SOUTH CENTRE

CLIMATE POLICY BRIEF

www.southcentre.int

No. 26 ● October 2021

Some Key Elements for Developing Countries in Climate Change Negotiations of COP 26: Climate Finance, Article 6 Negotiations and Implications

By M. Natalia Pacheco Rodríguez * and Luis Fernando Rosales **

Introduction

Human influence is deepening the climate crisis at an unprecedented pace. According to the Intergovernmental Panel on Climate Change (IPCC) 2018 report, global warming was estimated to reach 1.5°C between 2030 and 2052.[1] However, 2020 was already one of the three warmest years on record - the global average temperature was 1.2°C above the pre-industrial baseline.[2] Recently, the World Meteorological Organization (WMO) warned that there is about a 40% chance of the annual average global temperature temporarily reaching 1.5°C above the pre-industrial level in at least one of the next five years.[3] In August 2021, the IPCC issued a Climate Change report, examining five scenarios in which

Abstract

Human influence is deepening the climate crisis at an unprecedented pace. Developing countries' economies have been hit hard by the crisis caused by COVID-19. Means of implementation are crucial for them to contribute to the achievement of the Paris Agreement goal. Developed countries must fulfill their commitments to provide US$ 100 billion per year by 2025 to climate finance. The latest years' negotiations have shown the importance of improving the reporting methodology and the need for an agreed operational climate finance definition. In turn, Article 6 negotiations offer an opportunity to ensure higher ambition of both mitigation and adaptation through cooperative approaches while respecting the agreed balance between market and non-market approaches. What should developing countries expect on these issues at COP 26?

***

L'influence humaine aggrave la crise climatique à un rythme sans précédent. Les économies des pays en développement ont été durement touchées par la crise causée par le COVID-19. Les moyens de mettre en œuvre sont cruciaux pour que ces pays contribuent atteindre l'objectif de l'Accord de Paris. Les pays développés doivent respecter leurs engagements de contribuer 100 milliards de dollars par an d'ici 2025 pour le financement du climat. Les négociations de ces dernières années ont montré l'importance d'améliorer la méthodologie de rapport et la nécessité de convenir d'une définition opérationnelle du financement climatique. Les négociations de l'article 6 offrent quant à elles l'opportunité de garantir une plus grande ambition en matière d'atténuation et d'adaptation par le biais d'approches coopératives, tout en respectant l'équilibre convenu entre les approches de marché et les approches non marchandes. Que doivent attendre les pays en développement sur ces questions lors de la COP 26?

***

La influencia humana está agravando la crisis climática a un ritmo sin precedentes. Las economías de los países en desarrollo se han visto muy afectadas por la crisis causada por el COVID-19. Los medios de implementación son cruciales para que estos países contribuyan a alcanzar el objetivo del Acuerdo de París. Los países desarrollados deben cumplir sus compromisos de aportar 100.000 millones de dólares anuales para 2025 para el financiamiento climático. Las negociaciones de los últimos años han mostrado la importancia de mejorar la metodología de presentación de informes y la necesidad de acordar una definición de financiamiento climático operativa. A su vez, las negociaciones del Artículo 6 ofrecen una oportunidad para garantizar una mayor ambición tanto en la mitigación como en la adaptación a través de enfoques cooperativos, respetando al mismo tiempo el equilibrio acordado entre los enfoques de mercado y de no mercado. ¿Qué deberían esperar los países en desarrollo sobre estas cuestiones en la COP 26?

* María Natalia Pacheco Rodriguez is former Counsellor of the Mission of Bolivia to the United Nations in Geneva and former negotiator on climate change negotiations. She holds a PhD in Social Sciences from the University of Geneva.

** Luis Fernando Rosales Lozada is Coordinator of the Sustainable Development and Climate Change Programme at the South Centre and former Minister Counsellor of the Mission of Bolivia to the United Nations in Geneva. He also participated in several climate change negotiations.

"the 1.5°C global warming level is *very likely to be exceeded* under the very high GHG emissions scenario (SSP5-8.5), *likely to be exceeded* under the intermediate and high GHG emissions scenarios (SSP2-4.5 and SSP3-7.0), *more likely than not* to be exceeded under the low GHG emissions scenario (SSP1-2.6) and *more likely than not* to be reached under the very low GHG emissions scenario (SSP1-1.9)".[4] Under the five scenarios analyzed by the IPCC, the world is going to reach 1.5°C sometime in the next 20 years (2021-2040).

In May 2021, the WMO Secretary-General Professor Petteri Taalas said, "Increasing temperatures mean more melting of ice, higher sea levels, more heatwaves and other types of extreme weather conditions, and greater impacts on food security, health, the environment and sustainable development".[5] We all have been witnessing extreme weather across the world in 2021. Disastrous flooding in western Europe, Japan, China, droughts in Iraq, extreme heat and wildfires in North America, South America, Australia and so on. The world cannot wait to confirm scientific predictions to take action.

In this context, climate change negotiations under the United Nations Framework Convention on Climate Change (UNFCCC) have been affected by the crisis caused by the COVID-19 pandemic. The UNFCCC Climate Dialogues 2020 and the May–June 2021 subsidiary bodies sessions were held online. Even though a high number of participants were registered (5,788 participants[6]) in the latter event, there were several complaints regarding the room for substantive and meaningful participation, in particular from developing countries.[7] Problems with Internet connectivity, poor audio, power-cuts, as well as different time-zones and other problems in capitals hampered the effective participation and engagement in the UNFCCC virtual activities.

The 26th UNFCCC Conference of Parties (COP 26) will take place from October 31, 2021 to November 12, 2021, in Glasgow. What developing countries can expect from that meeting is uncertain. On the table, according to the United Kingdom (UK) presidency, the most important issues are: more ambitious National Determined Contributions (NDCs) for 2030 to keep 1.5°C within reach, Global Goal on Adaptation, climate finance including the need for setting the new collective quantified (post-2025) goal and finalizing Article 6 in the Paris Rulebook.[8] There are also other issues of relevance for developing countries, such as loss and damage, indigenous peoples' concerns, climate finance from a developing country perspective and finance for adaptation, among others. How far will these issues help developing countries deal with the climate crisis? Are the concerns of developing countries fully considered?

This Policy Brief aims to contribute to the debate on climate finance and the current status of the negotiations about article 6 of the Paris Agreement.

