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Copenhagen: deal or no deal?

An update on climate negotiations from PricewaterhouseCoopers sustainability and climate change team.

Gearing up for the Copenhagen Climate Summit

There has been a surge of activity in recent weeks, both at the formal negotiations in Bangkok (28 September – 9 October) and at the high-level talks at the UN and G20 meetings in late September. With only fifty three days to go before the start of the climate summit in Copenhagen, the discussions have taken on a greater sense of urgency. Although no political advances were expected in Bangkok, the two critical issues are starting to crystallise: (1) who will take on what emissions targets; and (2) the approach to financing adaptation and mitigation in developing countries.

Progress in the US

In both New York and Pittsburgh, political leaders reaffirmed their commitment to securing an agreement in Copenhagen. China pledged to reduce carbon intensity “by a notable amount”, and did so without conditions for the developed world; President Obama promised a “new era” of promoting clean energy and reducing carbon pollution; Japan offered to cut emissions by 25%; and The European Commission said that the EU should provide up to \$15bn each year to help poor countries respond to climate change.

The G20 Leaders’ Statement also included a promise to phase out fossil fuel subsidies, but the critical issue of financing the response to climate change was left to Finance Ministers, who are not due to meet again until early November. The formal negotiations then shifted to Bangkok, for two weeks of more fractious discussions.

Arguing over emissions targets

Experience with the Kyoto Protocol has shown that the US will not commit to emissions targets without undertakings from the major developing countries, and there will be no deal in Copenhagen without the US. President Hu’s statement to the UN was therefore very encouraging, not least because China has some track record of achieving its targets; it also puts the pressure back on the US. The key concern is that in the absence of domestic climate legislation in the US, there is the risk that the Senate will not ratify any deal agreed in Copenhagen (as was the case with Kyoto).

The legislative process thus far has been tortuous. However, in a visit to London this week, the US Energy Secretary Stephen Chu (the Obama Administration’s first Nobel Laureate) said he remained hopeful that Barack Obama could sign a domestic climate bill before December, giving the US a firm position in the international negotiations. Though whether this will be sufficiently bold remains to be seen. The target set out in the Waxman-Markey bill is considered unambitious by European countries – a reduction of 17% on 2005 levels by 2020 is equivalent to only 4% on 1990 levels – and the Senate bill championed by Barbara Boxer and John Kerry is only slightly more demanding.

Financing the response to climate change

The discussions around financing for developing countries and the role of markets became increasingly heated in Bangkok. Many developing countries stated that financing should not be seen as discretionary aid, but rather as compensation or reparation for damages. Although many noted that the private sector would be a key source of funding, there was little understanding of the type of mechanisms or incentives that would stimulate private capital to flow. The US proposed a financing mechanism which would enable private sector investment, though some developing countries questioned the role of markets in any response to climate change.

Deal or no deal?

While it is too early to tell what form the deal will take in December, the options are becoming clearer:

- (1) Extending the Kyoto Protocol (which only commits non-US developed countries);
- (2) A single new treaty which incorporates the best elements of Kyoto (i.e. quantified targets, reporting, compliance and the market mechanisms) and includes the US and major emerging economies; or
- (3) A high level political statement with a series of national pledges.

The EU prefers the second option, so has been accused by some developing countries of trying to 'murder' the Kyoto Protocol, and is unwilling to take on new targets alone. While the form of the deal is important, agreement on the substantive issues is essential, otherwise there will be no deal at all at Copenhagen. Thinning down the negotiating text in Bangkok is helpful – it is now down from over 200 pages long to around 160 – but resolving the fundamental issues is the real challenge.

Listening to the voice of business and investors

What is the minimum that we should demand from any deal? Where are the red lines negotiators mustn't cross?

Over the course of this year, PwC has been actively engaged with a number of business groups – notably the G20 Taskforce on Low Carbon Prosperity, the World Economic Forum and the World Business Summit on Climate Change – which have set out the key elements of a robust deal at Copenhagen. These include setting emissions targets in line with the science, sending clear long term regulatory signals to business, managing the impact of carbon leakage¹ on competitiveness, new collaborative public-private financing mechanisms for mitigation and adaptation, harmonised reporting and compliance processes and tackling deforestation.

This may prove too much to ask for from Copenhagen. Many observers of the climate negotiations are now lowering their expectations, and there is a real prospect that Copenhagen will only deliver a less than satisfactory smörgåsbord of pledges and initiatives, rather than a comprehensive global deal. If it does, companies and investors will be looking anxiously for political support to sustain the confidence and continuity of the carbon markets.

So where does this leave the business community? Continued uncertainty in the regulatory environment is delaying investment decisions and the current negotiations are sending the wrong signals to investors. In the UK, this is most obvious in the energy sector, where the absence of a robust, long term price signal is delaying investment in the new power generation needed to replace ageing coal and nuclear assets. Low carbon generators are increasingly worried about investing in new wind or nuclear generation capacity given the uncertainty in the value and duration of renewables incentives, and with carbon price in the low teens of Euros and little visibility of higher prices in the longer term. Meanwhile, investment in coal generation is being held back by concerns over the potential cost of carbon capture post-2020, which can only be justified commercially at prices well above the current level. In this environment, it is likely that new investment will favour gas turbines, which involve lower capital costs but lock in carbon emissions and increase dependence on imported gas for the long term.

Next steps

In an attempt to maintain the political momentum, the Major Economies Forum is meeting in London in mid October. The final week of negotiations is then scheduled for the first week in November in Barcelona, after which Finance Ministers from the G20 are due to meet to finalise financing arrangements. The COP itself starts on 7 December.

The PricewaterhouseCoopers climate change team will be issuing regular updates on the status of the climate change talks in the lead up to, and at, Copenhagen. Register for updates at www.pwc.com/climateready or contact Rowena Mearley.

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Note(s):

1. Richard Gledhill, Jonathan Grant or Jon Williams are available for interview and further comment on issues surrounding climate change and carbon markets and will be attending the Copenhagen

¹ The risk that carbon intensive production (e.g. of steel) shifts away from countries with GHG emissions caps.

- Climate Change summit in December. Please contact Rowena Mearley for details. T: 07841 563 180.
2. The PricewaterhouseCoopers climate change team will be issuing regular updates on the status of the climate change talks in the lead up to, and at, Copenhagen. For more information please register at www.pwc.com/climateready or contact Rowena Mearley (rowena.mearley@uk.pwc.com)
 3. PwC is a strategic advisor to the World Economic Forum Climate Change Initiative, and a member of the Low Carbon Prosperity Taskforce which is working with the G20 governments to develop a set of practical projects and policy proposals to encourage a rapid transition to a low carbon economy.
 4. PwC has a 17 year track record of advising clients on sustainability and corporate responsibility issues across its assurance, tax and advisory practices. In the past 18 months the UK practice has trebled in size, joining a global network of over 800 practitioners.

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