

CEPS COMMENTARY



Thinking ahead for Europe

The 2015 Climate Agreement: What's in it for the EU?

Andrei Marcu

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The European Union, together with other countries, is making a second effort to reach a comprehensive global climate change agreement in Paris in 2015, after the unsuccessful attempt to do so in Copenhagen in 2009.

In a Europe still preoccupied with recovery from the economic crisis, why should the EU be tempted to offer leadership in the field of climate change and what would such an agreement bring? In short: What's in it for the EU?

The road to Paris 2015

The current discussions and negotiations on the global climate change regime have a number of strands. One is the so-called 'Second Commitment Period' (SCP) of the Kyoto Protocol (KP) that was agreed at the Doha Conference of the Parties (COP) and will enter into force once the necessary ratifications by Parties take place.

There are notable absences among the Parties that have signed the SCP, compared to the First Commitment Period of the KP. This makes it a much less representative and powerful protocol, and its ratification seems to take longer than expected. While there were significant issues with participation in the KP, in particular the inability to 'graduate' to a category in an Annex to the KP with commitments, it did have a certain 'Cartesian' logic, simplicity and transparency that stemmed from the fact that it was actually a giant cap-and-trade scheme, with international offsets attached to it.

The EU's ratification of the Kyoto Protocol is being held back by objections from some of its new member states, some quasi-procedural, some very substantive, related to the accounting of so-called 'assigned amount units' (AAUs) in the KP Second Commitment Period.

There is a point where this delay will start to affect the EU's credibility with its partners in the Durban coalition, especially the Small Island Developing States (SIDS) and the Least Developed Countries (LDC). They had made their own concessions as part of the deal with

Andrei Marcu is Senior Advisor and Head of the CEPS Carbon Market Forum.

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the EU in Durban and now they are starting to ask questions. If this continues, it may have some bearing on the upcoming rounds of negotiations leading to Paris and the levels of trust within the Durban coalition.

Another strand is the set of Copenhagen/Cancun commitments (under which Parties took commitments voluntarily, generally up to 2020), which are applicable to a whole set of countries. Only time will tell if these commitments are met. This strand is coupled with discussions under the so-called 'ADP Workstream 2',¹ which is looking at increased levels of ambition leading to 2020. That track is 'going nowhere fast'. It includes the EU's commitment to a higher level of ambition of a 30% reduction in GHGs compared to 1990 levels, which was outlined as a possibility in the 2020 Climate and Energy Package (in the case of an international agreement in Copenhagen). This is clearly not on the EU's agenda anymore.

The final strand is the negotiation of the global climate change agreement, which is due to be finalised in Paris at the COP in 2015. This negotiation is conducted under ADP Workstream 1. While this is the main ongoing event, in itself it has a number of subplots, one of which is finance and the commitments to support action after 2020.

Climate finance, and especially the Green Climate Fund (GCF), is also critical to the trust that is established between Parties ahead of the last 12 critical months leading to Paris. France and Germany have made commitments at the UN Climate Summit in New York to initiate the capitalisation of the GCF, each committing \$1 billion; Denmark, Luxembourg and the Czech Republic followed with \$70 million, \$5 million and \$5.5 million, respectively, but that does not seem to 'cut it' with the G77 and China partners.

The other element in the EU's preparation for Paris is, not unlike other Parties, to put on the table an Intended Nationally Determined Contribution (INDC) in the first quarter of 2015. It clearly had the intention to put forward a 40% reduction in GHGs compared to 1990 at the UN Climate Summit in September 2014 in New York. That did not work for others, and did not work for the EU. The -40% still remains the target that the EU wants to be able to present, but it needs to have it approved at the October Council.

Finally, the recent administrative changes in the European Commission, where the DGs of Energy and Climate were combined under one Commissioner, were welcomed by many in the EU as a good thing; that is, recognition of the need for better integration and coordination between these two portfolios. Yet it triggered concerns in the European Parliament and has raised eyebrows in the G77. It is seen by some as signalling, ahead of Paris, that climate change may now be playing more of a co-benefit than a central role, and that the EU is not willing to assume the role of leadership to the same degree as it once did, for many years.

International landscape

In reflecting on the role of the EU and its rationale, one must also recognise other changes in the international landscape, not only from the Copenhagen COP, but also going back to the Rio UN Conference on Trade and Development in 1992.

