

CARBON MARKETS MATTER FILE

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What is a carbon market?

Carbon markets are trading systems in which **carbon credits** are bought and sold . The idea behind carbon markets is that businesses or individuals that emit climate-warming carbon – that is, all of them – can voluntarily pay to neutralize some of those emissions by buying and trading “carbon credits.”¹

How does a carbon market work?²

The carbon trading market gives companies financial incentives to reduce their emissions **by allotting credits** to those who **pollute below their allowances**, while requiring those who go **beyond their limit** to purchase additional credits. Carbon markets aim to decrease emissions by offering financial rewards and punishments in the form of credits, allowances, or quotas that can be purchased and sold in a marketplace.

FOREXAMPLE CHINA...

Although the market’s scope is currently limited to energy companies, its arrival adds urgency for businesses in China to integrate carbon pricing into their business and risk strategies.

China’s carbon trading market is overseen by the Ministry of Ecology and Environment, while trading is run by the Shanghai Environment and Energy Exchange.

At launch, the carbon market covers over 2,225 companies that operate coal and gas plants to produce power and heat, most of which are state-owned enterprises (SOEs). Together, these companies are responsible for about half of China’s energy-related emissions, and 10-14 percent of the world’s total.

Policymakers plan on expanding the scope of the carbon market to include other polluting industries, including steel, cement, chemicals, and aviation.

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<https://www.conservation.org/blog/a-scientists-view-critics-of-carbon-markets-miss-the-mark>

2

<https://www.china-briefing.com/news/china-launches-carbon-trading-market-as-urge-ncy-to-cut-emissions-grows/>

Under the carbon trading scheme, each company is allowed by the government to emit a certain amount of CO2 emissions each year. If the company ends the year beneath its allotted limit, they can sell the difference on the market as a credit. Conversely, if the company exceeds its limit, it is required to buy additional credits to compensate.

After launching, the market's first transaction was a company purchasing 160,000 metric tons of emissions for US\$1.2 million. Overall, on the [first day](#) of trading, 4.1 million tons of CO2 quotas worth RMB 210 million (US\$32 million) switched hands.

This put the price on carbon at RMB 51.23 (US\$7.92) per ton, a 6.7 percent increase from the opening price of RMB 48 (US\$7.41).

Why create a global carbon market?

Global problems need global solutions. Multilateralism is based on the recognition that we cannot overcome these – and other – global challenges in isolation," Mr. Shava underscored. "Collective support for the poor and most vulnerable is in the interest of all of us.

Climate change is a problem that affects the whole of humanity and, as such, requires collaboration from everyone: governments, businesses, civil society, etc.

IMITATION

Imitation is based on a state adopting the successful methods of other states. The USSR as the predecessor of the RUSSIAN FEDERATION has a long experience with imitation of the US arms systems during the Cold War.

JUST as this model is effective in Mutual Assured destruction models, it can equally be effective to deal with climate change with the idea of a global carbon market.

EMISSIONS TRADING: THE ULTIMATE MARKET-BASED INSTRUMENT?

There are various approaches to emissions trading, but all are based on the same concept: a target, which can be either fixed or performance-related, is given to each source. In most trading regimes these targets are set by the regulator, not the market.

If a source does better than its target it can trade its overachievement, usually in the form of emission rights or 'allowances' with other sources. If it does worse, then it has to buy from other sources on the market.

The source will base its decisions on whether to buy or to sell allowances on the market price of the allowances and its marginal costs of abatement. If the market price is higher

than the marginal costs to reduce emissions at the source, the source will choose to reduce its emissions further and sell the allowances that are freed up by doing so.

If the market price of allowances is lower than the marginal costs to reduce emissions at the source, then the source will choose not to reduce its emissions, but maintain its emissions or even buy allowances on the market to increase its emissions. A well-functioning trading regime will level the marginal reduction costs across all sectors of industry, by allowing sources with high marginal reduction costs to invest in reductions in sources with lower marginal reduction costs through buying allowances freed up by these sources.

By allowing sources to optimally use all cheap abatement options, *emissions trading can significantly lower compliance costs and ease the achievement of targets*. The potential benefit depends upon differences in the marginal cost of reducing emissions among participating sources, due to the ability to use different control options, remaining life of the facility, or other reasons.

