

# COUNTRY GUIDANCE FOR NAVIGATING CARBON MARKETS

## MODULE 4

# How to decide between alternative uses for non-authorized credits?



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# Table of Contents

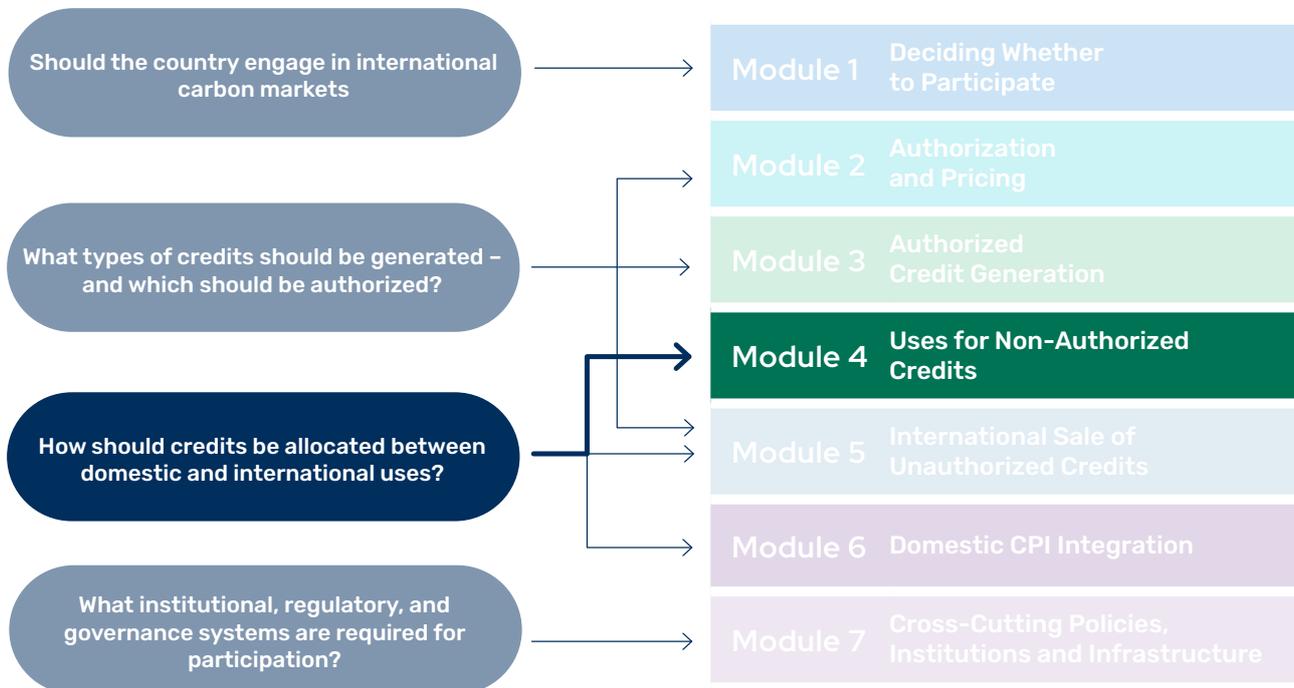
Abbreviations	5
<b>Question 4.1</b> Might host countries prefer to use non-authorized credits domestically or sell them internationally?	7
<b>References for Module 4</b>	12

