



Bali Changes the Equation

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The UN climate summit on Bali was a turning point for international environmental diplomacy. Now the international community is on track to negotiate a first comprehensive global climate agreement with far-reaching consequences for the future of energy and all our industries. Bali has also opened talks about new finance transfers from industrial to developing countries that have the potential to transform “development aid” as we know it. The negotiations underway have also reached a new level of complexity that poses difficult questions for the future functioning of the system of international governance. Most importantly, Bali has exposed a shift of power that has been long underway. The U.S. has lost its singular veto power in the climate process. A group of emerging powers, most notably China, India and Brazil – but also a re-emerging Russia - have started to use their new economic and political weight to shape the negotiations more actively than before. The European Union retains its political leadership role by acting as an honest broker between those diverging interests but will only be able to make a real difference if the transatlantic climate policy partnership can be revitalised.

The Bali Roadmap

The year 2007 brought an unprecedented number of high level international meetings that promoted the issue of climate change to the attention of world leaders, including the G8 summit in Heiligendamm, as well as special meetings of the UN Security Council and the UN General assembly in autumn. The last year also saw dramatically raised media attention and public anxiety, not only on climate change but also regarding the related issue of energy security. The annual UN conference on climate change in Bali (Indonesia) was therefore burdened with expectations and attended by a record number of governments and non-governmental observers. Indonesia’s President Yudhoyono and UN General Secretary Ban Ki Moon actively participated in the final hours of the meeting and thereby put their reputation on the line to close a deal on the so called Bali roadmap.

The Bali Roadmap sets the stage for two years of negotiations with the objective to agree on a comprehensive global climate agreement by the end of 2009, when another UN climate summit takes place in Copenhagen (Denmark). This agreement will replace the Kyoto Protocol that mandates climate targets for a smaller group of industrialised countries with the limited time view until 2012. An interim UN climate summit will take place in Poznan (Poland) in December 2008. The choice of Poznan and Copenhagen as stepping stones towards the post-Kyoto agreement underlines the leadership role the European Union has taken on in this process.

The so-called “Bali Roadmap” includes the following core elements:

- new climate policy measures in developed countries “including quantified emission and reduction objectives”;
- the comparability of efforts amongst different developed countries has to be ensured, meaning that the US will have to take on comparable reduction commitments to others like the EU;
- “nationally appropriate mitigation actions by developing countries”;
- those developing country actions have to be supported by technology, financing and capacity building “in a measurable, reportable and verifiable manner”; and
- a negotiating timetable that should conclude by the end of 2009.

Obviously, precise numbers and concrete legally binding agreements have to be hammered out in difficult negotiations over the coming two years.

New areas of interest

The global deal that might lead over the coming two years to a post-Kyoto agreement will have to include significant financial components, basically channelling money from North to South and into climate-friendly policies and technologies.

Technology transfer

Technology transfer was the deal breaker of the Bali deliberations. A new fund will be set up under the aegis of the Global Environment Facility (GEF), an UN-related body that is mainly managed by the World Bank. The governance structure and the scale of the fund still have to be negotiated. It is clear however that this fund will finance the introduction of technologies like carbon capture and storage (CCS), clean coal, advanced renewables and other efficiency technologies. The fund has the potential to expand those markets significantly into developing countries. One would also expect a boom of new companies and interlocutors who can manage related projects to be created over the course of the next years.

Adaptation

A new adaptation fund has been created, again under the GEF, and will be financed through a 2% fee on every Clean Development Mechanism (CDM) project over the coming years. The CDM was already established under Kyoto but has only been taking off in the last year, with the potential to move investments in the hundreds of billions per annum. There will also be new private money and bilateral aid for adaptation. Those funds will go in improved infrastructure as well as in the adaptation of natural habitats, e.g. through integrated coastal protection. This is a relatively new area of development cooperation and one should observe closely how countries' adaptation needs develop and which kinds of business opportunities arise.

