EU Communication

INTERNATIONAL CLIMATE FINANCE

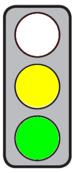
Status: 19.10.2009

cep Centrum für Europäische Politik

MAIN ISSUES

Objective of the Communication: The Commission presents its ideas for financing the climate agreement to be negotiated in December 2009 in Copenhagen.

Groups Affected: The entire economy



Pros: (1) It is necessary to take a worldwide approach to mitigation which also includes financial support for developing countries.
(2) International emissions trading should be used as the key instrument for the financial support of developing countries.
(3) As it is not possible to finance the planned EU financial aids for developing countries through the EU budget, and an independent EU fund is ruled out for this purpose as it would create a lack of transparency, the Commission's proposal of financing using the budgets of Member States is to be welcomed.

Cons: Advance payments to developing countries for announced emission reductions will create significant problems in terms of monitoring and surveillance.

CONTENT

Title

Communication COM(2009) 475 of 10. September 2009: Stepping up **international climate finance:** A European blueprint for the Copenhagen deal

Brief Summary

► **Background and objective of the Communication**

– In December 2009, a UN Climate Change Conference will take place in Copenhagen with the intention of concluding negotiations on a follow-up agreement to the Kyoto Protocol, which will expire at the end of 2012. International public finance for supporting developing countries with regard to climate protection is expected to form an essential part of the new Copenhagen agreement.
– The Commission has already stated its objectives for the Copenhagen agreement in a Communication dated 28th January 2009 [COM(2009) 39, cf. CEP policy brief].
– In the present Communication and the accompanying working document [SEC(2009) 1172], the Commission now states more precisely its ideas for financing the Copenhagen agreement. It is not a formal EU proposal, but provides "indications of the order of magnitude" of the finance that will be needed.

► **Global mitigation targets**

– The increase in global average temperature above pre-industrial levels ought to be permanently limited to a maximum of 2ºC.
– According to the Commission, this requires a reduction, by 2050, of global greenhouse gas emissions by at least 50% compared with 1990 levels.
– Developed countries should therefore have made emissions cuts of 25 – 40% by 2020, and of at least 80% by 2050.
– All developed countries, and as many developing countries as possible, should enter into the agreement.

► **Scale of finance necessary for developing countries**

– To manage reductions in emissions growth and adaptation to climate change, developing countries require additional finance from developed countries.
– The Commission estimates finance requirements for adaptation and mitigation actions in developing countries at around € 100 billion per year up to 2020. This should be financed in the following manner:
  - 20 – 40% from private and public finance in the developing countries,
  - 40% from the international market for emissions rights and
  - the remainder (20 – 40%) from international public finance in developed countries.
– As it is likely that the Copenhagen agreement financing regulations will first apply from 2013 onwards, the Commission recommends "fast-start financing" for developing countries up to the end of 2012.
– The Commission estimates the international public finance required from developed countries for developing countries to be
  - € 5-7 billion per year for 2010 – 2012 and
  - € 22-50 billion per year for 2013 – 2020.
– The more ambitious the mitigation targets agreed in Copenhagen, the greater the level of financial support for developing countries will need to be.

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- **Financing through the international market for emissions rights**
  - The Commission would like to develop international emission rights trading into the key instrument for lending financial support to mitigation activities in developing countries.
    - The developing world earned € 4.5 billion from international emission rights trading in 2008.
    - 75% of this came from the EU private sector.
  - According to the Commission's estimates, if developed countries were to commit themselves to a 30% reduction in greenhouse gas emissions by 2020 compared to 1990 levels, approximately € 38 billion would be diverted into developing countries via emission rights trading.
  - The Commission confirms its intention [cf. CEP policy brief on Communication COM(2009) 39]
    - to establish an OECD-wide market for emission rights by 2015 and to extend this to developing countries by 2020, as well as
    - to incorporate international aviation and maritime transport into emission rights trading.
  - The "Clean Development Mechanism" (CDM), which has to date been project-oriented, should be reorganized into a sector-oriented "Sectoral Crediting Mechanism" (SCM).
    - CDM to date: Developed countries receive credits for individual emission reduction projects financed by them in developing countries which count towards their own commitment to reducing emissions.
    - Planned SCM: Developed countries receive credits for projects financed by them in which emission reductions are achieved in entire economic sectors in developing countries.
      - Within the SCM, sectors that (1) have a large reduction potential and that (2) are exposed to high levels of competition on the world market should be included as a priority. This should help avoid the migration of production facilities into countries which set less demanding emission reduction targets ("carbon leakage"). This particularly affects the cement and chemical industries, iron and steel production and refining.
      - Revenue from the SCM should go to governments in developing countries ("sector administrator").
      - Crediting should no longer occur retrospectively but in advance.
      - Within the scope of the SCM, credits should no longer be given for any and every emission reduction, but only for those which exceed a specified threshold value. This should reward additional efforts.
    - The Commission sees the SCM as a transitory solution to comprehensive emission rights trading.