## Abbreviations

A6.2	Article 6.2 of the Paris Agreement
A6.4	Article 6.4 of the Paris Agreement
AML	Anti-Money Laundering
ART	Architecture for REDD+ Transactions
CCP	Core Carbon Principles
CDA	Community Development Agreement
CDAC	Community Development Agreement Committee
CDM	Clean Development Mechanism
CMA	Conference of the Parties serving as the meeting of the Parties to the Paris Agreement
CORSIA	Carbon Offsetting and Reduction Scheme for International Aviation
CPI	Carbon pricing instrument
DOE	Designated Operational Entity
D4C	Digital for Climate
EAC	Environmental attribute certificate
ERR	Emission reduction or removal
ETS	Emissions Trading System
FPIC	Free, prior, and informed consent
FRA	Financial Regulatory Authority (Egypt)
GGGI	Global Green Growth Institute
GHG	Greenhouse gas
ICVCM	Integrity Council for the Voluntary Carbon Market
IOSCO	International Organization of Securities Commissions
IPLC	Indigenous Peoples and local communities
IT	Information technology
ITMO	Internationally Transferred Mitigation Outcome
JCM	Joint Crediting Mechanism
KYC	Know Your Customer
LDC	Least Developed Country
LT-LEDS	Long-term Low Greenhouse Gas Emission Development Strategy
MACC	Marginal Abatement Cost Curve
MCU	Mitigation Contribution Unit
MtCO <sub>2</sub> e	Million tonnes of carbon dioxide equivalent
NDC	Nationally Determined Contribution
OIMP	Other International Mitigation Purposes
OMGE	Overall Mitigation of Global Emissions
PACM	Paris Agreement Crediting Mechanism
PFM	Public financial management
RBCF	Results-based climate finance
REDD+	Reducing Emissions from Deforestation and Forest Degradation
SDG	Sustainable Development Goal
SIDS	Small Island Developing State
SOP	Share of Proceeds
TCAF	Transformative Carbon Asset Facility
TREES	The REDD+ Environmental Excellence Standard
UN	United Nations
UNDP	United Nations Development Programme
UNESCO	United Nations Educational Scientific and Cultural Organisation
UNFCCC	United Nations Framework Convention on Climate Change
VCM	Voluntary Carbon Markets
VCMi	Voluntary Carbon Markets Integrity Initiative



This Module turns to what host countries might do in relation to credits that they decide not to authorize. It focuses on the strategic question on whether host countries might prefer to see non-authorized credits used domestically or for them to be sold internationally. In cases where the host country government has ownership of the unauthorized credits, it can directly determine this. In cases where unauthorized credits are developed by the private sector, the emphasis could be on using policy and regulatory instruments to incentivize (or discourage) particular uses.



## Question 4.1 Might host countries prefer to use non-authorized credits domestically or sell them internationally?\*

### What are the key actions or options host countries may consider?

**If a host country does not authorize a credit, it may still wish to influence who can purchase the credit and for what purpose.** There are three main potential options to consider:

- **Domestic use:** Restrict or encourage credit sales to domestic entities, such as companies covered by a domestic carbon pricing instrument (ETS, carbon tax).
- **Results-based climate finance:** Sell credits to an international development partner providing climate finance to help the host country itself meet/exceed its NDC. These credits are cancelled and not used towards the partner's own targets. Typically, the partner helps design and finance the credit-generating activity.
- **Voluntary buyers:** Allow or encourage sales to private sector entities who buy them as part of their climate change strategy. These credits may be used for different purposes. Some private sector entities may use them as offsets to neutralize emissions beyond their established targets, thereby claiming to have met specific, quantified, climate commitments<sup>1</sup>. Others may acquire and cancel credits without making specific counterbalancing claims. However, credits sold with the expectation that they will be used by voluntary credit buyers may pass through multiple intermediaries, which can limit host country visibility over final use.

**These options are reflected in the language of the Article 6.4 Rulebook.** Under Article 6.4, credits that are not authorized are referred to as Mitigation Contribution Units. The Article 6 Rule Book states that the Article 6.4 mechanism registry shall track<sup>2</sup>:

A6.4ERs not specified as authorized for use towards achievement of NDCs and/or for other international mitigation purposes (mitigation contribution A6.4ERs), which may be used, inter alia, for results-based climate finance, domestic mitigation pricing schemes, or domestic price-based measures, for the purpose of contributing to the reduction of emission levels in the host Party.

Domestic mitigation pricing schemes and domestic price-based measures are both examples of domestic credit use, while the text explicitly refers to RBCF. The inclusion of the phrase 'inter alia' is recognized as referring to the international voluntary buyers of credits.

**The same three strategic options also apply for unauthorized credits generated through mechanisms other than Article 6.4.** However, while the same three options apply, the Article 6 Rulebook does not regulate the generation or transaction of unauthorized credits in these cases.

**Host countries can also adopt a flexible approach – allowing both domestic and international buyers to compete for credits, leaving the unauthorized credit owner (e.g. project developer or other) to choose.** However, this is not an option for selling credits through RBCF, where sales are exclusively to the finance provider due to its public sector role.

