Nationally Determined Contributions and the Voluntary Carbon Market

Why they do not compete but complement each other

With the Paris Agreement, all governments have made commitments to reduce their carbon emissions. These commitments are expressed through a government's Nationally Determined Contribution (NDC). Governments have various tools at their disposal to achieve the targets in their NDCs, in particular:

- Direct intervention, for example forest preservation projects that are financed either by the government itself, or by foreign partners (such as REDD+ projects)
- Norms and standards, for example on the composition of fuels, or the maximum allowed carbon emissions of cars.
- Market-based schemes, which incentivize companies and the private sector to reduce their carbon emissions or engage in carbon-capture activities. The main tool here is the compliance market for carbon credits, but other markets can also be useful, for example for Renewable Energy Certificates or for White Energy Certificates.
- Subsidies, for example for cleaner technologies so as to support the transition to a low-carbon economy.
- Awareness-raising among civil society and the private sector, to lead to behavioural change that will reduce net carbon emissions.

Aside from governments, many private sector companies have also made commitments to reduce their net carbon emissions, and many individuals are keen to reduce their footprint. Their tools are primarily behavioural change, investment in new technologies, and investments in and purchasing from carbon offset and other net carbon reducing projects.

From this simple description, it is clear that private sector and civil society will contribute to the achievement of the government's NDC – for example, through subsidies, companies will invest more readily in new technologies, which will help a faster energy transition; and if a forestry offset project does not require government funding because it can sell its carbon credits to companies and individuals, then the government can spend its funds otherwise.

A possible complication may arise if a foreign company buys carbon credits from an Indonesian offset producer – will this carbon credit then count towards that buyer's home country NDC, rather than Indonesia's NDC? It will only when the Indonesian government has decided so. In the Paris Agreement, there are only two ways for carbon credits to be transferred from the jurisdiction of one country's NDC to the jurisdiction of another country's NDC:

- There is a bilateral agreement that allows for such transfer; or
- There is a multilateral market to which Indonesia is a party, and Indonesia has agreed that under certain conditions, carbon credits can be bought and sold on this market with their NDC-related rights attached.

Note that under the Paris Agreement, as under the Kyoto Agreement, "greenhouse gas emission right" belong to governments, and carbon credits, for all official purposes, can only be transferred to another country when both governments have both agreed to do so. As long as the government has not **explicitly** agreed that a certain carbon credit can be transferred in this manner, then the benefits of that carbon credit will stay in Indonesia. In other words, in the current situation, the verified carbon credits produced by Indonesia's large forestry carbon offset projects, when sold to foreign buyers, still count towards Indonesia's NDCs. The foreign buyers **cannot** count them towards their own obligations towards their own governments. This is currently not a major problem because most of the buyers active in the voluntary market are not restrained under their countries' compliance regimes – their "net zero" commitments are either purely voluntary, or much more ambitious than what is imposed on them by their governments.

While sorting out the details of its own compliance regime and the market that will support it (including by radically reducing the costs of compliance), Indonesia therefore has much to gain from allowing the voluntary market to operate at its fullest capacity. Purchases of carbon offsets by companies and individuals, whether they be in Indonesia or abroad, will fund carbon offset projects, which contribute fully towards Indonesia's NDC without costing the government any money. Market instruments like renewable energy certificates or the possibility for individuals to buy carbon credits so as to offset their carbon footprint help speed up the transition to a low-carbon economy, again without costing the government any money.

The Presidential Decree has already made clear that only the Government can permit the international transfer of carbon credits that count towards NDCs. To avoid any possible confusion, the Government may repeat this while allowing a local voluntary carbon market to start operating – no other action by the government is needed.

In the medium term, the Government may consider how best to enable the export of carbon credits in such a way that they count towards the NDC of the buyer's country, rather than Indonesia's NDC. This will require an extra effort by Indonesia to reduce greenhouse gas emissions, but it will be handsomely rewarded for this. There will then be two markets through which carbon credits can be exported: the voluntary market, where the buyer can only use the carbon credits to report on his voluntary carbon reduction goals, and where prices will be relatively low (but still much higher than they are now); and the compliance market, where foreign buyers will compete with Indonesian ones, and where the carbon credits that are bought can be used to meet the buyer's compliance obligations – and where prices will thus be much higher. The ability to sell to foreign buyers at a very high price will unlock new project opportunities that would not be economic at a lower price, and the overall impact is likely to be that projects can cross-subsidize local carbon credit sales through the high prices that they receive for their exports. The effect is that Indonesia can achieve its NDC at a lower cost, while at the same time generating large sums (possibly in the billions of USD) of new export revenue.

In conclusion, there is no competition between the voluntary and the compliance carbon markets. In fact, by promoting the voluntary market, the government will be able to achieve its NDC targets at a lower cost while at the same time generating new employment opportunities and export earnings. Both the voluntary and the compliance market will benefit much by having an organized exchange to support them, for many reasons, and it can be hoped that the government will allow the value-added generated by such an exchange to be kept in Indonesia.