MDB WORKING GROUP ON ARTICLE 6 OF THE PARIS AGREEMENT

Rationale and Objectives

1. Context

Climate change is a threat to the global development agenda. Without further action to reduce extreme poverty, provide access to basic services, and strengthen resilience, climate impacts could push an additional 100 million people into poverty by 2030[1]. Against this backdrop, countries have submitted Nationally Determined Contributions (NDCs) as part of the Paris Agreement to limit global warming to well below 2°C, and make best efforts to limit warming to 1.5°C. While the bottom-up nature of the Paris Agreement enables broad participation, domestic public finance will be insufficient to meet the estimated costs of mitigation and adaptation. In some NDCs, this need for support is explicit in the form of a conditional reduction target. MDBs recognize that significantly increased private sector financing is required to support the low carbon transition and to adapt to unavoidable climate change. For example, it is estimated that the world needs to build about $89 trillion in new sustainable infrastructure over the next 15 years, some two-thirds of which is going to be in the developing world[2]. Further, there is an urgent need to raise the ambition of NDCs, since current pledges cover only about one third of the emission reductions needed to be on a least-cost pathway for the goal to stay well below 2°C[3].

Given the limited public and concessional finance available, countries are increasingly exploring the use of market/price-based mechanisms to reach targets cost efficiently and to leverage private capital intelligently. For example, 81 Parties indicated in their NDCs that they are planning or considering the use of market/price-based mechanisms to drive GHG mitigation[4]. The Paris Agreement also gives climate markets a much needed, renewed basis for support by enabling Parties to voluntarily cooperate in achieving their NDCs through the use of internationally transferred mitigation outcomes (ITMOs) under Article 6. Article 6 creates a framework that will enable the creation of an international carbon market, leading to a convergence of domestic carbon pricing approaches, including carbon markets[5].

The Kyoto Protocol delivered proof of concept that an international carbon market can be used to achieve mitigation targets in a cost-effective manner. For example, by the end of 2014, the Clean Development Mechanism (CDM) alone supported investments worth about US$90 billion in GHG emission reduction projects, or approximately 13% of total renewable energy investments in developing countries[6]. However, there is a need to significantly expand mitigation to meet the Paris Agreement goals. Under the Kyoto

[1] World Bank Group (2016), World Bank Group Climate Action Plan
[2] Brookings Institute (2016), "Financing Sustainable Infrastructure"
[3] UNEP (2017), UNEP Emission Gap 2017
[4] World Bank Group (2017), "State and Trends of Carbon Pricing 2017"
[5] Asian Development Bank (2018) "Decoding Article 6 of the Paris Agreement"
[6] World Bank Group (2015), "State and Trends of Carbon Pricing 2015"

Protocol market mechanisms were introduced to provide flexibility for countries with quantitative emission reduction targets, whereas the Paris Agreement introduces these approaches to provide for increased ambition and support sustainable development. Countries need support to develop approaches and financing to implement them. Research suggests that comprehensive linking arrangements could reduce the global costs of implementing NDCs by a third in 2030, and halve the costs of the world's decarbonization efforts by 2050[7]. A broader, more liquid carbon market also allows private sector participants to better hedge risks and enhance the flexibility of reducing emissions.

Unfortunately, there is little time to incubate an international market: 20 years after Kyoto, there is greater urgency and the Guidance and Rule for Article 6 are expected to be developed under the "Paris Rulebook" by COP24 (i.e., by the end of 2018).

There are also challenges to creating an international market under Paris, despite the global momentum. First, the creation of these international climate markets has not featured heavily in climate negotiations to date, partly due to the emergence of other issues and priorities in climate diplomacy. Further, while carbon pricing approaches continue to gain traction globally, policymakers need to overcome certain common challenges associated with implementing market/price-based mechanisms, such as overcoming competitive concerns, building stakeholder acceptance, and developing the required infrastructure and legal framework.

2. Rationale of the MDB Working Group on Article 6

In light of these issues, it was agreed during the Meeting of MDB Vice-Presidents and Senior Directors during the IMF-WBG Annual Meetings (October 13, 2017) that an MDB Working Group would be established to support the design and operationalization of Article 6. In 2018, MDBs, which would also include other International Finance Institutions (IFIs), meet regularly to share experience and knowledge on Article 6-related activities, and support client countries in developing the modalities and procedures for Article 6 as the elements of the Paris Rulebook are being finalized. The ultimate goal of the Working Group is to position Article 6 as a high strategic priority in climate negotiations and encourage Parties to leverage market/priced-based mechanisms as an important tool to deliver NDC commitments cost-effectively, drive increased ambition and support sustainable development.

