



Business and Industry Advisory Committee to the **OECD**

Comité Consultatif Economique et Industriel Auprès de l' **OCDE**

BIAC VIEWS ON THE KYOTO MECHANISMS

Introduction

One of the principles of the Framework Convention on Climate Change is that measures to deal with climate change should be cost-effective to ensure global benefits at the lowest possible cost. However, the Kyoto Protocol did not define how the Kyoto mechanisms (emissions trading, joint implementation and the Clean Development Mechanism) are to function, leaving to future negotiations of the Parties the development of guidelines, rules and methodologies. The necessary frameworks and specific rules are currently under discussion, proceeding according to a "Plan of Action" agreed at COP4 in Buenos Aires in November 1998. BIAC believes that the OECD has an important role to play in informing these deliberations given that its expertise can help to ensure economic soundness and free market compatibility.

The extent to which the Kyoto Mechanisms negotiations develop truly "flexible" frameworks and institutions is a fundamental concern for business and industry and will be critical in ensuring cost-effective responses to the climate challenge. At this point, many unanswered questions remain, and the implications for economic growth under an absolute domestic emissions cap, and how countries may apply this to industry, are a concern for many industries. Industry is opposed to the imposition of absolute emission caps.

The mechanisms should be carefully analysed as to their impacts on economic activity. Fundamentally these mechanisms must be market-oriented and business friendly with minimum bureaucracy. In particular, the OECD should assess costs, benefits and operational modalities of these mechanisms, involving the full range of interested parties, prominent among them the business community. One aim of the OECD analysis should be to determine how the mechanisms could be developed to be most user-friendly to business, allowing for progress in the areas of economic growth and environmental effectiveness. We believe it is also important for the OECD to assist in identifying government barriers that impede such progress.

Excessive rules, regulations and costs should be avoided and potential barriers to industry participation should be eliminated from the outset. A range of policy options, including voluntary initiatives, negotiated long-term agreements and the Kyoto mechanisms, changes in capital depreciation schedules, and tax incentives for research and development, among others, can also, if correctly designed and with proper enabling conditions in place, play an important role in reducing emissions cost-effectively.

Comprehensive, well-designed, flexible mechanisms, should allow economic growth, permit markets to allocate resources efficiently and reduce the bureaucracy and compliance costs necessary to implement legislation. They should also facilitate the spread of current and emerging technologies and broaden international co-operation. Private sector foreign and domestic capital is the major source of finance for energy-related infrastructure investments in developed and developing countries. If well designed, these new mechanisms could create commercial opportunities for private sector entities and redirect international capital flows to climate-friendly investments.

Voluntary Approaches: Industry's First Choice to Address Climate Change

Business-led, market-based voluntary initiatives and actions are industry's first choice to address climate change and should continue to be recognised as an effective policy option for the mitigation of climate change. The OECD and its Member states should encourage companies to initiate and implement voluntary initiatives to address climate change, and factor such voluntary approaches into domestic action plans.

The very nature of climate change requires a long-term framework for a response strategy. The wide range of voluntary approaches, initiatives and agreements lends itself to such custom-tailored long-term responses, offering early and cost-effective action and allowing for great flexibility to suit the different conditions and circumstances in various OECD countries and industries. There are many examples of successful and ongoing voluntary actions, such as the Australian Greenhouse Challenge, the Keidanren voluntary action plan on the environment and the German agreement on global warming prevention, which have become cornerstones of national climate change policy (see also the Keidanren/ICC/WBCSD joint statement on voluntary business initiatives for mitigating climate change, which has also been endorsed by BIAC).

There is a broad diversity and range of voluntary actions, many of which include setting goals, taking measures to achieve them, monitoring and communication. Many countries have had positive experiences with voluntary initiatives which:

- Can be more cost-effective than alternative measures in a given period, due to their flexibility and reduced bureaucracy.
- Provide a framework for innovation and creativity that allows for new approaches and more rapid changes than would be possible under mandatory programmes.
- Allow for easier and thus more rapid adaptation to changing conditions than legislative measures.
- Are an effective means of ensuring consultation and partnership.
- Promote awareness of existing and new technical management practices.
- Encourage the dissemination of existing effective technologies, the development of innovative approaches, and faster implementation of both.

Emissions Trading: The Potential for Reducing Costs Through the Market

Emissions trading has the potential to reduce the costs of attaining the Kyoto targets by encouraging mitigation of GHGs where the costs are lowest. Under emissions trading, an Annex I country with an actual emission below the target agreed under the Kyoto Protocol can sell its excess allowable emissions units to another Annex I country unable to meet its commitments. Under an emissions trading scheme, emission permits or assigned amounts of emissions as well as emission reduction credits acquired through Joint Implementation or the Clean Development Mechanism projects should be tradeable.

Business should be actively involved in the effort to design and implement any proposed emissions trading system. A number of design issues should be addressed:

- Agreements should be established on the minimum administrative systems essential to the practical implementation of a trading system to minimize bureaucracy on national, regional and international levels and to let markets work.

