Supporting adaptation through Article 6 of the Paris Agreement

Innovative funding through non-market cooperation and shares of proceeds

An ecbi-Perspectives Climate Research Workshop

21 October 2021

On 21 October 2021, leading Article 6 negotiators and experts came together in the run-up to COP26 to discuss generating innovative finance for adaptation through shares of proceeds (SoP) and in Article 6 work programme at the workshop **Supporting adaptation through Article 6 of the Paris Agreement: Innovative funding through non-market cooperation and shares of proceeds**. The workshop was co-organised by ecbi and Perspectives Climate Research and was attended by 30 participants, including representatives from Non-Governmental Organisations (NGOs), academia and key Article 6 negotiators from developing and developed countries.

Kishan Kumarsingh, Co-Chair of the ecbi Advisory Committee and longstanding negotiator for the Alliance of Small Island States, moderated the workshop.

Finance for adaptation through different types of market-based cooperation at different levels

Aglaja Espelage, Researcher at Perspectives Climate Research (PCR), presented the key messages from the ecbi-PCR policy brief, "**Share of Proceeds: An innovative Source of Multilateral Climate Finance**". Under the Kyoto Protocol (KP), SoPs were created as an alternative to an international tax on transfer of mitigation outcomes. Initially, the SoP was levied only on the CDM. Its scope was later expanded to cover all KP mechanisms such as the Joint Implementation (JI) and International Emissions Trading (IET), with the goal to cover the administrative costs of international oversight and to raise funds for adaptation to assist vulnerable countries. Administrative SoP under the Clean Development Mechanism (CDM) was a monetary charge which was directed towards administrative expenses of the UNFCCC secretariat. It was levied ex ante and at credit issuance and generated USD 356 million in revenues. Adaptation SoP was an in-kind charge of 2% of issued CERs, that was directed towards the Adaptation Fund (AF) and generated USD 200 million in revenues.

As can be observed, balance of contributions towards the two purposes was rather unexpected in the context of the CDM. Administrative SoP generated more revenues than the Adaptation SoP, even though the administrative costs were not as high, leading to an accumulation of a surplus. The funding for adaptation was much below expectations. The reason for such a phenomenon was the lack of regular assessment of administrative SoP to react to market fluctuations. Furthermore, sales revenues of Certified Emission Reductions (CERs) collected under in-kind SoP are highly dependent on market price. Consequently, it is risky to accumulate CER reserves. Another issue that contributed to the failure of SoP under the CDM was the lack of flexibility of the monetisation guidelines for sale of CERs by the World Bank (WB) to prevent losses.

With the Doha Amendment, SoP was extended to JI and IET in the second commitment period of the KP, a move pushed for by the developing countries to bolster adaptation support. Under this expansion, a further 2% of the SoP would be levied on the first international transfers of the Assigned Amount Units (AAUs) and issuance of Emission Reduction Units (ERUs). Since the Doha Amendment came into force in late 2020, the impact of extending SoP to other KP mechanisms was minimal since JI and IET did not play a role in the second commitment period.

Under Article 6 of the Paris Agreement (PA), the Article 6.4 mechanism clearly foresees the levy of SoP. However, it is still under contention whether and how SoP or any other modality to generate adaptation finance should be implemented under Article 6.2. Many developing countries are for this solution because it creates a balance between various mechanisms and avoids perverse incentives to prioritise one mechanism over the other. Industrial countries, however, oppose this by arguing that the bottom-up nature of the Article 6.2 and the diverse approaches therein make the collection of SoP difficult. At COP25, the presidency put forth the option to have a voluntary “commitment to contribute” to adaptation finance but this was not met with agreement. There are many open questions and issues that require close considerations. One key consideration is if the SoP were a monetary contribution with flexibility on how it is levied, then the question is on how it should be levied.

Looking at Article 6.4, Ms Aglaja explained that Parties have agreed on the main lesson learnt from the KP era and are thinking about how to design a better SoP system going forward. To strike a balance between stable income and opportunity to benefit from high credit prices, there is a push to have a combination of monetary and in-kind SoP. Such a combination limits the burden on project developers and reduces transaction costs. Learning from the experiences from the KP era, there is a call to reassess administrative expenses on a regular basis. A key question that requires further discussion is how the levying of SoP links to the accounting requirements. Any in-kind levy of Article 6.4 credits for sale by the WB for the AF should ensure that the credits have a corresponding adjustment, to facilitate monetisation.

