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**Research Report**

## A tailwind for climate policy

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## A Tailwind for Climate Policy

*Friedemann Müller*

There is new hope for climate policy, and at least three events have provided a reason for this hope: The Russian ratification of the Kyoto Protocol enables it to come into force on February 16, 2005. With Tony Blair's G-8 initiative, announced in a forceful speech on September 14, 2004, a heavyweight in international politics gave his full support to the goals of an extended climate policy for the first time. Finally, on January 1, 2004, the European emissions trading system will come into force, a premiere that is receiving worldwide attention. Now accompanying measures are needed to take advantage of the present boost. The Tenth Session of the Conference of Parties (December 6-17, 2004) in Buenos Aires offers the first chance. This momentum, however, must also be used at the G-8 Summit next year (July 6-8, 2005) to establish a basis for climate policy that extends beyond Kyoto.

The times when President Putin's economic adviser and G-8 Sherpa Andrei Illarionov compared the Kyoto Protocol with the Gulag and Auschwitz, and Prime Minister Fradkov called the protocol "inefficient, unfair and harmful" (September 2004), have abruptly come to an end. Only 7 weeks elapsed from the decision of the Russian Cabinet (September 30) to pass the Kyoto Protocol to the Parliament for ratification, to the votes in the Duma and the Federation Council, to the President's signature and the receipt of the ratification instrument by the United Nations on November 17. The world had waited two years for Russia's accession to the Kyoto Protocol.

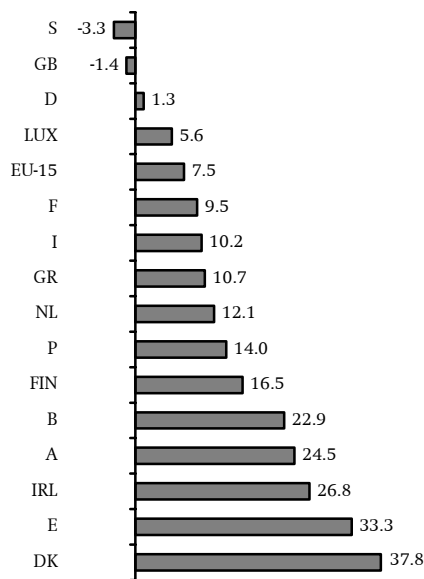
### **The Kyoto Protocol**

With the receipt of the Russian instrument of ratification, the requirements for the first legally binding, multinational climate protocol, adopted in 1997, to come into force have been met: The necessary number of industrialized countries (Annex I Countries), which in the base year 1990 were together responsible for more than 55% of emissions of the Annex I countries, have now ratified the protocol. From now, many countries are confronted with the hard work: adhering to the obligations of the Protocol. In Japan, for example, the country that named the Kyoto Protocol, greenhouse gas emissions have increased 8% although the Kyoto Protocol requires a six percent reduction in between 2008 and 2012. In Canada, which is in competition with the

United States for attracting business and investments, the situation looks even worse (a 20% increase). In addition, various EU member states, such as Spain and Denmark, must undertake brand new efforts if they want to reach their Kyoto targets by the initial commitment period 2008–2012.

**Chart**

**By how many percent will the EU countries miss the Kyoto targets?**  
(Statistics in %, Estimates made on the basis of existing policies)



Source: *EU Commission, EU-News, June 2, 2004.*

The coming into force of the Kyoto Protocol has not only created an instrument for discipline but has also revealed some problems. It is clear that the Kyoto Protocol does not subject those countries which have the highest emission growth rates—e.g. China, India and the large developing countries—to emission limits. In the meanwhile, it has also become clear that in the western industrialized nations altogether, following the exit of the USA and Australia, emissions will increase by at least 10% by 2012 instead of sinking by 6.7%. In any event, the countries for the former Eastern Block including Russia will attain, thanks to the economic decline of the socialist systems from 1990 to 2012, a drastic reduction of their greenhouse gas emissions (40% by 2002). In the

coming years, until 2012, the eastern countries will make efforts, using the flexible instruments of the Kyoto Protocol (emissions trade, Joint Implementation) to sell the results of their “over-fulfillment” (in expert jargon “hot air”) or to implement modernization measures in exchange for a reduction of the obligations of the western industrialized countries.

The Kyoto Protocol was significantly weakened by many factors: the exit of the USA and Australia, the non-inclusion of developing and newly industrializing countries in the emission obligations, and the flexibility available to eastern industrialized countries via economic restructuring, which was already set in motion by the time of the Kyoto negotiations. The countries that have especially contributed to this weakening are those that criticized the Protocol the most and subsequently withdrew their signatures (USA, Australia).

Now however, given that the instruments of the Kyoto Protocol will be available, pressure must be applied to ensure that it will be practiced and applied and that the global efficiency of the system will be improved by the time the next phase begins. In order to do this, the ability of heavyweight political actors to assert themselves is needed, because a consensus for the redirection of enormous investments has to be made.

**Emissions Trading**

The Europeans have, with respect to tradable emissions rights, gone through an astonishing learning process. The initial reluctance during the negotiations of the Kyoto Protocol with respect to the emissions trading, which had only been tested in the USA, has turned into a concrete trading regime on the European level with several thousand market participants. The original American thesis, that emissions trading presented the most efficient form of distributing the scarce goods of emission rights, is being implemented. Indeed, for the time being, not all sectors have been

included—transportation, households and industry are not yet part of the national allocation plans—but for the test phase from 2005 to 2007 a still impressive market will be developed.

