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Climate Agreement in Bonn Leaves U.S. Businesses Facing Increased Uncertainty

International climate negotiators meeting in Bonn this summer achieved a major breakthrough when participating countries agreed to most of the key provisions for implementing the Kyoto Protocol. Notably absent from this agreement was the United States, following the Bush Administration's decision earlier this year to unilaterally withdraw from the negotiations. President Bush argued that the Protocol was unacceptable due to its high costs on the U.S. economy and the failure to require developing countries to also reduce their greenhouse gas (GHG) emissions. Other countries do not share these strenuous objections, and while the Protocol still needs to be ratified by most countries, the European Union was able to offer sufficient incentives to Japan, Australia, and Canada to obtain their agreement.

Where does this leave business? Arguably, for many companies in the United States, there was an initial sigh of relief that carbon constraints are not imminent. However, there is also an increasing realization that constraints are inevitable. The International Panel on Climate Change has made it clear that human activities are indeed affecting the global climate, and with other countries indicating their willingness to move forward on reducing GHGs, it is more a question of *when* and *how* GHGs will be restricted rather than *if*. In this context, businesses located in Europe and other regions are clarifying the rules of the game and are already factoring carbon constraints into their business planning. In the United Kingdom (UK), for example, companies are preparing for entry into the UK Emissions Trading Scheme that commences in April 2002. A recent European Union paper has proposed a framework for EU-wide trading by 2005. U.S. companies are receiving no such clarification. Moreover, many U.S.-based companies have operations worldwide and are facing a more complex array of decisions because their facilities in other industrialized countries will need to consider the impact of the Kyoto targets as committed by their respective governments.

The next round of international climate negotiations convenes in late October at COP-7 in Marrakech, Morocco. The Bush Administration is deciding if it will introduce specific concrete proposals and how stringent those proposals ought to be. Complicating the picture for U.S. business is that legislative activity is also hastening in Congress and at the state level. For example, the New England states recently agreed with Eastern Canadian provinces to work cooperatively to reduce GHG emissions over the next several years.

Ultimately, the fundamental challenge is whether global energy policy in the 21st century will remain focused on extracting as much carbon from the ground as possible, or whether governments diligently pursue more sustainable options. In some respects, the battle is between the technologies of the past and the technologies of the future. There is no question that fossil fuels will be a major energy source for some time to come. However, embracing an approach that encourages new technological development indicates that the United States intends to put its entrepreneurial, high-tech muscle into developing better solutions to meet global energy needs. Ultimately, this is the path the world must take if a long-term response to climate change is to be successful. At this point, companies around the world need clarification about what is expected of them (and just as importantly, what is not).

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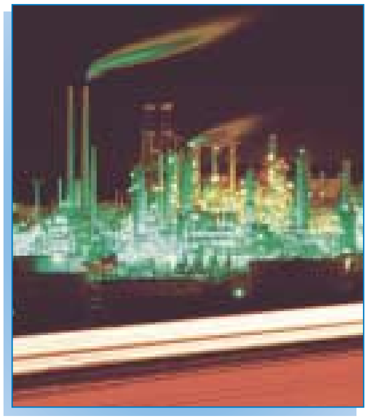
A key component of the U.S. negotiating position on climate change all along has been to harness the power of the market-place to find more effective, lower cost solutions to the challenge. This has been represented most prominently by the demand for inclusion of unfettered flexibility mechanisms, such as emissions trading, to allow companies to pursue emission reductions as easily as possible. Ironically, the agreement that came out of Bonn was a major endorsement of this U.S. position. The global market for GHG emission reductions (also known as a carbon market) is in its infancy and, after the Bonn agreement, will be maturing without U.S. involvement.



ICF Consulting's analysis indicates that—in the short-term, with the United States absent from the Kyoto Protocol—the balance of supply and demand suggests lower carbon prices than previously forecast. In an environment of increased uncertainty and complexity, each company should now be developing a strategy that reflects their unique exposure to GHG emissions and their portfolio of available opportunities to mitigate these emissions.

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