Professor Benito Müller, Director of ecbi, took the floor to open the discussion on SoP beyond CDM and Article 6. Before the PA, there was dissatisfaction with the amount of money that flowed into the mechanism and with the unpredictability of these flows. There is a clear need to extend the contributors’ basket. Currently, only national governments contribute to funding to other national governments.

Before Paris, Prof Müller lobbied the provincial government of Quebec, who agreed to contribute a certain proportion (CAD 6 million) of their emission trading revenues to the Least Developed Countries Fund (LDCF). This was a first step causing a shift in the paradigm of what multilateral finance is like.

As highlighted before, one of the problems with voluntary contributions is the lack of predictability of financial flows. Furthermore, governments are subject to the tedious appropriations procedure. Therefore, it is necessary to have a flow of finances that is independent of political interference. One such way to do so is to earmark a share of revenues from the sub-national or national trading schemes for SoP. Considerable potential was identified in three countries in

Europe, namely Portugal, France and Germany. These countries have contributed a share of emission trading revenues to help developing countries. 14.3% (EUR 240.7 million) of the revenues were earmarked by these countries for international climate and energy purposes. Therefore, expanding the donor base and making the funding more predictable through earmarking a share of revenues beyond and outside of Article 6 should be considered.

Feedback and Discussion

El Hadji Mbaye Diagne, lead negotiator for the African Group (AGN) on Article 6, was invited as the first panellist of the first session of the workshop to reflect on the arguments presented for adaptation finance through Article 6.2 and Article 6.4. As a representative of the AGN, he stated that the AGN is pushing to having SoP in both Article 6.2 and Article 6.4. He recognised that there is a general agreement that SoP must be levied under A6.4 and lessons learnt from the KP era can be adopted to improve revenues for the Adaptation Fund (AF).

As far as Article 6.4 is concerned, Mr Diagne indicated that in-kind contributions for the AF and monetary contributions for administrative costs is the way forward. Biannual assessment of the administrative costs is required, and any excess funds must be directed to the AF. He recommended that such a mechanism can be set up after the approval of the management plans and the needs of the SB. He called for clarity on SoP being levied under Article 6.2 and said that while there is no mention of SoP in Article 6.2 in the draft texts, it does not necessarily mean that levying SoP is prohibited. As under KP, the scope of levying SoP expended from CDM to all KP mechanisms, similarly, we should be able to expand the current SoP scope from Article 6.4 to include Article 6.2 activities as well. In his opinion, such a decision can be made at COP26 in Glasgow. His argument is that if similar crediting activities can be conducted under Article 6.4 as well as under Article 6.2, then SoP can also be levied under both mechanisms.

MJ Mace, representative of AOSIS and the second panellist for the first session of the workshop, agreed with some of the statements made by Mr Diagne. She also stressed the need to have a mechanism in place to ensure that money does not stockpile for administrative costs as under the CDM, and that excess funds or a percentage of the funds be shifted to the AF. Like Mr Diagne, Ms Mace pointed out that there is no real rationale for treating project-based activities differently under Article 6.2 from Article 6.4 when talking about levying SoP. Not keeping the same SoP requirements would rather lead to creation of disincentives for Parties from registering under Article 6.4. Talking about achieving an overall mitigation in global emissions (OMGE), Ms Mace quoted a study submitted by the least developed countries (LDCs) that found that even with the application of a simple OMGE, project developers would still be profitable. Her argument was that Parties engage in bilateral cooperation as there are cost savings involved when generating units to meet their NDCs, and a proportion of these cost savings can be recycled back to SoP and overall mitigation of global emissions (OMGE) without largely affecting cost savings.

Addressing the presentation made by Prof. Müller, Ms Mace noted the main takeaway being the earmarking of auction revenues from emission trading schemes (ETS) for raising substantial funds, quoting the example of the IKI initiative in Germany. However, she cautioned that domestic politics can still undercut the efforts to direct funds towards vulnerable countries even with the presence of such earmarking. There is a need for an international level encouragement and Article 6.2 is a channel through which this can be achieved. An expectation, set at international level, that programmes that aim to generate units that qualify for Article 6.2 will have to embed a percentage for SoP and OMGE will be helpful. Addressing Ms Mace's concerns, Prof Müller clarified that the successful IKI initiative by Germany took place without any international connection. While this does not mean that domestic or sub-national funding entirely supplants international support, it would be a missed opportunity if this domestic potential is not fully harnessed.

