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Repositioning Brazil towards Regulation of Article 6 of the Paris Agreement

Lack of consensus on issues affecting the environmental integrity of the Agreement and the cost-effectiveness of transfers have put the regulation of Article 6 on hold; however, such barriers should be overcome at COP26 in Glasgow.

This document analyzes some of these barriers and sets guidelines on Brazil's positioning. Finally, it suggests a climate governance framework that will allow the country to tap into the opportunities arising from such instruments.



EXECUTIVE SUMMARY

Article 6 of the Paris Agreement provides two market-based instruments for trading greenhouse gas emissions: one instrument, for trading internationally transferred mitigation outcomes (ITMO), provided for in Article 6.2, covers centralized and direct trades of mitigation outcomes between countries, and a decentralized mechanism, described in article 6.4, which encompasses trades between public and private entities of carbon credits generated by projects or programs.

Such instruments replace the clean development mechanisms (CDM) for transfers between countries without targets and countries with targets, and the joint implementation (JI) for transfers between countries with targets, of the Kyoto Protocol, replaced by the Paris Agreement.

1. Corresponding adjustments as an opportunity to strengthen the carbon market

Article 6 has not yet been regulated as consensus remains to be reached on several issues; however, divergences should be overcome at the upcoming COP26, in Glasgow. One of the key issues concerns the corresponding NDC adjustments, which occur when a country selling ITMO, or credits under Article 6.4, increases its NDC based on the quantity traded, thus enabling the buying country to deduct it from its NDC target.

This adjustment had been adopted in JI in view of the targets of sellers and buyers; however, it did not apply to CDM at the time, as the latter was traded by countries that had no targets. Since all countries have targets for their NDC commitments under the Paris Agreement, the overall reduction of the Agreement will be much smaller without these adjustments.

While such flexibility allows the sale of credits without corresponding adjustments, it also affects demand due to the lack of environmental integrity. For that reason, many developed and developing countries have already pledged to refuse transfers without such adjustments. Furthermore, the country transferring the credits would have to compete with several countries that accept the adjustment procedure.

It is therefore estimated that by 2030, average prices for trades of emissions without corresponding adjustments covered by Article 6 would not exceed \$10/tCO₂e, while prices with corresponding adjustments would rise above \$30/tCO₂e, generating up to 40% revenue increases¹.

¹ Schwieger et al. (2019).



Likewise, trading CDM credits under the Paris Agreement would result in double counting, as such emission-reduction outcomes will be also counted towards the emissions inventory of the selling countries. A full carryover of CDM credits would not only decrease global emission reductions, but also bring the prices of the trade described in Article 6 down below \$10/tCO₂e.

As for Brazil's position in the regulation of Article 6, the country has always advocated that the corresponding adjustments in the mechanism of article 6.4 should not be applied in the first sale, that is, only in the subsequent sales, since the additionality criteria provided by mechanism 6.4 will be too stringent and the main buyers would not have sufficient technical capacity to ensure their governance.

Nonetheless, Brazil recently put forward a conciliation proposal comprising a transition period, to be defined between 2021 and 2030, in which activities of projects outside the scope of the NDC could be traded without corresponding adjustments.

Brazil's insistence towards the voluntary nature of the obligations of NDC commitments is comprehensible, as it gives developing countries more flexibility to meet the targets, just like in the Kyoto Protocol.

However, Article 6 and its corresponding adjustments offer an opportunity for the country to harness its competitive edge through low-carbon activities and attract investment and technological development.

This trade is expected to generate approximately US\$ 16 - 72 billion ² in revenues for Brazil by 2030. But this potential would only be realized with rules that provide for corresponding adjustments and minimize the CDM carryover to Article 6. Otherwise, many buyers will drift away, and prices and revenues will be negligible.

2. NDC achievement and over-achievement: We have surplus for Corresponding Adjustments

The end of illegal deforestation, the continuous expansion of the offer and management of rural credit for low-carbon activities, and the expansion of Renovabio are strong assurances that we can easily meet our NDC target. Such surplus may increase with the creation of a National Offset Registration System and a Brazilian Trade System, as proposed by CEBDS (which represents Brazil at WBCSD) in replacement of Bill (PL) No. 528 currently being processed in the Chamber of Deputies. It may also be driven by the strengthening and increased engagement in planning and coordination initiatives created within Brazil's National Policy on Climate Change and environmental agencies.

