

SUBMISSION OF EVIDENCE TO THE ALL PARTY PARLIAMENTARY GROUP ON CLIMATE CHANGE

“Is a cross-party consensus on climate change possible – or desirable?”

A cross-party consensus on climate change is possible provided the parties agree to work from the same point of departure. A consensus is also highly desirable because of the radical steps that will have to be taken to respond adequately to the seriousness of the problem.

The point of departure

No British political party is likely to have too much trouble reaching agreement that an international “cap-and-trade” approach would be the most effective and economically-efficient way of reducing the greenhouse-gas emissions that have caused the climate crisis.

Using cap-and-trade on a world level would involve four steps:

1. agreeing the maximum rise in the Earth’s average temperature above pre-industrial levels that does not present an unacceptable risk of touching off a runaway warming process and which does not involve doing massive damage to habitats around the world. There seems to be a widespread consensus already that a 2 degrees Celsius rise is this maximum.
2. estimating the maximum atmospheric concentration of greenhouse gases that is consistent with this temperature rise. This estimate is likely to vary over the years as the performance of the natural sources and sinks of greenhouse gases is monitored. Because the concentration figure would be based on the best scientific advice, it should be possible to for parties to agree to accept it.
3. setting a downward trajectory for greenhouse gases emitted as a result of human activities which is consistent with meeting the temperature target. This trajectory would determine the total tonnage of gases that could be released each year. It would be the “cap” in the “cap and trade” approach. This step should be politically non-contentious.
4. gaining international agreement on the basis on which each year’s tonnage of greenhouse gases should be distributed around the world. This will be the hardest step to agree both internationally and amongst the political parties. Trading cannot begin until the allocations have been agreed.

The only basis for allocation likely to command widespread support both amongst the parties and internationally is equal per capita entitlements. In other words, Feasta thinks that an all-party consensus might be possible that the distribution of emissions should be according to the size of each country’s population subject, in the interests of equity, to a mechanism for making adjustments to the total quantity of emissions permits a country receives to allow for its particular circumstances. Details of Feasta’s proposal for such a mechanism, which is a variation on the Global Commons Institute’s Contraction and Convergence, are given in the Appendix but other people will offer different solutions for adjusting the equal per capita principle to improve its international political acceptability and fairness. However, provided they do not delay the system’s implementation, any disagreements between the parties on the best adjustment mechanism should not matter as they would be over details not the basic approach.

There are two other areas on which the parties might also be able to achieve consensus. One is the question of who owns the rights to emit which are being distributed, governments or people? Feasta insists that the right to emit greenhouse gases is a human right rather than a national one and that each person’s entitlement should therefore go to him or her personally, and not to their governments. The importance of this point will be explained later.

The second area on which consensus should be possible is the desirability of turning the “cap and trade” emissions trading system introduced by the EU to control its greenhouse emissions into one which could serve as a prototype for a post-2012 world climate treaty.

As a step towards building such a prototype, the parties should have no difficulty in agreeing that the EU’s Emissions Trading System (EU ETS) is seriously flawed and needs to be reformed. Under the EU ETS, member states prepare National Allocation Plans which distribute emissions permits free of charge to certain categories of heavy fossil energy user, such as electricity companies, cement plants and steel works. The energy users then buy and sell the permits amongst themselves.

What's wrong with the ETS?

1. It is not working

“The ETS has done more for power-generating companies than it has for curbing pollution ... permit holders found they were sitting on unexpectedly valuable property rights ... meanwhile there’s no sign that the permit regime has brought about a switch to cleaner fuel – indeed the reverse is happening ... nobody is going to start investing on a three-year view ... markets need to be part of a scheme that has been well designed. The ETS hasn’t.” *The Economist* 6 May 2006.

2. It is not working because it does not deal with all emissions.

The ETS deals with only 45% of Europe’s carbon emissions. It does not include households or the rapidly rising emissions from transport (airlines in particular).

3. It does not deal with all emissions because it fails to control carbon fuels at the point they enter the economy.

In 1999 the EU considered introducing an ‘upstream’ system that would control carbon fuels entering the economy. Only the few dozen companies that import or produce fossil fuel would have needed to be regulated and existing excise tax procedures could have been used. Instead the Council of Ministers decided to adopt a ‘downstream’ scheme involving controlling the emissions from carbon fuels once they are in the economy. As a result, the present system has - to monitor, measure and control the emission of greenhouse gases from 11,500 large installations with an arbitrary cut-off point to smaller ones. The bureaucracy that this entails is hugely elaborate and depends on the probity of all European governments and their industries. It is already showing severe signs of strain.

