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**REINVENTING THE CLIMATE NEGOTIATIONS:
AN ANALYSIS OF COP6**

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Reinventing the Climate Negotiations: An Analysis of COP6

Christian Egenhofer & Jan Cornillie*

Executive Summary

With the cancellation of the Oslo ministerial mini-summit, the prospects for an early entry into force of the Kyoto Protocol are rapidly fading. Even if the US agrees to an outcome at a resumed COPbis in July, continued Congressional opposition and unresolved questions concerning the developing countries' commitments make US ratification highly implausible.

This puts the European Union on the spot. The EU has declared on several occasions that if the Kyoto Protocol failed to be ratified by the requisite number of Parties, it would demonstrate its leadership by undertaking a unilateral reduction commitment. Has the EU's hour of glory finally come? Or is it bluffing? The answer lies in whether the EU is actually able to summon up the courage of its convictions and takes the decision to ratify the Protocol unilaterally. Given the current deadlock, this may be the only way to implement the Kyoto Protocol. Moreover, it may not merely be the only way, but it may also have the effect of speeding up ratification. And speed is now of the utmost importance. The urgent reality of climate change has just been confirmed by the IPCC's Third Assessment Report. Further delays to implementation will also increase compliance costs.

Would unilateral ratification make sense – either politically, legally or economically? Our response is yes, in all three respects. First, EU environmental ministers are on record as having pledged to undertake a unilateral commitment in case of non-ratification. The moment to make good on that pledge is now, given the state of the negotiations and the results of the

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¹ Com(2000)87 final of 8 March 2000.

Third IPCC Assessment Report. A show of commitment and good faith by such a large participant as the EU can only have a salutary effect on the proceedings. The legal implications of unilateral ratification are tied to the EU's burden-sharing agreement, which is the pillar on which all the EU climate change policy rests and will become legally binding with ratification. In the absence of ratification, there is a risk that the burden-sharing agreement would unravel, depriving the EU of the very basis of its climate change strategy and it would also undermine its ambitions for leadership. The most difficult part of the equation is the economic dimension. By building alliances and effectively using flexible mechanisms, the potentially harmful economic effects of unilateral action can be minimised and transformed into an advantage, at least in the long term. The EU should push for early CDM at COP6bis or COP7 to encourage cooperation on the part of developing countries. Some EU member state governments are giving serious consideration to embarking on JI alone with the Central and Eastern European and CIS countries, based on bilateral protocols, until the international negotiations catch up. In any case, domestic EU-wide emissions trading along the lines of the Commission's Green Paper (European Commission, 2000) can and will be pursued independently of progress at COP6. There are also signs that Russia/Ukraine and other CIS countries are interested in stronger cooperation with the EU and that Russia/Ukraine has a strong interest in seeing the Protocol enter into force. People are increasingly realising that the fears over "hot air" are grossly exaggerated. The study of monopolistic behaviour tells us that Russia/Ukraine is unlikely to sell regardless of price developments.

Such an EU-Russia/CIS-developing countries alliance would go some way towards ratification and entry into force of the Protocol. Eventually, Japan and other Umbrella Group countries might become interested in joining rather than staying outside the club. After all, trading opportunities were always meant to act as an incentive to join. This is why the business community has broadly supported the COP process. Although this strategy is ambitious, an analysis of the potential motivations of the various groups of countries to come on board suggests that it is also feasible.

Such an approach however, will necessitate changes within the EU. Rather than chasing the chimera of US ratification, the EU should focus on alliance-building. But to build alliances, the EU must first put aside its internal squabbles. This will be the biggest single task of the current Presidency and even more so for the incoming Belgians. In order to strengthen the EU negotiating position, it will also be necessary to more deeply involve ministers dealing with

economic and trade affairs via a shared distribution of responsibilities between environment and economic/trade ministers, as occurs for example in Finland. Climate negotiations seem to have outgrown environment ministers. The Hague was as much about economic policy as about the environment. Some additional proposals for improving the EU's performance in climate change negotiations include the involvement of professional negotiators from the Foreign Offices, redefining the role of the European Commission, and more generally, making better use of COREPER. Their feasibility should be further investigated.

Regarding the *immediate COP6bis/COP7 strategy*, it is crucial that the EU endorses flexibility somewhat more but continues to remain strict on compliance so that the Umbrella Group would be obliged to publicly support a loosely binding agreement, if that is what the constituent countries want. There are signs that the EU is moving in the direction of such an approach. At the December Environment Council, the EU was more conciliatory on flexibility (notably sinks) but stood firm on compliance. Equally, the EU should use the conflicting positions within the Umbrella Group on developing countries' participation as an opportunity to strengthen its ties with Russia and all of CIS and developing countries. Russia and other CIS have an interest in seeing the Protocol enter into force, not least because of the trading opportunities. US-style developing country participation, on the contrary would undermine the dominant position of Russia/CIS in "hot air". And one should not forget that any Annex I deal should not neglect developing countries' concerns. A clear EU position on funding has to be worked out which facilitates moderate and isolates hard-line G77 Parties. Any stance that is softer than that taken by the US will incline developing countries to look favourably towards the EU.

At COP6bis, the EU should push for early CDM – on which agreement was almost reached in The Hague. On the domestic level, the EU should – and almost certainly will – move quickly on EU emissions trading, gradually incorporating the CEE candidate countries as they join the EU. This approach will establish efficient flexible mechanisms at the heart of EU climate change policy, which will keep the business community – so far a major driver – on board as well as the developing countries and Russia/Ukraine and possibly some Umbrella Group countries. Time will be working for the EU. Those unwilling will not be able to drag their feet forever. Climate change policy will not go away. Even if the Kyoto Protocol fails, the UNFCCC is still in force.

Introduction

The Oslo ministerial mini-summit has not taken place. The short-term Pronk strategy for brokering a deal has failed. Negotiations finally broke down following a last round of teleconferencing between Annex I Party ministers. The Umbrella Group pulled the plug by rejecting the five-point negotiating plan the EU had come up with at the December Council meeting of the European environmental ministers. In the days immediately following adjournment in The Hague, some observers erroneously suggested that another 48 hours was all that needed to clinch a deal.² As we now know, however, time was not the real problem. The reasons for failure are more fundamental and include:

- i) a lack of political commitment on the part of certain Parties (mostly Umbrella),
- ii) an inadequate mandate given other Parties (mostly the EU), and
- iii) the inability of the UNFCCC's multilateral decision-making process to deal with complex implementation issues.

