Chapter Six

"Global Warming" and its Discontents: The Threat of Populism to Sovereignty and Prosperity

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The public call for the Australian Government to do "something" about global warming has led the major political parties to adopt policies which would have been considered unthinkable on both sides of mainstream politics a decade ago.

They entail governments returning to substantial intervention in how economic affairs are conducted. The first intervention seemed minor – regulating targets which set how much power should be generated from renewable resources – although the impact of the 20 per cent target set by the Rudd Government would not be minor for the considerable hike it would create in the cost of electricity. The decisions by first the Howard Government and then the Rudd Labor Party/Rudd Government to establish what is loosely called an "Emissions Trading Scheme" (ETS) to reduce emissions of carbon dioxide is a giant step.

Most discussion about how trading in permits to emit carbon can be undertaken has focused on the question of how to do it in a way that keeps faith with market principles, thereby leaving an impression, intended by some, that this system will be consonant with, if not enhance, an open economy. The general counter consideration has been on the cost and efficacy of operating such a system. In this a fundamental reality and the implications of it have been overlooked. The key tool in an emissions trading system is the device which artificially creates the demand for permits – the cap to limit consumption and thereby production of energy. The cap is a command and control tool whose natural home is a Soviet five year plan, not a modern open economy.

As becomes strikingly clearer as one wades on through the multiple pages of reflection produced so far by government work (and the Garnaut Review) about how to make a trading system function, a key issue preoccupying those officials is trying to work out how to ensure the cap does its job – reducing production of energy to a set target. It is a complex matter. At each adumbration of the problem, the invariable answer is some additional, usually onerous, form of regulation to ensure the cap works.

Garnaut proposed creation of a super regulator to control the supply of emission permits to the secondary market which he argues is necessary, and to manage it to achieve the cap.[1] He also proposed that another super regulator be appointed to predict global commodity prices so reimbursements could be made to exporters after that regulator assesses their competitive disadvantage.[2] Where is the free market common sense? Commodity traders and Central Banks have been bankrupted trying to control and predict markets.

Garnaut is not the only one to revert to regulation of the market for a solution. Early work by officials under the Howard Government suggested that a condition for giving trade exposed industries offsets in an ETS might be that they be required to use the latest available low emissions technology, and that an official be tasked to monitor compliance with this requirement.[3]

So much for the professed virtue of emission trading that businesses would be left free to determine how to invest in their business according to the demands of the market.

The cap and trade ETS model introduces a very potent command and control economic tool to control production of a key input into the economy – energy. This is a massive change in how government should intervene in the economy. In Australian terms, it is as philosophically significant as a return to protectionism. Yet there has been virtually no discussion of the pros and cons of reverting to active management of enterprise, the like of which we have probably not seen since the end of wartime rationing.

Why is it that after a quarter of a century of economic reform which has made the Australian economy the strongest it has ever been – not measured by the size of the economy or the level of wealth of Australians, but by flexibility of the economy to adjust to change and to enable investors to decide what enterprises to establish and support – we now contemplate reversion to State domination of key economic activity?

There are several reasons, which include the timing of the electoral cycle in Australia and relatively low level of interest in discourse on things that fundamentally matter in Australian politics. They are not specific to the question of global warming. But one reason is specific, and that is the nature of the global debate about global warming and the international instruments established to date to reduce emissions of greenhouse gases – in particular, the *Kyoto Protocol* to the *UN Framework Convention on Climate Change*. The *Kyoto Protocol* aspires to legislate a global cap on production of energy.

The message is clear. By some means or other, the amount of energy each economy consumes which generates greenhouse gases will be controlled. Each economy will surrender its right to let market forces decide where they will operate in the energy sector. And the international system created by the *Kyoto Protocol* will provide international policing of that surrender of that right.

The extraordinary ambition of this notion is only matched by the great difficulty of trying to implement it. That is why the *Kyoto Protocol* has been a failure. It has had only a negligible impact on its primary purpose – a global reduction in emissions of greenhouse gases. However, it has had a very large intellectual impact. It made establishment of global cap and trade systems to reduce consumption of energy the leading idea for tackling climate change. The result was that both major parties in politics in Australia committed to introduce a system to cap production of greenhouse gases, without any significant discussion of the implications of the use of such an interventionist instrument for economic management in Australia, and next to no public consideration of alternative options such as a carbon tax.[4]

We can bemoan lack of political discussion in Australia about the implications of the *Kyoto Protocol*, but to be fair, we cannot hold the thinking public too much to account, since every other major industrialized economy except the United States acceded to the *Protocol* and has attempted to implement its requirements.