² IEYA (2019) e Piris-Caeza et al. (2016)



This NDC surplus will be used as guarantee for the corresponding adjustments the country may make in order to compete in the carbon trading described in Article 6. Break-even prices for transfers provided for by instruments in Article 6, with corresponding adjustments and low CDM carryover, can reach US\$ 30 to 80/tCO₂e. Such favorable price levels would enable granting of corresponding adjustments in activities that are not yet financially feasible but need to be scaled up to match the paths to carbon neutrality in the country and its companies.

To do this, such corresponding adjustments must be allocated in trades that pay prices above the NDC achievement cost and sufficiently high to drive surplus. Activity-based quotas exceeding the price threshold may be also adopted to avoid the use of all the options that will be required for future Brazilian NDCs. Additionally, a technology transfer or development or application criteria could be included in the corresponding adjustment granting, either separately or combined with price and quota criteria.

For example, Floresta+ and fundraising through payments for outcomes of mitigation or neutralization of greenhouse gases from deforestation and forest degradation and the increase in forest stock and sustainable management of forests (REDD+), as provided in Article 5 of the Paris Agreement, can also harness the opportunities arising from the market instruments of Article 6 of the Paris Agreement

ITMO contracts can offer national and sub-national programs including projects and activities for mitigating or neutralizing GHG emissions, both forest and non-forest, on a large scale. That would also result in much larger revenues, lower transaction costs and greater focus. These contracts could even be made conditional on payments for deforestation and forest degradation (REDD+) mitigation outcomes under Article 5 of the Paris Agreement. In other words, the ITMO buying country would be purchasing surpluses from our NDC but would additionally pay an amount for the reductions already achieved in Brazil since 2012, in the form of payment for outcomes, whose revenues could be allocated in initiatives such as Programa Floresta+ held by the Ministry of the Environment.

Decentralized initiatives by government and private entities within the trade described in the mechanism of Article 6.4 should be encouraged for programs involving smaller-scale projects. The creation of a National Offset Registration System could streamline and guide the implementation of certification standards to be adopted within this mechanism while giving visibility and transparency to the projects and legal certainty for transfers of their certificates.

Brazil could even maintain its proposed transition period yet restricting the possibility of not applying the corresponding adjustments exclusively to countries that



are not listed as main emitters, provided that such countries undertake to adopt targets for the entire economy and for all gases by 2030, as already adopted by Brazil and other countries. Only then will the transition period be more inclusive, with incentives and funding to match a greater ambition for future NDCs. Brazil's journey in the Convention on Climate Change as a consistent advocate for the most economically vulnerable countries and its participation in the development and management of the CDM qualifies the country to propose a CDM carryover focused on low-emitting countries holding credits from 2016 of the second commitment period of the Kyoto Protocol.

3. Recommendation: Corresponding Adjustments are an opportunity

Despite the numerous challenges, a participatory and technical governance of the corresponding adjustments cannot be considered a barrier; it is an opportunity for the country to finally value its efforts to reduce and neutralize GHG emissions and, thus, finance our path to carbon neutrality while expanding our competitiveness and international presence in the new low-carbon, circular, and inclusive green economy.

To this end, CEBDS recommends a Task Force for the Implementation of Article 6, coordinated by the Ministry of the Environment with the effective participation of the private sector and civil society in order to: (i) establish priorities for ITMO and carbon credit programs and projects and (ii) define criteria for granting corresponding adjustments in 6.2 and 6.4.

Article 6 creates a window of opportunity for Brazil to sell its forestry and agricultural offsets, thus increasing the value of the great natural assets of the country, and to engage its private sector in the global emissions trading throughout its journey towards neutralization.

I – INTRODUCTION

Article 6 of the Paris Agreement establishes market-based instruments, through trades of outcomes or credits associated with activities for reduction, removal, or capture of greenhouse gas (GHG) emissions, to encourage voluntary cooperation between signatory countries in implementing their nationally determined contributions (NDC)³.

Articles 6.2 and 6.3 provide an instrument to trade internationally transferred mitigation outcomes, that is, centralized and direct emission reduction transactions between countries with volume and price contracts without the need for project certification (countries). Articles 6.4 to 6.6, on the other hand, establish a decentralized mechanism for trades between public and private entities of

³Article 6.8 covers non-market instruments that will not be discussed in this publication.



carbon credits generated by projects or programs with verified credits and GHG mitigation certificates.

