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# The G7 Summit: Advancing International Climate Cooperation?

**Options and Priorities for the German G7 Presidency**

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**At the G7 summit in June 2022, the German government intends to promote international climate cooperation by establishing a climate club. This club is envisioned to foster implementation of the Paris climate goals and, ideally, grow into a global alliance of ambitious countries. In light of Russia's attack on Ukraine, energy policy cooperation is now one of the most pressing issues at the G7 summit. Energy security as a short-term priority must be reconciled with accelerated decarbonisation and the international climate agenda. A climate club can certainly provide an impetus for this through agreements on joint regulatory approaches and climate action projects. In terms of the international political process, however, it is important to prevent the initiative from being perceived as a rich countries' club. The German government should carefully manage expectations: Strong signals are needed for COP27 in Egypt in autumn, first and foremost by way of increasing climate finance commitments. Moreover, it will be crucial to shape the G7 club as an ambitious but inclusive initiative.**

At the Conference of the Parties (COP26) to the United Nations Framework Convention on Climate Change (UNFCCC) in Glasgow, countries focussed on accelerating the implementation of nationally determined contributions (see SWP Comment 2/2022). To this end, a number of new climate initiatives were launched, including some with German engagement. More cooperation is vital because the European Union (EU) can neither implement its Green Deal nor accomplish the targets set out in the European Climate Law on its own, given its complex economic and political relations with other countries. The war in Ukraine has complicated the conditions for ambitious climate policy at the United Nations level because it has focussed much political attention on security issues and energy supply and the question of how to deal with Russia is overshadowing climate policy cooperation among key players. Under these political circumstances, what are the chances for a climate club, and how does it fit into the overall structure of international climate cooperation?

## Climate Clubs and the German Proposal

Climate clubs are not a new idea. For some time now, there have been groups of countries in international climate negotiations that cooperate closely, including regional groups or groups that focus on specific issues. Countries have also worked together on joint climate projects within the G7 and G20 and in the various initiatives and programmes of institutions such as the World Bank. When the 2009 climate summit in Copenhagen (COP15) failed to produce a new comprehensive global climate agreement, the idea of working in small coalitions to achieve results more quickly gained further traction. For example, in 2009, the United States (US) established the Major Economies Forum on Energy and Climate Change. This was intended to help compensate for the lack of a global agreement.

After the adoption of the 2015 Paris Agreement, which encompasses all countries, the question arose as to how ambitious countries could make more rapid progress on mitigation efforts if important players do not follow suit to the extent required. The Paris Agreement does not prescribe binding emission reduction targets, but leaves the formulation of targets to individual states. This creates the risk that first-movers bear the costs, while free-riders get away with insufficient contributions. As a response to this problem, economist William Nordhaus proposed a widely discussed idea for a climate club in 2015. Club members would agree on a carbon price and raise a common external tariff to protect themselves against potential competitive disadvantages. This would prevent production from being shifted to countries without a carbon price (carbon leakage), which would ultimately undermine mitigation effects.

Moreover, as has often been argued, countries with the highest historical greenhouse gas emissions should make the largest contributions to global climate action. Since China and India are now among the largest emitters alongside the US and the EU, however, mitigation measures of industrialised countries alone are no longer sufficient.

The German government considers climate action to be an integral part of its foreign policy strategy. Its draft for a climate club, which will be launched within the framework of the G7, is characterised by several key aspects. It is intended to compensate for the lack of enforcement mechanisms in the Paris Agreement. The *Pledge and Review* reporting processes that the Paris Agreement mandates have so far not provided the necessary momentum for climate action, even in combination with the continuous increase in ambition levels *(Ratcheting-Up)*. In addition, the German government's proposal aims to protect club members from competitive disadvantages in international trade and to avoid carbon leakage. Members of the club with comparable carbon pricing systems would introduce a joint levy on imports from third countries that lack such a system, a so-called border carbon adjustment. This would create additional incentives for innovation in climate mitigation technologies and enable the creation of common lead markets, for example for green hydrogen. Lastly, the German government's proposal puts an emphasis on openness and inclusiveness. Through partnerships, the club is envisioned to grow into a global climate alliance with an outreach far beyond the G7. Since many countries of the Global South are unable to immediately meet the requirements for membership, the German government's proposal foresees funding for capacity-building.

### Between exclusivity and inclusivity

The endeavour to form a broad climate alliance faces the challenge of respecting the UNFCCC principle of Common But Differentiated Responsibilities and Respective Capabilities. This principle stipulates that industrialised countries, which have historically been responsible for climate change, should also contribute accordingly to climate action. At the same time, developing countries, which are particularly affected by climate change, must be able to retain a say in decision-making. However, a climate club functions precisely because of exclusive club advantages to which not every country has immediate access. Exclusivity sets the incentives for cooperation for those countries that have not yet sufficiently implemented their announced climate mitigation efforts. The G7 initiative should therefore be careful when exploring the global potential of such an approach for the coming years — now and beyond the German presidency. G20 countries such as India, China, and Indonesia might be compelled to consider joining, depending on the particular club benefits under discussion. In order for a large number of developing countries to support the G7 initiative, appropriate club benefits need to be offered to foster cooperation.

