CENTRE FOR EUROPEAN REFORM
policy brief

EU climate policies without an international framework

By Stephen Tindale

★ The Durban summit on climate change takes place in November-December 2011. Only the EU can inject impetus into the international negotiations.

★ Whatever the outcome of the Durban discussions, the EU should give priority to agreeing its draft energy efficiency directive, which will be good for human health and energy security as well as climate protection.

★ The EU should strengthen the Emissions Trading System (ETS) by setting a floor price for the carbon permits.

★ The EU should introduce border tax adjustments for goods imported from countries without a carbon price. The revenue should be returned to the country of origin, for use on clean energy projects, but only if that country agrees to an international carbon reduction target.

The next UN climate summit will take place in Durban, South Africa from 28th November to 9th December. This follows the unsuccessful 2009 Copenhagen summit and the partially-successful one in Cancun in 2010. The EU has the opportunity to lead the world in climate negotiations by strengthening its climate and energy policies, and by offering bilateral financial deals to developing countries which accept obligations under the UN climate framework.

The Durban summit will not lead to final agreement on new international legally-binding commitments. Differences between negotiating parties, on how deep emissions reductions should be and who should foot the bill, remain too great. At best the summit can lay the groundwork for a new legal agreement. But progress will only be possible with greater leadership, and only the EU can provide such leadership. US politics make leadership by the Obama administration impossible. China, India and other emerging global powers regard international climate negotiations with deep suspicion – part of attempts by 'the West' to keep them in their place. And Durban will be overshadowed by the ongoing global economic crisis.

The EU should provide leadership in Durban by stressing that climate policies can strengthen, not hinder, economic recovery. It should outline how its own climate policies will be made more effective. And it should offer countries resisting UN targets on climate change strong economic and financial incentives to accept such targets.

The EU line at Durban should be based on four main points:

1. Continuing to promote the Kyoto Protocol framework;

2. Continuing to offer an increase in its 2020 emissions reduction target from 20 per cent to 30 per cent, if other countries commit to ambitious targets;

3. On energy efficiency and renewables, outlining how the existing 20 per cent targets will be met, notably by stressing that the draft energy efficiency directive will be top of the EU's agenda in 2012;

4. A statement that the EU's ETS will be strengthened with a Europe-wide floor price, with border tax adjustments to protect energy-intensive European

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industry from competitors based in countries without carbon pricing. The revenue from these border tax adjustments should be returned to the country of the imports' origin, to be spent on clean energy programmes – but only if the country signs up to a Kyoto target.

UNFCCC and Kyoto

The Durban summit is intended by its organisers, the UN Framework Convention on Climate Change (UNFCCC) to negotiate an international legally-binding protocol to extend or replace the 1997 Kyoto protocol, which runs out at the end of 2012. The UNFCCC was signed in 1992, and the Kyoto protocol took a further five years to negotiate, partly because of the complexity of the issue and the strong opposition of the fossil fuel industry, and partly because the UNFCCC operates through consensus.

Kyoto is clearly not without flaws: the targets set are not ambitious enough to prevent dangerous climate change; the enforcement mechanisms are not strong; the schemes to transfer money from developed countries to developing countries in order to reduce emissions there (called 'flexible mechanisms') have been subject to corruption. Nevertheless, the Kyoto framework should be retained and extended. Under Kyoto, countries entered into clear obligations with agreed and well-defined rules on how progress should be measured. The promises which countries offered at and after the 2010 Cancun climate summit have no such clarity. Some refer to reducing national emissions, others to reducing emissions per unit of GDP. And there are different baseline years against which to measure progress.

Only developed economies and economies in transition from communism were given targets at Kyoto. The US accepted a target at Kyoto, but the Clinton administration never sent the protocol for ratification by the Senate because it had no chance of passing. The Senate had passed a resolution before Kyoto, with 96 votes for and none against, stating that there should be no US target unless there were also targets for major developing economies such as China. The Bush administration formally withdrew the US from Kyoto, but even if Al Gore had won the presidency he would have had no chance of getting Kyoto ratified.