To realise the potential savings, the trading programme must include **enough buyers and sellers to create a competitive market**. A well-designed emission allowance trading programme shifts the location and the timing of the emission reductions, but, provided there is effective compliance and enforcement, ensures that the target is achieved. The programme design must ensure that such shifts do not create environmental problems, such as local pollution ‘hot spots’.

CARBON CREDITS

What is a carbon credit?

A carbon credit represents a reduction of 1 metric ton in greenhouse gas emissions to compensate for emissions made somewhere else, or in another sector of a country’s economy. These credits can be bought, sold or traded – but once used, a carbon credit is “retired,” meaning it cannot be traded again, assuring that only the buyer can claim to have cut emissions associated with that credit.

What carbon credits are not

Not a license to pollute: Carbon credits are expressly designed as a “bridge” for companies already working to reduce their emissions, not a free pass for business as usual. In fact, companies that invest in carbon projects are climate leaders, not laggards: A 2016 survey of industries found that companies that bought voluntary carbon credits

had more ambitious emissions reduction targets and did more across the board to cut emissions compared with companies that did not. Many countries and regulators set a limit on the number of credits that emitters may purchase.

Not a silver bullet: Carbon projects alone are not going to solve climate change — doing so will require a transformation of the global economy to one powered by renewable energy. Rather, they can be part of that transformation as one tool that companies and governments can use to flatten the carbon curve.

Not doomed by technical challenges: Carbon projects have been implemented in various forms for more than a decade, passing from the experimental to the commonplace thanks to testing and scientific advancements. Most of the problems of ensuring that carbon projects deliver on their intended benefits have been solved.

Not a 'land grab': High-quality carbon projects are necessarily built on the [free, prior and informed consent](#) of local communities where the project will take place. These projects do not separate people from their lands, but rather are predicated upon strengthening and upholding their rights to their lands.

Carbon credits are most often created through agricultural or forestry practices, although a credit can be made by nearly any project that reduces, avoids, destroys or captures emissions. Individuals or companies looking to offset their own greenhouse gas emissions can buy those credits through a middleman or those directly capturing the carbon. In the case of a farmer that plants trees, the landowner gets money; the corporation pays to offset their emissions; and the middleman, if there is one, can earn a profit along the way.

But this only goes for what is called the “voluntary market.” There is also something called the involuntary or “compliance market.”

What is the “compliance market” for carbon credits?

In the compliance market, or involuntary market, governments set a cap on how many tons of emissions certain sectors — oil, transportation, energy or waste management — can release.

If an oil company, for example, goes over the prescribed emissions limit, it must buy or use saved credits to stay under the emissions cap. If a company stays under that cap, it can save or sell those credits. This is known as [a cap-and-trade market](#). The cap is the

amount of greenhouse gases a government will allow to be released into the atmosphere and emitters must trade to stay within that limit.

PRINCIPLES IN THE CARBON MARKET

Carbon projects must meet various standards, including but not limited to:

- **Additionality:** That emissions cuts would not have occurred without the carbon project investment.
- **Permanence:** That emissions reductions or removals represented by a carbon credit endure for the long term.
- **Leakage:** That deforestation is not simply displaced from a specific forested area to somewhere else.
- **Benefit-sharing:** That the beneficiary communities of carbon projects are equitably compensated.

How these requirements are being met

All forest carbon credits traded internationally will need to meet requirements agreed under the U.N., including:

- **Baseline:** A national baseline against which deforestation, degradation, conservation and restoration are measured to ensure that emissions are being reduced or removed
- **Monitoring:** A forest monitoring system so that changes against that baseline can be accurately measured, to ensure additionality
- **Strategy:** A national strategy to ensure permanence and avoid leakage
- **Safeguards:** Adherence to and reporting on a series of social safeguards to ensure respect for indigenous rights and the participation of local stakeholders, and environmental safeguards to mitigate the risk of forest loss.

Why are carbon markets vital?

