



## **Carbon markets: Challenges and opportunities in Iceland**

This report was prepared by a working group appointed by the Minister of the Environment, Energy, and Climate in spring 2023. Its purpose is to analyse the status of carbon markets in Iceland, explore Icelandic companies' opportunities in these markets, and assess whether the Government could use carbon markets to satisfy Iceland's international climate obligations. The bulk of the report centres on the voluntary carbon market, which has developed rapidly in recent years. Also discussed is Article 6 of the Paris Agreement, which covers international cooperation on transactions with carbon units.

The report explains how international cooperation on climate issues has shaped carbon markets, including through agreements such as the Kyoto Protocol and the Paris Agreement. Because of this cooperation, many countries, including Iceland, are exploring the possibility of using carbon markets to mitigate greenhouse gas emissions.

The report also describes how Iceland's objectives, particularly in the context of the Paris Agreement, affect the possibility of its participating in carbon markets. In addition, it outlines Iceland's carbon neutrality strategy, the goals the country has set for reducing emissions, and its cooperation with the European Union and Norway on climate issues.

The report discusses Article 6 of the Paris Agreement, which centres on international trade in carbon units, and the potential for Iceland to participate in such trading. It outlines the two main options available under Article 6: on the one hand, bilateral cooperation between countries with the aim of reducing emissions; and on the other, an international market for carbon units, which will be strictly supervised by a designated supervisory body. It also discusses projects relating to carbon capture and storage/mineralization in Iceland.

The report places primary emphasis on the discussion of the voluntary carbon market, where Icelandic companies can produce and sell carbon units without being legally obliged to do so. This is a rapidly growing field that could create opportunities for various Icelandic projects centring on afforestation, ecosystem restoration, and other sequestration efforts. The report gives an overview of key certification systems, standards, and business processes relating to these markets.

It also provides an overview of the Icelandic and international regulatory frameworks for carbon markets. It explores ways to shape the Icelandic framework so as to ensure integrity and transparency of transactions with carbon units, which is important in order to prevent problems such as double-counting and greenwashing.

Recommendations to the authorities concerning remedial action can be found at the end of the relevant chapters, and a complete list of the recommendations can be found at the end of this summary. These recommendations are intended to support the development of carbon markets in Iceland and make it easier for stakeholders to take advantage of the opportunities offered by the markets. Among other things, it is recommended that the Icelandic authorities formulate a policy on participation in global carbon markets. Other recommendations centre on ways to improve the structural and regulatory framework for trading of carbon units. The work group also emphasises that an assessment should be made of whether or not to authorise the exportation of international carbon units that would affect Iceland's climate accounting, and how it would be possible to promote Icelandic companies' further participation in the voluntary carbon market.

During the preparation of the report, the working group consulted extensively with stakeholders and held a large number of meetings with them so as to elicit their views on the project at hand. It is clear that remarkable progress is being made in this area, and a number of points were clarified during the preparation of the report.

The working group sought out consultants on certain aspects of the project, particularly to include a summary of other countries' regulatory frameworks for trading in carbon units, prepared by Cathrine Wenger of Wenger Law in Norway. The report contains a summary of Ms. Wenger's findings, and the full report can be found on the website of the Ministry of the Environment, Energy, and Climate.<sup>1</sup>

The working group presents the following recommendations, which fall into five categories: A. The State as purchaser of carbon units; B. Strategy formulation; C. Statutory amendments; D. International cooperation; and E. Unclassified (Other).

#### **A. The State as purchaser of carbon units**

1. The law should require the adoption of a set of guidelines for the quality of carbon units purchased by the State.
2. Carbon units and projects that produce them – and that public entities purchase – should have received confirmation from a accredited/credible certification body and should be of genuine benefit to the climate.
3. Carbon units purchased by public entities should be listed in a third-party registry that is deemed satisfactory.
4. Projects generating carbon units that are purchased by public entities should satisfy basic requirements; i.e., they should be real, measurable, permanent, and traceable. It is also necessary to demonstrate additionality, uniqueness, and the absence of double-counting.
5. Individual purchasers (public entities) should publicly disclose the number of purchased and utilised units and the types of projects underlying the units. Furthermore, they should report annually on the scope of their emissions.
6. The Environment Agency of Iceland should revise the 2020 guidelines on carbon offset for public entities and should undertake such revisions regularly (albeit with consideration given to the execution of Item 1 above).
7. The possibility should be explored of public tenders for the purchase of carbon units by entities falling within the scope of Article 5(c) of Act no. 70/2012.
8. The State as landowner shall take the initiative to identify land to be allocated for climate action with an implementation plan for improved land use for the benefit of the environment. The allocation of land for climate action shall be carried out in a non-discriminatory manner; for instance, via public tender.

#### **B. Statutory amendments**

1. The term *carbon unit* should be defined by law.
2. A bill of legislation on a carbon registry should be prepared in cooperation with the business community, with the aim of creating a general framework for such activities, including provisions on establishment, eligibility requirements for owners, requirements concerning the process of registering and deregistering carbon units, the legal effect of registration, and participants in the registration/deregistration process.

#### **C. Policy formulation**

1. A policy should be adopted on the purchase of carbon units from other countries to meet targets for reduced emissions and carbon neutrality through effort sharing, to the extent that such targets cannot be met through domestic action.
2. The Government should formulate a policy – for instance, with an appendix to its Climate Action Plan – prohibiting the exportation from Iceland of internationally transferred mitigation outcomes (ITMO) that would have a detrimental effect on Iceland's emissions

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<sup>1</sup> [Ministry of the Environment, Energy, and Climate website](#)

accounting. The policy can be reviewed when Iceland has fulfilled its emission reduction commitments.

3. The tax framework for operations involving the production and purchase of carbon units should be reviewed in light of possible inducements and to deductibility of operating expenses.
  - i. Additional scope for deductions of expenses relating to carbon offset in a company's own operations, with further specification of when targets (concerning carbon neutrality, for instance) can be considered related to revenue generation. This could include deciding when the purchase of carbon units from third parties could be considered actual operating expenses (instead of gifts/contributions) (and also with value-added tax).
  - ii. Specific depreciation provisions regarding investments in real estate (including land) and equipment for the production of carbon units and/or reduction or removal in the company's own operations.
  - iii. The possibility of reimbursement of a specified percentage of capital expenditure on projects contributing to permanent carbon reduction/removal and the production of carbon units for sale.
  - iv. Whether companies should be authorised to use carbon units to pay environment taxes (or lower their tax base).

#### **D. International cooperation**

1. It is proposed that the Icelandic authorities participate in a pilot project on international trading based on Article 6 of the Paris Agreement, which entails, among other things, mapping out the administrative infrastructure needed to carry out such projects.
2. The Ministry of the Environment, Energy, and Climate (URN) should request that the Ministry for Foreign Affairs, in cooperation with the URN, examines how climate-related development cooperation projects could help developing countries to meet their targets on the path to carbon neutrality on the basis of Article 6 of the Paris Agreement. All factors covered in Article 6 should be considered and information gathered on how similar countries operate in relation to this.

#### **E. Other**

1. The authorities should take the initiative to bring stakeholders together to examine the interest in establishing a venue for trade in carbon units. Public entities could also consider using such venues, including auction markets, with the aim of efficiency in public sector operations and ensuring competition and equality among sellers, which could also foster innovation and development of solutions to climate issues.