

What happens if nothing happens? Views on the prospects for climate action after COP17

Judging solely by the outcomes of the last two years of negotiations, the world is facing long odds for a breakthrough agreement on global climate policy from the 17th Conference of the Parties (COP17) to the United Nations Framework Convention on Climate Change (UNFCCC) in Durban, South Africa. Although the dialogue and outcomes at COP16 in Cancun surpassed many people's expectations (which had been set fairly low in the run up to the event), none of the subsequent discourse suggests that industrialized countries, fast-growing economies, and less developed economies are any closer to agreeing on terms for a second commitment period for the Kyoto Protocol in the Seventh Conference serving as the Meeting of the Parties (CMP7). Consider that:

- The standoff between industrialized and developing countries persists because of various wedge issues: certain developing countries' refusal to mitigate emissions unless they receive financial support, certain developed countries' opposition to such demands, questions about respective targets for emissions reductions, and debate over measurement, reporting, and verification protocols
- The governments of Canada, Japan, and Russia have already declared that they will not sign on to a second commitment period under the Kyoto Protocol, which is set to expire at the end of 2012
- Controversial proposals have been advanced, such as those from India that would prohibit industrialized countries from enacting border taxes on carbon and guarantees that developing countries receive intellectual property rights to the low-carbon technologies transferred from industrialized countries

This paper sets forth a point of view about the likely or possible practical outcomes from the COP17 talks, given the odds that a second commitment period will not be established and that no meaningful progress will be made on other issues such as NAMAs, climate finance, carbon

markets, and bilateral agreements. Few observers who are concerned about the impacts of climate change would hope for a conclusion like this. But the looming possibility of such a conclusion makes it worthwhile for businesses and other organizations to consider what the resulting dynamics would look like.

Will NAMAs have a future?

No matter what happens in Durban, developing countries will continue to look to developed countries for the technology and finance they need for adaptation and mitigation efforts. With a second period of the Kyoto Protocol appearing unlikely, most national submissions after Cancun agree upon the need for New Market Mechanisms (the "new" here refers to post-Clean Development Mechanism), but these vary greatly in their design. Nationally Appropriate Mitigation Actions, or NAMAs, constitute one such mechanism.



Created in 2007 at COP14 in Bali, NAMAs refer to the actions that developing countries voluntarily take to mitigate their carbon emissions, usually enabled by assistance from developed countries. They can be sector-specific and include actions that are integrated with other priorities for sustainable development, such as job creation and poverty eradication. Businesses have a significant role in the dialogue over NAMAs given their contributions to economic development as well as to carbon emissions reduction.

Several considerations in play at the Durban talks pose challenges to the future of NAMAs. First, if a second commitment period for the Kyoto Protocol is not established in Durban, developed countries will not be bound by their reduction commitments. This could lead developing countries to abandon NAMAs out of concern that their own carbon mitigation efforts will put them at an economic disadvantage to industrialized countries.

The future of NAMAs also depends upon the development of a scheme for providing NAMA programs with two enabling elements: a framework for monitoring, reporting, and verification (MRV) to promote environmental integrity; and financial and technological support for mitigation actions. In principle, domestic MRV practices need to be aligned to global MRV requirements. However, MRV requirements have yet to be defined by the parties to the UNFCCC. Negotiations on enhanced reporting provisions began in Cancun. Should the negotiators in Durban fail to agree on a definition of these requirements, then NAMAs could be rendered all but irrelevant as a multitude of national-level MRV practices take shape, with varying degrees of reliability.

The most promising prospect for an MRV scheme is the International Registry that was proposed in Cancun and could be formalized in Durban. The Ad Hoc Working Group on Long-term Cooperative Action meeting in Panama, the final such meeting before Durban, pointed to a forthcoming agreement on the need for this Registry, which would track NAMA programs in a transparent manner through agreed-upon MRV standards and would match developing countries' NAMAs with available financing and technology from industrialized countries.

In addition, the ability of developing countries to secure adequate funding and technical support from developed countries will remain challenged. While industrialized countries pledged US\$100 billion per year by 2020, meeting that goal will be difficult amid the grave fiscal problems faced by many contributing parties.