Carbon markets mobilize resources and reduce costs to give countries and companies the space to smooth the low-carbon transition and be able to achieve the goal of net zero emissions in the most effective way possible. Carbon markets incentivize climate action by enabling parties to trade *carbon credits* generated by the reduction or removal of GHGs from the atmosphere, such as by switching from fossil fuels to renewable energy or enhancing or conserving carbon stocks in ecosystems such as a forest. It is estimated that trading in carbon credits could reduce the cost of implementing countries'

Nationally Determined Contributions (NDCs) by more than half – by as much as [\\$250 billion by 2030](#). In other words, carbon trading could facilitate the removal of 50% more emissions (about 5 gigatons of carbon dioxide per year by 2030) at no additional cost. Over time, markets are expected to become redundant as every country gets to net zero emissions and the need to trade emissions diminishes.

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Carbon markets **offer two things** / values to the climate change crisis we need right now.

The first is **speed**: Carbon markets can provide a turbo boost to a low-carbon future by delivering more climate benefit, more quickly, on a mass scale for less money.

For example, [California's cap-and-trade system](#) has hastened the speed at which industries change by integrating mandated emissions cuts with the ability to trade more expensive emissions reductions alongside less expensive ones, while continually ratcheting up the market price of carbon.

[One estimate](#) suggests that carbon markets will have to grow more than 15-fold by 2030 to enable the investments needed to keep Earth's climate well below the 2-degree C (3.7 F) threshold identified by scientists as extremely dangerous. Fortunately, humanity has much experience in building well-functioning markets quickly – provided the right systems and rules are established, as a [recent report](#) urges, to ensure maximum climate impact.

The second is **reach**: Carbon markets can enable solutions that regulations and carbon taxes alone cannot – that includes using the power of nature itself to draw down carbon.

A subsistence coffee farmer in Central America, for example, would not respond to U.S. laws requiring corporations to halt fossil-fuel emissions. But carbon markets can provide the funding to allow that farmer to make a sustainable living by restoring carbon-absorbing forests while growing shade coffee, instead of the usual method of clearing forests.

STATISTICS

- Tropical deforestation accounts for 11 percent of human-caused greenhouse gas emissions.
- Protecting and restoring tropical forests represents at least 30 percent of the necessary emissions reductions to avoid climate catastrophe.
- Yet these “natural climate solutions” receive only 3 percent of global finance dedicated to protecting the climate.
- More than 25% of people on Earth depend directly on forest resources for their livelihoods.

COUNTRIES WHERE CARBON MARKETS ARE PREVALENT

According to the World Bank³, [More than two thirds of countries are planning to use carbon markets to meet their Nationally Determined Contributions \(NDCs\) to the Paris Agreement](https://www.worldbank.org/en/news/feature/2022/05/24/countries-on-the-cusp-of-carbon-markets). Countries such as Chile, Ghana, Jordan, Singapore and Vanuatu are already building end-to-end, state-of-the-art digital infrastructure to support their participation in international carbon markets.

Delegates at the 2021 global climate change meeting, COP26 in Glasgow, approved [Article 6](#) – the Paris Agreement’s rulebook governing global carbon markets. The approval gave the green light to a market where countries can trade *carbon credits* generated by the reduction or removal of greenhouse (GHG) emissions from the atmosphere -- such as by switching from fossil fuel to renewable energy or by increasing or conserving carbon stocks in ecosystems such as a forest.

The largest carbon compliance markets are in the European Union, China, Australia and Canada.

CASE STUDIES

Driving emissions reductions in Peru

Despite its protected status, Peru’s Alto Mayo Protected Forest – an area of Amazonian forest twice the size of New York City – had some of the country's highest deforestation rates. To halt this cycle, Conservation International worked with partners

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<https://www.worldbank.org/en/news/feature/2022/05/24/countries-on-the-cusp-of-carbon-markets>

– including local communities, corporations and Peru's government – to develop a REDD+ program. Now, 70 percent of the community in the Alto Mayo basin benefits directly from the initiative; since 2008, the program has generated more than 8.4 million metric tons of emissions reductions – the equivalent of taking nearly 150,000 cars off the road each year.

Trading forest credits in California

California's cap-and-trade program is already financing forest conservation and restoration there. To date, more than 100 million forest credits have been traded, generating more than \$500 million in revenue, with more than half of that going directly to local Indigenous communities. To address concerns that forest carbon credits amount to a license to pollute, California has limited the share of companies' compliance obligations that can be met through offsets at 8%, to reduce to 6% in 2020.

