

## **Policy Proposals on Carbon Tax and Emissions Trading Scheme**

**We urge the Japanese government to specify an appropriately-designed carbon tax mechanism and emissions trading scheme (ETS), and ensure that citizens are well informed about the purpose and benefits of carbon pricing.**

We, Japan Climate Leaders' Partnership (JCLP), recognize that an effective carbon pricing scheme is an indispensable means to avert a climate crisis. We would thus like to contribute to the Japanese government's ongoing discussions on carbon pricing with the following proposals.

### **Background:**

**1. The 1.5°C target must be achieved in order to protect the social infrastructure essential to our lives and business activities.**

Extreme weather events and catastrophic disasters triggered by a rise in temperature are already threatening our lives and significantly impacting our economies.<sup>1</sup> A failure to stop climate change from worsening would undermine the very foundation of our society such as infrastructure, financial systems and public health, and would hinder economic growth.<sup>2</sup> To protect our lives and business activities from devastating climate disruption, we must meet the 1.5°C target set out in the Paris Agreement.

**2. Meeting the 2030 GHG emissions reduction target is crucial for the achievement of the 1.5°C target. Swift, society-wide behavior change is required toward 2030.**

As global temperature is determined by cumulative net carbon emissions, achieving the 1.5°C target requires a significant cut in GHG emissions by 2030.<sup>3</sup> This prompted Prime Minister Yoshihide Suga to pledge that Japan will "reduce GHG emissions by 46% from the 2013 levels by 2030 and continue its efforts to meet the lofty goal of 50% reduction". With limited time remaining, immediate action must be taken by the whole of society.

**3. Emissions reduction needs to be done efficiently to minimize the cost borne by society.**

We must avoid aggravating the country's fiscal health and passing on the burden to future generations. To this end, emissions reduction must be pursued in a cost-efficient manner.

**4. An effective way to bring about society-wide behavior change and minimize the overall cost of emissions reduction is to introduce an explicit carbon price through a carbon tax mechanism and an emissions trading scheme (ETS).**

Carbon taxes and ETS are called "explicit" carbon pricing, with a price set per ton of carbon emissions. Advantages of explicit carbon pricing are as follows:

- The cost competitiveness of carbon-intensive products and services will diminish, which generates a strong incentive for businesses to provide low-carbon products and services. Dissemination of such products and services accelerates society-wide emissions reduction.
- The comparability between the cost of emissions and the cost of emissions reduction improves. This in turn encourages emitters to choose reduction measures that are more economical than

continuing to emit carbon. In addition, emitters are incentivized to employ the most cost-efficient measures, which will help minimize the overall cost of emissions reduction borne by society.

**5. Voluntary carbon credits and internal carbon pricing alone will not bring about society-wide behavior change or minimize the overall cost of emission reductions.**

Carbon emissions aggravate climate change and cause various losses to society, as indicated above. A fair scheme which ensures that emitters take responsibility for these losses by paying for their emissions is essential. If such responsibility is not widely recognized and fulfilled, society-wide behavior change will be difficult to achieve.

Voluntary measures like carbon credits are practiced only by a small group of companies that are actively working to reduce emissions and willing to pay for additional costs. While beneficial to some degree, such voluntary measures alone are not sufficient to raise awareness of the fact that emissions incur societal costs, and they also fall short of ensuring fairness in terms of allocation of responsibility for losses. Voluntary credits also make it difficult to compare the cost of emissions and the cost of emissions reduction, reducing the overall cost-efficiency of mitigation efforts.

**6. An appropriately-designed carbon tax and ETS will lead to economic growth.**

The pledge by Prime Minister Suga has spurred a flow of goods, investments, and human resource toward the development of zero-carbon products and services. In order to ensure successful commercialization and mass production of these products and services, the market design needs to be suitably adjusted by introducing a carbon tax and ETS.

Implementation of an explicit carbon pricing scheme will send a signal that the price competitiveness of zero-carbon products and services will be sustained in the Japanese market, which will in turn encourage companies to engage actively in research and development, increase capital spending, and attract green investment.<sup>4,5</sup> The quality and price competitiveness of zero-carbon products and services will likely improve as a result, creating a positive feedback loop of increased demand for those products and services. It should be noted that expert analyses presented to a carbon pricing committee set up by the Ministry of the Environment also demonstrate that a carbon tax and ETS are conducive to economic growth, when designed appropriately.<sup>6,7</sup>

**7. A delay in introducing an effective carbon pricing scheme may threaten the global competitiveness of Japanese companies and reduce the attractiveness of Japan as an industrial location.**

A growing number of global companies are emphasizing the ability to comply with their net zero emissions policy as a key element of supplier selection criteria. Other stakeholders — institutional investors, shareholders, clients and employees — are also putting increased scrutiny on corporate decarbonization efforts.<sup>8,9</sup> Delays in emissions reduction are beginning to have an impact on corporate values.<sup>10,11</sup>

Sourcing of renewable energy is a particularly pressing issue. Renewable energy has seen a huge expansion and has become the cheapest source of electricity in many parts of the world. Failing to speed up the expansion of renewables with effective carbon pricing schemes like a carbon tax or emissions trading may weaken the global competitiveness of Japanese companies and reduce the attractiveness of Japan as an industrial location.<sup>12,13</sup>

Furthermore, more and more countries are considering implementing a carbon tax and ETS, as well

as carbon border adjustment mechanisms. An explicit carbon price needs to be introduced at a globally acceptable level in Japan, in order to prevent a levy on Japanese exports.

