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How Cap-and-Trade Could Replace Foreign Aid

*Alex Evans
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Developing countries could earn tens of billions of dollars from pollution credits thanks to climate change—and make foreign aid a thing of the past in the process.

The report issued last week by the [Intergovernmental Panel on Climate Change](#) left no doubts about the dire consequences of global warming. Soon, the world will see less snow and ice, as well as more floods, hurricanes, droughts, and heat waves. The world's policymakers have long understood what they must do to avert even worse catastrophes: Reduce the growth of the greenhouse gas emissions that are causing the Earth's temperature to rise.

To succeed, however, policymakers need the cooperation of developing countries, without which there can be no genuine solution to climate change. But rapidly developing countries such as China are finally seeing millions of their citizens climb out of wrenching poverty, and they don't want to see their economic growth jeopardized. Yet they just might change their tune when they realize they could reap a windfall of billions of dollars thanks to global warming.

How? With a truly global “cap-and-trade” system for greenhouse gases. Four main components are necessary. First, the international community must set a sensible “cap”—a ceiling for global emissions. It would shrink over time to ensure that levels of greenhouse gases in the atmosphere don't accumulate beyond a certain level. Second, all countries would have to participate in full. Third, there's the crucial task of fairly divvying up the “carbon cake”—the target amount of carbon dioxide each country is allowed to emit. Fourth, there must be a way for every country to sell credits if it pollutes less than it is allowed, or buy credits if it can't meet its target—global emissions trading.

The 1997 Kyoto Protocol, the United Nations' first attempt at a cap-and-trade system, made modest steps toward this solution, but—crucially—developing countries did not participate fully. They feared that industrialized countries would use Kyoto as an excuse to restrict their economic growth. As a result, no emissions targets were set for developing countries, and in the end only 35 countries in total took on caps to their emissions. The United States, the world's largest emitter of greenhouse gases, was not among them, refusing to sign an agreement that had no quantified targets for China and India. Negotiators could slice through that Gordian Knot if there were a way to safeguard developing countries' desire to develop without ignoring the perils of climate change.

In fact, there is—through fully global emissions trading. Developing countries could earn billions of dollars by joining developed countries in selling emissions credits. How? By following the example of places like the United Kingdom. Under Kyoto, the UK is committed to reducing its emissions of greenhouse gases to 12.5 percent lower than 1990 levels by 2010. If it beats that target—say, by making a 15-percent reduction—then it can sell the surplus emission permits to someone else. Developing countries, however, can't sell surplus permits yet because, under the compromise agreed upon in Kyoto, they have no quantified emissions targets in the first place.

For a “Kyoto II” to work, then, that has to change. Many developing countries have said that they might be prepared to take on quantified emissions caps—if these targets were based not on current emission levels, but countries' populations. That would be more fair, they argue, since everyone enjoys an equal share of the atmosphere. Adopting such an approach immediately would be politically impossible for developed countries, since the average person in the United States, for example, contributes about twenty* times as much to global warming as the average person in India.

But what if a move to equal per-person allocations took place gradually, over a negotiated period of decades, rather than overnight? This could lead to a breakthrough in negotiations, because it would shift the focus of the debate from where it's stuck now (in an abstract back-and-forth between developed and developing countries about fairness) to one crucial variable: the date of convergence, when the “carbon cake” is finally divided on the basis of population.

Over time, emissions trading could even become more significant for the developing world than foreign aid, or replace it altogether. Global aid now totals around \$100 billion each year, including debt relief. Those financial flows could quickly become dwarfed by those of emissions trading, even at quite modest prices for carbon dioxide permits. And in fact, under a permit allocation system based on population, the poorest countries would be the biggest beneficiaries.

Emissions trading would thus become a major new source of finance for development, and perhaps the best example of “trade not aid.” At the same time, developing countries would have every incentive to invest the proceeds of emission permit sales in renewable energy and clean technology, as it would keep their emissions down and allow them to continue selling permits.

Unprecedented? Certainly. But developing countries effectively have a veto here: No one can force them to participate in a global climate deal if they don't think it's fair. The key is to find a solution that demonstrates that a sustainable world can be a profitable one too.

**Editor's note: An earlier version of this article used an incorrect figure for this ratio. FOREIGN POLICY regrets the error.*

Alex Evans is a senior policy associate at New York University's Center on International Cooperation and a former special advisor to the UK secretary of state for international development, Hilary Benn.