Climate Finance

Climate finance is one of the most crucial elements to help developing countries to achieve the common goal of holding global average temperature "to well below 2°C above preindustrial levels and pursuing efforts to limit the temperature increase to 1.5°C".[9] When the Paris Agreement was adopted in 2015, it was clearly agreed that developed countries will financially support developing countries for their mitigation and adaptation efforts:

> *Developed country Parties shall provide financial resources to assist developing country Parties with respect to both mitigation and adaptation in continuation of their existing obligations under the Convention.*[10]

This commitment was built upon previous agreements such as the UNFCCC[11] and the Copenhagen Accord, whereby developed countries committed to mobilize US $100 billion per year by 2020.

> *(…) In the context of meaningful mitigation actions and transparency on implementation, developed countries commit to a goal of mobilizing jointly USD 100 billion dollars a year by 2020 to address the needs of developing countries.*[12]

The timeframe was further extended to 2025 in paragraph 53 of Decision 1/CP.21 Adoption of the Paris agreement:

> *in accordance with Article 9, paragraph 3, of the Agreement, developed countries intend to continue their existing collective mobilization goal through 2025 in the context of meaningful mitigation actions and transparency on implementation; prior to 2025 the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement shall set a new collective quantified goal from a floor of USD 100 billion per year, taking into account the needs and priorities of developing countries;"*

One thing is clear for all: without appropriate financial support for developing countries the goals of the Paris Agreement may not be achieved. A large number of developing countries are facing many challenges related to their socio-economic development, particularly widespread poverty and lack of access to financial resources to implement their development strategies. The climate crisis makes these challenges even more complex. Their limited and fragile productive capacities will be further tested and their objective of 'trading out of poverty' undermined.[13] On top of that, the COVID-19 pandemic not only has adversely affected developing countries' economies but also it has altered the context for international climate finance. This crisis is, according to the 2020 report of the Independent Group of Experts on Climate Finance, convened by the United Nations (UN) Secretary General, "*the most damaging humanitarian and economic crisis since the Second World War and its impacts have been particularly severe on emerging markets and developing economies*".[14]

In this uncertain context, what should be expected in terms of climate finance in the COP 26 for developing countries?

The landscape is not very encouraging. One of the first assertions during the May – June 2021 Subsidiary Bodies (SBs) meeting was the verification that developed countries unfulfilled its USD 100 billion target agreed in 2009.[15] This situation runs against the promises and commitments made by them on several occasions. It is also clear that without financial and technical support, developing countries will not be able to implement their NDCs, the key vehicles for implementing the agreement reached in Paris in 2015.[16]

Another problem is the lack of an agreed operational definition of 'climate finance'. During the 2020-2021 meetings, mentioned before, it was noted that the lack of an agreed definition of climate finance creates problems in the reporting, counting and transparency.[17] Without an operational agreed definition, the reporting is made in a very open-ended manner which do not allow Member States to have a clear picture of the climate finance. The current methodology is allowing developed countries to report loans in non-concessional terms to developing countries as part of its contributions to the global commitment of $100 billion for 2020.[18] Analyses conducted by some entities, such as OXFAM International and the Organisation for Economic Co-operation and Development (OECD), show that loans and other non-grant instruments account for 70% to 80% of reported public climate finance.[19] According to OXFAM, from an estimated $59.5 billion annual public climate finance reported in 2017– 2018, only $12.5 billion was provided in the form of grants; $22 billion was provided as concessional loans and other non-grant instruments; and $24 billion was provided as non-concessional loans and other instruments;[20] that means that about 40% of the loans are made in commercial terms.[21] OXFAM Climate Finance Shadow Report 2020 rightly stated that "*the excessive use of loans and the provision of non-concessional finance in the name of climate assistance is an overlooked scandal*".[22] It is expected that the Standing Committee on Finance may come up with some suggestions to address this concern during the COP 26.

During a workshop on climate finance organized by the UNFCCC Secretariat during the May-June 2021 SBs meetings, participants expressed the view that commercial loans, guarantees and export credits should not be counted as finance towards the USD 100 billion goal.[23] One of the key concerns highlighted in the workshop was the fact that the net financial value of climate finance provided to developing countries may be less than half of that reported by developed countries after adjusting for grant equivalence.[24]

Debt is going to be a major issue for developing countries in the COVID-19 pandemic recovery. Therefore, **should developing countries accept non-concessional loans, semi-concessional loans and guarantees[25], as part of developed countries commitment on climate finance**? Is this approach to climate finance consistent with the principles of the UNFCCC?

The development needs of developing countries to provide essential services to their people, including health, education, housing, among others, compel them to recur to all possible sources of finance. This includes climate finance loans to fulfill their NDCs and also to provide some relief to their financial limitations. This is a consequence of developing countries' structural weakness that lead them to a very pernicious result - they become more indebted (see Box 1 in next page).

Nowadays, due to the COVID-19 pandemic, the situation of developing countries in terms of public external debt has worsened. Most developing countries have suffered large losses of revenue with knock-on effects on their fiscal and debt positions. 54% of low-income countries are deemed to be in debt distress or at high risk of debt distress as of September 2020, a trend likely to continue in 2021 onwards.[26]

Under the UNFCCC and the Paris Agreement (PA), developed countries shall provide financial resources to developing countries. It is not only an issue of climate justice and equity but also a legal commitment. Moreover, developed countries are committed to mobilize financial resources from different sources, unfortunately, with no specification about the type or nature of the instrument.

Even though the nature of financial instruments is not defined in the UNFCCC and subsequent instruments, there are indications in the Convention that financial resources to developing countries should be in the form of grants or concessional terms taking "*…fully into account that economic and social development and poverty eradication are the first and overriding priorities of the developing country Parties*".[27] Article 11 of the Convention, when defining a financial mechanism, states that financial resources to implement the financial mechanism are *"on a grant or concessional basis"*.[28] It is also relevant to note that under the UNFCCC provisions, Parties must take fully into consideration the specific needs and concerns of developing country Parties arising from the impact of the implementation of response measures.[29]

The Kyoto Protocol and the Copenhagen Accord also do not define the nature of the financial resources to be provided to developing countries. Neither does the PA. However, Article 9.4 of PA states that the provision and scaling up of financial resources should be done "*…considering the need for public and grant-based resources for adaptation*."[30]

Notwithstanding these elements, as previously said, the actual situation is that about 40% of the public financial resources provided to developing countries for climate finance are non-concessional loans, semi-concessional loans, equities, or instruments of the like, meaning loans in commercial terms. It can exacerbate the debt distress that developing countries are currently facing.

