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**T7 Task Force Climate and Environment**

**POLICY BRIEF**

# CREATING AN EFFECTIVE, LEGALLY BINDING, AND ENFORCEABLE CLIMATE CLUB

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**Rafael Leal-Arcas** Singapore Management University



# Abstract

An effective, legally binding, and enforceable climate club needs to be immediately created. The climate problem has become a threat to humankind. The historical perpetrators are the western countries, but today increasingly major developing countries. The climate-club solution may prove to be multi-dimensional in that it may have benefits for famine, net greenhouse gas emissions, biodiversity loss, air pollution, et cetera. Nobel-prize winner William Nordhaus so aptly highlights how climate mitigation solutions must also be sought outside a multilateralism that, under its current form, has persistently failed to produce a legally binding international agreement on climate change when one considers the 30 years of its life, namely since the early 1990s. Such solutions must be well attuned to the realities of failed multilateralism, including the lack of adequate and binding targets, incentives, and penalties to achieve critical mass in global mitigation efforts, which is why Nordhaus calls for some complementary solution to multilateralism – namely the climate club model – that takes stock of existing pitfalls. The G7 (and G20) is a great platform to create an effective climate club. To solve the issue of potential resistance, membership could be designed in an open / gradual / incremental way.

### **Recommendation: Concluding trade agreements in the context of climate clubs to eliminate barriers and tariffs on green goods**

The G7 (with the help of the G20 and the European Union) could and should design a new climate regime based on plurilateral trade, making it legally binding and enforceable. The Paris Agreement on Climate Change of 2015 is neither. Absent a global, legally binding, and enforceable climate agreement, the creation of a climate club would make sense.

Three characteristics appear evident for the creation of a climate club:

1. Most big greenhouse gas emitters need to be members of the club;
2. Membership benefits are a must, and they should outweigh obligations;
3. The club would need to be related to sanctions for non-compliance.

One would need to make sure that such sanctions would not violate international law and/or World Trade Organization (WTO) legal rules. However, one should be concerned about the overuse of sanctions as a tool of diplomacy and economic statecraft. One should also take into account the response to retaliation and escalation resulting from sanctions in climate clubs. In William Nordhaus's analysis, the level of sanction of border adjustment required to do the job is not just on the carbon intensity of carbon-intensive goods and services; rather, it is across the entire economy.<sup>1</sup>

Going forward, the international community should aim at concluding agreements to eliminate barriers and tariffs on green goods; it should eliminate barriers to trade in environmental services; it should put an end to fisheries subsidies; and both the WTO and the World Bank should work together to phase down and gradually out fossil fuel subsidies, which are diametrically opposed to climate-change mitigation.

Moreover, the WTO rules (and other rules of international trade) should be drafted through the prism of sustainable development to serve the needs of the 21<sup>st</sup> century. This may only be achieved via plurilateral agreements, not multilaterally, since the WTO has proven time and time again that it is not feasible. For instance, a group of like-minded countries could take this initiative.

In addition, carbon border adjustment mechanisms throughout the world may help put a price on carbon via a carbon tax. With climate a major global priority, it remains to be seen whether the European Union will disrupt the global trading system as it will inevitably implement carbon border adjustment taxes.

In recent years, and certainly since the collapse of multilateral trade negotiations in 2008, we have seen the rise of free trade agreements (FTAs). Recent FTAs have environmental chapters that promote environmental protection. A case in point is the United States-Mexico-Canada Agreement (USMCA), although its deficiency is that anything related to climate change is omitted in the agreement. The good news is that many countries are promoting climate change-related technology and many governments throughout the world would like to see a pro-climate agenda in their trade policies (largely because it is in their interest—both in terms of health for their citizens and economic sustainability—to do so). That may mean trade restrictions as part of climate change mitigation measures.