A potential additional reason for failure, namely the lack of real involvement of developing countries grouped mainly around the G77, India and China, did not come into play this time since negotiations broke down before these countries could have their say. One should expect, however, to have to reckon with their participation in the future.

In the light of the bleak prospects facing COP6bis, we strongly feel the need for an analysis of what has gone wrong and how the negotiations can be revived in a different form. We can already draw one conclusion at this stage: more effective approaches must be developed for implementing the Kyoto Protocol, possibly even entailing a complete reinvention of the climate negotiations. This paper attempts to analyse events at COP6 and the cancellation of the Oslo ministerial mini-summit in order to draw conclusions for a more effective EU strategy in the future. It consists of two sections. Section 1 analyses the performance of the three main actors – the Umbrella Group, the EU and the developing countries – and also examines the UN decision-making process itself. The second section proposes a new EU strategy and outlines its principal elements.

1. The politics of the negotiations

The COP6 negotiations in The Hague increasingly turned around the dynamics of the relationship between US and EU, with the developing countries left on the sidelines to be courted later by both. The key to an agreement, therefore, lies in the interaction between these

² At the time, we too concurred with this view (see Egenhofer, 2000b).

three groups. In this section, we briefly analyse the performance of each of these groupings in the negotiations.

1.1 The Umbrella Group: Star alliance or climate rogue states?

Some observers question the commitment of certain members of the Umbrella Group to establish an effective and binding Protocol. The behaviour of the Umbrella Group reinforced this suspicion in the final night of post-Ottawa teleconferencing. The EU had put forward a proposal containing five key issues on which it was prepared to negotiate without preconditions: sinks in the first commitment period, no sinks in CDM, mechanisms tied to compliance regime, strict liability rules and stress on domestic action.³ One observer described this move to issue a constructive proposal as an attempt to switch to a more offensive strategy. The underlying negotiating position could be seen as an attempt to save the architecture of Kyoto while allowing flexibility on the “furniture”. When the Umbrella Group vetoed any substantial language on eligibility and liability rules for trading and on supplementarity, negotiations broke down and the mini-summit in Oslo was cancelled. This result has fuelled speculation that some Umbrella Group members do not really want a binding treaty anyway. The rejection of the EU proposals reveals that not only are the targets problematic for these countries, but also the long-term commitment to any legally enforceable agreement on climate change.

In hindsight, one can now ask whether the US negotiator, Frank Loy, was serious when he pronounced a near-deal that final night in The Hague? Or was he bluffing in order to induce the EU to give in after having kept firm till the very end? The support of the NGOs and continental European press for the final EU position at The Hague was almost unanimous, except for the UK.⁴ In an attempt to temper the EU’s self-confidence in the wake of COP6, some threatened the EU Parties with the difficult prospect of negotiating with an unwilling Bush administration. Given that the EU needed the deal more urgently than did the US if it were to achieve its aim of ratification in 2002, and given the worrying prospect of the Bush presidency, it was thought that the EU would agree to a compromise. Within the EU, the UK, represented by John Prescott, the British Deputy Prime Minister and minister for environment, transport and the regions, pushed – or rather hit – this alarm button very hard, but in vain. Seen from this perspective, the pressure exerted on the EU in the post-Hague

³ See Council Conclusions of 18 December 2000: <http://ue.eu.int/newsroom>

⁴ The UK media took the view that the UK has done all it could to reconcile the US and the EU, but its attention was quickly diverted by the more sensational Prescott-Voynet row.

period could have been nothing more than another negotiating trick in Loy's arsenal. Others dismissed the Ottawa-Oslo attempt as a display of end-of-career vanity on the part of President Clinton or as a Democratic attempt to smuggle a Trojan horse into the Bush administration. Whatever incentives the Umbrella Group may have had to continue negotiating after The Hague, they were not reinforced by a sufficient shift in the negotiating position to make a deal with the EU feasible.

The Kyoto negotiations have been handed over to the Bush administration in this incomplete state. Christina Todd Whitman, the head of the US Environment Protection Agency, strongly suggested that the US supported the goals of the Kyoto Protocol. Bush generated concerned reactions from the EU when he indicated in a letter to Republican senator Chuck Hagel that he opposed the Kyoto Protocol and that, contrary to an election campaign pledge, he would not seek to impose mandatory emission reductions for power plants. Nevertheless, there are no signs yet, that the US will pull out of the negotiations. With American public opinion and the business community increasingly supportive of a firm climate change policy – which explains the falling away from the Global Climate Coalition and the recent embrace of the Pew Center for Climate Change – will Bush risk attracting the label of big polluter, thus making him an all too easy target for Democratic opposition? Some fear that Bush will do just the strict minimum, enabling him to avoid losing face on the issue but without displaying any real enthusiasm for or commitment to reaching an agreement. It is also suggested that the US would want to renegotiate its target. This seems to be a very dangerous strategy for renegotiating one element would open the door to renegotiating the whole Protocol – a scenario most observers and negotiators regard with horror.

One card the Bush administration is likely to continue to play is the question of developing country participation, which would have the advantage, among others, of keeping him on firm ground with Congress. Bush's statement that the Kyoto Protocol is fundamentally unjust to the American people suggests that this may be his strategy. Refusing to approve any extra transfers of money to developing countries or to UN bodies or tying them to a reduction commitment could offer an easy opt-out. Moreover, action of this kind would be almost completely consistent with the US position at COP6. One observer noted early in the COP6 negotiations that the US would keep the developing country issue in reserve as a possible pretext for opting out in the future. In the final night of COP6, Loy's closing statement is reported to have been that the US wanted to see the transfer of \$1 billion in additional

financial resources to developing countries over the *whole* commitment period and not just annually.

If the US follows this strategy, the EU might respond by strengthening its ties with the developing countries building on the latter's desire for transfers, and with Russia and other CIS countries that might be interested in selling at least some of their excess permits. Russia appears to be willing to play a more constructive role after having been heavily criticised for weakening the Protocol with "hot air", although its negotiating team appeared to be split at The Hague and its final position was unclear. So far, contrary to its public pronouncements, there is no real sign of change in Russia's strategy. But US-style developing country participation, including an emissions target, is not necessarily in Russia's interest, as LDC participation would erase their dominance of the GHG permits market⁵ enjoyed by Russia. Hence, the EU could exploit this conflict between the US and Russia to build an alliance with the latter. There were also signs that some members of the Russian negotiating team were interested in using JI as a means of attracting investment in their energy system, and were prepared in return to give somewhat on "hot air".