Loans in non-concessional terms and the like should not be counted as climate finance. Non concessional loans, semi-concessional loans and the like should not be considered as a contribution from developed countries to their climate finance commitments[31] because they run against

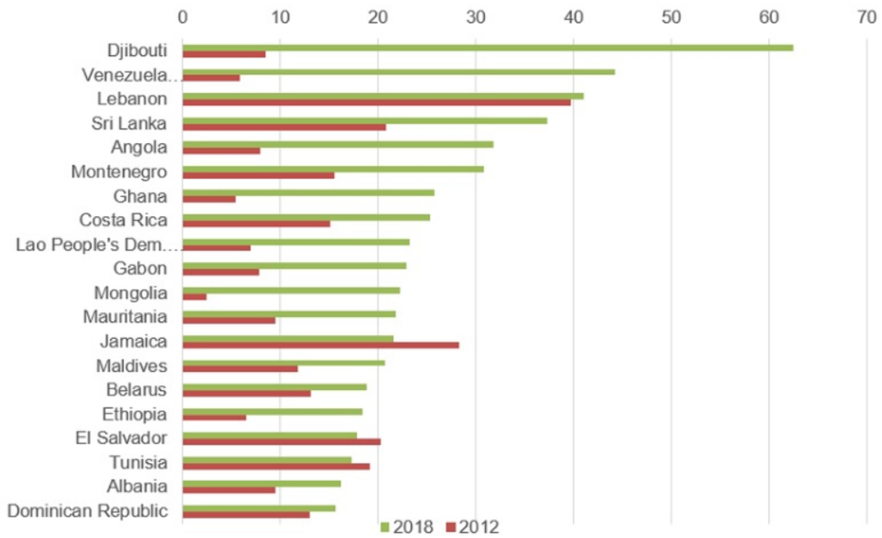
Box 1

COVID-19 is a matter of life and debt, global deal needed

The coronavirus pandemic hits developing countries at a time when they have already been struggling with unsustainable debt burdens for many years, as well as with rising health needs. The United Nations Conference on Trade and Development (UNCTAD) calls for US$1 trillion in debt relief. In 2020 and 2021, developing countries' repayments on their public external debt alone will soar to between US$2.6 trillion and $3.4 trillion.

The situation is much more severe in many developing countries where more than a quarter of revenues are absorbed by debt servicing. The graph below shows the distribution of debt service burdens, as a share of government revenues, in some developing countries in 2012 and 2018:

Ratio of debt service on public and publicly guaranteed external debt to government revenues, top 20 developing countries, 2018

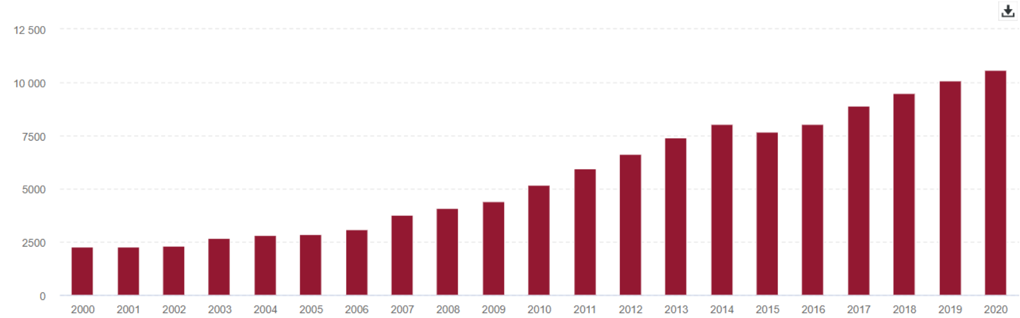


Source: UNCTAD, https://unctad.org/news/covid-19-matter-life-and-debt-global-deal-needed. Last accessed 17 September 2021.

External debt grew to a record high in 2020, with worsening risk profiles

In the wake of the COVID-19 pandemic, external debt stocks of developing countries reached US$10.6 trillion, their highest level on record, more than twice their value of US$4.4 trillion registered in 2009, and more than four-fold their level of US$2.3 trillion in 2000. Given the sluggish growth since the global financial crisis of 2007-2008, this translated into a renewed increase in the average ratio of external debt to gross domestic product (GDP) from 23 per cent in 2008 (its lowest point in the last 20 years) to 31 per cent in 2020. Moreover, 2020 has seen the highest annual increase since the financial crisis, probably as a result of the COVID-19 crisis.

Figure 1. External debt stocks, developing economies
(Billions of current US$)



Source: UNCTAD calculations based on data from World Bank (2021), IMF (2021) and national sources.
Note: Figures for 2020 are UNCTAD estimates.

Source: UNCTAD, "Developing country external debt: From growing sustainability concerns to potential crisis in the time of COVID-19". Available from https://sdgpulse.unctad.org/debt-sustainability/. Last accessed 17 September 2021.

the UNFCCC and Paris Agreement principles. Probably, loans will continue to prevail in international finance and they must be recorded. However, under the UNFCCC and the PA frameworks they should not be counted as developed countries' contributions to the $100 billion goal of climate finance.

Climate finance reporting

Under the UNFCCC, developed countries are committed to report on their financial contributions.[32] In 2010, COP 16 created the Standing Committee on Finance "*…to assist the Conference of the Parties in exercising its functions with respect to the financial mechanism of the Convention in terms of improving coherence and coordination in the delivery of climate change financing, rationalization of the financial mechanism, mobilization of financial resources and measurement, reporting and verification of support provided to developing countries*".[33] Even though improvements have been made, in particular in Decision 18/CMA.1 in the Katowice Meeting[34] the methodological problems of reporting persist and are still pending a satisfactory resolution.

The independent group of experts convened by the UN Secretary-General to consider this matter found that current methods of reporting have a number of important shortfalls in the quality and composition of climate finance flows.[35] According to them despite steps taken to date for improving consistency, comparability and overall transparency of reporting on climate-specific finance, the methodology for reporting is not applied on a consistent basis across reporting countries and is not fully transparent for both bilateral and multilateral providers.[36] The OXFAM report also highlighted "*[r]eported finance is based on methodologies which inflate donor numbers and are not acceptable to the majority of recipient countries – such as counting the face value of loans as if they were grants, and overcounting the climate change value of development programmes.*"[37]

During the May–June 2021 SBs meetings, many countries expressed their concerns about lack of comprehensive data, common definition and accounting method which pose additional challenges to track progress on the finance mobilization goal and financial flows.[38] Questions also were raised about the transparency of the reporting.[39] According to the statement of the Group of 77 (G77) + China, the lack of a clear and transparent reporting system creates doubts about the net financial value of climate finance provided to developing countries which may be less than half of that reported by developed countries after adjusting for grant equivalence.[40]