As much as one wants this pioneering project to succeed, it is still not clear whether it will be stifled by petty, competing interests. For example, the way the amount of allotments were bargained for in the run up to the creation of the national allocation plan in Germany in Spring 2004 does not bode well for the future. It is true that, in principle, business has welcomed the regulatory instrument of emissions trading. However, when it concerns the allocation of rights—essentially a zero sum game—then the shared responsibility is quickly ignored and, out of self-interest, the threats and fears of competitive distortion, the loss of jobs and the export of entire industries are raised. This is especially problematic because designing emissions trading in the most competition neutral way possible presents an immense challenge for the long-term solution to the climate problem. The magnitude that is involved in the upcoming test phase is just a tiny proportion to the overall problem, which in fact requires a far-reaching restructuring of the global energy sector. This problem is obviously more aggressively taken on in the USA, which focuses more on technological breakthroughs (hydrogen, coal sequestration, etc.) than does Europe (see the Department of Energy’s “Strategic Plan” of 2003). Thus, in order not to relinquish the competitive advantage of the emissions trade right from the beginning and to preserve credibility for the phase in which real restructuring is necessary, more open-mindedness from industry in EU countries would be appropriate.

The phase of an effective climate emissions trade is unfortunately hampered by a not very convincing handling of the national emissions limits in the Kyoto Protocol. According to the Kyoto Protocol, Poland is allowed to emit 31%, Ukraine 88% and Russia 105% more per capita (based on the

census of 2003) than the EU-15, and this is in light of significantly smaller per capita GDP. If these relations were fixed beyond the initial Kyoto commitment period (2008–2012) and these countries were linked to an emissions trading system, there would in fact be a reason to complain about distortions of competition and the export of energy intensive industries. Breaking up these fixed positions, in contrast, will require significant political efforts.

If a long-term global climate regime is to be established, which siphons off the huge potential for efficiency gains in China, India and other newly industrializing and developing countries, a system must be reverted to which the German Advisory Council on Global Change (WBGU), in its Special Report (2003) “Kyoto and Beyond,” adopted as its own. By recommending the “contraction and convergence” approach, the Advisory Council aims at a renunciation of the so-called “grandfathering principle” which underlies the Kyoto Protocol. According to this principle, the emissions of the participating countries in a base year (1990 in the Kyoto Protocol) will be chosen as the starting point for future emission rights. From the points of view of opportunity and political viability, deviations from these rights were agreed upon in the Kyoto Protocol. When this system was in effect, during the Kyoto negotiations, China and India declared that they would not accept limits on emissions. In contrast, the system of “contraction and convergence” is based on a target year (2050 for WBGU), by when the “grandfathering principle” must be converted to a principle of equal per capita emission rights. Such a regime could be agreed upon by and would be worthwhile for developing and newly industrializing countries, which according to the International Energy Agency (IEA, World Energy Outlook 2004) will be responsible for almost 70% of increases in emissions by 2030. It would offer them, to the extent a global emissions trading system would be established, the ideal incentive to increase

efficiency and investments in non-fossil fuels. However, this could also imply massive expenditures for those industrialized nations, which insist on not drastically reducing their carbon emissions. Thus, it is to be welcomed that the WBGU pushes this regime change from “grandfathering” to the principle of “reductions and convergence,” but it has been little discussed in Germany thus far.

### The Blair Initiative

Even if he had already toyed with the idea for a longer time, British Prime Minister Tony Blair first officially committed himself in a speech on September 14 to make climate policy one of the two main themes at the coming G-8 Summit in Scotland. Blair has various goals in mind: in light of the fact that the costs of climate damage could amount to US\$150 billion annually in ten years, emissions which are produced by aviation should be included in the emissions trading regime of the EU, countries such as China and India should be included in a sustainable concept, technological developments—his priorities go far beyond the renewable energy sources promoted by the German government—should be advanced through cooperation between governments and industry.

It is important that the new found momentum continues to grow as much as possible. British-German cooperation and leadership responsibility is desirable. The November 3 conference in Berlin, which was opened by the Queen, was a good start. In fact, Germany must provide a more creative contribution than just reducing its greenhouse gases by 40% by 2020, in comparison to 1990 (under the condition that the EU-15 reduce their emissions by 30%). This would mean specifically that Germany’s share of EU emissions, after the decline in the 90s, would increase again and that (with the same population) the per capita emissions in Germany, which in 2001 were 11% higher than the EU-15

average, would surpass this average by 14% in 2020.

Together with Britain and if possible all EU countries, Germany should now think beyond the Kyoto commitment period 2012. This includes *first* that, in addition to ambitious emissions reductions, research and the development of forward-thinking technologies—renewables alone do not suffice according to multiple calculations—should be emphasized. *Second*, there is a need for more intelligent regulatory guidelines for the inclusion of the newly industrialized and developing countries in emissions limits. This means, in particular, that the regulations which govern the global energy sector—according to the IEA investments in the amount of US\$16 trillion should be expected by 2030—should be designed in such a competition neutral way that the climate objective is attainable. The “contraction and convergence” principle would offer a good starting point. However, the mandate of the annual party negotiations is not adequate for this purpose. The heads of government, following Blair’s example, must give top priority to such a paradigm shift. The G-8 initiative would be a good opportunity.

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