Major Economies Business Forum
on Energy Security and Climate Change
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Major Economies Business Forum
GHG Markets and Article 6 of the Paris Agreement:
The Way Forward

Key Messages

- In principle, markets allow consumers and business to identify and pursue the most economically efficient means to meet their needs and achieve policy goals at lowest cost.

- Several nations today are pursuing a wide variety of mitigation approaches, including greenhouse gas (GHG) markets. Many jurisdictions have established GHG markets—such as emissions trading systems, carbon taxes, and credits transfers from emissions offsets from qualified activities, *etc.*—as a way to meet their mitigation goals efficiently.

- A variety of GHG markets are being used today in and among regions, nations, states, provinces, and cities. These provide many examples of how markets can be developed under diverse circumstances without a single overarching international design or rules.

- Article 6 of the Paris Agreement explicitly recognizes cooperative approaches, which include GHG markets, and its implementation should be clarified at COP-22.

- The Business Major Economies Forum (BizMEF) calls on governments that choose to use market mechanisms to enable their continued use, expansion, and evolution and to ensure the flexibility of future GHG markets by allowing differentiation in cooperative approaches.

- BizMEF calls for regulatory restraint in the guidance to Article 6.2 Paris Agreement; transparent reporting is the best way of enabling GHG markets to develop while guaranteeing an international "level playing field" and enhancing competitiveness. (See BizMEF's T*ransparency and Measurement, Reporting, and Verification* paper. Available at: http://www.majoreconomiesbusinessforum.org/issuepapers.html.)

Introduction

Among several other provisions, the Paris Agreement contains two elements that continue and enable GHG markets. Both these elements are in Article 6. Within the logic of Article 6, specific further work has to be undertaken.

- For the element "internationally transferred mitigation outcomes" (which is in 6.2 and 6.3), participating Parties have to develop guidance for mutually-agreed transfers; this is the context for "bottom up" GHG markets.
- For the element "Sustainable development mitigation tool" (6.4 – 6.7), Parties are tasked with developing modalities and procedures; this is the context for one specific GHG market-mechanism under the authority of the Convention.
- Finally, for the element "non-market approaches" (6.8) a work-program has to be set up. All these elements stand under the chapeau of the introductory provision to Article 6 calling for correct accounting, environmental integrity, and the promotion of sustainable development.

GHG Markets Role in Mitigation

In principle, properly designed GHG markets (or more commonly "carbon markets") have the advantage of reducing emissions at the lowest cost to consumers and society, while providing long-term market predictability to the sectors covered by them. They encourage innovation and action by a wide variety of actors, including scientists, engineers, entrepreneurs, and business, to develop innovative technologies, finance and business models. This implies, however, that there are no regulatory interventions that distort the market from functioning effectively. Internationally, GHG markets might help stimulate investments in advanced technologies, infrastructure, installations, and products, especially in locations where they can be deployed at the lowest economic cost. Comparable framework conditions would encourage business to participate with minimal competitive disruptions.

GHG markets can distort competition among participating nations. Limiting competitive distortions can be accomplished by, among other things, employing similar methodologies, tools, and standards, including clearly defined indicators to assess the performance and efficiency of markets in different nations, while also taking into consideration diverging local conditions.

One form of GHG markets, emissions trading, is already being widely used to tackle climate change. Trading markets can take various forms:

- at the regional level such as the European Union Emissions Trading Scheme (EU ETS);
- at the national level, such as in New Zealand or South Korea;
- at the state level such as the Regional Clean Air Incentives Market (RECLAIM) in California (US) and the cap and trade scheme of Quebec (Canada);
- at the provincial level such as in the Chinese provinces of Guangdong and Hubei, and;
- at the city level such as Beijing, Tianjin, Shanghai, Shenzhen, and Chongqing in China.

Other countries are also looking into establishing their own GHG markets, such as Mexico. These offer very good examples of how GHG markets can be built and tailored to suit widely differing geo-economic situations. Additionally, international, regional or national market-based mechanisms for offsetting GHG emissions—for example the Clean Development Mechanism and Joint Implementation and the new Joint Crediting Mechanism—have demonstrated that multinational instruments are possible and create many other advantages that go beyond pure offsetting, for example co-benefits, technology transfer, and voluntary cancellation.

