

“It is in the long-term self-interest of the EBRD countries to be part of the energy-industrial revolution, adapt their economies and avoid being left behind.”



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The 2010 summer saw forest fires and poor harvests, the threat of a melting taiga and conflicts over diminishing water resources in the EBRD region. These served as a wakeup call; until then, the region had the lowest levels of public awareness of climate change in the world. This was a legacy, no doubt, of its history of central planning, with its cheap energy and chronic environmental neglect.

But despite the limited attention previously paid to climate change, no world region has reduced its output of greenhouse gases more radically over the last two decades than the countries in transition. Since 1990 regional greenhouse gas emissions from fuel combustion have fallen by 28 per cent.

The deep fall in emissions is to a large extent the result of an abysmal starting point. At the beginning of transition, energy and carbon intensities were substantially higher than anywhere else in the world. Emissions fell as a by-product of transition, as economic restructuring, price and regulatory reforms, pursuit of economic efficiency and greater respect for the environment began to take effect. Some countries switched from coal to natural gas, a cleaner and more efficient fuel. All this was, however, motivated by economic and air pollution considerations; climate change was not high on the agenda in the first decade of transition.

Chapter 1 of this report documents the region’s considerable achievements. While regional greenhouse gas emissions began rising again after 2000, the rate of increase has been much lower than economic growth. The carbon performance of the leading countries in the region – Hungary, Latvia and Lithuania – has now caught up with the advanced economies of the EU-15. This demonstrates that a strong carbon performance is feasible with adequate reforms and good policies.

Yet the carbon performance of the EBRD region as a whole remains mixed. Kazakhstan, Russia, Turkmenistan, Ukraine, and Uzbekistan are among the most carbon-intensive countries in the world. In these countries, the polluting legacy of central planning is still pervasive.

Over the coming decades, transition countries will have to reduce emissions even further. Global emission reductions on the scale required will be impossible unless all major regions are involved. As members of the international community, EBRD countries will be expected to play their part.

However, the interest of transition countries in fighting climate change goes beyond international solidarity; they have much at

stake themselves. While other world regions – low-income countries in particular – may be worse hit by climate change, the transition countries will also suffer from the negative effects of climate change.

One cannot know for certain whether recent extreme weather events were the result of natural climate variability or human-induced climate change; the climate process involves both natural fluctuations and anthropogenic trends. But these events demonstrate that the region is vulnerable to the sort of calamities that climate change is likely to bring. Further – and here the region may be particularly vulnerable – unmanaged climate change would be likely to lead to major and disruptive movements of population, within the region and probably into the region.

The world is embarking on a new energy-industrial revolution that will see wholesale changes in economic activity, from what we consume to the ways in which we produce our goods. Established and emerging markets alike see new business opportunities in clean energy, low-carbon transport and carbon-efficient manufacturing.

The industrial revolution can and will happen everywhere, including agriculture and buildings. It is in the long-term self-interest of the EBRD countries to be part of this revolution, adapt their economies and avoid being left behind. The risk is not just falling behind technologically, but also in a decade or so of being shut out of markets if products are seen as “dirty” by countries and regions taking strong action.

Chapter 2 discusses the future decarbonisation challenges for the region. There is no denying that reducing emissions in countries with extensive fossil-fuel reserves and an energy-intensive industry base will be more costly in the short term than in already well-diversified economies. However, transition countries have the resources to transform their old and increasingly obsolete high-carbon capital into the low-carbon capital and human capital that will drive the new economies. Economic diversification in the energy-rich transition economies over the next two decades would lower the costs of reducing emissions.

In parallel, an adequate global collaboration arrangement would incentivise transition economies to take part in global climate change mitigation efforts, improve their access to clean technologies and facilitate their participation in emission-trading schemes that can further reduce the costs of decarbonisation.

Chapter 3 shows that with thoughtful policies it is possible to make emission reductions financially attractive and turn low-carbon technology into an opportunity for domestic and international investment. Many of the reforms that are needed are already on the policy agenda – and have been for years – and not all of them are specific to climate change. Implementing what is required includes broader economic reforms such as cost-reflective energy pricing, a better business environment and reduced transaction costs for investments in energy efficiency.

Improved general management and corporate governance have also proven to be powerful drivers of energy efficiency. Ultimately, the most important contribution to climate change mitigation will come from the economy-wide changes the EBRD was conceived to foster.

The most basic climate change policy is putting a price on carbon. Emissions trading and carbon pricing are powerful measures, not just to encourage emission reductions but to turn emission

reduction into an engine for clean energy innovation. Businesses in the new European Union (EU) member states are already becoming accustomed to carbon pricing as members of the EU Emissions Trading Scheme (ETS). Elsewhere in the region, emission savings can be monetised by selling emission offsets on the international carbon market, through schemes such as Joint Implementation (JI) and the Clean Development Mechanism (CDM). The region has yet to take full advantage of the opportunities these mechanisms provide.

In the absence of well-functioning global carbon markets at the present time, an international carbon financing architecture is needed to encourage countries to start undertaking the necessary investments. The international financial institutions like the EBRD will play an important role in implementing these schemes and ensuring that the money is well spent. But the political feasibility of climate investment related grants from high to middle-income countries is limited and, as large as these grant funds may seem today, they are just a drop in the ocean if the EBRD region is to achieve mitigation objectives consistent with limiting global temperature increases to 2°C. Without functioning carbon markets or other mechanisms to generate predictable global prices for carbon emissions and dramatically improved policies the region will inevitably fall short.

Whilst these carbon markets and associated policies may be weak today, it would be unwise and risky to make investments with 10 or 20-year horizons on the assumption that policy structures will stay like this. Indeed it is more likely than not that over the next decade carbon markets and regulations will strengthen and tighten across the world, and dirty producers may find themselves shut out of markets. Both economically and environmentally, high carbon is a risky route to follow.”

Good policy to make markets work well must, however, go way beyond carbon pricing. There are fundamental market failures, which good policy can correct, including on research and development, networks and infrastructure, capital markets and risk, property markets and information.

Political economy challenges can make some of the necessary reforms difficult to achieve. In particular, there are strong vested interests among incumbent industries. The short-term social costs of reform and economic adjustment costs due to higher energy prices can also be significant in the absence of well-functioning social support. It is important to recognise these problems, as they will require strong political leadership to overcome. We explore these in Chapter 4.

The public debate about climate change in the transition region is still at a relatively early stage. There are many misconceptions and the low-carbon agenda brings back memories of the painful early years of economic transition. The global debate is progressing much faster. Other countries, both established and emerging economies, are rapidly positioning themselves in the coming low-carbon world. But the EBRD region has the great advantage of understanding, through direct experience, the challenge and opportunity of a transition and the deep social and economic change it brings.

We hope that this Special Report on Climate Change – produced jointly by the EBRD’s Office of the Chief Economist and the Grantham Research Institute at the London School of Economics – will further increase awareness of the challenges of climate change and help to stimulate and advance the debate about low-carbon prosperity in the transition region.