

THE ROLE OF ARTICLE 6 IN CONTRIBUTING TO THE NCQG

Discussion Paper

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Federal Ministry
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Contents

1. Introduction.....	2
2. The NCQG unpacked – actors, finance types, and activities.....	5
3. Reporting on climate finance.....	9
4. Resource flows and benefits under Article 6	12
5. What to count and what not to count.....	18
6. Article 6 contributions to the NCQG goals	22
7. Endnotes	26

Introduction

01

1. INTRODUCTION

Climate finance has become a defining pillar of international climate policy, supporting efforts to achieve a global transition to a low-carbon and climate-resilient future. During the 29th session of the Conference of the Parties to the United Nations Framework Convention on Climate Change (COP 29 of the UNFCCC) in Baku, Azerbaijan, the adoption of the New Collective Quantified Goal (NCQG) marked a critical milestone for climate finance mobilization. The NCQG sets a goal mainly for developed countries to collectively mobilize financial resources to support developing countries in their climate actions, with a scale target of at least USD 300 billion per year by 2035.¹ It is intended to replace the previous USD 100 billion per year climate finance goal and forms a financial foundation for implementing the Paris Agreement. Additionally, it includes a broader ambition to scale up total climate finance for developing countries to at least USD 1.3 trillion per year from all public and private sources by 2035.² Delivering on these climate finance goals is a key ingredient for building trust among developing and developed countries. This is a pre-condition for collectively raising the ambition of NDCs over time to align with the long-term goals of the Paris Agreement.

To achieve the NCQG goals, large amounts of climate finance must be mobilized from different sources. Among the resource flows that hold significant promise to mobilize climate finance are international carbon markets, codified in Article 6 of the Paris Agreement. Article 6 outlines mechanisms for voluntary international cooperation, with the potential to both enhance cost-effectiveness and unlock new financial resources. Article 6.2 provides for the trading of Internationally Transferred Mitigation Outcomes (ITMOs) among countries, potentially lowering the overall cost of mitigation and generating new revenues for countries and actors that are able to achieve additional mitigation outcomes, including both emission reductions and removals.³ Article 6.4 creates a UN-supervised crediting mechanism designed to attract robust private investment and generate high-integrity international carbon credits, with environmental and social safeguards.⁴ Article 6.8, which receives lesser attention in this paper, establishes a work program to channel technical and financial resources towards non-market approaches.

While carbon pricing has long been recognized as a significant source of climate finance⁵, negotiations under the UNFCCC have paid limited attention to how Article 6 could contribute to the NCQG. A reference to carbon markets had briefly appeared in the draft negotiation text but not been included in the final NCQG decision due to concerns from developing countries that it distracted from developed countries' lead role in providing resources. Within the climate finance community, the adoption of the NCQG poses significant new challenges.⁶ It is unclear, for example, how to monitor the full spectrum of contributions to the USD 1.3 trillion goal and collect data from the private sector. The accounting of Article 6 flows therefore does not appear as one of the most pressing issues in the overall landscape of issues to be resolved.

At the same time, clarity on the accounting of Article 6 towards the NCQG goals is an important element for the mobilization of resources. Governments have many direct and indirect opportunities of influencing carbon credit market-related expenditures.⁷ To make full use of the tools offered by Article 6, they need to understand how flows, both public and private, can be accounted for. Conversely, governments need clarity whether the blending of concessional finance with carbon finance can, in the context of Article 6, limit the reporting of these resources as climate finance or Official Development Assistance (ODA). This paper seeks to provide a first conceptual framework for analyzing these questions. Acknowledging that the

global dialogue on the NCQG goals and the contribution of various sources of finance, including through Article 6, has only recently started, it is framed as a discussion paper. The paper offers a categorization of the Article 6 related flows and benefits and several propositions as to how such flows could count towards the USD 300 billion and the USD 1.3 trillion goals respectively. However, rather than presenting definite conclusions, the propositions are tentative in nature, with the goal of inspiring further reflection and discussion between the climate finance and Article 6 communities. Deeper and wider conversations will be necessary to build consensus around the accounting rules for Article 6 related flows.

As a basis for the analysis, the paper starts by dissecting the NCQG targets—USD 300 billion and USD 1.3 trillion—in terms of their contributor bases and types of finance (Section 2). Next, the paper takes stock of the existing reporting practices of climate finance (Section 3). It then examines the potential resource flows and benefits that may arise under Articles 6.2, 6.4, and 6.8 (Section 4). Section 5 discusses what could (or not) be counted as climate finance, based on existing guidance and recommendations from the UNFCCC and the Organisation for Economic Co-operation and Development (OECD). The paper concludes with the formulation of several propositions how Article 6 resource flows and benefits could contribute to the NCQG targets and a discussion of the way forward (section 6).