The future trade agenda is full of mega-trends, side-effects of geopolitical conflicts (like that between the US and China, which will most likely be the most important bilateral relationship in the world for years to come in fields such as energy security, international trade, climate change, or finance, to name but a few), it is about e-commerce (especially when it comes to data flows), as well as open, sustainable, and assertive trade. Areas for potential cooperation with the US are, among others, carbon capture and storage, hydrogen power, and the development of green financial instruments to fund such cooperation. That said, Chinese leaders seem cautious in their bilateral relations with the West, which they see as a region of the world in economic decline and political instability, as opposed to the economic rise and social stability of China.

# Challenges

The policy brief offers new ideas on the creation of a climate club linked to the international trade regime as an effective way to mitigate climate change. How should policies, regulations, laws, and agreements change to get us there? What incentives will be necessary to get there effectively? What has failed and why? We conclude that innovation and technology will be among the key elements of this equation, without which we will miss the goal.

The premise of this policy brief is that global action on climate change has not been effectively implemented, as it relies on consensus from too many actors. Thus, it proposes how international trade mechanisms may be re-oriented to address climate change. The policy brief challenges the assumptions about the existing multilateral-agreement regime, and argues that reducing dependence on these multilateral mechanisms may influence greater attainment of sustainability goals (more flexible, not reliant on difficult-to-gain consensus among many actors). The policy brief, therefore, examines the future of international regimes and how they may contribute to climate-change mitigation. Its forward-looking orientation – how international trade can leverage climate-change mitigation – is an important and novel contribution in examining how environmental concerns can be included into international regimes. What changes will look like and how change is attained (through policy, regulations, law, agreements, incentives) may contribute to developing global-level institutional solutions for how climate-change mitigation is framed in international regimes and discourses.

The climate-club concept is a very interesting idea for how one can come together with a set of countries and then encourage and force other countries to escalate their ambition. Three indicators seem relevant to give legitimacy to a climate club: 1) how much of the world's population it represents; 2) coverage of the world's GDP; and 3) level of greenhouse gas (GHG) emissions' coverage. On this point of indicators, around 50% of humanity lives within the world's ten largest economies. Bringing together these economies would make an effective climate club. However, one needs to think carefully about what happens after that, how countries respond to it, and whether that may cause a breakdown of much of the international trading system that is so important and necessary to advance trade in clean technologies.

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More than 100 countries/trading blocs, many of the biggest companies,<sup>3</sup> and 400 cities have promised to reach net-zero carbon emissions by 2050. The European Union (EU), the UK, South Korea, and Japan are among them. China said it will get there by 2060. This means that their economies will not put more carbon dioxide into the atmosphere than they take out, which will come at an enormous economic price. It remains to be seen whether voters in liberal democracies will accept higher energy prices to fix climate change. President Biden of the US is also keen to reach that target by 2050. Doing so puts all these economies in line with the Paris Agreement on Climate Change of limiting global warming to 2 degrees Celsius above pre-industrial levels. Therefore, those six players, among others, are ideal candidates for a climate club.

Along the same lines, we would argue that (major emitting) companies should also create their climate club. Why? Because companies are on the front line on issues such as climate change and some have promised to be carbon-neutral by 2050. In addition, we could have a green recovery, turning the covid crisis into a climate opportunity,<sup>4</sup> whether in COP26 or China stating that it will reduce the carbon intensity of GDP by 18% between 2021 and 2025<sup>5</sup> and by 65% by 2030 (based on the 2005 levels), and go net-zero by 2060.<sup>6</sup>

## Proposals

### **Concluding trade agreements in the context of climate clubs to eliminate barriers and tariffs on green goods**

Going forward, the international community should aim at concluding agreements to eliminate barriers and tariffs on green goods; it should eliminate barriers to trade in environmental services; it should put an end to fisheries subsidies; and both the WTO and the World Bank should work together to phase down and gradually out fossil fuel subsidies, which are diametrically opposed to climate change mitigation. Moreover, the WTO rules (and other rules of international trade) should be drafted through the prism of sustainable development to serve the needs of the 21<sup>st</sup> century. This may only be achieved via plurilateral agreements, not multilaterally, since the WTO has proven time and time again that it is not feasible. For instance, a group

of like-minded countries could take this initiative. In addition, carbon border adjustment mechanisms throughout the world may help put a price on carbon via a carbon tax. With climate a major global priority, it remains to be seen whether the EU will disrupt the global trading system as it will inevitably implement carbon border adjustment taxes.