### What factors might shape decision-making?

**Host countries may find it beneficial to consider these options sequentially, as shown in Figure 4.1.** The first step is deciding whether to prioritize the use of non-authorized credits for domestic purposes, to sell them internationally, or to remain flexible by leaving the choice open to credit sellers. If the host

<sup>1</sup> Entities subject to a domestic carbon pricing mechanism may, in some cases, be permitted to purchase unauthorized international credits to meet their compliance obligations, as allowed by the mechanism's rules. This is akin to voluntary buyers of credits using these credits as offsets. When a domestic compliance system permits the use of unauthorized credits for compliance, careful consideration is needed to assess its role in achieving the country's NDC to avoid any risk of double counting.

<sup>2</sup> Annex 1 to Decision 7/CMA.4, paragraph 29

country favors international sales, the next decision is whether to actively seek results-based climate finance (RBCF) or to permit sales to international voluntary buyers.

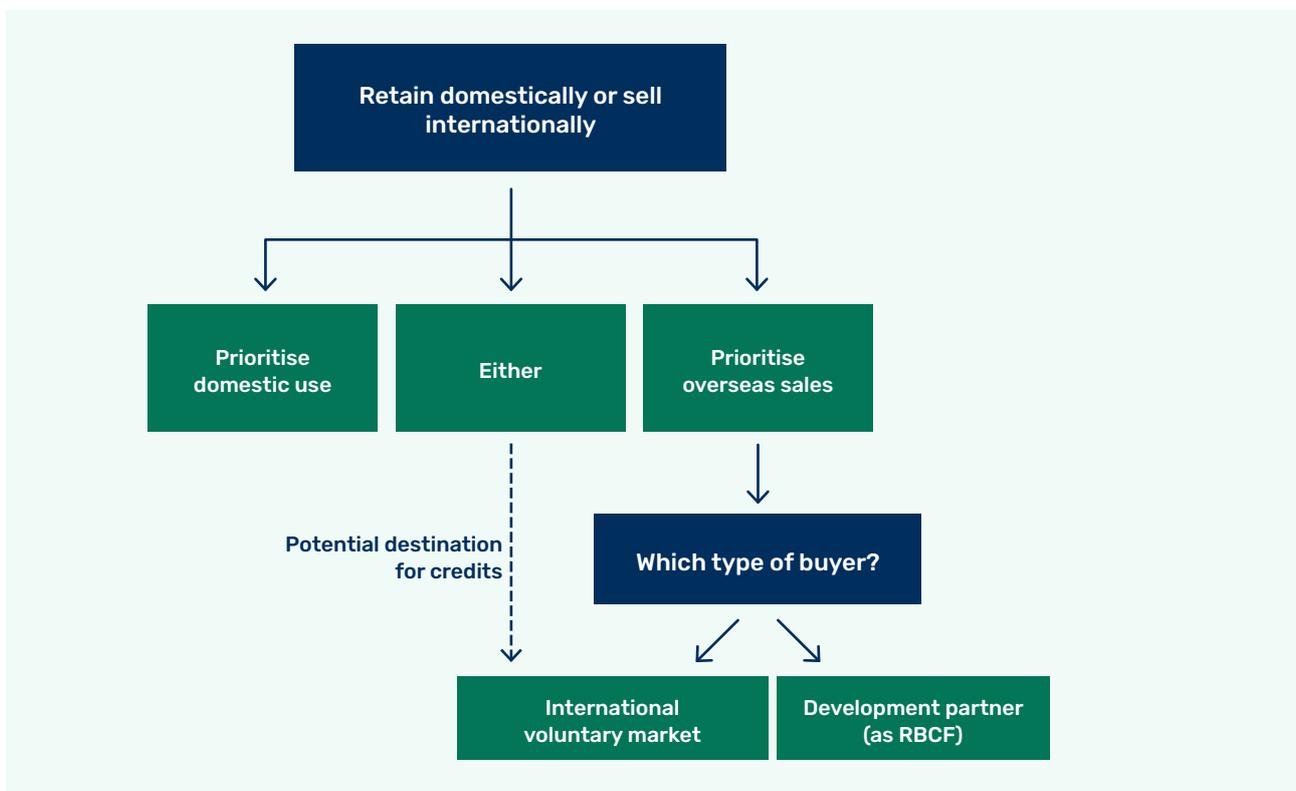
**Selling credits internationally brings clear financial benefits by generating external inflows and supporting domestic economic activity linked to credit generation.** Furthermore, if credits sell for more than they cost to produce, this creates economic rents that can be reinvested in further climate action or broader development goals. In contrast, limiting sales to domestic buyers is likely to reduce foreign exchange inflows and external investment.

