



The Voluntary Carbon Market as a Catalyst of Climate Ambition in Developing Countries

DRAFT NARRATIVE
AND ACTION AGENDA

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The VCM Global Dialogue

The narrative and Action Agenda presented in this paper is the result of the VCM Global Dialogue held between June and September 2021. It complements the VCM Manifesto that sets out a new vision for the Voluntary Carbon Market (VCM¹). The goal of the Dialogue was to identify measures that would enhance the mitigation potential of the VCM with an emphasis on supporting climate action in developing countries.

In consultations with over 350 stakeholders, the VCM Global Dialogue served as a platform to discuss how the VCM can support national and local climate plans, serve developing countries' preferences and needs, and unlock greater levels of private investment, while strengthening the rights of and opportunities for local communities in developing countries.

The Global Dialogue published five position papers on the following topics:

- the perspectives of host country governments;
- the perspectives of VCM project developers;
- the perspectives of corporates buying VCM credits;
- the prospect of REDD+ in the VCM;
- GHG accounting in the VCM.

This paper synthesizes the main conclusions of the VCM Global Dialogue in the form of six agenda items. These items, paired with actionable recommendations for VCM programs and standards, private entities, and governments, clarify how the VCM can complement public policies and regulated carbon markets.

¹ In this paper the term VCM refers to the transactions of verified GHG reductions and removals issued as tradable carbon credits outside regulated systems.

The role of the VCM in driving climate ambition

The VCM can play an important role in facilitating the transition towards a sustainable future - a future with a stable climate and that respects nature and the rights of all people to live prosperous and healthy lives. The VCM recognizes the global dimensions of climate change and facilitates cooperation between private actors in developing and developed countries. Building on a range of standards, protocols, and greenhouse gas (GHG) crediting programs, the VCM offers tools to estimate and measure GHG emissions and removals² and enables the creation of tradable carbon credits. The VCM enables private actors to drive climate benefits beyond their own operations and supply chains.

Since the adoption of the Paris Agreement in 2015, the VCM has seen a step change in issuances of carbon credits, especially over the last three years, rising from 104 million tCO₂e in 2019 to 235 million tCO₂e in the first eight months of 2021 alone.³ With thousands of companies around the world adopting ambitious net zero and carbon neutrality targets

that rely to a greater or lesser extent on carbon credits that offset or counterbalance unabated emissions for meeting these goals, the market is set to accelerate further over the rest of this decade. At the same time, the Taskforce on Scaling Voluntary Carbon Markets is aiming to create the conditions for the market to grow by 15 times by 2030.

Despite its evident potential for rapidly channeling significant additional funds to climate mitigation, especially in developing countries, concerns are often raised that the VCM could undermine public and private climate ambition. The fear is that a robust VCM could displace both company and public action. Companies could favor cheap carbon credits over costly internal decarbonization efforts, and governments could become overly reliant on private action. However, the displacement risk may be smaller than concerns suggest, as the VCM should – and as pointed out by participants in the VCM Global Dialogue almost always does – complement rather than replace the

efforts of companies or governments to address their own emissions. In addition, the characteristics of VCM investments mean that it can realize different mitigation potentials than public policy.⁴

The widely accepted “mitigation hierarchy” suggests that companies should prioritize abating emissions in their own value chains, taking action in line with climate science to ensure a swift transition of their operations towards net-zero emissions,⁵ before turning to carbon markets. Companies can use carbon credits to offset historic emissions, those of their customers and/or employees and emissions they cannot yet abate, or to achieve carbon neutrality by compensating residual GHG emissions or emissions above their corporate reduction targets. They can also acquire carbon credits for

non-offsetting purposes, for example, to meet broader sustainability or climate goals. In so doing, the VCM can accelerate the take-up of clean technologies and techniques, clean energy, zero-emissions transport and sustainable agriculture, and promote the restoration and protection of forests, wetlands and other natural carbon sinks. By channeling foreign direct investments and technology into developing countries, the VCM can support developing countries in bypassing carbon-intensive development patterns.

² Unless otherwise indicated, any reference to emission reductions refers to measured and verified GHG emission reductions and/or the removal of CO₂ from the atmosphere.

³ Ecosystem Market Place Insights Report, Markets in Motion: State of the Voluntary Carbon Markets 2021, Installment 1.

