



## Developments in International and European Climate Policy in 2003

by

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### Introduction

The year 2003 was characterized by a large degree of uncertainty over the fate of the Kyoto Protocol (because of Russian non-ratification) and by a corresponding slowdown of diplomatic and political activities at the global level. Nevertheless the Ninth Conference of the Parties in Milan resolved the remaining outstanding issues on the implementation of the Kyoto Protocol. Moreover, by the end of this year, the UN Framework Convention on Climate Change had reached near-universality with 189 Parties and the Kyoto Protocol had received 120 ratifications, among them almost all industrialized countries with the exceptions of the US, Russia and Australia (<http://unfccc.int/resource/kpstats.pdf>). There was furthermore considerable development at the European level, where Council and Parliament adopted decisions to implement a Union-wide emissions trading scheme for enterprises from 2005.

Climate impacts were again being felt in many parts of the world: Global mean temperature in 2003 was the second highest ever recorded (after the record year 1998), on a par with temperatures in the year 2002. The five hottest years on record all have occurred since 1997, the 10 hottest years since 1990. It has been 221 months since the world recorded a colder-than-normal month. After the previous year of heavy flooding, the year 2003 in Europe was particularly hot and dry, which led to 13.000 deaths in France alone and approximately 20.000 deaths in Europe. According to a study led by researchers from Zurich University, unusually hot conditions like the one experienced in Europe might at the end of this century appear every two years instead of every couple of hundred years as in

the past. And according to a study led by the University of Leeds, between 15 and 37 percent of the world's existing plant and animal species could go extinct by 2050 as a result of global warming.

This article will, first, report on the most recent developments concerning the European emissions trading scheme and, second, examine the results of the conference in Milan. Finally, some reflections on the way ahead will conclude the article.

## **Emissions Trading in the EU**

Just seven years back from today, during the negotiations of the Kyoto Protocol, the European Union demonstrated strong opposition against the instrument of emissions trading. Yet since then the European Commission and many of the Union's Member States have undergone a fundamental learning process and a shift in policy paradigms (Damro/Mendez 2003). By now the EU has become the most progressive administration in applying market based, flexible mechanisms to reduce domestic green house gas emissions. Besides of the value of introducing this instrument as such, there is another and politically important aspect: These developments in the EU are formally independent from the international negotiations and thus provide a second pillar on which climate policy can rest in the years to come.

In June 2003 the Environmental Council of the EU member-states adopted a directive that foresees a union-wide cap and trade-scheme (Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 Establishing a Scheme for Greenhouse Gas Emission Allowance Trading Within the Community and Amending Council Directive 96/61/C. Brussels: Official Journal of the European Union, L 275/33, 25.10.2003). With this the Commission intends to substantially contribute to achieving its commitment of reducing 8% the EU's 1990 greenhouse gas emissions. The directive covers roughly half of EU 1990 emissions. It will be the largest emissions market created so far, with considerable economic implications to be anticipated.

After more than ten years of fruitless discussions about a union-wide energy tax, this legislation was passed surprisingly quick. Only a few changes to the initial draft version of the directive have been made during discussion process that lasted one and a half-years. The German Government was divided on this issue and other member states such as Britain and Belgium raised significant concerns, yet business communities were internally diverse in opinion and did not talk with one voice. Most of the EU member states have remained quiet or supported the directive. This miracle was mirrored in the EU Parliament. After all, those

parliamentarians who called for an even stronger environmental effectiveness of the directive had a bigger impact than its opponents. Even the NGO community, which had strongly opposed emissions trading at the time of Kyoto, appreciated the directive.