Following the reactions of the panellists to the presentation in Session 1 of the workshop, the floor was open for negotiators and other key observers for discussion.

To better understand the characteristics of the AF, a workshop participant asked for clarification on the stock of units within the AF, appreciating that not all units were monetised by the WB. The participant noted that such a clarification would allow for better evaluation of the potential that flows into the AF. Ms Espelage shed some light on the WB data source on revenues generated and indicated that the ecbi-PCR policy brief on SoP will incorporate information on the remaining stock of AF. She also brought to attention that while the WB continued to monetise CERs, there are still some stranded assets that do not have any value in the markets, and it has proven difficult to monetise such units. Dr Axel Michaelowa, Research Director at PCR, further clarified that it is important to understand the characteristics of these units. A large share of the issued CERs is from industrial gas projects and such CERs are not popular amongst buyers. Therefore, while there are still a few million CERs in the WB coffers, the implicit value of these CERs is quite low.

A question put forward by another key observer was whether Article 2.1c can play a role in providing a framing for the extension of SoP to Article 6.2. Ms Espelage concurred and said that the discussion on better operationalising and understanding Article 2.1c, i.e., the goal of aligning finance flows with low carbon and resilient development, is a good framing for the discussion on how to mobilise adaptation finance and the context of market instruments for mitigation.

Some participants held different views regarding earmarking a share of ETS revenues for raising finance for adaptation. One participant pushed back on the idea of earmarking ETS revenues, stating that they could see no link to Article 6.2. They also highlighted that there is a pre-condition that must be fulfilled first, i.e., the transaction must be done through Article 6.2 and the internationally transferred mitigation outcomes (ITMOs) authorised must follow Article 6.2 guidance. They also did not agree on having a compulsory SoP under Article 6.2. Prof Müller communicated that it is the idea that ETS revenues can be earmarked for funding that can be utilised and is not meant to be seen as linked to Article 6, but to expand the considerations of innovative funding beyond Article 6 approaches.

Promoting adaptation finance through an Article 6.8 work programme

Session 2 of the workshop began with Dr Axel Michaelowa, Research Director of PCR, giving an informative presentation on promoting adaptation finance through the Article 6.8 work programme. He began with reminding workshop participants that non-market approaches (NMA) have had a long history in UNFCCC negotiations and that Article 6 explicitly recognises non-market-based forms of international approach through Article 6.8 and Article 6.9. The objective and role of the work programme is under debate, with three crunch issues in negotiations being a) definition of the NMAs, b) structure and governance of the framework, and c) objectives, modalities and instruments of the NMA work programme.

Following a short presentation of the current status of negotiations on the work programme for Article 6.8 approaches, Dr Axel explored the presence of linkages between Article 6.8 and Article 7 on adaptation, presenting some ideas of promising NMAs that could be promoted in such a work programme.

As an example of a possible NMA, Dr Michaelowa discussed the 'Bulk Purchasing' instrument. Bulk purchasing has been empirically proven to drive down the costs of climate technologies for adaptation and mitigation. Such an instrument can be particularly beneficial for LDCs and small island developing states (SIDs) as it provides an entry point for these countries and allows for information and knowledge sharing. The Ujala LED purchasing programme in India, one of the largest purchasing programmes, is a prime example of bulk purchasing wherein more than 360 million LED lamps were distributed.

One of the top candidates of the Article 6.8 NMA is the Adaptation Benefits Mechanism (ABM). The ABM aims to promote private finance for adaptation through the creation of the non-tradable 'certified adaptation benefits' (CABs). The ABM contributes to de-risking adaptation investments and increasing the bankability of adaptation projects. The pilot phase of the ABM is underway from 2019 until 2023 with the support from African Development Bank. The ABM consists of an executive committee that approves methodologies, defines activity cycle and overseed third party auditors. Recently, the first methodology to calculate Climate Awareness Bonds (CABs) from adaptation activities was submitted.

