

# International Energy Law Review

## Climate Policy On the Road to Copenhagen

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Climate change is a subject still in the early stages of unfolding. Communities and policymakers are only just beginning to understand the reality of its dimensions and ramifications.

Because climate change has so many angles: environmental, political, scientific, economic, social, ethical and legal, it invites grand statements and attracts controversy. For almost any assertion or generalisation, one hears a contrary view – or there is a specific instance that does not easily sit with the generalisation.

Communities and policymakers have a need to develop a shared understanding of the answers to a number of key questions:

- (i) what is really responsible for the high level of global greenhouse gas emissions?
- (ii) what is the science now telling us we should do about it?
- (iii) what initiatives and abatement technologies are best suited for the task?
- (iv) in mature economies, can emissions be cost-effectively throttled back without disproportionately penalising particular industries for no global environmental benefit?
- (v) in growing economies, can projected increases in emission rates be cost-effectively contained?
- (vi) how can sufficient investors be attracted to make the necessary investments?

### The International Climate Negotiations

In Rio de Janeiro in 1992, the Conference of Parties to the UN Framework Convention on Climate Change (UNFCCC) agreed that developed economies would take the lead in addressing climate change. The UNFCCC also called for cost-effective measures to bring about global benefits at the lowest possible cost.<sup>1</sup>

Since Rio, there has been protracted and wide-ranging public debate over the causes and consequences of climate change. Now this is being overtaken by debate over what can actually be done about it and who has the capacity to undertake this.

In December 2008, the 192 parties to the UNFCCC will meet at COP 14 in Poznan, Poland to discuss the 'nuts and bolts' of the Copenhagen Protocol. Poznan is seen by the UNFCCC Secretariat as '*an important stepping stone on the way to COP 15 in Copenhagen*', where it is intended that '*an ambitious climate change deal will be clinched to follow on the first phase of the Kyoto Protocol, which expires in 2012*'.<sup>2</sup>

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<sup>1</sup> UN Framework Convention on Climate Change, Section 3.

<sup>2</sup> UNFCCC Fact Sheet: Poznan – COP 14 / CMP 4.

The parties will assemble in Copenhagen in December 2009. With the collapse of the WTO Doha Round discussions highlighting the difficulties of reaching global agreements, the prospect of achieving a comprehensive agreement are daunting. The negotiations will be deeply political.

At COP 13 in Bali, the parties established a subsidiary body called the Ad Hoc Working Group on Long-term Cooperative Action (AWG-LCA) to conduct negotiations on the Copenhagen deal. The Group's mandate is to enable *'full, effective and sustained implementation'* of the UNFCCC, commencing with the articulation of a shared vision of cooperative action.<sup>3</sup>

For Copenhagen, the Group may be well advised to go back to first principles. It needs to start with a global cost-benefit analysis, undistorted by political geography. And this must be followed at COP 15 by a discourse that is not deflected by preconceptions or partisanship. This would be more in keeping with the shared concerns that first brought the parties together in 1992.

### **The Global Nature of the Problem**

Nicholas Stern of the UK widened the international public debate in 2008 with the publication of his study, the Stern Review on the Economics of Climate Change ("the Stern Review"). Three analogous pieces of work have since been produced in Australia: in 2007, the Report of the Prime Ministerial Task Group on Emissions Trading chaired by Peter Shergold ("the Shergold Report") and, in 2008, the draft Garnaut Climate Change Review ("the Garnaut Review") and the Australian Government's Green Paper on a Carbon Pollution Reduction Scheme ("the Australian Green Paper").

Stern grandly described climate change as *"the greatest market failure the world has seen."*<sup>4</sup> Many people would however regard market failure as an unsatisfactory explanation of climate change, even if it has some resonance with economists.

Increased levels of emissions are of course a by-product of industrialisation. The climate change problem is a global environmental problem, and it is a problem without precedent.