Avoided deforestation

Three significant developments took place:

- the launch of the World Bank's Forest Carbon Partnership Facility (FCPF), which will carry out pilot projects to finance forestry projects through carbon credits;
- the announcement by the Norwegian government of a 500 million USD p/a fund to finance forest protection in tropical countries; again, the purpose of the exercise is to create a carbon market and – amongst other objectives – offset Norway's emissions to make the country carbon neutral by 2030; it might well be, that other countries follow Norway's example soon and commit additional, potentially significant, amounts of funding; and
- the start of negotiations to include avoided deforestation and sustainable forest management into the emerging post-Kyoto agreement.

The issue of avoided deforestation has to be seen as part of an emerging global carbon market, but also of individual countries' and companies' efforts to off-set their emissions. Again, there will be a boom of companies that want to profit from the market, either by offering consulting services, environmental expertise or by facilitating deal making.

All three issue areas mentioned above have the potential to create potentially huge new markets, establish relevant new policy frameworks and advance new technologies.

A realignment of powers

Bali was noteworthy for the enhanced role that major emerging economies played in leading the discussions and shaping the outcome. Four negotiating blocks could be distinguished:

- the European Union, taking the lead on stronger greenhouse gas mitigation commitments;

- the United States (plus some allies like Canada and Japan), being more reluctant on reduction commitments but keen to see concrete obligations for developing countries;
- China, India and Brazil representing the developing country block and – for the first time in the history of the negotiations – accepting possible commitments to reduce emissions for their own economies; those will probably take the shape of sectoral agreements, efficiency targets or a step by step inclusion into regional and global carbon markets; some countries might even be willing to accept absolute ceilings for their growing emissions, which is quite a novelty; and
- Russia, which proved to be a major headache for the EU, and stated in informal consultations that they expect to benefit from climate change and that the proposed reduction commitments were incompatible with President Putin’s goals to double electricity production and to increase oil and gas exports.

Generally speaking, the US found themselves in a remarkably weak position, a trend that will continue as long as the current administration is in power. China asserted itself and the EU played the role of a broker between developed and developing country interests.

A cautionary note on Russia

Russia’s role in the climate talks has always been underreported and therefore deserves special mentioning here. The Russians have never played a constructive role in international environmental negotiations, but the times when they could safely be ignored are over. Russia’s new political and economic weight was on plain display on the Bali stage. Russian opposition almost blocked agreement on the final package for the Bali Roadmap until everyone else gave in to a seemingly minor demand that the Russian delegation had brought forward in the last hours of the negotiations. Many observers shared the impression that Russia wanted to score a symbolic victory to show the world its veto power on any future climate change agreement.

Russia’s position on climate change is defined and determined by the interests to increase both fossil fuel exports and electricity production at home. International efforts to set ceilings for energy consumption are therefore met with scepticism. Russia is also the only major country left where significant parts of the scientific community and political leadership still doubt the insights of mainstream climate science. Prominent Russian scientists argue that climate change might even be favourable to Russian interests, considering that a shift in climate zones might open up vast parts of the Russian Arctic to agriculture and resource exploitation. Russia has a weak domestic civil society and tightened the screws on international civil society organisations that

could support an open dialogue on those subjects and include Russian leaders and academics more actively in the international discourse on climate change.

As opposed to China, India or Brazil, Russia does not act as part of a negotiating block or informal coalition. US-Russian relations are at a low point. The EU has a vaguely defined strategy to engage Russia through a new Partnership and Cooperation Agreement (PCA). A negotiating mandate for such a renewed agreement is still under discussion between the EU's member states. Energy and climate change are both defining elements of today's and future EU-Russian relations and should play centre stage in discussions for a new PCA. Both Western partners, Europe and the US, have to do more to bring Russia back into the climate policy mainstream. Scientific and technological cooperation needs to be strengthened and might be a crucial element for a successful strategy to engage Russian politicians, business and academics.

