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PERSONS: KIMBLE, M

SUBJECT: FWD STATE MEMO ON PLANS FOR KYOTO SUMMIT

ACTION: PREPARE MEMO FOR BERGER

DUE DATE: 11 NOV 97 STATUS: S

STAFF OFFICER: TARULLO

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UNDER SECRETARY OF STATE
FOR GLOBAL AFFAIRS
WASHINGTON, D.C. 20520-7250

NOV 3 1997

Andy Sous,

I thought this a very thoughtful start.
My guess is that the White House has not given
any thought to what we do post-Kyoto, & we
should start to jog them now.

Would it be possible for you to take a
cut at a first draft of a memo that we might
send to the White House (Albright → Gore?
Eisenstat-Wuth → Spelling et al?); it might be
organized as follows:

1. Statement about need to follow-up after
Kyoto - this issue will be with us for the
next 40 years.
2. Urge that a senior office out of the Executive

office of the President be named now (someone of stature of Charlie Curtis or Ev Eberlich) - this timing would demonstrate seriousness of President that this is long term, continuing issue.

3. Charter of office should include

a. Vetting the Budget to be sure climate issues are clearly defined for Budget that goes to the Congress in early 1998

b. Follow-up with key Cong'l committees

c. Orchestrate Technology investments and initiatives

d. Work to broaden base of private sector partnerships (autos, utilities)

e. Establish special working group to work with industries that will benefit from Climate Initiatives (Kevin Fay et al)



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- f. Set up an Advisory Group to include Key NBO's & Industry - President personally changes them.
- g. Organize special capability to work with World Bank & other IFI's, with leadership from Treasury
- h. Continue domestic agency energy savings & "Climate Friendly" Initiatives, with DoD in lead.
- i. Maintain High Level Interagency Working Group

This outline is a good beginning, and I am

once what other items should be added. But we should get something formal over there now, and start getting them to focus.

I am sure that Stuart will agree with the imperative of this, and the Vice President's office certainly has a big stake in this.

Would it be possible for you to do a first cut at such a memo, and let's see what it looks like? Obviously talk w. Melinda / Rafe

With thanks again - delighted that you are on board to help!

Best,

PLEASE STAFF

Vin

November 1



United States Department of State

Washington, D.C. 20520

October 24, 1997

MEMORANDUM

To: G - Under Secretary Wirth
From: OES - Melinda Kimble, Acting *Melinda Kimble*
Subject: A Before and After Kyoto Road Map

You asked for an outline of the issues/tasks that we must address as we get ready for Kyoto in December, and as we move into the period after Kyoto when we will want to engage others in developing a post-Kyoto GHG emissions strategy.

Accordingly, Andy Sens, Rafe Pomerance and I met with a small group to consider steps we may need to take at home and abroad as we develop a response to climate change, and to look at the interagency structure that will develop policy and manage the negotiations to follow Kyoto.

The attached "roadmap" is an initial effort, and it proposes a rough "timeline". It notes policy issues and practical concerns that will clearly need to be given more thought as we develop our positions and negotiating strategies. For example, per Craig Johnstone, resources/budgets will need to be addressed at several levels. There are other, more substantive issues, as well.

As many of the issues to be addressed call for responses by more than one agency, we suggest that after Kyoto, when we have a clearer idea of the negotiating landscape, an early *deputies committee* meeting be convened to create necessary structures and assign "lead" responsibilities and deadlines for specific tasks. We will be happy to assist in drafting an agenda for such a meeting.

FYI -- EB, EAP and SA have reviewed and commented on the "roadmap", as has Terry Kelly. We have not shown it to anyone outside the building at this point.

NOV 5 10:25

A Post-Kyoto Roadmap on Climate Change

Steps We Should Take Now With the World Community

- Exploit opportunities provided by APEC Ministerial and Summit and EU Summit (occurring in same timeframe as Kyoto meeting) to engage others in developing a post-Kyoto strategy. ?
- Reinforce US "pledge and review" proposal at APEC with emphasis on air quality.
 - Take advantage of Indonesian smog and El Nino generated weather problems to build support regionally for more monitoring and appropriate environmental regulation.
 - Set up an APEC working group to support environmental policy development.
- Review FY 99 resources/budget requests for:
 - UNFCCC (in IO&P budget request).
 - US AEP (AID's ASEAN Environmental Program).
 - AID bilateral climate action programs.
 - AID/DOE/EPA joint implementation activities.
 - IFI's financing/criteria for climate friendly projects.
 - GEF resource levels (and related US arrears issue.)

Steps We Should Take Now at Home

- Decide whether we can proceed with a domestic GHG emissions initiative should Kyoto outcome disappoint.
- Take stock of what US is doing in developing countries in response to climate change (e.g. efforts by US agencies or American industry to promote development and adoption of energy efficient/cleanest technologies, deregulation of energy prices, and to encourage acceptance of "no regrets" measures.)
- Establish a State/Treasury/Aid/DOC/DOE working group on developing country power projects. Assign as an early task preparation of a strategy for ensuring that energy-efficient and cleanest technologies are financed.

Working Group should also examine and promote options for securing active private sector involvement.

- Review OES and EB FY 99 budget requests (Can we sustain a post-Kyoto leadership role for State given the resources we have asked for?)
- Assign appropriate IWG with fleshing-out US domestic fiscal and other incentives to industry to encourage development and deployment of most efficient technologies.
- Explore how best to encourage government/private sector partnerships. (Is this a task for Wirth/Atwood Group?)

A Post-Kyoto Timetable

December 97 to January 98

- Press UNFCCC to develop a post-Kyoto work plan.
- Make State's *Climate Change Task Force* permanent. (Should there be a White House task force?)
- Create interagency teams within IWG on Climate Change to develop further policy on joint implementation, emissions trading, monitoring and verification and pricing & financing.
- Develop detailed IWG work plan.
- Create OES/EB core team to conduct post-Kyoto negotiations.
- Establish outreach team to develop public affairs strategy.
- Review staffing requirements in relevant OES, EB and IO offices and submit proposals to the Director General.

March 98 to December 99

- Undertake next round of climate change negotiations with close focus on developing country commitments.
- As negotiations proceed, develop and implement proposals/programs to support developing country actions to limit GHG emissions.

January to March 2002

- Submit Kyoto+ protocol (if any) for ratification.

In the Longer Term (assuming a successful outcome in Kyoto and follow-on negotiations.)

- Begin developing mechanisms and timetable for:
 - Crediting joint implementation projects.
 - Monitoring and verifying emissions trading under an agreed emissions permit program.
- Seek international agreement to begin regimes within Annex I in the 2005 - 2007 period. (If successful, we can develop market system for Annex I trading complemented by joint implementation in first budget period. By third budget period (o/a 2022 - 2030) we could fold joint implementation into global market-based trading regime.)

Some Other Factors to Consider.