For all the speculation about the US position, it should not be forgotten that the Umbrella Group is in itself not homogeneous. The Ottawa meetings have shown that the Umbrella Group is unable to take a uniform line. Umbrella Parties vetoed different issues while showing flexibility on others, which were vetoed again by other Umbrella Group Parties. Once the united stance for flexibility becomes obsolete, is there anything left that would unite them? Countries such as Norway and New Zealand have advocated environmental integrity with increasing support from countries as diverse as Korea and Switzerland but also Mexico and Liechtenstein. As for Japan, there seems to be some interest in seeing that the Protocol that carries the name of its ancient capital does not become associated with failure. Australia has become less vocal in the negotiations since it is generally considered to have obtained a good deal under Article 3.7 (baseline adjustment) of the Kyoto Protocol. In general, it should be noted that different priorities underlie a united Umbrella front. From the Hague and Ottawa negotiations, one could state that a generous interpretation of sinks is the *conditio sine qua non* for the US and Canada, whereas Japan and Australia put more a higher premium on compliance mechanisms that are not excessively binding.

⁵ Current estimates assume that Russia might control up to 50% of total reductions of potential import countries.

One might question the seriousness of any commitment if the flexible mechanisms are not backed up by a strong compliance regime. Making the case for flexibility is one thing, opposing enforcement rules is another. The need for a strict compliance regime in an emissions market is textbook economics. Theoretically, trading is strictly limited to Parties that comply with monitoring and verification schemes. The compliance regime itself demands a penalty for non-compliance that is higher than the price of permits. These considerations seem to underlie the decisions of the EU Environmental Council of December (summarised in Annex I). An insistence on the EU position on eligibility for trading and on compliance is likely to make the heterogeneity of the Umbrella Group even clearer and hence, make it possible to blame the Umbrella Group for not being serious about reaching a deal. Whether that was the strategy or not, the ambivalence of the Umbrella Group members, other than the US, towards such issues as compliance has become increasingly clear since The Hague.

1.2 The European Union: A self-proclaimed winning team

Soon after it claimed that no agreement was better than a flawed one and turned down a deal brokered by Prescott – thereby precipitating the failure of The Hague negotiations – the EU went public with its internal squabbling. Regardless of who wrecked the possible late-night deal in The Hague, the EU's performance at The Hague was clearly flawed.

It seems that the post-Hague row between Dominique Voynet and Prescott revealed mainly one thing, namely how electorally vulnerable both ministers are. Prescott is said to be desperately in need of a deal to shore up his poor record in the run-up to the elections in spring-summer 2001. Voynet's small but hard-headed electorate would relish quixotic battle against the giant US. It is suggested that the Germany's environment minister Trittin faces similar pressures from his domestic constituency. All three are said to be dominated by strong Prime Ministers and equally strong finance ministers.

On the substance of the negotiation, one can add that the climate talks have somewhat outgrown the environmental ministries and now increasingly combine environmental with economic concerns. The difficulties associated with an under-representation of economics and trade ministers are best be illustrated by the ill-fated discussions on the emissions trading liability regime at the pre-COP6 Environmental Council.⁶ EU environment ministers seemed

⁶ The EU proposal for a "mixed liability" system makes the seller responsible in principle for the validity of the permits. But even if environment ministers could trust those trading, in addition they would like to be able to prevent the buyer from using assigned amounts until the seller proves that he is in compliance. In fact, those

to have been guided by the desire to have absolute certainty and to keep both buyers and sellers responsible for “bad” permits. Even prior to COP6, we suggested that EU environment ministers should work more closely with their trade and industry counterparts on how best to create a simple and effective trading environment. It might therefore be a good idea to integrate trade/industry ministers more closely in the international climate change policy process. Not only would they add to the seriousness of the climate talks, but they would also be likely to have a more powerful mandate and more discretionary power with which to negotiate.

Some member states have already taken steps in this direction. In Finland, for example, climate change negotiations are conducted by the environment minister, whereas implementation of the national strategy falls under the responsibility of the minister for trade and industry. Such a division of competencies would do more justice to the economic realities of climate change policy. Prior to and during COP6, such a balancing act was also going on within the Commission between DG Environment and the other DGs involved in the implementation. It is worth noting that the lead role on climate change in the new Bush administration for UNFCCC negotiations remains with the State Department, but the Department of Commerce has been given responsibility for overall co-ordination of the US position. Sharing responsibilities between environment and economics and trade ministries has the additional advantage that final arbitration is likely to be done by the Prime Ministers, which in turn should heighten their sensitivity to climate change. Ultimately, the issue might then be dealt with in more depth at the European Council, the body where all major decisions are taken. Perhaps it will require the direct involvement of the Prime Ministers and the Presidents of Parties to the UNFCCC and the Kyoto Protocol before a deal can be struck. If one looks closely, some sign that this already happening can already be detected. Both Blair and Clinton are reported to have exchanged phone calls during the negotiations. The Belgian Prime Minister Verhofstadt, who will hold the EU Presidency at COP7, is also said to have a strong interest in climate change.

Ultimately, EU governments will have to ask themselves whether the EU approach of keeping climate change largely outside the COREPER structure will ensure efficient and effective negotiations. In the long-term, it might be more effective if the European

willing to trade get the worst of both worlds: seller liability, and buyer liability. This appears to be a recipe for putting an end to emissions trading before it has even started. If the risk incurred with buying is too high, however, there will be no trade. See Egenhofer (2000a).

Commission were to lead climate change negotiations as is the case for trade, including most services in the future. Presidencies do matter, perhaps too much, as COP6 has shown. The EU position under the French presidency was too strongly in opposition to the Umbrella Group, and some diplomats thought that this inhibited a constructive evolution to a final agreement in the last night.