It is envisioned that joining forces through a Working Group could have several benefits:

1. As evidenced in the NDCs, different countries have different national circumstances, and require differentiated action and support. Through the Working Group, MDBs could work together to ensure that the support for Article 6 is provided with the specific country/region context in mind, and enable further synergy in MDB's engagement with client countries.
2. MDBs have a strong track record in supporting the development and implementation of market/price-based mechanisms at both the domestic and international levels. The Working Group therefore provides a useful platform for MDBs to share lessons and knowledge, incubate innovation, and enhance the credibility and legitimacy of their Article 6-related services.
3. As mentioned above, climate finance will likely play a critical role in mobilizing the resources required for a low carbon development pathway. This calls for an integrated approach, in which

[7] World Bank Group (2016), "State and Trends of Carbon Pricing 2016"

climate finance can be used more strategically to catalyze the development of well-designed and balanced climate markets. According to the 2017 Joint Report On Multilateral Development Banks' Climate Finance[8], the world's six largest MDBs combined provided US$35.2 billion in climate finance to developing countries in 2017, of which US$27.9 billion was dedicated to climate mitigation finance. These activities can well be the basis for market transactions. MDBs are a key channel for climate finance, due to their capacity for public and private sector lending at scale, ability to blend financing from different sources, wide network of strategic relationships, and willingness to innovate.

4. The operationalization of Article 6 must consider the inherent linkages between different Articles of the Paris Agreement (e.g. Article 4 on the NDCs and accounting, Article 13 on transparency, Article 15 on implementation and compliance), as well as other relevant international agendas like the Sustainable Development Goals (SDGs) or the market-based mechanism under the International Civil Aviation Organization (ICAO). The Working Group could facilitate a birds-eye view on MDB's broader activities on climate and sustainable development, create best practices, and help ensure a holistic approach in the implementation of these international agendas.
5. The Joint MDBs could offer a market-making platform for Parties wishing to accelerate the development of Article 6 and help to set the new market standards and practices. A precedent for this development could be the Climate Investment Funds (CIF), which has paved the way for other climate finance activities. As market-makers, MDBs can potentially lower market uncertainties and incentivize private sector investors to move forward with the required low carbon investments.

3. Objectives of the MDB Working Group on Article 6

The objectives of the Working Group are to (a) come to a common understanding on key issues and options related to Article 6, and (b) demonstrate that Article 6 can be a credible financing instrument for climate finance. The following priority areas were identified for the Working Group's work plan in 2018/19:

a) **Share knowledge and lessons learned through technical and analytical work:** Given the general uncertainties around how markets will develop under Paris, this work-stream seeks to provide an evidence-based case for key policymakers and stakeholders to engage in Article 6.
b) **Inform the regulatory framework for market instruments under the Paris Agreement:** Given the urgency to finalize the Paris Rulebook by December 2018, this work-stream seeks to map options of different approaches, and test innovative frameworks that could potentially support the operationalization of these approaches.
c) **Pilot the creation of an initial supply of Mitigation Outcomes (MOs) from operations with climate mitigation benefits:** The purpose of this work-stream is to develop a consensus-driven approach for operationalizing Article 6 by collaboratively piloting the creation of MOs through MDB operations with high mitigation potential.
d) **Seek to generate initial demand for MOs and create financial products to leverage private capital:** The purpose of this work-stream is to stimulate the initial demand for international

[8] European Investment Bank, Asian Development Bank, African Development Bank, World Bank, Inter-American Development Bank, European Bank for Reconstruction and Development (2017) '2017 Joint Report On Multilateral Development Banks' Climate Finance'

climate markets under Paris, and explore the use of tailored financial instruments to reduce the risks of transferring MOs. A joint platform may be explored for this development.

e) **Explore and pilot non-market mechanisms under Article 6.8:** The framework for non-market approaches is not well defined but could encompass a wide variety of activities that could compliment market-based actions and reach countries and sectors which are not otherwise easily accessible. The Adaptation Benefit Mechanism developed by the AfDB is one example of such actions.

f) **Communication and outreach:** General outreach and communication will be conducted to ensure coordination and linkage with other relevant stakeholder groups, in particular the International Financial Institutions working group on GHG accounting.