Harnessing Corporate Climate Action for Sustainable Development

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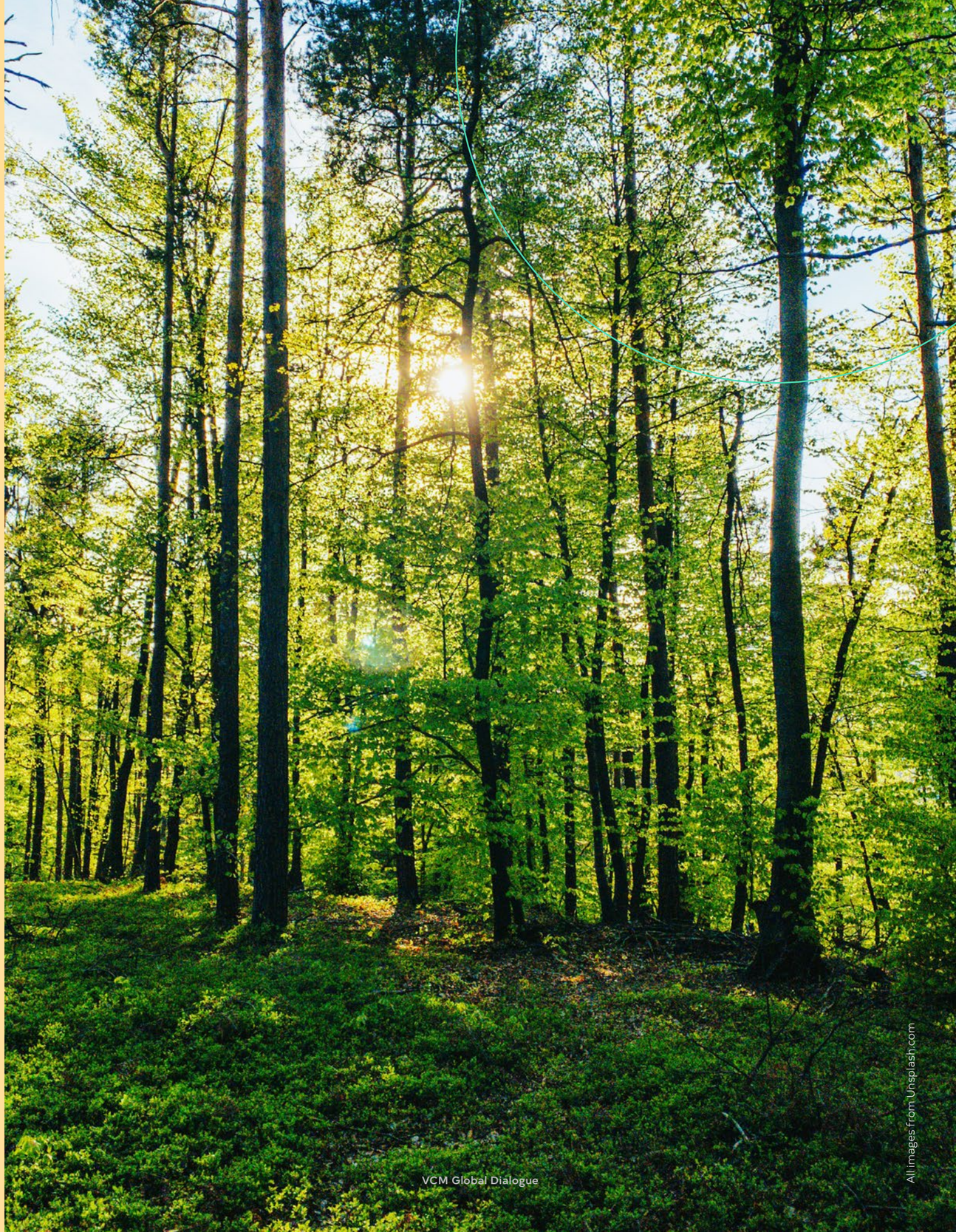
VCM Global Dialogue

About the Voluntary Carbon Markets Global Dialogue

Fulfilling the promise of the Paris Agreement will require the widespread adoption of more ambitious mitigation commitments and significantly scaled-up flows of finance, technology, and capacity to developing countries. Well-designed voluntary carbon markets can help to achieve both aims.

The Voluntary Carbon Markets Global Dialogue helps to identify how voluntary carbon markets can drive mitigation activities that support national climate plans, local priorities with additional benefits for communities and businesses, unlock greater levels of private investment, and help motivate more corporates to reduce their emissions and to neutralize their remaining emissions. The Global Dialogue team is led by Climate Focus, the Indonesia Research Institute for Decarbonization (IRID), SouthSouthNorth (SSN), and Transforma, with assistance from an inclusive team of leading carbon market experts and analysts, and with the support of Verra.



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Harnessing corporate climate action for sustainable development

By Sandra Garavito and Pedro Moura Costa [1]

[1] With additional support from Pedro Carvalho and Pablo Fernandez, Ecosecurities.

To ensure that the Voluntary Carbon Market (VCM) incentivizes greenhouse gas (GHG) emission reductions and removals in a way that is consistent with global mitigation ambition and national and local priorities, understanding the motivations of – and constraints on – VCM buyers can help to maximize their engagement. The paper therefore seeks to answer the following questions:

- How can the VCM stimulate the engagement of voluntary carbon credit buyers and investors in a manner that accelerates the climate transition?
- How can projects and investments be structured to increase benefits to the host country, and align these actions with Nationally Determined Contributions (NDCs) and Sustainable Development Goals (SDGs)?

