

Home

Introduction

Why a
change of
course?

The
framework
evolves

The
developing
country
voice

The
developed
country
dilemma

The agenda
for the
developing
world

Outcomes

And for
business?

Deloitte.

Climate Change & Sustainability

Copenhagen: Political realities to the fore, business leaders wait



Home

Introduction

Why a
change of
course?

The
framework
evolves

The
developing
country
voice

The
developed
country
dilemma

The agenda
for the
developing
world

Outcomes

And for
business?

Recent developments from the APEC meeting in Singapore—the agreement to delay the deadline for the agreement on carbon reduction targets previously set for the COP15 meeting in Copenhagen in December, and the dramatic trip to Singapore (the last major leaders meeting before Copenhagen) by Danish Prime Minister Lars Lokke Rasmussen—may have left business leaders wondering what they should expect from the current round of climate negotiations. But we should not be surprised.



Bali two years ago set the agenda for today's reality:

- The target date was too aggressive.
- It would take too long for that many countries and different interest groups to come to a conclusion.
- The matters to be resolved were too complex.
- There was no obvious strong political will for agreement.

But in the past year, there has been much change in the political environment. The United States has voted in an administration with a new perspective on these issues. And, no less important, China is more engaged and is showing leadership.

For China and the US, the new reality is clear. They are the largest emitters of greenhouse gasses and the largest users of coal in the world. They both have very large solar and wind energy plays. This "G2" will be an object of increasing focus.



So what can we expect from Copenhagen, and what is really meant by 'one agreement–two purposes'? Here are the further steps to be made:

- The target date was too aggressive.
- There will likely still be concerted action at a political level to set a broad framework for allocating load-sharing responsibilities, among the developed, the developing and the undeveloped world and between countries.
- There is also likely to be greater clarity about what those commitments would be at a country level. Remember that this is difficult, as there is competitive advantage to be gained, and the tendency exists to try to 'game' the system.
- The miasma surrounding the negotiation by officials needs to be cleared, and this is only likely if there is strong instruction from the political leaders. The position that we have got to after 2 years of negotiation—where the 'square brackets' of not agreed clauses are so complex no one truly knows what they all mean and they are reduced to producing non-papers—is clearly unsatisfactory.

So the two purposes—solid content for all the building blocks of the Bali agreement which can be a foundation for the later legal agreement, and the provision for immediate action, mainly around capacity building, technology cooperation, early mitigation and adaptation—can be met. The challenge will be to go from the framework to delivery.



Home

Introduction

Why a
change of
course?

