Article 6: Panacea or Placebo?

The carbon credit space remains opaque and complex, even amongst practitioners within the ESG community.

Article 6 of The Paris Agreement was one of the key outcomes of COP26 and will form the cornerstone for market-based mechanisms towards climate and sustainable development goals. What remains to be seen is whether it will simplify or further complicate carbon markets?

As noted in a previous article, carbon markets are meant to incentivize positive climate action, while the additionality requirement is meant to pull the industries into more sustainable practices towards the carbon transition. However, in the long term these markets should theoretically become redundant as every nation moves towards carbon neutrality.

The Clean Development Mechanism (CDM)

These were some of the aims of the Clean Development Mechanism (CDM) when they were agreed as part of the Kyoto Protocol in 1987. The CDM can be classified as a mixed success, on the one hand it has generated 7 845 projects and produced CERs amounting to more than 2.2 billion tonnes of CO2 equivalent. However, on the other hand it is criticised on many fronts due to its; inherent lack of adequate incentives, disproportional focus on emissions reductions, questionable environmental integrity, reliance on counterfactual baselines, inaccessible information, poor capacity building, unbalanced distribution of benefits and prohibitive transactional costs. Furthermore, although a lot of theory supports good future demand for carbon credits the global carbon markets have been perpetually oversupplied, this is due to the general uncertainty on the framework around credits which is exacerbated by weak or non-existent carbon tax and compliance measures implemented by governments.

Despite the above, the CDM was able to achieve much due to its ability to reform itself and remain relevant within a changing landscape. The CDM remains in limbo until the supervisory body of the new article 6.4 mechanisms develop recommendations, which will essentially be an extension of the CDM's flexibility.

The Spirit of the Laws

The Paris Agreement is a legally binding international treaty established as a global response to the threat of climate change. In this dynamic and ever-changing landscape, I find it more beneficial to focus on the "spirit of the law" as opposed to the "letter of the law" as laid out in the agreement.

The Paris Agreement is essentially built around the principles of conservation and enhancement, whilst recognizing differentiated responsibilities and the respective capabilities under differing country circumstances and needs.

It acknowledges that mitigationary actions carry corresponding reactions that affect stakeholders, who in turn are exposed to varying levels of vulnerability. It emphasises the intrinsic link between poverty eradication, food security, employee relations, education and climate change mitigation under the sustainable development umbrella. Furthermore, this Agreement was based on the understanding that developing countries require support, whilst developed countries could contribute by transitioning to more sustainable patterns of consumption in a mutually beneficial partnership supported by finance flow, science and technology towards remaining within a 2°C increase on pre-industrial levels.

Article 6 of the Paris Agreement in particular outlines how reductions can be traded between countries under new mechanisms that better control additionality and double counting while also allowing for non-market alternatives.

Regulatory vs Voluntary Markets

Outside of international negotiations around credits created through a regulatory framework, there is plenty of scope on a corporate level to contribute to emission reduction with businesses offsetting towards their own internal and pledged goals. Such markets traditionally function outside of compliance markets with credits traded on a voluntary basis with no intended use for compliance purposes. It is generally accepted that such markets allow for higher ambition and a more aggressive exploitation of science and technology towards innovative business opportunities.

What Does Article 6 Mean for Privately Funded Carbon Reduction Projects?

Although the Paris Agreement is primarily an international treaty, Article 6 does extend beyond compliance markets into voluntary markets by providing flexibility for host countries to make adjustments for private emission reductions allowing voluntary credits to be compatible to the country's Nationally Determined Contributions (NDC). It is hoped that this element of the Paris Agreement will lead to a better alignment between voluntary and compliance markets increasing the credibility, viability and the potential for scaling the voluntary carbon markets.

Panacea or Placebo?

The improved control promised by Article 6 to ensure additionality and avoid double counting should have a knock-on effect of alleviating the oversupply issue. Furthermore, the potential that Article 6 might be a catalyst for greater government and corporate partnership holds much promise.

However, the effectiveness of Article 6 cannot be fully assessed because real issues around new mechanisms typically only emerge after implementation, and political sciences teach us that even well intended policies may have negative effects in the long run.

One thing that is for certain is that the potential integration of voluntary and regulatory markets, no matter how superficial, will undoubtedly increase the complexity of an already complex ecosystem. Now, more than ever, practical experience is required for generating credits from projects and selling them in the voluntary markets, taking advantage of the opportunities presented by the ever-changing landscape.

XMS has its finger on the pulse of current developments, with unrivalled expertise to guide mining companies from being carbon powered to being empowered through carbon.

WRITTEN BY: Joshua Kilani, Managing Director - Xpotential Mining Services (XMS)

SOURCES:
CDM Criticisms: Don't Throw the Baby out with the Bathwater, Jørund Buen
https://www.oxfordenergy.org/publications/article-6-and-voluntary-carbon-markets/
https://www.greenbiz.com/article/article-6-creates-two-kinds-carbon-credits-what-means-business

INSIDE STORY:
Harnessing market mechanisms to promote sustainable development - Lessons from China, CDKN

Strengths and weaknesses of the CDM in comparison with new and emerging market mechanisms Axel Michaelowa

The Paris Agreement United Nations Framework Convention on Climate Change (UNFCCC)