The NCQG unpacked – actors, finance types, and activities

02

2. THE NCQG UNPACKED – ACTORS, FINANCE TYPES, AND ACTIVITIES

The NCQG adopted at COP 29 emerges from over three decades of debate on the scale and ambition of climate finance targets. The 1992 Rio Summit introduced initial commitments by developed countries to provide new and additional resources for developing nations.⁸ A turning point came with the 2009 Copenhagen Accord, which pledged USD 100 billion per year by 2020—a goal later formalized at COP16 in Cancun and reinforced in the Paris Agreement at COP21.⁹ Subsequent COP decisions further emphasized the need for climate finance to be accessible, predictable, and sustainable, while also addressing funding for loss and damage in vulnerable countries.¹⁰

Building on these foundations, the NCQG for climate finance targeting 2035 and beyond reflects the international community's pledge to significantly scale up resources, particularly for developing countries' mitigation and adaptation efforts. This focus on climate finance, specially towards developing countries, closely aligns with Article 2.1(c) of the Paris Agreement, which calls for financial flows to be consistent with pathways toward low greenhouse gas emissions and climate-resilient development.¹¹ Both goals within the NCQG are structured with timelines and interim milestones intended to promote accountability. The USD 300 billion annual target represents a negotiated floor that developed countries have committed to mobilize for developing nations' climate needs. It builds on the USD 100 billion target set for 2020, using similar accounting methods and contributor bases.¹² The larger USD 1.3 trillion target is grounded in independent needs assessments, notably from the Independent High-Level Expert Group on Climate Finance (IHLEG).ⁱ

The USD 300 billion and USD 1.3 trillion climate finance goals established under the NCQG require differentiated contributions from various actors, financial instruments, and target activities. Official NCQG reporting will mostly track government financing and mobilized private finance, where states act to facilitate or catalyze private flows. The USD 300 billion goal primarily mandates developed countries to lead in mobilizing at least this amount annually by 2035 to support climate action in developing countries. Key contributors to this target include bilateral finance involving direct transfers from developed to developing countries, multilateral institutions such as Multilateral Development Banks (MDBs), dedicated climate funds, and alternative sources such as international taxes or solidarity levies (see Table 1).¹³

While achieving the far greater USD 1.3 trillion goal will rely on the financing sources listed above, it also requires a broader and more inclusive group of contributors. Beyond the continued leadership of developed countries, this larger target calls for stronger participation from developing and emerging economies, the full spectrum of MDBs, private sector capital—particularly cross-border and independent private flows—as well as non-state actors, philanthropic organizations, and innovative international financing mechanisms.¹⁴ As public

ⁱ The group finds that domestic resources, which currently provide about 70% of climate finance, could contribute around USD 1.4 trillion annually toward the total investment requirement of USD 2.4 trillion by 2030, and USD 1.9 trillion out of USD 3.2 trillion by 2035. This leaves a financing gap of roughly USD 1 trillion per year by 2030, rising to about USD 1.3 trillion by 2035, which would need to come from external sources, including international public and private finance. For more information see: https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2024/11/Raising-ambition-and-accelerating-delivery-of-climate-finance_Third-IHLEG-report.pdf

finance alone is insufficient, the NCQG places stronger emphasis on mobilizing private finance and calls on all actors to contribute. Importantly, the USD 1.3 trillion figure is framed as an aspirational, non-binding target encompassing all sources, rather than a formal obligation.¹⁵ In this context, the NCQG introduces the “Baku to Belém Roadmap to 1.3T,” which aims to scale up climate finance flows towards developing countries to facilitate GHG mitigation and adaptation measures, through grants, concessional and non-debt creating instruments, and measures to create fiscal space, taking into account relevant multilateral initiatives as appropriate.¹⁶

Table 1. NCQG Contributors

Type of Contributor	USD 300 Billion Goal	USD 1.3 Trillion Goal
Developed countries	Primary actors	Continued leadership
MDBs and dedicated climate funds	Large share	Full range of support
Private sector (financial institutions, corporations, etc)	Via mobilized finance, not core	Major role
Emerging economies, developing countries	Voluntary only	Voluntary and encouraged
Other non-state actors, philanthropies, and innovative international financing mechanisms	Encouraged	Fully included

Regarding the types of finance, several categories potentially contribute to the goals (see Table 2). Public finance can include direct grants and concessional loans primarily from developed country governments, as well as concessional lending, guarantees, and grants from MDBs and global climate funds.¹⁷ Private finance can encompass investments catalyzed by public incentives and guarantees, direct private sector flows such as project finance, equity, debt, and venture capital targeting climate mitigation and adaptation in developing nations, as well as institutional investments from entities like pension funds and insurance companies.¹⁸ Additionally, alternative or innovative finance mechanisms, including international taxes on emissions-intensive activities, rechanneled IMF Special Drawing Rights (SDRs)ⁱⁱ, high-integrity carbon markets and carbon pricing, financial transaction taxes, philanthropic contributions, and blended finance structures, also hold potential to expand the resource base for climate finance.¹⁹

ⁱⁱ The Special Drawing Rights (SDR) is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. To date, a total of SDR 660.7 billion (equivalent to about US\$943 billion) have been allocated.

Table 2. Types of finance for the NCQG

Type of Finance	USD 300 Billion Goal	USD 1.3 Trillion Goal
Public (direct grants and concessional loans)	Major share	Foundation, but smaller % of total
Multilateral finance (loans, guarantees and grants)	Core channel	Important, but focus on leveraging private investment
Private (equity, direct investments, etc.)	Mobilized via public channels	Direct investment is essential
Innovative (carbon finance, taxes, credits, blended finance, etc.)	Supplementary, growing, supported by developed nations	Scaled up and mainstreamed, expected to surge, incentive-driven

The activities eligible for these financial flows span mitigation, adaptation, and cross-cutting measures, addressing both emission reductions and the strengthening of climate resilience across sectors. Notably, the USD 300 billion goal tends to emphasize a balance of grant-based public finance supporting adaptation and mitigation priorities, particularly in vulnerable countries, where private sector involvement is limited due to higher risks.²⁰ The expanded USD 1.3 trillion goal, however, anticipates the large-scale mobilization of private capital, concentrating on mitigation projects where investment returns are more readily identified, while recognizing that adaptation finance may require considerable public de-risking and support mechanisms.²¹ Challenges remain in mobilizing private finance for adaptation, given uncertainties around risk and returns. At the same time, frameworks for accounting and activity eligibility remain under negotiation and may change as new mechanisms emerge. Overall, the two goals reflect a move toward more diverse sources and shared responsibility in climate finance, while raising questions of effectiveness, equity, and the true additionality of funds.