It is essential to note that allowances and credits in GHG markets relevant to the United Nations Framework Convention on Climate Change (UNFCCC) provide economic efficiency that serves two separate purposes: (1) for nations to meet their international objectives; and (2) for firms (and other covered entities) to meet domestic obligations. Without legal assurance and certainty regarding exchanges undertaken through GHG markets (both trading and offsets), firms will be unwilling and unable to use them. All of this is recognized in Article 6 Paris Agreement.

Competitiveness & Other Concerns

Considering the diversity of national circumstances and priorities—such as existing energy mixes, industrial sectors, infrastructure, and economies—GHG markets must be flexible to allow for diversified domestic policy measures and the likelihood that even similar policies may have different impacts in different nations, *e.g.* on competitiveness and social welfare.

Consequently, GHG markets in nations or regions that choose them must be able to allow for flexibility to address the international competitiveness of the industrial sectors concerned. While some may easily pass on the costs of carbon, others may not be able (fully or partially) to do so. This situation can give rise to carbon leakage that shifts emissions, as well as jobs and investment, from one jurisdiction to another, leaving global emissions unchanged or even increased. So long as there is no global level playing field, allowing for flexibility to tackle competitiveness concerns should be part of GHG markets design.

While jurisdictional approaches to competitiveness concerns are important and unavoidable, a patchwork of different approaches has risks of its own. Jurisdictional approaches will be more efficient, sustainable, and trade-friendly if they benefit from ongoing dialogue and information-sharing. Over time, the development of common approaches and co-ordinated action could level the competitive playing field somewhat.

Authorities that choose to build GHG markets and are responsible for market design must also bear in mind its interactions with overlapping and counter-active policies so as to avoid negative interactions. According to the Third Working Group contribution to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change, "if a cap-and-trade system has a binding cap, other instruments such as subsidies or feed-in tariffs for renewable energies have no further impact on reducing emissions, but may affect the overall costs of the system." This calls for a careful combination of policies.

Understanding the Different Elements of Article 6 Paris Agreement

Article 6 Paris Agreement is diverse and flexible by design. It notes that cooperative approaches, especially GHG markets, are useful in climate-change mitigation and adaptation. It also captures the diversity of circumstances, nationally determined contributions, market types, timeframes, *etc.* Article 6 also recognizes the advantages of diverse and flexible approaches, and it contains different elements to promote these advantages.

Article 6.2 Paris Agreement describes the use of internationally transferred mitigation outcomes. This is a general provision for the continuation of many market programs mentioned above, but also the creation of new bilateral or multinational markets and the linking of different ETS-systems among willing nations. 6.2 acknowledges that there is a diversity of market-types and these will be developed by Parties. More importantly, these forms of market-based co-operation will continue or emerge “bottom-up”. 6.2 places no restrictions whatsoever to the forms of cooperation. On the other hand, 6.2 determines national sovereignty over these approaches. Subnational or private sector participation, for example, are possible only if allowed and recognized by participating nations.

Because of the emphasis of 6.2 on the national sovereignty, the provisions making Parties take into account Environmental Integrity and Sustainable Development should be addressed on a practical level, i.e. by the Parties to the Convention when designing or continuing specific GHG markets. Guidance under the Convention should only concern issues of transparency and reporting. Also, the governance of the different GHG markets can be only decided at the practical level by the respective Parties involved. Again, the governance can be made transparent and reported upon to fulfil Paris Agreement’s requirements.

Accounting, on the other hand, is a major requirement of the Paris Agreement (paragraph 37 of the Decision and Article 4.13 Paris Agreement). The need for clear accounting rules corresponds to the need of a “level playing field.” Moreover, because accounting touches on many other issues in the Paris Agreement, the rules governing it must be thoroughly considered and be clear from the beginning to avoid subsequent rounds of changes. The more often the rules are changed, the less attractive and the less effective GHG markets will be.