The international economic order and emissions profile has changed significantly. Tables 1, 2 and 3 show how different the world is now. While in Kyoto it was acceptable to have the

¹ The mandate of the ADP (Ad Hoc Working Group on the Durban Platform for Enhanced Action), established in December 2011, is to develop a protocol, another legal instrument or an agreed outcome with legal force under the Convention applicable to all Parties, to be completed no later than 2015, for adoption at COP 21 in Paris in 2015 and implementation from 2020 onwards.

Clean Development Mechanism as an instrument to help with development, in exchange for 'cheap credits' that lower the costs of meeting the compliance obligations of developing countries, in 2014 it is not acceptable to have the Clean Development Mechanism (CDM) subsidise competition to EU industry. The world has changed and the climate change regime must recognise that.

Table 1. GDP (in billions of PPP USD)

Country	GPD 1997	Share worldwide GDP (1997), in %	GDP 2010	Share worldwide GDP (2011), in %	Δ 1997-2011, share worldwide GDP, in %
Australia	444.15	1.224	877.22	1.175	-4.00
Brazil	1,125.57	3.012	2,186.54	2.928	-2.79
Chile	133.49	0.368	276.80	0.371	0.82
China	2,285.33	6.297	10,128.40	13.562	115.37
Germany	1,914.29	5.275	2,957.38	3.960	-24.93
India	1,251.59	3.449	4,051.36	5.425	57.29
Indonesia	523.76	1.443	4,051.36	1.385	-4.02
Japan	3,105.05	8.556	4,384.48	5.871	-31.38
Mexico	887.66	2.43	1,569.89	2.10	-13.58
Russia	965.11	2.659	2,237.41	2.996	12.67
Saudi-Arabia	314.94	0.868	628.93	0.842	-3.00
Singapore	112.40	0.31	293.69	0.39	25.81
South Africa	263.26	0.725	526.95	0.706	-2.62
UK	1,273.62	3.51	2,223.25	2.977	-15.19
US	8,332.35	22.961	14,498.93	19.414	-15.45
EU-27	9,124.47	25.143	15,283.06	20.464	-18.61
World	36,246.70	100	74,683.81	100	

Source: IMF World Economic Outlook 2012.

Table 2. GDP per capita (in PPP USD)

Country	GDP per capita (1997)	GDP per capita (2010)	Growth (percentage)
Australia	23,867.08	39,545.16	165.69
Brazil	6,872.47	11,314.41	164.63
Chile	9,021.85	16,192.75	179.48
China	1,848.59	7,553.38	408.60
Germany	23,330.32	36,172.68	155.05
India	1,291.97	3,403.00	263.40
Indonesia	2,628.27	4,352.65	165.61
Japan	24,634.41	34,240.98	139.00
Mexico	9,386.74	13,977.30	148.90
Russia	6,529.82	15,657.16	239.78
Saudi Arabia	16,543.75	22,818.04	137.93
Singapore	28,622.05	56,708.69	198.13
South Africa	6,182.12	10,540.87	170.51
UK	21,840.79	35,730.86	163.60
US	30,541.33	46,811.20	153.27
EU-27	19,159.04	30,604.20	159.74

Source: IMF World Economic Outlook 2012.

Table 3. CO₂ emissions per country (in thousands of metric tonnes)

Country	CO ₂ emissions (1997)	CO ₂ emissions (2009)	Growth (percentage)
Australia	333,624	400,194	19.9536
Brazil	300,547	367,147	22.1596
Chili	56,171	66,732	18.8015
China	3,469,510	7,687,114	221.5619
Germany	863,975	734,599	-14.9745
India	1,043,940	1,979,425	89.611
Indonesia	278,659	451,782	62.1272
Japan	1,201,632	1,101,134	-8.3635
Mexico	358,383	446,237	24.514
Russia	1,559,238	1,574,386	0.9715
Saudi Arabia	216,239	432,772	100.136
Singapore	69,240	31,896	-53.9341
South Africa	371,328	499,016	34.3869
UK	553,673	474,579	-14.2853
USA	5,501,365	5,299,563	-3.6682
EU-27	4,009,329	3,617,579	-9.771

Sources: UN and Carbon Dioxide Information Analysis Center (CDIAC), US Department of Energy.

