MISCHA CLASSEN ASSESSES THE CURRENT STATUS OF THE UN CLIMATE CHANGE NEGOTIATIONS

A lock with many keys

In Bali last year, the UN put us on the track to a successor climate change regime to the Kyoto protocol. Today, we still do not know a great deal about where that track is leading. But one thing became clear at the latest round of negotiations in Bonn in June: it is no country lane, but rather a hi-speed track and we have to be very careful that everyone has boarded before the train arrives in Copenhagen in December 2009.

So, where will we end up in 2013?

In the realm of pure conjecture, imagine that immediately after the UN climate change meeting in 2015 the carbon market is in a bullish mood due to the resolutions adopted. The agreements are based on the accord between the emerging economies belonging to Annex II of the Copenhagen protocol and Annex I – industrialised – countries. While granting mutual acceptance and supplementarity of Copenhagen carbon credits traded within globally-linked trading schemes, a sufficient amount of the proceeds is redirected to the global development and adaptation facility. This fund complements the clean development mechanism (CDM) and provides a means for countries to adopt a low-carbon development trajectory. With the agreement, the market continues its growth with the prospect of stable regulation over at least 10 years. Although the supply of carbon credits from the protocol's flexible mechanisms is drained somewhat by the omission of the former major CDM hosts, there is still enormous potential for project activities in non-Annex countries.

Of course, this is a mere projection of what could be. In fact, the picture is an ideal one and a lot of things would have to coincide to reach it. However, the picture is apt to show the building blocks of the UN-led negotiations.

With the 'Bali roadmap' – agreed at the UN climate change meeting in December last year – a timeline was determined and furnished with issues to be tackled in the negotiation process. This shall lead to a successor to Kyoto, ultimately at the UN conference in Copenhagen in 2009. As of today, the UN negotiations about post-2012 issues take place in four parallel bodies that share the road to Copenhagen.

However discouraging Bonn might have proven to be for some, a sounder understanding of the parting lines between countries has been accomplished – as well as the recognition of how little time is left to reach an agreement. The building blocks of the positive utopia outlined above may nonetheless be recognised against the background of the current negotiations.

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Of highest importance, the commitment to emissions reductions is a simple, yet delicate negotiation block. Long-term reduction targets have broad support and were recently confirmed by the July G8 meeting in Japan of the world's leading economies, with the commitment to at least halving greenhouse gas (GHG) emissions by 2050 and the pledge to adopt ambitious mid-term targets. The G8 statement (see page 4) is seen as another step in a process that will lead to mid-term targets adopted within the UN framework. The agenda for this has already been worked out by the delegates: figures on the range of mid-term reductions are planned for the end of 2008 and further refined by March 2009.

Altogether, the global community seems to be on track towards utopia. The G8 countries have committed to continued long-term climate policy and a 2009 agreement on mid-term targets is likely be supported by the new US president, after he has worked out domestic strategy.

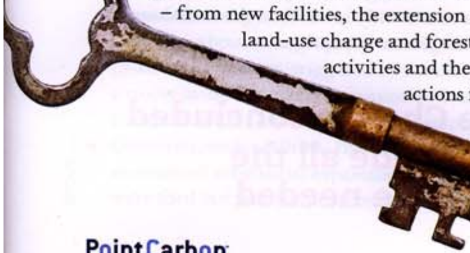
Fifteen years ago, few would have believed that non-Annex I countries would contribute almost half of global GHG emissions. A prerequisite for a successful post-Kyoto deal is to answer the question about how to get those countries on board that are not yet willing to commit to reductions. One solution discussed is a sector-wide approach. Benchmarks shall define the sector-specific emissions intensity, under which projects or countries gain carbon credits. In contrast, emissions above such benchmarks would face no penalty. This sector-wise approach should lead in the mid-term to a binding, but relative emissions reduction target.

Sectoral crediting fits with the existing mechanisms and would enhance the carbon market. After Bonn, it also seems certain that there will continue to be project-based mechanisms after 2012. The votes of the developing countries emphasise the importance of the CDM to achieve low-carbon development.