Reporting on climate finance

03

3. REPORTING ON CLIMATE FINANCE

While climate finance is a concept under the UNFCCC, its reporting has significant overlap with the reporting of official development assistance (ODA) outside the climate regime. Climate finance in the context of the UNFCCC and climate-related development finance represent two connected but distinct concepts. While climate finance targets are adopted under and reported to the UNFCCC, climate-related development finance is a type of ODA and reported to the OECD. Historically, the OECD has also been leading international efforts on tracking progress towards the annual USD 100 billion climate finance goal under the Paris Agreement. In addition, donors of climate finance have used the datasets provided to the OECD as a starting point for reporting on climate finance to the UNFCCC.²² While these datasets are useful, climate finance under the UNFCCC covers a broader range of flows explicitly aimed at climate mitigation and adaptation, of which climate-related development finance is only a subset. Moreover, climate finance should be new and additional, meaning that resources should go beyond ODA to provide genuine, supplementary support. Climate finance reporting is characterized by fragmentation, as multiple international systems apply differing mandates, methodologies, and institutional approaches. While these processes collectively provide an overview of mobilized finance, significant divergences remain in scope, definitions, and practices. The prevailing practices for climate finance reporting from the OECD, UNFCCC and Multilateral Development Banks (MDBs) are briefly reviewed in this section as a prerequisite to analysing the NCQG and the potential role of Article 6 contributions.

The OECD Development Assistance Committee (DAC) provides an internationally recognized **dataset on climate-related development finance**. Donors mark projects as “principal” or “significant” contributors to climate objectives using Rio Markers (see Box 1), which helps track the climate component of development finance flows.²³ The OECD has also developed methodologies for quantifying mobilized private sector finance — that is, private investment that can be attributed to public interventions such as guarantees, equity investments, or credit lines.²⁴ These datasets inform UNFCCC reporting, but they are governed by OECD rules and applied mainly by DAC member states, meaning they do not capture all global donor flows.

Under the UNFCCC, Parties report on climate finance within the **Enhanced Transparency Framework (ETF)**, defined in Article 13 of the Paris Agreement, which serves as overarching system to track action and support by Parties.²⁵ Amongst others, its purpose is to capture progress towards NDCs and national climate change commitments, including in mitigation, adaptation and climate finance. Parties report on these elements by submitting standardized Biennial Transparency Report (BTRs) every two years, which undergo a technical expert review.²⁶ The ETF and BTR also capture progress made by Parties in i) mobilizing and providing finance and ii) receiving and identifying needs for finance, in line with the ETF guidance. The reported information is then assessed by the SCF in its Biennial Assessment.²⁷

In parallel, Multilateral Development Banks (MDBs), the largest mobilizers of private sector finance, have developed their own approach for measuring climate finance. They apply the **Joint MDB Methodology on Tracking Climate Finance** to identify the shares or components of each MDB project that support climate change adaptation or mitigation. This harmonized approach is published annually in the Joint MDB Climate Finance Report, while allowing for institution-specific application.²⁸ Along with MDBs, dedicated multilateral climate funds such as the Green Climate Fund (GCF) and the Global Environment Facility (GEF) play a central role in channeling resources. Both funds are operating entities of the UNFCCC's financial mechanism and provide transparent, regularly reported data on climate finance flows.²⁹ⁱⁱⁱ Donor contributions to the GCF and GEF are reported under the BTRs. MDBs often act as implementing entities for these funds, further linking their operations with UNFCCC-designated climate finance channels.^{iv}

A major gap in the current system is the limited capture of **non-Party actors' contributions**. While governments report their direct and mobilized finance, private companies and other non-state actors are not formally required to do so. As systematic reporting of private finance is lacking, a key question therefore is how these flows—particularly those critical for meeting the USD 1.3 trillion target—can be measured and reported. Therefore, new sources of information, including commercial and non-profit data aggregators, are currently being considered by the OECD to inform future assessment of progress toward the non-state actors' climate finance scale-up goal.³⁰

The prevailing practices of climate finance reporting are important to keep in mind when analyzing how different flows under Article 6 could not just theoretically count towards the NCQG goals but also be reported on in practice.