It might be interesting to draw an analogy between the COP6 negotiations and the temporary failure of the Uruguay Round trade negotiations in Brussels. The immediate conclusion of Renato Ruggiero, then Italian Trade Minister and holder of the Presidency, was that one reason for failure was the lack of trade ministers in the EU, ministers who had actually mastered not only the details of trade but also the necessary negotiating skills. We are not suggesting the creation of climate change ministerial posts. Rather, we would like to see the strengthening of the negotiation capacity. This could be done for example by a stronger involvement of professional negotiators from the Foreign Office as has been suggested in Italy. It is worth noting that the US has treated climate change talks as if they were international trade negotiations.

With the benefit of hindsight, we can say that the indecisiveness at The Hague adds one more black mark to the poor record of the French EU presidency. Insiders pointed to the language barrier and the lack of leadership shown in efforts during the first week to coordinate a European position. It is not clear whether the outcome of either Nice or The Hague could have been notably improved had the presidency been better co-ordinated and had the French President himself not been so abrasive. The second week at The Hague had been dominated by the Franco-German alliance between Voynet and Trittin, who jointly maintained a strong position till almost the very end. Some EU officials felt that the hostility against the US and the lack of high-level preparation were counterproductive. As Voynet remarked in the final plenary, the US has always in her opinion been the enemy, among the worst of the polluters. At The Hague, she continued, Parties had at least learned to understand each other, provoking some commentators to wonder what had she been doing for the last few years.

The EU was prepared to antagonise the Umbrella Group not only for electoral or substantive reasons. The tough EU stance could also be found in the anti-Umbrella Group position of the NGOs and possibly the public. In the middle of the first week, the favourable reaction of the EU to the softening of the US position on sinks was altered the next day after fierce criticism by some member states and the NGOs. From then on, the EU seemed to be all too cautious of

stepping on the NGOs' toes. After the conference, the NGOs applauded the EU for preferring no agreement to a weak agreement, but this honeymoon may be ending soon with the EU coming under pressure to strike a deal.

On the other hand, it should be noted that whereas the EU is usually seen as the weak negotiating partner, incapable of formulating a long-term strategy, the EU's position in The Hague and in Ottawa reveals the increasing shrewdness of the EU in contrast to the growing disarray among the Umbrella Group. The last round of negotiations belies the conventional view of the EU as a weak negotiating partner, incapable of speaking with one voice. This new strong line has boosted the EU's self-confidence, but it remains to be seen whether it will result in a stronger Kyoto Protocol or in no Protocol at all.

Although most EU member states have learned to understand and even appreciate flexible mechanisms, the general EU position remained more biased towards integrity at the expense of efficiency. The result was a stream of amendments creating institutional barriers to flexible mechanisms, most notably with the quantitative ceilings on trade. It can be argued that by doing this, the EU's stance has had the effect of overcharging the negotiations. To rephrase Abraham Lincoln's dictum, you can reject some flexibility some of the time, but you cannot reject all flexibility all the time. By firmly rejecting all of the limitations on flexibility, too many crunch issues entered the final negotiations, obscuring an easy deal with clear trade-offs. Accepting more flexibility in exchange for a strict compliance regime should have been an earlier EU strategy, thereby forcing the Umbrella Group to take a defensive position. Instead, the EU had to explain its proposal on ceilings over and over again, resulting in endless discussions on an issue that never had any chance of implementation. Moreover, some suggest that the EU put an emphasis on the right problem but lacked the vision on how to deal with it. For example, the uncertainties surrounding the scale, dynamics and verifiability of sinks might be clarified more quickly once there actually exists a market for them, rather than when they are altogether excluded from the agreement. By emphasising the short-term environmental integrity, the long-term progress towards a greenhouse gas concentration plan might be slowed down. It is ironic that the learning-by-doing approach written down in the Commission's Green Paper on emissions trading is no longer an objective when it comes to worldwide emissions trading. It is to be hoped that its domestic experience with emissions trading would enable the EU to make a strong case in favour of flexibility while maintaining an equally strong position on compliance. As was suggested

above, this would significantly clarify the negotiations and it would put the Umbrella Group on the defensive instead of the EU.

Although the environment and by extension climate change figure high on the agenda of the Swedish presidency, it is not yet clear what the current presidency can actually do, given the state of negotiations and the uncertainty regarding a date for COP6bis. The EU urgently needs to address the issue of how to deal with a possible COP6bis if it falls into both the Swedish and Belgian presidencies. Aside from the issue of timing, the negotiation package may have become so complex that it is becoming unworkable. Therefore, the Swedish presidency might find itself with the main task of finding an adequate way to settle the broad policy framework without specifying the implementation details. This could mean pulling the strings back altogether or agreeing to a major specification of the Protocol and finding a way to deal with the details by doing. The earlier this can be done, the more time the incoming Belgian presidency will have at its disposal to assume leadership of the EU delegation at COP7, which might still turn out to be crucial.

The biggest issue the Belgian presidency will face is ratification, or to be more precise, unilateral ratification. Even if the US agrees to an outcome at COP6bis or COP7, the prospects for US ratification, in the short-term if not the medium-term, are close to nil as a result of continued Congressional opposition to ratification, the questions of developing countries' participation and the new Bush administration. This puts the EU on the spot. Having declared on several occasions that if the Kyoto Protocol was not ratified, it would undertake a unilateral commitment, in order to maintain leadership. The Belgian presidency faces the hard choice of whether to push for unilateral ratification. Given the current deadlock, it is the only possible way to implement the Kyoto Protocol, but it might ring alarm bells in some quarters, and industry might worry about its implications for competitiveness.

There are three good reasons in support of unilateral ratification. First, if the claim of EU leadership is real, then unilateral ratification is the right choice, especially given the state of negotiations and the results of the IPCC Third Assessment Report. Moreover, ratification and entry into force⁷ of the Protocol is the best way to safeguard the EU burden-sharing agreement. Without ratification there is a risk that the burden-sharing agreement will unravel,

⁷ The burden-sharing agreement will become legally binding if the EU plus member states ratify and deposit their ratification documents. It could, however also enter into force via a Council Decision. Politically speaking, the results are the same. Why make the burden-sharing agreement legally binding if it is not linked to a GHG abatement policy?

depriving the EU of the very basis of its climate strategy and its claims of leadership. The most difficult part to justify is the economic aspect of unilateral action. Some assert that Europe will simply be shooting itself in the foot, but this does not necessarily have to be the case. By building global alliances with e.g. developing countries, CIS and some other Umbrella Group countries, combined with efficient use of the flexible mechanisms, the potentially harmful economic effects could largely be offset by the first-mover advantages it would accrue in both the short-term and the long-term. Why should the EU be reluctant to develop bilateral protocols to put the CDM, JI and ET into operation, at least for a transition period? In order to make such an approach credible, one precondition would be to involve the developing countries as well as the Russian Federation and other CIS. We argue that this can be done. It would however also require that NGOs remain broadly supportive of such a move. An EU-Russia/CIS-developing countries alliance would go a long way towards ratification. Japan and other Umbrella Group countries might become interested in such an approach. After all, trading opportunities were always meant to act an incentive to join. Finally, what better way accelerate – as we have said, speed is important – US ratification than to bring the Kyoto Protocol into force so that the US and its business community fear losing out on CDM/JI/ET opportunities? Although ambitious, the strategy is feasible.