⁴ VCM investments are mostly geared towards projects that allow the generation of side-specific emission reductions (e.g. through restoration of forests or investments into decentralized clean energy) while public policy can access emission reductions at scale through changing investment incentives, standards, public infrastructure or enabling environments. That is not to say that overlap does not exist, and displacement effects could not happen.

⁵ Net zero means that all man-made GHG emissions must be reduced and residual emissions must be compensated by carbon dioxide removals from the atmosphere.

The VCM can fast-track emission reductions while governments design, formulate, and adopt relevant strategies, policies, and laws to abate GHG emissions and mitigate climate change. The information generated by VCM projects – abatement costs, technical and regulatory barriers, and capacity needs – may help governments better understand abatement opportunities and costs that create the basis for policy making. While laws and policies are in the making, the VCM channels investment into developing countries and achieves early emission reductions and removals. As public policies start to mandate action, fewer projects will pass the additionality test, and the VCM will be increasingly less relevant. However, the VCM can continue to play a role in driving mitigation beyond regulation. The VCM will also continue to provide a platform testing new technologies as governments are unlikely to ever catch up with the capacity of the private sector's drive for innovation.

The VCM provides access to financial resources -- beyond development

finance and climate funds - that governments can use to increase their mitigation ambitions and attain their Sustainable Development Goal (SDG) targets. The VCM - if used strategically and to its full potential - can drive climate action and increase confidence among countries to raise their climate ambitions and communicate more ambitious Nationally Determined Contributions (NDCs). For this to happen, it is essential that individual projects or programs create high-value, real and certified GHG emission reductions and removals. However, VCM activities must be considered in their broader implementation context, their relation to public policy, their relevance in creating an enabling environment for foreign direct investment, and their ability to increase the number of actors concerned about contributing to climate mitigation.

The following Action Agenda for a high-ambition Voluntary Carbon Market lists six steps to ensure that the VCM maximizes its contribution to ambitious climate action with particular emphasis to developing countries.





An Action Agenda for Maximizing Climate Benefits of the Voluntary Carbon Market in Developing Countries

1. Promote strategic engagement of governments with the VCM

For the VCM to make meaningful contributions towards the achievement of national climate ambition and the temperature goals of the Paris Agreement, governments need to engage proactively with the opportunities the market offers. Governments can consider the VCM when planning climate policies, strategies and measures to be implemented, with or without international support, to achieve or go beyond their NDCs. The VCM allows governments to access mitigation potentials in sectors, industries, or regions where the reach of public policy is limited due to a lack of political agreement, limited public finances, or difficulties reaching remote areas. Governments can actively encourage and support VCM investments in these areas. They can also go beyond encouraging VCM investments by integrating them into policy frameworks.

So far, most national governments are, by and large, not directly involved in the VCM process. A distinctive feature of the voluntary market is that it enables project participants to trade carbon assets without public market regulation. With distance comes disengagement from the VCM, which can in turn lead to mistrust of the unknown. There are exceptions where governments have embraced the VCM as a feature of their national policy landscape. Colombia, for example, has linked its domestic carbon pricing schemes to independent GHG crediting programs such as the VCS,⁶ and, in the United Kingdom, the Woodland Carbon Code defines a domestic voluntary carbon standard for forest projects.⁷ However, despite these exceptions, governments tend to be relatively unaware and, by extension, distrustful of the VCM.

⁶ Verra (2020) "Data and Insights: Colombia." VCS Quarterly Update. Issue #1 - Q2/2020. Available at <https://verra.org/data-insights/colombia/july-2020/>

⁷ Government of the United Kingdom (2018) "The Woodland Carbon Code Scheme for Buyers and Landowners. Guidance". Available at <https://www.gov.uk/guidance/the-woodland-carbon-code-scheme-for-buyers-and-landowners#background>. Accessed 14 September 2021.

⁸ So proposed, for example, by the Grown Climate Solutions Act of 2021 of the US Senate: <https://www.congress.gov/bills/117th-congress/senate-bill/1251> (accessed 14. September 2021).

Recommendations on how governments can engage with the VCM

Collect information and create a VCM database. It is critical that governments have information about VCM project activities within their territories - including the emission reductions that are being generated, traded, and used - in order to develop strategies and policy that engage the VCM going forward. To support data collection and exchange of information, GHG standards and crediting programs should be required to provide country-specific information setting out emission reductions achieved, and link VCM registries to public databases. In parallel, standards organizations - or international entities such as the International Carbon Reduction and Offsetting Alliance (ICROA) or the International Emissions Trading Association (IETA) - could provide information regarding the dynamics, benefits, and potential of the VCM to host countries.