The core features of the scheme are its mandatory nature, limited to certain energy intensive industries, and the installation-based allocation of emission permits. Although it is a company-based trading scheme, companies identify themselves as trading participants only through their ownership of specifically identified installations. As it is framework legislation, the directive only shapes the nature of the permits (CO<sub>2</sub> only during the initial 2005-2007 phase, all six-Kyoto gases after 2008), the common trading rules (banking; duration of trading periods etc.), and prescribes harmonized sanctions for non-compliance (EURO 40 in the initial phase, afterwards EURO 100). With this, the directive guarantees the fungibility of permits across member-states. Yet the actual method of allocation as well as the number of permits issued will be determined individually by each member state. As a concession to business concerns, opt-in and opt-out clauses allow the exclusion of certain installations by the Member States – as long as these are treated equally. Another compromise was the agreement on pooling of installations, which allows companies to designate a trustee who will conclude the trading, e.g., based on a common reduction target of a business administration.

While by many observers, the directive is perceived as one of the finest environmental legislations in the past years, the devil lies in the detail. This especially regards the process of putting the scheme into practice, because the directive demands tight timelines. Since it was decided upon in the Council, member states had less than nine months to develop comprehensive national allocation plans until 31 March 2004. These plans need not only to develop a formula on allocating emissions permits and to outline in detail which installations will be allocated how many permits. In order for the Commission to evaluate whether the emission restrictions are sufficient to contribute to the EU Burden Sharing Agreement, the plans also need to specify what kind of policies and measures will be applied to other sectors of the economy. Therefore the directive will act as a ‘transmission’ in promoting comprehensive national climate policy programs. Since some member states did not have such programs before, the workload on individual governments is enormous. As of end of 2003, several member states were still at the outset of gathering intelligence on installations and of developing allocation methods.

It thus remains to be seen whether trading between all member states can in fact begin on 1 January 2005. Nevertheless, the European Union appears to be determined to use emissions trading as the centerpiece of its climate policy. Links with other schemes and countries are envisaged (like Canada, Japan, Switzerland)

and the emissions trading regime might turn out to be an important pillar of global climate policy in the future, not just an instrument of regional implementation.

## **Outcomes of the Milan Conference**

The Ninth Session of the Conference of the Parties to the Framework Convention on Climate Change (COP 9) concluded in Milan on 12 December 2003. Already in 2001, the Bonn Agreements and the Marrakech Accords had established the main rules for the implementation of the Kyoto Protocol. The concluding negotiations in Milan thus centered on four left-overs: the criteria for sinks projects under the Clean Development Mechanism (CDM); the Least Developed Countries Fund to assist adaptation to climate change; the evaluation of the Third Assessment Report of the Intergovernmental Panel on Climate Change (IPCC); and the funding of the Bonn Secretariat of the Climate Convention and (in future) the Kyoto Protocol (see <http://unfccc.int/cop9/index.html>).

### **Sinks projects under the CDM**

With new rules agreed in Milan on the modalities and scope for carbon sequestration activities within the CDM (“sinks”), namely the conditions under which afforestation and reforestation projects should be carried out, negotiations on preparing the Kyoto Protocol for its entry into force have concluded. The negotiations took place under the chairmanship of the German head of delegation, Karsten Sach. These decisions have put the CDM in full working order, and all that remains for COP 10 (December 2004 in Buenos Aires) is to decide on special provisions for so-called CDM-Small Scale Projects.

The disputed issues were project quality requirements and the duration of emission certificates (“allowances”) resulting from CDM activities. Some governments and environmental NGOs had demanded that activities under the CDM should in principle exclude genetically modified organisms (GMOs). Others, including the United States, preferred to leave the risk management at the national level. As a compromise it was agreed that the Project Design Document should clearly identify plant species and strains – and therefore indicate whether GMOs were actually being used. Furthermore, host countries to a project will be required to assess the risks associated with GMO use, and purchasers of the certificates will have to assess the value of certificates resulting from such projects. Therefore, although the use of genetically modified plants has not been excluded, market transparency might have a similar effect since purchasers concerned about sustainable development can refrain from buying them. Non-local (invasive) tree species have also been permitted for afforestation projects. The spread of these species may endanger local species and pose a threat to forest

ecosystems in the country where the investment takes place. However, as in the case of GMOs, the requirement to declare in the Project Design Document which species have been used does at least ensure transparency.