**However, allowing credits to be sold internationally can introduce challenges for domestic carbon pricing instruments (CPIs).** Many host countries exploring Article 6 participation are also developing CPIs to achieve their NDCs. CPIs often allow covered

entities to use domestic credits for compliance, mitigating potential industrial competitiveness concerns and helping to address any regressive impacts of carbon pricing. However, credits cannot typically be used both internationally and within a domestic carbon pricing instrument (CPI).<sup>1</sup> Therefore, where a CPI exists—or is anticipated— whose effective functioning will require/generate strong domestic demand for credits, allowing some credits to be used domestically may be desirable. Moreover, this approach allows the host country regulator greater flexibility to design crediting rules that are tailored to national circumstances, a flexibility that is more constrained when credits are intended for international sale.

**Some host countries adopt a flexible approach, leaving the decision to sell credits domestically or internationally to project developers.** This can maximize demand for credits thus encouraging credit generation. However, it may also create policy

Figure 4.1 Different uses and markets for unauthorized credits



<sup>1</sup> It may distort the impact of the domestic CPI if only some actors are able to access domestically generated credits that have been sold internationally (and which can therefore be sold at a lower cost), while international credit buyers may find it challenging to demonstrate the additionality of the associated ERRs if credits associated with the same ERRs are also allowed to be used in the domestic CPI.

uncertainty – making it harder for governments to plan for CPI coverage or project future revenues from international sales.

**If a country chooses to focus on attracting international interest, it may also decide whether it wishes to prioritize attracting voluntary buyers of credits or working with international development partners to develop RBCF schemes.** While many sales of unauthorized credits to voluntary credit buyers will be determined by whoever is responsible for generating the credits<sup>1</sup>, host countries can assess whether to invest political and institutional resources in facilitating these transactions. Host countries may also need to decide how to respond to proposals/opportunities from international development partners to provide RBCF in relation to certain ERR activities.

**A key consideration is the respective scale of each opportunity – at present, RBCF is more prevalent:**

- In 2023, MDBs reported that they provided around \$2.5bn of RBCF for mitigation in low- and middle-income countries (European Investment Bank 2024)<sup>2</sup>. Unfortunately, the scale of ERRs associated with this finance is not available.
- In the same year, total voluntary purchases of credits were around \$0.7bn, with transaction values at around \$6 per credit, implying trades accounting for around 120m tCO<sub>2</sub>e (World Bank 2024c). This includes domestic transactions by voluntary credit buyers.

**By contrast, the market for voluntary credit purchases likely has greater scale potential, though there is uncertainty about whether this potential will be fully realized.** Some projections suggest that the market could reach \$12 billion in 2030 and \$27 billion in 2035 (AlliedOffsets 2024), although the share of this for unauthorized credits is currently unclear.

**A key difference between the two is the level of government involvement.** RBCF requires close government coordination with development partners to co-design supported activities. This allows host governments to align RBCF with national mitigation strategies and broader development goals, such as preparing sectors for more ambitious mitigation or targeting adaptation co-benefits. In contrast, sales to voluntary credit buyers may involve limited government oversight, with transactions often negotiated directly between private sector entities. This offers faster access to revenues, encourages innovative projects, and can act as a broader stimulus to private sector development within the host country. However, it may reduce government control over project selection and strategic alignment.

Two further considerations may also shape preferences for these two alternatives:

- **Price risk:** RBCF typically offers fixed price whereas the allocation of price risk in a carbon market transaction is determined through negotiation between buyer and seller. While fluctuating prices can provide valuable signals and incentives, the fixed price of RBCF can make it easier to mobilize finance for the underlying ERR activity. **Credit use visibility:** RBCF agreements clearly define credit use (usually cancellation). For voluntary buyers, final credit use may be less transparent, especially if credits are sold through intermediaries. This can pose reputational risks for host countries. To manage this, host countries could endorse / highlight / promote high integrity end use via, for example, support for VCMI Carbon Integrity Claims and Scope 3 guidance (Voluntary Carbon Markets Integrity Initiative 2024b; 2024a).