Why did it choose to work downstream? One view is that the downstream approach was favoured by both the British and German governments because it creates lucrative business opportunities for the financial service sector in Frankfurt and London.

4 It distorts competition.

Since all firms use energy, those firms which use enough fossil energy to qualify for the free emissions permits gain a big advantage over those which do not. For example, an aluminium smelter that generates its own electricity is given permits to cover the emissions from the fuel it uses. A smelter buying its electricity from the grid has to pay extra for its power because the electricity generators who are supplying the grid will pass on the market value of their permits in higher prices. Moreover, the smelter getting the subsidy produces metal which it sells in competition with other materials which require much less energy to make but whose prices have increased because of the extra cost of the electricity used in their production.

5. It creates uncertainty.

No-one knows yet exactly what allocation firms will get from 2008 onwards. “I have an uncomfortable feeling that we might be singled out for a hefty cut in emissions permits when the next allocation plan emerges,” David Porter, chief executive of the Association of Electricity Producers, was reported¹ as saying in early 2006. This uncertainty gives firms no basis to plan and in their evidence to a committee of the House of Lords on May 3rd, energy firms Centrica and E.on said that companies’ emissions targets should be set over a 15-year period.

The total British allocation for the 2005-2008 period was still uncertain until March 2006 because the previous year the British government had submitted a new national allocation plan with updated emissions projections, asking for another 20 million permits. The EC refused to consider it so the British went to the EU court which ordered the Commission to look at it again.

6. It imposes unnecessary costs, and hardship, on the public.

Because firms can charge, and are charging, for using permits in their production processes that they were given free, the scheme has enabled them to make profits at the expense of their customers. Even if those customers are not members of the public, the price rises are passed on to the next business in the chain and, in the end, to the public who have to pay. The ETS contains no provision for eliminating the fuel poverty the scheme will cause and, because the permits are given away, does not provide governments with the funds to do so.

7. It gives rights to own, buy and sell a common asset to a small group of companies.

The atmosphere is the common property of us all and, therefore, the right to use it as a dump for the gases given off when fossil fuels burn belongs equally to us all. The danger with the EU-ETS is that, if it is not changed, each company's emissions allocation will eventually become something to which it is legally entitled to receive year after year and which is recorded as an asset on its balance sheet. Common property will have been privatised by stealth.

8. It encourages companies to keep their dirtiest plants open.

If a company closed down a plant with a lot of emissions now, would it get emissions permits for the dirty plant in the 2008-2012 phase of the ETS? Probably not. No assurances have been given about this by the national governments who are responsible for deciding who gets what under the next National Allocation Plan. So any sensible company will keep its dirty plant going until at least 2008 to get the emissions permits for it for all five years of Phase 2.

9. It makes it easier to build more fossil-fuel power plants rather than renewable ones.

This is because, although wind farms benefit from the higher electricity prices that result from the permit scheme, so do the promoters of, say, new gas-fired power stations, because they are given the permits they require to buy their fuel. This effectively reduces the costs of constructing their new power stations "For a new combined cycle gas turbine electricity generator, the subsidy in the period 2005-2012 could amount to at least 50% of the capital cost of the new plant" writes Professor John Fitz Gerald of the Economic and Social Research Institute in Dublin. says². A Dutch study³ confirms this: "A free allocation of emission allowances to new investments in generation capacity implies a lump-sum subsidy to the fixed costs of particularly fossil-fuel power production, leading to negative or perverse capacity and production outcomes from an environmental or social efficiency point of view." It suggests that the best way to counteract this is not to give new fossil generators their permits free. However, this would be unacceptable to most governments as it would impede the development of new competition in the electricity market.

10. It is wide open to corruption.

Under the ETS, it is up to the government of each member state to set the limit on its emissions. In Phase 1, this allowed governments to set lax targets to avoid penalising their domestic economies and also to minimise the number of permits their country might have to buy in from other EU members. Only Germany and Slovenia did not allocate to their companies more than they currently emit and Finland, Lithuania, Luxembourg and Slovakia allocated more than 25% more than their current emissions⁴. Moreover, as the ETS also allows governments to decide how many permits each energy user covered by the scheme should get, civil servants can easily assign a company rather more permits than it is likely to use. This would be the equivalent to giving the company cash and it would be surprising if some companies have not already offered financial or other inducements to officials to ensure that they get a generous allocation. Another easy form of corruption would be for ministers to order their department not to enforce the ETS stringently by, perhaps, underestimating a company's emissions so that it needs to buy less permits or has more to sell. And if government

departments don't underestimate emissions on their minister's orders, individual companies might bribe their officials to do so themselves.