The paper was prepared in two phases. The first phase consisted of a series of interviews with companies engaged in the VCM from a range of economic sectors, including oil and gas, information technology (IT), and energy generation as well as carbon credit brokers and retailers in Europe, and North and South America. These interviews sought to get insight into the motivations for, views on, and experiences with VCM engagement of carbon credit buyers and investors.

In the second phase, several virtual regional stakeholder consultations were held inviting stakeholders from Asia and the Pacific, Africa, Latin America and the Caribbean to discuss the findings. These consultations sought input from host country governments, project developers, non-governmental organizations and civil society, to enhance and enrich the recommendations.

The recommendations in this report are also informed by a case study on the role of the VCM in Colombia, one of the few developing countries with a vibrant domestic carbon market. This allowed for a comparison of the needs of international and domestic buyers in Colombia.

Main findings

Companies engage in the VCM to identify cost-effective solutions to reduce their corporate carbon footprint or to meet carbon neutrality or net zero goals. While some companies prefer to purchase carbon credits from small, locally owned mitigation projects, corporates typically look to purchase credits from larger-scale - and ideally 'charismatic' – projects. These large-scale projects generate high volumes of credits, thereby reducing buyers' transaction costs, and provide social and environmental co-benefits, ideally contributing to the Sustainable Development Goals (SDGs). Corporates also seek to avoid reputational damage by requiring robust environmental integrity of the carbon credits that they purchase.

For host countries, the VCM represents a source of international finance for climate change mitigation. It is therefore in their interest that VCM investments are aligned with the countries' development objectives. Corporates do not reject such alignment but are wary of government involvement and regulatory requirements that can slow projects down and create additional costs.

Recommendations

To enhance the effectiveness of the VCM, corporate interests, host country requirements and project development capabilities need to be aligned. Institutionalized regional or national dialogues that engage both public and private sector stakeholders can foster better understanding of the role of the VCM in particular sectors or areas of a country or region. Countries can also decide to actively invite and facilitate VCM investments.

To foster better understanding between host countries and investors, a **platform or dedicated agency** could proactively encourage dialogues to help to clarify government priorities and investor constraints, manage mutual expectations, build trust and ensure an alignment of public and private interests. This interaction could incentivize private investments that are aligned with NDC host country priorities.

To maximize the effectiveness of the VCM in delivering sustainable development benefits to host countries, **host country governments** can:

- **Align investment preferences with national climate policies through a number of strategies.** The example of Colombia shows how a government can combine a mandatory policy (such as a carbon tax) with a voluntary compensation scheme to incentivize private investment in mitigation projects. To be successful, such an approach requires regulatory clarity and certainty about the eligibility of credits, clear procedures, clear timelines, close coordination among implementing entities and outreach and training for participating entities to understand the mechanism.

- **Institutionalize their engagement with the VCM.** Voluntary Carbon Market Investment Promotion Agencies (IPAs) could be established by host countries to attract VCM investment into a set of priority projects that support national (climate) policy objectives. Such a VCM IPA would be designed to provide scale, efficiency, and clarity of rules, in doing so enabling enhanced corporate engagement with the VCM. To facilitate financial flows to climate mitigation projects, IPAs would help promote, implement and manage a set of activities which together make successful VCM investments possible. This could include conducting all the necessary work of planning (e.g., land use plans, energy sector plans), stakeholder identification and engagement, consultations, establishing baselines, and providing fiscal and legal clarity, among other things. Establishing such an IPA allows for the costs of these activities to be centralized, and can be designed to attract and direct finance to national or regional priorities.

Corporates can support governments with the establishment of an IPA. An IPA would be in the interest of corporates as it will stimulate (cost-)efficiency, reduce transaction costs of individual projects, and ensure alignment of investment with national climate and development ambitions.

Finding the right balance between safeguarding integrity and regulating markets

The recent increase in demand for VCM credits reflects a growing pressure on corporates to engage in global mitigation efforts. Many corporates plan to engage in the VCM to reduce mitigation costs and offset a portion or all of their actual, historic or future emissions. The spike in demand and transactions on the VCM has raised concerns about the potentially negative impact of a flurry of uncoordinated VCM activities. The absence of regulation or a compliance framework may lead to inconsistencies between country-level and corporate GHG accounting systems. Other concerns include limited coordination between countries' Nationally Determined Contributions (NDCs) under the Paris Agreement and VCM trading activities; the lack of coordination and harmonization between different GHG crediting programs; and insufficient safeguards to ensure a positive impact of the VCM on indigenous peoples and local communities. Discussions about the quality and transparency of VCM transactions [2] have resulted in at least one carbon standard publishing a list of potential conditionalities on the VCM.[3] Such conditionalities would require, for example, an alignment of projects with jurisdictional approaches where available [4] and national priorities, the creation of co-benefits, and for some, corresponding adjustments.[5]

Beyond tapping into cost efficient mitigation, corporates also have a clear interest in project benefits 'beyond' carbon, such as sustainable development and community benefits impacts, looking to maximize benefits of their VCM investments. This has resulted in buyers seeking a larger impact for their investment – topping up emission reductions with co-benefits, SDG contributions, country approvals, 'integrity' safeguards, corresponding adjustments and scale – without necessarily translating the extra quality attributes into higher prices. While this corporate demand for benefits beyond carbon can boost the positive impact of mitigation projects, inadequate financing can make VCM investments one-sided and exploitative of the host countries and/or projects.

