



The world business organization

Department of Policy and Business Practices

## **CARBON PRICING PRINCIPLES**

# CARBON PRICING PRINCIPLES

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The anticipated Paris climate agreement will combine a broad range of national and local policy approaches in what will be a novel form of bottom-up global architecture. **Carbon pricing<sup>1</sup> instruments** are a policy option that a growing number of countries and regions are utilizing to implement national climate and energy policies and to achieve emission reductions. While carbon pricing can be the most cost-effective climate solution in many countries, other approaches – such as incentive-based systems or efficiency standards – can be a more viable option in other countries. This policy paper outlines a number of **basic principles and recommendations** for governments and policy makers to take into account if they decide on the development and implementation of such instruments.

Carbon pricing is also foreseen to play a role in the Paris Agreement being referred to inter alia as “Framework for Various Approaches and the New Market Mechanism” but its form and content is yet to be finalized. ICC is supportive of the notion that the Paris Agreement and its implementation should include and enable market-oriented instruments. Market-oriented instruments **continue to be an essential part of the international climate policy, reflecting the global challenge of ambitious mitigation action.**

Business therefore urges policymakers to agree on how the market-based approaches under the UNFCCC can be further developed.

Many companies and sectors already have experience with carbon pricing instruments. The energy sector and other industry sectors often have significant emission reduction obligations under national climate policies. New business opportunities can arise when carbon pricing leads to efficiency investments in industry and private households – or indeed other areas of the economy. Individual companies have also explored internal carbon pricing and trading.

Based on this range of experiences, ICC has developed the following principles on carbon pricing, which we believe form an essential part of national and international approaches to climate change of the growing number of countries which decide to use a carbon pricing instrument. These principles should also be taken into account for developing market-based instruments under the UNFCCC in order to:

- **tackle climate change at the scale needed, irrespective of location, and at the lowest cost to consumers and society;**
- **avoid economic and competitive distortions between regions and sectors in order to achieve net emission reductions on a global scale, while preventing the shifting of emissions within sectors and between regions;**
- **give companies a long-term, reliable framework and policy clarity to support their investment decisions.**

These principles are aimed at helping policymakers find a balance when implementing a carbon pricing instrument that allows to achieve two main objectives:

- **reducing emissions** and triggering investments in low carbon technologies,
- while at the same time **keeping energy prices at a level that does not overburden industry and does not impede consumer access to energy.**

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<sup>1</sup> Carbon pricing is a term commonly used. However it should be noted that in the context of this paper the term carbon pricing refers to greenhouse gas emissions in general.

## 1. **CREATE A RELIABLE AND PREDICTABLE OVERALL FRAMEWORK FOR COST-EFFECTIVE ENERGY AND CLIMATE POLICIES**

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**Creating a long-term perspective and reliable framework conditions in national and international climate and energy policies is essential for business investment decisions.** Such a perspective and framework conditions provide the most important elements for a carbon pricing instrument to fulfil its purpose, **which is to reduce emissions and to this end trigger appropriate investments.** Those investments, however, require appropriate timescales and reliable expectations on future carbon prices - in particular because investment cannot happen overnight. An inconsistent or unpredictable general approach in climate and energy policies, both at national and international level, will inevitably limit the effectiveness of any carbon pricing instrument or even eliminate its ability to deliver emission reductions.

## 2. **PROMOTE CONSISTENCY BETWEEN CLIMATE AND ENERGY POLICIES**

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A carbon pricing instrument can be **designed in many ways**, for instance as a **tax or an emissions trading scheme**. Other ways to price carbon are to **directly reward emission reductions** or even to **reward the use of less carbon-intensive** or renewable energy, thus providing a competitive advantage for such energy sources. A hybrid system can also sometimes better reflect national circumstances and the diversification of national policy objectives, which policymakers aim to achieve with a carbon pricing instrument.

Governments that use carbon pricing instruments should pay special attention to potential **interactions with other instruments** and carefully examine **how to coordinate and align their climate and energy policy instruments. In doing so it is vital that policies are calibrated in such a way as to avoid possible conflicts and do not negatively affect each other.** In this respect, the IPCC's fifth assessment report WG3<sup>2</sup> states that **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.