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### **Prioritizing the implementation and enforcement of Free Trade Agreements**

Countries and regional trading blocs are prioritizing the implementation and enforcement of their FTAs, especially the sustainability commitments in FTAs. A case in point where sustainability is at the heart of trade policy is the EU-Mercosur FTA, as without sustainability clauses, there would be no political support in the EU for the ratification of this FTA as of early 2021. In fact, the notion of sustainability is present in all labor and environmental protection chapters in recent EU FTAs.

Equally, an increasing number of countries are aiming at carbon neutrality by 2050 or 2060 (which is perceived as benign unilateralism) as well as greater integration of trade policy with other domestic policies (such as sustainability—in its three dimensions, namely development, environmental, and social—and the digital economy). Similarly, governments could enact policies that greener consumption. Putting a price on carbon is a good way forward, making sure that companies and consumers pay for their emissions.

### **Positive impact of green technology on climate-change mitigation**

Lastly, we should not underestimate the phenomenal positive impact green technology can have on climate change mitigation. In recent times, there have been scientists stating negative views on the future of humanity and that humans should forget about solving the climate crisis and, instead, invest their efforts and money in migrating from Earth to other planets. However, technology evolves very rapidly. The current debate is that green hydrogen will guarantee a sustainable future for our planet. For instance, hydrogen sustains three times as much energy as kerosene and is lighter. In addition, public spending in research and technology is growing in most countries that belong to the Organization for Economic Cooperation and Development (OECD), and more and better subsidies for R&D may take place.

Therefore, there are many reasons to believe that tomorrow's technology will be able to tackle climate change effectively, especially if we continue to invest in green technology. In addition, many countries increasingly have green policies. Technological advancement is a clear example of human progress and, as a result, governments and companies should aim at the promotion of green technology to fight climate change. This can be done with the creation and proliferation of climate clubs, whether for countries or companies.

### Implementation

The G7 would be the right forum to address effective climate action because it would serve as a solid, mature climate club. A club approach would overcome free-riding issues of climate change mitigation (eg., the EU and NATO as examples of clubs where only members have benefits). This area is of great importance because, despite all the progress in scientific and economic understanding of climate change, achieving international agreements on climate change has proven difficult because of the threat of free-riding. In addition, a carbon price, rather than carbon emission reduction requirements, should be a core element of this climate-club approach because states are more likely to reach agreement on a carbon price than on carbon emission reduction levels. Ideally, carbon prices should reach a level up to that of the social cost of GHG emissions.<sup>7</sup>

An option to be explored is plurilateral action to promote green technology transfer among club members – eg., G7, the Major Economies Forum, or the participation of cities (C40), namely a group of 90+ of the largest cities in the world for the implementation of the Paris Agreement on Climate Change.

In addition, climate measures pursuant to a climate agreement should fall within the scope of Article XX(b) and (g) of the General Agreement on Tariffs and Trade and of Article XIV of the General Agreement on Trade in Services (i.e., the general exceptions). Moreover, one could envisage granting a waiver for a climate club organized outside the WTO framework to become a plurilateral agreement under the WTO Agreement.

The G7 as a climate club could serve as a way to promote technology transfer within the club members and could serve as a platform to conclude regional trade agreements (RTAs) in green energy technologies.<sup>8</sup>

In the context of climate change, there is hardly any international cooperation in that countries do what they think is best for them, as opposed to what is good for the world as a whole. International climate agreements offer no incentives for countries to go beyond what is in their self-interest, which explains the lack of international climate cooperation. An example is Canada's withdrawal from the Kyoto Protocol in 2011 without legal consequences, which weakened both the environmental effectiveness and legitimacy of the Kyoto Protocol regime.<sup>9</sup> The current legal instruments are not enough for what the international community needs to solve the climate change issue.