- Will we be able to support government-to-government trading (especially with Russia) that would require federal appropriations?
- How can we develop incentives to spur private sector to participate at early stage?
- How can we promote complementarity without harmonization internationally?
- How do we promote development of new technologies that preserve domestic competitiveness?

URGENT

US Del to UNFCCC
at Bonn

8 pages

To: Rake Pomerance

7-0217

from: M. Hambley (Mario Merida)

Date 10/29/97

The attached DRAFT "options" paper has
not been cleaned by the USDEL.

Please do not take "action" until
speaking w/ Mark Hambley or Melinda
Kimble.

Mario Merida for Amb. Hambley

Additional page ~~at~~ to follow 10-15 minutes

Options For Advancing Negotiations With Different Groups

The following summarizes negotiating issues, provides a table of pros and cons, and suggests some packages of importance to groups of countries. Some negotiating issues are near resolution and are not included. Those are: (1) budgets; (2) which gases are included in budgets, and (3) policies and measures.

Negotiating Issues -- Possible Types of Flexibility

1. Level of the budget in the initial period.
2. Offer a possible second period number like minus 5%. Guidance on the acceptable limits would assist in negotiating this target.
3. Announce a willingness to commit to a third budget period number.
4. Indicate flexibility for start year of initial budget period (with 5-year or longer budget period.)
5. Accept differentiation or begin participating in differentiation discussions without fully committing to acceptance.
 - a) Agree to formula for differentiation
 - b) Agree to differentiated budgets as part of the Kyoto Agreement
 - c) Agree to differentiate budgets in principle, but leave determination of actual budgets to a post-Kyoto process
 - d) Agree to differentiation for the second budget period only in Kyoto or in post-Kyoto process.
6. Limit which sinks are included, e.g., omit soil carbon.
7. Accept New Zealand proposal for a stock approach to sink accounting with or without re-allocation scheme. Accept Iceland proposal to count sequestration due only to human activities.
8. Set 2005 as the year by which national institutional arrangements required to meet the budget are in place and subject to review by the Parties.

Flexibility

1. Trading
 - a) Limit the amount of trading or JI, together or separately, that could be applied to each budget
 - b) Credit based trading -- Rule out pre-budget period paper tons while legitimizing them during the budget period. Limit trading to the second and subsequent budget periods.
2. Joint Implementation
 - a) Limits on amounts of JI credit that could be added to budgets.
 - b) Allow to participate only Annex I and Article 10 Parties.
 - c) UNFCCC-charted carbon banks or exchanges. This would create independent institutions to sell JI credits while at the same time provide a vehicle for aggregating small projects into financially attractive sizes.
 - d) Postpone decision on JI until the end of the pilot phase.
3. Banking and Borrowing
 - a) Indicate quantitative limits on borrowing in the protocol
4. Limit banking to JI projects only

Pros and Cons:

<u>Issues</u>	<u>Pros</u>	<u>Cons</u>
Budgets		
1. Level of 1st budget period	Symbolic importance; may reduce "paper ton" controversy. Stronger budget appeals to EU, AOSIS, and to a lesser extent, Japan.	President, himself, announced target. Stronger target may be unwelcomed by OPEC, China, India and Australia.
2. Level of 2nd budget period	Further appeal to all groups but OPEC, China, and India	Need to keep EIT's "comfortable" with target. Greater incentive to bank likely to limit "paper tons" Will be opposed by OPEC, China and India
3. Announce a willingness to commit to a 3rd budget period.	May appeal to EU and some JUSCANZ countries -- Would indicate to continue a known reduction path through 2023	
4. Differentiation -- move from flat rate proposal	Appeals to JUSCANZ countries and G-77	No single solution addresses concerns of all differentiation advocates. All option variants may complicate negotiations. Difficult to reach consensus on formula, all of which disadvantage some parties
a) Agree to formula for differentiation at Kyoto	Proposed by Japan	Difficult for countries to determine acceptable solution in short period of time, although easier than agreeing on a formula. Possible never ending negotiating process
b) Agree to specific differentiated targets (not derived by formula) at Kyoto	Allows political solution without a formula, if solution can be found.	
c) Agree to post-Kyoto process for arriving at differentiated budgets	Favored by Australia	
d) Differentiate in 2nd budget period only	May be compromise	If a post

- | | | | |
|----|---|---|---|
| 1. | Exclusion of sinks | Favored by EU, AOSIS, and environmental NGO's | Premature movement towards excluding sinks limits flexibility but reduces reductions US needs for a given target. |
| 2. | Changing to New Zealand accounting basis for sinks | More analytically sound; favored by most JUSCANZ | May accentuate impact of uncertainties. Some countries, e.g. Australia, are particularly disadvantaged (surgical fix for them may be possible). May look, to some, like gimmick without strengthening target. |
| 3. | Start year for first budget period | Earlier start years favored by EU and G-77 | Earliest years (e.g., 2003) may not allow time for implementation measures to be put into place and begin to have an effect. |
| | a) Agree to put in place domestic mechanisms for meeting budget, e.g., domestic trading by 2005 | Possible compromise for EU; might be done outside the protocol (i.e., "prompt start" decision). | Moderate risk of noncompliance included in protocol and ratification is delayed. |
| | b) Agree to a non-binding target prior to initial budget period | | |
| 4. | Trading | Some variant likely to find acceptance with all Annex I | Opposed by G-77 (but not strongly) |
| | a) Limit on amount to be traded | Appeals to EU and G-77 | Industry opposition (intensity depends upon how restrictive) -- possible increase in costs |
| | b) No trading in first period (credit based trading) | May be favored by EU | Severely restricts trading and increases implementation costs |
| | c) Allow paper tons | Favored by EITs -- increases market liquidity in initial budget period, lowering costs | Strong opposition in EU; would likely generate heavy criticism from environmentalists in the |

US -- may result in
increased emissions

- | | | | |
|----|---|---|--|
| 1. | JI | Appeals to different degrees to all Annex I Parties | Opposed by G-77 (despite some support from individual developing countries outside this forum).
May increase cost |
| | a) Limits on amounts | Favored by EU | |
| | b) Limits on participating countries (e.g., Annex I) | Favored by EU | Increases cost -- opposed by electric utilities. "Holding-out" for trading may be a better option. |
| | c) Green Development Fund (re-engineered) | May attach some G-77 support | Would take work to overcome Congressional and industry wariness of new approach. |
| | d) Drop JI in favor of emissions trading with Parties that accept budgets under Article 10. | Appeals to G-77 | Would take work to convince skeptical Congress, industry. |
| 2. | Banking and borrowing | Banking attractive to most Annex I countries, borrowing enhances compliance, but has much less support. | Borrowing opposed by most groups. |
| | a) Early period banking limited to JI | Broadens appeal to many groups | Requires that domestic early action be accommodated by domestic budgets. |
| 3. | EU Bubble | | |

Major Groups:

European Union: Seeks tighter GHG emissions reduction targets and favors limitations on exercising each type of flexibility. They support budgets if the initial budget year begins in 2003. They favor a variety of limitations on trading and JI to insure that some portion of Annex I budgets are met domestically. The EU is likely to support banking but not borrowing unless as a compensation mechanism. The EU opposes compensation funds. The EU favors a flat rate budget approach except for their own bubble.

