“Climate clubs or climate partnerships?
How effective climate cooperation can succeed”

Workshop summary

DIW Berlin and online, May, 20th 2022, 9 AM – 12 PM

Background and objective

The workshop took place as part of the SNAPFI project[1] on interactions of climate finance with national climate polices and addressed the topic of effective climate cooperation between industrialized countries and emerging economies. Proposals for cooperation structures related to climate clubs (such as by the German government), partnerships (for instance the Just Energy Transition Partnership with South Africa) and sectoral alliances (such as the Glasgow breakthrough alliances) are currently proliferating. Hence, the workshop sought to find answers to pertinent questions they raise. It provided a forum to discuss with researchers from international think tanks and policy actors - ahead of German G7 summit from 26 to 28 June 2022 - to offer input on how political attention and motivation could contribute effectively to a global momentum on climate action. The input presentation based on the background paper shared with participants before the workshop provided an overview and analysis of the three partnership approaches mentioned above and is distributed with the present workshop summary. The subsequent four discussion rounds addressed questions as to how these initiatives can contribute to raising ambition levels, how they could support transitions to climate neutrality and how they are addressing carbon leakage and EU policies.

Key results

Overall, the debate among participants has shown how important it is to:

1. Further clarify the role and design of international versus national carbon pricing mechanisms and what realistic expectations to the Carbon Border Adjustment Mechanism (CBAM) are in a climate club approach.
2. Linking debates around suitable cooperation initiatives with the G7 initiative to advance coordination of international climate action in the industry sector and cooperation[2] – particularly with emerging economies and developing countries.
3. Clarifying and establishing cooperation structures which can help to implement international climate finance and potentially closing related finance gaps, by (I) creating durable cooperation structures (ii) aligning interests and objectives across partners (iii) anchoring individual cooperation in strong partnerships.

The fruitful discussions have been summarized and structured according to three key functions of any cooperation initiative which were identified by participants. Their major findings are outlined in detail below.

[1] For further information on the project, funded by the International Climate Initiative (IKI), see www.diw.de/snapfi_en

[2] See the G7 communique here: http://www.g7.utoronto.ca/environment/2022-ida.html

Three functions of any type of international cooperation initiative

From the discussion around differences and synergies between the three main types of current climate cooperation initiatives – climate clubs, sectoral alliances and targeted climate partnerships – three main functions of any initiative to enhance international climate cooperation of EU and third countries emerged. Discussions have shown that the climate club concept is evolving beyond club benefits and carbon pricing coordination towards a stronger emphasis of coordination and creation of synergies between initiatives. It was also raised as an important function that an initiative should channel direct support for domestic transitions in the global South and create a fair level-playing field for cooperation. The three functions are:

1. **Introducing a pricing mechanism or access to benefits shall directly incentivize the shift to a cleaner production.**

According to most of the literature, a pricing mechanism is the essential aspect of a climate club, even though it is currently not high on political agendas beyond the EU. The pricing mechanism shall contain two aspects:

- *Joint carbon pricing*: all club countries set a premium on the CO_2 emissions of produced goods via tax or emissions trading, thus, “dirty” production technologies become more expensive.
- CBAM: applied to goods entering the club area, discourages carbon leakage (i.e. the relocation of companies to avoid stricter emissions regulations).

The club goods could be joint markets for green products and would create incentives for joining the club, not accessible to countries outside the club – this would be an inherent challenge for inclusivity.

For some attendees, a pricing mechanism - esp. the CBAM - offers the possibility to start with a few countries and would therefore not have to rely on a general multilateral agreement. This may facilitate further cooperation via new members or a stronger integration of club members.

However, various concerns regarding a club with a pricing mechanism were raised, mainly focusing on the interaction of the club with third countries:

- To be effective, a climate club must be able to attract a relatively heterogenous group of member countries[3] and requires support by additional infrastructure and/or institutions. This would make the inclusion of new members more difficult than it may seem at a first glance.
- An exclusive club can be seen as a parallel structure to the Paris Agreement, which would weaken the role of the latter in the UNFCCC process and thus, the basis for common standards.
- The club could increase the barriers between the global North and South by being perceived as forcing a set of norms on emerging economies and creating financing problems for companies in emerging economies. While paying the CBAM sets these companies at a disadvantage, changing production technology may simply be too expensive.

[3] Because to cover a relevant share of emissions or production it would need to include countries at very different stages of development, from the US to India.