<sup>1</sup> Which in some cases may be the government itself (see question 5.1).

<sup>2</sup> In some cases, this RBCF may have been provided without the climate finance provider acquiring and then cancelling carbon credits.

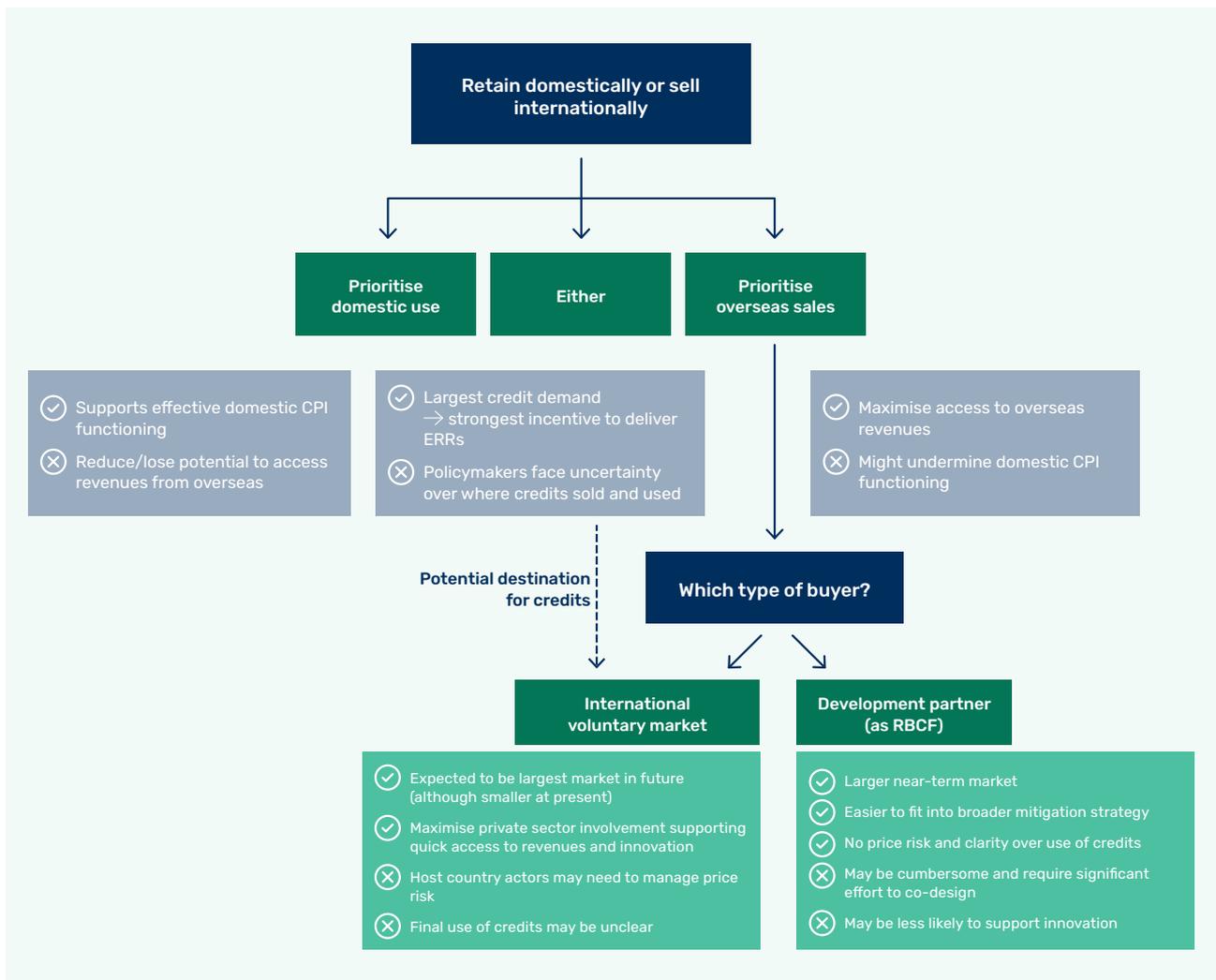
**Both cases can be designed to offer host countries the flexibility to convert into authorized credit sales at a later date.** For instance, the World Bank’s ‘Scaling Climate Action by Lowering Emissions’ (SCALE) program – an RBCF initiative – includes transactions with opt-out provisions, allowing host countries to authorize and sell credits to carbon market buyers. Similarly, host countries generating unauthorized credits under Article 6.4 can convert MCUs into AERs or unilaterally authorize credits that have previously been developed without anticipation of authorization.

