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Climate change convergence? The potential for global collaboration following China's momentous announcement

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With the election of Joe Biden, it is widely expected that the US will reengage with the international community in the fight against climate change and in efforts to reduce overall emissions. Indeed, President Elect Biden has pledged to rejoin the Paris Agreement on his first day in office and has named former Secretary of State John Kerry special envoy to lead the Biden Administration's efforts to fight climate change.

This development is one part of the turn among world leaders toward addressing climate change. Indeed, in September 2020, President Xi Jinping of China pledged in his address to the UN General Assembly that his country will achieve carbon neutrality by 2060.

This momentous announcement challenges the rest of the world, including countries that have been making progress (such as those in the EU) and those that have not (such as the US), to join a global effort to convert commitments into decisive action to address climate change.

These actions are expected to include:

- alignment of climate disclosure and investment standards;

- coordination and linkage of emission trading systems that could help set appropriate global carbon pricing; and
- reformulation of international trade policies to incorporate carbon border tax.

Since China's announcement, other countries have made similar commitments.

Japan and South Korea have recently followed the EU in pledging to achieve net zero carbon emissions by 2050.

A group of countries including France, the UK, Sweden, Denmark, Hungary and New Zealand have already made such commitments in law.

Under the Trump Administration, however, the US withdrew from the 2015 Paris Agreement and rolled back policies and regulations designed to reduce carbon emissions in the US. This will now be reversed when President Elect Biden takes office and will add impetus both nationally and internationally to the stated aims of the Paris Agreement.

The ultimate goal of the Paris Agreement is to limit global warming this century to "well below" 2ºC above pre-industrial levels and to pursue efforts to limit temperature increase to 1.5ºC. This is expected to be achieved through a bottom-up approach in which 197 signatory nations set individual commitments to reduce emissions. These commitments, known as "Nationally Determined Contributions" (NDCs), are guided by the Paris Agreement's goal of limiting warming to 1.5ºC by the end of the century. China's commitment to carbon neutrality puts additional pressure on the US and other large emitters to set aggressive NDCs and to accelerate action to ensure compliance with such NDCs.

The growth story of the next 30 years will come from products, services and markets in resource efficiency, resilience and zero carbon energy sources. Investment and financial services will play a decisive role in allocating capital and resources to generate returns and long-term value.

A change of direction in the US

The incoming administration of President Elect Biden is expected to reengage with the international community on climate change early to support a new round of international actions. Biden has committed to reenrolling the US in the Paris Agreement on his first day in office and to adopt a wide array of climate-oriented executive orders and policies to reduce emissions.

Biden has identified climate action as a top priority for the US and has pledged a US$2 trillion plan to cut emissions. Broad national policies and programs oriented towards renewable energy and away from fossil fuels are also expected from the Biden administration.

These policies and orders are also expected to target publicly traded companies, and efforts to require robust climate and ESG-related disclosure are expected in the form of regulations and guidance documents from the US Securities and Exchange Commission in the first year of the Biden presidency.

Biden has also said he will, on the first day of his administration, sign an executive order requiring public companies to disclose climate change-related financial risks and greenhouse gas emissions in their operations.

China's climate strategy

China has demonstrated it can move fast if required. In 2017, the People's Bank of China was part of a group of eight members that established the Central Bank and Supervisors Network for Greening the Financial System (NGFS), which now has over 70 members.

Recently, the Federal Reserve has indicated it may join the NGFS. The NGFS is focused on greening the financial system, but there is also urgent need to finance more green and sustainable assets. Two months on from President Xi's announcement, the first details of China's carbon neutrality policies are beginning to emerge, including in relation to finance.

In October 2020, in clear display of national coordination, which involved key ministries, commissions, regulatory bodies and the Bank of China, the government published *The Guiding Opinions on Promoting Climate Change Financing*. This is a first set of principles for the promotion of financing activities to both mitigate the effects of and adapt to climate change.

It sets a framework for the development and coordination of climate investment standards, including standards for information disclosure and climate performance. It also includes policies supporting Chinese financial institutions and enterprises on climate change financing overseas, as well as helping foreign institutional investors take part in green bonds and investments in green RMB assets.

China's carbon neutrality pledge raises interesting questions about how existing and planned projects under its Belt and Road Initiative may need to be revised to pivot away from fossil fuels and give greater emphasis on renewable energy, to make the initiative more environmentally sustainable.

Towards alignment in standards

Harmonised green and sustainable investment standards are also essential in ensuring international coordination to achieve the Paris Agreement goals. Investors have been consistently calling for such standardisation.

So far, the EU has led the way, but there is now optimism that alignment between the EU, China and the US can deliver real and sustainable emissions reductions. The diverse set of stakeholders in the financial sector also appears to be aligned.