Dr Michaelowa stressed the importance of learning from the past for designing the Article 6.8 work programme. An important precedent has been set by the Paris Committee on Capacity Building (PCCB), which concerns itself with developing a strategic approach to capacity building, engaging with important stakeholders and providing a platform to coordinate capacity building exercises. These targets are similar to what is being observed under Article 6.8. The PCCB has successfully held dialogues with the civil society actors, which were appreciated by the latter. However, it did face many challenges such as lack of financial resources and unclear place of the PCCB in the universe of capacity building and financing institutions. The key lesson that can be learnt from the PCCB is that the work programme needs sufficient buy-in by the key governments and institutions and needs to be seen as a facilitator and not a competitor.

Feedback and Discussion

Rene Orellana, Bolivia, was invited as the first panellist of the 2nd session of the workshop to reflect on the presentation given by Dr Michaelowa. He highlighted the difficulties in finding adequate instruments to implement NMAs and the need to develop more instruments, like the Adaptation Benefit Mechanism (ABM).

He suggested 'Debt for climate swaps' and 'Debt for nature swaps' as possible instruments. These swaps have been applied since the 1980s at the micro-level and NGOs have primarily been involved in implementing these instruments. Lately, the International Monetary Fund (IMF), the WB and other multilateral development bank (MDB) families have been proposing and developing these instruments and would prepare a menu of possibilities that countries can choose from in the future. Another example put forward by Mr Orellana is the Common Debt Service Suspension initiative, which is taken up by the IMF and other MDBs, in line with the decision of the G20, lending support to developing countries to deal with pandemic challenges. Although the Suspension is about to come to an end and was only able to cover 16.8% of the debt payments of the developing countries, it is still an important first step and is inspiring banks to implement other such policies. The key question raised by Mr Orellana is how such policies and instruments can be applied. It is of utmost importance to put such instruments in the agenda, when discussion the Article 6.8 work programme.

Gebru Jember, representative of LDCs and the second panelist for the 2nd session of the workshop, stressed that a lot of work remains to be done, including on the ABM. He raised concerns regarding quantifying adaptation as well as financial implications in terms of mobilising finance for implementation. He called for an innovative approach to increase ambition and address adaptation and mitigation gaps.

Following reflections from the panelists, the floor was open to discussions. A workshop participant questioned the role played by NMAs. They asked if NMAs are ideas incubators or if the NMA framework and work programme have an active role in piloting activities identified as NMAs. Dr Michaelowa added that the key question here is to understand how the work programme will be designed. It is important to understand if it just has an incubation function and is eventually taken up by other actors who are setting up the specific cooperation or if there are any concrete steps written down in the work programme which would in turn allow those who underwrite this operation to have better access to technical and financial resources.

An additional question on the political sphere of influence of the NMAs in pushing forward such ideas of adaptation finance in the UNFCCC process was raised by a workshop participant. Mr Orellana addressed this concern, stating that there is now a political advantage, especially in the case of debt for nature swaps and debt for climate swaps that have been developed by MDB officials. The IMF President, Ms Kristalina Georgieva, then called for the issue of swaps to be considered. Pushing such ideas of adaptation finance can be used to propel and foster the private sector, SMEs and indigenous countries. However, he noted that the way to implement this is still in the works but ideas on this issue can be proposed considering the initiative comes from the MDBs.

Conclusion

The workshop ended with a few concluding remarks from the workshop presenters and panellists. Some highlighted that the workshop provided a lot of food for thought on the need to set examples and best practices for how carbon market instruments, generating cost savings for mitigation, can generate adaptation finance. One suggested an agreement on SoP in the Article 6 rules could set such an example, but even if not, such approaches to mobilise funds for adaptation can be implemented in all systems.

Beyond the SoP, some noted the importance of exploring innovative approaches for adaptation to ensure there is secured funding for vulnerable countries to tackle climate change and that the Article 6.8 work programme can be a valuable space to discuss these innovative ideas. The main challenge for the Article 6.8 work programme would be to establish itself successfully in the UNFCCC process and promote action on the ground. Mr Kumarsingh hoped these discussions wouldl contribute to the negotiations at the upcoming UNFCCC COP26 in Glasgow.