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Opportunity knocks: business expectations for a global climate change agreement in 2009

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The conclusion of a comprehensive global climate change agreement to replace the Kyoto Protocol which expires in 2012 is essential. If well designed, it will ensure the long-term competitiveness of British business and unlock the potential of a low-carbon future. A robust agreement will create a market for low-carbon technologies that could be worth \$1 trillion in the first five years of its implementation.

Climate change is a global challenge which must be met through a global agreement that includes all major greenhouse gas emitting countries. Achieving a new deal will require leadership. The UK and EU have already displayed leadership and must continue to do so. Through its 2007 Climate Change Taskforce, the CBI has been a progressive business voice in the UK and is now seeking to work with other business associations to support an ambitious global agreement.

Businesses are already taking steps to reduce emissions. Throughout their operations and supply chains they are capitalising on low-carbon opportunities and investing in the technologies central to achieving global emissions reductions. Fully realising business potential to deliver low-carbon growth will require the correct policy measures at global and national level – such as emissions caps, trading schemes, and energy efficiency standards.

The Bali Roadmap established last December started a two-year negotiating process to reach an agreement in

Copenhagen in December 2009. Delivery at Copenhagen will require the urgent development of practical solutions in key areas such as emission reduction targets, financing mechanisms, and sectoral approaches. Business has an important role to play in the design and implementation of the agreement to ensure it complements and supports business action on climate change.

This brief sets out the CBI's high-level expectations for a post-2012 climate change agreement and its four sections represent our priorities within the negotiations:

- 1. Creating business opportunity by providing long-term confidence**
- 2. Improving and expanding market mechanisms to deliver efficient low-carbon growth**
- 3. Building a level playing field to enhance UK competitiveness**
- 4. Unlocking investment to deliver low-carbon innovation**

¹ CBI Climate Change Taskforce 2007, *Climate change: everyone's business*, available for download at www.cbi.org.uk/climatechange

1 Creating business opportunity by providing long-term confidence

Dangerous global climate change poses a major risk to UK business: evidence suggests that over time it would inflict damage to the UK economy of over £75bn annually. Scientists calculate that addressing this risk will require global action to limit greenhouse gas emissions to two tonnes per-person by 2050 compared to the present level of around six tonnes per-person (the current UK average is around ten tonnes).

While UK mitigation action is important, a comprehensive global framework of binding emissions reduction commitments will be essential to achieving this. It will enable businesses globally to methodically plan and implement the decarbonisation of their operations, and will provide a clear signal of an expanding market for low-carbon innovation. For example, it is projected that by 2050 the market for low-carbon energy generation could be worth \$3 trillion annually.²

The principle established within the global negotiations of common but different responsibility for global climate change is correct and fair. Historical polluters, such as the EU and US, should show leadership and adopt demanding targets. But, emissions from emerging economies, such as China, India, Brazil and South Africa are rapidly growing (see **Exhibit 1**), with these countries anticipated to account for around 70% of energy related carbon emissions by 2030.

A global agreement must therefore establish a deadline for emerging countries to adopt binding commitments. This would be supported by commitments to monitor and report emissions and adopt defined minimum standards or energy efficiency regulations. The clarity provided would grant international investors added certainty over climate change policies and enable them to invest in low-carbon growth in emerging countries.

2 Improving and expanding market mechanisms to deliver efficient low-carbon growth

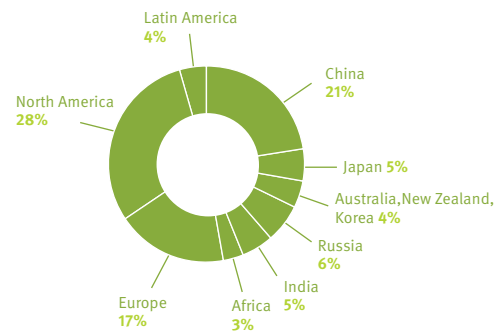
A global price for carbon must be a core objective of a post-2012 climate change agreement. There are two recognised policy mechanisms that can create this – cap and trade schemes or carbon taxes.

Cap and trade has several advantages over carbon taxes. It offers greater certainty over the level of emissions reductions to be achieved and provides these in the most cost-effective way possible. Cap and trade should therefore be established as the preferred mitigation instrument in major economies, and the new agreement should envisage linking trading schemes to create a global carbon market. The CBI will be conducting more work on the future of cap and trade in 2009.