G-77 and China: Great divergence within the group, with potential to neutralize it. Much of their position may be characterized as a "poison pill" to derail negotiations, particularly of interest to OPEC. Have announced the most aggressive targets, namely, 7.5% by 2005, 15% by 2010, and 35% by 2020. They formally oppose all flexibility provisions including budgets, trading, JI and banking and borrowing. They favor both a Green Development Fund capitalized through non-compliance penalties, and managed by geographically representative countries, and a compensation fund for costs incurred both from mitigation actions and climate damage. While their targets are flat rate, they are believed to be sympathetic to differentiation as a principle they could utilize in subsequent amendments. AOSIS and Latin American countries would most favor 1) a deeper (even symbolically), lower target, 2) an earlier budget period, 3) a 2nd budget period target showing "meaningful" reductions, and 4) stronger compliance provisions. They also support flexibility with long limits.

JUSSCANNZ: Except for New Zealand and the U.S., all JUSCANZ countries favor differentiation, although with somewhat different approaches. All JUSCANZ favor flexibility provisions with minor differences. All JUSCANZ countries oppose compensation funds. All oppose EU bubble.

RUSSIA AND EITs: Want to maximize their budgets, including by counting reductions since 1990 and allowing future undefined flexibility. Opposes EU bubble.

JAPAN: Stands alone in JUSSCANNZ on opposing inclusions of HFC, PFC, SF6 and sinks (awaiting instructions from Tokyo on this last item); strongly opposes EU bubble. Strong on differentiation and wants slightly tighter target (below 1990 levels).

Package Options:

Designed to appeal to G-77: Dropping evolution from protocol text is an important G-77 objective. They would tend to favor weaker mandate options with longer time period for negotiation of subsequent agreement. Limits on JI and trading would appeal to these countries. One possibility might be to re-label JI, e.g., Annex I compliance partnerships, but to keep the crediting provisions of our JI proposal. Providing language that speaks to their technology transfer concerns would be appealing -- perhaps by providing some process for facilitating technology transfer.

Designed to appeal to EU: Higher target numbers in every period will appeal to the EU. Indicating an acceptable reduction number for the second period and for a third period might be helpful. Early start provisions may be attractive, including providing a specific date that national implementation systems would be in place and subject to review by the Parties. Indicating in the agreement a provisional long term, quantified concentration goal would build credibility with the EU. Acceptance of the bubble would accommodate a critical EU position. Any movement toward credit trading would be favorably received. Dropping or limiting JI would be attractive to the EU. Finally, acknowledging that the U.S. favors a Kyoto Mandate and dropping our insistence on evolution would assist.

Key Players within the G-77:

China, India and Brazil are the most powerful players within the G-77. China and India appear to be most concerned with the level of the target. The weaker the budgets, the less they are under pressure to do in the next negotiations. Brazil seems more driven by other issues, particularly the treatment of sinks.

There are a second tier of important actors which are unwilling to buck the big three, but are nevertheless opinion makers on some issues. Those include: Malaysia, Philippines, Indonesia. Technology transfer issues are particularly important to them.

AOSIS as a group are important within the G-77. Their principle concern are the stringent budgets.

Saudi Arabia on behalf of OPEC are the final major actor. They appear to favor no agreement in Kyoto. There are few options for changing or mollifying their position.

Benjamin F. 0002
Don
Negotiations

To Jonathan Adashek		From Rafe Pomerance	
Dept./Agency WH		Phone # (202) 647-2232	
Fax # (202) 456-2215		Fax # (202) 647-0217	
NSN 7540-01-317-7368		5099-101 GENERAL SERVICES ADMINISTRATION	

PREDECISIONAL DRAFT-DO NOT CITE OR QUOTE

97 OCT 28 PM 3:48

Issue: Should the use of "paper tons" (emissions reductions that have occurred since 1990 as a result of policy initiative or economic conditions not related to climate change) be eligible for emissions trading, where they could be used to help meet another Party's obligation?

Note: "paper tons" primarily arise in the period around 2010. Countries where emissions have fallen include the former Warsaw Pact countries, Germany and the United Kingdom.

Discussion: Allowing for international emissions trading in "paper tons" means that a given set of national obligations might result in a higher aggregate emissions level than would occur if each country were constrained to meet its national target level within its borders. However, the overall Annex I obligation specified by the commitment (i.e., returning to some fraction of the 1990 emissions level in a given target year) would still be satisfied.

- Thus, it is in the eye of the beholder whether allowing trade in "paper tons" is considered as a way of relaxing the target, or whether denial of such trade should be viewed as a way of making the target tighter than it appears.

Workability: A calculation of "paper tons" must be based on projections of future emissions that are subject to considerable uncertainty. There is a wide range of opinion regarding "business as usual" projections of emissions 10 or 15 years into the future, and Parties could dispute the choice of particular projections as a basis for determining the existence or quantity of paper tons.

Environmental Significance: The treatment of "paper tons" may have political significance, but it has little if any environmental importance. Typical projections of "paper tons" are minuscule relative to emissions and small relative to widely-discussed emissions reductions. The influence of paper tons on atmospheric concentrations of greenhouse gases is virtually imperceptible.

For example, the Energy Information Administration estimates that former Soviet Union (FSU) would have approximately 125 MMT in paper tons relative to a target of stabilizing energy related carbon emissions at their 1990 level in 2010. Taking the EIA estimate of 125 MMT as a starting point, and assuming a linear decline to zero over 5 years due to economic growth, the total paper tons available to FSU in the first budget period (assumed to be 2010 to 2020 for purposes of this example) is 375 MMT (125+100+75+50+25). This figure may be compared to the budget available over a 2010 to 2020 budget period under a stabilization agreement to all of Annex 1 (43,000 MMT) or the FSU (13,400 MMT). Given that current annual global emissions of roughly 7,500 MMT (including land use changes) result in an annual increase in atmospheric concentrations of carbon dioxide of approximately 1.5 ppm per year, the entire "paper tons" problem is a 0.075 ppm issue --compared to a current concentration level of approximately 360 ppm.