The key to success for the Belgian presidency in such a strategy is to concentrate on building alliances with key negotiating partners and streamlining internal EU negotiations and coordination. The Belgian presidency might be particularly well suited for the task given the government's extensive experience in coalition governance. In that respect, the environment minister Magda Aelvoet was widely applauded as a very effective chairperson of European meetings at COP6. Moreover, Belgium is expected to avoid some of the mistakes of the French presidency since it is assumed in general to be less insistent on its own plan and more inclined to consult fellow EU member states.

1.3 Developing countries: The unknown quantity

The developing countries were often overlooked in The Hague negotiations. Issues of mitigating the adverse effects, technology transfer and capacity-building were overshadowed by discussions on flexible mechanisms and sinks. In the final night of negotiations as well as in Ottawa, the developing countries were made to feel ancillary to reaching a deal. Although it is true that many of their interventions and even more of their concerns boil down to transfers of financial and technological resources accompanied by the least conditionality possible, their claims should not be taken lightly. Apart from addressing genuine needs,

developing countries' desire for extra revenues from the share of proceeds might undermine the efficiency of the flexible mechanisms and their demands for additional transfers are likely to be vetoed by EU finance ministers as demonstrated in the recent action by the German finance minister Hans Eichel. As noted earlier, the Bush administration may find an easy pretext for opting-out in the form of the developing countries' position.

An Annex I deal that does not sufficiently address developing country concerns risks being vetoed in the UN plenary and would certainly not improve cooperation during subsequent COPs. More strategically, some delegates feared that the reluctance of the Annex I countries to commit themselves to extra financial and technological transfers allowed climate policy opponents such as Saudi Arabia to remain firmly backed by a united G77/China front. It was only after some vague promises were made that Nigeria as president of the G77/China could take a more compromising position, which was supported by the G77 but immediately scorned by Saudi Arabia. It should be noted that Iran, the next G77/China president and a proponent of the win-win doctrine, is more likely to take a more moderate position than did Nigeria. Annex I Parties should be wary of making moderate positions impossible by bluntly neglecting the developing countries' concerns.

In conclusion, developing countries have been progressively sidelined during and after COP6, whereas Annex I countries are increasingly reluctant to transfer additional financial and technological resources. Without reassuring signals from Annex I Parties, the moderates within the G77/China group will be easily overruled by the hard-liners.

1.4 It's the process

During and after COP6, it was widely felt that the text of the ever-expanding draft decisions had become unworkable. As one participant noted: 'The negotiations got too political for the officials and too technical for the politicians'. President Pronk's strategy consisted of reaching a political deal by Thursday in the second week that would have settled the framework for a complete and detailed agreement by late Friday. Although some delegates complained about Pronk's thinly disguised disdain for the work of the officials, he may have had no other choice but to sort out the political issues separately, given that the ministers proved incapable of dealing with the bracketed texts. The Pronk paper that was issued as the platform for a deal was rejected by almost every Party, but as he himself noted, the fact that no one had been able to improve upon it suggests that the paper might have been the only compromise possible. Even more than the content, the Pronk paper's timing and his call for

written reactions were criticised as being too late and counterproductive. The written reactions set back even further the poor progress that had been achieved by that time. The breakdown of the Ottawa negotiations, however, showed that timing was not the only problem. The positions of the different blocs and perhaps the process itself might not have been able to lead to a compromise agreement.

Given the significant efforts undertaken by most Parties and by the Dutch in particular to make The Hague a success, it can be asked whether the process is still capable of leading to a positive conclusion. Some dismiss this doubt by pointing to even larger agreements – the Rio Convention, in particular – that were concluded only after considerable delay. The comparison might be spurious, however. The Rio Convention dealt with the framework, the basic principles of an internationally coordinated climate policy strategy. What The Hague tried to do was to fine-tune the implementation of what was agreed in principle in Rio and Kyoto. This might be a too difficult a task for the UNFCCC. Apart from the workload and the problem of manageability of the process, the more fundamental political problem of clashing political cultures could underlie the sorrowful state of the post-Kyoto negotiations. Some Parties whose foreign policy is very much inspired by realism and deterrence, as opposed to cooperation, might have problems with the attempt to micro-manage the Protocol. Members of the Umbrella Group in particular and G77 Parties and China are wary of entering into binding agreements that could be seen as an infringement of their sovereignty and their legislative independence. It is not surprising that the EU, given its tradition of supranational cooperation, finds it less problematic to settle implementation details.

The Pronk strategy of negotiating an all-in-one final agreement, first politically and then technically, has failed. One negotiator noted that almost 90% of the draft text on the CDM had been agreed. Why then not agree on the CDM first at COP6bis or COP7 and settle emissions trading and the compliance regime at COP8 or later? One way to proceed could be to decide on the complete CDM package and to give the Executive Board some discretionary power in settling the standard procedures for monitoring, verification and certification. This would have the advantage that the carbon market in developing countries, allegedly the one with the highest transaction costs, could start already. This early CDM would yield experience on the merits of permits from emissions reduction projects and possibly from sinks. This experience could also be relevant for emissions trading and JI. Moreover, the permanent Executive Board could organise and develop consensus procedures for the CDM, setting the standard for the other mechanisms. This board could become a fundamental player

for the debate on standardisation while leaving room for businesses specialising in that area to develop the market. Early CDM would also get developing countries involved. Lastly, it could produce some real experience as to how much abatement the flexibility mechanisms could actually achieve. This information could be very valuable for negotiating targets for the second commitment period, prior to the first. The verdict on the effectiveness of the CDM is still out. Project mechanisms will run against transaction costs, which are an inevitable feature of setting emissions baselines. Such costs would matter less if the potential rewards were bigger.