ⁱⁱⁱ For more information, see: <https://unfccc.int/sites/default/files/resource/GEF%20report%20to%20COP30.pdf> and <https://unfccc.int/sites/default/files/resource/14th%20Report%20of%20the%20GCF%20to%20COP%2030.pdf>

^{iv} For a detailed list of implementing agencies, see: <https://www.thegef.org/partners/gef-agencies> and <https://www.greenclimate.fund/about/partners/ae>

Resource flows and benefits under Article 6

04

4. RESOURCE FLOWS AND BENEFITS UNDER ARTICLE 6

Article 6 of the Paris Agreement establishes three distinct pathways for international cooperation, each with different implications for mobilizing climate finance. Articles 6.2 and 6.4 are market-based approaches: Article 6.2 allows countries to engage in bilateral or multilateral approaches that involve the transfer of ITMOs, requiring corresponding adjustments to avoid double counting. Article 6.4, known as the Paris Agreement Crediting Mechanism (PACM), is a centralized market mechanism that generates A64ERs that can be authorized by host Party and become ITMOs, or used as unauthorized mitigation contribution units (MCUs). Article 6.2 specifies that ITMOs may be used towards nationally determined contributions (NDCs) or other international mitigation purposes, such as compensating aviation emissions under the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA). Non-regulated uses of either authorized or non-authorized mitigation outcomes (MOs) also exist. Public entities may purchase MCUs to support domestic mitigation in developing countries through results-based climate finance (RBCF) while private sector buyers may purchase MOs or ITMOs in support of company decarbonization targets. In contrast, Article 6.8 provides a framework for non-market approaches focused on cooperation through finance, technology transfer, and capacity building, which does not involve the transfer of ITMOs.

The paper assumes that the reader is largely familiar with the workings of carbon markets and Article 6 including the various purposes for which carbon credits can be used to either compensate emissions or contribute to mitigation targets. The section therefore focusses directly on the resource flows and benefits associated with Article 6 transactions as a prerequisite for analyzing possible contributions to the NDCQ targets. These flows are largely ignored at the level of the rulemaking given that the primary aim of the Article 6 rules is to ensure robust accounting of mitigation outcomes, environmental integrity of cooperative approaches and contribution to sustainable development in host countries, Article 6 related flows and their relation to climate finance accounting have also received little attention in literature. A notable exception is the paper by Schneider and Haase on Carbon crediting and official development assistance,³¹ which has provided valuable inspiration for the analysis. However, the paper has been published before the adoption of the NCQG goals in Baku and considers a different research question, namely whether ODA funding may be used for different Article 6 related interventions. Efforts to unpack the relationship of carbon credit market-related expenditures with development and climate finance are also ongoing under the G7-led Carbon Market Platform and within the Climate Change Expert Group (CCXG) of the OECD and the International Energy Agency (IEA). The associated technical notes and discussions with the authors have been of invaluable benefit to this paper.³²

As in the publications quoted above, our starting point is to categorize carbon market related flows into three broad categories, namely (i) the investment into a mitigation activity, (ii) carbon credit payments and (iii) readiness support. A fourth category is added to capture Article 6.8 related flows given their inherently different nature. In the following, we will look deeper into these four categories to identify the associated resource flows and benefits in each.

Investment into a mitigation activity

As captured in its chapeau, the purpose of Article 6 is to allow for higher ambition in Parties' mitigation and adaptation actions, and to promote sustainable development and environmental integrity in the implementation of NDCs. This is predominantly achieved through investment in mitigation activities in host countries by private and public sector entities. The upfront investment prior to the generation and purchase of unauthorized mitigation outcomes (MOs) or authorized ITMOs normally constitutes the largest and most important of the Article 6 related flows. Upfront investments can be supported through different types of finance and come from public, private or blended sources, including but not limited to commercial or concessional loans, private equity and government grants. Crucially, these flows may or may not involve flows into developing countries as the investments can be undertaken by either foreign or national entities. It should also be noted that Article 6 does not differentiate between developed and developing countries. Although in most cases investments will likely occur in developing countries, also developed countries can host Article 6 activities. Important distinctions for assessing eligibility of the flows towards the NCQG targets therefore are:

- Whether investments result in flows to developing countries, and
- Whether the funding is commercial or concessional in nature.

