

Major Economies Business Forum

on Energy Security and Climate Change

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Major Economies Business Forum: Examining the Effectiveness of Carbon Pricing as an Approach to Emissions Mitigation

KEY MESSAGES

- Carbon pricing has received a great deal of publicity recently, notably during the Climate Summit at the U.N. General Assembly, coupled with calls for its use in the post-2020 Agreement.
- The endorsement often rests on benefits ascribed to an ideal policy—one implemented globally as a common, comprehensive price covering all greenhouse gas (GHG) sources and sinks.
- In practice, nations are pursuing a patchwork of different approaches. Even where implemented, pricing coexists with other policies that limit its efficiency, and typically extends only to a portion of the economy.
- Moreover, current framing of the post-2020 negotiations appears set to embody an ongoing system of commitments based on self-determination according to national priorities and circumstances. So, it unlikely that nations ever will adopt a single pricing approach.
- Consequently, the Major Economies Business Forum stresses the importance of going beyond support for the abstract concept, to understand the manner in which GHG

pricing is or will be implemented, in particular its size, scope, timing, and consequences, especially in a world where nations pursue different timing and approaches to mitigate emissions.

- A variety of unsettled choices affect pricing policies, for example, whether and how to:
 - Set prices, either directly through a GHG tax or indirectly through a cap and trade system;
 - Include domestic or international offsets;
 - Link with other jurisdictions via markets or bi- and multi-lateral agreements; and
 - Address competitiveness issues at boundaries.
- For nations that link mitigation systems and those that participate in transactions, it will be essential to establish credible, efficient, transparent, recognized procedures for measurement, reporting and verification, and to assure that exchanges occur without double crediting.
- Business participation in policy discussions will be essential to understand and assess the emerging assortment of mitigation and other policies, both for their domestic implications and to understand consequences in a globalized economy.
- BizMEF members intend to be active in these discussions through existing national processes and by contributing to understanding of Intended Nationally Determined Commitments.

INTRODUCTION

For many years, economists have stressed the benefits of establishing a common, comprehensive, global price on GHG emissions. While this is often referred to as *carbon pricing*, an efficient pricing policy should apply to emissions from all GHG sources and also provide an incentive for sequestration, for example, by enhancing carbon storage in land and forests.

The arguments underlying pricing GHG emissions as a policy to mitigate them are straightforward. The price provides an economic signal that encourages suppliers and customers to reduce emissions. It discourages activities and products that create emissions and encourages

innovation leading to alternatives. The ideal policy equalizes the marginal cost of emissions abatement across all activities and sectors globally. Market forces then provide billions of consumers and millions of companies and entrepreneurs an incentive to minimize costs and develop profitable alternatives. This important aspect is often ignored in policy discussions. Unleashing innovation through markets, rather than through government mandates and incentives, is a fundamental precept of carbon pricing.

In principle, the price should reflect the societal cost of damages associated with emissions that are not currently accounted for. While it remains challenging to develop credible methods to monetize externalities, stabilization of atmospheric carbon dioxide

concentrations requires that net carbon dioxide emissions ultimately must fall to zero. For that to happen, the price must increase to a level that incentivizes transformational change through thousands of multi-billion dollar investments in low emissions technologies and infrastructure. These would affect nearly all sectors including power, transportation, agriculture and land use. Even with ideal implementation, models project in coming decades that prices must increase to several hundred dollars per metric ton of carbon emitted. Absent ideal conditions, for example, if some major emitting nations delay participation in mitigation, the GHG price would be significantly higher.

Consequently, as with any significant policy approach, BizMEF points out the importance going beyond support for the abstract concept to understand how GHG pricing would be implemented, for example: its size, scope, timing, and consequences for competitiveness and emissions, especially in a world where nations will pursue different approaches and timing.

In the issue paper [New Mitigation Options](#), last year BizMEF provided views on the emerging framework for mitigation involving multiple approaches. It recommended basic principles and provided perspectives on the many options under discussion (then and now), including new market approaches, non-market approaches, other approaches, the Clean Development Mechanism (CDM), and nationally appropriate mitigation actions.