We should not overlook the fact, however, that separating CDMs from the other flexible mechanisms at this stage in the negotiations may make their integration into a single trading scheme increasingly difficult. It is also worth mentioning that such an early CDM policy might run into opposition from NGOs, which do not want CDMs nor any flexible mechanisms to be more than “supplemental”. NGOs also insist that choices on eligible technologies will remain in Annex B countries’ remit. Rightly or wrongly, the economic fact is that supplementarity might be a key element in making the CDM effective or obsolete. Further complications may also arise from the question of how the share of proceeds from each CDM project, which has the effect of a tax, is distributed. On the other side of the NGO spectrum, there are signs that industry is becoming worried about the direction in which the discussions on the CDM are going.

Provided that the benefits of early CDM are larger than the risks associated with the approach, Annex I Parties can simultaneously experiment with emissions trading domestically and settle the international rules subsequently on the basis of their domestic experience. The EU should be well prepared for such a strategy. The EU emissions market would enable it to transfer EU experiences to an international regime, if and when prospects for a deal become real. Moreover, as suggested above, the EU could go it alone with CDM and JI by already making it an extra possibility in an EU trading market. In any event, EU enlargement will quickly bring the number of countries being able to trade to 20 or even 25. This might pave the way for a considerable emissions trading market. An EU emissions market would not only give valuable experience; if carefully designed, it could deliver a exemplary policy framework showing how environmental integrity can be combined with economic efficiency. Thus, going it alone could allow the EU to demonstrate the strong eligibility and liability rules it adheres to in the international arena. It can be hoped that other

Parties would develop domestic markets too. The rules for Kyoto emissions trading and for the compliance regime could then be established after COP7.

This two-track strategy – a quick decision on CDM and regional trading prior to an Annex I trading decision – could give the necessary signal to the business community that the long-term process remains on track. It must be noted that the business community is showing signs of nervousness. Is it right, senior management asks, to spend a company's precious resources on climate change rather than other, more imminent environmental issues? This nervousness can be assuaged if a deal is struck at last at COP7 or if a regional alternative emerges. If not, however, this nervousness might quickly translate into a revision of business plans. In the aftermath of Kyoto, a whole new business of decarbonisation has emerged. In a relatively short span of time, a lot of knowledge and experience in preventing climate change has been gained. There is widespread conviction that this business dynamic could lead to greenhouse gas reductions far beyond the actual Kyoto targets and should therefore be nurtured.

2. Towards a new EU negotiations strategy

Irrespective of whether COP6 finally delivers a deal – mainly between the US and the EU – the proceedings of COP6 so far and the changes in the US government mean that US ratification is still far off, at best. But what will be the consequences? A scenario in which governments confess to their electorates that Rio, Kyoto and all subsequent COP negotiations have been a mistake and that effects of climate change are not really as bad as we thought, cannot be seriously considered. And it is even less plausible after the IPCC's Third Assessment Report. Furthermore, even if the Kyoto Protocol fails, the UNFCCC will remain in force. Similarly, scrapping the Kyoto Protocol and launching into fresh negotiations on a new Protocol is hardly a realistic option either. Any attempt to renegotiate only a part of the Kyoto Protocol is seen as opening a Pandora's box and should therefore be avoided at all costs. We can also safely dismiss other approaches characterised by one observer as "scientists trying to push their pet ideas", as they would surely be tabled again, e.g. a global carbon tax, on grounds of improbability. Precisely such a proposal was rejected in Rio and we see no reason why it would be received differently this time round. This leaves us little alternative but to continue with the Protocol we have, which might turn out to be the best possible scenario. This is both comforting and worrying. Worrying because virtually no concrete political progress on its implementation has been achieved in the intervening three years since its Kyoto negotiation. Comforting, because the reference framework in which we must operate has not changed and we therefore do not need to start from scratch.

If declaring the Kyoto Protocol dead is not a serious option, if timing alone will not resolve the current deadlock, and if there is no quick fix in sight to the negotiation strategy do, what can be done?

2.1 Concentrate on alliance-building rather than on the US

The EU should abandon its strategy of concentrating on the US. This has neither worked in the past nor during COP6 and in light of the change in administration, is even more unlikely to work in the future. And even if the US agrees to an outcome at a resumed COP6, US ratification remains highly unlikely due to continued Congressional opposition and the developing country commitments' question. The unilateral concentration should be replaced by an approach based on alliance-building with those most likely to benefit from entry into force of the Kyoto Protocol. Such an approach will need a rigorous re-assessment of the incentives leading different parties to ratify the protocol, i.e. an assessment of its potential costs and benefits.

The Kyoto Protocol offers plenty of incentives. As with most international agreements, it is based on flexibility to accommodate different Parties' interests and to address different concerns.⁸ It includes the following three elements: transfers, flexibility and international policy linkages.⁹ *Transfers*, for example, encompass the sharing of proceeds from the mechanism and compliance funds, but also directly dedicating subsidies for adaptation measures by small countries. *Flexibility* provisions include not only the Kyoto mechanisms but also bubbles as a way to increase inter-geographical flexibility and banking to encourage inter-generation flexibility. Hot air and sinks fall under both categories: flexibility and transfers. While they provide flexibility to the buyer, they constitute a transfer to the seller. With most people concentrating on flexibility and transfers, potential *policy linkages* (e.g. with trade or development agreements or more generally, foreign policy) have been somewhat overlooked. We recommend emphasising the link between climate change and R&D cooperation, which enhances technology diffusion.

We urge negotiators, especially those in the EU, to reassess how this flexibility can be applied to make a convincing case for ratification and entry into force.¹⁰ One precondition is

⁸ International agreements on global problems, such as greenhouse gas emissions, typically permit free riders to benefit from action taken by others without incurring the costs.

⁹ The following section draws heavily on Carraro and Galeotti (2001).

