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Leadership and Linkages: The Political Economy of Climate Change

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June 2007



Economics is what is left once all the interesting politics have been solved

Anon (economist)

Stern vs IPCC



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Stern Review

- Climate damages are 5-25% future GDP
- We should value future costs and human welfare highly
- Moving to a low carbon economy is relatively cheap – 1-3% GDP

CBA is clear – we should act now

IPCC 2007

- Climate damages are 5% future GDP
- Future costs and human welfare based on current preferences
- Moving aggressively to a low carbon economy is not cheap – 5% GDP

CBA is unclear – no optimal emissions pathway



The Realities of Political Markets

- Trying to generate two public goods – energy and climate security – from the same energy system
- Energy price rises have driven more investment in coal and coal-to-liquids than efficiency – and have swamped carbon prices
- Political priorities of energy security are driving investment into high carbon solutions using direct policy tools (spending, subsidy, regulation)
- Even Germany is planning up to 40 coal power plants – plus 40% renewables – both subsidised

The politics of energy security is shaping energy markets far more than the politics of climate change – coherence is needed

Climate Geopolitics has rising importance but poisonous power dynamics



- Collective Action Dilemmas:
 - **First mover disadvantage**: waiting to act gives a better deal
 - **North-South Chicken**: if the rich won't act – then the poor won't act; except poorer countries suffer first and most
 - **Paying the polluter**: biggest polluters with lowest damages can demand “payment” to join agreement; China and India pay USA to reduce emissions?
- Leadership essential to an effective global deal; EU only credible world leader? US post-2008 elections?

3 Ways A Global Deal can Fail



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1. Fail to agree – we don't care
2. Fail to agree to enough action – we don't care enough
3. Fail to agree on effective mechanisms for cooperation:
 - Alignment with domestic politics
 - Enforcement of agreements
 - Effectiveness of international instruments

Political Framing to Drive Economics



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- **Climate Security:** climate stability is a vital national interest which requires outcomes to be delivered and strategic interests to be reevaluated (US-China?)
- **Climate Justice:** climate justice is firstly about the unfair distribution of 25% GDP in impacts, and then the allocation of 5% GDP in mitigation costs
- **Economics of Transformation:** need a new attitude to clever intervention in the economy to drive major change in a specific timescale. UK example shows markets are a small component in early stages.

Economics of Transformation: From “What” to “How?”



Post 2012 framework needs to target three core activities:

- **Investment:** consistent signals to investors to move on-going energy system investment towards low carbon alternatives.
- **Innovation:** produce sufficient “market pull” to generate radical investment in innovation in the next generation of low carbon technologies, services and businesses.
- **Institutions:** redesign the market, regulatory and business models currently shaping the energy system so they efficiently and effectively drive low carbon investment, and are increasingly sensitive to carbon price signals.

Very weak understanding of what is a robust system of incentives and institutions to drive the transition to a low carbon economy.

The Political Economy of Climate Change



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- Climate risk management **not** Cost-Benefit
- Imperfect politics will always define the carbon market
- Build domestic politics before going global
- Security is Security is Security
- Invest in outcomes and innovations **not** markets
- Don't share burdens share opportunities