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Financing Climate Change
Bailing out the environment in the long-term may be just as important as bailing out financial markets now

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Arno Behrens*

In response to the current financial crisis, the US Congress reached agreement last week over a $700 billion (€492 billion) state fund to buy 'bad' banking debts – so-called 'toxic assets' – with the aim of restoring the strength of the financial system. In total, US government support to the financial market and some of its institutions could amount to more than $1 trillion over the next two years – equal to about 3.6% of US economic output, or just more than 1% of global GDP annually. The justifications for putting so much money on the table so quickly were manifold. President Bush was quoted saying: "America's economy is facing unprecedented challenges, and we are responding with unprecedented action". The US Treasury Secretary, Henry Paulson, commented that "this bold approach will cost American families far less than the alternative". This argumentation is strikingly similar to the point made by many of the recent studies on the financial impacts of climate change.

Climate change could hit the global economy much harder than the current financial crisis. In addition to affecting economic growth in industrialised countries, climate change will hit economic development especially in poor countries. Extreme weather events have the potential to wipe out the results of years of successful development policy. Hurricane Mitch in Honduras, for example, caused total damages of more than 50% of GDP and 10 years later the country has still not recovered from the storm. Similarly, climate change is increasingly seen as a threat to national and international security. In particular, it will fuel conflicts over resources, including water, food and energy. It will also increase the likelihood of border disputes due to receding coastlines and the submergence of large areas of land especially in low altitude islands, and increase the phenomenon of 'environmental' migration from the most vulnerable countries.

Limiting global warming to 2ºC above pre-industrial levels – a level below which it is believed that irreversible catastrophic events may still be avoided – will be costly. The European Commission suggests annual costs of roughly €200 billion ($250 billion). These costs would need to be borne globally, not just by one nation, and the effects on real GDP growth would be very small. As a logical consequence of historical responsibilities and economic capabilities, industrialised countries will need to shoulder the largest share of these costs. But due to private sector contributions, governments around the world would be burdened by as little as €30 billion per year, although this is at the very low end of the various estimates being put forward.

The cost of delaying decisive action, on the other hand, could be tremendous. Although it is very difficult to forecast the physical impacts of climate change and to attach an economic value to these future impacts, temperature increases of 5-6ºC by the end of this century may decrease global GDP by 5-10%. The Stern Review concludes that "mitigation – taking strong action to reduce emissions – must be viewed as an investment, a cost incurred now and in the coming few decades to avoid the risks of very severe consequences in the future". Observe the similarity to the arguments used by Bush and Paulson to justify US government action to stabilise today's financial markets.

* Arno Behrens is a Research Fellow at CEPS. CEPS Commentaries offer concise, policy-oriented insights into topical issues in European affairs. The views expressed are attributable only to the author in a personal capacity and not to any institution with which he is associated.

The US Congress was able to reach agreement over support to the US banking sector within two weeks, yet the US and other governments remain reluctant to contribute significantly to the global climate change bill. Instead of buying bad assets, however, climate change mitigation is an investment in a global public good and in future prosperity. In view of the estimated costs of climate change, it is hoped that the global response to climate change will be as decisive as the one taken by the US government to rescue the financial markets. There is no need to take a hasty decision to increase global resources for adaptation and mitigation, but there is a strong case to be made for 'bailing out the environment' with all due speed. After all, the sooner governments act, the less costly the response will be.

See also the following related CEPS Working Documents, originally prepared as briefing notes for the European Parliament:

- Arno Behrens, Jorge Núñez Ferrer & Christian Egenhofer, *Financial Impacts of Climate Change: Implications for the EU Budget*, CEPS Working Document No. 300, August 2008
- Arno Behrens, *Financial Impacts of Climate Change: An Overview of Climate Change-related Actions in the European Commission's Development Cooperation,* Arno Behrens, CEPS Working Document No. 305, September 2008