

EFFECTIVE GLOBAL CLIMATE PROTECTION IS ONLY POSSIBLE WITH AN EXTENDED INTERNATIONAL SYSTEM OF TRADABLE EMISSION RIGHTS, SAYS **JUERGEN HACKER**

# Missing Links

The U.N. Security Council on July 20 unanimously expressed its concern about the impact of climate change on world peace and security and the territorial integrity of individual nations. However, this announcement cannot disguise the fact that the U.N. climate change talks are at an impasse.

Agreement has been reached to limit global temperature rises resulting from man-made climate change to 2 degrees Celsius. But no progress to secure this target was made either at the high-level U.N. climate talks in Cancun last December or at the follow-up meetings, so far, this year. Little is expected from the next high-level talks in Durban, South Africa, at the end of the year.

Yet, the solution for providing effective global climate action has long been known – a global system of tradable emission rights. Only through such a scheme – involving, in the long term, all countries and business sectors – can global greenhouse gas (GHG) emissions be reduced drastically below current levels and, at the same time, minimise the unavoidable costs for the global economy. The achievement of both goals will be the only way for governments to gain and keep public support.

Political decisions are required on two criteria – the desired probability of staying below the 2C target, and the peak year when global GHG emissions stop rising and start to fall. On this basis, climatologists can establish the maximum global GHG emissions permissible each year in the coming decades.

This analysis will determine the annual budgets for emissions rights that are available to the global economy. The emissions rights will be auctioned worldwide and will then be freely tradable. The markets will identify existing reduction measures and find new, cost-effective measures so that only emission reduction or avoidance measures with the lowest specific costs per GHG equivalent will be implemented.

While independent national emissions trading systems can, in sum, be environmentally targeted as effectively as a global system, the magnitude of the task of reducing emissions means that we also require the full economic potential of tradable emissions rights.

The greater the cost differences within the boundaries of the system, the greater the potential saving or the potential for additional emission reductions at the same cost. The



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lower the specific cost differences, the smaller this potential will be. System boundaries here refer not only to internal sectors of one national economy, but also to national borders. A regional system offers more potential savings than separate national systems, and a global system more than separate regional programmes.

However, linked systems not only offer greater optimisation potential than independent national schemes, they also reduce the threat of relocation of emissions-intensive industries to countries without strict climate policies – so-called carbon leakage. This threat of leakage has been raised to block nearly all national attempts to introduce cap-and-trade, most notably in the U.S.

In theory, national systems could be linked at a later date, but the experience of recent years shows that unless there is prior agreement, national schemes may never be implemented at all. Without a common approach in the EU there would have been no national programmes across the 27 member states. For example, initiatives in Germany in the mid-1990s failed miserably.

The third advantage is that a global or linked approach can simplify the design of the system. Therefore, bureaucracy surrounding a scheme could be cut, especially regarding the initial allocation of emission rights. This offers benefits both for the countries involved and those acquiring the emissions rights.

Without the risk of relocation of emissions-intensive industries, all the emissions rights can immediately be auctioned without the need to allocate some or all of the emissions rights for free to the most affected sectors of the economy. The experience of the first three compliance periods of the European scheme has shown only too clearly the enormous effort involved with “free” allocation.

The government first has to develop allocation criteria under massive pressure from lobbyists, whether nationally or with EU-wide harmonisation, and based on historical emissions or on product benchmarks. Following this, much work is required to draw up and verify the applications for allocation, to process and approve them. In some cases, this process also has to go through judicial review. None of this is necessary in a global or linked system.

### Overcoming the U.N. impasse

The full auctioning of emissions rights would also help to break the impasse encountered in the U.N. climate negotiations. This is because it would no longer be necessary to establish any rigid emissions limits for national economies. Decisions would be required on the distribution of the global emissions rights budget only, and, more precisely, the allocation of the auctioning revenues. These would have to be divided fairly between countries.

In the long term, the only acceptable way to decide the budget and allocate revenues would seem to be on a per capita basis. Of course, this would involve large transfers of money from rich to poor countries. But this is only fair, because all people have the same fundamental rights, including the use of the earth’s atmosphere. Therefore, the recipient governments should pass the money directly to its populations. Certainly the auction revenues do not belong to the emitting industries or the government bureaucracies for subsidising projects.

Although a U.N. agreement on a global system does not seem feasible in the short term, it would be possible to begin “linking” the existing regional and national systems with programmes that are currently in preparation. For example, linking the EU and New Zealand with Australia, Japan, South Korea, China, USA, Mexico, etc and then expand it step-by-step as other countries join in, gradually leading towards a global system. The question is whether the first step should be to form regional systems or whether global linking should be the goal right from the start.

The following things should be taken into account.

Linking of national systems will not happen by itself.

Someone (a government) must take the initiative to bring the interested (willing) countries to the negotiating table.

In the beginning, this need not involve all the countries in a region or all countries worldwide, but only a “critical mass” with respect to emissions and economic power.

By setting up semi-regional or semi-global systems, as though they were already components of a global system, it will be easier for other countries to “join in” or for regional systems to link together.

Systems need not be identical, but essential structural elements should be harmonised in order to avoid distortions of competition within the linked systems.

Of course, linking systems appropriately is not a trivial matter, and it will represent a regulatory challenge. Price- and quantity-related interaction requires the coordination and harmonisation of at least the following design elements:

- distribution of rights budgets between countries: on a per capita basis;
- allocation rules: total auctioning;
- economic sectors included: all if possible (including transport and heating sectors);
- banking: yes; and
- borrowing against future years: no.

There is the need for basic harmonisation of the emissions rights register, the monitoring, reporting and verification

## No other instruments can offer the environmental effectiveness and cost-efficiency

of emissions, and the safeguarding of compliance with the duties to issue permits in accordance with the verified emissions.

Finally, it is necessary, at least in the initial stages, to provide protection against competition from other countries that have not implemented comparable climate measures. This could include agreement on compensatory measures for sensitive products on the outer borders of the systems. These should be maintained until the system has become so large that the distortion of competition becomes marginal. The more credible the compensatory measures are, the fewer states will avoid cooperation and, thus, the less need there will be to implement the measures at all.

The proposed (semi-) regional linking of national systems by 2015 and a semi-global system by 2018–2020 are ambitious targets, but the challenge of the 2C target demands high economic efficiency. No other political instrument or mix of instruments can offer the same environmental effectiveness and cost efficiency for reaching this target as a well-designed system of tradable emissions rights. Therefore, a global system of tradable emission rights is essential by 2025–2030 at the latest. ●

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