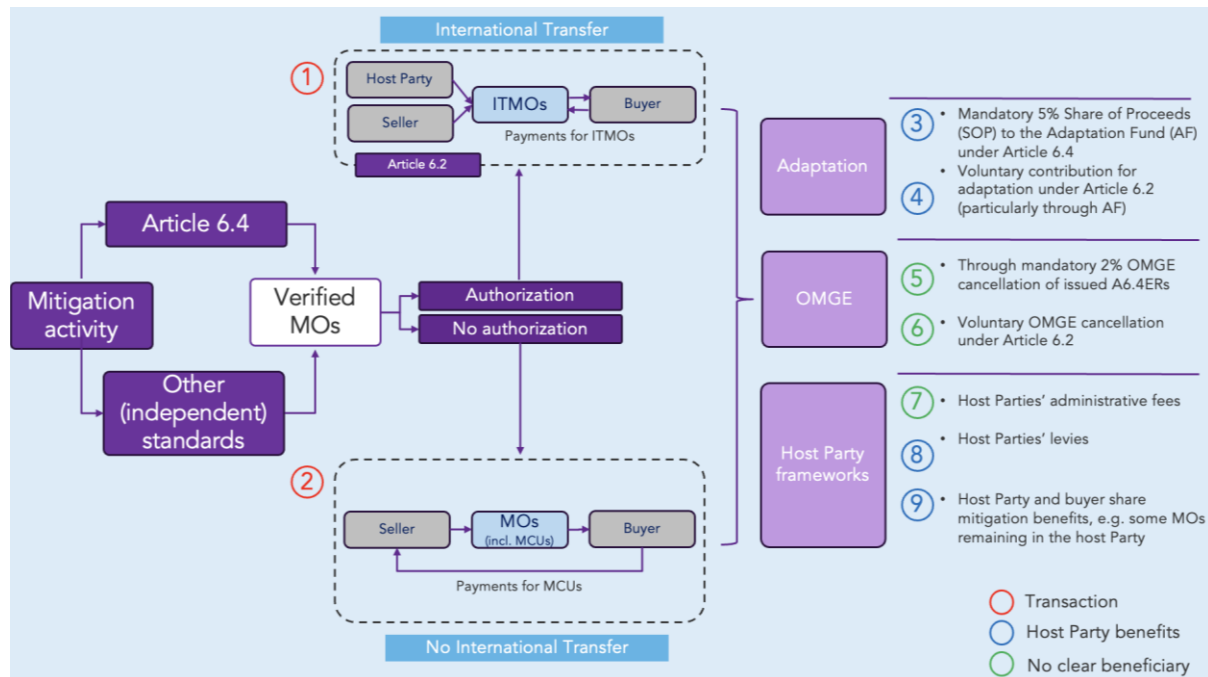
Carbon credit payments and benefits

While the first category of flows is relatively straightforward, the second involves a host of monetary and non-monetary payments as well as benefits and is more difficult to assess. These are flows associated with generating and transacting carbon credits which are either part of the commercial transaction between the buyer and the seller, imposed by the Article 6 rules or required by host Parties. The latter can be grounded in national laws or negotiated as part of bilateral agreements. Figure 1 identifies nine different resource flows, including benefits, that are associated with Article 6.2 and Article 6.4. These are:

- Transactions of ITMOs or MCUs (1 & 2)
- Contribution to adaptation finance through the share of proceeds or bilateral arrangements (3 & 4)
- In-kind contributions to Overall Mitigation in Global Emissions (OMGE) (5 & 6)
- Host Party fees, levies and sharing of mitigation outcomes (7,8 & 9)

While not the focus of this paper, some of the resource flows depicted in figure 1 also occur in voluntary markets, or where mitigation outcomes are certified not by the Article 6.4 mechanism but by independent standards.

Figure 1: Flows and benefits under Article 6 (source: own illustration)



An important distinction from a climate finance perspective is whether the resource flows create only benefits for developing countries or whether they are transactional in nature and create also benefits on the side of the provider of the finance. This is the case when the buyer receives ITMOs in return for the payment, which can be used towards NDCs or CORSIA. For MCUs the situation is less clear and may depend on whether the buyer is a sovereign entity (providing results-based climate finance) or a private company that uses carbon credits against its own decarbonization targets.

Similarly, one needs to consider whether the payments result in a net gain for developing countries or create a proportional burden. Only flows that constitute net benefits to developing countries can potentially count towards the NCQG goals. A liability is created when developing countries are required to make corresponding adjustments for ITMOs as these move them further away from their own NDC targets. Where the payment for ITMOs equals the cost of the mitigation, no net benefit is created from the payment. Schneider and Haase point out that whether an ITMO transaction creates a proportional liability for host Party depends on many factors, including whether there is sharing of mitigation outcomes, the underlying mitigation activity is additional and the extent to which emission reductions are conservatively calculated and visible in the host Party's GHG inventory.³³

When analyzing the various flows in figure 1, three types of flow/benefit combinations emerge: i) transactions benefitting both buyers and sellers (red), ii) flows that only benefit host Parties (blue), and iii) resource flows without a clear beneficiary (green).

Table 3 summarizes the direction of payments and benefits for each of the identified resource flows.

Table 3: Resource flows and benefits under Article 6 (source: authors)

① Transaction of ITMOs	Private or public sector entities in the host Party receive payments for ITMOs but a liability is created through corresponding adjustments. A benefit occurs on the buyer side, which could either be a sovereign or private entity.
② Transaction of MOs	Public or private sector buyers could also purchase unauthorized MOs (incl. MCUs). Payments constitute a net benefit to the host Party. MOs may be a benefit for private sector buyers if used towards company claims but not for public buyers that use MOs as a vehicle for RBCF.
③ Mandatory SOP to Adaptation Fund under Article 6.4	Project investors are required to contribute a 5% share of proceeds (SOP) of A64ERs generated by their projects to the global Adaptation Fund. The Adaptation Fund supports climate action in developing countries, and therefore the SOP benefits developing countries as a whole. However, a liability in the form of corresponding adjustments is created for the host Party for the portion of A64ERs authorized as ITMOs.
④ Voluntary contribution to adaptation under Article 6.2	Under Article 6.2, the buyer may agree to make a voluntary contribution to the Adaptation Fund or a national adaptation scheme. As per Decision 2/CMA.3³⁴, Parties “<i>are strongly encouraged to commit to contribute resources for adaptation, in particular through contributions to the Adaptation Fund</i>”. Technical or monetary support for adaptation in the host Party results in benefits to the host Party without benefits for the buyer in return.
⑤ Mandatory OMGE under Article 6.4	Under Article 6.4 a minimum 2% of issued A64ERs must be cancelled for OMGE. No clear beneficiary can be identified as reduced GHG emissions are a global good.
⑥ Voluntary OMGE under Article 6.2	Similarly, if the buyer decides to make a voluntary OMGE contribution under Article 6.2, there is no clear beneficiary beyond the global atmospheric benefits.
⑦ Host Party administrative fees	Many host Parties charge administrative fees to cover the bureaucratic costs associated with the approval, authorization and registration of Article 6 activities. If designed as a pure cost recovery mechanism, no net benefit occurs.
⑧ Host Party levies	In addition, host Parties may apply additional levies or taxes to share in the benefits of an Article 6 transaction. This includes corresponding adjustment levies, or a share in the proceeds of the transaction directed to local communities or the national government and may serve to finance additional adaptation or mitigation activities. These levies are of benefit to the host Party and a pure expenditure for the buyer.
⑨ Sharing of mitigation outcomes	The host Party has a non-monetary benefit if not all the mitigation outcomes achieved by the mitigation activity are transferred as ITMOs to the buyer but a portion remains with the host Party to support the achievement of its NDC.