Lack of consensus on issues affecting the environmental integrity of the Agreement and the cost-effectiveness of transfers have put the regulation of Article 6 on hold; however, such barriers should be overcome at COP26 in Glasgow. This document analyzes some of these barriers and sets guidelines on Brazil's positioning. Finally, it suggests a climate governance framework that will allow the country to tap into the opportunities arising from such instruments.

II – INTERNATIONALLY TRANSFERRED MITIGATION OUTCOMES AS PER ARTICLE 6.2

Articles 6.2 and 6.3 set forth internationally transferred mitigation outcomes (ITMO) for direct trades of actual emission reductions between the Parties (countries). Such trades will be contracted between the Parties, accounted for, and reported to the supervising authority of the Paris Agreement. Article 6.2 requires environmental integrity, transparency, and robust monitoring. The rules that will guide the interpretation of these requirements remain under discussion, and their regulation require achieving a balance between climate integrity assurances and transaction costs related to the application of said instruments.

The commercial strategy of a country selling ITMOs would be to negotiate emission reductions that exceed its NDC target, which would only be financially feasible if purchased by countries dealing with high GHG abatement costs⁴ and/or that rely on these transfers to diminish the risk of a more ambitious NDC in the form of offsets – including for its emissions trading systems. The selling country must evaluate actions within policies, programs, and projects, including those run by the government and the private sector, to be financed through funds arising from the ITMO trade. The buying country will likely review these options as for the climate and financial integrity of the transaction before entering into an agreement.

Therefore, ITMO trading costs will be lower than those in the credit trade provided by Article 6.4 mechanism, as each credit-generating project will have to be verified and certified, as discussed below.

⁴The marginal abatement cost is the cost for reducing or removing an additional unit of emission.



III – EMISSION REDUCTION CREDITS MECHANISM AS PER ARTICLE 6.4

Articles 6.4, 6.5 and 6.6 establishes a mechanism for public and private entities to trade credits from GHG emissions mitigation projects. The projects must be validated by third parties and accepted by the Designated National Authority, and subsequently submitted to the supervisory authority of the Paris Agreement, which will be responsible for issuing the carbon credits to be traded.

The Conference of the Parties will approve the rules, modalities, and procedures of Article 6.4, in addition to establishing the aforementioned supervisory entity to oversee the application of such provisions.

Article 6.5 establishes that emission reductions resulting from the mechanism may not be used as evidence of compliance with the selling Party's NDC if used by the buying Party to fulfill its own targets. Such veto protects the environmental integrity of the Paris Agreement by avoiding double counting of carbon credits by host and recipient countries.

Finally, article 6.6 specifies that part of the resources generated through the mechanism should be used to cover the administrative expenses incurred in the trades, and to aid adaptation efforts of developing countries that are more vulnerable to the adverse effects of climate change.

Note that the carbon credits of the mechanism in article 6.4 are generated through projects that reduced their emissions below the baseline they receive credits for. In other words, these reductions would be additional to those that would be generated without the incentives created by the carbon credit market, like previously required by the Kyoto Protocol for the Clean Development Mechanism (CDM) and the Joint Implementation (JI).

The rules, modalities, and procedures to be adopted in mechanism 6.4 are under consideration and pending approval by the Conference of the Parties. However, the need to protect the integrity of reduced carbon should not lead to an excessive increase in transaction costs. The Parties must reach a breakeven point, which will set the scale and attractiveness of the projects, including their potential use in emissions trading systems, whether jurisdictional or voluntary.

But NDC comes as an addition to the Paris Agreement, since all signatory countries have pledged to achieve specific targets. Therefore, as specified in Article 6.5, buying and selling countries must avoid double counting of emissions or credits traded through the two instruments described in Article 6 by making adjustments corresponding to the amounts traded in their NDCs⁵.

⁵ For a more detailed discussion, refer to ADB (2018), Michaelowa (2019), CEBDS (2019) and Seroa da



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Motta (2021).



IV – MAIN ISSUES CONCERNING THE REGULATION OF ARTICLE 6

Below is a review of some of the key issues concerning the regulation of Article 6.