Climate finance needs to be reported in a way that better reflects its real value to developing countries and the real effort made by developed countries. The OXFAM analysis showed that bilateral flows of public finance specifically targeting climate action could be $10.5–13.5 billion lower than reported figures. OXFAM also questioned the reporting of Multilateral Development Banks (MDBs). According to them, MDB finance counted towards the $100 billion goal was in the range of $25 billion in 2017–18 (annual average) but this figure cannot be verified as "*…the method is not transparent, and explanations of its usage are not public, preventing accountability and independent scrutiny*".[41]

The Development Assistance Committee (DAC) Creditor Reporting System (CRS) of the OECD is one of the most important sources of information on this matter.[42] Reports also are made from MDBs, regional banks and other available sources. Despite all this, countries and observers noted that the diversity of accounting methodologies makes it difficult to assess and compare climate finance flows and differentiate climate finance from official development assistance and therefore creates confusion about the information that is made available to the public.[43]

A solution already suggested is the need for a clear and more detailed definition of climate finance.[44] The UNFCCC itself does not have an agreed definition thereof. The Standing Committee on Finance in 2014 adopted a definition stating that "*[c]limate finance aims at reducing emissions, and enhancing sinks of greenhouse gases and aims at reducing vulnerability of, and maintaining and increasing the resilience of, human and ecological systems to negative climate change impacts.*"[45] However, the adopted definition has not proved to help developing countries to get the right information timely and therefore to take the appropriate decisions. Many Parties have observed that reporting on climate finance is unclear, lacks transparency and quality.[46] The absence of an agreed definition led to several problems in the reporting, measurement, verification and, in some cases, to double counting.[47] Sometimes a multilateral mechanism, such as a central clearing house mechanism has been proposed aiming to resolve the problem,[48] but if a mechanism is created, it must be inside the UN system (e.g. UNCTAD). In the absence of a clear definition and methodologies for reporting on climate finance, the expectations of developing countries and many observer entities remain unfulfilled.

Adaptation finance

Providing resources for adaptation is an obligation for developed countries emerging from article 4.3 and 4.4 of the UNFCCC. "*The developed country Parties…shall also assist the developing country Parties that are particularly vulnerable to the adverse effects of climate change in meeting costs of adaptation to those adverse effects*". Since the adoption of the UNFCCC, developed countries have been primarily focused on mitigation and insisting that developing countries should undertake ambitious mitigation targets, without providing them adequate finance, technology and capacity-building support. One of the constant struggles for developing countries has been to get a meaningful support for adaptation.[49]

The current status of climate finance reflects this reality. Most of the resources have been allocated to mitigation. Mitigation finance continues to represent over two thirds of total public climate finance provided and mobilized.[50] According to the OECD 2020 report, finance for adaptation grew by 29% per year on average to reach USD 16.8 billion in 2018, while finance for mitigation grew by 15% per year on average and more in absolute terms, reaching USD 55 billion in 2018. Mitigation continues to represent over two-thirds (70%) of the 2018 total, adaptation 21% and cross-cutting the remainder.[51] In terms of private climate finance, the allocations are worse, as 93 per cent of resources mobilized in 2016–2018 was for mitigation and mostly aimed at middle-income countries.[52]

OXFAM highlighted this imbalance between mitigation and adaptation finance. They estimated that 25 per cent of reported public climate finance is allocated for adaptation compared with 66 per cent for mitigation in 2017–2018.[53]

The United Nations Environment Programme (UNEP) has estimated the requirements of developing countries for adaptation in a range of $140 billion to $300 billion per year by 2030 and $280 billion to $500 billion annually by 2050. Another reference point comes from what countries are including in their Nationally Determined Contributions (NDCs). In their initial NDCs, 46 countries included estimates of their adaptation costs totalling cumulatively $783 billion by 2030. Overall, finance for adaptation remains inadequate and is far from reaching the aim of balanced allocation.[54]

Adaptation finance has become a priority for developing countries to deal with a problem not caused by them. At COP 26, as OXFAM suggested, a clear global public finance goal only for adaptation is necessary as a component of the new collective finance goal starting in 2025.[55]

Article 6 Negotiations and Its Implications

Article 6 of the Paris Agreement recognizes voluntary "*cooperative approaches*" in implementing Parties' NDCs to "*allow for higher ambition in their mitigation and adaptation actions and to promote sustainable development and environmental integrity*".[56] However, the interpretation of these approaches and the definition of rules to operationalize them continue to be the subject of long negotiations. In the run-up to COP 26, and in light of increasing climate change impacts, it is uncertain whether Parties will agree upon rules for cooperative approaches that ensure higher ambition of both mitigation and adaptation and respect the agreed balance between market and non-market approaches. The draft negotiating texts resulting from COP 25[57] and the Ministerial Consultations held on July 2021 showed that still much more needs to be done.[58]

The cooperative approaches as described in the Paris Agreement consist of three main elements: a) internationally transferred mitigation outcomes or ITMOs (Articles 6.2-6.3); b) a mechanism allowing the international exchange of mitigation reductions resulting from activities (Articles 6.4-6.7); and c) non-market approaches to assist in the implementation of Parties' NDCs (Articles 6.8–6.9). These approaches do not come from a vacuum but rather follow lengthy negotiations under the UNFCCC and the Kyoto Protocol.[59] Thus, the questions of governance, real and additional contributions, sustainable development, environmental integrity and various approaches are not new. At the same time, the new nationally led format of the Paris Agreement further increases some of the methodological and philosophical challenges.[60] In this context, it will be even more critical that international rules governing cooperative mechanisms increase ambition in all elements, contribute to equitable and sustainable development and support alternative approaches. However, the discussions so far have not been very encouraging.

a) Discussions regarding Article 6.2

Article 6.2 of the Paris Agreement recognized the use of internationally transferred mitigation outcomes (ITMOs) towards NDCs. The article also states that ITMOS should "*promote sustainable development and ensure environmental integrity and transparency, including in governance, and shall apply robust accounting to ensure, inter alia, the avoidance of double counting*".[61] Some of the main discussions surrounding the implementation of this article concern: governance, metrics and accountability, the share of proceeds to adaptation, limits and sectors.

The centralization level and scope of governance was an essential element of debate from the start of the negotiations after the adoption of Article 6.2. While some countries believed that a decentralized system was more aligned with NDCs, others considered that only a centralized system could achieve the overall objective. The current draft emanating from COP 25 refers to governance as a prerogative of each Party participating in ITMOs. It suggests that the Subsidiary Body for Scientific and Technological Advice (SBSTA) would guide accountability and reporting matters.[62] A centralized register is also proposed, as well as a technical expert review team to examine the reports and provide recommendations. While there seems to be a minimum international oversight in this proposal, the main prerogative to rule upon ITMOs remains on the Parties. This proposal raises the question of whether such limited control from the Parties to the PA over the quality of ITMOs and its restricted capacity to enforce recommendations would be enough to ensure the ambition, equity and environmental integrity of ITMOs.