## 3. **PREVENT CARBON LEAKAGE**

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**Climate protection is a global challenge calling for global action.** Costs and efforts should be fairly distributed between regions based on their respective responsibilities and capabilities. If local or regional carbon pricing instruments are put in place, ideally these should converge over time to **create a global level playing field with comparable reduction requirements—and, moreover, comparable costs for business and industry sectors across the world.** Until this is the case, it is important that carbon pricing instruments **do not lead to shifting of emissions between regions.** Solely shifting investment, production and emissions to other regions does not reduce emissions and hence does **not have any net climate benefit.**

Therefore, policymakers should clearly **address carbon leakage concerns for those sectors** in global competition and for those that are not in a position to pass on additional costs arising through carbon pricing. One approach to **safeguard against carbon leakage** is for example to allow for industrial installations that are in a global competitive situation **not to bear financial burdens relating to carbon pricing, if in global comparison the installations do belong to the most efficient ones of their type.**

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<sup>2</sup> IPCC, 2014: Summary for Policymakers, Mitigation of Climate Change. Contribution of Working Group III to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change, page 30

#### 4. CREATE A CLEAR AND ROBUST TRANSPARENCY FRAMEWORK

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Carbon pricing instruments should be transparent, based on robust criteria for emission reductions and based on a clear legal framework. Emissions, especially if covered by a carbon pricing instrument, should be measured, reported and verified (MRV) on the basis **of agreed international criteria**.

**A transparent approach to MRV** is important not only for the accountability of emission reductions, but also for building trust between countries and regions about the appropriateness and comparability of their reduction goals. In addition, **a strong MRV framework is an important element to guarantee the security of long-term investments in small- and large-scale mitigation projects**.

#### 5. MAINTAIN ACCESSIBILITY TO AND AFFORDABILITY OF ENERGY

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Regardless of the concrete carbon pricing instrument that is chosen, financial burdens arising from it must **remain at a reasonable level**. Policymakers have to find a balance when implementing such an instrument that allows **to achieve the following two objectives** outlined previously:

- firstly, **reducing emissions** and triggering investments in low carbon technologies; and
- secondly, **keeping energy prices at a level that does not overburden industry and does not impede consumer access to energy**.

#### 6. PROMOTE INTERNATIONAL LINKING OF CARBON PRICING INSTRUMENTS

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A carbon pricing instrument should enable those countries who wish to do so to eventually link their carbon pricing instruments together. **Linking carbon pricing instruments can lower economic costs, reduce carbon leakage risks and competitive disadvantages for certain industry sectors**. At the same time, it can increase the economically viable options for mitigation actions in different regions. In this respect, regional carbon pricing instruments **should allow for the use of offsets from foreign sources**.

#### 7. RECOGNIZE THAT THERE IS NO “ONE-SIZE-FITS-ALL” INSTRUMENT

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In principle, ICC considers that **economy-wide approaches offer the best opportunities to minimize societal costs of mitigation**. The wider the scope of emission reduction possibilities under a carbon pricing instrument the more cost efficient options for emission reductions can be identified. **The scope of incentives for mitigation actions depends on how broad the range of segments of society and economic sectors are affected**.

However, it should also be recognized that **a “one-size-fits-all-approach” for all economic sectors and segments of society does not exist** and not all specific sectoral needs can be included under one single instrument. For instance, while a market based cap and trade approach will guarantee that a certain mitigation target is fulfilled, the exclusive use solely of a carbon tax will give an incentive for mitigation action too, but cannot guarantee the achievement of such.

#### 8. RE-INVEST CARBON PRICING REVENUES CLIMATE CHANGE MITIGATION

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The main purpose of a carbon pricing instrument should be to reduce emissions at the lowest possible economic cost. At the same time, a carbon pricing instrument may create new revenues for governments, which can be substantial depending on the overall design of the instrument. Therefore, the allocation of such revenues is an important element of a carbon pricing instrument. Ideally revenues would be redirected to climate change mitigation efforts. Governments should consider making commensurate reductions in other taxes, to keep the level of overall tax burden on business the same. Additional issues to consider include: providing compensation for trade exposed sectors; targeted rebates/support to low income families; and support for research and innovation to accelerate the development of new low carbon technologies.

# ICC CARBON PRICING PRINCIPLES

THE ROAD TO  
**COP21**

**TO MAXIMIZE THE EFFECTIVENESS OF CARBON PRICING INSTRUMENTS, ICC RECOMMENDS THAT POLICYMAKERS SHOULD:**

**1**

Create reliable and predictable frameworks for cost-effective energy and climate policies

**5**

Maintain accessibility to and affordability of energy

**2**

Promote consistency between climate and energy policies

**6**

Promote international linking of carbon pricing instruments

**3**

Prevent carbon leakage

**7**

Recognize there is no “one-size-fits-all” instrument

**4**

Create clear and robust transparency frameworks

**8**

Re-invest carbon pricing revenues in climate mitigation efforts

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