**Host countries may select different options for non-authorized credits depending on the type of activity generating the ERRs.** For example:

- A share of credits may be prioritized for domestic CPIs, helping to reduce compliance costs and ease the introduction of carbon pricing. For this to be effective, it will be necessary for the generation cost of these credits to be lower than the (expected) domestic carbon price, while still ensuring that the credits are perceived as being credible and of high quality. In essence, domestic entities with compliance obligations would choose to buy credits only when their price is lower than the prevailing price of the domestic CPI.

**Figure 4.2** takes the same options as presented in Figure 4.1 and maps the discussion of the key advantages and disadvantages for host countries to consider.

Figure 4.2 Advantages and disadvantages of different uses and markets for unauthorized credits



- International voluntary buyers may suit activities with an existing project development ecosystem, where market transactions have already proven effective – such as land use emission reductions. Historically, this would also have included credits from renewable energy projects but opportunities to sell these credits from these activities, except when developed in LDCs, are increasingly more limited.<sup>1</sup> (see Box 9 in Question 5.2 below). Voluntary buyers are also increasingly interested in credits from nature-based and technological removals, although buyer guidance on these credits remains contested (Coordinator of Indigenous Organizations of the Amazon Basin et al. 2023).
- Meanwhile, RBCF could focus on less proven mitigation opportunities or support innovative crediting methodologies, where fixed pricing and development partner support help manage risk.

### How does responding to question 4.1 relate to the obligations or opportunities countries have under Article 6 Guidance?

The Article 6 Rulebook first introduced the distinction between authorized and unauthorized credits in relation to credits generated through the PACM, and it requires that the PACM registry tracks both authorized (AERs) and unauthorized (MCU) credits generated through the mechanism. This is specified in Annex 1 to Decision 7/CMA.4, paragraph 29. However, beyond this, it does not place any constraints on how host countries use unauthorized credits.

### Links and dependencies to other questions in the Guidance

**Host countries wishing to prioritize unauthorized credits for domestic purposes, or to restrict sales to certain types of buyers, will need to ensure that they have sufficient visibility and control concerning the activities expecting to generate credits.** This has implications for the way in which non-authorized credit generation activities in the country is organised (question 5.1).

Likewise, opportunities to sell unauthorized credits to international voluntary market buyers will be shaped by the growing scrutiny attached to the third party standards that are often used for credits sold to these buyers (question 5.2). More generally, if the host country decides that it wishes to sell the unauthorized credits to international voluntary buyers then the discussion throughout Module 5 will be relevant.

**Module 6 discusses the introduction of carbon credits into domestic CPI in more detail, including the role of quantitative and qualitative restrictions.** These are different ways in which a host country might allocate credits between domestic and international uses.

### Further resources

**A series of World Bank reports have explored the role of RBCF in more detail.** For example:

The Information Note *'Defining Results-Based Climate Finance, Voluntary Carbon Markets and Compliance Carbon Markets'* further clarifies and explains the relationships between these terms.

*'Results-based Climate Finance in Practice: Delivering Climate Finance for Low-carbon Development'* provides some empirical grounding on different types of RBCF

*'Results-based Climate Finance to Support Mitigation Policies in Developing Countries'* explores how RBCF can be used to support policy change that delivers emission reductions .

<sup>1</sup> Independent standards like Verra and Gold Standard have evolved their policies on utility scale renewable energy projects due to inability of these projects to meet the additionality criterion, particularly in regions outside LDCs where renewable energy is already economically viable.

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