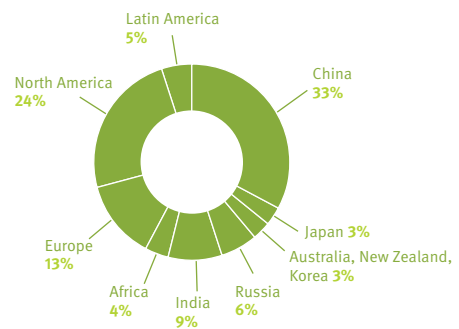
As well as maximising cost efficiency, expansion of carbon trading should ensure sufficient demand for carbon credits generated through the offset mechanisms created under the Kyoto Protocol. Currently there are two offsetting mechanisms, or market-based flexible mechanisms – the project based Clean Development Mechanism (CDM) and Joint

Exhibit 1 Change in sources of global greenhouse gas emissions

Current global greenhouse emission



Projected 2030 emissions (without GHG policies)



Source: IEA (2007)

Implementation (JI). Both allow businesses and governments in developed countries to fulfil their emission reduction commitments by purchasing carbon credits generated by projects that result in additional emission reductions elsewhere. In recent years these mechanisms have started to have an increased impact on global climate change efforts: over 1,000 projects have been registered by the CDM Executive Board with expected savings of 2.7 billion tonnes of CO₂e anticipated by 2012.³

This has helped contribute to rapid growth in the international carbon market. In the first nine months of 2008, \$22bn in credits was traded compared to \$10bn in the whole of 2005. This represents a major opportunity for the UK, and London has become the centre of the global carbon market. As **Exhibit 2** shows, the UK was the primary purchaser of 59% of CDM/JI credits in 2007,⁴ largely for onward international trading.

To ensure an adequate flow of finance to de-carbonise global growth and to succeed in making global carbon emissions reductions as cost-efficient as possible, CDM/JI must continue and improve in the post-2012 period. This could be achieved by:

² UK Department for environment, food and rural affairs 2008. *Building a low-carbon economy, unlocking innovation and skills*

³ UNFCCC. 2008

⁴ World Bank 2008, *The State and Trends of the Carbon Market*

- A Increasing the capacity and speed of the mechanisms and processes for creating, approving and regulating CDM/JI projects. There are currently around 2,000 CDM projects initiated which each face up to a two-year wait to pass through the registration process
- B Re-examining the scope of the project-based CDM to consider new sources of credits, such as carbon-capture and storage and avoided deforestation
- C Considering the expansion of the CDM towards a sectoral and/or a policy basis. This would reward installations or countries for achieving sectoral benchmarks, or reward countries for implementation of policies such as fuel efficiency standards, or deforestation measures
- D Ensuring all countries recognise the international approval process and avoid the regional determination of permissible credits.

3 Building a level playing field to enhance UK competitiveness

In the absence of a global price of carbon, the EU established an emissions trading scheme in 2005 (the EU ETS) which puts a cap on the carbon dioxide emissions from around 12,000 of the largest installations across the region. In a relatively small number of trade-exposed sectors these emission reductions can be undermined when industry in one country is forced to bear a carbon cost not faced by competitors elsewhere. This phenomenon, often described as carbon leakage, is a genuine threat in two ways:

- Environmentally, because if production and/or investment shifts to installations which are less energy efficient, global emissions will actually increase
- Economically, because even if emissions do not rise as a result of shifting production or investment, the effect will be to undermine the industrial base.

To effectively address this there should be free allocation of ETS allowances for industries shown to be exposed to carbon leakage after an evidence-based process.⁵ This should be recognised as compliant with the global agreement, and should persist unless and until it can be demonstrated that a global agreement places an equivalent carbon cost burden on the exposed sector's international competitors.

In addition, a level playing field should be advanced through the adoption by all developed countries of comparably challenging medium-term emission reduction targets. Likewise, participation for emerging economies whose emissions are rising quickly should be encouraged through agreements which seek to address emissions from carbon-intensive sectors of their economies, or so-called sectoral agreements.

Several potential options have been developed for such sectoral agreements (see **Exhibit 3**). One clear option for further consideration could be for sectoral agreements that include a handful of major emerging countries and cover a significant proportion of emissions in a given sector.

