

# UNICE

THE VOICE OF BUSINESS IN EUROPE

## EU STRATEGY RESPONDING TO CLIMATE CHANGE



UNICE input ahead of COP 6 at The Hague, November 2000

### Headlines messages:

- European business and industry has already demonstrated its commitment to significantly reduce greenhouse gas emissions through initiatives and agreements.
- The EU needs to agree how the Kyoto protocol can be implemented effectively and efficiently before committing to ratification and implementation. A unilateral European implementation ahead of its major trading partners would be damaging to the competitiveness of European industry.
- The Kyoto mechanisms can help meet commitments most cost-effectively, so helping to protect the competitiveness of European business and industry. The environmental effectiveness and the economic efficiency of the Kyoto mechanisms will depend on establishing open and transparent global markets.
- Engaging developing countries in the process of responding to climate change must be a prime objective at COP 6.
- European business and industry needs COP 6 to set a clear basis for climate change policies and measures to be integrated with its business strategies.

## UNICE MAIN MESSAGES:

- The European Union strategy responding to climate change should be implemented in a framework aiming to achieve balanced and sustainable economic growth within an overall Community sustainable development strategy.
- At The Hague, the EU needs to agree with the other parties in the UNFCCC process how the Kyoto protocol can be implemented effectively and efficiently, before it commits itself to ratification and undertakes implementation of its commitments.
- To ensure environmental effectiveness, and to protect the competitiveness of its business and industry, the EU should ratify and implement the Kyoto protocol in step with its major trading partners.
- Engaging non-Annex B parties in the process of responding to climate change must be a prime objective, to ensure there will be an environmentally effective response.
- European business and industry is already acting to control its greenhouse gas emissions through company and sectoral initiatives, and long term agreements.
- Initiatives and agreements are UNICE's first choice of instruments to respond to climate change. The Kyoto mechanisms can help meet targets agreed in this way.
- The Kyoto mechanisms can help EU Member States and companies to meet their commitments in the most efficient and cost-effective way, so helping to ensure the environmental effectiveness of the protocol, whilst protecting the competitiveness of European business and industry.
- Both the environmental effectiveness and the economic efficiency of the Kyoto mechanisms will depend on establishing open and transparent global markets, with equivalent emission reduction units being fully tradable between all three of the mechanisms, and without artificial or arbitrary constraints being placed on trading.
- Emissions trading by companies should be encouraged on a voluntary basis, since the lowest cost to reduce emissions will come from encouraging trading on the widest possible basis, that will also ensure greater liquidity and price transparency.
- Project-based mechanisms of Joint Implementation and the Clean Development Mechanism (CDM) need to have minimum transaction costs, to encourage sound projects, with parallel rules for both mechanisms that allow trading of emission reduction units, and the encouragement of the early start of both of these project mechanisms.

## UNICE VIEWS ON POLICY ISSUES

### Policies and Measures for an Integrated Approach:

- Meeting targets for reducing greenhouse gas emissions will require a range of policies & measures to be used in an integrated approach, including long term agreements with business & industry, and the use of all three Kyoto mechanisms.
- Key criteria to test policies & measures should be: environmental effect, cost-effectiveness, flexibility, transparency, equity, avoiding market distortion, and respecting the principle of subsidiarity when applying the policies & measures.
- Long-term agreements are business & industry's first choice, combining early and cost-effective action with flexibility, so helping to protect competitiveness. They should become an essential component of EU response strategy, with incentives offered to encourage business & industry to deliver early emission reductions.
- Long term agreements and the mechanisms can be complementary, with scope for the mechanisms to add confidence that these agreements will meet commitments.
- Agreed targets should be treated as equally committing regardless of how they have been set.
- If well designed, with sound rules, the Kyoto mechanisms have the potential to become effective global market instruments, and can become key components of how EU Member States should be able to meet their targets most cost-effectively.
- Business & industry should be involved in helping to design and implement all three mechanisms, since it has the expertise to ensure global markets will work.



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## Implementing the Kyoto Protocol:

- **Monitoring:**

Sound and consistent monitoring of greenhouse gas emissions is an essential basis for equitable treatment of companies in the European single market, and for protecting the competitiveness of European companies in a global market. It is also essential for providing a sound basis for trading using the mechanisms. Existing monitoring structures should be used wherever possible to help keep the administrative burden to a minimum.

- **Compliance:**

Similarly, a fundamental requirement for trading is an effective international compliance regime. An effective compliance regime will be simple, predictable, transparent and equitable. Then markets will be able to take account of risks associated with compliance issues, incorporating these risks in traded values. An acid test of a compliance regime is the extent that it minimises uncertainty of the validity of emission reduction units traded in good faith. **Seller liability** is consistent with the need to minimise uncertainties, and reduce the risks of trading. Buyer liability would lead to great caution in buyers, and discounted values traded.