The VCM can only thrive if stakeholders find a balance between market integrity that ensures the positive GHG, social, environmental and development impact of the VCM, and the complex rules and procedures that make market participation burdensome and costly. Voluntary corporate buyers engage with the VCM of their own volition – because they feel a social responsibility, or because their customers or investors ask them to act – but there is no law obliging them to do so. Consequently, the prospect of having to navigate local bureaucracies and protracted host country approval processes, or the lack of flexibility created by rigid rules, may reduce the attractiveness and flexibility of voluntary mitigation projects for corporates. In addition, investors always try to minimize risk and maximize certainty. Insecurity over rules or changing investment requirements creates a major obstacle to incentivizing finance flows into mitigation activities.

A concerted effort from buyers and host countries is needed to incentivize investments that contribute to host countries' low-carbon development objectives and NDCs, and meet buyers' need for cost-effective emission offsets and recognition of their contribution to mitigating climate change. Alignment of corporate and government interests reduces investment risks to corporate investors while ensuring that corporate investments support government climate and SDG objectives. The greater the collaborative effort made, the higher the impact that can be generated by these projects.

[2] See, for instance: Seymour, F. and P. Langer. 2021. Consideration of Nature Based Solutions as Offsets in Corporate Climate Mitigation Strategies. WRI Working Paper.
[3] For instance, a current focus on promoting the adoption of the ART TREE standard (https://www.artredd.org/trees/)
[4] For instance, Seymour (2020) Insider: 4 Reasons Why a Jurisdictional Approach for REDD+ Crediting is Superior to a Project-Based Approach. Available at https://bit.ly/3DZB6Ja. It is important to highlight that, at this stage, few jurisdictions are ready to meet the requirement of REDD+ jurisdictional approaches envisaged by its advocates.
[5] See, for instance: Moura-Costa, P. et al. (2020) Programa Floresta+ and Voluntary Carbon Markets. Article 6, voluntary markets and the new Brazilian REDD+ programme. Published by Brazilian REDD+ Alliance. Available at https://www.bvrio.org/publicacoes

Box 1.

The perspective of corporate buyers

The interviews conducted for this paper indicate that a primary driver of corporate VCM engagement is the desire to find *cost-effective* solutions for reducing corporate carbon footprints or to meet carbon neutrality or net zero goals. Corporates also mentioned that the ability of projects to create social and environmental co-benefits and contribute to other SDGs was a positive attribute of the VCM, as the VCM may strengthen their brand reputation and allow them to display their climate engagement. Corporate carbon credit buyers have the following expectations of the VCM:

- While in the past companies may have invested in VCM projects driven by corporate social responsibility objectives, the more recent flurry of VCM activity is mostly driven by objectives of 'carbon neutrality' or net-zero claims. These buyers tend to prefer larger projects that can generate high volumes of credits. Considering that the average size of a VCM project is quite small (the average project generates tens of thousands of emission reductions per year) and the expectations of large corporate credit buyers, but also funds or traders to contract with projects that generate millions of emission reductions per year, there is a disconnect between typical supply and the volumes demanded.
- To minimize reputational risk, a unanimous requirement of buyers is for the 'environmental integrity' of credits. The focus on potential reputational risks is exacerbated by recent NGO campaigns and negative press. [6] However, there is no market-scale agreement as to what constitutes "environmental integrity".
- Buyers are in favor of having defined requirements for companies to substantiate climate-related claims, so that there is a clear standard to be met and lower reputational risk.
- Buyers also favor credible and effective certification standards. They are worried about the strong criticism of GHG crediting programs by some sections of civil society and the press but, at the same time, most interviewees do not believe that additional rules and requirements are the solution. Some corporates complain about the complexity and costs associated with the validation process under existing GHG crediting programs. Corporates suggested a harmonization of GHG crediting programs and shared set of minimum requirements for GHG integrity.
- There was little interest in requiring corresponding adjustments for VCM transactions between private entities, as participants prefer to keep their projects independent from official accounting and regulation, and some suggested that this could create additional costs and regulatory delays.
- There is a preference for 'charismatic carbon', such as nature-based solutions which are perceived to deliver more co-benefits than the renewable energy and industrial energy efficiency projects that were popular under the Clean Development Mechanism.
- Clarity and reliability of rules is a must, so that investors can make long term (e.g., 10 – 20 years) investment decisions with long term predictability.

When engaging with the VCM, corporates are concerned about the ability of host countries to coordinate the actions needed to host, facilitate, and/or approve VCM projects. Buyers are worried that local governments may over-regulate the VCM. Another major concern is the potential for corruption associated with VCM regulation. While in theory many recognize the benefits that proper planning and coordination with the host country could bring (i.e., generation of co-benefits, alignment with NDCs, etc.), corporates are skeptical that such arrangements can be constructed and operated efficiently and transparently. As a result, many corporates prefer project-based approaches over jurisdictional models and nesting, as the latter are very reliant on host country government involvement.

