



## Copenhagen and beyond – a glass half full

January 25, 2010

**The glass is half full.** The Copenhagen Accord has disappointed many observers of the negotiations, particularly as no legally binding agreement was reached and no specific reduction targets were agreed upon. Still, the Accord addresses many crucial elements of a framework for tackling climate change and was drafted by the heads of state and government of leading emerging markets and the US and agreed by many industrial countries. For these countries the Accord may acquire politically rather than legally binding force. What is more, the fact that the Accord is not legally binding at this time might turn out to be an advantage, as it provides scope for improvement over the course of 2010 ahead of the COP-16 in Mexico. In that sense, the glass is half full rather than half empty.

**Uncertainties about carbon markets.** The greatest near-term risk stemming from the Accord concerns the future of carbon markets. In order to reduce uncertainties it is necessary to make quick progress on both carbon market reform and financing of international mitigation projects.

**National policies remain key drivers.** Many countries have embarked upon their own climate policies. The Copenhagen Accord does not end these policies or slow down the momentum that was gained in the run-up to Copenhagen. The weeks ahead will of course reveal countries' willingness to register ambitious policies and thus keep up the momentum.

**Trend towards renewable energies and energy efficiency unbroken.**

The deployment of renewable energy technologies depends now more on incentives created by national policy and regulatory frameworks, energy security concerns, as well as rising energy prices. These factors will continue to favour renewable energies in the coming months and years.

**Building trust is crucial.** A strengthening of public-private finance partnerships as well as bilateral agreements can be catalysts for rebuilding trust, and Europe should play a leading role, here. For future conferences, it might be reasonable to break down the discussion into smaller, still complex topics, for example by separating mitigation and adaptation issues.

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The Copenhagen Accord leaves us with a choice – we can decide whether the glass is half full or half empty. The majority of the analysis has been negative, both on the outcome as well as the way forward. Two reasons for such pessimism stand out. First, there was no legally binding agreement, and second, there was no agreed global emissions reduction target. Despite these two glaring deficiencies, we believe that the “glass is half full” and that the Accord presents a meaningful interim result which offers a way forward if trust can be restored and public-private collaboration on climate change can be launched in earnest.

### The glass is half full

The assessment that the glass is half full is based on at least three factors:

1. The coalition of those prepared to take mitigation actions expanded to include the key emerging markets (China, India, Brazil and South Africa), and coverage was extended to all sectors, most notably forestry and agriculture;
2. The Copenhagen Accord was drafted by the heads of state and government of these four countries plus the President of the United States – an unprecedented outcome in international negotiations;
3. The very fact that the Accord is not legally binding leaves room for improvement on the substance of the Accord.

Importantly, the political understanding that underpins the Accord could provide an important foundation for a more ambitious international agreement. Breaching this agreement will bring with it political consequences – diplomatic responses, efforts at public shaming. In that sense, the Accord is politically binding – and commits the countries who agreed to it to adhere to it. Significantly, the absence of a binding international agreement places responsibility for action squarely on national authorities as well as on the private sector.

### Even a legally not-binding document can be politically binding

While the Accord lacks the detail many had been hoping for, it also avoids the pitfalls of a weak legally binding agreement, which would have most likely been the alternative. Our research has shown that the policies and targets announced by countries ahead of Copenhagen would add up to emissions reductions by 2020 that are about half as ambitious as those required for the 450 ppm pathway, i.e. a 14 Gt CO<sub>2</sub>e reduction or 25% compared with a business-as-usual scenario.

Why was there not enough trust among the Parties to improve upon the earlier announcements and agree an ambitious deal? Many policymakers and observers have been disappointed that in the end no mention was made either of the 50 percent global reduction target by 2050 (which science suggests to be broadly consistent with a 2 degree Celsius limit on the rise in temperature) or the 80 percent reduction for the developed world. However, such a construct would have defined an emissions reduction target for the developing world – but without giving other countries a say in this. What is more, it would have implied emission allowances by 2050 for the developed world that are almost 2.5 times higher than for the developing world. The large emerging market emitters in particular took issue with this.