The provision of information about possible ecological and socio-economic effects of projects was another controversial issue in the CDM negotiations. Talks in the run-up to the conference centered on a special appendix that was supposed to define the foundations on which projects would rest. Yet it was eventually agreed to incorporate only a few requirements concerning social and ecological effects into the Project Design Document – a long distance away from the “Gold Standard” developed by the WWF for CDM activities. Project partners are nevertheless free to agree on a voluntary application of these standards.

A further issue was the duration of emission certificates, because carbon storage lasts for only a limited time and – in the event of forest burning or a massive attack by pests – the temporarily fixed carbon may be released again into the atmosphere. Parties therefore agreed that they would attach only a limited period of validity to certificates resulting from sequestration projects. Two new and different kinds of certificates were worked out: “Temporary CER” (tCER), expiring after a specified period but then open to renewal, and “Long-term CER” (lCER), whose expiration date is set in advance to cover the duration of a particular project but may become invalid in the event of forest loss.

### **Financial issues**

In Milan, more specific rules were developed for both the Least Developed Countries Fund (LDCF) and the Special Climate Change Fund (SCCF). These are two of the three funds involving transfers to non-Annex I countries, adopted at COP 7 in Marrakech. The European Union, Iceland, Canada, New Zealand, Norway and Switzerland reaffirmed their willingness to make Euro 450 million available annually for these funds and other climate protection activities. The Adaptation Fund, unlike the other two approved at Marrakech, is a fund not of the Climate Convention but of the Kyoto Protocol and, therefore, was not the subject of discussions in Milan.

Until the final day OPEC countries reiterated their demand that the SCCF should be made available for economic diversification of oil producing countries and for any future loss of oil revenues. This position was unacceptable for industrialized countries. In particular the UK and Germany outrightly rejected the demand – not least because, for internal political reasons, they would be unable to raise money for a fund that supported OPEC countries. A decision on this matter was postponed to COP 10. The second main dispute concerned the EU’s demand of tying financial transfers to the regular fulfillment of reporting obligations (National Communications, among others). Yet, many developing countries

feared that the demand of industrial countries for regular reports would be used as a basis for the establishment of obligations for them in future periods. With regard to the LDCF, a decision was taken that will make it possible to finance national adaptation plans on a full-cost basis.

### **Policy evaluation of the IPCC's Third Assessment Report (TAR)**

The decision on the TAR adopted at the end of the negotiations contained nothing that took the issue any further. During negotiations lasting for almost two years, some parties had hoped that warnings contained in the TAR might prompt a common appeal for the further development of the climate regime and for faster implementation of mitigation measures. But this was unwanted by other governments, including China and Saudi Arabia. Instead, the final resolution merely recalls two points ("Aspects of impacts of, and vulnerability and adaptation to, climate change" and "Aspects of mitigation"), which had already been placed on the agenda at the meeting of the Subsidiary Bodies in June 2003. However, it was decided to organize workshops on each of these issues.

### **Funding of the Secretariat**

The usually rather marginal question of the Climate Secretariat's budget became a political issue in Milan. As the United States has withdrawn its support for the Kyoto Protocol, it now wishes to limit its contributions to the Secretariat's work for the UNFCCC. This means that the Secretariat has to separate its spending on Protocol and Convention tasks, thereby stepping up the pressure on all other parties to increase their share of the funding. Thus, the total budget of US\$ 35 million now includes \$ 3.3 million for Kyoto "preparatory activity". The US government has already announced that it will lower its contribution correspondingly.

### **The way forward**

For many participants it seemed that the key issues facing the climate regime were not dealt with in the negotiations, but in the corridors and at the side events. While civil society and scientific community representation was somewhat lower than at previous conferences, committed discussions took place, namely on two topics: the coming into force of the Protocol and the further medium to long-term development of the climate regime.