A solution would be to find a mechanism where countries want to join the club and no country wants to leave. That would mean offering benefits to the club members,<sup>10</sup> where the negatives become positives, and where the members can exclude others, who themselves do not wish to join the club.<sup>11</sup> To be in the club, one would need participation and compliance.<sup>12</sup> Such a situation would create stable coalitions. Economic theory and empirical evidence show that stable coalitions with substantial emissions abatement are not likely to form without sanctions against non-participants.

Arguably, in the case of climate change agreements, they are doomed to failure because there is no incentive to remain a Contracting Party to the agreements, as there is no penalty if a country chooses to withdraw from the agreement. Equally, there is no punishment if a Contracting Party does not comply with the agreement. So a future club for climate mitigation could be construed as one that offers benefits for joining, but there would be no punishment if countries wish not to join.

The coalition of the willing will champion my idea of a climate club. There may be resistance from the rest of countries that stay outside the club. A way to solve this issue is by creating an open/gradual/incremental membership club.

The fight against climate change will continue despite the current war in Ukraine. Many of today's big changes are demographics, a shift in power from the West to the East, rapid urbanization, technology, health and well-being, and climate change and natural resources. The last two points are crucial in the broader context of inclusive prosperity. Access to affordable and clean energy as well as climate action are two of the seventeen UN Sustainable Development Goals, which the international community is committed to meeting by 2030.

The Earth is our home and common inheritance. We need to make sure it is sustainably managed. We now have enough scientific knowledge to know that climate change is a problem. But many of the policies in place are wrong and good leadership is essential to meet the agreed targets. More specifically, collective action by all leaders would make a difference: we see that leaders are good at individual goals for their own company/country; what is required is collective vision of a dream to share among leaders.

# Endnotes

<sup>1</sup> William Nordhaus, “A New Solution: The Climate Club,” *The New York Review of Books*, 2015, available at <http://www.nybooks.com/articles/2015/06/04/new-solution-climate-club/>

<sup>2</sup> William Nordhaus, “A New Solution: The Climate Club,” *The New York Review of Books*, 2015, available at <http://www.nybooks.com/articles/2015/06/04/new-solution-climate-club/>

<sup>3</sup> <https://carbon.ci/insights/companies-with-net-zero-targets/>.

<sup>4</sup> Restrictions related to covid caused a 6% reduction in energy-related global CO2 emissions in 2020. The decline in road activity accounted for 50% of the fall in demand for oil and 35% came from aviation. *The Economist*, 6 March 2021, p. 7.

<sup>5</sup> *The Economist*, 13 March 2021, p. 5.

<sup>6</sup> *The Economist*, “Cleaning Up: Can China’s carbon market take off?” 27 February 2021, p. 57.

<sup>7</sup> See generally World Bank and Ecofys. 2018. “State and Trends of Carbon Pricing 2018 (May)”, by World Bank, Washington, DC.

<sup>8</sup> For views on regional integration and climate change, see Fujiwara, N. and Egenhofer, C. ‘Do Regional Integration Approaches Hold Lessons for Climate Change Regime Formation? The Case of Differentiated Integration in Europe’ in Carlo Carraro and Christian Egenhofer (eds.), *Climate and Trade Policy: Bottom-Up Approaches Towards Global Agreement* (Edward Elgar, 2007).

<sup>9</sup> *The Guardian*, “Canada pulls out of Kyoto protocol,” 13 December 2011, available at <https://www.theguardian.com/environment/2011/dec/13/canada-pulls-out-kyoto-protocol>.

<sup>10</sup> M. Tomz, J. Goldstein, and D. Rivers, “Membership Has Its Privileges: The Impact of the GATT on International Trade,” 2007, available at <https://web.stanford.edu/~tomz/pubs/TGR2007.pdf>.

<sup>11</sup> For further details on the economic theories of clubs, see J. Buchanan, “An Economic Theory of Clubs,” *Economica*, Vol. 32, No. 125, pp. 1-14, 1965.