Consequently, a club with a pricing mechanism may avoid carbon leakage unilaterally in EU, but hinder further multilateral climate cooperation with third parties.

2. **Improving international coordination by linking and strengthening sectoral alliances and partnerships.**

Discussions during the workshop demonstrated that the climate club concept is evolving from an original idea of creating a club of countries that benefits all participants by agreeing on uniform carbon prices to avoid leakage towards more cooperative approaches to support countries in efforts for industry decarbonization beyond EU borders. While the initial debate was triggered by the ambition to contribute to international carbon pricing, (see function 1 above), the debate has shown that this may currently not be feasible and may not be necessary. What however has captured large attention in the discussions is the question how to improve coordination across different sectoral alliances as well as of bilateral partnerships. Accordingly, additional dimensions related to improved coordination were added, that now take the center of the attention.

In the discussions the role of an open multilateral structure was emphasized to support existing initiatives by avoiding redundancies or replacements and aligning them into a comprehensive vision. An open multilateral structure would have the following advantages according to the participants:

- During the decarbonization period industries require closer policy support. An open multilateral structure could coordinate policies and solve trade-conflicts between countries.
- As multilateral treaties are hard to negotiate; effective coordination of partnerships for specific sectoral foci could help strengthen bilateral/ sectoral cooperation.
- Improving resource pooling, thus allowing larger projects and increasing capabilities (administrative, financial or technical).
- Addressing the lack of trust between countries - a result of a long history of fragmentary implementation of big initiatives - is a key concern in global climate cooperation (esp. between global North and South). A multilateral negotiation framework is generally understood as the best way to build trust and to avoid that countries feel left out. However, to enable trust, a condition sine qua non is, that existing multilateral frameworks are perceived as fair. To improve trust, participants see it as necessary that negotiations are held between peers. Various speakers also mentioned the importance of communicating how a cooperation initiative would fit into the multilateral landscape and the process of the Paris Agreement and discussed the adequate format: a long-term horizon would favor permanent structures but informal structures would allow using existing forms of cooperation (e.g. G7, OECD, etc.).

Next to the positive aspects, various participants also raised concerns for this kind of coordination:

- Changing the role of existing institutions like G7 or the OECD by upgrading them to a club could allow fast cooperation, but their exclusiveness would pose problems for integrating/ including non-members.
- Embedding a club in the multilateral framework is challenging as within the current policy landscape few countries have sufficient policies in place. An exclusive club would face the risk of arbitrary inclusion/ invitations.

- An insufficient focus on climate aspects of the club would send the wrong signals and it should therefore not be used as a tool to strengthen trade and competitiveness.
- Instead of adding value, such a framework structure might rather choke individual initiatives.

3. Providing support for countries of the global south through partnerships and international financial institutions.

Emerging economies grapple with limited capacities to transform industry sectors, to attract the capital which is needed for transformation, and to lead the energy and industry transitions in a socially just way. These challenges should guide the design of a collaborative climate action if it is to involve emerging economies. The consensus amongst the participants was, that some form of structuring of financial support and increasing the assistance is necessary.

High financing costs in emerging economies could be addressed with de-risking instruments, thus reducing the cost of a transition to capital intensive climate neutral technologies. But tighter financial conditions, the necessity of a large roll-out and debt problems prevent emerging economies from providing guarantees etc. themselves: Thus, financial support from countries of the global North is necessary to reach the desired scale and private as well as public commitments need to be coordinated. However, the risk perception from the global North is often misplaced, which leads to hesitant actions and makes it difficult for countries of the global South to get finance for long-term projects.

Various speakers pointed out that the increase of capacities and capabilities is front and center to raise ambitions in emerging economies. This includes especially access to technologies, administrative aid, planning capacities, cooperation on innovation amongst others. In this context information sharing and global standards could support motivated actors in the transition to low-carbon technologies.

However, the following challenges occur:

- The large scale of finance required to start the transformation: to reach a wider impact financing must not be on a project-by-project basis but rely on long-term commitments. But the lack of trust obstructs the required large transfers.
- Climate action support might be reduced to CO_2 mitigation efforts in a narrow sense, ignoring other costs of decarbonization and adaptation such as cost of stranded assets, transaction costs, necessity of just transition, adaptation measures and cost of climate related losses/ damages.
- A focus on partner countries may be too narrow. As decarbonization requires a global effort, partnerships must also help third countries with their transformation.
- The risk of organizing aid in a way that offers little value creation and inclusion to countries and communities of the global south.