¹⁰ Strictly speaking, US ratification is not necessary for the Protocol to enter into force. Ratification by the EU, CEECs and CIS plus Japan would be sufficient to bring the Protocol into force. To become binding international

to acquire a better understanding of the socio-economic consequences of climate change, and hence the costs and benefits. By extension, we could then discern which incentives would be the most effective in enticing Parties to sign up.¹¹

The Umbrella Group is not as homogeneous as it is conventionally pictured, although the US seems still to be the dominant member. Thus, the incentives that could bring the member countries into an agreement will vary one from another. It appeared at COP6 that the aim of most members of the Umbrella Group was to negotiate a *non-binding* Protocol, which would represent a substantive and detailed promise to do something about global warming. That would be in the interest of neither the EU nor developing countries. By playing its strongest card, unilateral ratification, the EU might increase the pressure on Japan and Canada, which could not afford to fail to secure an agreement on grounds of diplomatic interest and green self-esteem. In the end, they could settle for an agreement based on a careful balance of flexibility and compliance. Japan is said to have an interest in preventing the Kyoto Protocol from being associated with failure and – although not at any price – it might be ready to pay a price, as it did in Kyoto. An emerging emissions trading system might provide a powerful incentive to both to move to an agreement.

For the US, another incentive apart from unlimited flexibility, would be the inclusion of sinks, much to the pleasure of the US agricultural lobby. That would however, mean, an implicit subsidisation of the US agricultural sector. If approached as a *policy*, there might be a link with the next WTO negotiation round on agricultural subsidies. This link might open new possibilities for a settlement of both areas. Fundamentally, however, there might indeed be something unfair about establishing a target on ‘gross’ calculations and reaching that target on a ‘net’ basis. We do not wish to speculate on whether the US wants to rewrite the Protocol. It appears however that the EU might tolerate a broad interpretation of sinks for one commitment period for the sake of a deal as the EU signalled in their Annex to the December Council decision (See Annex 1). This would oblige the US, however, to accept a “meaningful” compliance regime. So far, it remains somewhat unclear whether the US position on compliance differs from that of other Umbrella group members.

law, the Protocol has to be formally ratified by 55 Parties to the UNFCCC of which Annex I parties ratifying have to account for 55% of 1990 Annex I carbon dioxide emissions.

¹¹ Further research is therefore needed on the potential benefits (direct and secondary) of climate change policy as well on the damages inflicted on different countries. The recent study on the climate change effect on European regions (Perry 2000) financed by DG Research of the European Commission is a good start.

The incentive structure for Russia appears to be relatively clear. On the basis of the Kyoto Protocol it is granted a dominant position in the GHG permits market, the defence of which can be expected to be primary objective of Russia's negotiations strategy. The risk that Russia will sell all of its "hot air" is unlikely, however, given the negative impact on prices. Experience – and theory – suggests that Russia will sell to maximise profits. Hence, they will sell as much as is necessary to maintain the price. Moreover, overselling is also unlikely for more practical reasons of policy linkage. Russian negotiators increasingly realise that "hot air" is a double-edged sword. Although it is an asset, Russia is increasingly becoming the pariah of the climate negotiations. Will Russia risk weakening its negotiation position in a number of other – possibly more crucial – policy areas such EU and NATO enlargement, accession to WTO, EU-Russia energy trade or economic co-operation? Most importantly in our view, Russia might also see an advantage to use the international climate change regime as a means to foster investment through JI. The potential of JI for Russian investment is increasingly appreciated within reform-minded circles. Thus, reducing Russian incentives to sell "hot air" could be more effectively achieved by placing a priority on JI-sponsored investment in energy-efficiency. The EU should start exploring this gateway further.

The countries of the former Soviet Union consist not only of Russia and Ukraine. Further attention should be given to those countries not only in the context of the Kyoto Protocol but also in general regarding the EU's policy towards the CIS. New possibilities for alliances may emerge.

We pointed out that the EU's stance is still somewhat ambiguous on flexible mechanisms, obscuring the Umbrella position on compliance and overloading the agreement. However, we also found in the Annex to the December Council of environmental ministers a tendency to favour flexibility in exchange for strong compliance rules. Both the Swedish and the Belgian EU presidencies should concentrate on these points to present a clearer position, making the case for flexibility while exerting stronger pressure on the Umbrella Group regarding compliance. Such a position could be seen as an investment in future commitment periods. In case of an agreement, it can be seen as a solid EU achievement. In case of no agreement, it should be easier to blame the Umbrella Group for not being serious about climate policy.

The concerns of the developing countries – at COP6 largely overlooked in favour of the sinks and complementarity issues – are a clear case for policy linkage. One lesson is that Annex I Parties should take care not to provoke the G77/China by ignoring their needs for capacity-

building, technology transfer and adaptation measures. Although officially, G77/China want 'new and additional financial and technological means through a new and additional system' for all their concerns, they are not a homogeneous group. Most obviously, the Parties that strive for funding for adverse impacts of climate change are not so keen on calls for funding for adverse impacts of climate policy. Funding unites, but that may be the only thing. OPEC has very specific interests while African countries are mainly concerned that CDM projects will largely pass them by; hence a proposal for a quota system. Another example is sinks where there exist deep divisions. Most of the support for sinks comes from the countries of Latin America. To return to incentives, a replenishment of the GEF and an extension of its mandate beyond capacity-building to technology transfer and mitigation of adverse impacts might be a good basis on which to start an agreement, provided that the principal concerns raised by the various groups are addressed. Although this proposal may sound easy in principle, since it involves transfers, either direct GEF or indirect via CDM, EU Finance Ministers might object or at least cause a delay. We suggest therefore that the EU considers this case in principle and takes a decision on whether it will be willing to accept additional funding or not. Unless it is, it is hard to see how the developing countries will sign on.

2.2 Is agreement possible?

In Coasian bargaining theory, the question of whether or not there is an equilibrium in the core is important. Does there exist an agreement for the UNFCCC Parties that is better for everyone than no agreement at all or an agreement among small coalitions? Such an agreement seems difficult unless each Party will be satisfied to receive half of its bottom line. This seems to have been the negotiation strategy in the past – which has failed to date – and seems also to be the basis for the future negotiations. One should not entirely rule out the possibility of an agreement, and the December decision of the Environment Council (Annex 1) sets the right tone for such an agreement.

