Germany and L14

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GENERAL CONSIDERATIONS

Any climate strategy must first crack the "public goods" problems. Climate change is a "public bad" of the first order, but that does not mean that individual countries will act to produce public goods.

To put the theory of collective/public goods in the vernacular, the problem is "Let George do it." If I contribute to the production of such goods, which requires action by all, how can I know that others will obey duty, too? If they "free-ride," I bear the costs and they reap the reward. Free-riding is the killer of collective action because a public good (like CO_2 reduction), by definition, is a good that can be enjoyed by all once it is on the market – whether I pay for it or not. Hence, the Commons is always overgrazed, unless individual penalties and incentives can be imposed.

This is precisely the Kyoto problem. Why me, ask India and China – we are just at the beginning of industrialization and should therefore get a break. If they are exempt, why should I impose an enormous tax on my economy, asks the U.S., given the high energy-content of my GDP, heating/cooling and transportation system?

Why me, asks Germany? We have decided to run down our nuclear-energy production ("Ausstieg aus der Atomenergie"), and so we have to rely on coal, gas and oil – fossile fuels in short. So we demand a generous allocation of emission certificates.

GERMAN ENERGY POLICY

No advanced industrial country is more fervent in its rhetorical attachment to Kyoto et al., and few are so flexible when it comes to implementation.

The recent spat with Brussels is a case in point. Originally, Berlin wanted CO_2 certificates for 482 million tons. Under pressure from the EU, it came down to 465 million but refuses to accept the EU offer of 453.

Interestingly, chancellor Merkel recently adopted a softish American line: "Even if Europe would produce zero CO_2 emissions, world temperatures might still rise by more than

2 percent, unless *all* (read: China and India) demonstrate more sensitivity for climate protection."[1]

Germany also warmly endorses emission-trading. But there is an interesting footnote. Berlin wants those 465 million tons for free, which is an indirect way of saying: We want certification of the status quo. It gets more interesting still. German coal utilities get them for free, but charge their customers an add-on amounting to the current market value of these certificates. One million tons for 2008-2012 currently fetches 18 million euros.

In other words, a tool designed to reduce emissions now acts as a hidden subsidy for coal-fired power production. Finally, German policy claims a special dispensation for all new power plants. Those built between now and 2012 should be exempt from emission limits for 14 years.

What goes for Germany, goes for much of the EU. The National Allocation Plans submitted to Brussels pretty much consecrate the status quo. .To avoid stringent caps, governments have thrown emission licenses at their utilities "like confetti," reports *The Economist.*

Finally, Germany enjoys a wondrous historical benefit: the "Wallfall Profit." In 2005, the country could proudly point at a 17-percent reduction in greenhouse gases, as compared to 1990. Most of this was a windfall from the demise of East Germany: from the general de-insustrialization of the former GDR plus the replacement of CO_2-spewing soft-coal plants with modern, more climatically-correct hard-coal ones. In other words, this was a one-time effect that cannot be projected into the future. In fact, German CO_2 emissions have risen slightly between 1999 and 2005.

Thus a meager bottomline on climate control has been wrapped into a rich rhetoric of environmental virtue. And what is true for Germany holds true for all other European economies with a high manufacturing content. Germany's manufacture is still a bit less than 30 percent – as opposed to the U.S., where it has come down to 16 percent.

IMPLICATIONS FOR POLICY AND L14

Back to the collective-goods problem. In the absence of an enforcement mechanism that penalizes the wayward and rewards the virtuous, public goods will always be produced sub-optimally because of free-riding. Kyoto has not cracked this problem, and neither do such extravaganzas as the Nairobi Climate Summit in November 2006.

[1] Interview with *Financial Times Deutschland*, 3 January 2007.

German ecology minister Sigmar Gabriel put the public-goods dilemma quite nicely upon his return: “The problem of climate conferences is this: Nobody wants to go first with his offer, true to the motto: Whoever moves first, loses.”[2]

Whence follows a framework for collective action that must be high-level and permanent rather than Kyoto-like with long hiatuses in between meetings. (This is like the first bullet point subsumed under the sub-head “The L14 could encourage actions under the Kyoto umbrella.”

This could soften the “prisoner’s dilemma” game where the two players, acting in ignorance of each other’s moves, end up maximizing common losses. Empirical game theory suggests that reiterating the game leads to more fruitful collective outcomes. Since ecological virtues is such a powerful ideology in Germany, the government would probably sign on. So it is time for a permanent Kyoto.

This framwork probably could not make binding decisions, given all the divergent national interests (and economic positions) of member nations. But the commission should closely monitor and publish individual nation’s achievements (or failures) in the compliance game. This is the “shame’em” strategy that will hold governments more closely to what they do than what they say.

Another benefit is domestic. Regular publication of targets met and failed would galvanize the eco-lobby at home into action against their government. (But note: EU governments have screamed bloody murder when told by Brussels that they have not met, say, the deficit-reduction criterion enshrined in monetary union. Berlin and Paris which overshot the 3 percent deficit/GDP ratio for years, have been past masters in this game of counter-pressure.)

As to substance, Germany would probably sign on to the next bullet point: softer target rules for developing than for advanced countries. Plus a built-in dynamic: As they get richer, targets become progressively more rigorous.

As in all public-goods production, there have to be opt-outs (or “safety valves”) in the form of expanded emission rights. Economies moving at a rapid pace cannot be frozen in time with caps set for eternity. The task here is to convince Germany to sell the additional permits at market rates, rather than hand them out for free.

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[2] As quoted in “Trippelschritte statt Siebenmeilenstiefel, *Süddeutsche Zeitung*, November 21, 2006.

Throw in “Research and Technology” (Point 5) for the Germans. Germany will love “funding investments” because it sees itself as world leader in ecology-minded technologies from solar to wind as well as energy-saving heating and production.

Add to this another incentive Germany will jump at: a regular fair for such technologies, on the assumption that the world will copiously buy stuff “Made in Germany.” This is good for employment and growth, which can compensate for climate-serving sacrifices elsewhere. In exchange for that benefit, Germany could be asked to live up more rigorously to its Kyto rhetoric. Above all: Sell emission rights; don’t give them away for free.