Readiness support

Host Parties may receive financial and technical support targeted at building an enabling environment for Article 6. This can be support for institutional and governance readiness, the development of legal and regulatory frameworks, the set-up of appropriate infrastructure (e.g. MRV and registry systems), and capacity-building for public and private sector stakeholders. Host Parties may also receive support through technical and strategic advice on their carbon markets engagement, often financed through MDBs and bilateral sources. In most cases, readiness support is provided at the sole benefit of the recipient with no return for the provider of the support. Some contracts or bilateral agreements may however include provisions that take into account the finance provided for readiness support, which is either deducted from the purchase price or otherwise reflected in the determination of the ITMO pricing.

Article 6.8

Lastly, non-market approaches (NMAs) under Article 6.8 offer Parties a pathway to support climate action without any transfer of carbon credits, complementing Article 6.2 and 6.4. This can come in form of financial support, technology development, and capacity-building to host Parties to promote mitigation and adaptation ambition and enhance public and private sector participation for NDC achievement. Similar to readiness support, expenditures in the context of non-market approaches appear to be non-transactional, benefitting only the recipient, although this generalization would need to be confirmed given the large variety of non-market approaches.

The following section will discuss generic accounting principles guiding the relationship between carbon markets and climate finance before offering specific propositions on the counting of the Article 6 related flows.

What to count and what not to count

05

5. WHAT TO COUNT AND WHAT NOT TO COUNT

Existing guidance on the interface between carbon markets and climate finance

The counting of carbon market related flows towards climate or development finance goals is not a new topic but at its core concerns a debate that dates as far back as the Marrakech Accords. While Article 6 and the NCQG have added additional layers of complexity, the basic considerations were already discussed in the context of the Kyoto Protocol's Clean Development Mechanism (CDM) and remain valid today. Our analysis therefore starts with a recollection of how past guidance has interpreted the relationship between carbon markets and climate finance and which arguments have been put forward. These existing guidelines aim to clarify common rules and establish how public and private funds related to the generation and sale of carbon credits can be transparently accounted for and reported. Key topics covered in these guidelines include avoiding double counting, attributing mitigation outcomes to carbon finance and climate finance, and the eligibility for ODA. The following rulings are important predecessors for the paper:

Marrakech Accords (2001)³⁵

The Marrakech Accords from 2001 constitute a set of agreements that enabled the operationalization of the Kyoto Protocol and outlined the detailed rules and procedures for its flexible mechanisms such as the CDM. A main concern at the time was that climate finance should be new and additional to any funding provided to developing countries through ODA. Parties therefore agreed that *“public funding for clean development mechanism projects from Parties in Annex I is not to result in the diversion of official development assistance and is to be separate from and not counted towards the financial obligations of Parties included in Annex I [i.e. Parties with emission reduction targets]”*. To implement the ruling, a section was added to the CDM's Project Design Document (PDD) requiring confirmation from project participants that the project does not lead to a diversion of ODA.

OECD-DAC recommendations (2004)³⁶

The OECD-DAC later sought to translate the ruling from the Marrakech Accords into practical guidance for climate finance practitioners. It provided the following recommendations:

- ODA funds should not be used to purchase Certified Emission Reductions (CERs)
- Donors should report the value of CERs they receive from ODA financed projects
- The value of CERs received by donors should be deducted from the provided ODA.

The recommendations are based on the rationale that ODA measures the net effort of donors in providing finance, whereas CERs present a return to the donor and therefore should be deducted. In accordance with the ruling, providers of climate finance, such as the International Climate Initiative (IKI), are requesting grant recipients to report whether their projects result in the generation of CERs. Given that prices of CERs are often subject to confidential agreements and made up of various components, including the provision of upfront finance and the allocation of liabilities, the accurate valuation of CERs remains challenging in practice.

OECD-DAC WP-STAT meeting (2023)³⁷

In March 2023, the OECD DAC Working Party on Development Finance Statistics (WP-STAT) held a meeting to clarify reporting rules for ITMOs. The meeting resulted in a valuable exchange of views but remained inconclusive and did not produce a comparable set of recommendations for Article 6 as earlier for the CDM. Some members expressed the view that cooperative approaches should be treated similarly to the CDM and thus be ODA-eligible, albeit with a deduction in their value. Others opined that Article 6 was inherently different due to the liability it creates for developing countries in the form of corresponding adjustments. It was also questioned whether the intent of the activity should impact the reporting, i.e. whether an activity is mainly supported for development or compliance purposes. To date, this discussion remains open.