Trust needs to be restored.

## What does the Accord entail?

On the positive side, the Accord includes:

- The 2 degrees Celsius limit and (unspecified) deep cuts in line with science and equity to achieve this goal; review in 2015 with the option to tighten to 1.5 degrees;
- Fast start funding of USD 30 bn for the period 2010-12, of which 50% will be spent on adaptation; and the goal of mobilizing (public and private) finance of USD 100 bn per year by 2020;
- Agreement to start REDD+ mechanism;
- Targets for developed countries which will be entered into a registry and subjected to international monitoring, reporting and verification (MRV);

### No future legally binding document

- Nationally appropriate mitigation actions (NAMAs) for developing countries to be entered into a registry; increased frequency and improved methodology for communicating these actions; domestic MRV via international consultation;
- Internationally funded NAMAs subject to international MRV;
- Pursuit of opportunities to use markets for achieving cost-effective abatement action.

On the negative side, the Accord makes no reference to a future legally binding instrument. Its bottom-up approach does not ensure that emissions will be reduced by as much as we need for a 450 ppm pathway. There is no global 2050 reduction goal embedded in the Accord nor was there a decision on the future of the Kyoto Protocol or reform of the Clean Development Mechanism.

## Uncertainties about carbon markets

### Viable carbon market is crucial

Uncertainty about the future of carbon markets presents the greatest near-term risk stemming from the Accord. Disappointment immediately following the conclusion of Copenhagen contributed to a drop in carbon prices by about 10%. Since early January, the market has recovered virtually all of the earlier losses. On the positive side, the Accord states that the Parties should pursue opportunities to use markets to achieve cost-effective abatement. This language could be interpreted as being as close as one can get – under the circumstances – to an agreement on linking of markets. This is especially so in light of the commitment to raise USD 100 bn from public and private sources. It is clear that this amount of funding cannot be raised without the development of a viable carbon market.

### Uncertainties even for European Emission Trading Scheme

On the negative side, the absence of any language on reform of the Clean Development Mechanism (CDM) and the lack of specificity concerning carbon finance mechanisms in general – be they for REDD or technology – are leading to uncertainties about even the most established market of all, the European Emissions Trading Scheme, by undermining demand for post-2012 Certified Emission Reductions (CER) and new project development.

The High Panel set up by the Accord should move quickly and include CDM reform in its work agenda. It is important that such reform be tackled quickly for at least two reasons: First, the current CDM cannot deliver the tons of CO<sub>2</sub>e reduction demanded by existing and contemplated trading systems. For example, legislation passed by the U.S House of Representatives included up to 1 Gt of offsets from international sources alone. By comparison in 2008, the CDM delivered roughly 325 m tons. And second, without a

multilateral mechanism there is a risk that individual trading schemes will define their own standards, as already contemplated under legislation passed by the U.S. House of Representatives. Europe in particular should have an incentive to strengthen the multilateral mechanism the EU ETS has relied on.

### **Impact on national policies**

All countries have been asked to report their commitments and plans for climate action by January 31, 2010. Many of these targets were announced prior to Copenhagen. Others were announced in the course of the meetings. For example, Japan announced that it would register a target of 25% reduction below 1990 levels, and Brazil signed into law its target of reducing GHG by 39% compared to a business-as-usual scenario.

There are already many market incentives to support clean technologies (where German companies occupy a leading position). All major countries have formulated goals to increase their share of renewable energies, increase the energy efficiency of their economies, reduce wastage of natural resources and the like. Among developing economies, green growth will accelerate in countries already committed to such a growth path such as Mexico, Korea and Ghana.

Moreover, governments will be driven not just by the climate debate itself but by the realization that the green economy generates investment and jobs – low-carbon growth and prosperity – and can improve national competitiveness. For some countries energy security has also been a key driver of policies, notably the key players in the Copenhagen Accord, the US and China. The renewed steep rise in oil prices to over USD 80/bbl will only reinforce the debate over energy security and the diversification away from high carbon fuels.