Climate finance: "New and additional" or nonexistent?

The Copenhagen Accord called upon developed countries to provide "new and additional" climate finance for developing countries to pursue mitigation and adaptation. Their commitment consisted of US\$30 billion of "fast-start" finance through 2012 for those countries most vulnerable to climate change. For long-term climate action, developed countries also agreed to US\$100 billion per year by 2020 — an ambitious amount. While the verdict is still out about whether individual contributors are on track to deliver their shares of yearly support in the long term, total pledges from developed countries are arguably in the ballpark of the short-term goal (allowing for some leeway in their adherence to calls for new and additional monies and balance between adaptation and mitigation).¹

The vessel currently envisioned to contain and distribute much of the US\$100 billion of annual climate finance is the Green Climate Fund (GCF). Established under the Cancun Agreements, the GCF will "support projects, programs, and policies in developing countries" that achieve measurable, reportable, and verifiable reductions in greenhouse gas emissions to prevent a 2° C rise in global average temperature.² While the Transitional Committee (TC) of the GCF plans to present structural recommendations at COP17, the means for raising and distributing funds are still very much in the exploratory phase. And the upcoming discussions of where money will come from and how it will be handled could become divisive.

Building on findings from the UN High-Level Advisory Group on Climate Finance (AGF), a World Bank report commissioned by the G20 Finance Ministers and leaked to the press elaborated on how to mobilize climate finance from the public and private sector.³ The largest potential sources of public finance for climate action, as highlighted in the report, are revenues generated from carbon pricing mechanisms in developed economies, taxes on international aviation and shipping emissions, and redirected fossil fuel subsidies.

¹ <http://www.wri.org/publication/summary-of-developed-country-fast-start-climate-finance-pledges>

² http://unfccc.int/cooperation_and_support/financial_mechanism/green_climate_fund/items/5869.php

³ <http://www.guardian.co.uk/environment/interactive/2011/sep/21/mobilising-climate-finance-report-g20>

The report emphasizes that a “successful climate stabilization effort will, in the long run, draw largely on competitive, profit-oriented private investment.” Were the TC to seriously pursue this line of thinking in Durban, there would be an abundance of opportunities for the private sector to invest in centralized efforts to finance the shift to a low-carbon global economy.⁴ However, most developing nations would prefer direct financial support, and developing countries will likely demand that the majority of funding come from public sources. This demand could stall or derail the negotiations altogether.

Should the Durban talks result in no progress on climate finance, private sector capital is likely to remain on the sidelines or be deployed into other projects that continue to offer attractive financial returns. Alternatively, if design recommendations are presented in Durban that do not allow for sufficient private investment, the GCF will be cut off from sources of funding that experts believe are needed in order to reach the US\$100 billion annual goal. Yet another possibility is that the GCF will dominate the negotiations and distract parties from establishing a broader climate finance framework that some private sector finance professionals believe is needed to mobilize meaningful levels of investment.⁵

A centralized mechanism such as the Green Climate Fund ought to play a role in harnessing capital that developing countries could use to support their climate change efforts. The carbon markets, which enable developing countries to access payments for emission reductions they achieve on a project-by-project basis, could also continue to play a role in channelling finance for climate mitigation — although the future of the international carbon markets will be in doubt if little progress is made in Durban.

Carbon markets: Business as usual?

Today, carbon markets worldwide are worth some US\$140 billion. Under the framework established by the Clean Development Mechanism (CDM), carbon project developers organize mitigation efforts in developing countries that generate carbon offset credits known as Certified Emission Reductions (CERs). These CERs can be purchased to help achieve compliance with emissions limits imposed by national or regional governments that are signatories to the Kyoto Protocol. In principle, the CDM encourages companies primarily in Europe to buy CERs from projects in Latin America, Asia, the Middle East, and Africa in order to meet their obligations under the European Union’s Emissions Trading system. But in practice, most CERs have been sourced from China and India — a phenomenon that has caused the program to come under substantial criticism.

On 1 January 2013, if the Kyoto Protocol expires, the dynamics of the global carbon market will change drastically. From that date, the EU will allow CERs only from projects registered before the end of 2012 or sourced from new CDM projects in least-developed countries, or LDCs, primarily in Africa. In anticipation of this development, carbon reduction investments in fast-growing economies like Brazil and India have been drying up, with many investors and project developers leaving the market.