11. It sets nation against nation.

Up to 2012, the ETS should be able to avoid major conflicts between the participants because the original fifteen countries of the EU will use it as a tool to keep their emissions within the limits they agreed with each other when they worked out how to meet their collective Kyoto Protocol commitment to a 7% reduction on their 1990 emissions level while the ten accession states will use it to meet the individual reduction commitments they took on under the Protocol. But what happens in the post-Kyoto period? How will the EU's new, and much harder-to-meet emissions target be divided up amongst all 25 countries then? The difficulties over relatively small sums of money in the EU budget in late 2005 should be taken as a warning, especially as far more will be at stake for each country when it comes to agreeing its share of the EU's total emissions commitment from 2012 onwards. Moreover, these difficulties will increase as stiffer and stiffer climate targets need to be met.

12. It puts no effective limit on the number of permits that a country can import from outside the EU.

Under the Kyoto Protocol, these permits can come from Joint Implementation (JI) projects which cut emissions in developed countries and from Clean Development Mechanism (CDM) projects in developing ones. However, although the Protocol says that use of such credits must be "supplemental" to domestic efforts to cut emissions, lawyers doubt⁵ whether the Commission can limit member states' use of such permits under the EU ETS. Ireland in particular is hoping to offset recent rapid increase in emissions by buying CDM permits from abroad rather than restricting the country's energy use.

13. It was introduced without any public debate.

We have been unable to trace any newspaper or television coverage of the choices involved in setting up the system during the period in which it would have been possible for the plans to have been changed. The system was debated in the European Parliament on 10 October, 2002 but this was not reported in *The Irish Times*, *The Times* of London, *The Guardian*, *The Daily Telegraph*, *The Financial Times* or *The Economist*. The debate itself seems to have been very brief⁶. Many MEPs may not have understood the issues because the policymakers' summary⁷ of the official briefing paper *Evaluation of Alternative Initial Allocation Mechanisms in a European Union Greenhouse Gas Emissions Allowance Trading Scheme* limited itself to discussing which sectors of the economy should be covered by the scheme, how many permits should be given free and what should happen to the revenue from those permits that were sold. The real issue – who owned the rights for which the permits were being issued – was not discussed. Nor was the question of whether it was sensible to operate part-way downstream. In any case, even if the vote had been against the Commission's proposals, the Parliament has so little influence that it is almost certain that the scheme would have gone ahead.

There has been almost no debate on the design of the ETS and the ownership of the rights since then. Although the ETS directive calls on governments to inform the public and to accept comments from it, this only applies to details such as which firms are to get what quantity of permits under the national allocation plans, not the wider issues. The consultations governments have carried out have amounted to little more than industrial vested interests stating their cases for increased allocations to civil servants. There has been no serious public scrutiny of the development of national allocation plans although in Britain and Ireland the companies' written submissions can be inspected on the web. Climate Action Network Europe, an NGO, has concluded that the process was not open and transparent in most member states. "Few Member States held two rounds of consultations. In many cases, only representatives of industry were consulted in the drafting process or special arrangements were made for the involvement of industry, such as the setting up of closed working groups or roundtables..... Many questions regarding the crafting of allocation methodologies and data reliability cloud the assessment of the development of the NAPs for 2005-7, and there are few examples of sufficient levels of transparency and wide public involvement" it says

What Feasta suggests

In view of this evidence, Feasta thinks that all parties ought to be able to reach consensus on the need for the urges the total reform of the EU ETS in a way which makes it a model for future world climate treaty. The parties ought also to be able to agree that the national allocation plans giving

rights to less than half of the EU's emissions to favoured big polluters should be scrapped as soon as possible and that, instead, permits covering all the emissions allowed in any year under the EU's Kyoto commitment should be divided up on an equal per capita basis and distributed to every EU resident⁸.



This is how an EU resident's emissions permit might look if permits were issued on an annual basis. The weight of carbon dioxide shown assumes that children get permits too, but practical considerations are likely to dictate that only adults receive a share. Illustration by Per Håkan Nilsson

When each of us got our permits, we would take them to the bank or post office and sell them at the current market rate, exactly as if the permits were a foreign currency. The banks and post offices would then sell the permits on to companies importing fossil fuels into the EU and those producing them here. Importers would be required to hand over to Customs enough permits to cover the eventual emissions from the fuel in a shipment whenever one came in. Oil, gas and coal producers in the EU would be monitored by inspectors who would collect permits for the emissions that their output would produce when burned. All very simple. No need to involve any energy users, large or small, further downstream.