Corresponding NDC Adjustments

NDC adjustments occur when a country selling ITMO or credits under Article 6.4 increases its NDC based on the amount traded, thus enabling the buying country to deduct it from its own NDC target.

These adjustments are more imperative in the Paris Agreement, since all signatory countries have pledged to achieve specific NDC targets. In the case of CDM, the selling country had no target and, therefore, adjustments only occurred downwards and on the buyer's side. As for the JI, which traded credits from countries that had targets, both the seller's (upwards) and the buyer's (downwards) targets had to be adjusted.

In the case of the Paris Agreement, both in ITMO and in mechanism 6.4, if there is no corresponding adjustment, the buying country's NDC is adjusted downwards while the selling country's NDC remains unaltered, thus decreasing the overall emissions reduction target of the Paris Agreement.

This requirement for corresponding adjustments is already in place for the acceptance of carbon offset credits in the Carbon Offset and Reduction Scheme for International Aviation (CORSIA), a market-based mechanism to offset emissions ⁶.

The voluntary carbon market may see a similar situation occurring under specific circumstances – the so-called double claiming –, which is when activities of voluntary market-based projects are framed within the scope of the host country's NDC and the emissions reduction obtained will be counted in the emissions inventory of that country, being, therefore, double claimed by both the purchasing company and by the country in the fulfillment of its NDC target ⁷.

Thus, players of the voluntary market are gathered in the Taskforce on Scaling Voluntary Carbon Markets (TSVCM, 2020) to discuss ways to prevent this situation from encouraging the host country to reduce its mitigation efforts proportionally, otherwise trades in the voluntary market might not contribute to reduce total global emissions.

⁶Emissions from international air and sea transport are not part of the scope of the Climate Convention (UNFCCC). These are regulated by its international agencies. See more details on the criteria adopted in CORSIA in ICAO (2020).

⁷Refer to Fearnough (2020), TROVE (2021) and TSVCM (2020) for a more detailed analysis of the effects of double claiming on the voluntary market.



This is because the voluntary market is a funding source – particularly for developing countries and most of the less developed economies, where many of these voluntary market-based projects are implemented. Furthermore, the development of offset projects raises awareness about emissions mitigation in the countries where they are located.

Perhaps the voluntary market will merge into a framework regulated according to Article 6, but these two approaches will have to coexist with distinct objectives and structures if and until that happens.

It is estimated that average prices for trades of emissions without corresponding adjustments covered by Article 6 would not exceed US\$10/tCO₂e by 2030, while prices with corresponding adjustments would rise above \$30/tCO₂e, generating up to 40% revenue increases⁸ in the same period.

CDM Carryover

Likewise, trading of CDM credits as per article 6.4 would result in double counting, as such emission-reduction outcomes will be also counted towards the emissions inventory of the countries. Hence the belief among many Parties that using these credits to meet the Paris Agreement targets would reduce their ambition and environmental integrity.

Other Parties, such as Brazil, however, suggest a transition for credits issued under the Kyoto mechanisms before 2020, claiming that since these credits were generated for a protocol adopted in the Climate Convention, they should be transferred to the Paris Agreement in order to provide security for investments made in changes of regimes.

Solutions to ensure less impact on global emission reductions include limiting the CDM carryover to activities with perceived financial vulnerability and adopting novel validation and verification procedures.

If only 30% of the current CDM supply were transferred to Article 6 without corresponding adjustments for CDM credits issued after 2016 and 2013, the global emissions agreed in the NDCs would increase by 139 and 763 MtCO₂e, respectively⁹. However, a full carryover of all CDM credits would have a much larger impact, with average trading prices under Article 2 dropping well below \$10/tCO₂e¹⁰.

⁸ Schwiieger et al. (2020) and TROVE (2021).

⁹ Fearnough et al. (2021).

¹⁰ Schwiieger et al. (2020).



Overall Mitigation in Global Emissions (OMGE) Principle

Article 6.4 stipulates that the mechanism is to deliver an “overall mitigation in global emissions” (often referenced as OMGE), constraining trades based on the additionality risks associated with such credits. The principle could be operationalized through a percentage discount on the total amount of credits traded. This way, the selling country will adjust its NDC target upwards based on the total credits transferred, but the buying country would not be allowed to deduct that percentage from its target.