①b

Evaluation: Allowing "paper tons" adds some slack to the system, modestly lowering the near-term cost of meeting a given emissions commitment. In this sense, paper tons might help negotiators in reaching a target that is both politically appealing and acceptable in cost. The availability of foreign emissions rights, regardless of whether they result from "paper tons" or mitigation actions, would likely be welcomed by coal and other interests that might otherwise bear the brunt of domestic emissions reductions. However, others may cite the ability of the European Union or the former Soviet Union to profit from "paper tons" as the basis of an argument that the underlying targets and timetables are fundamentally flawed and will generate large transfers to foreign entities. For example, if permit prices are \$25 per ton, the 375 MMT of tradable "paper tons" assumed for purposes of the previous example would have a cumulative value of \$9 billion. Of course, transfers are not inherently bad: they can also be viewed as a source of savings to the U.S. economy from tapping the comparative advantage of the FSU or as a valuable transfer to the FSU.

Equity Issues: Paper tons could be an important issue in the context of the European Union (EU). This reflects both the current situation of Germany and because it is widely anticipated that many former Warsaw Pact nations will eventually join the EU. It would be difficult for the United States to accept a regime in which an "EU bubble" implicitly allowed the use of paper tons within the EU for purposes of meeting the EU commitment, but which denied access to paper tons through the international emissions trading regime to the U.S. and other non-EU parties. Such a scheme would significantly damage prospects for ratification and implementation by the Congress, placing at risk the environmental effectiveness of an agreement.

Options: There are two possible ways of approaching this issue while circumventing the workability concerns associated with estimation of paper tons.

- Ignore the "paper tons" "problem." As stated above, the influence of "paper tons" on atmospheric concentrations of greenhouse gases is virtually imperceptible.
- Restrict countries with "paper tons" from banking credits before the start of the first budget period. This approach might limit the impact of paper tons, albeit at the cost of reduced liquidity.

(2a)

PREDECISIONAL DRAFT--DO NOT CITE OR QUOTE

Issue: Language in the AGBM Chair's negotiating text proposes to restrict international emissions trading and joint implementation by making the domestic policies and measure the main means of meeting a Party's emissions reduction commitment. Other discussions currently underway would prohibit trading until the end of the first budget period.

This paper addresses the workability of the following options, and assesses the impact of such trading restrictions on carbon allowance prices and U.S. compliance costs, based on existing analyses.

- Option 1. Require domestic compliance efforts to close at least 50 percent of the gap between allowed commitments and projected emissions. International purchases of emissions permits could not exceed 50 percent of needed compliance efforts.
- Option 2. Prohibit trading until the end of the first budget period. Parties would be required to meet their commitments exclusively through domestic emissions limitation efforts until the end of the first budget period.

Workability:

Option 1: Any restriction in the form of Option 1 above presumes that the "gap" required to achieve compliance with a given commitment can be explicitly identified, so that the domestic effort test can be applied. In other words, we need international agreement on where each country's emissions would have been in the absence of any new actions as well as agreement on the target for each country to implement this approach. The notion that countries could reach agreement on a single set of future emissions projections for the purpose of applying this test seems far-fetched -- there is significant controversy regarding the "business as usual" projection for many countries, and all such projections are inherently uncertain.

Option 2: A restriction in the form of Option 2 is workable, but it could have very significant adverse economic implications. The first budget period is where trading is likely to be most valuable, as new low- and no-carbon energy technologies are developed and premature retirement of capital stock is averted. This option would raise a serious inequity if the European Union were considered as a "bubble" for purposes of its application.

Both Options: Both options have the fundamental problem of restricting parties' access to the most cost-effective emissions reductions. With either option, the marginal cost of control is likely to vary widely within Annex 1, meaning that opportunities to lower the cost of achieving a given level of emissions reduction have been foregone. This outcome is arguably inconsistent with Article 3 of the Framework Convention.

Projected Economic Impact on the U.S. and Other Countries

What is the impact on the cost of control and overall US compliance costs from each of these

(26)

options? One point of reference is draft analysis prepared by the Interagency Analysis Team and subsequent analyses by Dr. Jae Edmonds of Batelle. The attached table provides the percentage of reduction from permit trading in each region in Edmonds' model.

Option 1:

As noted above, the application of a percentage effort standard from domestic reductions presumes agreement on forward looking "business as usual" emissions baselines. Assuming that this hurdle can be overcome, work done by Jae Edmonds suggests that a 50 percent domestic reduction requirement would not be binding on the U.S. if trading is restricted to the Annex 1 area (permit imports meet 26% of the required reduction in 2010 and 37% of the required reduction in 2020) and "paper tons" are somehow removed from the system -- which itself requires agreement on future "business as usual" baselines. If "paper tons" are not removed, the 50 percent restriction is slightly binding on the U.S., leading to a small increase in compliance costs but leaving them below the level in the "no paper tons" case.

The 50% restriction would be binding on the U.S. in a full Joint Implementation regime, where lower permit prices would lead the U.S. to import permits covering 70% of its required reduction in 2010 and 80% of its required reduction in 2020.

According to Edmonds' analysis, Canada and Japan would be constrained by the 50 requirement even in a regime of Annex-1 only trading.

Option 2:

Option 2 is binding on the U.S. and significantly raises compliance costs. For example, the draft IAT analysis concludes that eliminating trading would double the implicit 2010 value of carbon in the U.S. economy in 2010, placing it in the neighborhood of \$100 per tonne, and approximately doubling the economic impact of commitment to a stabilization target. Some energy-intensive industries might be concerned about competitiveness impacts.

Option 2 would also be particularly onerous for Japan and Canada.

Option 2 is a more costly constraint than Option 1. In the initial years, presumably the entire first budget period, capital stock changes are both more difficult and more costly. The capital stock turns over slowly, and early replacement of capital requires premature retirement. Without trading opportunities, short-term carbon reduction would require fuel input reductions and would impose significant costs on many important sectors of the U.S. economy.

Prohibiting trading would give rise to vastly different carbon allowance prices among participating nations. In an isolated U.S. carbon market, the estimated carbon price might be \$50 or more per tonne higher during the first budget period tied to a 1990 baseline, compared to the expected price under a regime of free international trading with allowance quantities linked to 1990 emission levels.

SGM Results (10/28/97)

26

Case: Annex I Stabilization at 1990 levels in 2010

EE&FSU Allocated NO Paper Credits

	Reference Level Emissions			Percentage of Emissions Reduction from Permit Trading			
	1990	2010	2020	Annex I Joint Stabilization		Global JI	
				2010	2020	2010	2020
Canada	117	169	180	59%	52%	82%	80%
Japan	272	368	373	65%	60%	85%	86%
USA	1350	1729	1871	26%	37%	70%	81%
W. Europe	835	1074	1146	42%	42%	76%	79%
Australia	62	88	96	38%	35%	71%	72%

EE&FSU Allocated Paper Credits

	Reference Level Emissions			Percentage of Emissions Reduction from Permit Trading			
	1990	2010	2020	Annex I Joint Stabilization		Global JI	
				2010	2020	2010	2020
Canada	117	169	180	75%	60%	89%	84%
Japan	272	368	373	79%	66%	91%	88%
USA	1350	1729	1871	55%	47%	83%	84%
W. Europe	835	1074	1146	65%	52%	86%	83%
Australia	62	88	96	60%	44%	82%	77%

3a

ISSUE: How do different baselines for the Eastern Europe and the Former Soviet Union affect emissions limitation commitments?