The failure of the Copenhagen summit, slow progress at Cancun and lack of prospective progress at Durban have led some to argue that attention should shift from 'top down' measures – internationally negotiated targets – to 'bottom up' measures implemented by national or local government. Such bottom up measures are clearly necessary, and focus on delivery rather than targets. In addition to their climate protection benefits, they make strong social and economic sense, increasing energy security, improving economic efficiency and helping consumers struggling to pay fuel bills. So energy efficiency and decarbonisation policies should be introduced and implemented whatever the state of international climate negotiations.

However, the top down approach is needed too. Not all governments are committed to protecting the climate, and many of those that are committed rhetorically have made little progress on delivery. For example, UK governments under Prime Ministers Tony Blair, Gordon Brown and David Cameron have repeatedly emphasised their commitment to reducing emissions and moving to clean energy, but the UK gets a lower proportion of its energy from renewables than all other European countries except Malta and Luxembourg. EU institutions can themselves implement top down policies to require unenthusiastic or ineffective member-states to take action. But global agreement gives arguments for Europe-wide action greater traction. Many of those involved in the negotiations leading to the establishment of the ETS in 2005 believe that member-states would not have agreed to a cap on emissions had the Kyoto Protocol not been agreed 8 years previously. Kyoto gave the 15 states that were members in 1997 an internationally agreed target.

What the EU is planning to say in Durban

All EU discussion of climate change is framed by the EU's 2008 climate and energy package, usually called the 20-20-20 package. This commits the EU to three targets, all to be reached in 2020:

★ A 20 per cent reduction in greenhouse gas emissions, compared to 1990 levels (the agreed Kyoto baseline year). This would mean a further reduction of 12 per cent compared to the EU's Kyoto target of –8 per cent by 2008-12 (the average annual emissions of each of these years). The EU said that it would increase this target to 30 per cent if other countries offered similar reduction targets.

★ 20 per cent of all energy (including not only electricity, but also heating and transport fuel) to come from renewables. This would mean a near-doubling of renewable energy from 2010 levels.

★ A 20 per cent improvement in energy efficiency, against 'business as usual'. This is the least well defined of the targets, as business as usual is open to different interpretations, and this is not a binding target – unlike the other two.

On October 10th 2011 the council of environment ministers recommended a line to take in Durban. This will be further discussed at the EU summit on October 23rd. The key points from the council were:

★ the EU should support a continuation of the Kyoto protocol as the international framework for climate commitments;

★ developed countries should reduce emissions by 25-40 per cent, from 1990 levels, by 2020;

★ developing countries should "achieve a substantial deviation below the currently predicted emissions growth rate".

The EU favours renewing the Kyoto commitment period, and is prepared to sign up to a further international target to match its own 2020 target, and possibly to increase it to 30 per cent, but only if other countries also agree to sign up to further targets. The EU points out that its emissions are only 11 per cent of the global total.

The EU favours a continuation of Kyoto because the protocol represents an agreed set of rules and measurements, and incorporates legally-binding commitments. Many developing countries, including China and India, have called for a second commitment period under Kyoto. However, several countries which have Kyoto targets, including Russia, Japan and Canada, are opposed to a second Kyoto period and are calling for a new framework to be negotiated. The US remains unenthusiastic about Kyoto.

The EU delegation in Durban will be led by climate action commissioner Connie Hedegaard. Before becoming commissioner Hedegaard was Denmark's climate change and energy minister. She has been widely blamed for the lack of progress at the Copenhagen climate summit. This is unfair. There were some administrative and organisational mistakes, so Hedegaard should perhaps take some responsibility for those. But the lack of agreement at the summit was due to much larger issues: national disagreements about the level of ambition and who should pay for the emissions reductions. Hedegaard was an effective climate and energy minister.