## Club Benefits and Common Interests

The German government is proposing a minimum carbon price for a climate club in combination with a common carbon border adjustment mechanism, which is about to be established in the EU (CBAM, see SWP-Studie 9/2021). These two elements would create a common regulatory space and deter free-riders. Third-party countries would have to pay the border adjustment charge and — as argued by Nordhaus — would ultimately want to join the club.

Additional club benefits are conceivable, for example through harmonised emission, product, and technology standards. Increasing demand for climate-friendly goods through public procurement and privileged market access for companies from member states would constitute further benefits. Joint climate research and development initiatives for green technologies — for example battery development, green hydrogen, smart infrastructures, and circular economy — could create new lead markets in the member states. In the best case scenario, this would permanently alter international supply and value chains towards an increasingly decarbonised economy.

So much for the theoretical approach, but given the political priorities and the geo-economic context, it is an enormous political challenge to initiate and implement any of this. The official positions of all current G7 governments may be essentially aligned. They all support the international climate agenda and the goals of the Paris Agreement. But national ambition levels and implementation strategies vary significantly.

### Starting points for the G7

With the EU and British emissions trading schemes in place, all four European G7 countries share a common instrument. The US, however, is not expected to introduce a nationwide carbon price in the foreseeable future, and its climate legislation is only making slow progress. The Japanese government is not planning a carbon pricing system for energy suppliers and industry either. While Germany, France, Italy, and the United Kingdom (UK) are part of a joint climate governance system, there are few options for linking up with Japan, Canada, and the US.

Japan, whose government will assume the G7 presidency in 2023, has set itself the goal of becoming carbon neutral by 2050 and, after much hesitation, now seems to agree to the introduction of an international carbon tax on maritime transport. However, given Japan's domestic economic problems, climate action is still not very high on the political agenda and is perceived as an elite project by large parts of the population. Carbon prices have been introduced in Canada and parts of the US at the provincial and state levels, but there is no national approach. Any G7 agreement on a minimum carbon price that goes beyond a declaration of intent is therefore not realistic at the moment. Agreement regarding a common regulatory basis would be an option that could be pursued instead, as it would prepare the ground for future G7 progress.

Moreover, reducing carbon emissions in energy-intensive industries (steel, cement, aluminium, etc.) is a common interest of the EU, Japan, and the US. The EU and the US abolished punitive tariffs on steel and aluminium as well as corresponding counter tariffs at the G20 summit in Italy in 2021 as part of a new Global Arrangement on Sustainable Steel and Aluminium (GSA). By 2024, the two parties are to negotiate how trade in these energy-intensive goods can also be aligned with carbon-intensity criteria. The topic is therefore well-suited to the G7. The US and Japan have also agreed not to impose any more steel tariffs on each other. However, cooperation with China, which is one of the largest trading partners for energy-intensive goods, is being hindered by the fact that the US government is ruling out cooperating with China under the GSA.

Another hurdle to be overcome within the G7 is how to deal with the EU's planned introduction of the CBAM on steel and other energy-intensive products. Since not all G7 countries have introduced a carbon price, the CBAM is currently more of a stumbling block than a lever for the German climate club initiative. One way to tackle this problem, which is promoted by the US, is to recognise US regulatory measures as being equivalent, that is, to determine an indirect carbon price on the basis of companies' costs from regulatory standards. Further joint decarbonisation initiatives could also be developed, which would ultimately reduce carbon emissions from industrial production and thus also reduce the basis on which the CBAM is calculated.

In the near term, however, the securing of energy supplies is coming to the fore as a common interest of all G7 countries. Russia's attack on Ukraine will result in further supply shortages, rising prices, and shifting energy dependencies for the foreseeable future, not only in Europe but globally. Governments are now occupied with diversifying energy suppliers and cooperating in order to tackle rising prices. There are existing climate policies that can help in this regard, particularly increasing energy efficiency, expanding renewable energy use, and ramping up hydrogen production and sustainable mobility systems. These projects should be jointly accelerated. They also offer solutions to the macroeconomic challenges that have arisen as a result of the pandemic and the war in Ukraine, such as price increases and the search for additional sources of public financing.

## Intensifying Partnerships beyond the G7

The way in which countries outside the G7 perceive the German club initiative will be crucial for building partnerships and generating strong impact. From the perspective of particularly vulnerable developing countries, the initiative might be seen as problematic because G7 countries have been the main polluters, and not all of them can be considered strong promoters of international climate cooperation. In this light, protecting against competitive disadvantages, which the G7 club sees as a means of overcoming political obstacles, comes across as self-serving.