Several of the transition countries (Eastern Europe and the former Soviet Union) have advanced alternative base years for calculating their commitments. Not surprisingly, the base year proposals are generally structured so as to maximize the emissions base. This would also have the effect of maximizing the allowable emissions under a stabilization or percentage reduction commitment.

DISCUSSION:

The variations on baselines that the transition countries have proposed can be quite significant to them. For example, Poland's proposal to use a 1987 baseline increases their baseline by 25% relative to a 1990 baseline.

Because most of these countries are relatively small emitters, the total amount of tons added to the baseline by these proposals is actually quite modest. Based on published energy data from British Petroleum, the only readily available source of annual fossil energy consumption with enough detail, we estimate the effect of the baseline proposals (measured relative to a 1990 baseline) as follows:

Poland (1987 baseline)	+27 MMT of carbon
Hungary (1985-87 avg.)	+2.6 MMT of carbon
Czech Rep (1987 baseline)	+5.5 MMT of carbon
Romania (1988 baseline)	+9.2 MMT of carbon
Bulgaria (1989 baseline)	+2.7 MMT of carbon

TOTAL approx. 47 MMT of carbon

A table of carbon emissions estimates based on BP data is attached.

The total change in baseline emissions from accepting the baseline dates proposed by transitioning countries is slightly more than 1 percent of total annual carbon emissions from Annex 1 countries. While this may seem insignificant, the violation of the principle of a single baseline year for Annex 1 countries may matter.

Another concern is that Poland, Hungary, and the Czech Republic are all likely candidates to join the European Union (EU), with its possible "bubble," sometime before binding commitments become effective. Providing these countries with an extra 40+ MMT could raise domestic political problems given the perception that the EU is already exploiting the greenhouse issue to gain advantage over the U.S.

36

Total carbon

Total Carbon Emissions											
	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Bulgaria		22.04	22.00	21.62	21.64	18.93	14.75	13.79	14.75	14.31	15.24
Czech Republic	48.40	49.21	48.96	49.14	47.33	43.55	39.59	34.22	32.48	31.24	30.85
Hungary	21.02	20.55	20.98	19.73	16.91	18.24	17.32	15.50	14.47	14.81	15.00
Poland	119.54	122.83	126.90	124.24	119.31	99.12	95.18	89.41	90.92	89.91	88.48
Romania	47.66	49.28	51.55	52.15	53.29	42.99	34.63	33.01	31.65	30.30	32.59
Slovakia	14.46	14.35	14.17	14.17	13.71	12.66	12.66	11.36	11.30	11.03	11.20
Other Europe	57.51	59.95	60.66	62.15	60.98	57.97	49.48	44.34	42.77	40.92	42.30
Azerbaijan	13.79	14.92	14.40	14.51	14.69	15.19	14.60	12.69	11.16	10.79	11.06
Belarus	26.39	30.35	30.84	30.97	29.85	28.52	26.12	26.64	20.05	17.69	16.70
Kazakhstan	59.71	61.19	62.45	64.59	63.12	64.67	63.09	63.90	56.33	50.21	49.17
Russian Federation	583.65	593.42	610.84	616.13	616.66	603.40	586.79	555.12	503.41	452.99	422.56
Turkmenistan	8.70	10.40	10.34	10.46	10.69	9.05	9.32	8.92	7.44	6.30	7.32
Ukraine	175.14	177.37	179.91	174.30	166.38	193.10	172.49	152.93	125.24	105.07	97.44
Uzbekistan	29.85	30.16	30.48	31.56	32.70	33.50	32.21	29.67	29.57	29.08	28.79
Other Former Soviet Union	49.49	47.04	46.80	47.08	45.68	49.16	40.37	23.89	16.27	12.17	12.06
Total Former Soviet Union	946.91	964.85	986.09	969.58	960.76	996.58	948.99	872.96	769.47	684.30	639.09
Eastern Europe	252.08	256.22	262.54	259.42	252.54	216.75	199.58	183.50	180.82	177.30	178.12
* Commercial solid fuels only, i.e. bituminous coal and anthracite (hard coal), and lignite and brown (sub-bituminous) coal											

Super-Heated Air

Since the EU first announced its bubble policy, other Parties have been jealous and have asserted their rights to get in on the action. It should be remembered that the EU bubble is in the context of a 15% overall reduction. If other Annex I Parties were prepared to accept such ambitious targets it is likely that squabbling over bubbling and trading within Annex I would have long ago ceased. Nonetheless, as Parties consider various combinations of Annex I targets, bubbling, trading, and Joint Implementation, it is essential to consider the implications of these proposals for overall Annex I emissions.

Of particular interest is the disposition of the "paper tons" or "hot air" from Russia and other Central and Eastern European nations. IIASA has recently compiled an interesting set of emission scenarios to 2010 for this region. In the reference scenario based on Official Energy Projections (OEP), emissions rise from their current value of more than 30% below 1990 levels up to about 10% below 1990 levels by 2010. This implies that for a stabilization target, CEE countries would have excess emissions of over 300 million tons per year during a 2008 to 2012 budget period (based on extrapolating the 1995 to 2010 linear growth rate to 2015). If CEE countries were allowed to bank the difference between actual emissions and 1990 levels from 1990 onward, as Russia has proposed, the available Super-Heated Air would balloon to 2000 million tons/year, or 15% of 1990 Annex I emissions (assuming that all banked tons were used during a five-year budget period).

The Official Energy Projections are, however, likely to prove an overestimate of emissions growth in CEE countries. This implies that the hot air problem is likely to be even worse than these figures suggest. In the EEC-F scenario, IIASA examined the implications of CEE countries converging on Western European income and efficiency levels. In this case emissions would more-or-less stabilize at their current levels and unused tons available for trading would increase to 1000 million tons/year assuming no banking is allowed before 2008, as suggested by the Chairman's text. (Astonishingly the paragraph that prohibits such banking seems to have disappeared from the negotiating text sometime on Monday.) With banking, the available tons would increase to 3400 million per year, or fully 25% of 1990 Annex I emissions.

In another scenario, IIASA considered the emissions levels that could be achieved with explicit policies designed to limit emissions, particularly from the transport sector. In this case, emissions in CEE countries could continue to decline to 50% below 1990 levels by 2010, even as economies recover. This would imply over 1500 million tons/year available for trading without banking of pre-2008 reductions, and with banking a whopping 4500 million tons/year, or 33% of 1990 Annex I emissions.

