Major Economies Business Forum on Energy Security and Climate Change

Major Economies Business Forum: Perspectives on the Role of Markets

Key Messages

- Business sees markets as a critical tool to promote efficient allocation of resources. Carbon markets form a part of the much larger and wider flow of international investments in low-carbon infrastructure and technology development.
- A new international framework must be flexible enough to allow for diverse domestic market-based and other policy measures to address climate change, so that each country can pursue and learn from different strategies.
- Governments that pursue carbon markets as a mitigation option should consider establishing direct and indirect linkages among different markets as a way to improve efficiency and volume.
- The Clean Development Mechanism (CDM) must be greatly improved in operation and scope if it is to maintain the confidence of the business community and provide the growing volumes of finance that developed and developing countries in the CDM need.
- Approved offsets under the CDM or any new mechanisms should be technology neutral—leaving the market to pick technologies.
- Sectoral mechanisms, if structured properly, could potentially represent a promising way to promote mitigation financing, but procedures must provide incentives directly to those businesses that invest and make an effort, not just to sectors.
- More clarity is needed on how Nationally Appropriate Mitigation Actions will interact with current markets, other mechanisms, and, should it be pursued, sectoral crediting.
- Governments should vigorously seek free trade in clean energy goods and services.

Introduction

Throughout history, our economies have relied on markets as the most cost-effective tool to allocate resources.

Today, faced with the climate challenges of the 21st century, markets remain a powerful tool to mobilize resources efficiently to promote actions and investments to limit climate risks through emission reductions and adaptation. This is especially so in light of the need for both domestic and international policies to generate change over many decades in an environment characterized by uncertainty as to the ultimate solutions.

Much of the debate has focused on the role and status of greenhouse gas markets—more commonly known as carbon markets—under the Kyoto Protocol in supporting the commercialisation of these technologies. The markets created to implement the Kyoto Protocol have two linked elements:

1. greenhouse gas emissions trading systems with national or regional caps; and
2. offset programs that generate credits from approved actions outside national borders.

Many governments and businesses agree that carbon markets may be an efficient means to establish a commodity price on carbon and achieve the goal of emissions reduction in the most cost-effective manner.

The range and use of carbon markets will vary across different economies, but successful market-based systems to reduce greenhouse gas emissions will have certain attributes that support a stable, transparent domestic and international framework and address competitiveness concerns.

Furthermore, international offset market-based mechanisms, such as the UN's Clean Development Mechanism (CDM), play a prominent role in building international cooperative action on climate change among developed, emerging, and developing economies for a low-carbon society.

Such credit mechanisms direct climate finance from developed economies to developing countries, as well as, in developed countries, supporting the achievement of domestic emissions reduction targets through offset credits. However, CDM requires procedural reforms to limit current stifling arbitrary and bureaucratic decision making processes and to expand its scope. New mechanisms under consideration will need to be far more efficient and business-friendly if they are to succeed in contributing to the enormous challenge of reducing global emissions.

Carbon markets form a part of the much wider flow of international investments in low-carbon infrastructure and technology development. It is also to be noted that carbon markets under cap and trade programs are not the only approach to address climate change. Other policy approaches, such as those based on greenhouse gas taxes, tax incentives, loan guarantees, proactive commitments by business sectors, and other mechanisms, also utilize explicitly or implicitly market signals and potentially allow for offset investments.

Given the diversity of national economies, industrial structures, and energy situations, a new international framework must be flexible enough to allow for diversified domestic policy measures to address climate change, so that each country can pursue and learn from different strategies.

Carbon markets will continue to be a central aspect of the climate and energy policy mix in some countries, so it is important that they be effective both in their design and implementation. With this in mind, business would encourage our respective governments to consider the following during their meetings and discussions on a new international climate change framework.

Give a clear signal on the long-term future of carbon markets

Emissions trading markets have been used to address environmental problems, with probably the

most cited examples being the acid rain program in the United States and the greenhouse gas Emissions Trading System (ETS) in the European Union. India also is developing experience with an energy efficiency certificate trading program. However, lessons from these programs must be tailored to address the economy-wide, long-term implications of limiting climate risks.

