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The Climate Club

Why a global coalition is needed to contain global warming

Countries must be persuaded to put self-interest aside and adopt a common approach to pricing emissions. Climate clubs could succeed where other approaches have failed.

Climate change is forcing all of us, businesses, governments, society, and individuals alike, to find ways to really address major challenges on a global scale. Strong evidence suggests that the most effective way forward would be to put a price on carbon emissions. The price placed on a defined unit of emissions would constitute a levy, which, when paid, should be used to reimburse each inhabitant in equal proportion. But even this system has its drawbacks. One challenge that we've faced is an uneven playing field. As climate change is a global issue, carbon pricing must be implemented internationally and consistently. But this is difficult due to the multitude of independent jurisdictions involved. Those involved are typically national entities – sovereign states – which may engage in dialogue or compete with one another to secure emissions levels that are advantageous to them. There is no natural incentive that would encourage them to coordinate and collaborate.

In truth, despite the best intentions, we've achieved little thus far. The 1997 Kyoto Protocol, put into force in 2005, which entailed a cap and trade system, failed. The 2015 Paris Agreement on climate change seems not to have brought about the desired results. We believe, however, that putting a price on emissions allows genuine opportunities for progress. An idea postulated by 2018 Nobel Prize winner William Nordhaus for a 'climate club' that provides economic incentives to reduce emissions is worthy of attention. In essence, it calls for a group of countries to come together to price CO2 emissions. Through pricing mechanisms it would be possible to increase the cost of greenhouse gas emissions, and, by implication, reduce them.

Free-riding, or why the Kyoto Protocol and the Paris Agreement are not successful

When it comes to global policies on global warming, so-called 'free-riding' is the major hurdle to overcome. It refers to a situation in which individual countries that do little to reduce emissions can instead rely on emission reductions by others: basically, one country benefits from a public good without paying for it. Free-riding might be considered in strategic situations as each party acts in its own self-interest, without achieving an optimal outcome – a classic 'prisoner's dilemma.' Thus, in the end, nobody wins, and all parties are worse off. Since climate is a global public good and the climate agreements to date have been voluntary, the prisoner's dilemma is inherent in all of them. A freeriding syndrome is often at work in areas where we have a great deal to lose unless we can act in the best interests of all. Nuclear proliferation, overfishing in the oceans, littering in space, and transnational cybercrime are examples that demonstrate that global coordination is the only effective solution. Acting in concert with the ultimate goal in mind is a necessity.

Those negotiating major international agreements – the Kyoto Protocol and the Paris Agreement being cases in point – thus far paid too little attention to incentive systems. As is the case with such voluntary agreements, lack of an international body with enforcement capabilities means that countries cannot be held accountable for their climate commitments. Thus, agreements to address emissions have failed to achieve their goal.

Examples illustrate this: the U.S. withdrew from both the Kyoto Protocol and the subsequent Paris Agreement, in both cases without consequences. Thus, the world still has no binding climate agreement more than 25 years after the COP1 in 1995, the first formal meeting of the UNFCCC Parties (Conference of the Parties, COP) to assess progress in dealing with climate change.

The club rules

Yet even if there is general goodwill, some countries would require an additional incentive to introduce CO2 emission pricing as a means to limit emissions. That could, for example, take the form of trade benefits. This approach might induce some countries to take necessary measures, even when these countries are otherwise unwilling to spend part of their GDP on paying a price for failing to effectively curb their emissions. The carrot of trade benefits might goad governments to act, even when the political will is lacking or voter apathy around environmental issues provides limited impetus for doing anything about emissions.

> "States need to reconceptualize climate agreements and replace the current flawed model with an alternative that has a different incentive structure – what I would call the Climate Club."
>
> Nobel Prize laureate William Nordhaus

Taking the climate club approach to set the right incentives, introducing consistent national targets and aiming for coordinated policies on an international level could help achieve the aim of keeping the global temperature rise well below 2°C. And there are in fact examples of successful international 'clubs.' These range from multinational trade agreements going back to the 1930s, to NATO, and the EU.

To succeed, a climate club should focus on two main objectives:

- Every member country must put a domestic price on carbon, which would correspond to the true costs of climate change, for example, USD 50 per ton of CO2 emission. That could be raised gradually over time (e.g., by 3 percent per year in real terms). In wealthier countries the price could be set even higher, based on the examples of Sweden or Switzerland (currently USD 119 /ton CO2*, USD 99/ton CO2*, respectively).
- At the same time, members would also need to impose a cross-border adjustment levy on non-members, making their imports less attractive. For example, if the EU and the U.S. were in a climate club, but not Australia, aluminum imports from the EU to the U.S. would be exempt from the cross-border adjustment levy and vice-versa, whereas aluminum that either the EU or U.S. imported from Australia would be charged with the cross-border adjustment levy, and therefore less attractive. This could help to address the problem of free-riding. Countries that establish a domestic pricing mechanism on carbon emissions and become part of the climate club would no longer be penalized by competitive disadvantages.

Relevant core of countries

Of course, it is hardly realistic to expect that all countries would join a climate club. But it is a central premise, if the approach is to succeed, that a core of countries sufficiently big enough to be relevant trading partners would be willing to establish a club and forego free-riding benefits. The EU and the U.S., which account for a large share of global GDP, could form a strong climate club. If they could also get China on board as a founding member, that would already provide a strong incentive for other countries to join.

A climate club could allow real change

To sum up, putting national interests ahead of global ones – the classic prisoner's dilemma – will subvert even the best-intentioned efforts to tackle CO2 emissions. The ease at which even large countries fail to show accountability, while 'free riders' get off the hook without being held accountable, shows the flaws in the current approach. Global warming certainly falls into the category of a problem that cannot be ignored, is pressing and needs to be addressed within a shrinking window of time. The clock is ticking and we are all under threat, facing costs that are far greater than those put on carbon emissions. The climate club approach, combining international trade policy and domestic carbon pricing, could offer a viable path out of the global climate crisis, one acceptable to what is likely to otherwise be an unacceptable endgame in which nobody wins.

*as per April 2020: https://openknowledge.worldbank.org/bitstream/handle/10986/33809/211586figures.pdf

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