Select and promote priority project types. Governments can also approve and publish VCM activities that they consider particularly beneficial to their social, economic, and ecological context. Governments can approve GHG crediting programs or

other types of programs to create confidence among communities, project developers, and investors and reduce the barriers for entry for VCM engagement.⁸ For prioritized project activities government could also offer "corresponding adjustments" as additional investment incentive for project developers. Priority project activities could be those linked to technology transfer, higher costs, or sectors where public action is politically challenging.

Proactively promote VCM foreign investments. The VCM attracts foreign direct investment and channels it into climate mitigation measures. To actively promote such investments, governments can create Voluntary Carbon Market Investment Promotion Agencies (IPAs). As branches of existing investment agencies or as new institutions, IPAs could help countries attract private investment from the VCM and support national climate objectives. VCM IPAs would pave the way for enhanced private sector engagement by linking VCM investments to measures that create an enabling environment for private investments

2. Support coordination and cooperation among public and private entities

The positive impact of the VCM can be further enhanced if governments, companies, and civil society cooperate in scaling up mitigation action and targeting particular sectors or mitigation opportunities in a concerted manner. Governments have an interest in harnessing the financial power, expertise, and technological capacities of the private sector. Corporations in turn prefer coordinated international action to unpredictable and fragmented regulation.

Breaking down larger problems into smaller, clearly defined sub-problems can be a first step towards effective cooperation, not only among governments but also between governments and private actors. This is particularly true for programs working in the context of decentralized energy provision, transport, sustainable agriculture, or REDD+, which benefit from programmatic approaches and require a close cooperation between public and private sectors. The problem of tropical deforestation, for example, could be addressed through supply-side partnerships that target the drivers within a particular region (for example, beef and soy production in Brazil, or cocoa production in West Africa) with a mix of VCM finance, private supply-chain investments and national governance reform, while complementary partnerships could address the demand side of deforestation.

Recommendations on how to promote coordination and cooperation

Promote regional or sectoral VCM dialogues. The VCM lacks fora of international coordination, exchange of experiences and lessons among host countries. The absence of for a that allow discussions among governments contributes to reluctance and insecurities that many countries confess vis-à-vis the VCM. Sub-groups of countries with similar circumstances (e.g. countries with national pricing mechanisms that allow for offsets) or regional country groups could be invited, for example by development agencies, to join dialogues that allow the discussion of problems and challenges as well as solutions that may help to overcome those.

Create multi-stakeholder platforms of engagement. Dialogues among host countries should be complemented by national dialogues that clarify government priorities and investor constraints, manage mutual expectations, build trust, and ensure alignment between public and private interests. Such dialogues can help to identify opportunities for public and private entities to cooperate in developing VCM projects and programs in particular regions (e.g. in the land sector) or sectoral programs

(e.g. in energy or waste sectors). Civil society, including standards organizations, could facilitate dialogues between governments, market actors, and other stakeholders, and help to promote cooperation by providing information, building capacity, and supporting vulnerable actors.

Forge partnerships and support carbon development. Governments, NGOs, and corporations can promote and broker initiatives that reflect common interests, are built on investment opportunities, and fall into national climate strategies. Larger programs are likely to depend on a mix of public and private investments, and the VCM can support such efforts by linking finance to clear GHG results. Corporates can invest in carbon credits, and governments can use VCM methodologies to measure GHG results. Public finance can complement carbon finance by supporting an enabling environment, and official development assistance can link investments in mitigation to broader development or subsidize the development of relevant methodologies and identify appropriate standards and GHG crediting programs.