The saving grace in all this is that developing economies understand perfectly the economic implications of the attempt in the *Kyoto Protocol* to set a global cap on emissions. They are that the control on economic activity envisaged in the *Protocol* will reduce economic growth. This is why they insist these provisions in the *Protocol* not apply to them. There is irony in this, because developing nations in international economic affairs have been weak exponents of the virtues of using open economies to create growth, as we have just witnessed in the World Trade Organisation as the Doha Round has stalled yet again.

For good or bad, electoral sentiment in Australia wants to see action taken to reduce emissions of greenhouse gases. There is also a commitment among all parties to the *UN Framework Convention* to develop a new global strategy for the same purpose.

In this paper, the only way a new global strategy which will draw the support of all major emitters of greenhouse gases can be developed will be set out. It cannot be based on the principle of setting some form of global control over global production of energy. The developing countries will not accept this. It is also unlikely that the US Senate would approve such an instrument, unless equivalent commitments to those imposed on the US were also applied to key developing countries – especially China. So it cannot be based on instruments envisaged in the *Kyoto Protocol*.

If Australian leaders give primacy to the principle that any global strategy on climate change should enjoy the support of major emitters, then invariably they will set aside the concept of a global system of regulated caps on emissions.

In considering a national program to address climate change, it would be to the benefit for continuing prosperity for Australians if our leaders recognized that the most appropriate policy to apply is best formed after rational analysis of the problem and the most effective response, rather than taking a political decision to adopt the most promoted and worst idea. In the process, we should hope they would reflect on the economic misery visited on millions of people in the 20th Century by the disastrous efforts to use command and control tools in the Communist economies.

Kyoto's mechanisms – undermining national sovereignty

Kyoto commits industrialized economies which become party to it to adopt targets to reduce emissions over a nominated period.[5] It also states that a system to create and trade credits to emit greenhouse gases will be established. It does not say how this is to be done.

These are stupendous commitments, yet they are laid down in just a few words.[6] The *Kyoto Protocol* obliges parties to establish emissions trading without laying down agreement how it will work. The *Protocol* is the

most lamentable expression yet of a regrettable practice that has grown over recent years in the UN and international treaty-making. This is to enshrine political goals as legal commitments in an international Convention, then leave it to the parties to the Convention, once they have acceded, to decide how those commitments are to be implemented. It has been a marked trend, particularly in negotiation of Multilateral Environment Agreements.

This means that when sovereign governments accede to these agreements, they are not accepting specific obligations which can be easily enshrined in law (whether or not that in itself is regarded as desirable): they commit to be bound to adopt decisions determined collectively by a group which the international Convention has empowered to make policy in the form of new or elaborated commitments. In plain terms, national interests are being put into the hands of others.

That is the case in the *Kyoto Protocol*. It in fact obliges parties to do far more than adopt nominated caps and to participate in a yet to be defined system of emissions trading.

It also obliges parties (Article 2.1) which are industrialized economies to implement policies which:

- Enhance energy efficiency.
- Protect and enhance carbon sinks; promote sustainable forestry and afforestation and deforestation.
- Research, promote, develop and increase use of renewable technologies, carbon sequestration and other innovative technologies.
- Reduce or phase out measures that run counter to the Convention and market mechanisms (instancing market imperfections, taxes, incentives and subsidies).
- Promote policies and measures that limit emission of carbon dioxide and methane.

This obligation is limited with the condition that it is fulfilled "in accordance with national circumstances". This is a traditional way in international agreements of leaving each party the freedom to determine how it will fulfil the obligation. But that freedom is limited.

The *Kyoto Protocol* has enforcement mechanisms. The Secretariat to the Protocol (a standing and permanent administrative group established to support the *UN Framework Convention on Climate Change*) is authorized (Article 8) to review the performance of obligations by parties. That includes annual reports by Annex One parties on compliance with obligations to reduce emissions. It also stipulates that the review shall provide a "thorough and technical assessment of all aspects of the implementation by a Party of the Protocol". That would include the obligations set out in Article 2, which are listed above.

The Secretariat is authorized under Article 8 to manage those reviews and appoint experts to undertake them. It has considerable discretion in this regard. The reports shall assess "the implementation of the commitments of the Party and identify any potential problems in, and factors influencing, the fulfilment of commitments".