This is not an academic or intellectual criticism. Well-intentioned municipal politicians can easily be deluded into thinking that regulatory intervention in their domestic economies, by imposing emissions limits, is the best contribution they can make to solving the global problem. This is what many communities are now being asked to accept.

There is much more to solving the climate change problem than domestic market intervention. The challenge is how to reduce global emissions. We need to keep reminding ourselves of the stark truth: that all emissions are global emissions. No country can quarantine itself from the emissions of others any more than it can prevent its own emissions from escaping into the atmosphere.

As the Garnaut Review neatly explained, *"Climate change is a global problem that requires a global solution."*<sup>5</sup> And as the UNFCCC acknowledges, *"Climate Change is not restricted to national*

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<sup>3</sup> In this regard, Japan is making a particularly constructive contribution. See Government of Japan, "Information, Views and Proposals on Paragraph 1 of Bali Action Plan (For AWG-LCA2)", UNFCCC, 30 May 2008.

<sup>4</sup> Sir Nicholas Stern, Launch Presentation of the Stern Review on the Economics of Climate Change, London, UK, 30 October 2006, precedent by the explanation *"When people do not pay for the consequences of their actions we have market failure."*

<sup>5</sup> The Garnaut Review, p 18.

*boundaries. Fighting it therefore only makes sense through concerted action on the international level.*<sup>6</sup>

The Garnaut Review acknowledged that the combination of high oil prices and fears about energy security would promote the search for alternatives. However, this would also have the effect of increasing demand for coal, which is burdened by higher emissions characteristics.<sup>7</sup>

### **A Diabolical Policy Problem**

If climate change is a failure of anything, it is a failure of policy. The Garnaut Review called it "*a diabolical policy problem*", emphasising that "*effective remedies lie beyond any act of national will, requiring international cooperation of unprecedented dimension and complexity.*"<sup>8</sup>

The solution to the climate change problem is multi-faceted and must encompass a range of environmental, political, economic, social, technological and legal responses. The solution must also involve the "big three emitters": China, India and the United States.

### **Uncertainties in the Science**

Both the Stern and Garnaut Reviews acknowledged the large uncertainties in climate science as well as prominent dissenters in the scientific debate, who believe that human-induced increases in greenhouse gases are trivial by comparison with other causes of climate variations. Weighing the uncertainties up, the Garnaut Review concluded that "*the outsider to climate science has no rational choice but to accept that, on a balance of probabilities, the mainstream science is right.*"<sup>9</sup>

### **The Position of the Developing Economies**

Like the rest of the world, the developing countries, including the two largest, China and India, express great concern about climate change. However, there is no more telling criticism of the international negotiations to date than that all attempts to impose emissions caps have failed to win their support.

China has appealed to the developed economies to provide financial assistance and to transfer technology to enhance the capacity of developing economies to address climate change.<sup>10</sup> China has its own strategic priorities and is sticking to its chosen development strategy.<sup>11</sup> In the meantime, it is becoming increasingly dependent on imported energy. Its imports include oil from many sources and LNG and coal from Australia and it will soon accept its first shipment of Australian uranium.

India is also greatly concerned. On 30 June 2008, India's Prime Minister launched India's National Action Plan on Climate Change with the acknowledgment that "*Today, climate change ... threatens our planet. There is a real possibility of catastrophic disruption of the fragile life-sustaining ecological*

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<sup>6</sup> UNFCCC Fact Sheet: Stepping up International Action on Climate Change: The Road to Copenhagen.

<sup>7</sup> The Garnaut Review, p 107.

<sup>8</sup> Ross Garnaut, address to the National Press Club, Canberra, 4 July 2008.

<sup>9</sup> The Garnaut Review, p 1.

<sup>10</sup> China's National Climate Change Programme, National Development and Reform Commission, Beijing, June 2007.

<sup>11</sup> Joanna Lewis, "China's Strategic Priorities in International Climate Change Negotiations", Washington Quarterly 31 No 1, 2007.