3. Clarify the relationship of the VCM with the Paris Agreement

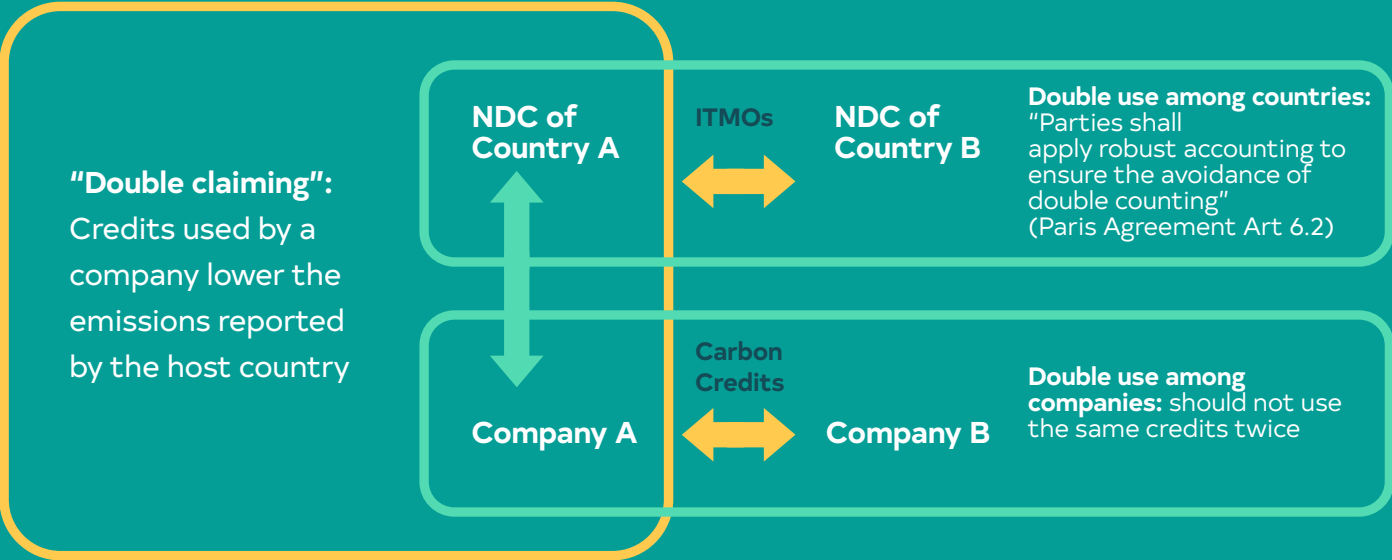
To mobilize the full mitigation potential of the VCM, it is important to establish a common understanding of when and how activities that generate carbon credits under the VCM contribute to host countries' Nationally Determined Contributions (NDCs) and company goals. This requires full transparency in the accounting of VCM activities and NDC coverage. The Paris Agreement also affects the eligibility of projects for carbon finance, and investments are held back by uncertainties about interactions between NDCs, baselines, and additionality, and about rules for trading under the Paris Agreement or voluntary trades.

The VCM has traditionally dealt with projects that reduce or remove emissions outside the scope of a company's emission inventory, enabling it to receive credits to offset its own emissions and meet its climate goals. In contrast, emissions accounting at a national level under the UNFCCC and the Paris Agreement operates differently in that national emission inventories allocate emissions on a territorial basis according to countries' physical borders. A country's inventory does not count emissions attributed to one of its companies if they occur outside of the country. This national accounting needs to consider any transfers of emission reductions that occur through international cooperation in the context of Article 6 of the Paris Agreement.

Both accounting for VCM emission reductions and their eligibility in the light of NDCs are closely related to concerns about the displacement of mitigation action. The concern is that companies and governments could claim the same emission reduction against their targets (see Figure 1) and companies could acquire non-additional carbon credits. In both cases, choosing the appropriate accounting treatment or clarification of additionality rules becomes a question of whether there is a

problem of double claiming. Many NDCs lack the specificity that allow conclusions about specific policies or measures to be taken, which makes it difficult to assess the risks of displacement or non-additionality. Some of these issues may be addressed in the UNFCCC negotiations. However, most questions cannot be addressed at the international level and instead require clarifications from governments and carbon standards on VCM accounting and crediting.

Figure 1: Multiple forms of double claiming



Recommendations on how to clarify the VCM in relation to the Paris Agreement

Establish a common understanding on accounting approaches. To mobilize the full mitigation potential of the VCM, it is important to establish transparency and a common understanding of the accounting measures that back carbon credits generated by the VCM. Governments and companies should clarify when and how they use carbon credits and towards their targets. Transparency around the use of carbon credits to offset emissions and associated corporate claims allows an assessment of double claiming and displacement risks. Common definitions and a clear taxonomy of accounting approaches - i.e. offset claims with or without corresponding adjustments and non-offset claims - would enable civil society to hold corporates accountable and enhance market integrity.