By reducing the volume of adjustments in the buying country, the implementation of OMGE would increase the price of traded credits. Such increase varies according to the discount percentage and the demand price sensitivity. Higher prices could bring the traded volume down; however, the total value of the transactions could increase for the benefit of selling countries while encouraging further domestic mitigation initiatives in the buying countries.

It is estimated that 10 and 20% discounts would increase Article 6 trade revenues by 5 and 8%, respectively, creating inelastic demand that would enable increasing the OMGE with no negative effect on the flow of investments¹¹.

In the case of Brazil, emission reductions exceeding its NDC targets would entail costs higher than those in countries with less ambitious NDCs. Therefore, a price increase could bring more competitive advantage for the country.

Although article 6.2 makes no mention to OMGE, there are discussions in place regarding its application in ITMOs for the purpose of increasing the climatic integrity of the transfers.

Share of Proceeds (SoP)

Article 6.6 rules that a portion of the proceeds coming from trades through the mechanism in 6.4 should be mainly destined to help developing countries in their climate adaptation efforts and to other management activities described in Article 6. This principle is called share of proceedings, SoP.

It was adopted for CDM and subsequently included in the Article 6.4 mechanism. However, it is not expressly described in article 6.2. To ensure equal treatment and financing potential, several countries including Brazil are suggesting that the SoP be equally applied to ITMO trades as in OGME.

The SoP directly affects prices, and its effects on supply and demand are similar to those described for discounts on OMGE amounts. SoP of 2% and 10% of carbon credits would increase Article 6

¹¹ Fearnough et al. (2021).



trade revenues by 1 and 3% respectively¹². This brings opportunities to increase funding for adaptation efforts without affecting the flow of investments.

V – BRAZIL’S REPOSITIONING

As for Brazil’s position in the regulation of Article 6, the country has always advocated that the corresponding adjustments in the article 6.4 mechanism should not be applied in the first sale, that is, only in the subsequent sales, since the additionality criteria provided by the mechanism 6.4 will be too stringent and the main buyers would not have sufficient technical capacity to ensure their governance.

Nonetheless, Brazil recently put forward a conciliation proposal comprising a transition period, to be defined between 2021 and 2030, in which activities of projects outside the scope of the NDC could be traded without corresponding adjustments.

The country’s insistence towards the voluntary nature of the obligations of NDC commitments is comprehensible, as it gives developing countries more flexibility to meet the targets, just like in the Kyoto Protocol.

However, as mentioned earlier, the additionality of emissions from an activity in the 6.4 mechanism can only ensure reduction; it does not prevent such emissions from being counted twice or having an impact on the climate integrity of the Agreement. Furthermore, the selling country could loosen its efforts to comply with the NDC if the corresponding adjustments are not in place.

Governance should not be an impediment. Previous experiences managing and accounting for the mechanisms of the Kyoto Protocol have given countries basic capacity to oversee the generation of these credits and count them towards their national inventories, which will monitor compliance with the NDCs – an activity supported by a range of technical assistance programs of the Climate Convention.

It is worth considering that foreign countries will subsidize increases in the NDC for the purpose of offsetting the corresponding adjustments in an emissions trading, attracting investments that would not otherwise be possible in the country. Therefore, whether through article 6.4 or article 6.2 mechanisms, the trades of Article 6 will generate jobs and boost the country’s technological performance within a low-carbon path.

As previously analyzed, without the corresponding adjustments, trade prices will fall dramatically, further benefitting competitors whose costs of mitigation through conservation, restoration and renewable energy are lower due to

¹² Fearnough et al. (2021).



lower growth rates of their emissions¹³. Without corresponding adjustments, the country's chances of attracting investors will be much smaller.

Furthermore, most European “potentially buying” countries and developing countries, which are important “sellers” under Article 6 (e.g., Peru, Colombia, and Costa Rica), are already signatories to the San Jose Principles (SJPs)), which include obligations concerning corresponding adjustments to avoid double counting¹⁴.

The Brazilian proposal for a transition period is unequivocally intended to alleviate global efforts to reduce emissions by 2030. However, it can be revised to ensure these losses will generate gains in the carbon neutralization paths after 2030. Brazil could maintain this proposal yet restrict the possibility of not applying the corresponding adjustments exclusively to countries that are not listed as main emitters and undertake to adopt targets for the entire economy and for all gases by 2030, as already adopted by Brazil and other countries. Only then will the transition period be more inclusive, with incentives and funding that match a greater ambition for future NDCs.