In order to counter this perception, the G7 need to secure climate finance for adaptation and loss and damage — a focus of the COP27 negotiations — and prove to be reliable climate finance contributors. New funding pledges are expected at the June summit. The German government also suggests in its proposal that revenues from a future CBAM be used for more international climate financing.

However, conditionality with regard to financial support for mitigation and adaptation efforts is an issue that has long been a source of friction between developed and developing countries in climate negotiations. Holding out the prospect of climate finance as a club benefit would mean to attach conditions to it — namely cooperation with the G7 initiative and its success in generating new income. For stakeholders of the Global South, however, the G7 countries' obligations to finance adaptation and mitigation efforts stem solely from the urgency of the climate problem and the historical responsibility of the industrialised countries. In addition, the volume of international climate finance neither meets the need nor the promise of the industrialised countries to raise $100 billion annually by 2020. From this point of view, it is diplomatically tricky to make finance dependent on revenues from a club that has yet to be founded, let alone to use finance as an incentive for cooperation. It should therefore be made unequivocally clear that all climate funding directly related to the club will include new and additional money only, specifically for capacity-building with regard to the technical and administrative requirements of club membership.

### Can large emerging economies join the club?

Indonesia will chair the G20 in 2022. A number of emerging countries from the G20 plan to increase coal consumption in light of the current energy price crisis. Against this background, it is difficult to identify joint projects, especially with China and India, and slow down investments in coal-fired power plants. China has made repeated efforts to reduce emissions, partly because air pollution from coal combustion has become a serious health issue. India and Indonesia, however, still consider coal to be essential in order to catch up economically.

Russia's war against Ukraine is having a political impact in this regard as well. Its confrontation with the West is disrupting energy policy cooperation and complicating cooperation with major emerging economies, at least in the short term. Emerging economies will not support sanctions against coal, oil, and gas from Russia. Fossil fuels are becoming more expensive, but it is not a given that China, India, and Indonesia will scale back their longer-term coal expansion plans because of this. The political importance of security of supply is growing everywhere, and some emerging economies are interpreting the recent increase in European coal-fired power generation as a turning away from coal phase-out plans. Nonetheless, there are common interests with regard to the expansion of renewable energy, which helps both supply security and climate mitigation. It is becoming apparent that the EU and Germany are also seeking to exert influence on certain G20 countries, such as India most recently, so that they will be more likely to support Russia's isolation on the energy markets.

Should individual emerging economies develop an interest in carbon pricing or pursue existing plans more vigorously, it will be necessary to realistically assess their institutional and economic capacities and to enter into talks about the benefits of carbon pricing. The G7 and G20 summits can provide an important impetus here, albeit with little binding force. Nonetheless, Germany, France, Italy, the UK, and Canada — together with the EU — can negotiate with China and South Africa about cooperation on the CBAM: Both countries already have a carbon price.

## Options and Priorities for the German G7 Presidency

The German proposal for a climate club can be useful to develop joint forms of cooperation in the G7 on the regulatory implementation of climate goals, depending on the level of ambition of each partner. This can include carbon pricing, sectoral initiatives, and other measures. For the Japanese government, a tangible project has to be identified that is suitable for them to continue during their own G7 presidency in 2023. Such a project could pertain to reduction targets for the production of energy-intensive goods and investments in hydrogen.

The war in Ukraine brings new challenges for the global energy supply. Mutual support within the G7, but also with other countries that are particularly vulnerable to price increases, must be aligned with climate goals. Financing and accelerating renewable energy production and related infrastructure as well as rapid efficiency gains are among the top priorities. At the same time, abandoning the coal-financing phase-out and a coal renaissance must be avoided at all costs. In the negotiations of the European G7 environment and energy ministers, there will be no way around a further diversification of European gas supply towards more liquefied natural gas (LNG) from the US. In this context, delegates should give high priority to joint measures for more energy savings and reducing emissions in the production and processing of LNG.

Moreover, the German government should manage expectations of the club. The G7 as an intergovernmental discussion platform has proven to be flexible and historically consistent due to its rather informal character. It can be a political incubator for a global climate alliance, but it cannot provide it with a binding set of rules. Ultimately, successful G7 initiatives will have to be delegated to international institutions.

For the implementation of the Paris Agreement, the club idea helps to align the types of club benefits offered from the outset with the interests of potential members and partners that do not belong to the G7. Germany has invited four such partners to the G7 summit in June: India, South Africa, Senegal, and Indonesia. Reaching an understanding with them would send an important signal of inclusiveness. It would help the German government to walk the fine line between strengthening international climate cooperation and its perceived undermining by the uncoordinated efforts of a group of rich industrialised countries.



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