Here we discuss GHG pricing in the real, far from ideal world, where nations simultaneously pursue a variety of

mitigation approaches with substantially different timing and effort. Our perspective reflects two Key Messages from the paper *New Mitigation Options*:

- As discussions on climate policy options continue, they should focus on developing effective approaches that encourage global engagement, are balanced and measured, support continued research and technology innovation and are transparent.
- The design of these new mechanisms should ensure that they can engage with the recently established technology and financial institutions such as the Technology Executive Committee, the Climate Technology Centre and Network, and the Green Climate Fund.

TRENDS AND POLICY CHOICES IN GHG MITIGATION

Nations today are pursuing a wide variety of approaches to mitigation. Indeed, many have chosen not to use pricing, and others have yet to implement any mitigation policy. Current framing of the post-2020 negotiations based on submission of Intended Nationally Determined Commitments appears set to institutionalize a system based on self-determination according to national priorities and circumstances and in keeping with the principle of common but differentiated responsibilities and respective capabilities.

It appears that the assumptions underpinning idealized carbon pricing have little chance of being met. Prices differ

among nations, and these disparities will continue and may even grow over time. Overall prices and economic costs will be far higher than estimates based on ideal assumptions.

Design choices, as described below, have major implications for competitiveness and efficiency of policies and they affect different sectors and regions in different ways. Because national circumstances and priorities differ so much, it is unlikely that a common framework will emerge.

GHG pricing involves a number of politically significant design choices, among them:

- Scope of coverage, including activities, sectors, GHGs and other emission sources and sinks;
- Means to set the price, e.g. directly through a tax or indirectly through an emissions cap—and ways to mobilize allowances under a cap;
- Evolution of the price with time;
- Availability (or not) of offsets from activities outside covered emissions, as a means to control prices while broadening the scope of mitigation options;
- Opportunity (or not) to use markets, bilateral or multilateral agreements to link mitigation in different jurisdictions;
- Utilization of revenues, if any;
- Procedures to address international competitiveness concerns;
- Procedures to address regional and socio-economic distributional impacts.

Decisions associated with offsets and linking, in turn give rise to questions

regarding measurement, reporting and verification of emissions, mitigation and offsets, and how to avoid double crediting if emissions allowances are transferred between jurisdictions. Clearly, GHG pricing raises a number of technical and political challenges.

STRIVING FOR EFFICIENT & EFFECTIVE MITIGATION POLICIES IN A MOSAIC WORLD

Mainstreaming Mitigation Policies: The debate over climate policy has moved from consideration of politically feasible emissions controls in developed nations to finding the means to stabilize global GHG concentrations, requiring significant, long-term emissions reductions by all major emitting nations. Achieving ambitious outcomes requires policies that affect mainstream investments in all major emitting nations. In a world characterized by patchwork climate policies, this presents significant challenges. In particular, such policy differences distort competitiveness in the globalized economy. These distortions, and efforts to counter them, may impact trade, investment and jobs in manner that hinders global efforts, cooperation and progress. It will be essential to discuss and understand policy proposals in the post-2020 process to minimize the possibility of creating adversarial barriers and to seek practical and efficient ways to promote global action.

Tax or Cap and Trade: A question for governments that wish to attach a price on GHGs is whether to set an emission target and allow the market to set the price or to impose a set the price through a tax schedule designed to reduce emissions (though some nations have chosen to do

both). A stable national cap can assure emissions outcomes for covered gases in covered sectors, with due allowance for offsets and market exchanges with other jurisdictions. Absent a price floor and ceiling, however, caps provide in practice little assurance on price. Price projections based on economic models have proven to be poor guides to realized prices. Impacts from unforeseen events, including recessions, natural disasters, and technological change, have all impacted prices. When prices fall far below anticipated levels, advocates may be disappointed that the cap stimulated fewer investments and less structural change than hoped for, even as emissions targets are met.

A tax provides little assurance regarding emissions outcomes, although, over time a tax can be adjusted to match more closely policy goals. A tax will provide a far more reliable basis for financial planning of major investments (as does a trading program that auctions permits using a price floor). Both raise challenging issues with respect to trade, investment and jobs in a globalized economy. And both embody the risk that future governments may change the basis for action (tax or cap) up or down.

Offsets: Many environmental regulatory systems allow for the use of offsets based on actions occurring outside otherwise covered sectors. Offsets can apply under tax or cap and trade policy. However, once again, a tax provides more clarity in assessing financial implications of offset investments than a trading program with no price floor.

The situation today with respect to offsets differs dramatically from that in the 1990s.