While delegates were in Bonn, the carbon market was complaining about the jammed UN approval process, blurry decisions in the CDM executive board (EB) – the UN-appointed body that manages the CDM process – and the ever-growing body of rules governing the mechanism. These issues were discussed and a list of improvements was compiled to be concluded at the end of this year. The list focuses on changes in the role of the EB, designated operational entities – companies accredited by the EB to assist the CDM process – as well as the UN Framework Convention on Climate Change secretariat. Technical decision-making shall be shifted from the EB to secretariat, freeing room for the EB to make more transparent decisions with a process for appeals. In turn, the secretariat shall be relieved from international transaction log – the software that tracks all carbon trades under the Kyoto protocol – and registry tasks.

In order to improve the efficiency of the flexible mechanisms, the additionality test – which is aimed at determining whether a project would have gone ahead without the carbon finance – shall become more predictable and less exhaustive through the use of benchmarks and more robust baselines. The barriers for CDM in less developed countries shall be lowered by simplifying the rules.

Hot topics in the negotiations are the inclusion under the CDM of carbon capture and storage projects and the destruction of the HFC23 – a potent GHG – from new facilities, the extension of land use, land-use change and forestry (LULUCF) activities and the inclusion of actions for reducing emissions



Mischa Classen: Uncertainty is reflected in current post-2012 carbon credit price levels

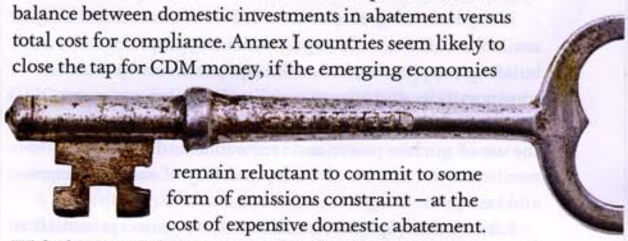
from deforestation and degradation (REDD) in developing countries. Furthermore, the EU would like to see the extension of the list of Kyoto gases – namely NF3, a gas heavily employed in the semiconductor industry.

All these innovations would lead to enhanced supply of carbon credits.

Linking of trading schemes is the preferred vision of the EU. It appears on the 'shopping list' for improvements to the flexible mechanisms. The issue will be discussed again at the negotiations in Accra, Ghana, in August, and will be concluded by year end. With national trading schemes evolving, linking might become a reality well before the UN adopts any conclusions.

Linking schemes is one thing, linking them to the flexible mechanisms is another. The latter determines a good deal of the demand for emissions reductions, by the degree of convertibility of the project-based carbon credits and emissions rights traded. With regard to this, there are many details left to be deliberated in Accra.

Supplementarity – the degree of emissions reduction effort that is to be undertaken domestically by industrialised countries – will probably remain under national authority. It represents a screw to fine-tune the carbon price and thus the balance between domestic investments in abatement versus total cost for compliance. Annex I countries seem likely to close the tap for CDM money, if the emerging economies



remain reluctant to commit to some form of emissions constraint – at the cost of expensive domestic abatement. With this in mind, it seems implausible to have stricter supplementarity limits for post-2012, supporting a constant and rising demand for carbon credits.

A post-Kyoto deal is a lock with many keys. Some of the details may be left open to further consideration after a 'Copenhagen protocol' is signed. Cutting this Gordian knot will eventually succeed, but only in the nick of time. The uncertainty regarding the post-Kyoto era is reflected in the current price levels for carbon credits generated after 2012. However, there are increasing signals that participants have confidence in a meaningful follow-up regime. Among them is the recent closing of the post-2012 carbon credit fund, a €125 ($200) million vehicle sponsored by five European public banks under the lead of the European Investment Bank. Its goal is to stimulate the market for post-2012 UN carbon credits. Together with the growing interest from private buyers, such initiatives help developers bridge the time gap, until a successor to Kyoto takes shape.

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