Dan Lashoff article from 10/28 ECO

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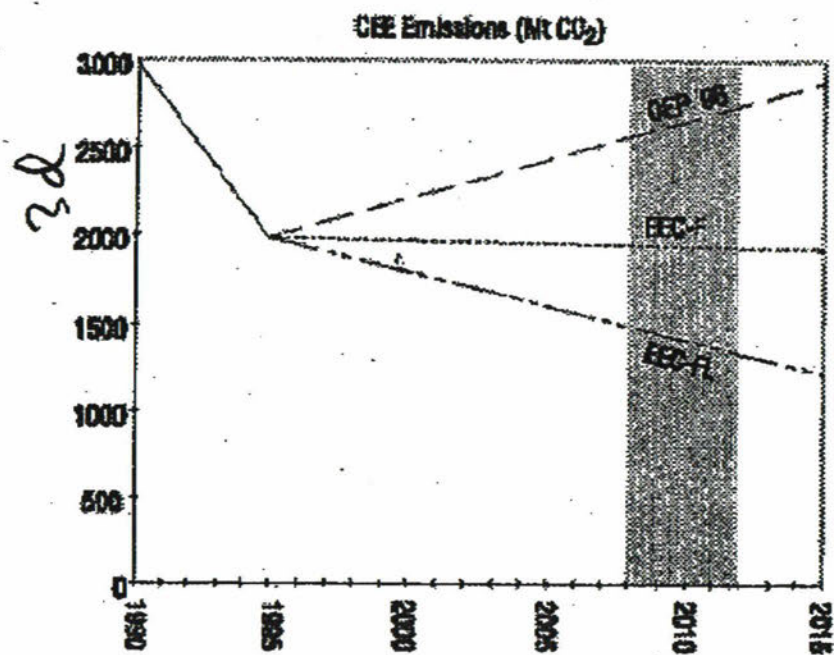


Table: Million tons CO₂/yr (% of 1990 Ann. I)

	OEP-06	EEC-F	EEC-FL
Hot Air -- No pre-	320	1020	1550
2008 Banking	(2.3%)	(7.5%)	(11.4%)
Super-Heated Air --	1990	3430	4520
with Banking	(14.5%)	(25.1%)	(33.0%)

[Return to the Front Page](#)

Dan Lashoff article from 10/28 ECO

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The New Zealand Approach for Accounting for Forest Sinks

Bottom Line: The New Zealand accounting system for forest sinks offers an opportunity to do more for the environment, have a more equitable distribution of reductions, and remove unfair penalties that exist under the current system.

Background: Forests can either be: a source of carbon; a carbon sink; or neutral (neither emitting or sequestering carbon). As forestlands are converted to other uses (e.g. agriculture or grazing lands) the carbon stored in trees and forest soils is emitted into the atmosphere. As forests regrow (as many US forests are currently doing) carbon is sequestered from the atmosphere. As forests age (and relatively stable harvesting and mortality patterns emerge) forest carbon sequestration slows, until gradually forests reach a point of maximum carbon storage. At this point, the sequestration rate is zero. Likewise, when forests are entirely deforested, the rate of emissions falls to zero.

The Current System: Currently the US position requires that annual carbon changes from forests be added or subtracted from a country's budget to estimate "net emissions". This "net emission" estimate forms the basis of a country's target. A country's future performance is measured against the change in forest carbon from the base year -- countries gain by either maintaining or increasing current rates of sequestration or by lowering the emission rate from forests. The approach does not consider the overall stock of carbon maintained by a Party (carbon storage).

The Problem with the Current Approach: The current approach penalizes Parties that sequestered carbon in the base year and rewards Parties that depleted sinks in the base year -- putting the US at a competitive disadvantage. The US sequestered a great deal of carbon in the 1990 base year. Either we must continue to sequester carbon at that rate or lower other emissions even further to offset the shortfall. We anticipate that while the US will continue to be a sink for forest carbon for the next 30-40 years, the rate of carbon sequestration will decline significantly. This will occur during a period where US forest carbon storage is increasing (albeit at a slower rate).

On the other hand, countries that deforested lands in the base year will receive a credit after their forest resources are depleted. When a country depletes its forest to the point where no economically viable forest is left, their deforestation rate will fall to zero. They will then receive credit for the amount they deforested in the 1990 base year -- and continue to receive this credit indefinitely.

The Solution Offered by New Zealand: The Framework Convention on Climate Change intended to protect and enhance forest carbon sinks. The New Zealand approach accomplishes this by creating a separate target for forests based on the stock of carbon in the first year of the budget period. By linking a target to the stock of carbon -- all future sequestration can be credited and all future emissions from forests must be offset. This system rewards all activities that protect and maintain sinks.

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Implications for the US: Since the US offsets over 15% of its annual emissions with forest carbon sequestration, the New Zealand system significantly lowers the amount of reductions the US would need in order to stabilize net emissions at 1990 levels.

In 2010, the US is expected to sequester 84 MMT of carbon in trees, 108 in forest soils, and 36 in landfills and wood products (227 MMT overall). It is important to note that forest soil carbon estimates are highly uncertain and have not been historically included in our official estimates.

Under the earlier accounting system, the US needed to reduce emissions by 403 to stabilize at 1990 levels. Under the New Zealand system, the US needs to reduce emissions by only 136 MMT to get to stabilization at 1990 levels. If the US emissions drop by 403 MMT (the equivalent of stabilization under the current system), the US would be roughly 17% below 1990 levels using New Zealand's accounting system.

