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Article

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COVID-19 Policy Response Can Inform the Design of a Climate Club

Annual global greenhouse gas (GHG) emissions have been rising steadily for decades and show no sign of peaking, notwithstanding the Paris Agreement of 2015 and the increased concerns about climate action. Even considering pledges made up to the 2022 UN Climate Change Conference, COP27, the world today is on track to reach 2.4 degrees Celsius of global warming by 2100, instead of 1.5 degrees Celsius. The health effects of climate change continue to increase, with disproportionate effects on the most vulnerable.

Climate is a global common good whose protection is hindered by the perfect mixing of GHG emissions in the atmosphere and difficulty of exclusion. Free riding is a major challenge as reducing emissions is costly, but benefits the entire planet. The failure of the current voluntary-based global climate governance calls for new solutions to accelerate decarbonisation, such as the establishment of an international climate club where members (1) commit to aligning strong climate ambitions, (2) coordinate on the implementation of their climate policies, starting with carbon pricing, and (3) agree on the enforcement of trade penalties or, to make it WTO-compatible, border carbon adjustment (BCA) measures vis-à-vis non-members.

The creation of an international climate club has been long debated in economic circles as a way to overcome the free-riding problem in global climate action. This idea has recently been gaining political momentum in Europe and beyond, notably as the G7 agreed in 2022 to build the foundations of a Climate Club to support the effective implementation of the Paris Agreement. In particular, BCA measures are important to avoid carbon leakage.

A common criticism of climate clubs is that no country has ever adopted BCA measures so far. This is not a result of the technical complexities of the scheme, but rather because it was not deemed necessary. This is due to a simple reason: today's average carbon price is US \$3 per tonne, i.e. far below the US \$40-\$80 per tonne range required to meet the Paris Agreement goals. While low carbon prices limit the risk of carbon leakage, this situation is set to evolve as climate policies become more stringent.

The key question now is how to design and implement an effective climate club. We argue that the aforementioned commitments are necessary, but not sufficient to launch a successful climate club. Today, most countries lack a carbon pricing system and would thus be excluded from the club regardless of how strong their climate regulations are. Only 20% of global GHG emissions are covered by carbon pricing instruments, and we do not have a reliable, internationally recognised methodology to calculate carbon price equivalents to climate regulations – at best, this would take years to develop. This shortcoming would increase global trade tensions and hinder the global impact of the club's action given its limited geographical scope.

To overcome this obstacle, climate clubs should integrate an interoperable and temporary Green Certificate (GC) system acting at the level of individual industrial installations.

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Such installations would be considered “green” if they can demonstrate that the produced goods have a sufficiently low carbon footprint according to an internationally recognised certification, or by offsetting a sufficiently large share of the emissions with the purchase of carbon credits. While the GC system could evolve in line with climate goals and new scientific evidence, not allowing for partial exemptions would incentivise companies to adopt ambitious decarbonisation paths. Importantly, countries with strong environmental policies – but no carbon price – could join the climate club provided they extend the use of GCs and that an important share of their production is “green”. Thanks to the GC system, green industries would be temporarily exempted from trade penalties when exporting to other club members.

The rationale for introducing the GC system originates in the COVID-19 crisis. To gain control over the virus, some countries have opted for strong containment policies at the macro level – or green zoning – while others have relied on the adoption of COVID-19 certificates, a tool which focuses on individuals’ (micro) status. Arguably, these initiatives can be reframed as a plethora of “COVID-19 clubs” – even though they were never officially set as such and lacked global coordination. Strong containment was successfully implemented in a handful of places, but most countries were unable or opposed to this approach due to its high social and political cost. In some of them, the adoption of COVID-19 certificates was effective to spur vaccination, and thus reduce the health burden caused by the virus.

While there are no such things as green zones or vaccination for GHG emissions, this highlights the potential for a double approach – micro and macro – to tackle the climate crisis. Equipping climate clubs with a GC system is viable, notably for carbon intensive goods such as steel, aluminium, cement and fertilisers. International standards already exist to identify low carbon footprints. The GC could thus build on these existing certification tools. Alternatively, countries could develop their own GC system and apply for its recognition within the club.

The GC system can allow countries to join the club while developing a national-level carbon pricing system. There, the GC would offer greater flexibility for companies to “procure their way out” from trade penalties, and foster bottom-up climate action.

Further, the GC can support companies that encounter difficulties in decarbonising, but can temporarily mitigate their climate footprint by offsetting. By triggering a wider use of offsetting, the GC system can support voluntary carbon offset markets, already key for companies, individuals and institutions willing to prove their commitment to fighting climate change, and expected to increase by 15 times from 2020 to 2030. It can also promote new synergies between mandatory and voluntary carbon markets, which are key to achieving global climate goals according to the Paris Agreements.

As the world is failing to tackle the climate crisis, we need to find new ways of facing this emergency collectively, even if countries adopt different approaches. A well-designed international climate club, equipped with an interoperable, reliable GC system, is the best way forward to accelerate decarbonisation while ensuring that countries with stronger climate policies do not compromise their economic competitiveness.

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