The falling prices of CERs under the Kyoto Protocol over the past several months — from about €12 to €7 — do appear to reflect sagging confidence in the future of CERs. Another signal can be read in the widening spread between the CER price and the price of European Union Allowances (EUAs) traded in the EU ETS. This trend is telling because it reflects the cost of swapping EUAs for CERs in order to meet compliance targets under the EU ETS. In other words, carbon traders believe that CERs are becoming less valuable in comparison with EUAs, which do not rely on the Kyoto Protocol.

The dominant assumption, then, seems to be that the EU’s 2012 deadline is firm, such that post-2012 carbon mitigation projects will have a tough time finding buyers for the resulting CERs. However, this assumption could prove faulty. The EU market may well close off to CERs from projects outside the least-developed countries, but other markets such as the New Zealand Emissions Trading



⁴ http://unfccc.int/files/press/press_releases_advisories/application/pdf/pr20110909_genevatc_gcfclose.pdf

⁵ <http://bnf.com/WhitePapers/download/46>

Scheme and the newly emerging program in Australia should continue to create demand for CERs. Australia, for example, could become the largest carbon market outside of Europe, as the 500 or so largest emitters — which account for 60 percent of the country's emissions — will eventually be capped under the country's recently-passed package of carbon pricing laws. By 2015, Australian emitters will be allowed to meet up to 50 percent of their obligation using CERs, which equates to around 170 megatons (Mt) of CO₂e per year compared to a projected average annual demand for Kyoto credits of 214 Mt of CO₂e between 2008 and 2020.⁶

Should no agreement come out of Durban, the most intriguing opportunities in the global carbon market may be found in China. To date, China has been the largest seller of CERs, but the Chinese are now considering the creation of regionally-based domestic carbon trading programs. In its Twelfth Five-Year Plan, China has pledged to reduce its carbon intensity by 40 to 45 percent by 2020 as compared to 2005 levels. To work toward this monumental target, China is setting up pilots in a handful of major cities as a precursor to a national program.

A pessimistic post-Durban scenario might therefore see declining CDM investment in the fast-growing economies and intense interest in the LDCs. The problem for LDCs, such as much of sub-Saharan Africa, will be generating an adequate supply of potential offsets, for these countries lack the carbon-intensive industries and infrastructure that provide opportunities for reductions. However, if forestry and agriculture projects are made eligible, then significant amounts of emission reductions could be achieved. Reduced emissions from deforestation and forest degradation (REDD) could be a game changer for some LDCs if accounting methods can be agreed upon.

Bilateral agreements: A path around the markets?

Bilateral agreements allow industrialized countries to offset some of their emissions by sharing technologies that allow developing countries to realize reductions of their emissions. For developed countries, bilateral agreements benefit domestic industries through the promotion of their technological innovation. For developing countries, the positive outcomes are infrastructure development and economic progress. The environmental gains redound to all concerned.

With a nationwide target to reduce carbon emissions 25 percent below 1990 levels by 2020, Japan is exploring bilateral agreements to generate carbon offsets for use toward its national emission reduction targets. Japan has launched numerous bilateral agreements with developing countries that have paved the way for more than 90 pilot projects.⁷ Many of these projects rely on advanced technologies from Japanese companies.

South Africa has also initiated several bilateral agreements. The Swiss Agency for Development and Cooperation is funding a US\$15 million (R120 million) climate change mitigation program in South Africa. The agreement is designed to provide financial support to the South African Department of Energy (DoE) for energy-efficiency monitoring and implementation projects. Other bilateral agreements are in place with the German International Development Agency (GIZ), the United States Agency for International Development (USAID), and a Climate Change Partnership with Australia.

The South African example underscores the role that regional development banks often play in bilateral agreements. Regional development banks can source funding from developed countries and match the funds with initiatives in developing countries. These financial entities can also support riskier projects by hedging risks or guaranteeing minimum rewards.