Incentivizing conservation in Costa Rica

Costa Rica established laws in the 1990s to reduce deforestation and restore forests, including an innovative fuel tax to fund payments to landowners to keep forests standing. The Central American country monitors deforestation rates to know whether they are getting results across the whole country or simply displacing (or delaying) deforestation. Through this system, Costa Rica generates \$30 million a year for forest conservation and has conserved or restored close to 1 million hectares (2.5 million acres). The next step: selling the carbon credits generated through this program to international buyers to support further environmental priorities.

Jordan's Pioneering Path to Addressing the Climate Crisis:

The country is facing significant climate challenges: temperature increases, precipitation decreases, increased incidents of drought and water lost to evaporation. At the same time, it remains heavily dependent on fossil-fuel imports, with limited natural resources and extremely scarce water supply for a population of 10.3 million that includes more than a million refugees. Extreme heat and water scarcity are driving up energy demand, creating fiscal burden and affecting economic competitiveness.

It was the first developing country to build MRV and GHG Registry systems to international standards that are the key building blocks for future emissions trading working with the World Bank's [Climate Warehouse program](#) and [Partnership for Market Implementation](#) (PMI) to develop and test this digital infrastructure

China's Emissions Trading System became fully operational in 2021 when companies under the program were required to deposit emission permits with the government to account for a portion of their 2019 and 2020 emissions. The program initially regulated carbon emissions from power plants, covering about 2,200 energy producers.

The vision for China's ETS has always been a much broader scope, covering more industries and emissions. When China announced a nationwide ETS in 2015, it envisioned the program covering, "a substantial percentage of China's carbon pollution." In 2016, early program design work proposed covering emissions from electric power generation and [six additional industries](#): iron and steel, aluminum, cement, chemicals, papermaking, and civil aviation.

In 2021, the implementing agency, the Ministry of Ecology and Environment (MEE), introduced mandatory data reporting requirements for these additional sectors, which China's ETS is expected to formally include by 2025. The chairman of the Shanghai Energy and Energy Exchange, which operates China's national carbon trading platform, expects program expansion to happen in 2022 with inclusion of aluminum and cement before the end of 2022.

As the world's largest greenhouse gas emitter, the success or failure of China's ETS will help determine the future of climate change. However, the timing of the program's progression is uncertain, slowed by political and bureaucratic hurdles.

China's national emissions trading scheme (ETS) became operational last year, obliging more than 2,000 big emitters in the power sector to account for their emissions in 2019 and 2020. The current scope of the ETS includes annual emissions close to 4.5 billion tonnes of CO₂ per year, or around 40% of China's total. Unlike similar schemes elsewhere, such as in the European Union, China's [allocation of emissions allowances](#) is not decided upfront via an absolute cap but is based instead on emissions intensity. One allowance means a company can emit 1 tonne of carbon.

So far, activity has been limited: in 2021 the ETS traded a total of 412.05 million tonnes of allowances, including those on regional pilot schemes and the domestic offsets known as CCERs. However, a slow start is not uncommon: in its first year of trading in 2005, the EU ETS saw 321 million allowances transacted, but this had topped 12 billion by 2021.

China's ETS pilots – most of which have been active since 2013 – continued operations in parallel, but for the most part saw trade volumes drop as power sector emitters turned increasingly to the national ETS.

What are CCERs?

The national ETS was announced in 2017 and officially launched in early January 2021 when the Chinese Ministry of Ecology and Environment (MEE) published key ETS policy documents. In July 2021, trading commenced on the platform operated by the Shanghai Environment and Energy Exchange. The year also saw activity on China's two other major carbon market institutions: first, the Beijing Green Exchange, which is the national trading platform for voluntary carbon credits (VERs) and for domestic offsets (CCERs) that operators covered under the national ETS may use for compliance; and second, the China Hubei Carbon Emissions Exchange, which serves as an interim registry of transactions and holdings until an official national ETS registry is established.

Upbeat results

The carbon emissions allowances closed the year at 54.22 yuan (US\$8.52) per tonne, up 13% on the opening price of 16 July. Including both listed and off-exchange trades, the weighted average price of allowances in 2021 was 43.85 yuan (\$6.89) per tonne.

