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POLICY BRIEF #5

Public policy instruments to promote private sector climate action: experiences from Latin America and the Caribbean.

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Private sector action is essential to decarbonize the economy and increase resilience, in line with the goals of the Paris Agreement. Public policies are the framework in which these private efforts happen, as they set forth the rules of the game and send investment signals. For this reason, having a clear and coherent policy framework is key to the effectiveness and efficiency of private climate action, for the achievement of both country and corporate goals.

The Community of Practice on Public-Private Articulation on Climate Action in Latin America (ArticuLAC) brings together representatives of government and private sector institutions from thirteen Euroclima Programme countries, who participate in dialogue, exchange and capacity building activities, with the aim of promoting greater articulation of climate strategies and actions in both sectors.

In this context, during the second half of 2022, a discussion group was organized to focus on public policy instruments to promote private sector climate action. This group held three working sessions, focusing on different instruments used in the region: carbon taxes, voluntary emissions reporting and sustainable public procurement. In addition, other sessions of the Community of Practice addressed concepts and experiences on carbon markets.

This document presents a summary of the main elements of the above-mentioned instruments and experiences of application in Latin American countries. Bibliographic references are also provided to further learn about these instruments.

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Carbon pricing mechanisms

Governments can use carbon price mechanisms to set a price for greenhouse gas (GHG) emissions, mainly carbon dioxide (CO2), aiming to promote such emissions by incorporating environmental costs in the price of the goods and services produced (UNPD, 2022).

There are two main types of policy instruments for carbon price setting: **carbon taxes and emission trading systems (ETS).** In the first one, price is set directly by means of a tax rate. In the latter, maximum emission limits are established for certain industries and companies that are allowed to buy and sell emission allowances; thus, carbon price is set by the market (UNPD, 2022).

Using one or the other to set the carbon price in a particular country depends on the local circumstances, since each one bears advantages and disadvantages. In terms of impact, the use of taxes gives certainty to the price, but not to the results in terms of reducing emissions; whereas, in ETS, the level of emissions to be achieved is certain, but not the price. Tax application can be more cost effective, but may face a greater opposition; market mechanisms, on the other hand, may be more attractive for the private sector, but they are complex and their management requires more resources (PMR, 2017). The next pages present the main elements for both instruments and the progress in their application in Latin America.

Carbon taxes

Carbon taxes set a price for GHG emissions by levying a flat rate tax on each ton of CO2 emitted by a product or process. This provides an incentive for those paying the tax to reduce their emissions in order to reduce their tax obligations, either through more efficient practices, the use of cleaner fuels or, in the case of consumers, by changing their habits, taking into account the need for this type of tax to be progressive and designed to reduce socioeconomic gaps. Furthermore, the government generates additional revenue. In some cases, taxpayers may have the option to reduce them, for example, by purchasing offsets or entering into agreements with other parties to reduce emissions (PMR, 2017).

Table 1. Carbon taxes in Latin America

National and subnational jurisdictions	CO_2 Taxes	Tax Base	Starting year	Tax rate (USD/TON CO_2e)	National Coverage (%GHG)
Argentina	Tax on Fuel, Carbon Content. Law 23.966 under Title III	Purchase/sale of fossil fuels; all sectors, except biofuels	2018	1 - 10 (2019-2028)	40
Colombia	Tax on Fuel, Carbon Content. Art. 221 of Law 1819, December, 2016.	Purchase/sale of fossil fuels; all fuels, except coal Note: coal was included after a 2022 reform	2017	5-10	16
Chile	Tax on Emissions. Art. 8 of Law 20.780 and its subsequent simplification Law 20.899	Emission in boilers/turbines (>50 MW); all sectors and fossil fuels, except biomass	2017	5	42
Mexico	Tax on Fuel, Carbon Content.	Purchase/sale of fossil fuels; all fuels, except gas	2014	1-4	30

Source: Romero, G. (2022) presentation for the Community of Practice ArticuLAC

This taxes apply to a wide range of products and services, including oil, natural gas and coal production, as well as vehicle and industrial use. At a subnational level, some Mexican states have implemented more limited taxes on the production and consumption of fossil fuels, where the funds collected are used in programs to reduce the environmental impact defined by the State Government. (García et al., 2021).