The
framework
evolves

**The
developing
country
voice**

The
developed
country
dilemma

The agenda
for the
developing
world

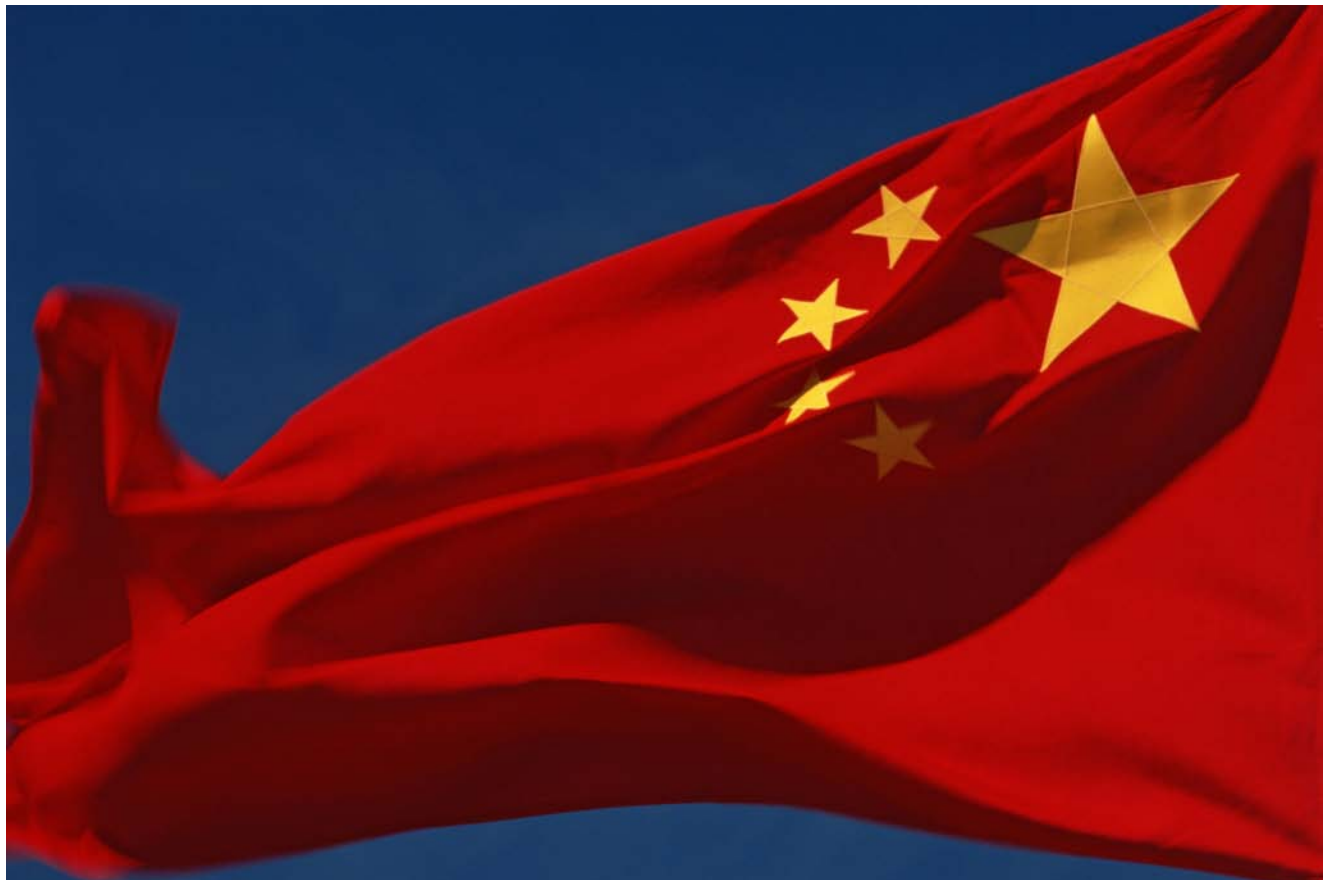
Outcomes

And for
business?

China is the lead voice for developing countries. It is coming on strong on alternatives, renewables and efficiency—emphasizing its solar and wind programs (already, China has stricter CAFE standards than the US). Clearly they see this as an area of future global competitive advantage, and they will own the intellectual property as well as the low-cost manufacturing base when they export these products.

However, China is unlikely to be able to reduce carbon in absolute terms for at least a decade. Rather, it will reduce carbon emissions relative to GNP. That is not to say that it does not understand the role that markets can play in reducing emissions and that restrictions are needed to make markets work; it's just the nature of those restrictions is likely to be different. Expect to see a 'grace period' for developing countries before they have to commit to absolute reductions. There is a precedent for such treatment in the Montreal Protocol on substances that deplete the ozone layer.

In other words, China is taking a muscular role in climate change, but within more flexible criteria than the West. Other developing countries will probably follow the Chinese and (increasingly) the Indian lead.



Home

Introduction

Why a
change of
course?

The
framework
evolves

The
developing
country
voice

**The
developed
country
dilemma**

The agenda
for the
developing
world

Outcomes

And for
business?

The main question for the US is: Will the US “walk the walk?” The Obama administration can and will say that ‘we are trying to pass legislation and, in any case, we are deputizing the EPA to ensure change in US businesses’.

The recent deferral of the Senate climate change bill, whilst reflecting reality, means the next steps in the process are not a single meeting but a round of meetings. It is unlikely that the US will sign up to a commitment that it does not think it can deliver on, so the passage of that bill and any eventual passing of legislation will be fundamental to any agreement.

Interestingly, the US and China—the new G2—will likely mirror each other when it comes to climate change policy.

Europe, for its part, will continue to play a strong hand and maintain a strident tone. Their view is that they lead in emissions reduction regulation, have been managing down their emissions profile, and will continue to do so. The stated intention is to continue policy despite what happens at Copenhagen, with a constant threat of border adjustments and out-of-border policy encroachment (consider air travel).



Here are three areas for development:

- There will be considerable focus on the clean development mechanism as a method of both reducing the pain of transition for developed countries and benefiting developing and undeveloped countries in a different path to low carbon growth.
- Expect some considerable emphasis on this clean development paradigm and a reduction in the emphasis on immediate developed country reductions. And of course this is valid. The planet really does not care where the reductions are made as long as they are real and sustainable.

Expect a significant emphasis on forestry issues and agricultural sequestration and emissions avoidance. Forestry credits have been existence for some time but are not recognized in the European ETS, the major buyer of CDM credits. This may change with a focus on not just sequestration credits but also REDD credits—credits from Reduced Emissions from Deforestation and forest Degradation—with 20% of global emissions arising from deforestation.



So what will be the end result? Deloitte member firms believe:

- Copenhagen attendees will likely structure a second round of talks and use Copenhagen as mere starting point. There will likely be some high-level agreement on what burden different countries may bear.
- The conference will likely be declared a success if attendees can create a broad framework for managing climate change with general benchmarks—something similar to the way the IEA handled oil issues in the 70s.
- China will likely emerge as the undoubted leader of the developing country voice with India not far behind. There will likely be a grace period before developing countries are required to meet similar absolute reduction targets to those of the developed world.
- There will likely be wide agreement on an extended Clean Development Mechanism (or equivalent). Forestry and agriculture credits will likely play a strong role.
- There may well be a consensus on carbon pricing.