A total of 179 million tonnes of allowances changed hands over the 114 trading days in 2021. Of these, 148 million tonnes (83%) were over-the-counter (OTC). Trades are conducted electronically, and only spot transactions are allowed. No futures or other derivatives are. Transactions are referred to as either listed trades or OTC bulk trades (bilateral OTC trades that cleared on exchange at the end of each session). The latter occur in minimum batches of 100,000 allowances by mutual agreement and a daily price fluctuation limit of 30%. Only covered entities may trade. Financial institutions and other "speculators" are not yet allowed to participate in the market, although the Chinese government has indicated this may change at a later stage.

ETS transactions occurred in two distinct stages, with those taking place during July to September representing a "learning and preparing" phase, and real trading starting from October to mid-December. By the end of September, however, some large state-owned enterprises had completed their company carbon asset management and trading strategies: 30 September saw some large OTC transactions. With covered entities having received their allowances gradually from the Ministry of Ecology and

Environment over the course of the year, demand picked up in October to mid-December as operators with a shortage began searching for allowances both on-screen and in block trades. Available supply was limited, as most surplus holders did not want to part with their extra allowances.

The regulatory framework of the national ETS allows companies to cover up to 5% of their compliance obligation with CCERs. A large share of covered emitters used near to the maximum allowed amount of CCERs for compliance and banked their received allowances for future use, which further limited supply. Prices fluctuated between 30 yuan (\$4.72) per tonne and 59 yuan (\$9.27) per tonne, forming a big U-shape.

CRITICS OF CARBON MARKET THEORIES

What is the pushback?

Critics of the voluntary market, where a company buys carbon credits from a business outside of a regulated exchange, point out that this does not lower the overall amount of greenhouse gases released by buyers. They are simply offset, which gives corporations a way to claim they are eco-friendly without reducing their overall emissions. Critics call this “greenwashing.”

Carbon credits can also be bought from projects that would have happened anyway. For instance, one investment company says they pay farmers to convert their fields into forests and sell those credits to corporations, [according](#) to Bloomberg. But several farmers claim they already planted trees through a government conservation program.

Recent experience with the implementation of market-based mechanisms in both the US and Europe has, however, shown that simply replacing existing ‘old’ regulatory instruments with new market-based instruments is often not an option, for a number of reasons.

Climate change is one of those ‘new’ areas. It is therefore in this area that, within the EU, the instrument of emissions trading has **also found its broadest application**. Before the adoption of the Emission Trading Directive emissions trading had already been implemented in Denmark and the United Kingdom, and trading regimes were in various stages of development in other Member States.

But perhaps the **most important argument** that shows that simply replacing existing ‘old’ regulatory instruments with new market-based instruments is often not an option follows from recent experience with the design and implementation of emissions

trading regimes. It is increasingly clear that market-based mechanisms are **no substitute** for legal controls on conduct, backed up by effective government enforcement and sanctions. Instead, these mechanisms are designed to **complement**, rather than substitute for, command and control measures. Most market-based mechanisms indeed rely for their success upon an underlying programme of government regulatory control (Johnson, 2001, p422; Schwarze and Zapfel, 2000, p293).

Emissions allowance trading is a prime example of this, as will become clear from the rest of this chapter. To function well, emissions allowance trading is in practice often built on top of existing permitting regimes.

Emissions trading may thus even be described as a ‘command and control plus’ instrument, with often even stronger government oversight, in particular in relation to the monitoring and reporting of emissions and high non-compliance sanctions.