Article 6.4 of the Paris Agreement creates the Sustainable Development and Mitigation Mechanism. This is a central and international mechanism under the authority of the Conference of the Parties serving as the meeting of the Parties to the Paris Agreement (CMA). Its modalities and procedures will have to be developed under the SBSTA but it is clear that the production, issuance, transfer and use of mitigation outcomes must be possible for all Parties.

Consistent with the call for a "level playing field", the design of this mechanism under 6.4 should take into account the experience, both good and bad, of the Clean Development Mechanism and Joint Implementation under the Kyoto Protocol. The knowledge gained from using these instruments could be used to design new instruments that reduce transition and transaction costs and delays. It is also BizMEF's understanding that the reference to 'overall net mitigation in global emissions' in Article 6.4 should refer to the use of mitigation outcomes that are ultimately a national prerogative.

While the modalities and procedures for 6.4 will have to be developed by CMA, it is important for them to be aligned with other aspects of Paris Agreement and Article 6 itself, especially with 6.2, to enable fungibility of mitigation outcomes. BizMEF further takes technology-neutrality to be an important requirement of any GHG market, and especially one in the centrally administered GHG market.

The third element of Article 6 is the non-market approaches. These are at an earlier stage of maturity and will require more work. However, it is clear that these approaches belong to international cooperation. And it is clear that many of the examples mentioned (finance, technology, capacity building) are currently also addressed by GHG market based instruments. An alignment of all elements of Article 6 is therefore necessary for the continuation of many existing measures.

BizMEF Recommendations

BizMEF calls on COP22 to bring greater clarity on the modalities and procedures for implementing Article 6.

Further, BizMEF members call for governments to affirm that they have the option to establish national market systems and to link them with others internationally, if participating nations voluntarily agree to do so in light of different national circumstances. This is explicitly recognized and even encouraged by Article 6.2 Paris Agreement. We recommend, too, that approaches should be simple and accessible, promoting access of developing countries to these mechanisms and considering a floor price for those countries.

As an obvious condition, BizMEF agrees that exchanges in such markets must maintain environmental integrity and also assure that transfers from one nation to another are properly recorded as offsetting debits and credits in their respective accounts. In view of the diversity of market instruments, environmental integrity shall be decided on each instrument's implementation level and be transparently reported internationally.

BizMEF members call for governments that choose to use market mechanisms to ensure that existing markets are well-designed and to guarantee that the development of new mechanisms will set out credible accounting rules and restrict other interventions in the market systems.

Business Council of Canada
BusinessEurope
BusinessNZ
Confederation of British Industry
Confindustria
Dansk Industri
Federation of German Industries – BDI
General Confederation of Moroccan Enterprises (CGEM)
Iniciativa para el Desarrollo Ambiental y Sustenable — IDEAS (Mexico)
Keidanren
Lewiatan
National Confederation of Industry Brazil (CNI)
Mouvement des Entreprises de France (MEDEF)
Swiss Federation of Small & Medium Enterprises
U.S. Council for International Business
World Steel Association

About BizMEF

The Major Economies Business Forum on Energy Security and Climate Change (BizMEF) is a partnership of major multi-sectoral business organizations from major economies. Modeled after the government-to-government Major Economies Forum, BizMEF is a platform for these groups to:

- promote dialogue and exchange views on climate change and energy security across a broad spectrum of business interests including major developed, emerging, and developing economies;
- highlight areas of agreement among participating organizations on the most important issues for business in international climate change policy forums; and
- share these views with governments, international bodies, other business organizations, the press, and the public.

Organizations that have participated in BizMEF meetings represent business groups in Australia, Brazil, Canada, China, the European Union, Denmark, France, Germany, India, Italy, Japan, Mexico, Morocco, New Zealand, South Africa, South Korea, Turkey, the United Kingdom, and the United States, as well as five international sectoral associations. Collectively, BizMEF organizations represent more than 25 million businesses of every size and sector. Because BizMEF partnering organizations represent a broad range of companies and industries—including energy producing and consuming companies as well as energy technology and service providers—the partnership is able to provide robust and balanced views on a range of issues.

For more information on BizMEF, please visit our website at:
www.majoreconomiesbusinessforum.org.