[6] See, for instance, The Guardian (2021) Carbon Offsets Used by Major Airlines Based On Flawed System, Warn Experts. Available at https://bit.ly/3wBUJCr; Bloomberg (2021) Startup That Rates Carbon Offsets Finds Almost Half Fall Short. Available at https://bit.ly/2QVRDtN; or Bloomberg Green (2021) A Top U.S. Seller of Carbon Offsets Starts Investigating Its Own Projects. Available at https://bloom.bg/3hXFmjC

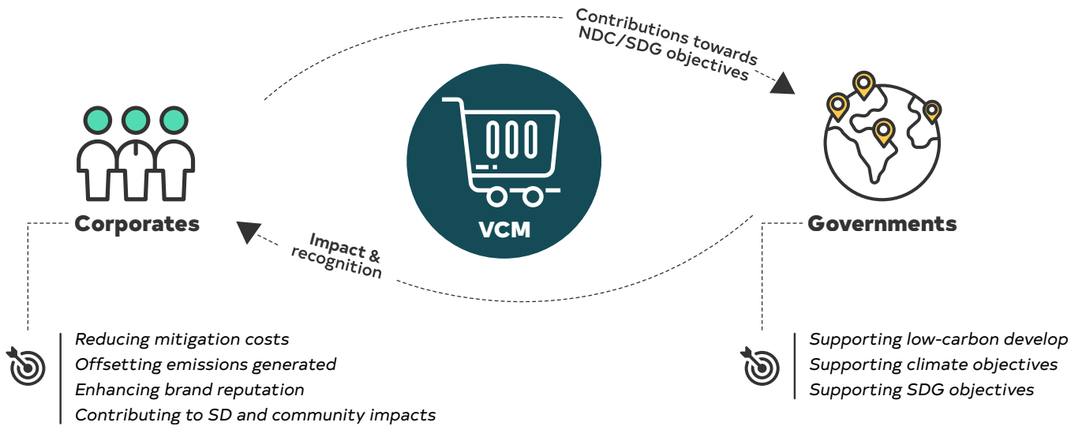


Figure 1. Corporates and governments have different motivations for engaging with the VCM

Public-private dialogues on the VCM

Aligning corporate interests with host country needs and project development capabilities would strengthen the market: it would manage expectations on what projects can achieve while ensuring funds are used effectively to achieve SDG impacts. Corporates are interested in cost-efficient projects that generate emission reductions and/or removals at scale and at low cost, with environmental integrity and creation of co-benefits. For host countries, it is important that VCM investments are aligned with broader development, climate and SDG objectives. Project developers, in turn, navigate this field by trying to deliver cost-efficient carbon credits that meet market demand while being in line with government policies.

In theory, planned or coordinated approaches (jurisdictional land use projects, sectoral energy or industrial projects) could ensure the integration of public and private sector interests. In practice, however, there is concern that such approaches could result in additional red-tape and bureaucracy, slowing the pace of project development, creating restrictions on innovation, and increasing costs.

Many developing countries are already implementing public-private sector dialogues to define their 2050 climate ambition, and to develop roadmaps for achieving their NDCs. This provides an opportunity to understand and balance the relative benefits of different mitigation options and tools. Where they exist, these dialogues provide an opportunity to engage the private sector in a strategic exchange of views, expectations and needs on the VCM. Where they do not exist, new formats could be created.

The establishment of public-private dialogues could help to inform private investors about VCM constraints and opportunities. Such dialogues would consider national political, economic and sectoral circumstances, and enhance the understanding of corporate credit buyers of the VCM. It would also help governments to appreciate the considerations of corporates investing in the VCM.

Establishment of VCM Investment Promotion Agencies

Host countries could also decide to further institutionalize their strategic engagement with the VCM. Entities dedicated to this objective, such as, for instance, Voluntary Carbon Market Investment Promotion Agencies (IPAs), could help them attract private investment into the VCM and support national climate objectives (see Figure 2). The host country government, potentially in partnership with the private sector and/or multilateral agencies, could create and operate (or co-create and co-operate with other entities) an IPA dedicated to attracting VCM investment into their planned sectoral development priorities,[7] mobilizing and facilitating financial flows from the VCM to mitigation projects in the host country.[8]

The IPA could capitalize on potential public sector financial support (by, for example, development finance organizations or bilateral donors) with the specific objective of leveraging higher levels of direct private sector investment. These IPAs would have the mandate to direct VCM investment towards the priorities of the host countries in a way that contributes to their development goals and societal needs. Unlike investment vehicles that channel private investments into government programs,[9] IPAs would pave the way for enhanced private sector engagement, as opposed to excluding it from the decision making, investment and financial flows related to the projects developed.