Home

Introduction

Why a
change of
course?

The
framework
evolves

The
developing
country
voice

The
developed
country
dilemma

The agenda
for the
developing
world

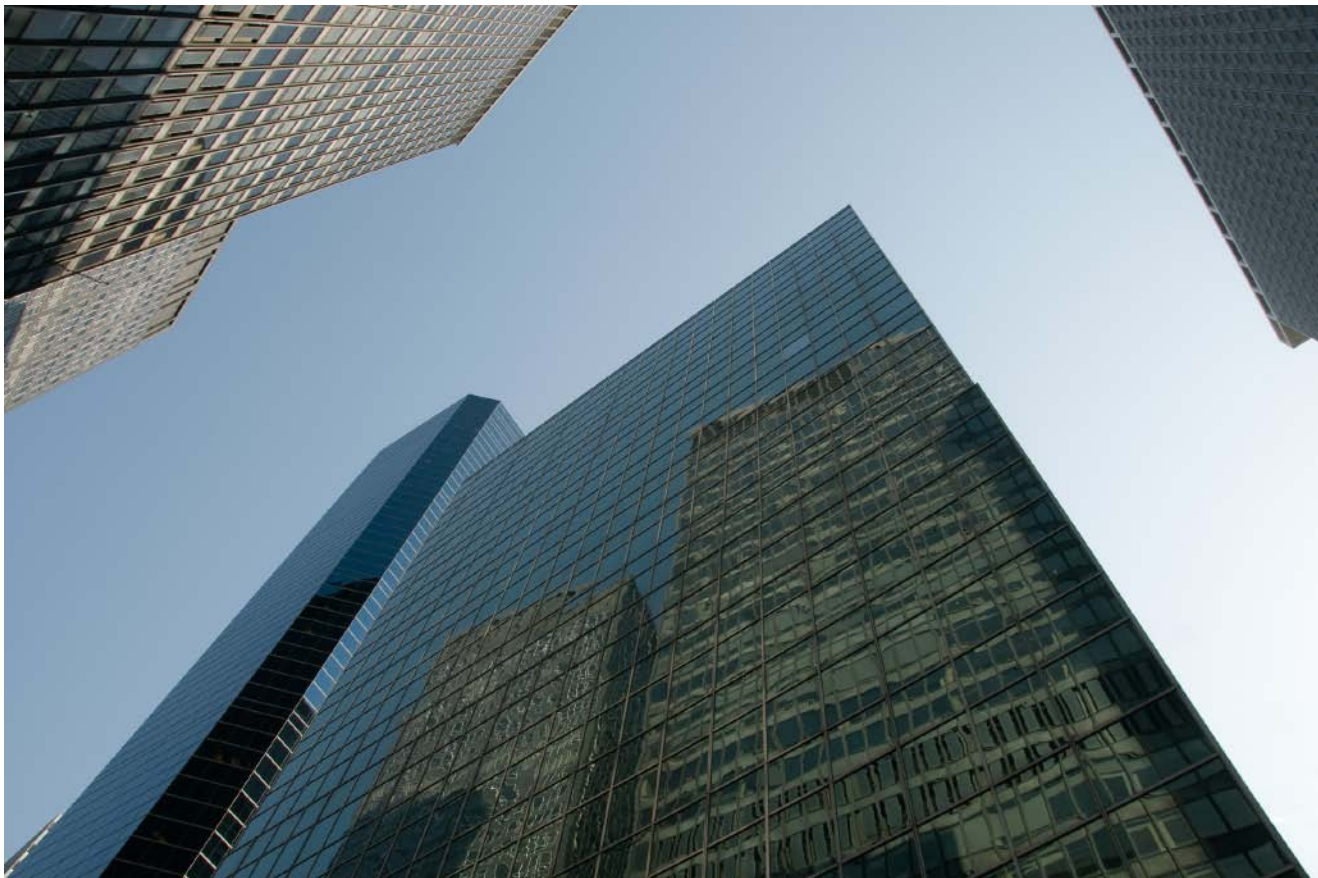
Outcomes

**And for
business?**

The reality is that a price on carbon is being put into the equation. If COP15 bis gives rise to binding agreements on significant emissions reduction, then prepare for this to be reflected in country systems.

- The cost of emissions will likely go up.
- Investment decisions will likely be reappraised.
- Reducing carbon intensity will likely become a strategic imperative.
- Competitive advantage will likely need to be reconsidered.

It is a whole new framework of risk and opportunity.



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