Which consequences for the transatlantic relationship?

Energy and climate change cooperation was one of the main themes of the EU-US Summit in Washington DC on April 30, 2007. Both sides committed to cooperate on new energy technologies, in particular renewable energy sources and carbon capture and storage (CCS). What has happened since? The European Commission has recently, on January 23rd, presented a comprehensive climate change package that sets the EU on a path to achieve its goal to reduce greenhouse gas emissions by 20 percent until the year 2020 based on 1990 levels. The EU has announced to reduce emissions even further, by 30 percent, if an international agreement can be reached that commits other industrialised nations to comparable – not necessarily the same – targets. The core of the EU's new climate package is an extension and expansion of the European emission trading system (EU ETS). In addition, new targets for renewable energy use and energy efficiency have been set. Financial incentives and a new legal framework will create the necessary support for new CCS technologies.

On the US side, very little has happened on the Administration's side. The President's biofuel target which was announced in his 2007 State of the Union has merely resulted in new subsidies for the inefficient production of ethanol from corn, though some of the research done on second generation biofuels might be more promising. The most important domestic development in the US is the Senate's discussion on a national cap and trade system for greenhouse gas emissions (Lieberman-Warner bill). This scheme draws strongly on lessons from the EU ETS. If the bill should be passed, the auctioning of emission permits would generate significant amounts of funding for the introduction of sustainable energy technologies and international climate change assistance.

It is likely that domestic climate policies in the EU and the US gain more of a resemblance after the 2008 elections. Both blocs might then have introduced cap-and-trade systems and a set of technology support programs that could be closely coordinated or even merged. In fact, closer technology cooperation might even be more feasible than linking the two regional emission trading systems with their different greenhouse gas accounting systems and legal frameworks. Credible domestic climate change action in the US will also prepare the ground for a realignment of interests in the international negotiating process. Since President Bush moved the US out of the Kyoto protocol, the US has largely been isolated in the international arena. The last-minute concession in the Bali negotiations – when the US gave in to majority pressure and gave up opposition to the Bali Roadmap – stands as a symbol of waning US power in the negotiations.

In a way, the Bush administration has already set the stage for the overdue realignment of the transatlantic climate policy debate by its recent acceptance of the science and – though more grudging – acceptance of the supremacy of the UN process in finding global common ground. The remaining question is whether a future US administration will accept two necessary cornerstones of any future global climate agreement:

- legally binding targets; and
- significant finance transfers to developing countries, even if those countries, like China, compete with the US in other economic areas.

The upcoming change of the US administration in January 2009 creates a historic opportunity to resurrect transatlantic leadership on global environmental issues. The EU and the US have three major reasons to start a new era of climate policy cooperation: First, the US remains the world's major emitter of greenhouse gases, even if China has surpassed the US last year in emissions of CO₂, the main gas under consideration. Without the US, as well as without meaningful participation of the big emerging economies, the problem cannot be solved. The EU's role remains that of an incubator for progressive policies and new technologies. The problem however can only be resolved if those are more widely adapted.

Secondly, Europe and the US still have an unmatched technological and scientific potential to address the climate challenge, even if China and others are catching up on innovation. Europe and the US also have the financial resources to invest into a next technological revolution. Some of those new technologies will also be produced in emerging economies, maybe even cheaper and on a bigger scale. However, only the established industrial powers of the West will be able to develop and introduce those technologies in a phase when they are still untested and relatively expensive.

Thirdly, both Europe and the US have to support an approach to resolving the climate problem that is based on democratic debate, international law and a system of global institutions. The Europeans have always been the main supporters of such an approach. The assertive style of China, India and others in Bali has shown that the time when the West defines the rules of the game is coming to a close. A new US administration would therefore show wisdom in helping to build a system of international law and strong institutions that will not only bind Washington but also the future powers to be.

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