- **Who can trade:**

Trading by companies should be encouraged on a voluntary basis, provided they accept targets, and domestic monitoring and compliance regimes. The lowest cost of compliance will result from trading on

the widest possible basis and the greatest flexibility. Encouraging companies to trade through brokers in independent markets will help ensure price transparency and sufficient liquidity that is needed to underpin the integrity of emission reduction unit trading.

- **Compatibility of tradable units:**

For a smooth transition to global trading of emission reduction units compatible between the three Kyoto mechanisms, from the domestic trading schemes that will be the first to start, it is necessary to ensure that the tradable unit is a tonne of carbon dioxide equivalent in all cases. This will enable separate trading schemes to converge towards a consistent global approach.

- **Land use and land use change, including forestry (sinks):**

Since nearly 30% of the carbon accumulated in the atmosphere in the period 1850 to 1990 came from changes in use of land, so including sound 'sink' projects within emissions targets is an important opportunity to reverse this trend. Similarly, including such projects within the scope of the CDM will be particularly important for the least developed economies, whilst encouraging carbon accounting procedures for the use of land, based on full carbon accounting, including above and below ground biomass, soils, trees and wood products.

## Emissions Trading:

- **'Supplemental to domestic action':**

The 'supplemental' principle in the protocol is consistent with the way an industrial company will approach meeting emissions targets, preferring to invest to improve both efficiency and global competitiveness. While the preferred way to meet targets is by investing to reduce emissions directly, trading should allow crucial flexibility for a company both to phase its investment and to supplement its own efforts. So, business & industry has a keen interest in ensuring that trading is not compromised by signals of inflexibility such as the EU 'concrete ceiling' proposal. The issue of 'hot air' in the first Kyoto budget period should be addressed directly, without using damaging quantitative

ceilings on trading. The way forward is to agree rules that will encourage sound trading, and, at the same time, ensure the integrity of the protocol is maintained.

- **Proposed levy on Emissions Trading, and Joint Implementation projects:**

There are proposals to extend to Emissions Trading transactions and Joint Implementation projects the kind of levy that provides for a share of the proceeds from certified CDM projects. It would be a mistake to seek to protect the CDM in this way, which would increase both the transaction costs and the overall cost of emissions abatement in Annex B parties in a way that would damage progress.

## Project Mechanisms: Clean Development Mechanism and Joint Implementation (JI)

- **Proposals to restrict the types of projects & technology eligible for the CDM:**

Proposals to restrict the CDM initially to 'a positive list of safe, environmentally sound projects', based on renewable energy, energy efficiency improvements and demand side management, would be too limiting, even to get the CDM started. We believe that there are many environmentally sound opportunities to reduce greenhouse gas emissions using technologies that would not be included here. To restrict eligibility for the CDM to a narrow range of projects would be likely to discourage innovation in seeking to transfer environmentally sound technology. The appropriate test of a CDM project is that it will contribute to the sustainable development of the host country, whilst being compatible with national priorities.

- **Project baselines:**

The prime test of a project baseline should be environmental additionality. Financial additionality would be unworkable, and undermines the concept of the CDM as encouraging the private sector to invest in technology transfer projects, and the sustainable development of less developed economies. To ensure environmental integrity, project baselines are best set for companies on a 'case-by-case' basis. A CDM project must result in 'reductions that are additional to any that would occur in the absence of the certified project activity'. To construct a 'business as usual' baseline as the level of emissions that would have occurred in the absence of a project is both arbitrary and hypothetical. What

are needed are practical operational guidelines that will deliver transparent, consistent and measurable emission reductions. A benchmarking approach may be helpful in encouraging an early start for the CDM by reducing initial transaction costs.

- **Consistency between Joint Implementation and the CDM:**

Both JI and the CDM are project-based mechanisms, but they have important differences that should be reflected in their methodologies and controls. JI is an allowance-based system, with assigned amounts included in the host country's emissions ceiling. Any uncertainty in the project baseline is automatically adjusted, since transfer of assigned amounts in the JI transaction does not lead to increased global emissions. In contrast the CDM is credit-based, relative to an agreed baseline, in a country with no emissions ceiling. The integrity of certified emission reduction units from a CDM project will depend on transparency and third party scrutiny for credibility of baseline, and verification and certification of project emission reduction units. Therefore, good governance of the CDM will require stricter controls than for JI. JI must not be burdened with the same rules and approval processes as the CDM. But, needs of some Annex B parties for clean technology transfer and sustainable development are just as pressing as for the less developed economies, and so there should be similar consideration of how to encourage the early start of JI projects.

# KEY UNICE PRINCIPLES FOR IMPLEMENTING EMISSIONS TRADING OF GREENHOUSE GAS EMISSIONS

## ● 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

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- the official voice of European Business and Industry vis-à-vis the EU institutions
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