- Trading will be most effective at the company level as business is best placed to seize the opportunities for and costs of reducing emissions. However, it should be noted that trading by and between industry alone will not provide a full solution to greenhouse gas stabilisation, as industry's share of total greenhouse gas emissions presents only a portion of the total emissions in developed countries. Considerations should be given to including other aspects of societal activity in trading.
- If an emissions cap and allocation of permits are introduced, the allocation should be done on a fair and equitable basis, including by acknowledging emission reductions already achieved. An acceptable method must be devised and applied for providing the initial and subsequent permits, and of addressing liability issues (based on baseline emissions, voluntary target setting and the registration of carbon offset generation and transactions). Regional characteristics should be taken into consideration and regulatory elements must be avoided.
- The purchase of carbon permits under any of the flexible mechanisms will result in increased costs to business with direct implications to competitiveness. This is of concern to industry, and poses particular challenges to energy-intensive industries whose products are traded as commodities having to compete on the global market with companies located in developing countries. Great care should be taken to ensure such policies (flexible mechanisms and carbon permits) do not result in an “unlevel playing field” and thereby damage competitiveness, growth and jobs in those sectors.
- Any trading system should guarantee openness and transparency to encourage a wide range of participants. Trading arrangements should be sensitive to the needs of competitiveness.
- Trading must not develop into a revenue-raising mechanism for governments. This instrument must under no circumstances be used in such a way that industry would first have to purchase emission rights upon introduction of the system.
- Banking of emission reduction units should be considered as an integral element of emissions trading, which encourages firms to produce early reductions and provides the flexibility to manage emissions over time.
- Trading mechanisms capable of dealing with all GHG emissions at an international level should be promoted.
- There should be no limit to the contribution of emissions trading towards achieving national reduction goals.

The OECD's study of the costs, benefits and effectiveness of emissions trading for a wide range of industry sectors should involve participation of the business community.

Joint Implementation: Investment and Climate Change

Through Joint Implementation (JI), industry can make investments in emission reduction and sink enhancement projects, receiving credits for achieved reductions. Joint Implementation allows Annex I countries to work together to meet their emission targets. The Parties may transfer or acquire emission reduction units resulting from projects and activities implemented in other Annex I countries. Projects that enhance carbon sinks are also included.

JI opens the possibility for a dynamic system of emission transfers between Annex I countries to evolve with the participation of "authorised" legal entities. The use of such a system can stimulate investment in projects that mitigate GHG emissions and encourage investment to flow to the most cost-effective project options regardless of their location. As a form of foreign direct investment between two parties (private sector, public sector, or a combination of the two), JI requires only a negotiated deal between the two

parties. As most JI projects will occur within the OECD Member states, the OECD has a particularly important role in assessing and encouraging this mechanism.

The Clean Development Mechanism

The Clean Development Mechanism (CDM) allows governments or private entities in industrialised countries to implement emission reduction projects in developing countries and permits industrialised nations to receive credit for these projects in the form of "certified emission reductions".

The OECD should engage developing countries in mitigating climate change through the CDM as essential to an environmentally effective global response. The CDM is potentially an important vehicle for flows of private sector investment and technology to developing countries and can contribute to the economic development of the host country, ensure measurable project outcomes and complement existing private sector initiatives. Given the predominant role of industry in technology innovation and diffusion, BIAC should be involved at an early stage in offering advice for the design of frameworks and specific rules of the CDM in all relevant forums, including the OECD.

Private sector foreign and domestic capital is a major source of finance for energy-related infrastructure investments in developing countries. If well designed, this new mechanism could create commercial opportunities for private sector entities and redirect international capital flows to climate-friendly investments.

Conclusions

Strategies to reduce greenhouse gas emissions must be achievable and be designed in a sustainable development context, taking into account economic, ecological and social factors providing for economic growth. By maximizing flexibility, the combination of voluntary initiatives/long-term agreements and flexible instruments can contribute to cost-efficiency in the implementation of climate change policies, the positive ramifications of which will be felt globally if correctly designed and implemented.

Due to the close links between emissions trading, JI and the CDM, the OECD must consider their interactions, and examine ways in which the framework and specific rules can be compatible and complementary. Voluntary initiatives, approaches and agreements on global warming prevention and other alternative approaches should also be considered when assessing the Kyoto flexibility mechanisms. Companies which have started reducing greenhouse gas emissions before 2008, through domestic measures and/or flexible instruments, should get recognition of their early actions, for which an appropriate framework needs to be developed.

Climate protection policy must be agreed world-wide, since the causes and effects of a possible climate change are of a global nature, and measures to protect the climate must not distort international competitiveness. Because developing country industries are not presently subject to obligations to reduce greenhouse gas emissions, policymakers in the OECD should exercise great care to avoid damaging industrial competitiveness through flexible mechanisms. Since industry's emissions only represent a portion of total greenhouse gas emissions, considerations must also encompass non-industry sectors.

The role of the OECD in partnership with BIAC in emphasizing and encouraging the need for co-operation with developing countries and economies in transition is indispensable. It is crucial that the OECD consider how flexibility mechanisms should be designed to allow for beneficial participation by companies in all countries.