In the United States, the outcome at Copenhagen has been seen as slightly positive as a result of major emerging market economies agreeing to mitigation targets and MRV (monitoring, reporting and verification), two significant political demands that President Obama is credited with helping to deliver. Nevertheless, passage of a comprehensive economy-wide climate bill in 2010 remains an uphill battle. At the same time, Congressional leaders remain focused on green energy incentives and mandates that can be tied to job creation.

### **Implications for the energy sector**

Moves toward energy efficiency and alternative energies (renewables) continue to be supported by market trends, including the (unexpectedly) fast recovery of energy prices, especially for oil.

- Energy efficiency and renewable energies will of course remain on the agenda, in the short term as well. The Copenhagen outcome will therefore have an only limited negative impact on the growth of renewable energies.
- Manufacturers of new green technologies – such as German and Swiss engineering companies – had pinned their hopes on Copenhagen providing an additional boost for their innovative climate solutions. We think their future-oriented products (e.g. more efficient and cleaner power plants, modern solutions for the production and use of wind, biomass, solar or geothermal energy) will find markets perhaps even sooner than they expected.

## **Green economy as job engine**

## **Market trends support move towards renewables**

**Tighter regulation in US as driver**

- In western Europe the use of fossil fuels will remain subject to tightened regulation, regardless of the Copenhagen Accord:
- 1. The currently debated life extension of German nuclear power plants could make investments in coal or gas-fired plants less likely.
- 2. The North Seas Countries' Offshore Grid Initiative, launched jointly by nine states at the end of 2009, will bring 100 GW of green (wind, tidal and hydro) power to the European electricity market and help Europe to meet the EU's 20-20-20 targets. The EUR 30 bn project can replace the construction of around 100 coal-fired plants.
- Last year, several U.S. utilities announced the early retirement of older coal facilities in anticipation of a tighter regulatory environment. In addition at the state level, numerous permits for new coal power plants were withheld in order to avoid subsequent liability. Going forward, we believe that some form of climate/energy legislation or EPA (Environment Protection Agency) greenhouse gas regulation will act to constrain US reliance on carbon fuels. Alternative energy tax credits, renewable electricity standards, and the clean energy bank proposals are still very much in political favour. If a comprehensive cap-and-trade bill proves too ambitious in 2010, it is possible that environmental groups may coalesce around a narrower approach that covers power utilities and refiners only.
- Business anticipates change in other areas as well. For example, at the end of December, 15 major Canadian, German, US and Mexican airlines agreed to procure bio-based and synthetic jet fuel from two U.S. providers. While non-binding, this agreement importantly paves the way for alternative fuel purchase agreements.
- Large scale industry initiatives like Desertec, which aims to deliver CSP (Concentrating Solar Power) electricity from the Sahara to Europe, combine business interests with political objectives such as energy diversification and energy security. Public-private collaboration on projects such as Desertec and the like will be crucial elements of our energy future.

**Building trust and a way forward**

One way for the most advanced countries to contribute to a trust-building exercise is to register and implement policies that have been conditionally flagged, such as the 30% reduction by 2020 in Europe and the 25% reduction in Australia. If climate or energy legislation is passed in the United States before the middle of 2010, this would also be a crucial trust builder.

It is also important that developed markets do not introduce protectionist measures in the name of climate policy, be they in the form of trade barriers, product standards that favour local producers or even requirements to buy domestic products.

At the same time, other leading emerging market economies, in particular China and India, should take note of Brazil's decision to implement a binding target domestically and take similar action. This would also help to build trust internationally while respecting sovereignty and common but differentiated responsibility.

The second way for introducing trust is to mobilize funding. The Accord establishes a new "Copenhagen Green Climate Fund" to manage the amounts pledged in Copenhagen. It provides that the

Fund will be part of the Convention's Financial Mechanism. However, this is not possible without a COP decision. Unless all Parties can agree, at the next COP or later, money raised under the Accord will have to be managed outside the Convention.