Emission trading systems

Emission Trading Systems (ETS) are an alternative for carbon price setting, in which the government sets a cap on the amount of emissions that a regulated sector can generate during a compliance period (usually one year), and issues an equivalent amount of allowances to be distributed or sold among regulated entities, which can be traded among participants: those generating less emissions than allocated can sell “excess” allowances and those who exceed their allocation can buy allowances to meet their obligations. The ultimate objective of this instrument is to bring about changes in technologies and in the behavior of agents (producers, consumers and investors) in order to reduce GHG emissions (Romero, 2022).

In Latin America, the most advanced country in this field is Mexico, whose General Law on Climate Change passed in 2012 and laid the groundwork for the creation of a carbon market in the country. Since then, with the support of several partners, the rules and mechanisms for the operation of the market have been developed and a pilot phase was implemented, which ended in 2022 (see table 1). On the other hand, the Ministry of Environment of Panama officially launched the “National Carbon Market Roadmap” in January 2023. In Colombia, the National Commission on the Promotion and Development of Carbon Markets was created in 2022 by means of government resolution.

There are also international regulated markets, which are associated with the fulfillment of commitments before the United Nations Framework Convention on Climate Change (UNFCCC): the one arising from Clean Development Mechanism under the Kyoto Protocol and those currently being developed under the framework of Article 6 of the Paris Agreement, which allows direct cooperation (6.2) and emission allowance exchange (6.4) between countries, for the fulfillment of the mitigation targets set forth by the Nationally Determined Contributions (NDCs).

In addition to regulated or mandatory carbon markets, there are voluntary carbon markets that trade carbon certificates or credits that companies and other organizations use to fulfill their emission reduction voluntary commitments, within the framework of their environmental responsibility. In this case, standards are used to verify the removal of or avoided emissions represented in carbon credits, such as Gold Standard, Voluntary Carbon Market (VCM), Verra or the ones from the Clean Development Mechanism.

The Latin-American region is the second largest supplier of voluntary carbon credits in the world, with almost 20 % of the total credit supply worldwide; having Peru, Brazil and Colombia as the largest credit contributors in the region - which represents over 80% (71 MtCO2e) -, followed by Uruguay and Guatemala. Most recent credits come from projects related to nature and renewable energy based solutions (ICAP and IETA,2021).

The increase of emission trading spaces, regulated and voluntary, regional, national, subnational and international, whose rules are still being developed, poses the challenge to governments and other actors of ensuring coherence between mechanisms, as well as the environmental integrity of the traded credits and the prevention of double counting. This is key to the credibility of the systems and the achievement of national and global climate goals.

Colombia

In Colombia, the national carbon tax was created in 2016 and took effect on January 1st, 2017. This tax is levied on the carbon content of all fossil fuels, including petroleum derivatives and all types of fossil gas used for energy purposes, provided that they are used for combustion (coal is not included). The revenue collected from this tax is allocated to activities and projects related to sustainable development. In 2019, approximately USD 131.7 million were collected; in 2020, USD 82.8 million; and in 2021, USD 84.8 (January 2022 estimate). In accordance with the applicable legislation, the tax is not levied on natural or legal entities subject to a carbon neutral certification payment, i.e. those that offset all GHG emissions generated by the use of fossil fuels on which the national carbon tax is levied. With the option for regulated entities to use the non-taxation mechanism instead of paying the carbon tax, the demand for certified emission reductions has increased, boosting the voluntary carbon market and generating experiences that will serve as a basis for the preparation of a future Emissions Trading System (ETS) in the country.

Source: adapted from MéxiCO2, 2022. **Technical note:** Carbon Tax in Colombia.

Voluntary GHG reporting program

Voluntary greenhouse gases (GHG) reporting systems are programs in which companies and organizations can voluntarily report their GHG emissions to a government body or an accredited private organization. These systems intend to provide information regarding GHG emissions and promote their reduction.

Usually, the carbon footprint (CF=reporting programs are driven by the ministries in charge of climate policy, in alliance with other climate action actors. This programs usually include a reporting guide, an emission calculation tool and, in some cases, a verification process to ensure the accuracy of the information they report. Additionally, awards are given to participating companies and organizations based on the fulfillment of certain criteria.

Table 2 summarizes key points of the national GHG voluntary reporting programs in Chile, Costa Rica, Ecuador, Peru, the Dominican Republic and Panama, which were presented by ArticuLAC members in a discussion session held on the matter.

Table 2: Main characteristics of the national GHG voluntary reporting programs in selected countries.