Paragraph 121 (m) (iii) of the MPGs - Annex to Decision 18/CMA.1, (2018)³⁸

Lastly, within the Paris Agreement Rulebook, a safeguard against the double counting of resources towards both climate finance and greenhouse gas mitigation targets has been adopted. These appear in the modalities, procedures and guidelines (MPGs) of the Enhanced Transparency Framework (ETF), which set out the reporting and review requirements under the Paris Agreement to track progress on mitigation, adaptation and support provided by Parties. The MPGs define that developed country Parties must report *“how double counting was avoided between the resources reported as provided or mobilized, and the resources used under Article 6 of the Paris Agreement by the acquiring Party for use towards the achievement of its nationally determined contribution.”* The hedge against double counting resembles the recommendations of the OECD-DAC in the context of development finance, which states that donor countries should not have a benefit from their engagement in the CDM or if so, the value they receive should be subtracted from the reported finance.

Overarching principles

From the above rulings, current practices and discussions, a set of overarching principles for the counting of Article 6 related flows towards climate finance in general and the NCQG in particular can be deducted. In the absence of clearly defined guidance on the relationship of Article 6 and the NCQG, they contain preliminary assumptions on what could classify as climate finance and intended to serve as a basis for discussion. The below overview is split in principles for the USD 300 million goal and those that apply to the USD 1.3 trillion goal respectively. While the USD 300 million goal stands in the tradition of the earlier USD 100 billion goal, new accounting principles apply for the aspirational call to all actors to scale-up climate finance to USD 1.3 trillions.

Principles for the USD 300 million goal:

1. There should be no double counting of expenditures towards both climate finance and mitigation targets of the donor. This follows from paragraph 121(m)(iii) of the MPGs.
2. There should be no counting of expenditures where a donor receives a proportional benefit, in particular ITMOs that are used for compliance targets such as an NDC.
3. However, expenditures can be reported if benefits are valued and subtracted from the provided finance (OECD DAC recommendations for the CDM).
4. There should be no counting of expenditures where a proportional liability is created for developing countries in the form of corresponding adjustments.

5. In accordance with the reporting on development finance, only mobilized private sector investments can be counted, i.e. those that are triggered by public intervention.

Principles for the USD 1.3 trillion goal:

6. All flows that count towards the USD 300 billion target also count towards the greater USD 1.3 trillion target.
7. Principles 1 to 4 equally apply to the USD 1.3 trillion target.
8. Private sector expenditures can count towards the USD 1.3 trillion goal even if not triggered by public intervention and benefits are received in return for payments.

Article 6 contributions to the NCQG goals

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6. ARTICLE 6 CONTRIBUTIONS TO THE NCQG GOALS

Propositions

Considering the prevailing practices of reporting climate finance and the broadening of the contributor base under the USD 1.3 trillion goal, payments and benefits under Article 6 can contribute to the NCQG in several ways. This section ties together the Article 6 related resource flows and benefits identified in section 4 with the principles for climate finance accounting discussed in section 5 to arrive at the following propositions offered for discussion:

Proposition 1: Government payments^v for ITMOs cannot be counted towards the USD 300 billion goal. They create a proportional benefit for the donor, who can use the ITMOs against its NDCs, and a liability for the host Party through corresponding adjustments. Moreover, it would create a direct risk of double counting expenditures towards both climate finance and mitigation targets of the donor (principles 1, 2 & 4).

Proposition 2: Government payments for MCUs can be counted towards the USD 300 billion goal. MCUs do not require corresponding adjustments and therefore do not generate liabilities for the host Party. The donor also does not receive a proportional benefit from the transaction, and no double counting occurs towards climate finance and mitigation targets. The most common scenario is if Article 6.4 (or another carbon crediting standard) is used as a tool for the disbursement of RBCF (principles 1, 2 & 4).

Proposition 3: Private sector payments for MCUs can be counted towards the USD 300 billion goal if the purchase can be attributed to a donor country intervention. As under proposition 2, no liability is created for the host Party and no double counting occurs. However, only private finance that has been mobilized by a public intervention, and which flows directly to developing countries is eligible. Generally, only primary trades can be counted as climate finance as the margins that stay with intermediaries in secondary trades do not flow to developing countries (principle 5).

Proposition 4: Private sector payments for MCUs can be counted towards the USD 1.3 trillion goal even in the absence of a policy intervention. All actors are called to contribute to the scaled-up NCQG target and hence private sector expenditures qualify even if not mobilized by a public intervention. It does not matter whether the private sector “uses” the MCUs as a way of boosting its climate change credentials and thus could be considered to benefit from the transaction. In line with the broad NCQG contributor base, finance streams must be flowing into developing countries but could come from private sector entities or other non-state actors that are based anywhere in the world (principle 8).

Proposition 5: Private sector payments for ITMOs cannot be counted towards the USD 1.3 trillion goal. Even if commercial interests are permissible under the goal, ITMOs create a liability for developing countries in the form of corresponding adjustments and hence private sector ITMO payments do not result in a net benefit for developing countries. In many cases, the private sector may surrender ITMOs under a compliance scheme, such as CORSIA or

^v This includes payments channeled through MDBs or other multilateral organizations.

domestic carbon pricing instruments, which therefore indirectly benefit the NDCs of developed countries (principles 2, 4 & 8).

Proposition 6: Government support to underlying investments in Article 6 mitigation activities and/or mobilized private sector finance can be counted towards the USD 300 billion goal if the value of ITMOs generated by the activity is deducted. Such expenditures are eligible as long as the benefit received by the donor is assessed and subtracted (principle 3).