It might be the case, however, that no equilibrium is possible, at least not for everyone on all issues; and hence no deal. One of lessons of COP6 so far may be that it might not be a feasible goal of international policy-making to *micro-manage* the Kyoto Protocol. Buenos Aires postponed all important decisions to COP6 – with COP5 downgraded as a technical COP – without making much progress on technicalities either. Now that COP6 – to date – has failed to deliver, the question is whether the current intergovernmental process revolving around COP will be able to set implementation rules. Rather than continuing with intergovernmental negotiations on highly complex, interrelated and politically as well as

environmentally contentious issues, we suggest an alternative strategy, consisting of the following elements:

- Irrespective of the outcome of COP6bis/COP7, the EU should quickly move towards unilateral ratification.
- Parties should strive for an early deal on CDM and its Executive Board that could maintain the momentum and add valuable experience to subsequent negotiations. Trading and compliance rules could be settled later on the basis of experience with CDM and domestic emissions trading.
- Meanwhile, the EU and other Annex I Parties should aim at domestic emissions trading. Such a step would be environmentally, politically and economically advantageous. Domestic emissions trading together with the CDM decision would give a clear signal to the business community that climate policy is still on track. Some might oppose this as a step towards fragmentation and regionalisation of the Kyoto Protocol implementation. Regionalisation, however – as seen in The Hague – has already begun. Rather than becoming an obstacle to implementation, regionalisation eventually enhances the chances for effective implementation.
- In parallel, on the basis of an efficient use of the flexible mechanisms, the EU should concentrate on building alliances with developing countries, Russia/CIS and some of the members of the Umbrella Group. Carefully designed proposals by the EU should be able to provide enough incentives to those most willing to move towards ratification and entry into force.
- In order to be successful, the EU will have to address the question of how it conducts the negotiations. We propose a stronger involvement of ministers dealing with economic or trade affairs to increase legitimacy. Other issues to explore include the involvement of professional negotiators from e.g. the Foreign Office, the role of the European Commission and making better use of COREPER.

Annex 1. Conclusions of the Environment Council of 18 December 2000

1. A limited opening of Article 3(4) sinks with a tight cap can be accepted for the first commitment period as a political deal. But we need to decide now that for the 2nd Commitment period clear rules and guidelines based on scientific criteria must be established.
2. The EU sees major difficulties in allowing sinks in the CDM in the first commitment period.
3. Parties can use the mechanisms only insofar as they are legally bound by the compliance regime. This regime will contain inter alia clear economic incentives and a compliance action plan.
4. Parties can only be allowed to sell permits insofar as they have them. Overselling by Parties will be prevented if their net sales are limited to a very low percentage of their assigned amount. It is to be recalled that such a liability provision would not restrict acquisitions of permits.
5. The EU insists on domestic action as the primary part of each Annex I Parties' efforts.

Annex 2. Glossary of Technical Terms and Abbreviations

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| Annex B | Industrialised countries (including OECD and the former Soviet Union) that have agreed an absolute reduction target under the Kyoto Protocol (see also Annex 1). |
| Annex 1 | Annex 1 of UNFCCC is by and large the same as Annex B of the Kyoto Protocol, although some modifications exist. The two terms are often used interchangeably (see Annex B). |
| CDM | Clean Development Mechanism. Art. 12 of the Kyoto Protocol establishes that Annex I Parties (and firms in these countries) can transfer certified emissions reductions (CERs) from projects in developing countries. |
| CEECs | Central and Eastern Europe countries of, most of which will soon become EU members. |
| CIS | Commonwealth of Independent States, i.e. countries of the former Soviet Union. |
| COP | Conference of the Parties, consisting of representatives of governments. It is the supreme decision-making body of climate change negotiations. COP6 is the sixth Conference. |
| COP6bis | The COP6 in resumed session, due to be held in July in Bonn. |
| COREPER | Committee of Permanent Representatives, the EU member states' ambassadors, and a central element of the EU decision-making process. |
| CO ₂ | Carbon dioxide, the main GHG. |
| ET | Emissions Trading. generic term for trade of emissions certificates (see also IET, International Emissions Trading) |
| EU | European Union. |
| Flexible mechanisms | Transfer or exchange of emissions reductions obligations between Parties, sometimes also referred to as Kyoto mechanisms or mechanisms (see also CDM, JI, ET). |
| G77/China | The group of developing countries and China, negotiating jointly at the COPs. |
| GHG | Greenhouse gases, usually referring to the six gases covered by the Kyoto Protocol: carbon dioxide (CO ₂), methane (CH ₄), nitrous oxide (N ₂ O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulphur hexafluoride (SF ₆). |
| Hot air | Large quantities of unused emissions allowances in some Parties that could be traded in IET. Trade of large quantities could reduce the carbon price to an extent that it could move towards zero, thereby undermining efforts to invest in emissions reduction. Hot air stems from the fact that the targets under the Kyoto Protocol for some Parties are up to 30% higher than actual emissions (e.g. Russia, Ukraine) or uncertainties from land use changes (for the latter, see also Sinks). |
| IET | International Emissions Trading. Art. 17 of the Kyoto Protocol establishes that Parties (or firms within Parties) can trade parts of allocated emissions under rules of the Kyoto Protocol. Modalities still need to be defined. |
| JI | Joint Implementation. Art. 6 of the Kyoto Protocol establishes that Annex I Parties (and firms in these countries) can transfer reductions of emissions – in the form of Emissions Reduction Units (ERUs) – compared to a baseline for individual projects. |
| LDC | Less developed country. |
| NGO | Non-governmental organisation. |

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| NIS | Newly Independent States; EU jargon for CIS (see above). |
| Parties | Refers to Parties of the UNFCCC, meaning governments (including the EU) negotiating on climate change. |
| Policies & Measures | Sometimes abbreviated as p&m or PAM, refer to domestic GHG reduction policies in comparison to the use of Flexible Mechanisms. According to the Kyoto Protocol, Flexible Mechanisms are “supplementary” to p&m. |
| Pronk strategy | A two-phase strategy to solve all outstanding issues in one final agreement. First a political agreement should be reached. Thereafter the decisions texts should be agreed embodying the political agreement. |
| Sinks | Refer to changes in land use that have an impact on emissions levels through up-take (e.g. afforestation, reforestation) or increases (e.g. deforestation). Sinks are one of the issues still to be settled. |
| Umbrella Group | Negotiating group of Annex I Parties aiming for flexibility. The group consists of Japan, the US, New Zealand, Canada, Australia, Russia and Ukraine. |
| UNFCCC | United Nations Framework Convention on Climate Change, agreed at the Earth Summit in Rio (1992) to stabilise greenhouse gas emissions. |
| WTO | World Trade Organisation. |

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