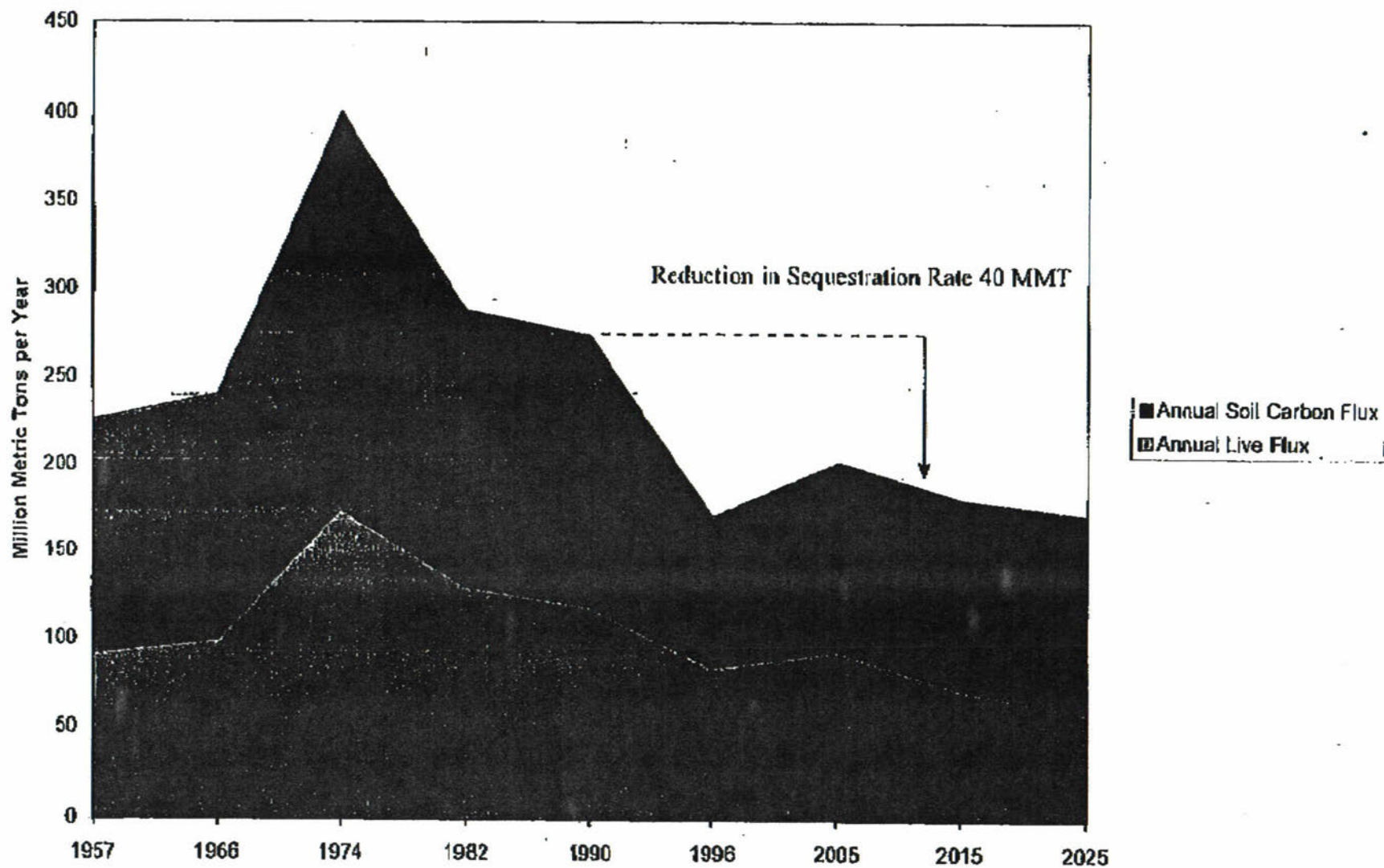
Implications for Other Countries: New Zealand, Sweden, and possibly Russia, would all gain under this accounting system. Australia could be seriously hurt, since it currently has large emissions of carbon from land use activities. As noted below, Australia cannot meet stabilization commitments if their patterns of land use change persist. Australia's options are to either significantly reduce their patterns of land clearing or to negotiate a differentiated target. All other Annex I countries either are completely unaffected or gain slightly.

Results from the Second Generation Model:

	Old Approach Stabilization	New Zealand Stabilization	New Zealand 6% below	New Zealand 10% below
\$/ton				
US	\$75	\$14	\$41	\$56
Annex I Trading	\$51	\$30	\$52	\$64
Global JI	\$19	\$11	\$19	\$23
Tons reduced (MMT)				
US	345	118	233	287
Annex I	730	506	730	836

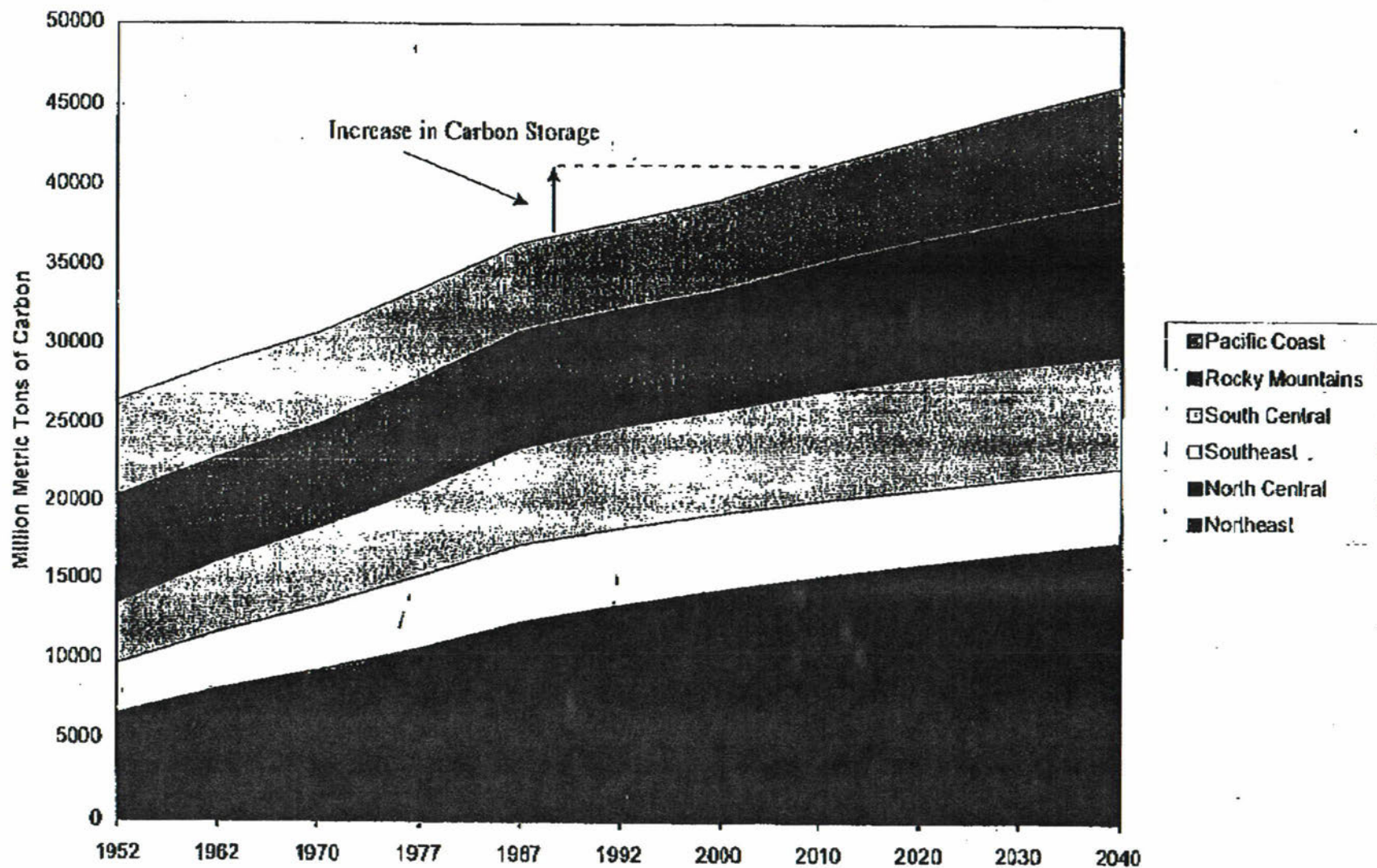
- In the SGM model, Australia cannot meet its targets under the New Zealand approach, due to the large amount of emissions from land use change (roughly one-third of their overall emissions).
- Under the NZ approach, the US sells permits (if the target is only stabilization) since the US permit price is \$14/ton -- less than the Annex I Trading permit price of \$30/ton.
- 10% below stabilization increases overall Annex I reductions by 106 MMT (relative to the old stabilization scenario) even though the US does not have to do as much (e.g. 58 MMT less). 6% below stabilization under the NZ approach is the environmental equivalent of 1990 stabilization under the old US approach.

