

Article 6 of the Paris Agreement Can Finance Innovative Low-Carbon Production for Countries with Domestic Carbon Pricing Systems

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Like any form of commercial exchange, international carbon markets depend on both a buyer and seller finding a transaction beneficial. While private parties are critical in setting up transactions, international carbon markets are primarily transactions between countries, as credits can affect the official greenhouse gas (GHG) inventories of countries that are used to track progress toward climate targets.

While the literature on international carbon markets (Michaelova et al. 2019) often discusses what type of investments may be financed by activities in the host country (i.e., the seller country), the potential for international carbon markets to finance investment in buyer countries with domestic carbon pricing policies is less recognized.

This article discusses an adaptation of the idea of using European Union Emissions Trading System's free allocation for low-carbon innovation as described in Elkerbout (2022a) and Elkerbout (2022b), instead focused on the use of international carbon market units from Article 6 of the Paris Agreement. Other recent policy research (Dietz et al., 2026; Zachmann & Weisser, 2026) discuss related rationales for engaging in international carbon markets.

A particularity of carbon markets under the Paris Agreement is that they are tools in service of a goal shared by both sides of the transaction—to ultimately reduce GHG emissions to net zero. Both sides of the transaction want (and need) to reduce emissions, albeit the buyer typically is committed to reducing emissions faster.

However, both buyer and seller countries may be hesitant to engage in carbon-market transactions.

For countries with stringent climate targets, the typical rationale to engage in international carbon markets is to access lower-cost abatement options, increasing the cost-effectiveness of a GHG-reduction target. Yet, while buyers may like the lower costs offered by international carbon markets, they may nevertheless worry that money invested abroad does not reduce emissions at home; it merely postpones when these costly reductions happen. Nor does money invested abroad bring the same local benefits, such as jobs or infrastructure. Seller countries may welcome the investment that carbon markets bring, but may also worry that selling their lowest cost abatement leaves them with higher costs for their remaining GHGs that they need to abate.

Here, I propose an additional rationale for buyers and sellers to engage with international carbon markets: The procurement of carbon credits enables the financing of industrial policies that make the costlier reductions in hard-to-abate sectors (such as steel or chemicals production) more feasible in the longer term. For example, a country may be seeking ways to finance expensive green industrial policy (such as the Inflation Reduction Act's tax credits) deemed necessary to finance the transformation of the industrial capital stock toward net zero.

Jurisdictions with comparatively high domestic abatement costs could therefore exploit the difference between international and domestic abatement costs for fiscal reasons.

A precondition is that carbon is scarcer in the buyer country—and therefore costlier—and that the carbon is priced explicitly through, for example, a carbon tax or cap-and-trade system. When the carbon price in the home jurisdiction exceeds price levels in the international carbon market, the difference in cost (the delta) could be used as a fiscal resource by retiring the international credit and creating a domestic unit—both representing the same ton of carbon dioxide equivalent—in its place.

This approach assumes that governments choose to centrally procure international carbon credits, rather than allowing individual firms to buy credits.

Governments can convert international carbon credits in this way for use in various carbon pricing policy designs:

- in an emissions trading system, via a domestic emissions allowance
- in a carbon taxation system, via a tax credit
- in a tradable performance standard or product standard model, via a domestic credit that counts toward GHG intensity in the reporting system

As an example, if the carbon price in a domestic emissions trading system is \$90 per ton of carbon dioxide equivalent and international carbon credits are available at \$25 per ton, the \$65 price delta can accrue to whomever the domestic unit is awarded.

By importing an international carbon credit procured at the comparatively low global price and converting it to a domestic unit, the unit is upgraded in value, and that value can be distributed. This new domestic unit can be allocated to whomever the regulator wants to reward. Industrial producers that produce with close to zero emissions are good candidates precisely because they have so few emissions to pay for. When these low-carbon producers do not need the domestic allowances/tax credits, they can instead sell the allowances to producers who do need them—thereby creating a financing flow. This reward for low-carbon production can be awarded after the products enter the market (i.e., ex post allocation) to finance the expansion of further low-carbon production.

Such an ex post financing instrument is particularly valuable to finance the scale-up of low-carbon technologies that are on the cusp of commercialization, but that have already been proven at small scale.

The caveat is that this exchange will affect the scarcity value of carbon as the supply increases. Carbon market prices depend on supply and demand; adding supply will reduce domestic carbon prices—with concomitant negative short-term impacts on domestic abatement. Likewise, in a carbon tax policy, creating tax credits replaces domestic abatement with international abatement. This is a reason to carefully consider volumes of newly created domestic units relative to the size of the domestic carbon pricing system.

The newly created unit, even if it is fungible with already existing units in a program, could be allocated in a different way: A policymaker is free to consider additional criteria that recipients need to fulfill. These could be related to any public policy goal in principle.

The requirement for very low GHG intensity of products is an essential criterion, however, as it is the sale of allowances or credits to other companies that need them for policy compliance reasons that creates a cash flow. What constitutes “very low GHG intensity” is up to the regulator, but as an example, GHG intensity of 5 percent or 10 percent of average national GHG intensity in 2025 within a sector can be used.

While it is assumed that in early stages, low-carbon products could not be supplied at a scale that risks an insufficient supply of “convertible” credits, over time the eligibility criteria would need to be adjusted so the available, desired international credit supply does not undermine the supply and liquidity balance in the domestic system.

Much like distributional issues are a key factor in climate-policy design in general, the integration of international carbon markets in domestic carbon pricing policies offers opportunities to make different distributional choices. Awarding “upgraded” domestic units to low-carbon industrial producers is a way to fund green industrial policy that may be feasible even in otherwise fiscally constrained environments, as the buyer country leverages the scarcity value of carbon in

its home market. This method sidesteps the constraints of regular revenue raising through taxation or allowance auctioning, as the revenues are created by the sale of units between private companies.

This approach assumes the existence of some system of centralized procurement of international credits in the buyer country. Alternatively, since a common way of making international carbon markets work is direct purchase by companies (which face a climate-policy obligation), limiting the eligibility for companies to surrender international carbon credits in a domestic carbon pricing system, commensurate with the volume of low-carbon products that companies have put on the market could also be considered absent centralized buying.

The proposal described here shows how allocation rules in climate policy, or differences between domestic and international policies, could be used to create incentives, either in terms of GHG mitigation or low-carbon investment, and why the distributional impacts of both climate policy and industrial policy matter.

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Milan Elkerbout is a fellow at RFF.

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