Otherwise, the breakdown of activities "outside" the NDC to avoid application of corresponding adjustments will constitute a perverse incentive, for it will discourage countries to set forth more ambitious NDCs and will result in just the opposite of Brazil's goal for its entire economy and to the purpose of the Paris Agreement.

As for the carryover of CDM credits, Brazil advocates the need to provide legal certainty for investments as global agreements change. This guarantee is important, but it must be provided in a way that minimizes the impacts on the global reduction effort established in the Paris Agreement. Brazil's journey in the Convention on Climate Change as a consistent advocate for the most economically vulnerable countries and its participation in the development and management of the CDM qualifies the country to propose a CDM carryover focused on low-emitting countries holding credits from 2016 of the second commitment period of the Kyoto Protocol.

Even though the Brazilian document puts forward a proposal for dialogue between the signatory countries of the Paris Agreement prior to COP26, it can be revised to ensure that the country's successful reputation in the Climate Convention and its competitive advantages arising from the market instruments of Article 6 will remain intact.

¹³E.g., countries in South America, West Africa, the Republic of Congo, and Indonesia. See IETA (2019).

¹⁴During COP25, in Madrid, a group of thirty-two nations including many developing countries and most of the European Union members created their own market rules to solve disputes over the regulation of Article 6. They adopted the “San José Principles for High Ambition and Integrity in International Carbon Markets (SJPs),” which seek to ensure the environmental integrity of the Paris Agreement by avoiding double counting with corresponding adjustments in the NDCs and prohibiting the use of credits from the Kyoto Protocol, see <https://cambioclimatico.go.cr/sanjoseprinciples/about-the-san-jose-principles/>.



This revision would be in line with Brazil's proposal for the application of the OMGE and the SoP, and for ITMO trades as well. This positioning must be maintained and supported. As discussed earlier, the resulting price and revenue increases benefit climate integrity and may even further our competitive advantages.

VI – GOVERNANCE RECOMMENDATIONS

Article 6 provides the country an opportunity to harness its competitive edge through low-carbon activities and attract investment and technological development. Failure to regulate this article will significantly reduce opportunities for countries with competitive advantages in mitigation outcomes or credits such as Brazil. RSM: Everyone loses, including buyers, otherwise there would be no trade.

This trade is expected to generate approximately US\$ 16 to 72 billion¹⁵ in revenues for Brazil by 2030. But this potential would only be realized with rules that uphold the corresponding adjustments and minimize the CDM carryover based on rules of the market instruments provided for in Article 6. Otherwise, many buyers will drift away, and prices and revenues will be negligible.

Therefore, we suggest that the following recommendations are discussed with academia, civil society, and the national production sector with the aim of outlining Brazil's positioning in the regulation phase, whose negotiations will continue at the next Conference of the Parties (COP26) to take place in November 2021 in Glasgow, Scotland:

- Revise the positioning that opposes to the corresponding NDC adjustments in the article 6.4 mechanism and the full carryover of CDM credits and activities. In addition to making our competitive advantages unfeasible, it threatens the environmental integrity of the Paris Agreement, harms the country's reputation, and creates complex additionality barriers; and
- Maintain the positioning for isonomy in OMGE and SOP in the instruments of articles 6.2 and 6.4, ensuring not only equal treatment, but also greater climate integrity and revenues.

The regulation of Article 6 is one of the main goals towards the finalization of the Paris Agreement's rulebook, ensuring its effective implementation and contribution to expanding the Agreement's ambition¹⁶. Such regulation will be one of the main topics at COP26, in

¹⁵ IETA (2019) and Piris-Cabeza et. al (2016)

¹⁶ COP26 will also prioritize periods and scopes for NDC goals (Article 4), the frequency of review of NDC ambitions (Article 14) and the transparency rules for monitoring the implementation of NDC commitments (Article 13), climate finance (Article 9), and irreversible *loss and damage* issues). They are equally important for the future of the agreement in



Glasgow. Whatever the final form of regulation at COP26 or even the subsequent one may be, regardless of whether there will be a transition period for the mandatory application of the corresponding adjustments, carbon credits with adjustments will have more value than those subject to the risk of double counting.

