International Chamber of Commerce
The world business organization

Policy and Business Practices

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International Chamber of Commerce Input to:

Outcome of the work of the Ad Hoc Working Group on long-term Cooperative Action under the Convention (AWG-LCA) - Submissions from Parties and accredited observer organizations on matters relating to the establishment of one or more market-based mechanisms to enhance the cost-effectiveness of, and to promote, mitigation actions, as referred to in document FCCC/AWGLCA/2010/L.7, paragraph 81. (See FCCC/AWGLCA/2010/L.7, paragraphs 80.82)

I. INTRODUCTION

COP 16 in Cancun decided to consider the establishment of, at its seventeenth session, various approaches, including opportunities for using markets, to enhance the cost-effectiveness of, and to promote mitigation of greenhouse gases.

ICC supports establishment of new market mechanisms. Properly designed, such mechanisms would bring important benefits by lowering the overall cost to society of developing and deploying options to mitigate emissions. ICC supports a UNFCCC post-2012 agreement that provides a clear and predictable framework in which business can contribute solutions. ICC considers that market-based and market approaches to address emissions are an essential component of enabling frameworks for business to contribute effectively to managing climate risks.

In particular, we are convinced that new market based approaches that go beyond the project by project approach of the existing KP flexibility mechanisms would provide valuable tools for the business community to engage.

II. KEY ROLE FOR MARKET BASED APPROACHES

ICC believes that market based approaches, in general, will have a key role in addressing climate change in those countries and regions that choose to use them. Critical components that will enable a response to climate change will first of all include technology evolution - deployment of existing efficient and low emitting technologies and practices - and revolution - creation and deployment of innovative, currently non-commercial technologies on a global scale.

Stabilizing greenhouse gas concentrations at the ambitious levels under consideration will require acceleration in the pace of technological advancement and diffusion. Given the size of the climate challenge, as well as other societal needs and priorities, achieving

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such an ambitious objective will require an efficient means of allocating resources for research and deployment solutions, for which cost-effective use of capital is critical.

Market approaches to address climate change and promote movement towards energy generation and use with higher efficiency and lower greenhouse gas emissions, may take a number of forms depending on national circumstances as well as the sector of economic activity to be addressed.

In general, ICC advocates the use of economy wide approaches because they offer the lowest cost to achieve a given objective. Promoting innovation requires consideration of different stages of development of a technology. Research and development (R&D) and pilot and demonstration phases will require strong public-private partnerships, while the technology deployment stage should rely more on pure market signals. In this context, greenhouse gas markets will be an important tool in the tool box.

III. GREENHOUSE GAS AND CARBON MARKETS

Greenhouse gas markets, for those Parties that will utilize them on a voluntary basis, can play an important role in creating signals and actions to stimulate technology development and deployment. From a private sector perspective, such markets should be designed according to the following principles:

- Ensure environmental integrity - which will require objective criteria to issue allowances and qualifying offset investment through measuring, reporting and verification (MRV) requirements;
- Encourage research and entrepreneurship in the business community;
- Provide a clear market signal that will affect the behaviour of consumers and business leading to decisions and actions that mitigate greenhouse gas emissions;
- Enable private finance to participate;
- Ensure compatibility with existing and evolving national policies and measures;
- Ensure that policies are consistent with strong protection for intellectual property rights to encourage innovation and deployment of advanced technologies;
- Ensure good market functioning and regulation.

IV. EXPERIENCE WITH EXISTING MECHANISMS

The Kyoto Protocol created three market-based instruments: the Clean Development Mechanism (CDM), Joint Implementation (JI) and Emission Trading.

The Clean Development Mechanism

The CDM has resulted in clean investments that contribute to sustainable development in host countries and has helped to meet compliance in nations with emissions obligations, but has been hampered by design and operational problems. While it has achieved more than many have expected, its scope of application has not, and simply cannot, under current practice, deliver enough to meet the challenge and make a material difference. In the view of ICC, CDM has been overly cautious in limiting the scope of technologies and projects eligible for consideration, and it requires reform to eliminate high transaction costs and overly bureaucratic, non-transparent decision making.

While CDM has delivered benefits, it has been unable to effect fundamental changes in the energy portfolio, especially because of its project by project approval process and limited scope for eligibility. Moreover, in practice, decision making in CDM has become heavily politicized and now essentially paralyzed. The outcome has been a complex and sometimes inflexible mechanism that has reached its limit.

Some of the well known issues around the CDM include, but are not limited to:

- Governance issues.
- Board capacity.
- Staff capacity.
- Lack of transparency and communication.
- Additionality.

Joint Implementation

At the same time, JI, the other project-based mechanism with significant potential, has been very slow to start. In addition to a late start, this has been essentially the result of many of the projects no longer qualifying due to potential host countries joining the European Union (EU) and becoming part of the EU Emissions Trading Scheme (ETS). As well, politicization of the approval procedures has hampered the progress in many of the eligible countries. Generically, this illustrates the need for mechanisms to be able to evolve to account for the evolution of national and regional circumstances.