Name of the program, Country	What kind of organizations do the reporting?	Are awards/certifications granted?	Web site and other references
Huella Chile	• Public and private companies • Municipalities	Grants the following seals: • Quantification • Reduction • Neutralization • Excellence in management	https://huellachile.mma.gob.cl/
Programa país carbono neutralidad (PPCN), Costa Rica	• Organizations (companies, government institutions, educational centers) • Municipalities (cantones) • Products and events	5 award categories: • Inventory • Reduction • Reduction + • Carbon Neutral • Carbon Neutral +	https://cambioclimatico.go.cr/programa-pais-carbono-neutralidad/
Programa Ecuador Carbono Cero (PECC)	Organizations of the country's productive and service sectors, with scopes: • Product • Organizational	3 levels: • CF Quantification • Certification of CF Reduction • Certification CF Neutrality	https://carbononeutral.com.ec/programa-ecuador-carbono-cero/
Huella de Carbono Perú	Public and private organizations	• 4 levels or stars according to: • (1) You measure • (2) You verify • (3) You reduce • (4) You compensate	https://huellacarbonoperu.minam.gob.pe/huellaperu/
RDuce tu huella, República Dominicana	Public and private organizations	No, for the time being it is a free calculation tool	https://empresasporelclima.empresassosteniblesrd.org/
Reduce tu Huella (RTH)	Public, private and civil society organizations	5 types of awards: • (1) CF Inventory • (2) CF Inventory plus • (3) CF Reduction • (4) CF Compensation • (5) CF Neutrality	https://rth.miambiente.gob.pa/

Source: own elaboration based on information provided by members of ArticuLAC

In addition to the programs included in Table 2, there are similar initiatives in several countries in the region, which have benefited from the experience exchange between countries and the technical assistance from international cooperation partners, such as the United Nations Development Program (UNDP), who has developed a Guide for the implementation of GHG voluntary reporting programs.

The ArticuLAC discussions identified, among others, the challenge of getting more companies to join these programs, which involves communicating the benefits to the participating organizations in an appropriate manner. Furthermore, there is a need to articulate the reports the companies make within this framework with the Monitoring, Reporting and Verification (MRV) systems.

Sustainable public procurement

In addition to the programs directly designed to promote climate action of the private sector and other actors in terms of climate change mitigation and adaptation, the government can strengthen the signals to the private sector by including climate action criteria in other economic, environmental and social policy instruments. As an example, the Community of Practice discussed the potential sustainable public procurement systems have to strengthen climate policy.

Sustainable public procurement systems leverage the government's purchasing power, which can stimulate, through public spending, a better performance of the private sector in the three axes of sustainability. These systems seek to promote sustainable practices through government procurement, adopting practices that give preference to environmentally and socially friendly products and services. Considering the transparency requirements of government activity, these elements must be included in the regulations, processes and criteria governing state institutional procurement.

The following are some examples of State procurement systems in the region that include sustainability criteria:

- Green Procurement, Brazil
- Institutional Procurement System, Mexico
- Sustainable Procurement System, Colombia
- National Sustainable Procurement Program, Peru
- Green Procurement System, Argentina
- Sustainable Procurement, Chile
- Sustainable Procurement Program, Uruguay
- Green Government Procurement, Costa Rica

The systems in Peru, Paraguay and Chile are supported by legal mandates and include some verification mechanisms. The rest of the countries mentioned offer public procurement portals with varying degrees of development, mainly informative.

Some of the barriers that have been identified for the establishment of sustainable procurement policies and programs are: lack of legislation, the difficulty to identify the impacts of the procurement, lack of information, insufficient supply of sustainable goods and services, and the perception that these are more expensive than conventional ones (Beláustegui, 2011). The ArticuLAC discussions also identified the need for better articulation of public procurement systems with climate policy, to include criteria related to mitigation and adaptation efforts, and thus promote compliance with national climate goals.

The challenge of policy coherence and public-private articulation

This document has briefly presented some policy instruments available to the governments to promote changes in the actions of businesses, consumers and other stakeholders to meet their countries' climate and development goals. The need to pay attention to two particular elements when designing and implementing these instruments became evident in the discussions that led to the elaboration of this document:

- Coherence and coordination between the authorities in charge of climate, economic, fiscal and other policies; so that policy signals, regulations and incentives are consistently aimed at low-emission resilient development.
- Dialogue and articulation with private actors that are subject to these policies and regulations, as well as other actors interested in the whole process of design, discussion and implementation.

This is consistent with the approach and learnings of the work of AricuLAC and its members, which targets the need to promote and strengthen spaces for dialogue and articulation between different actors, seeking to ensure the effectiveness and feasibility of public policy measures and the realization of co-benefits.

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