Therefore, the country needs to discuss how to better tap into the trade opportunities arising from our competitive advantages in low-carbon activities. The granting of corresponding adjustments to trades using the market instruments of Article 6 must be managed to further our competitive advantages, not hinder them.

The end of illegal deforestation, the continuous expansion of the offer and management of rural credit for low-carbon activities, and the expansion of Renovabio are strong assurances that we can easily meet our NDC target. Such surplus may increase with the creation of a National Offset Registration System and a Brazilian Trade System, as proposed by CEBDS in replacement of Bill (PL) No. 528 currently being processed in the Chamber of Deputies. It may also be driven by the strengthening and increased engagement in planning and coordination initiatives created within Brazil's National Policy on Climate Change and environmental agencies.

This NDC surplus will be used as guarantee for the corresponding adjustments the country may make in order to compete in the carbon trade described in Article 6 – even in the CORSIA and the voluntary market.

But these adjustments must be granted in compliance with the current NDC and its greater ambition for 2025. Breakeven prices for transfers through instruments in Article 6, with corresponding adjustments and low CDM carryover, can reach US\$ 30 to 80/tCO₂e. With prices at this level, the country would be able to grant corresponding adjustments in activities that are not yet financially feasible, but which can start up projects and technologies not required for achieving the current NDC, even with a greater ambition for the 2025 target.

On the other hand, these activities would have to be scaled up to match the paths to carbon neutrality in the country and its companies. To do this, such corresponding adjustments must be allocated in trades that pay prices above the NDC achievement cost and sufficiently high to drive surplus. Technically, Brazil would determine the shadow price of its NDC and would only grant corresponding adjustments for transfers above that mark. Activity-based quotas exceeding the shadow price threshold may be also adopted to avoid the use of all the options that will be required for future Brazilian NDCs.

Additionally, a technology transfer or development or application criteria could be included in the corresponding adjustment granting, either separately or combined with

the 2-degree trajectory, these rules will also influence the climatic integrity of the transfers carried out in Article 6.

price and quota criteria, creating a scale for technological processes that would be the baseline of future NDCs and necessary for the paths to carbon neutrality.

To this end, CEBDS recommends a Task Force for the Implementation of Article 6, coordinated by the Ministry of the Environment with the effective participation of the private sector and civil society in order to: (i) establish priorities for ITMO and carbon credit programs and projects and (ii) define criteria for granting corresponding adjustments in 6.2 and 6.4.

Once Law No. 14.119/2021 is regulated in Brazil, it will define concepts, objectives, guidelines, actions, and criteria for the implementation of the National Policy on Payment for Environmental Services (PNPSA) using federal resources. However, this PSA law is not aimed at fundraising, but at the distribution of funds available in agreements on payment for environmental services.

For example, Floresta+ and fundraising through payments for outcomes of mitigation or neutralization of greenhouse gases from deforestation and forest degradation and the increase in forest stock and sustainable management of forests (REDD+), as provided in Article 5 of the Paris Agreement, can also harness the opportunities arising from the market instruments of Article 6 of the Paris Agreement

It is worth mentioning that Brazil should prioritize the two instruments of Article 6. ITMO contracts can offer national and sub-national programs including projects and activities for mitigating or removing GHG emissions, both forest and non-forest, on a large scale. Consequently, it would also result in much larger revenues. As already mentioned, in this case, the selling country would manage the eligibility of activities and the allocation of proceeds with lower transaction costs and greater focus. ITMO proceeds could even be allocated throughout a project within the commercialized program, from the design to the implementation phase.

Thus, corresponding adjustments ensure climate integrity to the carbon market while creating demand and prices that strengthen Brazil's competitive advantages. Participatory and technical governance of the corresponding adjustments creates opportunities for Brazilian competitive advantages; not barriers. Hence the importance of the National GHG Offset Inventory (SNRC-GHG) proposed by Bill (PL) 528/2021 in replacement of CEBDS to account for offsets of GHG emissions reductions in the country, thus enabling management and registration of such corresponding adjustments.

Article 6 offers an opportunity for the country to finally value its efforts to reduce and neutralize GHG emissions and, thus, finance our path to carbon neutrality while expanding our competitiveness and international presence in the new low-carbon, circular, and inclusive green economy.



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