For many years, the EU has had an open floor on which to show leadership. More recently, many see the US-China trade relationship as the one to watch, in many fields, including climate change. This is in spite of the EU's bloc of 500 million people, which makes it a major economic power and the world's largest trading entity. Is the EU thus punching below its weight?

While the US has had trouble taking the lead in the United Nations Framework Convention on Climate Change (UNFCCC) negotiations, and in implementing federal domestic legislation, a series of regulatory decisions and state-level activities have made its role much more visible, and certainly more credible, and this has allowed it to become more assertive.

The situation is similar in China, as well as in some other countries that are implementing an increasing number of programmes to address climate change and making their presence felt in international climate change discussions. While calculating the costs of these programmes may not be easy, it does not mean that they are without cost. In some cases the costs are significant.

There is also increasing sophistication and knowledge about international negotiations from the G77 and China, which is being felt in how negotiations are expected to be conducted, through the questioning of assertions and positions and options that the group is able to put forward. The emergence since Kyoto of groupings such as the Environmental Integrity Group, Like-Minded Developing Countries (LMDCs) and the Independent Alliance of Latin America and the Caribbean (AILAC) testify to this fragmentation, but also to its growing sophistication.

Why is the EU's role under scrutiny?

What does all this mean for the EU? One view is that the EU feels that it has to lead by example, and show a high degree of ambition, similar to what it did on Copenhagen. But it also shows

the difficulty it is having in garnering support on the domestic front where both the approach and the implementation strategy are coming under scrutiny, and will increasingly do so as the Paris meeting starts to come into focus.

Why this increased scrutiny?

Climate change negotiations are presented as negotiations towards an environmental treaty. Fundamentally this view is correct because the trigger, the core problem, is environmental, driven by the generally accepted need to limit the concentration of greenhouse gases (GHG) in the atmosphere and to curb the temperature rise to 1.5 or 2 degrees Celsius. There are still a number of sceptics who speak up occasionally, probably more than we might think, but in the EU it is generally a difficult proposition, both socially and politically, to advocate a climate-sceptic line. The negotiations are also generally led by the Ministries of Environment, with an uneven presence of officials from Foreign Affairs and Economic departments in negotiation delegations.

In reality, the debate over climate science takes place in the Intergovernmental Panel on Climate Change (IPCC) and is not the central factor in the UNFCCC negotiations for the 2015 Paris agreement. Most of the items on the agenda would not be out of place in a trade and development negotiation: they include intellectual property rights, finance, capacity-building, technology transfer and markets.

The EU approach to the 2009 Copenhagen COP had been designed in a period of economic prosperity, in conjunction with its '2020 Climate and Energy Package'. The likely scenario at that time was based on a number of assumptions, which included an increasing price for fossil fuels, and rapid de-carbonisation, driven by high carbon prices in the EU Emissions Trading System (ETS). Competitiveness was thought to be addressed through the Copenhagen climate change agreement, where the EU's main trade partners would also take commitments.

This was seen as win-win scenario for the EU, which had an energy deficiency and was a big importer of fossil fuels. The EU had an increasingly sophisticated renewable energy industry that could lead to industrial renaissance, exports and jobs, while providing leadership with the 'soft power' of ideas from the high moral ground of global environmental protection.

Reality has turned out to be rather different, however. The economic crisis, a different energy scenario, driven by shale gas in the US and much lower economic activity, have all negated some of those assumptions. Fossil fuel prices turned out to be much lower than expected, including coal prices. Carbon prices in the EU emissions trading system (EU ETS) collapsed, and there was no Copenhagen agreement.

Other unforeseen developments played a significant role, including the Fukushima accident and the subsequent decision by Germany to rebalance its energy profile. Furthermore, while many jurisdictions are emerging from the economic and financial crisis, the EU as a whole still seems to be stuck, and this also affects European public opinion.

It must therefore come as no surprise that the issue of competitiveness has been increasingly tied to the EU's domestic energy and climate policies, carbon leakage (with its trade and investment component) and its stance on the 2015 climate change negotiations.

It is a stark departure from the 2008-09 situation when the 2020 Climate and Energy Package was agreed and the EU positions for Copenhagen were prepared. It is increasingly acceptable, if not fashionable, to question the rationale for the EU domestic and international positions and the rationale for it showing leadership.

What's in it for the EU?

This brings us back to the question of why the EU needs a 2015 agreement.