Some parties might argue that the system would be simpler still if, rather than each person getting his or her allocation of permits and selling them themselves, the government sold them on their behalf. They might equally argue that running a democracy would be simpler if, rather than giving each person the right to vote, the government decided who was to sit in Parliament on their behalf. The key point is that, if a party accepts that the right to emit is a human right, then each human, and not his or her government, has a right to get the emissions permit and then to do what they wish with it. They could sell it, of course, but they could also decide to let it lapse, thus sparing the planet of the emissions it represented. If the state auctioned all the permits, people wouldn't have that option. You don't own something unless you can dispose of it as you will. And you can't dispose of something if the state sells it for you

It might seem a fine point we are labouring here. Does it really matter in an EU country whether the government sells the permits and takes less tax or whether the people sell the permits and pay more to the government? Our view is that it matters a lot. It is important to get the emissions-rights-belong-to-the-people-and-the-permits-should-go-to-them principle established now because, in designing an emissions trading system for 25 or more countries (the EU could have 28 members by 2012) we would be missing an opportunity if we did not ensure that it could be extended to the rest of the world. So, while it might be all right to allow an EU government to sell its citizens' permits and use the revenue because the level of corruption is low, the same cannot be said for dozens of other countries around the world. If their governments were given emissions permits to sell on their citizens' behalf, most of the proceeds are likely to head for Switzerland. It is going to be hard enough to see that permits actually get to each person, just as it is hard enough to see that everyone gets the right to vote, but if the international community becomes aware of widespread theft it can suspend the issue of further permits until the country falls into line. We cannot have a system in Europe that allows governments to sell their citizens' permits and expect to be able to ban such a system in the corrupt parts of the world.

The advantages of the Feasta emissions proposal

In comparison with the present EU system, the Feasta proposal:

1. **Is adequate:** It would limit 100% rather than just 45% of EU emissions.

2. **Is fair:** Every company would be in the same position. No firm would get an allocation and others not.
3. **Removes uncertainty.** Firms would not have to worry about the size of their allocation. Only the price of an emissions permit would be uncertain, as it is with the present system. The price would vary with the strength of the EU economy but firms could be sure that the cost of permits would tend to go up and they could plan accordingly.
4. **Compensates the public for higher prices.** The cost of all goods would go up under the Feasta proposal by just as much as they are doing under the present EU system. However, the Feasta proposal means that everyone gets an extra income from the sale of their permits to cover these higher prices and, if they use less energy than the EU average, they will come out with a net gain.
5. **Is administratively straightforward, is cheap to operate and has no arbitrary elements.** Rather than attempting to measure emissions, it measures the quantity of fossil fuels sold. Very few firms would have to deal in permits. There would be no cut-off points between energy users, with some involved in the emissions trading scheme and others not.
6. **Confirms the right to use the atmosphere as a common resource** by making fossil energy producers and importers pay everyone a rent to use it as a dump for the emissions their fuels will release.
7. **Does not subsidise the construction of fossil-fuel-fired installations** by giving the operators valuable permits free.
8. **Encourages operators to close their dirtiest plants as soon as possible.** Once the system is in place, operators will know that the cost of permits can only get higher and that there is no point in hanging on to energy inefficient plants to qualify for an allocation of free but saleable permits.
9. **Has little scope for corruption.** Governments are not called upon to decide which firms should get permits and how many of them, or to enforce emissions regulations. Even the distribution of permits to individuals provides little room for fraud as EU residents would protest if they did not get their entitlement.
10. **Does not involve nation arguing with nation** over how many permits each should get. Each member state would know that all its residents were getting the same number of permits as every other EU resident.
11. **Offers a good working prototype of a whole-world emissions trading system.** If before 2012, 28 countries are sharing an emissions trading system that is working well and ensuring that, as the price of emission permits gets higher and higher, their citizens are getting an income to compensate, it would make getting an international climate agreement much easier.
12. **Would have widespread public support.** Not only would the system put money into people's pockets to counterbalance their higher costs, it would help protect the poorest from energy poverty. The big advantage of having a system that people strongly support is that they are likely to call for fewer and fewer emissions permits to be issued annually because this would not only slow the pace of climate change but also put up the price of each tonne of greenhouse gas. As a result, although their personal emissions allowance would be lower, their income from the sale of their permits would probably rise. No other system can give people the feeling that, as emissions restrictions tighten, they will at least get some personal compensation.
13. **Would create a transparent market** in energy and energy intensive goods across Europe thus delivering on the Lisbon agenda.
14. **Would lend substance to the concept of a European identity.**

In view of these advantages, Feasta believes that the parties should be able to reach consensus on the overall, international approach to the climate crisis and how that approach might be tested at an EU level.