CRITIQUE OF MULTILATERAL APPROACHES TOWARDS GLOBAL PROBLEMS

For one thing, I have found a lack of clarity when it comes to its meaning:

- When people talk about a “multilateral” approach, they might mean it in its literal sense (i.e., involving three or more parties), in its fullest sense (i.e., a global regime), or in a sense that is more political than legal (i.e., in contrast to “unilateralism” or “nationalism”).
- It is often not possible to motivate States to agree on a “multilateral” approach unless one State (or a small group of States) catalyzes such a solution by first acting unilaterally. When an international body reaches agreement, but was only able to do so because of a unilateral action, is that an example of multilateralism?
- An agreement might be “multilateral” in one respect but not necessarily in another. For example, a multilateral agreement might set an environmental standard but be silent on enforcement; if a State opts to enforce the standard through a trade measure, such as an import restriction, is that trade measure “multilateral” or “unilateral?” If a multilateral environmental agreement requires Parties to restrict trade with non-Parties, is the trade measure “multilateral” vis-à-vis the State that did not join?
- Even within the context of a global regime, there can be gradations of “multilateralism.” The international climate change regime is arguably at the extreme end of the spectrum; not only is there near-universal participation, but decisions are taken by consensus. However, a global agreement could operate in a different way. The Montreal Protocol, for example, is global in terms of its membership but can take decisions by less-than-global super-majority voting, in some cases binding all Parties.

GLOBALISATION

The growing threat of climate change, nuclear war, job loss from automation, and the spread of infectious disease isn't confined to a single country or stoppable at borders. Global challenges are rising. But as soon as "global" takes on "ization," "ism," or "ist," meanings multiply, debates intensify and we're in new territory of language and politics. What exactly do we mean, and not mean, by variations of the word "global"?

The root word defines itself: Globe means world, and global refers to it. But "ization" is the tripwire. "Ization" turns almost any concept into a process or result: the carrying out of a system, doctrine or theory. Globalization is an inexact term, but it generally means the process of the world becoming more interconnected or being treated as more interconnected.

Within globalization, there are generally two kinds: governing, which takes the form of institutions like the United Nations, and economics, which shows up in bodies like the World Bank and the World Trade Organization. Many people support one kind of globalization but not the other, a selective stance at the heart of movements like alter-globalization, or alternative globalization, which promotes limited global action to protect human rights and the environment, but opposes economic entanglements.

Critics hear "globalization" as a **slippery slope to imperialism or colonialism**, with fears of bullying, bigotry, elitism and bureaucracy. The good of globalization — cooperation and shared action — risks a heavy price: the threat to national sovereignty and self-determination. Critics also say globalization risks the exploitation of cheap labor and the bulldozing of cultures in developing countries, a key argument against a globalized economic model.

If "ization" is the implementation of a system or policy, "ism" is its underlying theory and mindset: Globalization is globalism in action.

The conversation veers toward a cliff when the word globalist is introduced. "Globalist" has long been an **epithet** with deeply racist roots. It's been used as an anti-Semitic slur to **disparage** Jewish people on false accusations of harboring loyalties to a global takeover conspiracy. Although some advocates call themselves "globalists," a more common self-identity today is "global citizen."

Is globalization our future or our failure? Is global citizenship our path forward?

The greatest competition to globalism is nationalism. **Nationalism is the worshipful devotion to national identity, or "nation first"** — a flag-waving anthem-singing celebration of national greatness. But nationalism does not have to mean isolationism, which is the refusal to participate in anything internationally.

Many nationalists support free trade.

Nationalism and globalism are incompatible on that view: You're in or you're out. A more compatible pairing is patriotism and globalism, where patriotism is national pride that is not unconditional. A patriot is proud of a nation's most admirable actions and efforts, but can criticize, as a duty, those actions that betray the values of that nation. A nationalist is proud of a nation no matter what it does.

It's a false choice to pit globalism against patriotism, but some nationalists try to, a rhetorical trick to convince people that nationalism and patriotism are synonymous, to position nationalists as the true patriots of a nation. But the distinction holds: A patriot often protests a country's actions and criticizes its power grabs. Nationalists tend not to, or will even celebrate those efforts.

Underlying many of these positions is a fear of totalitarianism, which can creep up slowly or quickly. Totalitarianism is a system of government so centralized and absolutist that it requires total submission to the state. Whether the state is national or global, totality is the fear.

Like many of these words, "globalization" is a mirror. It reflects how we see ourselves and our roles in the world. It tests whether we all see a world stage or just hear talk of one. It challenges us to find the best ways to respond to cross-border challenges and define our relationships with other nations and people. It asks whether the world must agree on common principles and an economic model that can benefit everyone, or if there is some way in between. Ultimately, it asks if we can agree, across differences, on a path forward.