International Emissions Trading

The third instrument, international emissions trading under Article 17, has only recently commenced, with a growing number of transactions. Green Investment Schemes have become an option for transactions involving Assigned Amount Units (AAUs). However, its future under the current architecture is unclear given the AAU surplus that may be carried forward from the 2008-2012 period.

V. ICC PROPOSAL - NEW MARKET BASED MECHANISMS

New market based mechanisms for emissions mitigation could include REDD[1]+, technology mechanisms, market mechanisms to address emissions from international marine and aviation activities, as well as sectoral crediting, sectoral trading, etc. Each poses challenges and opportunities.

All these mechanisms under the Convention, could be implemented as NAMAs, top-down (designed internationally, used voluntarily by Parties) and bottom-up (designed nationally and approved internationally). NAMAs could be divided into NAMAs that are internationally financed and domestically financed NAMAs . Some NAMAs will be market based, and Parties implementing these NAMAs may allow linkages to international carbon markets with some or all of the reductions resulting from these NAMAS being allowed in carbon markets by the implementing Party. Allowing credits in the international markets

[1] **Reducing Emissions from Deforestation and Forest Degradation in Developing Countries** (REDD)

will be decided by host Parties - one criterion that should be considered should be that credits from lower abatement costs NAMAs will be used domestically, while the higher abatement cost ones will be used internationally, by developed countries, for their compliance.

The discussion of new approaches must be seen in the context of how the private sector may contribute to the financing of NAMAs, which will cover many activities. NAMAs will provide a menu from which Parties will chose as it is appropriate to their interest and conditions and can be seen as an umbrella of activities covering the major emitting sectors of a developing country's economy.

Discussion on the various new approaches have focused in the UNFCCC debate on the ideas of sectoral crediting and trading, but it must be recognized that other market-based NAMAs can be helpful in facilitating investment and private sector participation.

These new mechanisms must be sanctioned by an internationally binding agreement and will be most effective and attractive to investors if they produce units that are fungible with all other GHG market units on the market.

Business contribution to NAMAs

Business provides at least three types of contribution to developing countries NAMAs:
- as a technology provider business can assess the needs of countries and develop and sell the needed technologies.
- through New Market Mechanisms (incl. risk-sharing and crediting) business can finance part of the NAMA.
- as an in-country operator both domestic and foreign owned business entities should be eligible to obtain allowances under the program through steps that reduce emissions.

Risk-sharing - mechanism

However, the extent of NAMAs which may be financed by the private sector can be enhanced and increased by developing a risk-sharing mechanism through public-private-partnership. Such a New Market Mechanism can cover part of the down-side risk of investment in specific developing countries. Applying fast-start-funding to develop and pilot-test such a mechanism is needed in order to pave the way for more private investments on commercial terms.

Carbon market NAMAs/Sectoral Crediting and Trading

Even with commercial activities, public funding and a risk-sharing mechanism to increase market-based, commercial investments in NAMAs there still remains a need for private financing through a crediting mechanism. For this purpose a NAMAs that create units that can be used in the international carbon market will be an important elements. Sectoral crediting and trading represent two potential such NAMAs that will take different configurations depending on domestic priorities, and conditions, such as capacity to implement.

ICC considers that economy-wide approaches offer the best opportunity to minimize societal costs of GHG controls. However, NAMA/sectoral crediting and trading represent a step in the right direction from a project-by-project approach towards an economy-wide up-scaled mechanism.

Two examples of NAMAs that can create credits for the international carbon market are sectoral crediting and trading. These mechanisms must be seen as intermediary steps for a move by developing countries, in the future, towards more inclusive, economy-wide programs. They are intended to, and will help address, issues related to the project by project offset system under the CDM. However, they are neither able, nor intended, to address issues of competition.

In considering options for NAMA/sectoral crediting and trading, it is important to recognize that firms in sectors compete with one another at the national and global levels. As such, they must be designed to complement and work with existing competition laws. Another issue that needs to be considered in judging whether these mechanisms will be effective and provide the right incentives, is whether these approaches will be able to provide transparent incentives for individual firms to improve their performance and for all firms to participate efficiently and effectively in sectoral trading.

Sectoral crediting will provide reductions ex-post, as the difference between a crediting baseline and the actual emissions. Being a crediting system there is no risk of overshooting and compromising environmental integrity - credits will be allocated only if reductions are achieved at the end of the crediting period

Sectoral trading will provide trading permits ex-ante (in that they will be allocated at the beginning of the period as in the current EU ETS) but that sector of the economy will have to meet its targets at the end of the specified compliance period, potentially, if needed, by buying on the international markets. Given the fact that commitments are made by broader segments of the economy, it would seem that compliance in this case will have to be at the level of Party.

