



THE PRINCE OF WALES'S

CORPORATE LEADERS GROUP ON CLIMATE CHANGE
UNIVERSITY OF CAMBRIDGE PROGRAMME FOR SUSTAINABILITY LEADERSHIP

The Carbon Price Communiqué **Frequently Asked Questions**

Questions:

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1. Why are businesses making this statement?

The scientific and economic evidence for the need to address the global challenge of climate change remains clear.ⁱ The International Energy Agency (IEA) has shown that CO₂ emissions in 2010 were the highest on record, and are still rising.ⁱⁱ If we do not act now, climate change risks seriously undermining future global prosperity and inflicting significant social, economic and environmental costs on the world. A significant group of international business leaders have repeatedly stepped up to alert the world through the Corporate Climate Communiqués, that we cannot afford to ignore the undeniable impact of climate change on global populations, natural resources, the economy, and on their businesses.ⁱⁱⁱ Businesses can make changes within their own operations, but to unlock the scale of action required across the economy by both the public and private sectors, governments need to introduce a strong policy framework. A key part of this policy framework needs to include a mechanism which places a price on carbon across the economy.

2. What is the scale of the required action and why?

In previous Communiqués, business leaders have consistently pointed to the need for stabilising global warming to less than 2°C.^{iv} This is the target that has been agreed by governments in multilateral fora including the UN Conference of the Parties in Cancún in 2010 and by the G8 in Italy in 2009. Science predicts that, even at a global average temperature rise of 2°C above pre-industrial levels, there are likely



to be severe impacts to many regions of the world, with some low-lying islands becoming completely uninhabitable.^v Above this level, the chances of a completely unstable climate increase.

While some commentators and scientists say 2°C is still too high, and negotiators continue to focus on it as the goal, evidence is mounting that the window for achieving even this is rapidly closing.^{vi} A growing number of scientists and organisations are now projecting much more pessimistic temperature scenarios, with organisations like the International Energy Association beginning to include 4°C and 6°C scenarios in their analyses.^{vii} This level of warming could wreak havoc with our climate, increase extreme weather events, and raise sea levels dramatically, along with all the damage to livelihoods, infrastructure and the economy this would bring. It is because of this growing urgency to act now that business leaders are reiterating their support for ambitious and pro-business policies to mitigate these impacts.

3. Why should anyone take notice of these Communiqués?

If we do not act, climate change risks seriously undermining future global prosperity and inflicting significant social, economic and environmental costs on the world. The global business Communiqués on climate change, authored by The Prince of Wales's Corporate Leaders Group on Climate Change (CLG) and supported by hundreds of world-leading companies, have increasingly set the agenda for the business response to climate change. They have established that a global big business constituency exists for a strong international policy framework on climate change.

Alongside governments and citizens, business has a major role to play in the transition to a low-carbon economy: it is the private sector that will innovate and invest in the new technologies and systems that will form the foundation of this new economy. It is also the voice of business at the table, supporting and influencing the design of the policy responses and institutional architecture, which will make this transition happen, as much as it is the voice of business which can undermine any action.

Policymakers are increasingly calling for support from business in this arena to help them build the necessary consensus for action, and to counteract the loud voices pushing for 'business as usual'. The Carbon Price Communiqué intends to step into this space, and serve as a call from the international business community to introduce a clear, transparent and robust price on carbon in the global economy.

4. Why focus on the carbon price?

The Carbon Price Communiqué is the first in a new series of Communiqués focusing on specific climate policy questions. It states that putting a clear, transparent and unambiguous price on carbon emissions must be a core policy objective, as part of a broader policy framework. It does not state that carbon pricing is a silver bullet, rather that it is a fundamental part of a comprehensive policy framework. This should also include policies to support, for example, climate resilience, low carbon technology and innovation support, resource efficiency, and behaviour change. Future Communiqués will be based on subjects such as these.

The Carbon Price Communiqué builds on and retains the ambition and the commitment to a comprehensive policy framework of previous Communiqués. The CLG will continue to push governments to deliver on the whole of this framework, but will focus on particular areas as the debate moves on.

5. What is carbon pricing?

Climate change can be seen as a market failure.^{viii} As a result of human economic activity, there is an increase in carbon dioxide and other greenhouse gases in the atmosphere, which has led to global warming. While it may be difficult to predict the precise long-term effect of this warming, this trend will impose a cost imposed on future generations. This cost is currently not reflected in the price of goods and services which have contributed to this warming; it is an externality.