What the EU should say in Durban

The Durban summit will be dominated by a discussion about targets, since this is what the UNFCCC sets. But Hedegaard should also emphasise what the EU is doing, and will do, to deliver emissions reductions, expansion of renewables and better energy efficiency. On renewables and energy efficiency, the emphasis should not be on increasing the targets, but on explaining how Europe will ensure that existing targets are met. The renewables target is already ambitious. It has given investors greater confidence that national renewables programmes will be maintained. Improved confidence coming from greater regulatory stability is the greatest benefit of targets. Rather than increasing the 2020 target, the EU should say that it will ensure that the move to a renewable economy is maintained after 2020 by setting a target for 2030.

Hedegaard should say that the Commission's draft energy efficiency directive, with its emphasis on improving the efficiency of energy production through combined heat and power, will be the top climate and energy policy priority for 2012 (and the Danish government, which holds the Council presidency for the first half of 2012, should support this line). In September 2011, Hedegaard's climate action directorate general criticised the proposals put forward by the energy directorate general for an energy efficiency directive[1] on the grounds that if adopted the directive would lead to less energy being used and lower emissions, and so undermine the price of permits in the ETS. DG climate action is in charge of the ETS, so its desire to make the ETS effective is understandable. But for officials in charge of climate action to argue against energy efficiency measures – cost-effective actions that are needed to protect the climate and would also deliver economic and social benefits – is an example of Commission departmental rivalry at its worst. The proposals in the draft energy efficiency directive should be implemented, and the ETS should be strengthened in other ways.

1 Maïté Jauréguy-Naudin, 'Energy efficiency versus the EU ETS: Counter-productive tribalism in the commission,', Institut Français des Relations Internationales, September 2011.

Making emissions trading effective

The EU set up the world's first international emissions trading scheme in 2005. This was an impressive act of global leadership, and also an example of rational policy making. The cap and trade approach is well suited to climate change policy, since it makes no difference to the global climate where greenhouse gases are emitted. However, being first does not mean that the EU's ETS has been effective. The ETS has yet to make a significant impact on European emissions. The price – just over €10 per tonne of carbon dioxide at the time of writing – is far too low to have much effect on emission levels or investment decisions. In its first phase (2005-07) the low price was a result of the cap being set by each member-state, so the combined European cap was far too high. Also, companies were given permits for free rather than having to purchase them. Only companies which emitted more than their (over-generous) allocation had to buy permits, from other companies.[2]

2 Simon Tilford, 'How to make EU emissions trading a success', CER report, May 2008.

The Commission also recognised the need to reform the system. So in 2009 it got member-states to agree to strengthen the ETS by allowing the Commission to set the overall cap from 2013. Major emitting sectors, including electricity generators, will have to buy their initial permits through auctions rather than receiving free allocations. Auctioning was strongly resisted by fossil fuel companies, so the 2009 decision was an example of Europe's leaders being prepared to stand up to existing economic interests in order to change the structure of Europe's economy.

In June 2008 prices for permits were €25-27 per tonne of carbon, high enough to send a signal to business. Then came the economic recession, which substantially reduced emissions. EU emissions in 2009 were nine per cent lower than in 2007. They rose slightly in 2010, but are still well below 2007 levels. The caps set by member-states for 2008-12 are much too high to make the ETS effective. And the Commission's proposed total number of permits for 2013 is to be based on the average total of 2008-12 caps. So the total will be too high and the carbon price too low. The total number will then decrease by 1.74 per cent each year. But this decrease will not be fast enough to result in a carbon price much above the current €10/tonne level.

So the Europe-wide cap looks unlikely to have much more impact than the caps set by member-states. The Commission could tighten the cap. But the economic outlook for the duration of phase three of the ETS (2013-20) is far from rosy. However high or low the cap is set, a cap and trade system will not offer much market certainty at a time of such economic difficulty. The Commission has suggested that it could simply decide to withhold some permits from the market if the price got too low. But this would depend on decisions taken by the Commission from month to month, so would reduce the stability and predictability of the system.

A much better way would be to set a floor price for permits. The UK government has said that it will do this: setting a de facto initial floor price of €18/tonne in 2013, rising to €34/tonne in 2020. The British government is proposing to achieve this by turning an existing tax on commercial and industrial energy, the climate change levy, into a carbon tax. (Despite its name, the climate change levy was introduced in 2001 as an energy tax rather than a carbon tax, because the then Labour government did not want to tax coal more than gas or nuclear power.)