Clarify the context of different accounting approaches. Governments may also provide information on when they are prepared to back VCM

transactions with 'corresponding adjustments.' Corresponding adjustments would provide for units transacted under Article 6 of the Paris Agreement to be counted towards the acquiring country's NDC, rather than the host country's NDC. Governments can opt to offer corresponding adjustments to certain VCM transactions, and provide assurance that the host country would not count the credit toward its own NDC. They can also channel finance into VCM investments that generate carbon credits but show a clear positive multiplier effect in the form of additional emission reductions. Supporting host country climate policies, companies should also ensure that their VCM investments create positive-climate effects by prioritizing investments in transformational technologies and projects that are likely to generate positive GHG spillover effects. Companies may also consider only using a portion of acquired carbon credits to compensate or neutralize company or product emissions

Clarify and confirm rules on additionality and baseline setting. Carbon standards and GHG crediting programs may also consider clarifying (or confirming) rules to prove additionality and the establishment of GHG baselines in the context of the Paris Agreement. Considering the vagueness of many NDCs, standards could confirm that the specific circumstances of each project remain the reference point for the generation of GHG reductions, rather than linking additionality and/or baselines to (planned) policy action in NDCs. Standards could also work to create clearer definitions of when a policy or regulation is considered to be applied so that policy additionality can be assessed in a more consistent manner.

4. Value broader development benefits and SDG contributions in the VCM

The VCM has the potential to support sustainable development in host countries through project benefits such as access to clean energy or clean water, reduced air pollution, improvement in health infrastructure, job creation, technical training, water and soil retention, and the protection of biodiversity. These benefits contribute to SDG targets and address global challenges beyond climate change, such as inequality, environmental degradation, social development, justice, and peace. However, while carbon buyers wish to support projects at scale that also generate co-benefits, SDG contributions, and equitable benefit-sharing, buyers are not consistently willing to pay high prices for those attributes. Furthermore, projects that generate credits with high sustainable development benefits can often have higher upfront costs and depend on investments and advance payments for future carbon credits that are often difficult to negotiate.

Corporate demand for benefits beyond carbon can boost the positive impact of mitigation projects. Prices that clearly recognize SDG attributes and transparent benefit-sharing with communities would drive the market to higher-quality projects and reward project developers and governments for effort in high-need sectors and regions.

Recommendations on how to drive finance towards projects with high SDG benefits

Promote the use of standards that certify the SDG impacts of projects. Programs such as Verra's Sustainable Development Verified Impact Standard (SD VISTa) or the Gold Standard for Global Goals mark a first step towards a market that recognizes the sustainable development value of carbon projects. However, relatively few projects are certified under these programs. By demanding the certification of SDG impacts of carbon projects, buyers can drive finance towards projects with high co-benefits.

Quantify and compare SDG impacts. A transparent market that values carbon credits differently depending on their SDG contributions and other attributes would enable such projects to attain higher prices. Standards that certify SDG impacts can revise their reporting requirements to obtain additional information that

allows the assessment of SDG impacts which would allow market players to benchmark investments by, for example, demand a certain number of SDG criteria to be met.

Facilitate up-front investment into projects with high sustainable development benefits. Governments could communicate SDG-priorities and identify project categories that have significant development benefits. They could work with investors or donors to design instruments that help such projects to access advance finance and mobilize investment.

5. Promote VCM transactions at sectoral or jurisdictional scales

The larger a VCM program is, the broader is its impact. Successful sectoral or jurisdictional programs can yield millions of tons of GHG emission reductions. If backed by governments, such programs can also facilitate the transition to long-term sustainable development and GHG mitigation policies. While project-level VCM approaches are common and tested, larger scale programs remain rare. If developed effectively with robust accounting, sectoral or jurisdictional programs can cover large sources of emissions, address issues of leakage and free-riding, and link government policies to private investments.

Large-scale programs are also likely to have system-wide transformational impacts through faster take up of low carbon technologies and techniques, sector-wide innovation, and economies of scale. Such programs, for example, could be implemented in the basic-materials or heavy industry, waste management or forestry sectors. Jurisdictional REDD+ programs are pioneers of sectoral crediting.

