence:** All assets, liabilities and equity interests exist. In a carbon market context this means replicability with an independent professional that can verify results (similar to the KP mechanisms);

3. **The Principle of Valuation:** All assets, liabilities and equity interests are included at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded. In a carbon market context this means there should be accuracy with clear use of defined units of measure, reporting periods, relation to INDC, etc. Units cannot be created from nothing or from a counterfactual baseline and the use of standard factors should be applied where precision is of little value. It also means materiality, by focusing on major factors rather than the small, inconsequential elements that may cost more to measure and report than they are worth (esp. where conservative factors can provide adequate comfort – or where error bands may provide a simple measure of confidence). Finally the valuation principle implies comparability in that a Party or stakeholder can easily compare with results from prior reports - and with those of peers;
4. **The Principle of Rights and Obligations:** The entity holds or controls rights to assets, and liabilities are the obligations of the entity. In a carbon market context this refers to what exact entity holds rights or control to assets and liabilities with emissions transfers.

The second group of principles involve **governance**:

1. **Presentation and Disclosure:** All disclosures are included and have occurred;
2. **Transparency:** There is a public release of emissions transfers in a standard format;
3. **Reliance:** All results are trustworthy and can be relied upon when making decisions;
4. **Assurance:** A high assurance is required in areas of high consequence; and there are lower levels for areas that are inconsequential.

In Article 6 accounting for emissions reduction transfers, IETA encourages policymakers to use existing market infrastructure from the Kyoto Mechanisms or the voluntary market (e.g. VCS) as these are likely to be more rigorous at the moment in terms of accounting for transfers even rather than accounting for NDCs at the national level. Currently a number of government-led groups (the Green Climate Fund, Forest Carbon Partnership Facility and the World Bank) are working to establish results-based payment frameworks. These approaches must be monitored to ensure that their final design outcome facilitates private sector trading. We also strongly endorse **double entry bookkeeping** by debiting from one Party's inventory and crediting to another Party's inventory at same time. This will help ensure accuracy and confidence in the future international carbon market.

Section III: Accounting in Article 6

Revisiting Global Emissions Accounting

Although nationally determined and always voluntary, the Agreement effectively establishes a cap, albeit notional in many cases, on national emissions in every country. The caps are also effectively declining over time, even for countries with emissions still rising as development drives industrialization.

The foundation for transparency is measurement and reporting, which further implies that emissions quantification is a foundation element of the Paris Agreement. Article 6 introduces the prospect of carbon unit trading through its internationally transferred mitigation outcome (ITMO) and emissions mitigation mechanism (EMM). Text in paragraphs 6.2 and 6.5 is included to avoid any possibility of double counting;

. . . Internationally transferred mitigation outcomes towards nationally determined contributions. . . . shall apply robust accounting to ensure, inter alia, the avoidance of double counting, Emission reductions resulting from the mechanism referred to in paragraph 4 of this Article shall not be used to demonstrate achievement of the host Party's nationally determined contribution if used by another Party to demonstrate achievement of its nationally determined contribution.

These provisions, in combination with the progressive shift towards quantification of all emission sinks and sources, means that full national accounting for offset crediting must take place for both the recipient and the source of the units. For the recipient, there will be no change in that the introduction of units will raise the effective national cap on emissions. But the source country will be required to make an equivalent reduction (or “corresponding adjustment”) from their stated NDC, therefore tightening their contribution. This was a feature of the Joint Implementation (JI) mechanism under the Kyoto Protocol, but was not the required practice in the CDM.

The example shown in the adjacent box illustrates this through a hypothetical case for a nature-based transfer (NBT) from Kenya to Canada, utilising the EMM as a means to acquire the necessary funding. The impact on the Kenya NDC implies a shift from a stated reduction of 30% from Business as Usual (BAU) in 2030, to some 37% below BAU. This ensures there is no double counting of the transferred amount and maintains the full integrity of the overall NDC approach such that the implied global cumulative emissions goal of the NDCs is maintained. However, Kenya will need to find further reductions in its economy as a result. One implication of this is that the price of carbon units will rise due to the additional demand that an overall emissions cap, even a notional one, places on the global economy.

Article 6 of the Paris Agreement offers great potential for carbon market development and emissions trading, therefore driving a lowest cost mitigation outcome and directing funding and financing to low emission technologies. But over time, it will also introduce an accounting rigour that has only featured in some quarters to date. This will likely change the supply demand balance, leading to a more robust and enduring carbon market.

In summary, we believe that ITMOs should be expressed in clear units of measure using defined standards. Transferred units should be verifiable, ideally with verification carried out by independent experts. Finally, transfers between Parties should be reported by sender and receiver in a clear manner so that independent reviewers can be assured that the accounts match, with no double-claims for use.

Section IV: Non-Markets in Article 6.8

How to yield emissions reductions and avoid the overlapping policy conundrum

IETA strongly believes that a market-based approach is the most efficient system for CO₂ regulation and reduction as well as for innovation in the energy system and overall energy mix. But we understand that there are important alternative approaches to address other greenhouse gas reduction opportunities such as technology transfer and capacity building. IETA recognizes that policymakers will want to regulate some emissions through direct regulation, rather than include them in a GHG market. Examples include appliance efficiency standards, fuel economy standards and lighting mandates. Others appear in the Climate and Clean Air Coalition, which is leading the way on non-market-based approaches to methane reductions through best practice, standards and voluntary measures.

We believe that as policymakers implement their NDCs, the goal should be a coherent policy framework whereby access to a national, regional, or international carbon market is the driving instrument for reducing emissions in a harmonized and cost-effective manner. Other segments of a country's greenhouse gas emissions inventory can be addressed in with non-market measures.

Non-market based approaches that fall under the scope of a Party's NDC should meet the same Article 6 standards for emissions reduction accounting and tracking as market-based approaches put forward by. Non-market based approaches should also meet the same standards for environmental integrity as those of market-based approaches put forward under a Party's NDC. As such market-based approaches should make use of mitigation infrastructure provided by the UNFCCC or other intergovernmental organisations including:

- a. Monitoring and verification protocols for key sectors;
- b. Standardized emission performance benchmarks for key sectors;
- c. A registry and issuance system to establish ownership of emission reduction units;
- d. A standardized reporting template;
- e. An accreditation system for independent verifiers; and
- f. A co-benefits 'checklist' to ensure approaches address sustainable development, etc.

Any non-market based approach that delivers emission reductions will need to be reported and tracked under the same standard as those of market-based approaches under Article 6. As such, non-market based approaches will need to be designed in conjunction and cooperate with Article 6 standards for reporting, tracking, and certification of emission reductions.

Next Steps

IETA offers these views on Article 6 and its potential accounting guidance as a basis for dialogue and discussion over the coming months with a view to beginning the design of the concepts laid down in Article 6 of the Paris Agreement at COP 22 in Marrakech. Should you have any follow up questions on this paper, please contact Jeff Swartz, IETA: swartz@ieta.org

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