*system that holds this world together".<sup>12</sup> However, India's new Action Plan plainly states that " ... the principle of equity that must underlie the global approach must allow each inhabitant of the earth an equal entitlement to the global atmospheric resource. In this connection, India is determined that its per capita greenhouse gas emissions will at no point exceed that of developed countries even as we pursue our development objectives. "<sup>13</sup>*

India's repeated references to per capita emissions are wearing thin. If a per capita basis were to be universally applied, it is unlikely that the climate change problem will ever be solved.

The main challenge is to provide positive incentives for both developed and developing economies to use more low-emissions fuels and adopt low-emissions-intense production processes and transportation systems.<sup>14</sup> For developing economies, instead of caps on their emissions, a quota system of green development projects could hold more promise.<sup>15</sup>

### **The Role of Domestic Emissions Trading Schemes**

Various proposals for domestic 'cap and trade emission' reduction schemes largely based on the EU model, have recently been put forward. In considering an emissions trading scheme, the question that any economy, especially a comparatively small economy like Australia, must ask is: what is a realistic, cost-effective domestic scheme, given the above uncertainties? Can an emissions trading scheme in an individual economy be framed so as to be cost-effective in global environmental terms and without penalising particular industries?

The connection between the proposed market intervention in Australia and the reduction of global emissions is so remote that it is almost non-existent. With a continuation of current global policies, global emissions are projected to increase by 57% by 2030, driven mainly by coal use in China and India.<sup>16</sup> It would be wrong to hold out hope to Australians that a domestic emissions trading scheme could reduce the danger of the drying up of the Murray-Darling Basin in Australia, as it would be to hold out hope to Chinese that it could reduce the danger of desertification in Western China. What is required at the very least is for global policies to change.

The Australian Green Paper nonetheless justifies its proposed domestic scheme with the platitude that market failure can be redressed by making *"those who generate the pollution ... accountable for the costs they impose on us all."*<sup>17</sup> However, the majority of the world's emitters remain unaccountable for these costs and are still showing little sign of accepting much more than token accountability.

### **The Need for Investment in Low-Emissions Energy Technologies**

The most urgent policy priority is to accelerate investment in low-emissions energy technologies, starting with expansion of natural gas production and transportation and, in some countries, development of nuclear power generation.

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<sup>12</sup> Dr Manmohan Singh, Prime Minister's Speech on Release of Climate Change Action Plan, New Delhi, 30 June 2008.

<sup>13</sup> Government of India, "National Action Plan on Climate Change", 30 June 2008.

<sup>14</sup> *"It is urgent for industrialised countries to seize today's opportunities to develop a more sustainable energy path that can enable developing countries to leapfrog the polluting phase of economic growth."* International Energy Agency, "IEA Work for the G8, 2008 Messages", Paris, 2008.

<sup>15</sup> The idea of a quota was outlined by Liz Bossley of Consilience Energy Advisory Group of the UK in "Time is Running Short for a Post-Kyoto Protocol Deal," Middle East Economic Survey, 7 April 2008.

<sup>16</sup> International Energy Agency, "World Energy Outlook 2007", Paris, France, 2008.

<sup>17</sup> Australian Green Paper, p 2.

As Yvo de Boer recently made plain:

*"What the world needs is a global, low-emissions economic development plan that makes climate-friendly economic growth globally viable. Such a plan needs to ensure that especially developing countries are tied into it and benefit from its fruits. A quick look at anticipated energy investments clarifies how important this is.*

*The energy sector is responsible for by far the largest share of global CO2 emissions. According to the IEA, global energy demand will grow by 55% by 2030. In the period up to 2030, the energy supply infrastructure world-wide will require a total investment of \$22 trillion, with about half of that in developing countries....*

*This means that we face the challenge of greening this massive investment sum by creating win-win opportunities for the money to be invested in low-emissions technologies, such as renewable energies. If we fail to achieve this, emissions will go up by 50% instead of down by 50%, as science says they should."<sup>18</sup>*

Clearly, the process of investment is pivotal to solving the climate change problem.