<sup>12</sup> A simple example of compliance would be a speeding ticket: if the speeding ticket is very high, the driver will be very careful not to go beyond the speed limit and would therefore comply with the law.

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# About the Author

**Rafael Leal-Arcas** – Singapore Management University



Rafael Leal-Arcas is Professor of European and International Economic Law, a Jean Monnet Chair holder (awarded by the European Commission), Program Director of the LLM in International Economic Law, and former Director of Research at the Centre for Commercial Law Studies of Queen Mary University of London. He is also a visiting professor at New York University Abu Dhabi in the UAE, the Inaugural Lee Kong Chian International Visiting Professor of Law at the Yong Pung How School of Law of Singapore Management University, Singapore, and a visiting professor at Tel Aviv University. Dr Leal-Arcas's research is funded by the EU Commission's Horizon 2020 program, most notably a grant of EUR14 million as part of a consortium of 21 institutions to work on renewable energy and smart grids.

Rafael is the author of the books *Climate Clubs for a Sustainable Future: The role of international trade and investment law* (Kluwer Law International, 2021), *The Great Energy Transition in the European Union, Volume 1* (Eliva Press, 2020), *The Great Energy Transition in the European Union, Volume 2* (Eliva Press, 2020), *Solutions for Sustainability: How the international trade, energy and climate change regimes can help* (Springer, 2019), *EU Trade Law* (Edward Elgar, 2019), *Energy Security, Trade and the EU: Regional and International Perspectives* (Edward Elgar, 2016), *The European Energy Union: The quest for secure, affordable and sustainable energy* (Claeys & Casteels Publishing, 2016), *International Energy Governance: Selected Legal Issues* (Edward Elgar, 2014), *Climate Change and International Trade* (Edward Elgar, 2013), *International Trade and Investment Law: Multilateral, Regional and Bilateral Governance* (Edward Elgar, 2010) and *Theory and Practice of EC External Trade Law and Policy* (Cameron May, 2008) and the editor or co-editor of *The Future of International Economic Law and the Rule of Law* (Eliva Press, 2020), *EU Energy Law and Policy: The external dimension* (Eliva Press, 2020), *International Trade, Investment and the Rule of Law* (Eliva Press, 2020), the *Commentary on the Energy Charter Treaty* (Edward Elgar, 2018), *University Initiatives in Climate Change Mitigation and Adaptation* (Springer, 2018), and *Research Handbook on EU energy law and policy* (Edward Elgar, 2017).

He has served in the Sustainable Energy for All Secretariat (Washington, DC), the Energy Community Secretariat, the Energy Charter Secretariat, the World Trade

Organization, and several EU institutions (EU Commission, EU Parliament, EU Council, EU Court of Justice). He is the author of more than 190 scholarly publications on international trade and WTO law, climate change law, energy governance, EU law, international investment law and the interaction among them in American and European scientific journals, such as the *Yale Journal of International Affairs*, *Georgetown Journal of International Law*, *Columbia Journal of European Law*, *Georgetown Environmental Law Review*, *University of Pennsylvania Journal of International Law*, *The George Washington International Law Review*, *Fordham International Law Journal*, *Chicago Journal of International Law*, *Legal Issues of Economic Integration*, *European Foreign Affairs Review*, and *Journal of World Energy Law and Business* (Oxford University Press).

Rafael has been a Visiting Researcher at Yale Law School, Global Research Fellow at New York University School of Law (Hauser Global Law School Program); Visiting Fellow at the World Trade Institute; Visiting Scholar at Georgetown University Law Center; Scholar at Masdar Institute at Khalifa University (Abu Dhabi); Tillar House Resident Fellow at the American Society of International Law; Visiting Researcher at Harvard Law School and Fellow at the Real Colegio Complutense (Harvard University); Emile Noël Doctoral Fellow at New York University School of Law; Fellow at the Australian National University; and Visiting Scholar at the University of Wisconsin-Madison Law School.

He received his graduate legal education at Stanford Law School, Columbia Law School, the London School of Economics and Political Science, and the European University Institute (Florence).



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