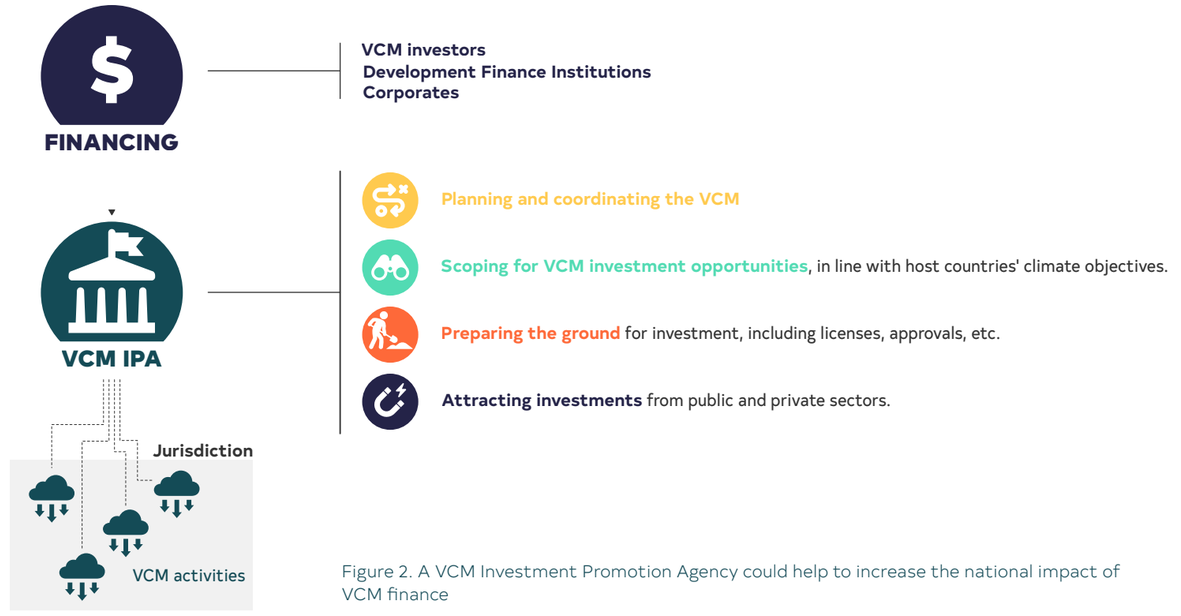


Figure 2. A VCM Investment Promotion Agency could help to increase the national impact of VCM finance

At an initial stage, an IPA would conduct – based on NDCs and national climate strategies – a diagnosis of VCM investment opportunities and needs. For example, a starting point for the land sector could be a multistakeholder integrated land use mapping exercise identifying areas for production, protection and community use,[10,11] as well as other national and regional priorities and needs. In the case of the energy sector, the IPA would quantify electricity demand, map existing energy sources, and identify future expansion and development needs, etc. Undoubtedly, the complexity of initial diagnostic and planning exercises would depend on the circumstances of each country or region, but it is an essential component of a coordinated development and investment approach. Many developing countries have advanced some of these efforts, which can serve as case studies for IPAs to be developed elsewhere.

Based on this initial diagnostic, the IPA could create the framework necessary to attract investment to identified priority project types and make information available that facilitates investments (see Box 2).

[7] For a longer discussion, description and analysis of the merits of an IPA model, see Moura Costa et al. (1999) Financial mechanisms for Sustainable Forestry. UNDP Profor. Available at https://bit.ly/3zZvlZu

[8] An example of this model was the World Bank's assistance to Nicaragua in the wake of Hurricane Mitch "to create and operate a Sustainable Forestry Investment Promotion Office for the development of certification of sustainable forestry practices and for the promotion of investment in sustainable forestry and reforestation" in the context of a broader sectoral initiative aimed at building management capacity and reducing market barriers. See: World Bank (1998) Project Appraisal Document on a Proposed Credit in the Amount of SDR 6.4 Million to the Republic of Nicaragua for a Sustainable Forestry Investment Promotion Project. Report No. 18653-NI.

[9] Such as, for example, the World Bank's Forest Carbon Partnership Facility (https://www.forestcarbonpartnership.org) or the Emergent fund for REDD+ (https://www.emergentclimate.com).

With the framework, an IPA could prepare informational materials and conduct activities to attract investors, for example in the form of roadshows, investment fairs, calls for proposals, or tenders. These activities could be part of broader NDC investment promotion activities, especially where carbon finance is part of a package of funding from different sources.

The IPA approach enables host countries to plan and integrate investments in relation to their social, economic and environmental development needs, as well as with their NDC implementation strategies. Other policy objectives could also be considered, such as supporting certain industrial or business sectors, integration with agricultural supply chains, job creation, etc. For corporate climate investors, the work conducted by the IPAs (e.g., land use plans, energy sector plans, stakeholder identification and engagement, consultations, baseline establishment, fiscal and legal treatment clarity, etc.), would reduce the costs of having to conduct these activities for their individual project, would ensure that their investments are aligned with national or regional priorities, and would reduce the length of time needed to develop mitigation activities that generate carbon credits for use on the VCM. Box 2 provides an overview of the activities an IPA could undertake.

[10] An interesting recent example of this approach is the initiative of the Edo State government in Nigeria, that conducted a thorough land use planning exercise prior to engaging private sector operators for forestry and agricultural development (Personal communication, Abraham Baffoe, Proforest).

[11] See, for instance, Bass, S., Moura Costa, P., et al. (2000) Rural livelihoods and carbon management. DFID Forestry Research Programme project R7374. IIED

Box 2.