Launching public-private finance partnerships will be crucial to the rapid identification of areas other than forestry for the fast-start funds committed in Copenhagen. Rapid deployment will be the sine qua non for rebuilding trust between developing and developed countries.

#### **Bilateral funding mechanism**

European countries and other leading economies should therefore quickly explore bilateral funding mechanisms, in particular those that will leverage maximum amounts of private capital to support mitigation action in emerging markets. For example, a public-private fund that helps co-finance the feed-in tariff in the host market that would at the same time make investment more attractive for private investors and help boost exports.

In addition, creative public-private mechanisms must be put in place to address the significant risks investors face when it comes to large scale deployment of renewable technologies as well as the shortage of capital, especially on the debt side.

#### **Three-pronged approach**

More generally, the experience to date suggests that in order to make meaningful progress on a legally binding agreement during the course of 2010, a three-pronged approach should be pursued:

1. The UNFCCC must be willing to distil the lessons taught by the Road from Bali to Copenhagen in order to achieve greater success at COP-16 in Mexico at the end of the year. One of the conclusions may well be to separate the discussions concerning the financing of adaptation from discussions regarding future mitigation actions;
2. Meaningful progress was made, but too late, in smaller groupings. The G20, the MEF (Major Economies Forum) and even ad hoc groups such as the one that drafted the Accord should be key for hammering out substantive and detailed understandings on mitigation in the months ahead. Carbon market reform must become an integral part of the discussions;
3. Bottom-up actions from the private sector as well as bilateral agreement between countries on financing technology transfer and mitigation – building on examples of the Norwegian forestry fund – are important components for progress in the absence of a fully-fledged international treaty.

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## Appendix\*

### Key elements of the Copenhagen Accord

1. Action should be taken to limit the increase in global temperature to no more than 2°C against pre-industrial levels, and – crucially – retains the Kyoto principle of 'common but differentiated responsibilities'
2. Global emissions should peak as soon as possible. While 'recognizing that the time frame for peaking will be longer in developing countries'
3. There should be enhanced action on adaptation
4. Annex-1 countries should submit non-binding quantified economy-wide emissions-reduction targets for 2020 to the UNFCCC by end-January 2010
5. Non-Annex-1 countries should submit nationally appropriate mitigation actions (NAMAs) to the UNFCCC by end-January 2010, and that non-Annex-1 countries should report their emissions and actions to the UN every two years; it further states that only actions benefiting from international support should be subject to international verification
6. Measures and mechanisms (including REDD-plus, 'to enable the mobilization of financial resources from developed countries) should be established immediately to cut emissions from deforestation
7. The COP has decided 'to pursue various approaches, including opportunities to use markets, to enhance the cost-effectiveness of, and to promote mitigation actions', and that 'developing countries, especially those with low emitting economies should be provided incentives to continue to develop on a low emission pathway'
8. Developed countries should provide USD 30 bn in financing to developing countries by end-2012, with this number rising to USD 100 bn per year by 2020 from both public and private sources, and that 'a significant portion of such funding should flow through the Copenhagen Green Climate Fund' (see point 10 below);
9. 'A High Level Panel will be established under the guidance of and accountable to the Conference of the Parties to study the contribution of the potential sources of revenue, including alternative sources of finance, towards meeting this goal'
10. A Copenhagen Green Climate Fund should be established to administer the financial mechanism to be established under the Copenhagen Accord
11. A Technology Mechanism should be established 'to accelerate technology development and transfer in support of action on adaptation and mitigation'
12. 'An assessment of the implementation of this Accord is to be completed by 2015', and that this 'would include consideration of strengthening the long-term goal referencing various matters presented by the science, including in relation to temperature rises of 1.5°C'

\* See Lewis, M. and I. Curien (2009). It's tough at the COP: After the confusion, uncertainty..., Deutsche Bank Global Markets Research. December 20, 2009.

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