This UK government initiative is a step in the right direction. But a much more effective measure would be an EU-wide floor price. It would not be straightforward to negotiate such a floor price. Reducing carbon emissions is challenging for all governments, but particularly so for those whose economies are primarily powered by coal; generation from coal emits much more carbon dioxide than does nuclear or gas generation. Over a quarter of Europe's electricity comes from coal power stations, and in some member-states the proportion is much higher. Poland uses coal to generate 90 per cent of its electricity.

Nevertheless, a floor price would not be impossible to achieve, provided the German government supported it. Germany has a unilateral target to reduce carbon emissions by 40 per cent by 2020. Chancellor Angela Merkel has reaffirmed her government's commitment to this target despite its decision to close Germany's nuclear power stations. The closure of nuclear stations will result in greater use of fossil fuel power stations, increasing carbon emissions. Germany is therefore becoming less enthusiastic about a stronger ETS. But Merkel's CDU faces a strong electoral challenge from the Green party, so the German government is looking for ways to prove its commitment to action on climate change. The British government and DG climate action should therefore work with the German government to introduce greater certainty into the carbon market. The EU should set a floor price to return ETS permit prices to the pre-recession of €25/tonne. The floor price should then be gradually increased each year.

Carbon leakage

A more effective ETS would need to be accompanied by measures to safeguard some energy-intensive sectors of EU industry. It would not help efforts to control climate change if European policies led to more of the goods consumed by Europeans being manufactured in countries such as China. There is little evidence of much of this so-called 'carbon leakage' so far, even for energy-intensive industries. The reasons why Europe imports so much from China are much more to do with labour and manufacturing costs than with climate or energy policy. But that does not mean that carbon leakage would not be a problem in future, if the ETS permit price became significantly higher.

In its proposals for the reform of the ETS directive, the Commission suggested two possible approaches to protecting industrial sectors at risk from carbon leakage such as cement, steel or aluminium. One was to allow the free allocation of permits to such sectors to continue. The second was to introduce border tax adjustments so that importers were required to make payments when their goods were imported into the EU, to reflect the goods' carbon content. Following negotiations with member-state governments, border tax adjustments were dropped in favour of free allocations. This approach is preferable to simply allowing sectors like cement and steel to become hopelessly uncompetitive and to move out of Europe. But it does set industrial policy against climate policy, and removes the incentive for energy-intensive industries to implement decarbonisation strategies such as carbon capture and storage.

The free allocation approach also does nothing to encourage developing economies such as China to develop cleaner energy sources and to reduce their emissions.

The EU should therefore replace the free allocation approach with a broader approach to shield European industry from competition from countries without a carbon price. The introduction of an ETS floor price should be combined with border tax adjustments so that the price of imports also includes a carbon price. Provided this was carried out in a non-discriminatory way, it would be compatible with World Trade Organisation (WTO) rules.[3] It would be inconsistent with WTO rules to exclude some countries' products from border tax adjustments on the grounds that the EU judged them to have strong climate policies; that could be considered discriminatory. However, imposing border tax adjustments on all countries which do not have a carbon price would not be discriminatory.

[3] *Michael Grubb and Thomas Counsell, 'Tackling carbon leakage', Carbon Trust, March 2010.*

There are fewer WTO restrictions on the use of revenue. It would be WTO-compatible to return the revenue from border tax adjustments to some countries, under bilateral agreements, as long as such agreements were on offer to all countries. So the EU should offer to return the revenue from ETS border tax adjustments to the country of the imports' origin, to be spent on energy efficiency and low-carbon energy programmes, but only if the country accepted a target under a Kyoto second commitment period.

Restricting the use of the money to climate and energy projects would help overcome political resistance to Europe transferring money to a country like China, which has a large trade surplus with Europe. The EU could use the procedures of the Kyoto protocol's flexible mechanisms to check that the funds were being used for clean energy projects.