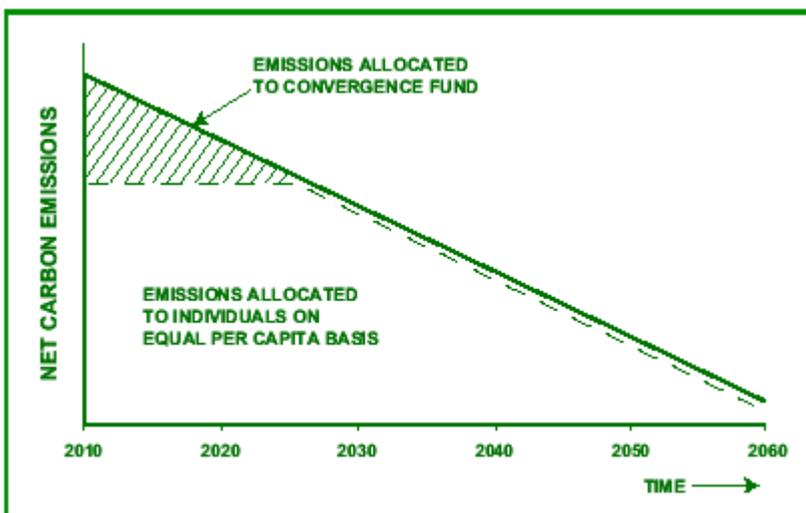


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If the world was an equal place, the annual amount of greenhouse gases that could be released in any year would be shared amongst the human population on an equal per capita basis. Every quarter or every year each person in the world would get an individual ration coupon entitling him or her to burn whatever amount of fossil fuel would result in releasing their portion of the allowable weight of greenhouse gas allocated for that year. They would not, of course, be entitled to the fuel itself but their ration coupons would be tradable and those getting them would sell them as will be explained shortly.

However, this system of allocation, while equitable, would not be very fair, as people living in some parts of the world have challenges to overcome before they can live as comfortably on their emissions allocation as people elsewhere. Feasta proposes that for the first, say, twenty years after the introduction of a global rationing system, everyone should get the same allocation each year but at the rate appropriate for year 20. This is represented by the dotted horizontal line on the Graph. The shaded area above the dotted line is the difference between the total amount of emissions permits available for any particular year and the amount distributed to individuals. These remaining permits would go into a "convergence fund" to be allocated to national governments by the club according to an internationally-agreed, transparent set of criteria.



The national governments would sell their permits to raise funds for projects which enabled their countries to make the transition to lower fossil energy use. For example, countries might be allocated permits because they needed to improve the energy efficiency of their buildings and transport systems, or to take precautions against the increasing storms, drought or rising sea levels brought about by climate change. Or they might qualify for them because they had a greater need than other countries to enable their industries to adopt new, low-energy technologies. Obviously, the size of the convergence fund would fall each year until it ceased altogether in year 20. Thereafter, each individual's emissions allocation would fall annually, so that the total number of permits issued globally kept to the downward dotted line and the target concentration target was met.

¹ *Carbon Market Europe*, February 10, 2006

² 'An Expensive Way to Combat Global Warming: Reform Needed in the EU Emissions Trading Regime', special article in the ESRI's *Quarterly Economic Commentary*, April, 2004. Can be downloaded from http://www.esri.ie/pdf/OEC0404_FitzGerald.pdf

³ Energy Research Centre of the Netherlands (ECN) report³ "CO2 Price Dynamics: The Implications of EU Emissions Trading for the Price of Electricity" can be downloaded from <http://www.ecn.nl/docs/library/report/2005/c05081.pdf>

⁴ 'Analysis of the National Allocation Plans for the EU Emissions Trading Scheme', Ecofys, London, August 2004. Downloadable from http://www.ecofys.co.uk/uk/publications/documents/Interim_Report_NAP_Evaluation_180804.pdf

⁵ *Carbon Market Europe*, February 10, 2006

⁶ <http://www.europarl.eu.int/omk/sipade3?PUBREF=-//EP//TEXT%2BPRESS%2BDN-20021010-1%2B0%2BDOC%2BXML%2BV0//EN&LEVEL=2&NAV=S>

⁷ http://europa.eu.int/comm/environment/climat/pdf/allocation_psum.pdf

⁸ The distribution might be just be to those aged 18 and above. This is a minor detail that can be settled later rather than one of principle.