**Proposals:**

- **We call for specific discussions on the design and timeframe for a carbon tax and ETS. We request that ministries work together to present a framework for carbon tax by the end of the year.**

For the aforementioned reasons, implementation of a carbon tax and ETS is a matter of urgency. Thus, we call on the government to immediately start more specific discussions on the design and timeframe for such mechanisms. We propose that priority should be put on carbon tax and ministries cooperate to draw up a framework by the end of this year, ahead of an ETS which is more complex to design.

- **Discussions on carbon pricing need to consider “just transition”. How carbon pricing can be designed to reduce the burden on SMEs and low-income groups should actively be discussed.**

When introducing carbon taxes and emissions trading, it is necessary to prevent excessive burden on SMEs and low-income groups so that “just transition” is achieved. The government committee members have proposed multiple measures to reduce this burden, including beneficial use of carbon tax revenues as well as to ensure various policy mixes.<sup>14,15</sup> We urge the government to hold forward-looking discussions as to what policy design can mitigate the risks of increasing burdens on the vulnerable, instead of shying away from difficult conversations.

- **We call on the government to ensure the public has access to clear and comprehensive information on the purpose and benefits of carbon pricing**

Carbon pricing is a policy tool with a major impact on society. To gain and maintain support for the policy, it is essential that the government effectively communicates the purpose and benefits of carbon pricing to the public. We, JCLP, also commit to strengthening our own efforts to convey the importance of carbon pricing to a wider audience.

End

## References

- <sup>1</sup> Between 2000 and 2018, heat-related mortality in people older than 65 years increased 53.7% compared with the previous 20-year period. 296,000 deaths were reported in 2018 alone. Most of the deaths occurred in Japan, eastern China, northern India and central Europe. (Source: Nick Watts MA et al. [“The 2020 report of The Lancet Countdown on health and climate change: responding to converging crises”](#) (December 2, 2020))

Heavy rains in July 2018 costed 1.22 trillion yen while the damages caused by Typhoon Hagibis in 2019 reached 1.88 trillion yen. The overall financial loss from flooding in 2019 hit a record-high. (Source: Ministry of Land, Infrastructure, Transport and Tourism [“令和元年東日本台風の発生した令和元年の水害被害額が統計開始以来最大に～令和元年の水害被害額（確報値）を公表～\[Release of 2019 Flood Damage Status \(final version\)\]”](#) (March 31, 2021, available only in Japanese))

For more examples of the impacts of climate change, please refer to [JCLP’s proposals on Japan’s Energy Mix](#) (October, 2020).

- <sup>2</sup> If the temperature rise reaches 3°C or higher above the pre-industrial levels, the world’s GDP could be up to 25% lower by 2100 due to the impacts of higher sea levels, food insecurity, more frequent natural disasters, and heatwaves. (Source: G30 Working Group on Climate Change and Finance [“Mainstreaming the Transition to a Net-Zero Economy”](#) (October, 2020))

The Bank for International Settlements (BIS) warns of risks of financial crisis triggered by climate change. (Source: BIS [“The green swan: Central banking and financial stability in the age of climate change”](#) (January, 2020))

According to Swiss Re, 11 to 14 % of the world’s GDP will be lost by 2050 in the BAU scenario. If more robust mitigation efforts are made, the loss can be reduced to 4%. (Source: Swiss Re Institute [“The economics of climate change: no action not an option”](#) (April, 2021))

- <sup>3</sup> The Intergovernmental Panel on Climate Change (IPCC) indicates in [the special report on the impacts of global warming of 1.5°C](#) that in order to achieve the 1.5°C target, CO<sub>2</sub> emissions must be reduced by 45% from the 2010 levels by 2030. The report also states that GHG emissions need to be reduced by 39-51% from the 2010 levels by 2030 in no or limited overshoot scenarios (interquartile range).