Larger crediting programs can build on and expand existing programmatic approaches, such as bundled projects or programs of activities, which consist of distinct actions that support policy goals. These programs reduce costs of measurement, reporting and verification (MRV), for example through setting sector or jurisdictional parameters, and make it possible to bridge the gap between investments into projects and promote policies.

⁹ Verra (nd) "Jurisdictional and Nested REDD+ (JNR). World's first accounting and verification framework for jurisdictional REDD+ programs and nested projects." Available at <https://www.gov.uk/guidance/the-woodland-carbon-code-scheme-for-buyers-and-landowners#background>. Accessed 14 September 2021.

Recommendations on how to scale VCM activities to the sectoral and jurisdictional levels

Develop programmatic and sectoral initiatives. Governments may coordinate programmatic approaches or scale them to the sectoral levels. Investors and carbon buyers can support such programs through investments or the acquisition of carbon credits. Governments could host sectoral dialogues in the context of VCM dialogues and create sectoral transformation and just transition plans that define programmatic policy interventions as well as areas for private involvement and investment. Private actors could support such efforts through sharing of lessons, expertise, and monitoring and emissions data. Industry representatives and specialized public sector entities could cooperate in the development of programs and appropriate MRV approaches.

Support 'nesting' beyond REDD+, as a strategy to integrate different accounting frameworks. 'Nesting' allows the integration of project accounting into sectoral or jurisdictional programs that cover a larger accounting area. This allows

investors can deploy finance at the project level, while benefiting from the credibility of the broader program, and ensuring the coherent and credible accounting for GHG benefits. The impact of projects increases if they are embedded in national policies, coordinated with the government, and embedded in national accounting frameworks.

Develop sectoral crediting standards. GHG crediting programs could develop approaches and methodologies that promote sectoral VCM investments. Recent developments in REDD+ crediting could inform and serve as a model for such efforts. REDD+ jurisdictional crediting and nesting rules, such as Verra's Jurisdictional and Nested REDD+ (JNR),⁹ offer a way to harmonize national programs and projects to the mutual benefit of governments and private project developers. This concept could be applied to other sectors and programs, combining incentives for investments into projects and support for larger projects.

6. Empower local communities to engage and benefit from the VCM

The VCM can strengthen the position and rights of Indigenous Peoples and Local Communities (IPLCs) and enhance their agency. A rights-based approach to the VCM can empower IPLCs through recognizing their good stewardship of natural resources. By providing communities options to engage and cooperate with their government but also to work independently of the government, IPLCs are able to actively participate in decisions on the use of natural resources

Nature-based interventions, in particular, can only be successful with full participation of IPLCs. IPLCs are the actors most directly impacted by the implementation of project activities and their engagement is essential to a project's or program's success. Successful and sustainable VCM activities are based on participatory approaches that allow IPLCs and other local actors to co-design and directly benefit from VCM interventions. Engaging IPLCs requires time and effort to build trust and understanding. As such, high-quality VCM projects and programs are geared towards long-term transitions rather than short-lived changes of behavior and operations, and require upfront investment to fund trust-building. IPLC engagement and empowerment can only be achieved with full participation of all relevant local actors, operating both in the public and private spheres.

Recommendations on how to increase VCM benefits for IPLCs

Use the VCM to channel finance to IPLCs. As long-standing defenders and stewards of forests and other key ecosystems, IPLCs should be empowered to define the conditions of their engagement in carbon markets. In many cases, IPLCs have fraught relations with government agencies and their past experiences with market-based mechanisms has not been good. However, the relative independence of the VCM from government interventions may be attract to IPLCs who may partner with trusted NGOs or businesses to design VCM projects that allow them to gain direct access to finance. Alternatively, IPLCs can negotiate fair participation through benefit-sharing arrangements with governments.

Ensure fair benefit-sharing. Project developers should publish their benefit-sharing agreements with local communities to enhance the

transparency around community benefits. Market participants should agree on a minimum percentage of carbon finance that is shared directly with communities and communities should participate in the design of the benefit-sharing arrangement as well as in project profits. Governments can also define criteria for fair benefit-sharing or publish model benefit-sharing agreements.

Promote IPLC land and carbon rights. If carbon market actors recognize IPLCs land rights in their investments, including claimed ancestral and customary rights, the market can help to re-enforce IPLC land claims. By demanding the explicit recognition of IPLC carbon rights, crediting programs and standards can empower IPLCs in their negotiations with governments and private market players.