Activities that an IPA could undertake to facilitate VCM investments

- Mapping the location of different types of project intervention needed;
- Defining emissions baselines for the region and in relation to national level baselines;
- Calculating emissions factors (in the case of energy and industrial projects when required);
- High conservation value and biodiversity assessments (in the case of land use projects), if appropriate;
- Consulting stakeholders and ensuring free prior and informed consent for projects;
- Identifying potential local partners, co-investors and service providers;
- Connecting investments with the local financial system, to ensure streamlined flows of finance into and out of the country;
- Providing clarity on the VCM standard to be used;
- Providing clarity on the treatment of carbon credits to be generated, including whether they will be subject to royalties or shares of proceeds;
- Providing clarity on the integration of the projects with the host country's NDC and whether the country proposes to make corresponding adjustments;
- Providing clarity on the legal treatment of these investments, as well as the applicable tax regime;
- Pre-approving priority projects, providing comfort to investors;
- Defining pre-determined benefit-sharing agreements and/or a levy to support the costs of the IPA (or adaptation projects, etc.).

While the role of IPAs should be to facilitate investment flows, their involvement should not be mandatory and companies should still be able to invest in independent projects and activities. In this way, the IPAs would complement, rather than displace, the role of developers and entrepreneurs in identifying cost effective, climate-related interventions.

While there are upfront costs involved in setting up an IPA and conducting the preparatory work, the IPA could also attract public sector resources to leverage much larger amounts of private sector capital for financing climate-related investments through the VCM. Transaction costs could also be recovered through fees or royalties charged to investors. Importantly, IPAs do not necessarily need to be new organizations. They can be integrated into departments of existing institutions in the host countries. What is important is that they have clear mandates and focus on the outputs required for increased VCM investment flows into the host country.

How corporates could reduce investment risks and support alignment with host countries' climate priorities

Corporates have an inherent interest to seek dialogue with host country governments on how to invest in meaningful projects and activities. At the same time, aligning VCM activity with host country priorities could create additional bureaucracy and 'red-tape' that private buyers want to avoid. However, cooperation with governments can increase the chance of long-term project success.

Supporting the establishment of an IPA by host country governments is in the interest of corporates. First, an IPA can reduce the transaction costs associated with carbon project development. It is a body that steers and facilitates VCM engagement at scale, and can thereby significantly reduce transaction costs for individual projects and increase efficiency of processes.[12] By having an IPA dealing with the existing bureaucracy, this would reduce the time and resource efforts needed for investment. The operationalization of an IPA could also lead to cost savings in project development, by standardizing and providing clarity on legislative requirements from the host country. Second, the IPA will help lower reputational risks for carbon credit buyers, as investments will be directed to projects that are aligned with the development priorities of host countries, generating co-benefits prioritized by national governments. The IPA will thereby help to ensure the alignment of corporate investment with national objectives.

[12] See Moura Costa, Fretz and Kohn (2001) Assessing the feasibility and operationalization of an Investment Promotion Entity for sustainable forest management. Lead paper on the Government-led initiative to support the UN Forum on Forests International Workshop, Oslo 2001. Published by CIFOR and UNDP.

Corporates should also ensure transparency around project development and share relevant information with the government, including on benefit sharing and measurement, reporting and verification (MRV) of GHG reductions and removals. Many host countries are working to establish or improve their MRV systems. However, there are limitations both with systems and procedures in government inventories, carbon accounting and MRV more generally. VCM investors often possess more granular information on GHG emissions and reductions. They could share relevant information with the host government and thereby improve overall data availability. Initiating and participating in national dialogues around the MRV processes that include all relevant stakeholders (project developers, carbon standards, verifiers, governments) could be a useful way to explore approaches to avoid verification inconsistencies or quality concerns. Credit buyers should also include relevant investment-related information about VCM activities in climate financial disclosures or climate/environmental corporate reporting.

In the absence of clear rules or guidelines on corporate climate claims and the use of carbon credits as offsets, buyers tend to ask for broad benefits and protections that can minimize their risk. To ensure that such demands remain reasonable, it is important to define the requirements for companies to substantiate different claims. This will allow for more nuanced and realistic contractual agreements with project developers and carbon credit suppliers.

Finally, corporates need to pay realistic prices for high-quality carbon credits. Prices should reflect both the value of sequestering or reducing a ton of carbon dioxide equivalent and additional social and environmental benefits. Developing, operating and maintaining quality VCM projects that incentivize emission reductions and generate meaningful co-benefits, at scale and with minimal risk, comes at a cost. Corporates need to be willing to make the necessary investment that keeps these projects operational, and justifies their offset, climate or carbon neutrality claims.