At that time obvious low-cost opportunities for mitigation existed in developing nations without emissions obligations. Indeed, the availability of international offsets became a major theme for cost control in many developed nations. On one hand, offsets provided a tool to reduce costs significantly, while on the other, they raised concerns that they would impede domestic action. In any case, offsets under CDM initially were limited in scope and became mired in lengthy delays and high transition costs that make them a poor model for large scale, mainstream mitigation.

Today, it is unclear whether recognized international offsets will even be available in the post-2020 agreement. If major emitting nations all undertake emissions commitments that cover important sectors of their economies, for example power, transport, industry, buildings and agriculture, then there will be few opportunities for international offsets. Foreign and domestic investors in developing nations will act in the context of domestic mitigation commitments. This raises important questions regarding the basis for offsets and the approach to link different jurisdictions.

Linking mitigation efforts in different jurisdictions: Key questions concern the legitimacy and acceptability of activities undertaken and how “allowances” might be transferred from one jurisdiction to another. As climate commitments evolve and become more mainstreamed, it seems unlikely that nations would agree to link mitigation systems solely on the basis of international agreements and methodologies. Rather, experience to date suggests that linking will require specific bilateral or multilateral agreement between

participating jurisdictions. For example, nations may restrict the type and amount of allowances they will accept, regardless of their international validity, *e.g.* under the CDM. In practice, explicit linking through a bi-lateral agreement could be a positive development for companies that operate in different nations. It would provide assurance that transactions they undertake, consistent with the agreement, will be accepted by both participating nations.

BizMEF recommends that the post-2020 Agreement should be framed so that nations satisfy their commitments with credible measurement, reporting and verification and transparency. The Agreement should not prohibit nations from voluntarily linking with others, as they see fit, so long as transactions are consistent with their international commitments. For example, nations should be allowed to transfer quantifiable emissions commitments, so long as the transaction is appropriately reported as a debit from one and a credit to the other. The obligation should be on participating nations to demonstrate that transfers do not result in double crediting or claiming of mitigation efforts. This need not require international restrictions or approvals for transactions that are consistent with national commitments and agreed MRV.

STANDARDS FOR MRV, OFFSETS AND ACCOUNTING

Under the UNFCCC, Parties established guidelines for national inventories, and under the Kyoto Protocol Parties developed an international registry and process to track the allocation and movement of assigned amount units and to issue credits from approved projects and track their movement. The Kyoto procedures were

explicitly designed in recognition of international emissions trading among nations and the availability of offset projects.

While these procedures may provide a model for the post-2020 Agreement, it may also be possible to create more efficient approaches. In particular, the absence, so far, of internationally recognized, CDM-like offset mechanisms may obviate the need for registries and approval processes for projects. Rather, it may be possible for nations that agree voluntarily to participate in exchanges to define efficient, credible procedures to track them without double crediting. Procedures would need to be consistent both with their international obligations and with domestic rules. For example, such systems could make it possible for nations voluntarily to create bilateral or multilateral agreements for project activities with provisions for joint crediting of emissions reductions and participation by companies.

The over-riding consideration would be that such emissions from projects would need to be quantifiable in a way that allowed consistent debiting and crediting with respect to national commitments, without double crediting. It would not, however, require international approval of projects, as is the case for CDM.

CONCLUSIONS

Nations are adopting a variety of approaches and timing to mitigate GHG emissions. GHG pricing may be a major element in some nations. However, GHG pricing requires a number of politically and economically challenging choices that affect nations, regions, sectors and people in

different ways. To date, this has led to a variety of approaches in those nations with GHG pricing, while some nations have rejected carbon pricing altogether. A variety of unsettled choices affect pricing policies, for example, whether and how to: set prices; include domestic or international offsets; and link with other jurisdiction via markets or bi- and multi-lateral agreements.

Consequently, BizMEF points out the importance of going beyond support for the abstract concept, to understand the manner in which GHG pricing will be implemented, for example: its size, scope,

timing, and consequences for competitiveness and emissions, especially in a world where nations pursue different approaches and timing.

Business participation in policy discussions will be essential to understand and assess the emerging assortment of mitigation and other policies, both for their domestic implications and to understand consequences in a globalized economy. BizMEF members intend to be active in these discussions through existing national processes and by contributing to understanding of Intended Nationally Determined Commitments.

ABOUT BizMEF

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, New Zealand, South Africa, South Korea, Turkey, the United Kingdom, and the United States. 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.