Another element of contention is the question of metrics and accountability. The different NDCs put forward by Parties do not always use the same metrics to measure their mitigation and adaptation contributions. While some countries[63] argue that Parties should only use internationally recognized metrics like tCO2eq,[64] others consider that this would exclude many Parties from participating in the international trading of mitigation outcomes.[65] This discussion is also linked with the avoidance of double counting,[66] which requires solid global accountability systems. However, the measurement of mitigation outcomes, either in terms of tCO2eq or other potential metrics, entails high levels of abstraction, simplification and assumptions over equivalence which can easily lead to overestimation of emission reductions. This fundamental weakness in emissions trading was already questioned under the Kyoto mechanisms and is still present under the PA.

Given that all cooperative approaches should contribute to both mitigation and adaptation, developing countries propose that ITMOs contribute with a share of proceeds to adaptation. Nevertheless, developed Parties argue that this requirement was not mentioned in Article 6.2 of the PA and thus reject such a reference. However, the chapeau of Article 6, which applies to all mechanisms under the article, clearly states that voluntary cooperation was intended to allow higher ambition in both mitigation and adaptation.

Another point of contention consists of the limits to the use of ITMOs. Supporting higher ambition would entail limiting the purchase of carbon credits or allowances resulting from emission reductions in third countries while enhancing internal contributions to greenhouse gas reductions. Even under the Kyoto Protocol, market mechanisms were bound to a supplementarity clause. This clause required that most emission reductions should come from endogenous actions. However, the current draft guidance for Art. 6.2[67] does not clarify the limits and seems to leave this critical decision for further guidance by the Conference of the Parties serving as the meeting of the Parties to the PA (CMA).

Other points of controversy in the negotiations concern the applicability of ITMOs and corresponding adjustments to sectors not covered under Parties' NDCs. Similarly, there is a question of whether the overall mitigation in global emissions should also apply for Article 6.2.

Finally, Parties have not yet fully discussed the high levels of financial speculation observed in international markets of emissions trading.[68] There appears to be a disconnection between the fast pace of financial transactions compared to the slow technological exchanges and improvements observed in the real economy, thus putting in question the capacity of international trade of emissions to promote the ambitious transformations required.

b) Discussions regarding Article 6.4

Paragraphs 4 to 7 establish a mechanism "*to contribute to the mitigation of greenhouse gas emissions and support sustainable development*". Under this mechanism, emission reductions resulting from activities in a host Party can be traded and used by a purchasing Party to fulfill its NDC. The main points of discussion around this mechanism concern the transition of projects and certificates of emission reductions (CERs) from the Kyoto Clean Development Mechanism (CDM), and the question of additionality and double counting.

One of the big questions in the negotiations to operationalize Article 6.4 has been the transition of the thousands of projects in the CDM pipeline to the new mechanism. Various emerging economies advocate in favor of the transition of these projects, arguing that these complied with the methodologies and procedures under Kyoto and that cancelling their CERs would undermine the trust of the private investors. Nevertheless, most developed countries and several developing countries consider that bringing all those projects to the new mechanism would risk inundating the market with thousands of emission reductions with negative impacts on the ambition required to achieve the Paris targets.

An essential element in the discussion of the transition is the requirement of additionality and environmental integrity. Indeed, emission reductions need to prove that they would not have existed in the absence of the mechanism and/or policy. Various methodologies were developed under the CDM for that purpose. Nevertheless, some studies showed that a large majority of CDM "*have a low likelihood that emission reductions are additional and are not overestimated*".[69] Various reasons underlie this problem, including the fact that several projects could have been financially viable even without entering into carbon markets. Furthermore, the measurement of baselines, unrealistic assumptions, perverse incentives and leakage have also undermined the actual contribution to greenhouse gas reductions claimed by many CDM projects.[70]

The proposal that emerged from the negotiations at COP 25 suggests addressing the transition issue by leaving a door open for aligning old CERs to the new or revised methodologies.[71] Furthermore, the text includes a timeframe to approve the transition of projects and CERs that comply with the new rules. If this proposal is adopted during the next COP, it will be essential to strengthen the methodologies to increase additionality and environmental integrity.

Another point of controversy is the question of corresponding adjustments to avoid double counting of emission reductions. Some Parties argue that the differences in NDCs are difficult for a homogenous approach to applying such adjustments. So far, the text emerging from the negotiations at COP 25 seems to suggest an opt-out period to avoid perverse incentives that could undermine efforts to add sectors or increase ambition in subsequent NDCs.

Finally, another crucial element for carbon markets is the question of human rights. Various experts,[72] including the UN Office of the High Commissioner for Human Rights, has called for more robust integration of human rights, stakeholder consultations, environmental and social safeguards and an independent redress mechanism in the cooperative approaches under Article 6.[73] Indeed, questions of equity are crucial to achieving the PA objective so as to ensure that those with higher capacities and responsibilities do not waive their obligations through market approaches.[74] Currently, the negotiation text includes a reference to avoiding negative environmental and social impacts and promoting consultations.

c) Discussions regarding Article 6.8

Paragraphs 8 and 9 of Article 6 define a framework for non-market approaches to sustainable development.

Thus, non-markets are recognized in the Paris Agreement as one of the cooperative approaches that can assist NDCs, including through mitigation, adaptation, finance, technology transfer and capacity building. However, to further operationalize this approach, the next COP 26 will need to agree upon establishing a governing body, which has been a point of controversy so far.

Several developing countries propose that a permanent institutional arrangement be established to enable non-market approaches to progress similarly to the other cooperative mechanisms under Article 6.[75] However, some developed Parties reject setting a "new" structure and consider that SBSTA could take that role. This latter option would leave the non-market approaches as one of the many other agenda items of SBSTA, while the mechanisms under Article 6.2 and 6.4 would have their competent bodies to review or discuss the methodologies and guidance required to implement them.

The proposal of the President resulting from COP 25 suggests leaving the discussion of the focus areas of the work programme to a forum under SBSTA.[76] Furthermore, it encourages Parties to engage in research and present submissions on examples of non-market approaches. It also proposes to organize an in-session workshop on the matter.