Standard-setter NGOs, rating agencies, stock exchanges, auditors, publicly listed entities, banks, institutional investors, and regulators are all working towards harmonisation of climate and sustainability-related standards.

The combination of these efforts and greater engagement by some of the world's largest and most powerful nations and trading blocs could result in a more integrated and consistent approach over time. And it could encourage outlier countries (such as Russia and Brazil) to revisit their climate priorities and make coordinated action more likely on a global scale.

Recently, the Sustainability Accounting Standards Board (SASB), the Global Reporting Initiative (GRI), the Climate Disclosure Standards Board (CDSB), the Climate Disclosure Project (CDP) and International Integrated Reporting Council (IIRC) proposed collaborating to form the building blocks of a set of metrics on global non-financial reporting.

Since the publication of that proposal, SASB and IIRC said they will merge to form Value Reporting Foundation. As further evidence of the consolidation of the corporate reporting market, CDSB has indicated interest in integrating with the Value Reporting Foundation.

Rating entities such as Moody's and MSCI have recently bought specialised data analytic firms to enhance their ability in this area. Moody's acquired 427 and VE, and MSCI acquired carbon delta.

Further, the IFRS Foundation issued a consultation paper on sustainability reporting. It proposes a Sustainability Standards Board under the governance structure of the IFRS Foundation to develop global sustainability standards. The goal of the SSB would be to develop and maintain a global set of sustainability reporting standards, initially focused on climate-related risks.

International collaboration and coordination by reporting bodies, governments, regulators and other stakeholders is essential to achieve further convergence. Now that China, the US, and the EU are more aligned, harmonisation of climate disclosure and reporting standards becomes more achievable than at any time in the past.

Price on carbon

Climate ambition is also now an essential element of international trade negotiations. Carbon pricing and carbon border adjustment mechanisms are important tools for accelerating the implementation of climate mitigation and levelling the playing field.

Countries with carbon pricing mechanisms and ambitious climate goals are increasingly seeking to avoid carbon leakage, where companies relocate to countries with lower pollution costs.

By making access to some of the world's largest markets subject to a carbon tax, countries with weak climate policies would be pressured to determine low carbon ways to remain competitive.

Coordination and collaboration between China, the US and the EU on carbon pricing would mark a new era in climate action.

The effectiveness of any carbon emission trading system (ETS) depends on setting the appropriate carbon price to encourage industries to invest in carbon neutral sectors. So coordinating the linkage of numerous domestic trading systems and achieving a global carbon price will enhance the efficacy of the ETS in incentivising the private sector to reduce carbon emissions and invest in low carbon technology.

The EU, with the world's largest carbon market, expects to expand and reform its ETS in line with its increased ambition of carbon neutrality, by including more sectors and curbing free permits given to EU industries to compete with overseas companies that do not pay a carbon price.

China is expected to launch its own ETS as early as next year, and this system likely will become the world's largest, covering several billion tons of carbon each year. In the US, the Regional Greenhouse Gas Initiative is attracting new entrants and encouraging other states, and groups of states, to develop their own carbon pricing initiatives.

To preserve its competitiveness in light of more ambitious targets, the EU proposes adopting a carbon border adjustment mechanism. The goal is to ensure the price of imports reflects more accurately their carbon content so domestic producers can operate on a level playing field with their competitors.

China, the US and the EU could lead the effort to formulate new World Trade Organization rules and revise existing ones to create a consistent framework for countries to incorporate carbon border tax into trade policies. This would help them achieve their Paris Agreement commitments and ensure appropriate protection for domestic companies in international trade.

Cumulative impact

It appears international commitments to reduce emissions and to achieve carbon neutrality, led by China, the EU and US, are now more likely to drive meaningful national and international efforts to combat climate change.

The United Nations Climate Change Conference (COP 26) in December 2021 in Glasgow provides a forum for countries to announce real and meaningful progress in addressing climate change on a global scale.

When coupled with trade and enforceable disclosure requirements, it is likely governmental and private actors will push to achieve the Paris Agreement's emission reduction goals.

The challenge for China and the US (and other countries) is whether they can set aside political and economic differences, overcome national political hurdles and play a collaborative role in leading the international community to translate commitments and pledges into action.

Some have suggested this may give rise to "green competition" that could pressure some of the largest emitters to give greater priority to address climate change; but a global problem requires holistic, collaborative solutions, not competition. Among the many other lessons, the global COVID-19 pandemic has reminded us that global action is needed to combat global phenomena, and there is none more pressing than climate change.

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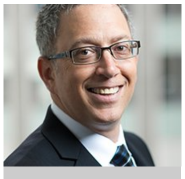

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