The aim of a carbon price is to amend this market failure and to stimulate the market to differentiate between goods and services based on their carbon footprint. A carbon pricing framework should ensure this cost is transparently passed on into goods and services –making high-carbon goods less competitive, and incentivising investment in low-carbon energy generation, manufacturing and transport. If created with sufficient ambition, a carbon price allows the market to choose the most cost-effective route for greenhouse gas emission reductions, and causes the trillions of dollars of private sector investment spent in energy to be diverted from high-carbon emission to low-carbon emission options. Governments can also use the revenue raised by a carbon price to stimulate new technological innovation or to mitigate any unintended consequences.^{ix}

A range of policy instruments can facilitate carbon pricing, both directly and indirectly. Direct carbon price mechanisms include carbon taxes, cap-and-trade, emission reduction credits and project-based mechanisms like the Clean Development Mechanism. Indirect methods include clean energy, emission performance and efficiency standards, and reductions in fossil fuel subsidies. Not all methods provide additional revenue for governments.

6. What should the carbon price be?

There is much debate about what the carbon price needs to be in order to generate the necessary investment. Each carbon pricing mechanism has a different method for setting this price. In a cap-and-trade system, the market determines the price, with the system parameters creating the conditions for a price to be determined. According to international institutions such as the World Business Council on Sustainable Development and the International Energy Association, in the absence of technology breakthroughs in the longer-term, a global carbon price needs to be in the range of US\$100–200 per ton of CO₂ to have a substantial impact.^x

7. Won't a carbon price undercut competitiveness?

The short answer to this is no, not if it is global. In the interim, there are certainly challenges and trade-offs, but these can be managed for most sectors. In the implementation of any meaningful climate policy instrument, there will be the potential increases in the cost of consuming energy which could adversely affect the competitiveness of energy-intensive industries. 'Carbon leakage' may actually be relatively modest, because a majority of the emissions in industrialised countries occur in non-traded sectors such as electricity, transportation, and residential buildings. However, energy-intensive manufacturing industries which produce goods or services competing in international markets, particularly international transport

services like aviation and shipping, may face incentives to relocate and to advocate against such climate change policies.

These impacts can be managed, for example through tax credits or temporary exemption thresholds in a carbon tax system, or through allocating free allowances in an emissions trading scheme. In fact, research suggests that during Phase II of the European Emissions Trading Scheme (EU ETS), the size of the allocations of these free allowances to carbon-intensive industries has potentially given them a competitive advantage, with these industrial sectors accruing major stores of carbon credits.^{xi} This, of course, undermines the carbon price. Lessons can be learnt from by future governments to ensure both that these sectors are not unduly undermined, and that the system does generate the necessary change. Also, longer-term evaluations of the impacts of energy prices on markets have found that higher prices have induced more innovation – measured by frequency and importance of patents – and increased the commercial availability of more energy-efficient products, especially among energy-intensive goods.^{xii} This innovation allows these sectors to increase market share in low-carbon goods and services, and increases their competitiveness.

Ultimately, international cooperation and coordination is vital. However, ensuring that national plans are transparent and are designed with future compatibility will facilitate a global solution, which is the better option for business in the long run.

8. My company isn't an energy producer or energy intensive - why would we want to be part of this debate?

An unstable climate system will impact all sectors. The energy system underpins all parts of the economy and is the primary place where emissions need to be tackled. To ensure a cost-effective transition to a low-carbon economy, a clear and robust price on carbon is critical. This will ensure that the necessary investment in low-carbon energy generation and distribution takes place at the necessary scale. This price will circulate throughout the economy and, as a result, be embedded across all products and services. By working with the market, a carbon pricing mechanism allows the market to choose the most cost-efficient route to decreasing emissions.^{xiii}

Working with the market in this way is better for business in both the short and long term. Companies across all sectors can support the pro-business rationale of this approach, even if they do not engage directly with the detail of how it is implemented.