Integrating the VCM in government climate policies

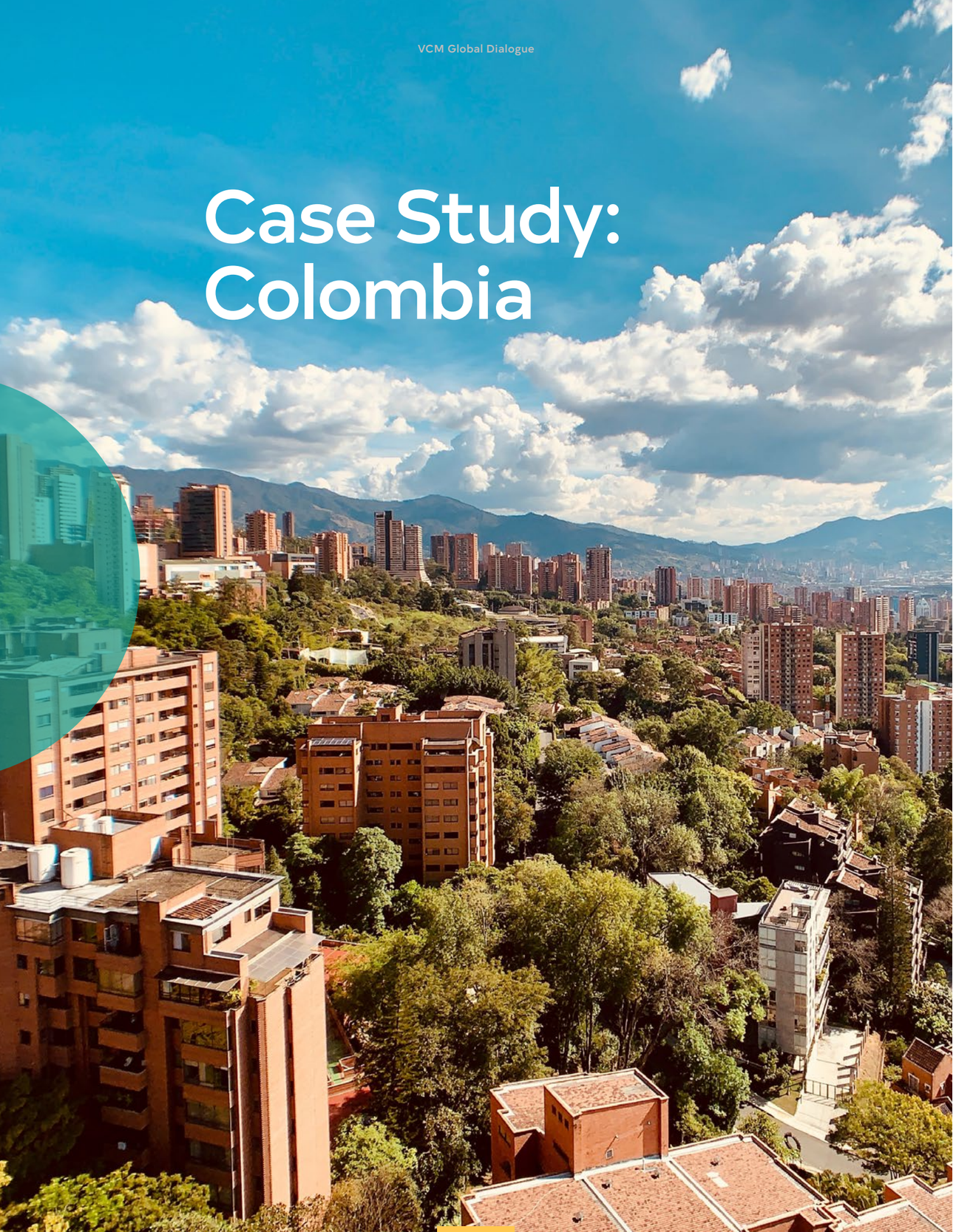
Governments can also integrate the VCM into national climate policies. A combination of a compliance measures (such as the carbon tax) and a voluntary compensation scheme (carbon neutrality mechanism) can incentivize private investment in mitigation projects. Colombia is a frontrunner in linking national carbon pricing policies to voluntary carbon market crediting programs. As the Colombian case study outlined below shows, corporates may prefer investment in VCM projects that yield attractive co-benefits, are highly visible, and generate credible environmental benefits over making a tax payment.

If a government puts in place regulatory or fiscal measures that involve the voluntary use of carbon credits, the following elements are key to ensuring private sector participation:

1. Regulatory clarity and certainty about the eligibility of credits, implementation period of the regulation, and eligibility of GHG crediting programs;
2. Clear procedures both for buyers and accreditation and validation entities;
3. Coordination among implementing government entities responsible for each procedure;
4. Outreach and training to understand the mechanism, in particular during the initial implementation phase.

Where the interests and incentives for host countries, investors, buyers and project developers are aligned, the VCM can accelerate emissions reductions and financial flows above and beyond existing policies and commitments. This alignment requires a careful balance between directing investments towards the climate and development priorities of host countries and creating bureaucratic requirements that make investments too difficult and/or costly. The proposals included in this paper – based on consultation with a range of corporates – show at least one way in which this balance can be struck.

Case Study: Colombia



Motivations and requirements of buyers in the Colombian market

Understanding the interaction between compliance obligations and voluntary carbon markets is essential for countries planning and implementing their NDCs. Private sector concerns can inform government positions in national and international policy formulation processes. The Colombian case provides an example of how a mandatory carbon tax and a voluntary decision to use carbon credits to compensate for such an obligation can complement each other.[13] See box 3 for a summary of the Colombian carbon tax scheme.

Prior to the implementation of the carbon tax and the associated carbon neutrality option in 2016, the Colombian private sector showed limited interest in investing in carbon credits. Traded volumes were low, usually linked to large corporations' desire to "green" their image or the climate commitments of internationally-owned companies. Some companies became project developers or credit buyers as they identified an opportunity to sell carbon credits through different international schemes.