These reports are to be considered by the Parties to the *Protocol* meeting as a group, where the ultimate decision-making process is by a vote by three-quarters of the members.

Penalties for non-compliance are addressed in two ways. Under procedures adopted by the Parties, any Party which fails to meet its commitments to reduce emissions in a nominated year is ineligible to participate in an arrangement to accept credits to reduce emissions under arrangements approved under the Clean Development Mechanism. The latter is a procedure allowing projects to be approved in developing countries which can generate credits for emissions which may be traded into an emissions trading scheme established by an Annex One party. This cost is not very high, since this mechanism has not been very successful.

There is also a provision to specify penalties for failure to fulfil obligations to reduce emissions, but these need to be set by parties to the conference meeting in a specified mode. Voting rules indicate that decisions by three-quarters of members are binding.

These mechanisms mean that an Annex One party can be assessed by a process over which it has no control. Particularly inappropriate is the fact that around three-quarters of the parties to the Protocol are not Annex One parties, who are not obliged to reduce emissions, but can constitute a majority, or most of a majority, which can determine whether Annex One parties have complied with the Convention.

Parties have the option to withdraw from the *Protocol* or the *Convention* at any time. In this respect, they can ultimately protect their rights to develop and implement national policy on matters covered by the *Kyoto Protocol*.

Notwithstanding that, the governance arrangements of the *Protocol* require parties to surrender to mechanisms and procedures which are either undefined, or over which they have no right of veto, and which can be largely determined by groups of parties who, prospectively, share none of the interests of Annex One parties – in particular, in not accepting onerous and costly obligations to reduce emissions.

Finally, the Secretariat of the *Protocol* is empowered by it to exercise considerable authority in the way in which assessments of compliance are undertaken. It is also relevant that, over time, the Secretariat to the *UNFCCC* and the *Protocol* has come to exercise considerable independence. The ideal governance standard is that parties to a Convention select and control administrative staff. It has become practice for the Head of the *UNFCCC* Secretariat to be appointed by the UN Secretary-General. As well, it is common practice with Multilateral Environmental Agreements for individual parties to provide voluntary funding for specific activities which are administered by the Secretariat or its Head. A noticeable feature of the work of the UN Secretariat is the large number of German nationals on the staff.

Forging global consensus and respecting national sovereignty[7]

The fact that there is a global consensus to address global warming is often overlooked. That is represented in the membership and provisions of the *UN Framework Convention on Climate Change*. While the United States (and formerly Australia) was widely pilloried for not acceding to the *Kyoto Protocol*, the US is a party to the parent *Framework Convention*, as are all other leading emitters of greenhouse gases, including China, India and other developing countries.

The *Framework Convention* is a classical example of good governance standards and law-making in international conventions. Aspirations for change and goals are set out, but the ultimate obligation for implementation lies with national governments acting under national law. There is an obligation on parties to submit reports on national actions taken to meet the aims and purposes of the *Convention*, but there is no mechanism providing penalty for non-compliance. There is the pressure of being seen to have failed to act.

This model is appropriate, given that the international community and the United Nations system do not have the approval of member states or the capacity to implement an executive function of such complexity as managing a global regulation to limit important economic activity, such as a global system to cap emissions and create and trade permits to emit greenhouse gases. Creating a global currency would be easier, and that is a task beyond the will or capacity of international institutions.

So what are the options to create a new global approach to address global warming? First it is worth reviewing the experience with the *Kyoto Protocol*.

- The *Protocol* failed to reduce emissions of greenhouse gases. Less than half of the world's emissions were governed by it. Emissions from Annex One parties have increased. The *Protocol* was a classic example of institutional functionalism. It established a process without agreement on a goal.
- It delivered few benefits to developing countries. They acceded to the *Protocol* on condition they were not obliged to reduce emissions, and in expectation that technical assistance would be provided, particularly to support adaptation to the effects of global warming, a goal laid out in the *Framework Convention* to which the developing countries attached parallel importance to the other goal – mitigation. *Kyoto* is a tool principally for mitigation.
- *Kyoto* demonstrated the high cost of reducing emissions. Most Annex One parties have failed to meet their targets to reduce emissions.
- The *Protocol* failed to build a global consensus The EU justified the decision to proceed to have some countries commit to reduce emissions on the grounds that the *Protocol* would be a "First Step", an exemplar that others would follow. They didn't. The EU was told directly at the three meetings of parties that preceded the Bali conference, which launched the negotiations for a new global strategy in December, 2007, that the US and the developing countries would not either accede to the *Kyoto Protocol* or accept binding commitments to reduce emissions.
- Experience with the European emissions trading system as well as research in the United States has demonstrated the formidable difficulty in administering a system of emissions trading. This includes over-active management by government in allocation of permits, gaming to acquire permits, and the difficulty of ensuring compliance and verifying the integrity and value of the traded instruments.[8]

So what lessons should be drawn from the Kyoto experience in developing a new strategy for global action on global warming?

