

Comments on the presentation by Mr. Nakai
"Growth-oriented Carbon Pricing Concept"

Study Group on “The Political Economy of Carbon Pricing and Green Finance :
Comparing the EU and Japanese Discourses and Policy Approaches“

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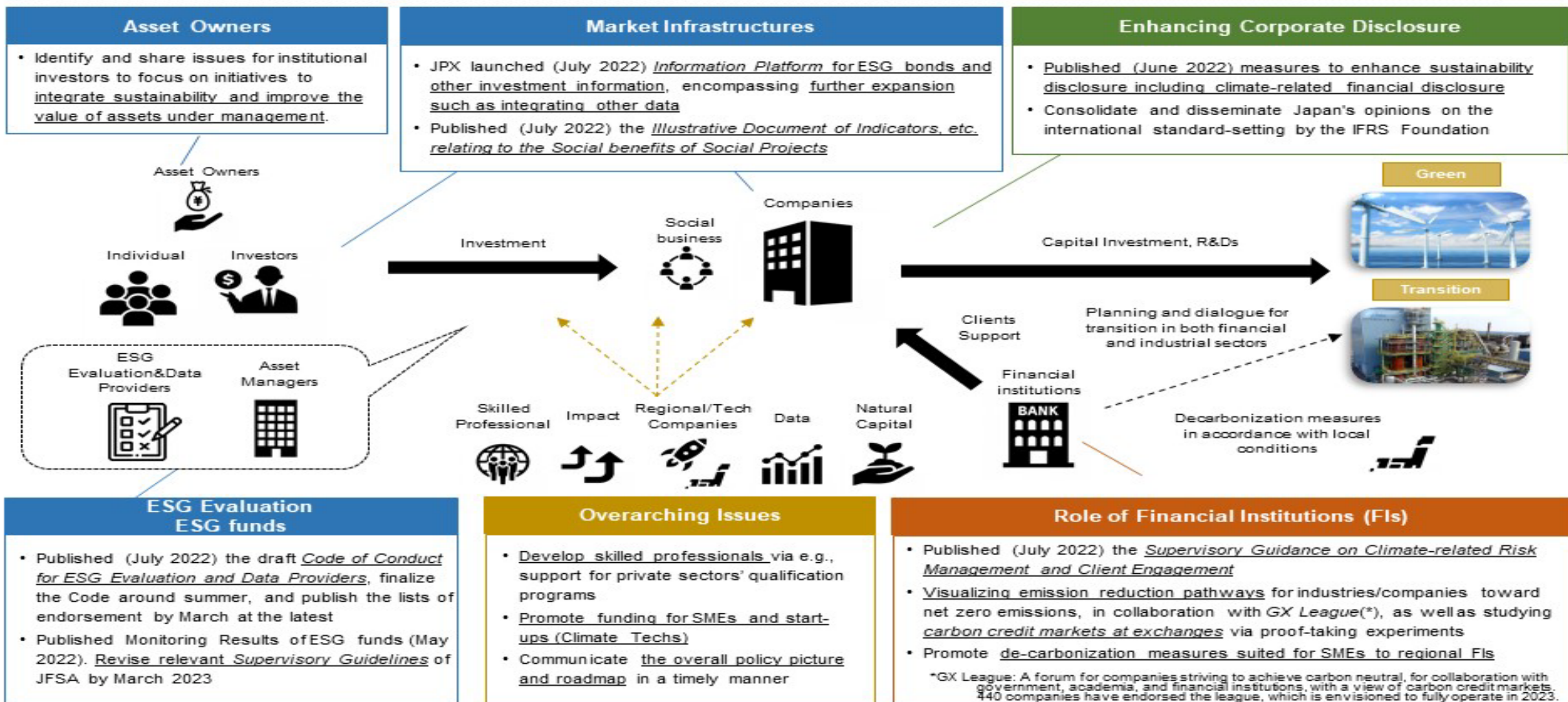
How do you expect the role of the governmental interventions and the price mechanism toward the solution of climate change problem in Japan?

- The target of carbon neutral in 2050 is far harder than ever. The whole economy should be mobilized toward this target by relying on the price mechanism.
- The governmental organizations concerning the climate change problem in Japan have been too small and not good integrated.
- In the central government, there are two divided control towers, the Ministry of environment and the Ministry of economy, trade and industry. They are both interested in the policy measures to reduce carbon emission but are not responsible to build up an infrastructure for carbon pricing.
- Besides, the pragmatic executions of the environmental administration are divided by the local governments.
- Moreover, the regulatory auction, which is the core concept of EU Emission Trade System, has never been employed before in the Japanese legal system.