While the exchange of examples and submissions are indeed essential elements, it seems that the President's proposal does not take the framework any further. A focus exclusively on the exchange of examples and submissions risks perpetuating the debates without a concrete implementation. Therefore, it would be important that Parties discuss an institutional arrangement to advance non-market approaches to promote ambition in all elements of the Paris Agreement. An institutional structure would entail, among others, a strong mandate, technical expertise, time and resources to further the discussions, guidance and implementation review.

Conclusions

The climate crisis is pushing humanity to the brink. We are in the crucial moment where solutions must consider developing countries' concerns and interests in terms of climate finance, as provided in the UNFCCC, the Paris Agreement and other climate change instruments. Developed countries failed to deliver on their pledge to commit $100 billion in annual climate finance. Without this support, developing countries will not have the appropriate means to implement their NDCs, putting at risk the achievement of the global goal to keep the temperature well below 2°C above pre-industrial levels and efforts to limit the temperature increase to 1.5°C for 2050.

Developing countries require financial resources to fight the climate crisis, but these resources should not increase the indebtedness of many of these countries already in high debt distress exacerbated by the socio-economic crisis caused by COVID-19 pandemic.

In this regard, concrete steps are required to put in place a clear process of reporting which is useful for monitoring and verify the contributions of developed countries according to their commitments. It is an issue of transparency and building confidence in climate finance for the years to come.

The Standing Committee on Finance is the UNFCCC body[77] in charge to find out a solution for an operational definition of climate finance, which is of interest to many developing countries. This definition should aim to differentiate grants, loans - in particular non-concessional or semi-concessional loans - and other non-grant instruments as part of the $100 billion commitment of developed countries and an appropriate methodology of accounting should be created accordingly.

Resources for adaptation are about one-third of that for mitigation. Adaptation finance remains a priority for developing countries and yet the expectations to funding this area have not been fulfilled. In COP 26 there is a need to explore mechanisms aiming to allocate more resources for adaptation efforts from developing countries.

In terms of Article 6 negotiations, it is clear that international rules governing cooperative mechanisms have to increase ambition in all elements under negotiation to contribute to equitable and sustainable development and support alternative approaches.

The governance, transparency and ambition of ITMOs remain an issue. The new rules will need to ensure close international oversight and transparency, set limits to guarantee endogenous actions and enable cooperation to support the diversity of NDCs. Furthermore, it would be crucial that ITMOs contribute with a share of proceeds to adaptation in accordance with the spirit of Article 6. Rules would also be required to limit potential speculation in the trade of ITMOs and ensure a real contribution of this approach to more ambitious emission reductions and the technological transformations needed.

The transition of the carbon credits under the CDM to the new mechanism under Article 6.4 will be a key element in the negotiations. Parties will need to discuss how to improve additionality and enhance the environmental, social and financial contributions of activities under this mechanism.

In addition, it will be important that Parties discuss an institutional arrangement to advance non-market approaches under Article 6.8. An institutional structure with a clear mandate, technical expertise, adequate time and resources could help further the discussions, including the exchange of experiences, development of guidance and implementation review.

Finally, mainstreaming social and environmental safeguards and integrating equity considerations in the negotiations of Article 6 will be central to achieve the Paris goals, avoiding that those with higher capacities and responsibilities waive away their obligations including through the use of market approaches.

Endnotes:

[1] Intergovernmental Panel on Climate Change (IPCC)*, Summary for Policymakers. Global Warming of 1.5°C. An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty* [V. Masson-Delmotte, P. Zhai, H.-O. Pörtner, D. Roberts, J. Skea, P.R. Shukla, A. Pirani, W. Moufouma-Okia, C. Péan, R. Pidcock, S. Connors, J.B.R. Matthews, Y. Chen, X. Zhou, M.I. Gomis, E. Lonnoy, T. Maycock, M. Tignor, and T. Waterfield (eds.)] (Geneva, World Meteorological Organization, 2018), p. 4.

[2] World Meteorological Organization (WMO), *State of the Global Climate 2020* (Geneva), p. 5. Available from https://library.wmo.int/doc_num.php?explnum_id=10618 (accessed 16 July 2021).

[3] WMO, "New climate predictions increase likelihood of temporarily reaching 1.5°C in next 5 years", Press Release, 27 May 2021. Available from https://public.wmo.int/en/media/press-release/new-climate-predictions-increase-likelihood-of-temporarily-reaching-15-%C2%B0c-next-5 (accessed 16 September 2021).

[4] IPCC, *Summary for Policymakers*. *Climate Change 2021: The Physical Science Basis. Contribution of Working Group I to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change* [V. Masson-Delmotte, P. Zhai, A. Pirani, S. L. Connors, C. Péan, S. Berger, N. Caud, Y. Chen, L. Goldfarb, M. I. Gomis, M. Huang, K. Leitzell, E. Lonnoy, J.B.R. Matthews, T. K. Maycock, T. Waterfield, O. Yelekçi, R. Yu and B. Zhou (eds.)]. (Cambridge University Press, 2021), p. 18, Paragraph B.1.3. In Press.

[5] WMO, "New climate predictions increase likelihood of temporarily reaching 1.5°C in next 5 years".

[6] United Nations Climate Change, Daily Dashboard - May-June 2021 Climate Change Conference. Available from https://unfccc.int/process-and-meetings/conferences/may-june-2021-climate-change-conference-sessions-of-the-subsidiary-bodies/daily-dashboard-may-june-2021-climate-change-conference.

[7] Third World Network (TWN), "Developing countries convey difficulties faced in virtual meetings", TWN News Update No. 5 (7 June 2021).

[8] United Nations Climate Change, "July Ministerial - Letter from the COP 26 President Designate, H.E. Alok Sharma", 15 July 2021. Available from https://unfccc.int/news/july-ministerial-letter-from-the-cop-26-president-designate-he-alok-sharma (accessed 19 July 2021).

[9] Paris Agreement, article 2.1 (a).

[10] Paris Agreement, article 9.1.

[11] United Nations Framework Convention on Climate Change (UNFCCC), article 4, paragraphs 3, 4, 5 and Article 11.

[12] Copenhagen Accord, paragraph 8.

[13] Pradeep S. Mehta and Rashid Kaukab, "Paris Agreement: A pact of solidarity for developing countries?", *ecdpm,* May 2016. Available from https://ecdpm.org/great-insights/from-climate-commitments-to-action/paris-agreement-pact-solidarity-developing-countries/.

[14] Independent Expert Group on Climate Finance, *Delivering on the $100 billion climate finance commitment and transforming climate finance* (December 2020), p. 6. Available from https://www.un.org/sites/un2.un.org/files/100_billion_climate_finance_report.pdf (accessed 24 August 2021).

[15] FCCC/CP/2021/6, p. 3.

