

**UNICE DISCUSSION PAPER ON  
KEY PRINCIPLES FOR IMPLEMENTING EMISSIONS TRADING  
OF GREENHOUSE GAS EMISSIONS**

**SUMMARY**

This document is a contribution from UNICE to the debate on the emissions trading green paper, currently being prepared by the European Commission. UNICE believes that a multi-stakeholder debate on all these questions is very important, which is why we took the initiative of organising a multi-stakeholder workshop on 10 January 2000 as a contribution to the Commission green paper.

The principles proposed in this document can be summarised and grouped as follows:

- **Environmental delivery and credibility:**
  - means, not an end : emissions trading is one means to help achieve agreed goals
  - environment : trading must deliver, and be seen to deliver agreed objectives
  - targets : targets need to be set to be appropriate for the specific businesses
  - credible : only credible systems will build trust and be effective, so succeed
  - delivery : credibility will depend on transparent monitoring and verification
  - investment : substantial environmental delivery will come from investment
- **Economic efficiency:**
  - economic : trading must be allowed the flexibility to deliver at lowest cost
  - trading basis : trading must be allowed to include both sectors & companies
  - flexibility : artificial restrictions will undermine both economics & delivery
  - equity of allocation : different approaches can be used according to circumstances
  - transaction costs must be kept to a minimum to ensure lowest cost of delivery
  - fungibility : credits for all 3 mechanisms need to be equivalent and tradable
  - compatibility : all trading needs to become compatible with a global system
  - full credit : baselines and reference cases must be clear, to encourage early action
- **Learning by doing:**
  - simple : no system will be perfect; simple, pragmatic solutions will succeed
  - equity : equity derives from encouraging all, rather than perfect knowledge
  - transparency : workable systems need to be practical, simple & transparent
  - certainty : is needed to ensure business has confidence to make investments
  - inclusive : broad participation will lower cost and assure delivery of targets

- learning by doing : early action must be encouraged, and also be recognised

## **INTRODUCTION**

The Kyoto Protocol states in Article 17 that the 'Parties included in Annex B may participate in emissions trading for the purposes of fulfilling their commitments'. The definition of relevant principles, modalities, rules and guidelines, in particular for verification, reporting and accountability for trading will be defined by the Conference of Parties.

However, many countries are developing their own national emissions trading schemes and it is highly probable that these, together with bilateral trades, will be in place over the next two to three years. Indeed, some substantial bilateral and international trades have already taken place between individual companies.

Emissions trading can be defined as a process whereby legal entities, who have agreed with public authorities emissions targets over a period of time, can buy or sell emission units among themselves to achieve an emissions target. If trading is carried out effectively in an open market, this process will result in meeting the aggregate target at least cost. If properly designed a national or international trading system can accommodate credits from the Kyoto mechanisms. Trading systems at all levels, national and international, must be compatible, transparent and open.

## **CONTEXT**

Emissions trading can be one way of ensuring delivery of industry and other sector contributions to meeting the Kyoto commitments in the most cost-efficient way, usually linked to long term agreements or other commitments to meet emission targets.

This industry contribution on emissions trading will be developed as part of a wider set of initiatives aimed at tackling the broader challenge of promoting economically, socially and ecologically sustainable development.

Emissions trading should be open to all companies or industry sectors who have committed themselves to binding GHG targets.

The trading schemes should comprise 3 categories of participants trading in a common market place :

1. firms or industry sectors that have agreed with public authorities absolute emission targets (the "absolute" sector);
2. firms or industry sectors that have agreed with public authorities an output related emissions target (the "unit" sector), with scope to develop an effective mechanism to manage the interaction between the unit and absolute sectors, as proposed by CBI/ACBE;
3. firms that have agreed to specific GHG emission saving projects to meet targets.

Trading will be of credits derived from both assigned amounts and those generated from projects. The case for output-related emission targets will be made by some industry sectors as the most appropriate vehicle for their contribution to greenhouse gas control. For all industry sectors it is important that a global approach, taking account of international developments, is maintained in committing to and implementing Kyoto obligations, so that the competitiveness of European industry is safeguarded.

## PRINCIPLES

In order for any emissions trading system to be successful it must meet certain criteria:

**Environmental rationale** – the trading system must, and must be seen by all stakeholders, to be achieving a valid environmental objective. Trading is simply one helpful means to achieve targets.

**Economic rationale** – the trading system must, and must be seen by all stakeholders, to be a flexible and cost-effective way of achieving the environmental objective.

**Trading basis** – trading must be allowed to take place on a sector or company-to-company basis; in fact, for an effective trading regime, legal entities must be allowed to meet their commitments in this way. Trading should be in CO<sub>2</sub> equivalent units.

**Credible** – the system must be credible since only credible systems are effective and succeed. Hence, the administrative procedures must be adequate to ensure compliance with the climate change goals. There must be scope for an element of trust to be built, since in many cases pragmatic solutions to problems will be needed. Transparent monitoring and verification will enhance credibility.

**Simplicity** – simplicity is essential and deviations from simplicity should only be introduced when demonstrably necessary. Multitudes of academic and institutional studies, of ever increasing complexity, have been undertaken seeking illusory perfection. No system will be perfect, and good simple, pragmatic solutions will succeed where more complex ones will often fail.

**Equity** – without perfect knowledge (in which case there would be no need for trading) any system will be inequitable particularly during the early years. In a successful system there should be something for everyone. Since the valuation of companies and their investment policies have been based on certain explicit and implicit rights, it is important that any trading system does not introduce a step-change shock to the status-quo, but enables the desired objective to be achieved.

**Compatibility** – trading systems at all levels, national and global, must be compatible, transparent and open.

**Transparency** – the system must be transparent, so national and international confidence in the system can develop over time.

**Credit for past action** – the system must give credit for action already taken which have resulted in certifiable GHG reductions.

**Certainty** – in order to inspire business confidence, and to encourage innovation and investment, there must be a high degree of certainty, so that business is ready to invest. This means that allocation must take place as far into the future as possible, and that permits must have long validity.

**A broad system** – including as many sectors of the economy as possible will lower total costs and give high assurance that the Kyoto commitments are met by the system as a whole.

**Flexibility** – There must be no quantitative or qualitative restrictions or limits, individually or collectively, on use of the market mechanisms.

**Eligibility** – Allow reductions and mitigation of emissions from all sources – all greenhouse gas sources must be eligible for inclusion in all mechanisms.

**Sinks** – Sinks and land-use, land-use change and forestry projects must be included in all mechanisms, with sound definition of how emission credits can be generated.

**Full credit** – Baselines/reference cases used to calculate greenhouse gas reductions and avoided emissions from projects must be clear, must provide full credit, and must not preclude any source.

**Learning by doing** – A basic framework for the market mechanisms should be determined quickly to ensure early action. This can then be further developed through a process of ‘learning by doing’ rather than seeking perfect design from the beginning.

**Transaction costs** – Transaction costs must be minimised, and all market mechanisms must be consistent with and promote sound business transactions.

**Fungibility** – Credits associated with the market mechanisms – certified emissions reductions (CER), emission reduction units (ERU) and emissions trading units – must all be tradable and convertible.

**Measurement, monitoring and verification, and reporting** – There must be transparent, accurate and cost-effective measurement, monitoring and verification, and reporting in order to ensure the environmental credibility of credits generated from projects and allocated assigned amounts.

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