- **Distribution of international public finance across developed countries**
  - The Copenhagen agreement should include a scale based on agreed principles to determine different countries' financial contributions.
  - In view of the current status of negotiations, the Commission assumes that the two significant criteria will be (1) ability to pay, measured by gross domestic product (GDP), and (2) the level of greenhouse gas emissions.
  - The weight given to these two criteria may lead to differing distribution of the finance to be raised for the contributing countries (see CEP overview, table 1)
  - The more heavily weighted the GDP criterion, the greater the EU's financial commitments.

- **EU contribution to international public finance 2010 - 2012**
  - The Commission expects that between 2010 and 2012, payment obligations of € 0.5-2.1 billion per year will be placed on the EU.
  - The Commission would like to investigate whether the EU should pay a higher contribution in order to support early adaptation.
    - These payments should be made from both the EU budget and national budgets.
    - € 50 million should be made available from the EU budget for this purpose in 2010.

- **EU contribution to international public finance 2013 - 2020**
  - The Commission assumes that, from 2013 onwards, the EU will initially make a contribution of € 0.9-3.9 billion per year. This will increase to € 2-15 billion per year by 2020.
  - Different channels are available for distributing the EU's contribution across Member States:
    - Funding through the EU budget,
    - Establishing a common EU climate fund outside the EU budget or
    - Direct contributions from Member States.
  - The Commission is in favour of funding through the EU budget.
    - As the Financial Framework of the budget is already fixed up to 2013, the Commission does not see how these sums could be made available from the EU budget.
    - The Commission also sees difficulties with providing the necessary funds from the EU budget from 2014 onwards.
  - If the EU's contribution is not made from the EU budget, payments from Member States should be calculated according to the same criteria as those laid down in the Copenhagen agreement (GDP and greenhouse gas emissions). However, "the special circumstances of Member States" should be "taken into account" (p. 4).
  - The hypothetical shares for EU Member States are compared in the CEP overview, table 2a and 2b.

– The Commission points out that revenue flows into Member States as a result of emission rights trading, and that this revenue could be used for these purposes.

Changes Compared to the Status Quo

- To date, no support payments have been made to developing countries within the framework of a mitigation agreement. These should now be agreed in binding form.
- The Clean Development Mechanism (CDM), which has to date been solely project-oriented, should be reorganized into a sector-oriented Sectoral Crediting Mechanism (SCM). Revenue from the SCM should no longer benefit individual projects, but governments in the developing world.

Statement on Subsidiarity

The Commission does not address the issue of subsidiarity.

Political Background

By signing the Kyoto Protocol in 1997, the EU committed itself to reducing greenhouse gas emissions by 8% between 2008 and 2012 (see CEP Dossier EU Climate Package, german only). The Kyoto Protocol will expire in 2012. In December 2007 at the UN Climate Change Conference in Bali, environment ministers from the EU Member States demanded obligatory emission reductions and a global emissions trading system. In March 2009, the European Council expressed the EU's willingness to contribute a fair share to the global financial effort as part of an international climate agreement.

Options for Influencing the Political Process

Leading Directorate General:	DG Environment
Consultation Procedure:	No consultation procedure provided.

ASSESSMENT

Economic Impact

Ordoliberal Assessment

The target to reduce greenhouse gas emissions by a certain percentage is set politically and thus defies ordoliberal assessment.

The Commission's **aim of involving as many countries as possible in reducing emissions is paramount.** It will only be possible to combat climate change if all countries that emit significant quantities of greenhouse gases are included. Otherwise there is a risk that successful reductions in the participating countries will be nullified by additional emissions from the rest of the world.