- <sup>4</sup> Since the Paris Agreement, sustainable finance has been more widely practiced globally with Europe taking a lead. The size of the market has reached \$30.7 trillion in 2018 (30% of all investment). (Source: The 1<sup>st</sup> meeting of the Committee on Transition Finance, the Ministry of Economy, Trade and Industry, Document 4 [“トランジション・ファイナンスを巡る動向 \[Current Trends in Transition Finance\]”](#) (January 27, 2021, available only in Japanese))

- <sup>5</sup> World Bank has signaled the potential of explicit carbon pricing to drive investment. (Source: World Bank [“Report of the High-Level Commission on Carbon Pricing and Competitiveness”](#) (September 21, 2019))

- <sup>6</sup> Researchers conducted analyses on the impacts of hypothetical on carbon prices on CO<sub>2</sub> emissions, GDP, and other macroeconomic indicators, and presented the results at the 16<sup>th</sup> meeting of the Sub-Committee on Carbon Pricing under the Central Environment Council, the Ministry of the Environment.

- <sup>7</sup> A number of countries have managed to improve carbon productivity and GDP per capita to the levels that surpass Japan, while raising carbon prices. Also, cases have been reported where carbon pricing schemes have been successfully utilized to decouple of economic growth from carbon emissions.

- (Source: The Sub-Committee on Carbon Pricing under the Global Environment Committee of the Central Environment Council, the Ministry of the Environment “[『カーボンプライシングのあり方に関する検討会』取りまとめ \[Report by the Sub-Committee of Carbon Pricing\]](#)” (March, 2018, available only in Japanese))
- <sup>8</sup> Through Deloitte’s survey of 750 business executives in 13 countries, the following factors were identified as motivations for them to increase environmental sustainability efforts in the future: investor and shareholder demands (38%), increased societal and employee activism (35%), direct negative impact to our business operations or finances (31%). (Source: Deloitte Touche Tohmatsu “[2021 Climate Check: Business’ Views on Environmental Sustainability](#)” (April, 2021))
- <sup>9</sup> The Nikkei “[投資家、企業に脱炭素迫る 総会で三菱 UFJ・住商に要求 \[Investors increase pressure on companies to decarbonize. Mitsubishi UFJ and Sumitomo Corp were demanded action at their AGM\]](#)” (June 29, 2021, available only in Japanese)
- The Nikkei “[ESG 圧力強める機関投資家 投資引き揚げ、業種に広がり \[Institutional Investors increase pressure for ESG. A broader set of sectors are now subject to divestment\]](#)” (July 5, 2021, available only in Japanese)
- <sup>10</sup> As ESG finance expands, an increasing number of global corporations are adopting reporting measures such as TCFD, and setting targets such as SBT and RE100. (Source: the Ministry of the Environment “[企業の脱炭素経営の取組状況 \[Overview of Corporate Activities on Decarbonization\]](#)” (accessed on July 27, 2021. Available only in Japanese))
- <sup>11</sup> The Nikkei “[GX の衝撃 \(1\) 4700 兆円が迫る経営転換 \[Impact of Green Transformation 1: The 4700 trillion yen pressure to reorganize business\]](#)” (July 5, 2021, available only in Japanese)
- <sup>12</sup> The 1<sup>st</sup> meeting of the Experts Panel on Climate Change hosted by the Cabinet Secretariat, Document 7 presented by Ms. Kurosaki of Bloomberg NEF “[世界の脱炭素変化とスピード 経済対策としての脱炭素 \[Change and speed in global decarbonization\]](#)” (March 31, 2021, available only in Japanese)
- <sup>13</sup> The European Union Emissions Trading System (EU-ETS) allocates at least 50% of the auction revenues to climate change and energy related measures. The largest portion of the 2013-2015 revenues was allocated to renewable energy development assistance. (Source: The Institute for Global Environmental Strategies “[欧州連合域内排出量取引制度の解説 \[Commentary on the European Union Emissions Trading System\]](#)” (March 2019, available only in Japanese))
- <sup>14</sup> The Sub-Committee on Carbon Pricing under the Global Environment Committee of the Central Environment Council, the Ministry of the Environment, “[カーボンプライシングの活用の可能性に関する議論の中間的な整理 \[Intermediate Report on the Discussion on the Potential of Carbon Pricing\]](#)” (August, 2019, available only in Japanese)
- <sup>15</sup> The 16<sup>th</sup> meeting of the Sub-Committee on Carbon Pricing under the Global Environment Committee of the Central Environment Council, the Ministry of the Environment, Document 3 “[中間整理 \(素案\) \[Draft Intermediate Report\]](#)” (June 21, 2021, available only in Japanese)

**Japan Climate Leaders' Partnership (JCLP):**

JCLP is a coalition of businesses in Japan (189 companies as of July 2021) that aim to create a carbon neutral society, built on the idea that decarbonization is essential to economic development. The group's total sales are 144.8 trillion JPY (1.3 trillion USD) and electricity demand together amounts to approx. 60 TWh. It was set up in 2009 to encourage the business sector to develop a sound sense of urgency on climate action. Since April 2017, JCLP has been the Climate Group's Regional Delivery Partner on RE100, EP100 and EV100 initiatives in Japan.

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