Further discussions and negotiations will be necessary to design workable systems with clear accountability, but some basic conditions and design considerations that these mechanisms would have to meet can be defined.

Basic Conditions

- Ensure environmental integrity of outcomes and actions result in issuance of tradable credits or allowances - this will require reliable procedures to design objectives as well as to measure, report and verify actions;
- Provide equitable procedures and incentives to assure access for all firms, foreign or domestic, that wish to participate in eligible activities;
- Ensure that their design moves us closer towards economy wide approaches;
- Ensure that they are linkable and their units fungible;
- Seek to work effectively with CDM and other national approaches to prevent double counting of obligations or benefits and to assure a smooth transition and mechanism evolve;
- Require comparable economic effort among all sectors and nations that participate - agreements must avoid the creation of hot air or favourable advantage for particular nations or firms;
- Ensure that the timing for making them operational is taken into account especially in relationship with the transition from existing mechanisms;
- Provides incentives for investments by individual firms within sectors;
- Establish sound compliance procedures for participating nations and businesses to assure the integrity of domestic and international greenhouse and carbon markets;

Compared to CDM

- Compared to the Clean Development Mechanism a new market mechanism needs to be scaled up significantly in order to deliver the needed global emissions reductions (Giga tonnes rather than million of tonnes emission reductions).
- In a new market mechanism it is no longer possible to continue a project-by-project approval. This will make the process too slow and emissions reductions too few.
- All technologies which can contribute to the reduction of GHG-emissions shall be accepted as part of the NAMA (or sub-NAMA activity) which is supported through a New Market Mechanism.
- In terms of not yet commercially available technologies a New Market Mechanism needs to be sufficiently flexible to adapt to new abatement technologies.
- Bearing the existing CDM in mind, the major barrier to project approval is the "additionality criterion". A New Market Mechanism must avoid running into a similar barrier. This problem needs to be solved by developing criteria for supported NAMAs activities versus NAMAs that can be credited and developing simple MRV rules. Furthermore, the fact that a baseline may be developed for countries and sectors as part of the NAMA-crediting is likewise a way of dismantling the existing additionality barrier.

Design Considerations

- Sectoral mechanisms should be flexible to account for differing national circumstances and priorities;
- In discussing and developing sectoral approach policy and partnership options, key considerations include:
    a. Economy-wide implications, through supply and value chain sectoral linkages;
    b. Implications for imports and exports, trade and investment;

c. National circumstances and priorities in any international approach;
d. Avoiding competitiveness distortions through setting appropriate criteria for eligibility, and giving guidance on implementation.

- Economy-wide and trade implications should be assessed taking account of supply and value chain linkages:
  - Sectors often draw on the same pool of limited resources;
  - Changes in a sector may inhibit or enable change in other sectors.

Procedures to qualify any sectoral mechanisms should be rigorous, uniform, transparent and efficient. A number of critical issues concerning environmental and economic integrity, equity, inclusiveness and competitiveness must be resolved. Timing alone will pose challenges, because potentially hundreds of sectoral agreements would have to be initiated to include even a handful of sectors in the many nations that may wish to participate. Expectations should be realistic in terms of what sectoral mechanisms can deliver and over what time-frame as part of a post-2012 agreement.

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The International Chamber of Commerce (ICC)

ICC is the world business organization, a representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world.

The fundamental mission of ICC is to promote trade and investment across frontiers and help business corporations meet the challenges and opportunities of globalization. Its conviction that trade is a powerful force for peace and prosperity dates from the organization's origins early in the last century. The small group of far-sighted business leaders who founded ICC called themselves "the merchants of peace".

ICC has three main activities: rules-setting, dispute resolution and policy. Because its member companies and associations are themselves engaged in international business, ICC has unrivalled authority in making rules that govern the conduct of business across borders. Although these rules are voluntary, they are observed in countless thousands of transactions every day and have become part of the fabric of international trade.

ICC also provides essential services, foremost among them the ICC International Court of Arbitration, the world's leading arbitral institution. Another service is the World Chambers Federation, ICC's worldwide network of chambers of commerce, fostering interaction and exchange of chamber best practice.

Business leaders and experts drawn from the ICC membership establish the business stance on broad issues of trade and investment policy as well as on vital technical and sectoral subjects. These include financial services, information technologies, telecommunications, marketing ethics, the environment, transportation, competition law and intellectual property, among others.

ICC enjoys a close working relationship with the United Nations and other intergovernmental organizations, including the World Trade Organization, the G20 and the G8.

ICC was founded in 1919. Today it groups hundreds of thousands of member companies and associations from over 120 countries. National committees work with their members to address the concerns of business in their countries and convey to their governments the business views formulated by ICC.

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