Without financial support for developing countries, it is likely that **no** global **climate agreement will be reached.** The distribution of these support payments across developed countries according to their emissions volume – which appears to be imminent – would, however, be unfair. With a global upper limit to emissions, the emission margins of developing countries are directly dependent on the emission volumes of individual developed countries. It is, however, intended, with the Commission's approval [cf. CEP policy brief on Communication COM(2009) 39], that the Copenhagen agreement provides for developed countries with high levels of greenhouse gas emissions to make a disproportionate contribution to reductions by allocating emission volumes. **The distribution of aid from developed countries to developing countries should** therefore **be calculated on the basis of the developed countries' gross domestic product only.**

With respect to financing the EU contribution – of up to € 15 billion per year – although the Commission favours covering this using the EU budget, it doubts that this will be possible with the current budget (€ 114 billion in 2008). At the same time, it does not give concrete proposals for saving on other budgetary items. Providing funding from a separate EU climate fund would disguise the fiscal burden on citizens, as it is not subject to any parliamentary scrutiny. This is why **direct payment from the Member States' budgets would be preferable.** The parliaments of the Member States will then have to decide whether the additional funds are to be financed through higher taxes or expenditure cuts in national budgets.

Impact on Efficiency and Individual Freedom of Choice

The Commission's intention to develop international emission rights trading into the key instrument for easing the financial burden on developing countries is to be welcomed, as this will allow emissions to be reduced in the most cost-effective manner. The expansion of emission rights trading to include additional countries is also to be viewed positively, as this reduces the overall global costs of the adaptations necessary.

Owing to alack of precise information, a definitive assessment cannot yet be made of the transition from Clean Development Mechanism (CDM) to Sectoral Crediting Mechanism (SCM). **The changeover to making pay-**

ments to governments in developing countries will – especially in the case of advance payments – however **create significant problems in terms of monitoring and surveillance**, particularly in countries where the rule of law is less well established.

Impact on Growth and Employment

The Commission expects a 1.2% reduction in GDP in the EU **and a 0.4% fall in employment by 2020** – as costs of mitigation – should a climate agreement on the intended points be concluded [SEC(2009) 101, part 1, p. 54].

Impact on Europe as a Business Location

The more successful the attempts to involve other countries in reducing emissions, the less negative an effect the EU's commitment to reducing emissions will have on Europe as a business location. This particularly applies to industry sectors in which business relocation becomes more attractive when mitigation actions are restricted to the EU (e.g. the steel and cement industries). On the other hand, the higher the payments made to developing countries by the EU, the more acutely Europe will suffer as a business location. A definitive assessment of the overall effect cannot be made until the negotiations have been concluded.

Legal Assessment

Legislative competence

As the EU is authorised, pursuant to Art. 175 of the EC Treaty, to undertake measures in the field of environmental policy, it may outwardly base similar action on the residuary power of Art. 308 of the EC Treaty (cf. ECJ, Case 22/70 – AETR, established case-law). Correspondingly, Art. 174(4) of the EC Treaty makes clear that the Community may conclude international agreements on environmental protection. Pursuant to Art. 300(1) of the EC Treaty, the Commission submits recommendations to the Council for this purpose. The Council then authorises the Commission to conduct the negotiations.

Subsidiarity

Unproblematic.

Proportionality

Unproblematic.

Compatibility with EU Law

With regard to the principles of integrity and unity of the EU budget pursuant to Art. 268 of the EC Treaty compared with Art. 4 et seq. of the Financial Regulation [Regulation (EC/Euratom) No. 1605/2002], the creation of an EU climate fund to finance mitigation actions, as considered by the Commission, is questionable. According to this, all the EU's revenue and expenditure must be fully estimated in a budget. As a result, the Commission rightly points out that a fund of this type outside the EU budget would require its own legal basis in the form of a new agreement between Member States.

Compatibility with German Law

Currently not foreseeable.

Alternative Policy Options

Support payments to developing countries should be distributed solely on the basis of gross domestic product of developed countries.

Possible Future EU Action

Currently not foreseeable.

Conclusion

The Commission's efforts with regard to a comprehensive international climate agreement are to be welcomed. However, the ambitious goals for reducing greenhouse gases will place a burden on the economy. Even more important is the choice of efficient means, which could be reached through the expansion of international trade with emission rights and the use of reduction credits. Burden-sharing between developed countries should be based on gross domestic product. As it is not possible to finance the planned EU financial aids for developing countries through the EU budget, and an independent EU climate fund is ruled out for this purpose owing to a lack of transparency, it is to be welcomed that, as a third option, the Commission explicitly proposes financing this through the budgets of Member States. The advance payments to developing countries envisaged for announced emission reductions will create significant problems in terms of monitoring and surveillance and should therefore not be introduced.