1. *Strategies need to recognize that the interests in every economy are different.* Developing countries supported the *Protocol* because it permitted them to consider strategies that met their development needs. The same principle should apply to economic differences among industrialized economies.

2. *Global regulation of economic activity does not work.*

Commitments that incur significant costs and penalize economic growth will not be met by governments. There is no consensus among parties to the *UNFCCC* to create a global system to regulate economic activity.

3. *Participants must regard strategies as equitable.* Reducing emissions or slowing the growth in emissions is costly. Each country has to regard the economic cost of reductions as reasonable and equitable. The measure of that cost is a national judgment, not a common international benchmark.

4. *Countries want to adopt differentiated approaches.* To secure support, *Kyoto* had to provide for a dual track approach –industrialized parties committed to mandatory targets to cut emissions; developing countries pursued voluntary national strategies. Other approaches to reduce emissions have emerged outside *Kyoto*, particularly the Asia-Pacific regional strategy.

A realistic strategy

No new strategy will succeed unless it sits within the policy parameters of the leading emitters of greenhouse gases. Governments have already set down their positions on how they will approach a new global strategy on global warming:

- The EU wants the architecture of the *Kyoto Protocol* – timebound commitments to reduce emissions and global emissions trading – extended. It wants new, deeper targets to reduce emissions and all major emitters to accept binding commitments. Part of its motivation is to shift costs it has imposed on itself via ambitious targets onto its competitors. It fears a loss of competitiveness if it cannot convince others to impose similar costs on themselves.
- The US wants a general non-binding approach that may recognize some general aspirational targets to reduce emissions in the long term but provides the flexibility for each party to design and adopt their own national programs. This may change depending on the position of future administrations. The leading candidates for the 2008 Presidential election both support introduction of a national cap and trade system, but with conditions and important nuances. The attitude of Congress will be critical. Until now it has rejected cap and trade models.
- Developing countries are insisting that the architecture of *Kyoto* not change – no binding targets to reduce emissions for developing countries, but there are signs national programs to restrain emissions might be considered.
- A clear preference among most parties to the *Framework Convention* and the *Protocol* that measures to implement strategies on global warming fully respect national sovereignty.

The inescapable conclusion from the foregoing is that a decision to create a new global strategy is a political decision. It is not a technical decision on how much emissions will be reduced, or in what timeframe or by how much levels of carbon dioxide in the atmosphere will be reduced, or by how much temperature rises in the future might be mitigated. No consensus can be achieved over those questions.

The most effective way of building a new political consensus which recognizes those realities is to start from where consensus currently exists; and that is on the common policy platform on which the *UN Framework Convention on Climate Change* currently sits. It sets out the actions countries should take as national measures, but without mandatory commitments or targets, and places equal emphasis on measures to adapt to the impact of climate change as on measures to mitigate it.

To secure consensus some additional elements are required:

1. Some sort of target: The US idea of a long term, aspirational target is the only way to bridge the positions of the EU, the US and the developing countries.

