

POSITIONING ON CARBON PRICING MECHANISMS IN BRAZIL – 2016

It is widely known that climate change and its effects are among the greatest challenges facing humanity this century. At COP 21 an international effort was established to ensure that global temperature increase does not exceed 2°C, with a more ambitious target of 1.5°C. The World Resources Institute¹ estimates that annual investment of US\$ 5.7 trillion is needed through until 2020 to promote the transition to a low carbon economy in various sectors. The signatories of this document believe that it is urgent and necessary to establish a carbon pricing methodology that is appropriate to Brazil's economic characteristics and greenhouse gas emission (GHG) profile to incentivise investments in processes with low carbon intensity and ensure Brazilian competitiveness. Furthermore, the document in question also aims to promote the engagement of Brazilian companies in the debate and to communicate to the government the vision and willingness of companies to contribute to the advancement of the pricing agenda in Brazil.

By internalising the cost of carbon in value chains, pricing mechanisms highlight less carbon intensive alternatives for companies, the government and society, thereby stimulating innovation and low carbon practices and technologies and helping to engage consumers.

Given the current context in Brazil a carbon pricing mechanism can be an efficient and effective alternative to encourage the reduction of greenhouse gas emissions and promote economic growth in the country, depending on the model adopted by Brazil. The signatories to this letter believe that the adoption of a carbon pricing mechanism is a key political measure in the global effort to limit temperature rise.

We place ourselves at your disposal to support the implementation of a carbon pricing mechanism in Brazil, through whatever means necessary. We believe that this implementation should:

- Take place through a gradual and interactive process, with a clear long-term perspective and without setbacks, i.e., by guiding businesses to make investment decisions - including in long-term assets - that opt for technologies that are less emissions intensive;
- Include a permanent communication channel with interested economic and social actors: public and business sectors, academic institutions and organized civil society;
- Be based upon the review of the economic instruments in vogue, since significant progress can be achieved through review of the current fiscal and tax structure with the aim of exonerating products and processes that are less intensive in emissions;
- Cover the majority of national emissions, regulating the least amount of sources possible, so that the sectors with lower emissions, as well as small and medium businesses, are not considered;

¹ Source: World Resources Institute, available at <http://www.wri.org/our-work/project/climate-finance>

² We wish to highlight tax neutrality as an important point for consideration in any pricing arrangement for Brazil, with the aim of preventing an increased tax burden on taxpayers.

- Analyze, with other interested parties, the most appropriate combination of instruments for the country, considering the sources and composition of national emissions and the context and dynamics of the Brazilian economy, aiming to provide **tax neutrality**² in the mechanism; avoid negative impacts on the competitiveness of the sectors³ covered by the pricing mechanism and ensure a long-term price signal. This combination of instruments should:

- » Prioritise market-based pricing instruments such as emissions trading schemes (ETS)⁴, which are more efficient economically and allow international integration with other schemes, making them even more cost-effective;

- » Strive for alignment so as to avoid overlaps between the instruments in the mechanism, ensuring that each regulated sector is covered exclusively by one instrument;

- » Incorporate recognition for past efforts at reducing emissions by regulated companies into the structure, in addition to the potential impacts on competitiveness;

- » Evaluate ways to prevent potential carbon leakage as a result of differences in regulatory frameworks between the states of the Federation.

Therefore, we propose to the government to:

- 1) Lead the process of structuring a consistent carbon pricing strategy in the country, with the involvement of the diverse interested parties;

- 2) Identify shortcomings in the implementation of this strategy and define a plan of action for their resolution. In particular we propose that special attention be devoted to the information system from the outset, including a basis for measurement, reporting and verification (MRV) of GHG emissions by source⁵ and accurate economic data;

- 3) Adopt policies and measures within the public sector that are consistent with the objective of offering a price signal for carbon to the economy as a whole, e.g. assume a value for GHG emissions in public organizations that will guide investments in infrastructure; and consider the carbon intensity per unit of production in sustainable procurement processes, initially only for certain economic sectors with the greatest capacities and potential to reduce related emissions, protecting micro and small businesses;

- 4) Analyze existing taxes that could be used as positive incentives⁶ in the transition to a low carbon economy and to compensate the sectors with the highest abatement costs and/or with the highest risks of loss of competitiveness;

- 5) Concomitantly to the implementation of a carbon pricing mechanism, harmonize the taxes, incentives and subsidies in place to ensure consistency in the signals offered to economic agents and avoid the overlapping of instruments that affect the same sectors and emissions sources. Ensure that the instruments to be adopted for carbon pricing are integrated with existing policies by means of a review of the apparatus in place, in order to suppress contradictory signals;

³ Analysis of the sector would be an important next step in this process, so as to ensure that more efficient sectors are not disadvantaged in any way and receive proportional recognition. We should also highlight the unique position of the financial sector and the important role it can play by ascertaining the emissions from its lines of business and investment. By understanding the portfolio's exposure with respect to GHG emissions investment decisions will be better informed

⁴ Market instruments may consist of taxes and fees. These instruments can be effective for long-term price signalling by including price stability mechanisms, such as a minimum price and market stability reserve. For more information, visit the rules and parameters of the EPC ETS: <http://mediadrawer.gvces.com.br/epc/original/sce-epc-2016-regras-e-parametrosj.pdf>

6) Commit to a schedule that includes the structuring of the carbon pricing strategy in Brazil by the end of 2018 and its implementation from early 2020;

7) Promote international cooperation by strengthening ties with other jurisdictions with carbon pricing mechanisms in place, especially in the Americas, paying attention to the possibilities of aligning rules and parameters between the ETSs with a view to integration between the schemes;

8) Disseminate widely – at a national and global level – the policies and initiatives to implement carbon pricing mechanisms and endorse them in international negotiations to adopt a global mechanism.

As leading companies in this process, we propose to:

- Individually evaluate the adoption of baselines⁷ for carbon emissions from business processes. Whenever possible, monitor and adjust such values;
- Collaborate with other companies, especially within our own value chain, through the dissemination of good practice, exchange of experiences and partnerships so that these companies can also engage in the debate on carbon pricing mechanisms;
- Publicly report our initiatives for the advancement of the carbon pricing agenda whenever possible and stimulate cooperation throughout the business sector, while also contributing to the collaboration with other sectors;
- Act as spokespersons for the environmental, social and economic benefits of carbon pricing mechanisms and the positive potential that engagement in the low-carbon economy holds for Brazil.

IEC is grateful for Carbon Pricing Leadership Coalition’s support and participation in developing its carbon pricing statement.

⁵ “Elementos para um Mercado de Carbono no Brasil” (“Elements for a Carbon Market in Brazil”) (GVces, 2013), Volume I - MRV and Volume II - Sistema Nacional de Relato (National Reporting System).

⁶ “Incentivos Positivos e Programas de Relato de Emissões de Gases de Efeito Estufa” (“Positive Incentives and Reporting Programs for Greenhouse Gas Emissions”) (GVces, 2015).

⁷ The adoption of baselines occurs through internal prices for emission of greenhouse gases.