As national and regional markets in emissions credits develop and interlock, they are also helping to underpin international cooperation on climate action—improving the cost efficiency of emissions reductions.

However, carbon markets cannot be successful in supporting us to accomplish our shared climate goals in the face of uncertain regulations and policies. Business is therefore looking for governments that choose to use carbon markets to deliver a clear signal on the role of market approaches and mechanisms in long-term global action to tackle climate change.

Make the incentives clear to business by setting achievable, transparent goals

Business rarely acts without a clear understanding of costs, risks, and benefits. If market uncertainties grow too large, it is difficult for the private sector to justify major investment. Business understands that even under the best of circumstances, perfect certainty is not a realistic outcome of the negotiations. Predictability is a much more reasonable expectation. For a robust and successful carbon market, business needs clarity, not unpredictability. Business is specifically keen to better understand how new international mechanisms, such as sectoral crediting and trading, will both function and be integrated with existing targets.

Governments that wish to pursue carbon markets as a mitigation option should consider establishing direct and indirect linkages among different markets as a way to reduce the overall costs of abatement, which would build more liquidity and enhance price signals for low-carbon investments. Large and more liquid markets are inherently more efficient, reducing transaction costs and providing capital with a larger pool of opportunities for low cost abatement. Large markets also are more robust, reducing concerns about the market power of actors, and reducing total price volatility. Nonetheless, linkage exposes all actors to decisions in each market that may have been made on the basis of domestic political compromise. Effective enforcement and transparency becomes, therefore, important in all regimes.

The comparability of carbon markets and targets must be transparently assessed. Monitoring, reporting, verification, compliance and enforcement are the critical underpinning of successful international carbon market mechanisms, and this is best assured through robust domestic measures. It is particularly important that countries clearly explain the basis for their goals, whether in terms of base year emissions, business-as-usual projections, or other measures. Rigorous and effective domestic compliance is essential.

Address competitiveness concerns by ensuring measures to tackle carbon leakage are effective

Where in operation, carbon markets must incorporate measures which provide flexibility to address "carbon leakage"—the risk that investment or production may shift to countries where businesses do not face the cost of climate policies. BizMEF members agree that such efforts must be consistent with existing trade agreements or they run the risk of undercutting cooperation and economic growth. The best means to do so would be through a comprehensive international trade agreement that addresses these issues directly.

Addressing competitiveness concerns starts with greater efforts to improve the accuracy of measuring the impact of all climate polices on business—as the impact of such policies on competitiveness is not uniform. Incomplete or insufficiently detailed data assessing the risk of carbon leakage serves as a barrier to business confidence.

Another concern is that the financial flows from the sectoral crediting of carbon markets could be unfairly utilized to underwrite the modernization of state-run firms. These competitiveness issues undermine carbon markets by creating an uneven playing field and discouraging private firm participation and should be addressed.

Reform and improve the Clean Development Mechanism

While worthwhile new mechanisms may be pursued, the CDM is real, valuable, and important to preserve. It must be greatly improved and expanded in scope, however, if it is to maintain confidence while providing the growing volumes of abatement and finance that developed and developing country participants respectively require. CDM bureaucracy must be reduced. The project approval procedure of the CDM Executive Board needs to be streamlined and supported by standardized project methodologies.

Participation of developing countries in CDM must be broadened, but for this to occur, greater capacity building will have to take place in developing countries, particularly less developed countries.

Furthermore, while harmonization of rules and procedures is certainly the most desirable outcome, it seems likely that nations and regions may develop their own procedures to qualify offsets. Therefore, governments should make every effort to assure that qualifying emissions offsets are real, verifiable, and permanent (or in the case of land use, replaceable).

Eligible offset activities under CDM should also be technology neutral, with the main focus being climate outcome rather than technology input. This would expand the scope of eligible projects. The Intergovernmental Panel on Climate Change Working Group III 4th Assessment Report on Mitigation highlighted the potential contributions of carbon capture and storage and nuclear power to greenhouse gas emissions reductions, but these and other technologies (such as biofuels produced using biotechnology) are mired in uncertainty or remain off limits under the CDM. This needs to be reviewed.