[16] Mariama Williams, "The State of Play of Climate Finance – UNFCCC Funds and the $100 Billion Question", Policy Brief, No. 21 (Geneva, South Centre, 2019).

[17] FCCC/CP/2021/6, p. 7.

[18] FCCC/PA/CMA/2018/3/Add.2, p. 37.

[19] OXFAM Climate Finance Shadow Report 2020 said that 80% of climate finance were loans. See Oxfam International, *Climate Finance Shadow Report 2020: Assessing progress towards the $100 billion commitment.* (Oxford, Oxfam International Publishing, 2020), p. 14. Available from https://www.oxfam.org/en/research/climate-finance-shadow-report-2020. The OECD in turn said that 74% of climate finance were loans. See OECD, *Climate Finance Provided and Mobilised by Developed Countries in 2013-18* (Paris, OECD Publishing, 2020), p. 17. Available from https://doi.org/10.1787/f0773d55-en.

[20] *OXFAM Climate Finance Shadow Report 2020*, p. 14.

[21] The level of concessionality of a loan is a core criterion for its eligibility to qualify as Official Development Assistance (ODA). Concessionality is assessed through the "grant element" calculation, i.e. an assessment of the financial terms that takes into account four factors: the interest rate, the grace period, the maturity, and the discount rate. See OECD, *Climate Finance Provided and Mobilised by Developed Countries in 2013-18,* p. 18.

[22] *OXFAM Climate Finance Shadow Report 2020*, p. 3.

[23] FCCC/CP/2021/6. p. 6, 7.

[24] Amount of money given to a developing country once repayments, interest and other factors are accounted for. See *OXFAM Climate Finance Shadow Report 2020.*

[25] Guarantees are not counted as ODA unless actually called. See Independent Expert Group on Climate Finance, *Delivering on the $100 billion climate finance commitment and transforming climate finance,* p. 48.

[26] Independent Expert Group on Climate Finance, *Delivering on the $100 billion climate finance commitment and transforming climate finance,* p. 6.

[27] UNFCCC, article 4.7.

[28] UNFCCC, article 11.

[29] UNFCCC, article 4.

[30] Paris Agreement, article 9.4.

[31] *OXFAM Climate Finance Shadow Report 2020.* See also Mario Draghi, Prime Minister of Italy, in a meeting with young activists on 30 September 2021. Available from https://www.reuters.com/article/climate-change-pre-cop26-grants-idAFR1N2OS02A (accessed 1 October 2021).

[32] UNFCCC, article 11.3.

[33] FCCC/CP/2010/7/Add.1, paragraph 112.

[34] FCCC/PA/CMA/2018/3/Add.2.

[35] Independent Expert Group on Climate Finance, *Delivering on the $100 billion climate finance commitment and transforming climate finance*, p. 7, 30.

[36] Independent Expert Group on Climate Finance, *Delivering on the $100 billion climate finance commitment and transforming climate finance*, p. 7.

[37] *OXFAM Climate Finance Shadow Report 2020*, p. 27.

[38] TWN, "Developing Countries Oppose EU Proposal to Sunset Long-term Finance Discussions", TWN News Update No. 6 (8 June 2021). Available from https://twn.my/title2/climate/unfccc31may21.htm (accessed 8 September 2021).

[39] Ibid.

[40] Ibid.

[41] *OXFAM Climate Finance Shadow Report 2020*, p. 13.

[42] The Creditor Reporting System (CRS) database is used to track ODA flows. The CRS Aid Activity database is to provide a set of readily available basic data that enables analysis on where aid goes, what purposes it serves and what policies it aims to implement, on a comparable basis for all DAC members. See https://www.oecd-ilibrary.org/development/data/creditor-reporting-system_dev-cred-data-en.

[43] Independent Expert Group on Climate Finance, *Delivering on the $100 billion climate finance commitment and transforming climate finance*, p. 7.

[44] FCCC/CP/2021/6, p. 7.

[45] FCCC/CP/2014/5, p. 17.

[46] Independent Expert Group on Climate Finance, *Delivering on the $100 billion climate finance commitment and transforming climate finance*, p. 7.

[47] Several reports from OECD, OXFAM, Independent Experts, previously referred, have highlighted that double counting is a problem, in particular when private finance is involved.

[48] Selin Henrik, "Climate Finance and Developing Countries: The Need for Regime Development", Global Economic Governance Initiative Working Paper, No. 9 (Boston University, October 2016), p. 3. Available from https://www.bu.edu/gdp/files/2017/07/Selin.Nov_.16.Final_.pdf.

[49] Harjeet Singh and Indrajit Bose, "History and politics of climate change adaptation at the United Nations Framework Convention on Climate Change", Research Paper, No. 89 (Geneva, South Centre, 2018), p. 5.

[50] FCCC/CP/2021/6, p. 4.

[51] OECD, *Climate Finance Provided and Mobilised by Developed Countries in 2013-18*, p. 7.

[52] FCCC/CP/2021/6, p. 6.

[53] *OXFAM Climate Finance Shadow Report 2020*, p. 4.

[54] Independent Expert Group on Climate Finance, *Delivering on the $100 billion climate finance commitment and transforming climate finance*, p. 30.

[55] *OXFAM Climate Finance Shadow Report 2020*, p. 19.

[56] Paris Agreement . Article 6.1.

[57] FCCC/PA/CMA/2019/6/Add.1. Decision 9/CMA.2 Matters relating to Article 6 of the Paris Agreement. Available from https://unfccc.int/sites/default/files/resource/cma2019_06a01E.pdf.

[58] Report by Minister Grace Fu (Singapore) and Minister Sveinung Rotevatn (Norway) on the Informal Ministerial Consultations on Article 6 of the Paris Agreement on 7 and 12 July (26 July 2021). Available from https://unfccc.int/sites/default/files/resource/Article%206%20Ministerial%20Consultations%20Report%20Back.pdf.

[59] Under the Kyoto Protocol, two main forms of carbon markets were recognized: cap and trade and project based. Under the cap and trade system, industrialized economies in Annex I as well as Annex B countries could trade emission allowances. The project-based system enabled developed countries to purchase carbon certifications from projects in developing countries under the Clean Development Mechanism or CDM, as well as projects in other Annex I Parties under the Joint Implementation system. Non-market mechanisms have also been discussed for many years, particularly under the framework for various approaches. See https://unfccc.int/topics/markets--non-market-mechanisms/resources/views-on-a-framework-for-various-approaches.