Insofar as developed countries can already count carbon reductions from bilateral agreements toward their commitments under the Kyoto Protocol, a second commitment period under the Kyoto Protocol would likely perpetuate interest in bilateral agreements. However if the Kyoto Protocol is allowed to expire, bilateral agreements could become considerably less attractive to developed countries other than those with serious national reduction mandates.

⁶ Australia to the Rescue? Trading Carbon. October 2011. <http://www.pointcarbon.com/news/tradingcarbon/>

⁷ The Real Deal? Trading Carbon. November 2011. <http://www.pointcarbon.com/news/tradingcarbon/>

If nothing happens: Implications for business in 2013

COP17 represents the last opportunity for the world's governments to set up carbon reduction targets for a second commitment period of the Kyoto Protocol. It will also provide a forum for addressing other issues under the Long-term Cooperative Action work stream and the Copenhagen Accord, which called upon countries to make emission reduction pledges and proposed financing mechanisms for mitigation, adaptation, technology transfer, and forest carbon programs (the latter commonly known as REDD+). While the negotiators in Durban may end up reaching agreement on certain narrowly defined issues, the chances seem faint that a comprehensive deal will be struck.

Such an outcome should not necessarily mean that the sustainability agenda for business will be significantly de-emphasized. Businesses prefer certainty to uncertainty, so in some respects a world without a global agreement on climate policy could enable executives to make clearer decisions about their sustainability investments — for example, by prioritizing immediate, obvious issues such as water scarcity over long-term issues such as climate change adaptation, and by focusing their attention on policy and technological developments in individual countries. In addition, pressures such as energy prices and security, public sentiment, supply chain resilience, and reporting requirements, just to name a few, are creating conditions that reward executives and directors who make sustainability a fundamental driver of their companies' strategies and programs. The vacuum of international policy on climate change could thus present an opportunity for business to exert leadership and push the sustainability agenda forward.

Still, a nothing-happens scenario for COP 17 will affect the business environment in myriad ways. Here are some of the foreseeable conditions that executives would do well to think about:

- The disappearance of NAMAs might mean that businesses operating in developing countries can expect significantly less regulatory pressure to reduce their carbon emissions, and little financial or technological support to do so. The impetus to reduce carbon emissions would be derived from other forces such as stakeholder attitudes and the motive to reduce energy costs. These forces may not be insignificant.

- The GCF would not attract participation from either the public or the private sector to the extent that is believed to be necessary for long-term climate action. This could undermine businesses that have staked investments in climate-friendly technologies geared toward meeting the needs of the developing world.
- The conditions for success with carbon emissions reduction projects through the CDM will be dramatically altered in favor of LDCs in the near term and then in favor of other jurisdictions, especially as new carbon markets such as Australia's begin operations.
- The EU Emissions Trading System (ETS) is slated to begin its third trading period in 2013, no matter what happens with the Kyoto Protocol. No new CDM projects are likely to be available in a post Kyoto world which would have an impact on price for credits in that market.
- If bilateral agreements lose momentum, then businesses that stand to benefit from technology transfer funding could be deprived of a considerable number of potential opportunities. Commercial viability based on pure private-sector potential would become a premium feature of any venture concentrating on solutions to climate change.

Contacts

Nick Main

Global Leader
Sustainability & Climate Change Services
Deloitte Touche Tohmatsu Limited
Direct: +44 20 7303 2486
nimain@deloitte.co.uk

Melissa Swift

Associate Director
Sustainability & Climate Change Services
Deloitte Touche Tohmatsu Limited
Direct: +1 212 492 4618
mswift@deloitte.com

Josh Rosenfield

Manager
Sustainability & Climate Change Services
Deloitte Touche Tohmatsu Limited
Direct: +1 212 492 2819
jrosenfield@deloitte.com

Duane Newman

Director
Sustainability & Climate Change
Deloitte Southern Africa
Direct: +27 082 783 5057
dnewman@deloitte.co.za

Peter Oldacre

Senior Manager
Sustainability & Climate Change
Deloitte Southern Africa
Direct: +27 082 920 4984
poldacre@deloitte.co.za

Sizwe Kuzwayo

Assistant Manager
Sustainability & Climate Change
Deloitte Southern Africa
Direct: +2711 806 5000
skuzwayo@deloitte.co.za

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.