### **The Global Playing Field**

A potential danger with any emissions trading scheme is to impose costs on emissions-intensive, trade-exposed industries that would make them internationally uncompetitive. This would distort the global playing field on which they compete.<sup>19</sup> Neither the EU scheme or any other scheme has gone as far as what Australia is considering.

As the Garnaut review explained the concern:

*"A potential distortion arises if an Australian emissions trading scheme is introduced in the absence of ... an international arrangement that results in similar carbon constraints or carbon pricing among major trade competitors ... the concern is that some firms may reduce their level of production too far ... [and] ... once productive capacity is lost, the effect may not be reversible at a later stage when a carbon-inclusive world price eventuates ..."<sup>20</sup>*

The ideal outcome of the international negotiations in Copenhagen would be a comprehensive global agreement involving all major emitting nations. This need not however exclude the possibility of cooperative sectoral agreements for specific industries.

Trade-exposed firms in an exporting economy should not be fettered by domestic emissions limits if they can export goods with no greater emissions-intensity than can be produced in importing economies. Domestic emissions limits that impede exports of low-emissions fuels or low-emissions-intensive products are not only sub-optimal in global environmental terms but will be counter-productive if they subordinate efforts to reduce global emissions to the pursuit of national emissions targets.

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<sup>18</sup> Yvo de Boer, Executive Secretary of the UN Framework Convention on Climate Change, address to the Africa Carbon Forum, Dakar, Senegal, 3 September 2008.

<sup>19</sup> Trevor Houser et al, "Leveling the Carbon Playing Field", Peterson Institute for International Economics and World Resources Institute, Washington DC, May 2008.

<sup>20</sup> The Garnaut Review, pp 382-383.

## Prospects for Cooperative Sectoral Agreements

Cooperative sectoral solutions were recently discussed at the UNFCCC workshop in Senegal. Sector-specific agreements can be negotiated between participating countries who agree to act simultaneously to introduce the same emissions limits on particular industries that compete on global markets. Examples are metal producers, such as aluminium producers, and LNG exporters.

The IEA has suggested that sectoral agreements may be more plausible than a comprehensive global agreement and that greater attention should be given to them in the international climate negotiations.<sup>21</sup> Australia is well positioned to initiate a sectoral approach to low-emissions energy exports. This could be achieved by Australia recognising emission reductions abroad that are attributable to the use of low-emissions fuels exported by Australia. This would accelerate the export of Australian low-emissions fuels, such as uranium and LNG, and would increase the volume of low-emissions fuels consumed by the energy-hungry nations of the world.

## Conclusion

The introduction by any country of a domestic trading scheme to regulate emissions can establish a domestic price for carbon. Any such scheme will also have a demonstration effect on other developed economies. But it will not make a significant dent on global emissions unless all major emitters take similar action.

Given that all emissions are global emissions, a national emissions target must always be subservient to gains that can be achieved globally. If low-emissions fuels are exported by one country, surely they should have an entitlement to offsets generated abroad or an exemption from any domestic trading scheme. LNG exports could therefore quite feasibly be the subject of the world's first sectoral agreement for greenhouse gas mitigation.

Two things cannot be in dispute: first, greater investment in low-emissions energy technologies is pivotal to solving the climate change problem. Secondly, there is a need for communities and policymakers to develop a more widely-shared understanding of the climate change problem and its potential solutions before their governments head off to Copenhagen for the deeply political international negotiations.

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<sup>21</sup> Richard Baron et al, "Sectoral Approaches to Greenhouse Gas Mitigation: Exploring Issues for Heavy Industry", IEA Information Paper, International Energy Agency, Paris, France, November 2007.