Business must also be assured that the credits it purchases through CDM (or any other system) have integrity and utility. Whether deserved or not, there is the impression that some CDM projects lack clear environmental benefits. CDM should be improved to ensure that projects clearly and measurably result in emissions reductions. Offsets that can be shown to be credible and verifiable and recognized by competent authorities (*e.g.*, national governments) should be recognized. Governments should honor credits issues under authorized programs.

Support and develop other credible credit mechanisms including voluntary markets

In addition to established mechanisms, new sources for financing greenhouse gas reductions are needed. Clear rules for offset credits must be established. A common rule book and procedures for different regional offset markets would go a long way toward reducing investor uncertainty. Equally important is that all mechanisms be transparent to ensure varying types of offsets are fairly assessed and represent real, verifiable emission reductions. Markets must provide a clear, direct signal to those responsible for investments, rather than providing a vague incentive to an entire sector that consists of competing firms.

The UNFCCC should also consider utilizing other recognized competent authorities to assist in the verification of offsets, which would encourage additional participation and improve investment and project development.

Voluntary carbon markets are already helping build positive experiences and standards across business. These markets should be given broader recognition and efforts should be made to prepare for their eventual incorporation into formal offset schemes and other market mechanisms.

Work for a better understanding of new sectoral programs and NAMAs

Sectoral mechanisms, if structured properly, could possibly represent a promising way to direct finance to more emission reduction opportunities. As sectoral mechanisms develop, they should aim to credit directly the point of emission reduction investment in the sector. Investors are not likely to take risks if the creation of carbon credits depends on the total success of the activities of others in the sector reducing their emissions.

Further elaboration and discussion of Nationally Appropriate Mitigation Action plans (NAMAs) is also necessary. In particular, it is not clear how NAMAs will interact with current markets and, if pursued, sectoral crediting.

Support free trade

Free markets function best. We are concerned, therefore, that some governments are considering imposing unilateral border adjustments on imported goods. Given today's dependency on open markets and a rules-based international trading system, these kinds of proposals may invite retaliation that could restrict trade flows sharply and slow the dissemination of advanced technologies and business practices. It is not clear that proposals to impose "border adjustment measures" for carbon-intensive imports would solve the carbon leakage issue, even if World Trade Organisation (WTO) compliant.

The international climate negotiations should not be used to erect barriers to free and open trade and investment. Instead, we encourage governments to work at the WTO level to eliminate tariff and non-tariff barriers to trade. Absent such an agreement, we would encourage the governments of the major economies to undertake voluntary action to eliminate tariffs on all goods and services that contribute to mitigating or adapting to climate risks. The challenge will be to avoid arbitrarily restrictive definitions of such of clean energy goods and services. In this regard, governments should work to ensure open access to rare earth elements, which are important constituents of many such technologies.

Business views

Efficient and transparent markets enable businesses to meet their commitments to reduce emissions in a more cost-effective and innovative manner. A variety of markets are playing important roles to achieve the goal of emissions reduction, and policies and measures should encourage flows in these markets.

The development of carbon markets in countries that adopt them must contribute to reducing emissions at global level, so as to avoid unbalanced commitments that could lead to carbon leakage and to competitiveness loss for companies involved in the system.

We recognize that such markets form just one component of a much bigger picture. Of equal importance are policies and measures that ensure additional financial flows (*i.e*. direct investments in low-carbon infrastructure and technology) that spur development and encourage the deployment of cleaner technologies. All these measures together must be part of a comprehensive global approach to tackling climate change while fostering innovation and economic growth.

Australian Chamber of Commerce and Industry
Australian Industry Group
BUSINESSEUROPE
Canadian Council of Chief Executives
Confederation of British Industry
Confederation of Indian Industry
Dansk Industri
Confindustria
Federation of German Industries – BDI
Iniciativa para el Desarrollo Ambiental y Sustenable – IDEAS (Mexico)
Korea Chamber of Commerce & Industry
Mouvement des Entreprises de France
Nippon Keidanren (Japan Business Federation)
US Chamber of Commerce, Institute for 21st Century Energy
US Council for International Business

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, Kenya, Mexico, 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.