Proposition 7: Private sector investments in Article 6 mitigation activities can be counted towards the USD 1.3 trillion goal. In a similar vein, private sector investments into underlying mitigation activities can be counted if the value of any ITMOs received is deducted. Under the USD 1.3 trillion goal, all foreign investments in developing countries that are climate related can be counted, regardless of whether they are non-concessional in nature and benefit the investor (principles 3 & 8).

Proposition 8: The Share of Proceeds for adaptation can only partially be counted towards the USD 300 billion goal. The SOP benefits the Adaptation Fund, which in turn supports adaptation activities in developing countries. Although it may appear intuitive to count adaptation finance as climate finance, only a portion of the revenues received by the Adaptation Fund can be classified as such considering the above principles. The Adaptation Fund receives the auctioning proceeds from both MCUs and ITMOs, levied in-kind from Article 6.4 projects and depending on the status of authorization of the A64ERs generated by these projects. Thus, a portion of its revenues may be associated with liabilities created on the side of a developing country. It can also be argued that the buyer of ITMOs from the auctioned SOP receives a benefit. Only revenues received by the Fund from the auctioning of MCUs can thus count towards the USD 300 billion goal or the 1.3 trillion goal respectively. Similar principles apply for any voluntary contributions to adaptation under Article 6.2 whereby the Fund receives proceeds from the sale of other types of mitigation outcomes generated under other carbon standards (principles 2 & 4).

Proposition 9: In-kind contributions to OMGE do not have a clear beneficiary and therefore should not count towards the NCQG targets. Since there is no resource flow to developing countries, it cannot be considered climate finance.

Proposition 10: Host Party levies and the sharing of mitigation outcomes could be counted towards the USD 300 billion goal and by extension the USD 1.3 trillion goal. These are levies that benefit the host Party without a comparable benefit to the buyer or investor in carbon market projects. It is questionable, however, whether fees that only aim to recover the administrative costs associated with the approval and authorization of activities can also be counted as they result in no net benefit to developing countries (principles 2, 4 & 6).

Proposition 11: Article 6 readiness support can be counted towards the USD 300 billion goal. Support activities can be considered as climate finance. However, this would not qualify in instances where the support is linked to a potential ITMO transaction and the financial support for capacity-building is reflected in the price of the ITMO. Schneider and Haase also point to grey areas where readiness support is provided for scoping and developing mitigation activities that ultimately result in an ITMO transaction.³⁹

Proposition 12: Support provided under Article 6.8 can be counted towards the USD 300 billion goal. Support through non-market approaches, including finance, technology transfer,

and capacity-building are not linked to any donor benefit or host Party liability and therefore, are eligible to be counted as climate finance.

How to monitor and report on Article 6 related finance

While the above propositions have been formulated from a theoretical point of view, the question is whether they would also be feasible to implement in practice. Climate finance reporting is not an exact science. Donors face considerable ambiguities when categorizing development finance projects as principally or significantly climate related and default approaches have been adopted to minimize administrative burden. Data gaps are a key impediment to accurate climate finance reporting. With the adoption of the USD 1.3 trillion goal, even greater challenges arise in tracking contributions from non-state actors that do not report to the OECD or the UNFCCC. Accurately estimating private finance flows to developing countries is particularly challenging and will likely have to rely on a disparity of data sources and proxy methods.⁴⁰

As it stands, the reporting structure for Article 6 does not help to address this issue, as it does not include reporting on financial spending. Instead, it is designed for ensuring environmental integrity, sustainable development and transparency of the cooperative approaches, as well as hedging against double counting of emission reductions by more than one Party.

Under Article 6.2, Parties must submit i) an initial report describing the cooperative approach and demonstrating how the participation requirements are met, ii) annual information on all actions related to authorization, transfer, use and cancellation of the ITMOs in the Agreed Electronic Format (AEF) and iii) regular information as an Annex of the BTR, in which the above information is summarized and tracked on a biennial basis.⁴¹ The BTR therefore contain information on both Article 6 transfers and climate finance (needed and provisioned) but without connecting the two.

Under Article 6.4, activity-level reporting is carried out by individual mitigation activities. Project participants must monitor baseline, project, and leakage emissions in accordance with centralized Article 6.4 rules and approved methodologies. Before A64ERs are issued, emission reductions must be verified by third party auditors. The monitoring and reporting obligations do not include financial aspects, other than the use of financial indicators to demonstrate additionality.⁴² Information on the commercial transaction of A64ERs, particularly the contract value and price of carbon credits, is generally seen as sensitive and not disclosed to the UNFCCC.

In conclusion, there are currently no specific provisions within the Article 6 reporting framework that would enable a more specific data generation on financial flows mobilized through carbon markets. Providing further clarity on the attribution and reporting of at least some Article 6 related payments and benefits, as proposed above under “propositions”, could trigger greater financial flows to developing countries. However, it is an open question where such guidance should come from (within or outside the UNFCCC) and whether including information on finance within the Article 6 reporting templates would add value or create unnecessary complexities. It is also worth exploring whether country-driven or multilateral initiatives could address the information gap and lead to better reporting of mobilized climate finance towards the USD 1.3 trillion goal.

How this might be achieved goes beyond the scope of this paper, which aims to provide a basis for discussion for the Article 6 and climate finance communities.

7. ENDNOTES

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