A considerable number of side events presented ongoing projects and academic studies concerned with the further development of the Kyoto Protocol in the second commitment period (beyond 2012) or, more generally, with the future of

international climate policy (check at <http://www.fiacc.net>). The Climate Action Network (CAN), a network of NGOs working on the issue, also presented a paper for the discussion of its positions in the years ahead; it addressed the issues of tighter emission targets for industrialized countries, greater involvement of developing countries, and differentiated measures for adaptation to climate change. The Wuppertal Institute presented its project “South-North-Dialogue – Equity in the Greenhouse” that assembles international researchers for a concerted attempt to arrive at recommendations regarding the future participation of developing countries in the climate regime (see <http://www.wupperinst.org/Projekte/Klima/1085-e.html>) These matters were supposed to be kept out of the political negotiations in Milan, as a result of the conflicts between the EU and the G 77 at last year’s COP 8 in New Delhi (see last year’s report).

In addition to questions concerning the long-term development of the regime, there were some worries about whether the Kyoto Protocol would enter into force at all. This will depend on Russia’s ratification, since only with the Russian emissions the 55 per cent of 1990 emissions levels necessary for the entry into force of the Protocol will be achieved. In Milan, however, the Russian government – which for the last two years has had an unclear position to the Kyoto Protocol – did not change its enigmatic attitude. In fact, at the beginning of the conference President Putin’s economic adviser, Andrei Ilarionov, once more surprised the rest of the world by announcing that Russia would not ratify the Kyoto Protocol in its present form. Shortly afterwards, however, a Kremlin spokesman denied this and stated that Russia was “continuing to move towards ratification”.

Many observers in the corridors of the Milan conference asked how long the international community should continue to wait for a decision of President Putin and whether, in the meantime, the 120 countries that have ratified the Kyoto Protocol should not meet to discuss future action. Such a meeting might serve several purposes: It would lead to a reaffirmation of the parties’ commitments towards the Kyoto Protocol and climate protection in general – both within the regime and to the outside world. It could, second, issue a strong appeal to Russia that they expect ratification soon. Third, the parties could confirm their determination to act as if the Kyoto Protocol had entered into force and to continue preparing implementation of their commitments. And, finally, such a meeting of the “Friends of the Kyoto Protocol” might serve as a platform for a renewed alliance between industrialized and developing countries, an attempt to heal the wounds inflicted at COP 8 in New Delhi 2002.

In the meantime, regional, national and sub-national activities are becoming a more important pillar of climate change policies. In this context, the emissions trading scheme developed by the European Union is of particular importance. It is

evidence of the Union's determination to implement its commitments under the Kyoto Protocol before the treaty has entered into force. In the United States, in the absence of significant activities by the federal government, measures to protect the climate are being taken at the sub-federal level ([http://www.worldwildlife.org/climate/rising\\_tide.pdf](http://www.worldwildlife.org/climate/rising_tide.pdf)).

Whether or not the Kyoto Protocol enters into force and irrespective of the formal arrangements for co-operation on climate change, the requirement of North-South agreement remains remarkably similar. It has often been said that Northern emissions alone exceed the carrying capacity of the atmosphere – but the same is true for Southern emissions, especially taking into account the projected rise in emissions. A renewed understanding between both groups is thus of paramount importance.

This will, however, probably require a new definition of “justice” or “equity” on both sides. Questions of equity have always loomed large in the climate negotiations, but were largely neglected in recent years due to the rather technical nature of detailing the provisions of the Kyoto Protocol. One of the aspects of equity concerns the well-known problem of allocation – according to which principles should a limited amount of emission be distributed? There has not been an attempt to deal with this issue at the political level, but it would be difficult to avoid it in the future when participation of developing countries is at stake. In a larger sense, however, equity in its meaning of fundamental human rights will take center stage – the right to life, health and the protection of property. What degree of damages in developing countries is the world prepared to accept? At what point does the duty to prevent damages arise? And how much are industrialized countries prepared to pay for adaptation to the inevitable climate change and the mitigation of its impacts?