# GHG Reduction Targets and International Competition:

Why COP15 Negotiations are Difficult and Options for Negotiators to Achieve an Agreement

The COP15 negotiations in Copenhagen this December will attempt to set the course and agree on a basis for reducing greenhouse gas (GHG) emissions post-2012. There are many complex issues to be resolved, but the most fundamental one is future targets for GHG emissions reduction – how much will countries commit to reduce their emissions, by when, and will such reduction commitments be binding, not just aspirational.

The challenge for countries to adopt binding GHG reduction commitments is the direct cost to their economies to achieve the reductions and the impact on their competitiveness. If one country's level of effort is deemed by them unequal to the GHG burden of a key country they compete with, then it is difficult for them to sign on to commitments. [1]

It is a complex process to estimate the relative burden on one country versus another due to GHG reduction commitments and what this means for competitiveness. It is akin to the assessment of subsidies and tariffs between two countries in a given sector when a challenge is raised in the World Trade Organization (WTO) that one country is benefiting from a market distortion at the expense of another country contrary to WTO rules.

The bottom line for both countries and industry in the post-2012 climate debate is how to achieve the substantial GHG reductions called for by the Intergovernmental Panel on Climate Change (IPCC) without politically unacceptable distortions to international trade. There are essentially four ways to address the competitiveness issue in the negotiations:

- **Add no new trade-related measures; rely on current WTO protections/procedures.** This is essentially the approach of the Kyoto Protocol where industrialized nations took on reduction commitments but many of their international competitors did not (consistent with the concept of "common but differentiated responsibilities"). The USA famously stayed out of Kyoto for this reason and states, along with many other countries, that they will not sign on to post-2012 targets unless the issue of international competitiveness is dealt with in setting new GHG targets.

- **Agree on 'sectoral approaches' in key areas of international competition:** The 'sectoral approaches' concept is to set GHG reduction targets in specified sectors (e.g., steel, aluminum, cement) where an international market prevails and competitiveness can be addressed via benchmarking across the given sector in participating countries to achieve a politically acceptable balance. All major countries in the market must join such a sectoral agreement if competitiveness is to be adequately addressed. The key challenge for such an approach is still how much burden is ascribed to the sector in each country based on benchmarking.

- **Allow emissions trading to find least-cost reduction solutions across borders:** The 'cap-and trade' approach is to set a binding emissions reduction target, then let industry in the countries that have signed up to targets find the least expensive reduction investments anywhere across the economies with targets. The benefit to the environment of this approach is fixed by the targets, not the trading, and targets will only be achieved if they are binding and no 'loopholes' are allowed in the trading system. There is no doubt that 'cap-and-trade' is the 'least cost' means to achieve emissions reductions, but controversy surrounds cap-and-trade either because caps are viewed as being too stringent or too loose, and traders are viewed as being able to 'game thesystem'. In fact, it is possible to design and implement an emissions trading system that delivers environmental results cost-effectively, but political pressures exist to aid different constituencies through allocation of free allowances, 'opt outs' or other means which complicate the overall trading system and risk undermining credibility and performance.
- Individual nations impose 'Border Tariffs' based on carbon cost differentials: This option assumes that 'do nothing to address competitiveness' [option 1 above] is unacceptable and that sectoral approaches [option 2 above] and/or emissions trading [option 3 above] are not adopted or are agreed with less than full coverage. In this case, countries still feel competitiveness impacts of GHG reduction targets are significant and must be addressed, but no commonly agreed international system has been agreed to do so to their satisfaction. Thus, they unilaterally impose 'Border Tariffs' on goods coming from countries which they allege have a competitive advantage because their industry has less of a GHG burden. Many assume that such a Border Tariff could be the 'cost of carbon' in a given country with tariffs imposed on imports from countries with no equivalent cost of carbon.

There is a real fear that misunderstanding of emissions trading or inability to agree on the architecture and functioning of international emissions trading could lead to the combative approach to address competitiveness (Border Tariffs) instead of the more cooperative approach which allows trading to find least-cost solutions across markets.

If negotiators can agree on market mechanisms such as international emissions trading to support achievement of post-2012 binding GHG commitments by leading nations in the world, it could be easier to sell the outcome of climate negotiations back home and avoid threats to world trade stability due to competitiveness pressures.

As an active member of the International Emissions Trading Association (IETA), the leading international business group promoting best practices in emissions trading, ERM works with clients to promote least-cost solutions to GHG reduction post-2012.

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[1] The Stern Report on the Economics of Climate Change suggests that the costs to economies of not acting on climate change are significantly greater than the cost of acting now, but the challenge this poses for policymakers is to impose direct costs now to avoid much higher indirect costs projected to occur later, and to appease domestic economic interests who claim loss of competitiveness in international markets.



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