[60] Consider for example the different metrics used by countries to measure their NDCs, the different scope of their intended measures and the low levels of ambition particularly by those Parties with higher capacities and historical responsibilities. This last point is crucial, taking into account that the sum of all NDCs so far is not enough to limit temperature increase below 2°C but could lead to an increase of temperature of more than 3°C by the end of this century. See United Nations Environment Programme (UNEP), *Emissions Gap Report 2020* (Nairobi). Available from https://www.unep.org/emissions-gap-report-2020.

[61] Paris Agreement, Article 6.2.

[62] Draft Text on Matters relating to Article 6 of the Paris Agreement: Guidance on cooperative approaches referred to in Article 6, paragraph 2, of the Paris Agreement, Version 1 of 13 December 11:15hrs. Available from https://unfccc.int/sites/default/files/resource/DT.CMA2_.i11a_13Dec.pdf.

[63] Submission to the Articles 6.2 and 6.4 of the Paris Agreement by the Republic of the Maldives on behalf of the Alliance of Small Island States (27 April 2017). Available from https://www4.unfccc.int/sites/SubmissionsStaging/Documents/201903130535---AO-SIS_Submission_Art%206%202%20and%206%204%20of%20%20PA%2027%2004%202017%20FINAL.pdf.

[64] Carbon dioxide equivalence (expressed per kg or tonne of CO2 equivalent, kgCO2eq or tCO2eq) is a quantity that describes, for a given mixture and amount of greenhouse gas, the amount of CO2 that would have the same global warming potential (GWP), when measured over a specified timescale (generally, 100 years). Available from https://www.eca.europa.eu/en/Documents/ECA_Carbon_footprint_report_2014_EN.pdf.

[65] Submission of the Like Minded Developing Countries - LMDC on the Article 6.2 & 6.4 & 6.8-6.9 of the Paris Agreement. Available from https://www4.unfccc.int/sites/SubmissionsStaging/Documents/713_318_131364935945235570-LMDC%20Submission%20on%20the%20Article%206%20of%20the%20Paris%20Agreement%20-%20SBSTA%2046.pdf.

[66] Only the last owner of the outcome should use it for the purposes of its NDC but not the party who emitted the ITMO.

[67] Draft Text on Matters relating to Article 6 of the Paris Agreement: Guidance on cooperative approaches referred to in Article 6, paragraph 2, of the Paris Agreement, Version 1 of 13 December 11:15hrs.

[68] Nathalie Bertanathalie, Emmanuelle Gautherat and Ozgur Gun, "Transactions in the European Carbon Market: A Bubble of Compliance in a Whirlpool of Speculation", *Cambridge Journal of Economics*, vol. 41, No. 2 (2017), pp. 575- 593.

[69] Martin Cames and others, "How additional is the Clean Development Mechanism? Analysis of the application of current tools and proposed alternatives" (Berlin, Oko-Institut e.V, 2016).

[70] Ibid.

[71] Draft Text on Matters relating to Article 6 of the Paris Agreement: Rules, modalities and procedures for the mechanism established by Article 6, paragraph 4, of the Paris Agreement, Version 3 of 15 December.1:10hrs. Available from https://unfccc.int/sites/default/files/resource/CMA2_11b_DT_Art.6.4_.pdf.

[72] Center for International Environmental Law (CIEL), "Rights, Carbon, Caution. Upholding Human Rights under Article 6 of the Paris Agreement" (2021). Available from https://www.ciel.org/wp-content/uploads/2021/02/Rights-Carbon-Caution.pdf.

[73] United Nations Office of the High Commissioner for Human Rights, "Integrating human rights at the UNFCCC". Available from https://www.ohchr.org/EN/Issues/HRAndClimateChange/Pages/UNFCCC.aspx (accessed 25 September 2021).

[74] Maria Natalia Pacheco, "Social Safeguards and Equity in the Provisions of Payment for Environmental Services in the Paris Agreement", Doctoral Thesis, University of Geneva, 2019.

[75] TWN, "Article 6 of the Paris Agreement is not about carbon markets – says Bolivia", UNFCCC Sessions of the Subsidiary Bodies (May-June 2021),, TWN Climate News Updates. Available from https://www.twn.my/title2/climate/fullpdf/UNFCCCUpdatesfinalversion1.pdf.

[76] Draft Text on Matters relating to Article 6 of the Paris Agreement: Work programme under the framework for non-market approaches referred to in Article 6, paragraph 8, of the Paris Agreement, Version 3 of 15 December 00:20hrs. Available from https://unfccc.int/sites/default/files/resource/DT.CMA2_.i11c.v3.pdf.

[77] See Decision 11/CP.25.

SOUTH CENTRE

The South Centre is the intergovernmental organization of developing countries that helps developing countries to combine their efforts and expertise to promote their common interests in the international arena. The South Centre was established by an Intergovernmental Agreement which came into force on 31 July 1995. Its headquarters is in Geneva, Switzerland.

The South Centre
International Environment House 2
Chemin de Balexert 7-9
PO Box 228, 1211 Geneva 19
Switzerland
Telephone: (4122) 791 8050
E-mail: south@southcentre.int
http://www.southcentre.int

Follow the South Centre's Twitter: South_Centre

Previous South Centre Climate Policy Briefs

No. 14, August 2014—Loss and Damage Mechanism Set Up for Climate Change by Martin Khor

No. 15, November 2014—Climate Change, Technology and Intellectual Property Rights: Context and Recent Negotiations by Martin Khor

No. 16, January 2015— Understanding the Lima Climate Conference A Proxy Battle for the 2015 Paris Agreement by Martin Khor

No. 17, May 2015—Policy Brief on Intended Nationally Determined Contributions (INDCS)

No. 18, November 2016—Gender and Finance: Coming Out of the Margins by Mariama Williams

No. 19, March 2017—Highlights of COP 22 in Marrakech 2016, including interpreting the Paris Agreement by Meena Raman

No. 20, February 2018—Overview of outcomes of the November 2017 UNFCCC climate talks by Meena Raman

No. 21, December 2019—The State of Play of Climate Finance – UNFCCC Funds and the $100 Billion Question by Mariama Williams

No. 22, February 2020—The Africa Energy Transition Program (AFRETRAP) by Rajesh Eralil and Youba Sokona

No. 23, March 2020—Flirting with the Private Sector: The GCF Private Sector Facility — achievements, challenges and constraints in engaging the private sector by Rajesh Eralil, Mariama Williams and Dianyi Li

No. 24, July 2020—Pathways for leapfrogging to reconcile development and climate change imperatives in Africa by Smail Khennas and Youba Sokona

No. 25, February 2021— The UNFCCC Virtual Regional Workshops on Gender and Climate Change 2020 by Mariama Williams