Exhibit 2 CDM Certified Emission Reductions (CER) supply 2012⁶

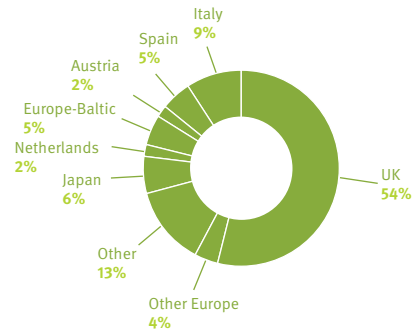


Exhibit 3: Sectoral agreements that have been raised within the policy discourse so far can be divided into four categories:

- 1 **Global, industry-led initiatives** in sectors such as cement, aluminium, and iron and steel have advantages in that they are global, but would require global buy-in and government involvement to form part of a global international agreement.
- 2 **Global sectoral agreements in aviation and marine bunker fuels** would bring sectors currently outside the Kyoto framework into global emissions reduction efforts. While that is to be welcomed, these industries must not be expected to shoulder a disproportionate burden and their specific characteristics should be taken into account.
- 3 **National sectoral approaches** would set targets for specific sectors in emerging countries, either on a binding or 'no-lose' basis, under which carbon credits would be generated by installations or whole sectors that produced emissions beneath a certain benchmark. Only a small number of agreements with emerging countries would have to be concluded to cover a significant proportion of emissions in certain sectors.
- 4 **Standards-based sectoral agreements** could enforce minimum standards for energy efficiency in sectors such as buildings, appliances or vehicles. Only a small number of agreements with emerging countries would have to be concluded to cover a significant proportion of emissions in specific sectors. Standards could also be incorporated in any of the above approaches.

5 As has been proposed in the Directive for Phase III of the EU Emissions Trading Scheme (an international agreement should recognise this as acceptable)

6 S J Fenhann et al. UNEP Risoe 2008, *UNEP CDM/JI Pipeline Analysis and Database*

This is achievable when we consider that India, China and South Africa between them are responsible for 80% of developing countries' emissions from coal-fired power, and that China, India and Russia represent around half of total global steel production (with production from those countries expected to grow eight to 10% annually). Such an approach would need to offer financial and technical support, establish common metrics and standards, and future binding targets for the sector, and if arranged in this way could play an important role in securing a new global agreement.

But for sectoral agreements to play a substantive role in a new agreement they will have to go beyond voluntary approaches by forming a part of governments' binding commitments. Consensus in this area must be developed soon for sectoral agreements to be able to play a key role. The CBI will work with government and other stakeholders to develop thinking on sectoral approaches.

4 Unlocking investment to deliver low-carbon innovation

Ambitious emissions targets and market mechanisms are vital elements of a new global agreement, but alone are not enough. Support for demonstration and deployment of pre-commercial low-carbon technologies – such as carbon capture and storage – is critical.

These technologies have a major role to play in emerging economies, notably China where coal-fired power stations dominate. As our recent innovation report, *Low-carbon innovation: developing technology for the future*,⁷ argued, the private sector will have a major role to play in making such technologies commercially viable, but needs to be supported by greater government investment in research, development, and deployment of families of key green technologies.

Globally, making these technologies commercially viable will require governments to provide substantial finance internationally, in a predictable manner, through mechanisms such as the World Bank Clean Technology Fund.

Protection of intellectual property rights is key to low-carbon collaboration. Business is already playing a leading role in creating low-carbon growth globally. But to be able to justify investing in the research and development of low-carbon technologies and to successfully deploy them through means such as cross-licensing agreements, consortia and joint ventures, intellectual property rights need to be properly enforced.

To maintain patent protection and improve business incentives, international discussions on technology transfer must be grounded in the experience of business in transferring technology. The CBI is ready to play a role in discussions about the nature of technology transfer, and in the design of mechanisms for its facilitation.

Finally, national political commitment and policy action will be central to delivery on the commitments made in a global climate change agreement. Domestic policies that empower consumers to take low-carbon choices and encourage energy efficiency in buildings, transport and industrial processes will be required. Many of these measures will also result in a quick positive financial return on investment for businesses and consumers through energy savings, and will improve energy security. A binding commitment from major emerging countries to enact such policies could significantly contribute to global emission reductions.

7 Available for download at www.cbi.org.uk/climatechange



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Climate change: everyone's business

The CBI climate change board: building a low-carbon economy

The CBI climate change board was set up in 2008 to deliver the commitments set out in the CBI 2007 climate change taskforce report *Climate change: everyone's business*. The report recognised that government, business and consumers all have a role to play in making the shift to a low-carbon economy. The board brings together senior business leaders from a range of sectors to demonstrate business commitment to managing the risk of climate change by:

- Promoting business-led policy solutions to realise carbon savings
- Showcasing business opportunities for green growth
- Leading by example on corporate commitments to manage carbon footprint
- Monitoring progress by government and business in realising the UK's carbon targets
- Influencing a post-2012 international climate change agreement.

[www.cbi.org.uk/climate change](http://www.cbi.org.uk/climatechange)