2. Multitrack implementation strategies: Scope has to be provided for each country to set out its own programs. It is speculated that China might consider setting a target of increasing efficiency in generation of energy, for example by reducing the number of emissions per unit of fuel burned. This would still allow it to increase emissions, which it has said is essential. If members of the EU or even Australian governments decided to set binding national targets as national policies, they could be their contribution to a global strategy to work towards a long term aspirational goal. This would also create a demand for some honesty in global warming policy, restricting the proclivity of governments to make high sounding commitments to take action on condition others do the same.
3. Annual reporting: It would be necessary for every party to the Convention that is a major emitter to report each year on actions taken to implement their national strategies. Peer review pressure does work in international *fora*.
4. Regular review: Given how much is not known about the science of global warming, it would be sensible every decade to review the goals and procedures of this global strategy. This would provide time needed to satisfy the five aspirations which require to be met if there is to be an enduring global consensus on how to tackle climate change, namely:
    i. The hope, held dearly within the EU and among Greens, that ultimately other major emitters will come to share their conviction that a more coordinated and common global strategy is necessary.
    ii. The desire of China and probably other developing countries to see the emphasis on global warming shifted to adaptation rather than mitigation in the foreseeable future.
    iii. The hope of those who consider the science of global warming weak or sufficiently open, that over time there will be greater clarity and certainty about the nature and trends of global warming.
    iv. That proper recognition is given in discussion about global warming in industrialized economies to the true cost to poor countries of early and sharp action to reduce global growth. Green and EU demands for sharp, early cuts carry unacceptable moral implications that continued elimination of poverty is less important than being seen to be acting to address global warming. The British Government-commissioned Stern Report sought to reverse the accepted wisdom among development economists that the most development-and-poverty friendly approach to global warming is to begin to restrict emissions by small amounts over a very long period. Comment by Pachauri, Garnaut and others notwithstanding, this remains the prevailing view.[9]
    v. That sound judgment and good policy will ultimately come to shape deliberations on practical approaches to the question of global warming.

Summary

The hype about global warming, and the pressure on governments to take action which validates that hype, has created the situation where it has become commonplace to see policies being promoted which won't work and will cause tangible harm.

The current debate over global warming cleverly exploits multilateral diplomacy through development of a new populist political tool for national governments. This is where national governments support policies which are impractical (like a global cap on emissions), or for which leaders or governments will never be accountable (like committing the international community to deliver a joint result in 2050), to win domestic political advantage and then deliver the problem to an international institution which is incapable of achieving it. This is one of the reasons the UN so rarely develops tangible results.

With global warming, we have traveled a bridge too far. Highly publicized promotion of the case for strong, impractical action in international *fora* on global warming has created an environment where seriously damaging national policies, such as use of command and control tools to limit emissions, are now receiving attention with a seriousness they neither deserve nor warrant.

This problem is not unique to Australia. It is a challenge to all governments in democracies which function most successfully when it is taken as given that prosperity depends on sound governance and not populist politics.

Endnotes:

1. In his Interim Report, Garnaut makes it clear that a secondary market price curve "provides fundamental stability to the market with opportunities for hedging price risks, and adjusting quickly to new information". (Garnaut Review Interim Report, p. 45.)
2. Apart from the practical difficulties involved in the proposal (especially calculating the carbon content of competing products), this intervention would also undermine the certainty which a secondary market requires.
3. Department of Prime Minister and Cabinet, *Abatement incentives prior to the commencement of the Australian Emissions Trading Scheme*, September, 2007.
4. The Report of the Howard Government's Prime Minister's Task Group on Emissions Trading, which was prepared to underpin the switch by that Government to support a cap and trade system, contains a slim discussion in a few pages on the pros and cons of using a carbon tax rather than cap and trade to reduce emissions. That is the only formal public review of options to manage emissions of carbon dioxide. The implications of policy to curb emission of greenhouse gases is arguably much more significant for the economy than the introduction of GST which, properly and in contrast, was preceded by a large, wide-ranging and extensive process of public debate sponsored by government.
5. Emissions of greenhouse gases are to be reduced by an average of five per cent below levels prevailing in 1990, by 2010. A schedule nominates the rate of reduction for each such party.
6. **Article 3.** 1. "The Parties…. Shall …..ensure that their aggregate anthropogenic carbon dioxide equivalent emissions of the greenhouse gases listed in Annex A do not exceed their assigned amounts……".
   Article 17. "The Conference of the Parties shall define the relevant principles, modalities, rules and guidelines…. for emissions trading".
7. The following analysis of the failings of *Kyoto*, and how a new global consensus on tackling climate change can be forged, draws heavily on *World Growth*, 2007, Oxley, *Building a pro-development strategy on climate change*, http://www.worldgrowth.org.
8. For a good overview of the problems of administering cap and trade systems see Robert J Shapiro, *Addressing the Risks of Climate Change: The Environmental Effectiveness and Economic Efficiency of Emissions Caps and Tradable Permits, Compared to Carbon Taxes*, February, 2007, 22, available at http://www.theamericanconsumer.org/Shapiro.pdf.
9. See work by Lomborg, (This case was originally cogently set out in *The Skeptical Environmentalist* and updated in recent work in the Copenhagen Consensus program. William Nordhaus is also a key reference point for analysis on this issue).