Soft power

The EU needs to continue to be seen as the leader. But the case cannot rest solely on the merits of 'providing leadership', as a component of the EU 'soft power' approach. That is not an unimportant component; it is actually a very significant and legitimate one. However, it needs to have the added justification of what concrete deliverables it will have for the EU – deliverables that will bring tangible benefits.

Given that European society sees climate as both a significant danger and a challenge, it feels that it is in its own interests to address it. The oft-cited 'cost of inaction' is in itself a compelling case for action, but what can international leadership and international agreement bring?

Competitiveness and carbon leakage

An international agreement can first and foremost bring transparency to the actions undertaken by competitors, through many components, including transparent accounting provisions. An international agreement could help provide answers to two questions:

- Can the 2015 Agreement help understand what other Parties, especially the EU's trade competitors, promise to do in terms of action?
- Can the 2015 Agreement help determine how the commitments are met; that is, what actions and costs are incurred, how it will affect the competitive stance of that Party?

We are currently in a world of perceived (and in many cases real) asymmetrical climate change policies. This is the result of climate change policies in one jurisdiction (e.g. the EU) that imposed a cost that is higher than that imposed through policies implemented by its trade partners. The visible price of carbon from the EU ETS, and the shadow one (through Renewable Energy and Energy Efficiency targets, which are much higher in many cases) are the most notable examples.

While the EU was alone for a while, that is no longer the case: there is a visible price of carbon in California, Quebec and the Regional Greenhouse Gas Initiative (RGGI), but there are also shadow prices in other jurisdictions. There will be other carbon pricing mechanisms such as in Mexico, the Republic of Korea and South Africa. And the World Bank's Partnership for Market Readiness (PMR) tells us that there are more to come.

Each of the Carbon Price Mechanisms is in some way different from the others. However, they share one common element: the concern over competitiveness, and how to mitigate the risk of carbon leakage. Different carbon-leakage risk-mitigation measures are proposed, with free allocation being a common denominator for the time being. This trend will continue; no one will want to lower the 'insurance' that it provides to its industry, or lose the political peace that it buys. However, national barriers and exemptions through free allocation are not a long-term solution, if the goal is similar to the EU's 80% de-carbonisation by 2050. An international cooperative agreement will have to be found to address competitiveness, and the 2015 agreement is the foundation for that. It is unlikely that there will be provisions to that effect in the Paris text, but the transparency provisions will make further discussions leading to the next round of commitments much more feasible.

Transition to a low-carbon economy and sustainable energy

The EU has started this transition, and various member states have reached different stages of this progression. The situation in Ukraine has served to highlight some real, or perceived, vulnerabilities of the EU in terms of diversification and energy security. This also shows the increasing need for efficiency and innovation to keep EU industry competitive.

The 2015 agreement should ensure that the main trade competitors of the EU will also have to make commitments and take action. An international coordinated transition to a more sustainable energy matrix will favour the EU as it is unlikely that it will be able to compete on energy prices.

The transition needs to be sustainable and show balanced environmental progress and economic sustainability, including stability in energy markets. The EU cannot do this alone and will benefit from an international climate change agreement.

Carbon markets

One of the fundamental tenets of the EU climate change policy is that carbon pricing, through a well-designed and liquid carbon market, is important. The EU ETS was designed and continues to be presented by the EU as the central pillar of its climate change policy.

The EU ETS has served as the central hub of an international market in a number of jurisdictions, through the CDM and Joint Implementation (JI). However, as the EU never intended, nor is it able, to absorb through its EU ETS, all international units of reduction created through such systems, it is now prioritising the creation of a global carbon market and focusing on linking with other cap-and-trade systems, together with credits from developing countries that are not trade competitors.

This can be done under the provisions of the KP, but there is no similar framework to help create linkages post-2020. A 2015 agreement can provide the accounting transparency, and assurance of quality in international transfers to address environmental integrity, minimise the overall cost of compliance and competitive concerns.

Reflections

The 2015 climate change agreement is important to the EU, for all the reasons outlined above. It may also be true that the EU's leadership role is changing. That may not be unreasonable because the world has changed, the discussion has moved on, and the global economic order has also changed.

The EU needs to continue to be a leader, however, for the sake of the world and for its own interest. But others will come and share that leadership and help shape it together. It is the only way that we, the EU, can be successful in Paris.