However, the adoption of Colombia's mandatory carbon tax and the voluntary carbon neutrality option created a new situation for both buyers and carbon project developers. Credits from VCM projects, as well as credits from CDM projects that could not find a buyer in the final years of the Kyoto Protocol compliance period, became eligible for compliance under the carbon tax's flexible mechanism. Private sector demand for these credits increased under the assumption that the carbon tax would become permanent within a countrywide tax reform (see Box 3).

[13] It is important to note that the government has some level of decision making about the rules of quality of such carbon credits including the valid credits to use and the standards allowed in the system. Modifications in such rules have happened in the 3 years of operation with different results and responses from the private sector and project developers.

As a result of this engagement, the view of Colombian corporates on the VCM has significantly changed. Today, corporates anticipate climate regulation, and carbon markets have become an attractive way to meet voluntary or compliance-related commitments. Soon, the carbon tax will be complemented by an emissions trading system. It is therefore important for companies to understand the features of the various carbon market mechanisms.

Some companies indicate that they would implement mitigation measures within their productive processes and operations in the context of voluntary or mandatory corporate commitments. In addition to in-house reductions they would appreciate the additional flexibility provided by the VCM to prepare for future regulatory requirements or increase their ambition. The relevant strategy depends on the sector in which the company operates, the scope it wants to address and the perceived risk of compliance regulations.

Project developers promote the use of voluntary carbon credits to corporates as a way to improve the corporate image. Corporates are also driven by consumer preferences for more sustainable and carbon neutral products, although this is a nascent trend in the Colombian context.

Box 3.

Carbon tax and carbon neutrality mechanism in Colombia

In 2016, Colombia adopted its first carbon pricing mechanism, a carbon tax on fossil fuels. The tax applies to liquid fossil fuels, natural gas for some selected activities and exempts coal from the obligation. Producers and importers of such fuels are considered liable entities and passthrough is direct to different industry users. Oil and gas companies, airlines and some other industries were therefore indirectly reached by the carbon tax. The carbon tax is currently at a level of approximately USD 5 /tonCO_2.

In 2017, the Colombian government also adopted a regulation that allows tax liable entities to voluntarily use carbon credits to compensate for their carbon tax obligations. This has created a positive environment for carbon credits transactions and increased demand from the private sector. The Government of Colombia has facilitated this by defining eligibility criteria for credits, as well as rules for validators and for the reporting of credits used for carbon tax compliance. Regulation has evolved in the past years to align with both NDC priorities (in particular related to MRV) and the functioning of this flexible mechanism.

Carbon credit selection criteria

Abatement costs are driving corporates to choose carbon credits over the tax payment. However, one of the companies interviewed in the context of this paper mentioned that when faced the decision, despite a very small cost difference between the tax and the credit, they chose the credit because it benefited communities and had higher visibility than a tax payment.

In a country like Colombia, where most emissions derive from the land use sector, it makes sense for corporates to source nature-based carbon credits. The private sector prefers solutions for climate mitigation that are appropriate to local conditions and priorities, and they indicated that in the Colombian case, efforts should be directed to the land use sector and forestry. However, the complex and expensive monitoring methodologies, the complexity of managing and implementing nesting and jurisdictional approaches, as well as national REDD+ policies guided by international cooperation requirements, were mentioned as barriers in increasing investment in such credits.

Corporates look for quality credits (with high environmental integrity), benefits to communities and, in the Colombian case, contribution to the implementation of the peace process. Even with all these elements in place, one key factor attached to increasing the volumes of their investment was certainty that the credits would be eligible for the carbon neutral option of Colombia's carbon tax legislation.

What do Colombian VCM buyers expect?

Clear information. Corporates adapted quickly to the carbon tax regulation and the carbon neutrality voluntary option. Although they indicated that initially regulation was ambiguous and new to them, both the outreach process of the government and the advisory services of project developers, helped them to understand the mechanism, the eligible crediting programs and in general the benefits of using the carbon neutrality option.

Processes certainty and eligibility of credits. Corporates have faced low availability of credits due to bottlenecks in the validation process as well as eligibility of validators. Uncertainty about the potential future eligibility of some GHG crediting programs, partly due to a delay and unclear responsibilities in the regulation for validators process approval and the deadlines the regulation imposed for the eligibility of certain GHG crediting programs, further hampered their engagement.

Quality. Corporate credibility is at the forefront in the investment decision process, and corporates prefer acquiring credits from recognized GHG crediting programs accredited through local accreditation bodies.

Key findings from the Colombian case study:

- There is general acceptance of innovative mechanisms such as the carbon neutrality option in Colombia to engage the private sector in increasing their mitigation actions even beyond compliance. One company with presence in several countries in Latin America plans to offer carbon neutral products to their clients with the option to expand the ambition of their clients to becoming carbon neutral through the use of carbon credits.
- Clear and realistic regulation related to eligibility of credits according to the capacity of the country is important. Any carbon pricing mechanism has to respond to local realities and capabilities of the government to implement the regulation and manage relevant institutions. Creating highly complex processes that overwhelm the government creates investment risk that is detrimental to the active participation of the private sector in a carbon market mechanism.
- Reputational risk is an important consideration in company decision making. It is therefore important for companies to assess the quality of credits when making investment decisions. Internationally recognized GHG crediting standards are relevant for companies with operations beyond Colombia and operations in international markets.
- Colombian corporates want to invest in credits that benefit local communities and national development goals. The ability to combine climate and community benefits in places where they have a presence is a key factor in the investment decision.