To be consistent with WTO rules, the EU would have to take the same approach to imports from the USA. The politics of transferring money from Europe to America would be as complex as the politics of returning money to China. But a future global agreement will be ineffective without US participation: the US is the second largest emitter of greenhouse gases (after China) and the highest in terms of per capita emissions. Border tax adjustments would be an effective means of ensuring that the ETS did not result in European industry losing out to US industry. And the possibility of recouping the revenue would be a tangible reason for the US government to accept a UNFCCC target.

The approach of treating China and the USA the same way is not only legally correct; it would also help overcome the widespread resentment in developing countries that climate negotiations are a forum for neo-colonial demands by rich Europeans and North Americans to less rich Asians, Africans and Latin Americans.

Even if the EU decided to return revenue to the country of origin, it could still face a WTO challenge. Even the EU's existing approach – free allocation of permits to sectors deemed by the Commission to be threatened by carbon leakage – may be subject to WTO challenge on the grounds that it represents an implicit subsidy. But the offer to return revenue would make retaliation less likely.

China and clean energy

Developing country leaders argue, correctly, than Europe, North America and other developed economies became rich by burning vast quantities of cheap fossil fuels. So, they say, it is unreasonable for 'the West' to insist that developing countries refrain from burning lots of cheap coal (of which both China and India have large reserves). The Chinese government is not ignoring low-carbon energy: China has greater installed wind power capacity than any other country and dominates the global solar market. It is also planning to construct many new nuclear power stations, and is building large-scale carbon capture and storage (CCS) demonstration projects, with some of the cost of the CCS plants being paid by the US.

The Chinese government is also concerned about the impact that uncontrolled climate change would have on China. These would include sea level rise, which would threaten Shanghai and the coastal plain, and further desertification, which would threaten Beijing. The Chinese government promised, at the Cancun climate summit in 2010, to lower China's carbon intensity – the amount of carbon emitted per unit of GDP – by 45 per cent by 2020, measured against 2005 levels. The country's 2011 five year plan includes targets on carbon intensity and the proportion of energy obtained from non-fossil fuel sources.

However, the Chinese government is resisting an international target for its total greenhouse gas emissions. Its economic development makes expansion of energy demand inevitable, and so all sources of energy are being expanded, including very polluting coal power stations. But, as the CCS example shows, China is prepared to clean up its energy system if it is financially supported to do so. The potential to recoup substantial sums of money from border tax adjustments would provide a strong incentive for the Chinese government to accept a Kyoto target.

Conclusion

The Durban climate summit will not lead to an agreement on new international legally-binding targets to reduce emissions of greenhouse gases. Some negotiators are saying privately that their objective is to 'keep the show on the road' – to avoid breakdown so that they can spend 2012 doing yet more negotiating.

Breakdown must be avoided, but will not be enough. The UNFCCC urgently needs new impetus, which can only be provided by bold political leadership. This can only come from Europe. The Obama administration has failed in most of its attempts to strengthen the US position on climate and energy. 'Climate scepticism' – questioning whether global warming is caused by human activity, despite widespread scientific evidence and agreement that it is – is widespread and growing in the US. And US politics are already dominated by the 2012 presidential election. The Chinese government is taking climate change more seriously than it did, but not nearly as seriously as required.

During Commission President José Manuel Barroso's first term of office the EU led the world in efforts to control climate change. The economic recession and eurozone crisis have eroded Europe's climate leadership. Yet climate policies need not be bad for economic growth. To give one example: improving the energy efficiency of existing buildings could create hundreds of thousands of new jobs that could not be outsourced to people in other parts of the world.

The EU delegation in Durban should stress the economic advantages as well as the human and social necessity of climate action. By emphasising the importance of the draft energy efficiency directive, the EU could demonstrate that, whatever the outcome of the Durban discussions, it will implement policies to protect health, create jobs and increase energy security. By outlining how the ETS would be strengthened, Europe could explain how climate control will be part of its industrial transformation. And by offering to return revenue to countries that accept UN targets, to be spent on clean energy programmes, Europe could inject much needed impetus into international climate negotiations.

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