9. Is the message relevant to the UNFCCC negotiations?

Any effective deal must have at its heart measures to cut carbon emissions. Business voices have consistently advocated measures that work with the market, such as a carbon price. Parties to the UNFCCC agreed at the COP17 meeting in Durban in 2011 to launch a new round of discussions aimed at forming an agreement in 2015 that will apply to all countries, including major emitters.^{xiv} Any such agreement should include proposals able to deliver large-scale mitigation, and incentivise private investment. The signatories to The Carbon Price Communiqué believe that a carbon price, combined with other appropriate policies, is the most cost-effective way to deliver this. A shift would be required in the negotiations for this to be reflected in any 2015 agreement.

Under the 'Durban Platform for Enhanced Action' which emerged from COP17, negotiators will work to define new market mechanisms under a successor treaty to the Kyoto Protocol; but they have, as of yet, not developed the necessary regulatory framework. Business leaders are increasingly becoming concerned that without clarity, the international carbon market will fragment. This will lead to different approaches in different locations, raising the cost of compliance and making things harder for businesses.

10. Does the message impact the priorities for national government action?

The UNFCCC remains the only legitimate forum for a truly global deal on climate change, which is essential for a clear and cost-effective response to climate change. However, it is the nature of international negotiations that the scope for agreement is constrained by the domestic political realities of each of the 192 countries engaged in the process. For action to take off at a global level, it needs significant national backing and implementation.

There is a rapidly growing list of countries, large and small, rich and poor, which are implementing a carbon pricing mechanism. Cap-and-trade systems for greenhouse gases are in place or under development in the European Union, Switzerland, Australia, New Zealand, South Korea, California, the north-eastern United States, and several Canadian provinces. Carbon taxation is in place in the UK, Denmark, Finland, Ireland, Norway, Sweden, the Netherlands, Switzerland, Japan and Canada – and is in the final stages of development in South Africa. China has announced that it will introduce emissions trading progressively, with trials having started in a number of key cities and provinces including Beijing, Shanghai and Guangdong (covering over 200 million people).^{xv} There are also an increasing number of cities and countries developing and trialling mandatory and voluntary trading schemes.

There are currently 16 countries implementing the World Bank's Partnership for Market Readiness forum, in which countries explore new market instruments for greenhouse gas reductions and receive capacity building and financial support to 'ready' their markets for carbon pricing.^{xvi}

11. If national action is taking place, what role is there for international cooperation?

The Kyoto Protocol remains the driver of the current global carbon market. There is potential for lessons from Kyoto to be applied to any new market mechanism which attempts to balance supply and demand. To ensure a level playing field for business, signatories of The Carbon Price Communiqué believe a global carbon pricing framework would be ideal. And while political momentum favours a bottom-up approach between nations, ultimately the international dialogue will need to focus on this long-term aim.

Linking existing and planned carbon pricing systems will help to reduce long-term abatement costs and reduce the overall cost of achieving a given global emissions target.^{xvii} It may also serve as an effective mechanism for building institutional and political structures to support a future climate agreement.^{xviii}

It is also within the international arena that greater action can be triggered and ambition increased. The Communiqué has been written to create support for this increased ambition and to create momentum both nationally and internationally for carbon pricing as a key foundation to any policy response to climate change. It is applicable both within the international fora and within national debates – to support increased ambition in places which already have a carbon price and to support its implementation in places where it is still being explored.

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- ⁱⁱⁱ This has been a consistent message found in The Prince of Wales's Corporate Leaders Group Communiqués, the series can be found here: <http://www.cpsl.cam.ac.uk/Business-Platforms/The-Prince-of-Wales-Corporate-Leaders-Group-on-Climate-Change/Communiques.aspx> (accessed 20 November 2012).
- ^{iv} The Prince of Wales's Corporate Leaders Group on Climate Change. Cambridge Programme for Sustainability Leadership. "2°C Challenge Communiqué." www.2degreecomunique.com (accessed 20 November 2012).
- ^v IPCC AR4
- ^{vi} UNEP (2011). *Bridging the Emissions Gap*. http://www.unep.org/pdf/UNEP_bridging_gap.pdf (accessed 20 November 2012).
- ^{vii} See International Energy Agency (2011) *World Energy Outlook 2011*. <http://www.worldenergyoutlook.org/publications/weo-2011/> (accessed 20 November 2012). and PWC (2012). *Too Late for Two Degrees?* http://www.pwc.com/en_GX/gx/low-carbon-economy-index/assets/pwc-low-carbon-economy-index-2012.pdf (accessed 20 November 2012).
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