The first attempt to introduce a regulatory auction system into Japan's regulation is started by the Ministry of Internal Affairs and Communication in November 2022 for the new allocation of radio frequency to mobile phones, but all telephone companies are objecting thoroughly. For the second, 'The Basic Attitude for the Transfer to GX economy' by the Global Warming Prevention Headquarters on 22 December 2022 has offered the introduction of auction system for the emission rights of electric companies, but it is supposed to start from as late as 2033.

The 2nd Report by the Expert Panel on Sustainable Finance, Japan FSA (July, 2022)

- Japan FSA's *Expert Panel on Sustainable Finance* proposed policies for promoting sustainable finance, framed in four agendas of "Enhancing Corporate Disclosure", "Capital Market Functions", "the Role of Financial Institutions", and "Overarching Issues", in its report published on June 2021.
- The **2nd Report of the Panel** was published to communicate the **progress of the past year**, as well as **further issues and recommendations**.



The Expert Panel continues its discussions and follow ups for measures taken, and periodically communicates the overall picture and progress of sustainable finance

How should we integrate the infrastructure for carbon pricing?

- In order to realize the best solution for the growth-oriented economy by depending on the price mechanism, following the Coase's theorem of the orthodox law & economics, we should have an infrastructure to discover price of the standardized carbon instruments.
- However, the incentive structures of issuers and investors are not always harmonized in a market. The issuers often claim that an exact price of an individual project to reduce carbon emission is indispensable and that their achievements must be definitely certified by authoritative organizations. On the other side, from the viewpoint of investors, 'one price for one article' principle has the top priority in their market transactions. They don't care which contents is involved in the instruments.
- As for the issuers' incentives, they might have various considerations including the economic analysis of their investment plans to reduce GHG emission or use the instruments as fundraising channel for their investments. As the conventional large enterprises might employ the new technologies in their investment plans, Japanese entities should share reliable price information for the investments based on these technologies.
- As for the investors' incentives, the role of Scope 3 of GHG-protocol is very important. With this disclosure standard, not only investors, who aim the profits from their transactions, but also broad economic entities including SMEs, which want to supply parts or materials to large enterprises, or depend their cash flow on commercial banks, would be incentivized to invest for the emission reductions in order to continue their orderly business.

What role should be played by the financial industry in the infrastructure?

- Some prefectures made the trial to introduce conventional compliance markets in Japan. However, they did not have worked as an effective infrastructure for the carbon pricing. For example, the potential investors were limited to the regulated entities in the prefecture, minority of the whole economic activities of the region. All major players of the economy should participate in the infrastructure for carbon pricing. In this regard, the role of disclosure standard is very important. Currently, the efforts to set up the reliable standard internationally.
- However, in the future, there still might be a contradictions between the incentives of issuers and investors. The ultimate purpose of carbon pricing is sharing the common monetary signal for the carbon emission. I believe it is the *raison de'tre* for a financial industry how to harmonize the contradiction with their own know-hows.
- Besides, we have a structural problem market related institutions in Japan. The markets of commodity instruments and financial instruments are supervised by different ministries and the division between direct and indirect financial system is quite tight. These hazards should be overcome by the effective coordination by the related agencies.

The evaluation of the carbon credits market experiment

○ Performance of the project:

- ① The price information is very diversified among reduction methodologies. The price of carbon credit generated from save energy was 800 ~ 1600 yen, forestry was 10000 ~16000yen.
- ② The market liquidities remained low. Total number of transactions during the experiment period, 85 business days, is just 163deals.

○ Deficiency of the project:

- ① The subjects of transactions are limited formal credits, such as J-credit or equivalent items. The participants can deal other kind of credit in overseas markets, and the idea of voluntary carbon credits market is published internationally,
- ② The forms of transactions are limited to exchange basis. Actually, in the real market, major part of transactions are not exchange basis, but OTC (over the counter) basis.
- ③ The major participants of the market was the governmental bodies and they made most of transactions. 88% of transactions are made with the governmental bodies which shifted the existing auction of their own carbon credits to the transactions in the experimental market.

○ Harmonization of the incentives of issuers and investors:

In order to harmonize the incentives of issuers and investors, we need the ingenuity for the composition of the transaction instruments. This task should be made in the primary market and by the investment bankers, just like overseas market.