



CARBON PRICING PRINCIPLES

Prepared by the
ICC Commission on Environment and Energy

Carbon Pricing Principles¹

The Paris Agreement accommodates and encourages a broad range of national and local policy approaches in a novel form of bottom-up global architecture. **Carbon pricing instruments** are a policy option that a growing number of countries and regions are utilizing to implement new and complement existing 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 and preferred 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.

ICC is supportive of the notion that the Paris Agreement includes and enables market-oriented instruments through Article 6 of the Paris Agreement. Business welcomes Parties recognition at the UNFCCC twenty-first session of the Conference of the Parties (COP21) of the important role of providing incentives for emission reduction activities, including through the use of carbon pricing (paragraph 137 of COP21 decision). The Paris Agreement provides for market-oriented approaches and instruments to **continue to be an essential part of international climate policy, reflecting the global challenge of ambitious mitigation action.**

Business strongly supports the use of market based approaches under the Paris Agreement and the successful implementation of a new phase of emissions trading under the Convention. With only a few years left until the first period of Nationally Determined Contributions (NDCs) are to be implemented, **we urge parties to progress with guidance and adopt rules, modalities and procedures as determined in paragraph 7 of Article 6 of the Paris Agreement, ensuring linkages to transparency and avoidance of double counting.**

Many companies and sectors already have experience with carbon pricing instruments in public policy and regulation. 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 in order to incentivize energy efficiency and to help identifying risks and guide investment decisions.

Based on this range of experiences, ICC has developed the following **8 principles on carbon pricing**. We believe those should form an essential part of national and international approaches to climate change for the growing number of countries that decide to use carbon pricing instruments. 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 any shifting of emissions within sectors and between regions (carbon leakage);**
- **give companies a long-term framework and policy clarity to support their investment decisions.**

¹ 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.

The principles are aimed at helping policymakers to find a balance when implementing a carbon pricing instrument that achieves three 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;** and
- **allowing the continued efficient conduct of business.**

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

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 and other public policy or even eliminate its ability to deliver emission reductions.

2. PROMOTE CONSISTENCY BETWEEN CLIMATE AND ENERGY POLICIES

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 paying for a lesser environmental impact. 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 conflicts and do not negatively affect each other where possible.** In this respect, the IPCC's fifth assessment report WG3 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

Climate protection is a global challenge calling for global action. Costs and efforts should be fairly distributed between regions with consideration of 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 necessarily reduce global emissions and hence may **not have any net climate benefit.**

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. ICC promotes the use of **safeguards against carbon leakage** that ensure globally competitive industrial installations **do not bear financial burdens relating to carbon pricing, if in global comparison the installations do belong to the most efficient ones of their type.**

4. CREATE A CLEAR AND ROBUST TRANSPARENCY FRAMEWORK

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.** 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

Regardless of the 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 **the achievement of the following two objectives:**

- 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

A carbon pricing instrument should enable countries to eventually link their carbon pricing instruments together. **Linking carbon pricing instruments can lower the overall economic costs and for certain sectors reduce carbon leakage risks and competitive disadvantages.** At the same time, it can increase the economically viable options for mitigation actions in different regions. **In this respect, carbon pricing instruments should allow for the use of offsets especially such deriving from the implementation of Article 6 of the Paris Agreement.**

On the way to a more inclusive approach to carbon pricing and linked instruments every effort should be made to design and implement all carbon pricing mechanisms in line with international trade rules and avoid creating trade barriers.

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

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 with the optimum impact depends on how broad the range of segments of society and economic sectors are affected.** In general harmonization of instruments can be advantageous in regard to overall cost reduction. 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 can guarantee that a certain mitigation target is fulfilled, the exclusive use of a carbon tax will give an incentive for mitigation action too, but cannot guarantee the achievement of a certain emission reduction target.**

8. RE-INVEST CARBON PRICING REVENUES IN CLIMATE CHANGE MITIGATION AND ADAPTATION

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. The allocation of such revenues is an important element of a carbon pricing instrument. Revenues should be redirected to climate change mitigation and adaptation efforts and **governments should consider making commensurate reductions in other taxes so as not to increase the overall burden on business and citizens.** Additional issues to consider include: **providing compensation for trade exposed sectors, targeted rebates/support to low income families that face higher energy prices and support for research and innovation to accelerate the development of new low carbon technologies.** However, revenues from carbon pricing should not be used for general budgetary tasks that are not related to climate change as **the ideal effect of a carbon pricing instrument should be to make itself superfluous over time.**

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