Total Carbon Sequestration in the US by Ecosystem Component 1957-1990, with Projections Through 2025



4C

Total Carbon Storage on Us Forestlands by Region, 1952-1992, with Projections to 2040



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Jan 1 odd

Stern!

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Negotiations

QUESTION

URGENT

Should we shift our position on the flat-rate (uniform) target and embrace differentiation?

The concept of differentiation has picked up momentum internationally. We believe that a move toward differentiation would inject a new dynamism into the negotiation. If we embrace differentiation, we may be able to revive the negotiation and, in the longer term, gain support for international emissions trading, a key element of the President's proposal for "flexibility." This shift could, however, implicitly pave the way toward acceptance of the EU bubble.

BACKGROUND

Our current position calls for a uniform target -- specifically, stabilization of GHG emissions at 1990 levels by 2010 for *all* Annex I countries. Ostensibly, the EU shares our interest in uniformity, but would get to differentiation internally, through its so-called "bubble." In adopting our position on uniformity, we chose not to support differentiation because we felt that (1) we had insufficient time to "successfully" negotiate the complexities of differentiated targets prior to and during the Kyoto Conference and (2) differentiation could work to our disadvantage, were it to lead to a negotiation over per capita emissions, especially without reference to a 1990 baseline. We did not oppose the concept of differentiation *per se*.

Differentiation, i.e. different targets for different Annex I countries, has picked up considerable support internationally, to the extent that the Chairman's text now includes a proposal to establish a process to develop targets for each Annex I country, based on application of specific criteria, as appropriate (see attached). Based on the contents of that text, and the range of proposals for differentiation from Australia, Norway, Japan (see attached) and others, we have identified three possible forms of differentiation:

- **Pledge and Review.** Each Annex I country would come forward with its own target and enter a process of review to try to achieve comparability/equivalency of effort.
- **Formula.** All Annex I countries would agree to the same formula, but adoption/application of the formula would result in differentiated outcomes (e.g. Japan's proposal).
- **Hybrid.** A process of pledge and review in which each Annex I country would come forward with its own target, guided by various criteria.

As a general matter, we recognize that "differentiation" in some fashion is unavoidable. Consider our proposal for a uniform target. Given differences -- across Annex I countries -- in trajectories for emissions growth under business-as-usual assumptions and in unit costs of emissions reductions, a uniform target would be tantamount, implicitly, to a differentiated target with respect to "effort." (For example, to stabilize emissions at 1990 levels by 2010, we would need to reduce our emissions by 22% relative to our business-as-usual projections. In contrast,

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DOE estimates that Western Europe would need to reduce its emissions by about 16% to achieve stabilization -- the EU, by its own reckoning, claims that it would need to reduce its emissions by only about 8%. Our unit costs of reduction, at the margin, could be considerably lower than those of the EU, but "flexibility," e.g. international emissions trading could, through arbitrage, equalize those costs, to our mutual benefit.) Moreover, we note that the Chairman and many others, including Japan, view explicit differentiation as the only way forward.

RESPONSE TO PRIOR CONCERNS

With regard to point (1) above, our level of expectations has shifted, somewhat, *vis a vis* a "successful" Kyoto Conference. In the context of differentiation, we recognize that there are at least two possible, potentially acceptable results. On the one hand, Kyoto could entail an agreement to meet differentiated outcomes. On the other hand, and perhaps more realistically, Kyoto could entail an agreement to begin a process to establish differentiated outcomes. (In either case, we can expect some difficulties. If we agree to outcomes in Kyoto, either by making specific pledges or committing to a particular formula, we will be "locked in" in future negotiations. If we agree to a process, which is likely to be a long-term endeavor, we may be accused -- perhaps rightfully -- of coming away with nothing. We should also be prepared to take some flack domestically when it becomes apparent that some Annex I countries have committed to doing "more" than we have and others have committed to doing "less.") With regard to point (2) above, our concerns have diminished, in part, because the 1990 baseline is in both the Chairman's text and Japan's proposal. Moreover, in unveiling our own proposal for stabilization at 1990 levels by 2010, we have, in effect, staked our claim. Nevertheless, we recognize that, in the context of differentiation, not all criteria will be favorable to our position.

Attachments: Annex C of Chairman's text and Japan's proposal for differentiation.

For Todd

Stern!

Proposal on QELROs
by the Government of Japan
September 29, 1997

URGENT

1. As the president-designate of the COP3, the Government of Japan proposes 5% as a base reduction rate for deciding a reduction target for each country on the premise that the following conditions from (1) to (3) are accepted. The base year of this reduction is 1990. The target period for the reduction is five years from 2008 to 2012 (the first budget period).

- (1) Green house gasses covered by this proposal include carbon dioxide, methane and nitrous oxide.
- (2) As the quantified target includes a portion prescribed by future technological development and changes of energy situation and industrial structure, etc. which are uncertain factors not foreseen at present, compliance clauses in regard to this portion should have certain flexibility. Formulation of this flexibility has to be stipulated in a protocol or another legal instrument. In any case, the emissions of any country shall not exceed its emissions in 1990.

- (3) The target for an individual country is differentiated by emission per GDP, emission per capita and population growth:

Countries with the following conditions may apply any one of the following Alternative Reduction Rates:

- (a) For a country of which emissions per GDP in 1990 (A) are less than the emission per GDP of all Annex I countries in 1990 (B):

$$\text{Alternative Reduction Rate (\%)} = 5\% \times (A/B)$$

- (b) For a country of which emissions per capita in 1990 (C) are less than the emission per capita of all Annex I countries in 1990 (D):

$$\text{Alternative Reduction Rate (\%)} = 5\% \times (C/D)$$

- (c) For a country of which population growth from 1990 to 1995 exceeds the population growth of all Annex I countries for the same period, the higher growth of population should be considered in deciding the target of the country. Concrete formulation of this alternative reduction rate is to be developed.

2. Banking, borrowing, emissions trading and joint implementation should be adopted under certain conditions.

3. Emissions for the second budget period shall not exceed those for the first budget period. More sophisticated method of differentiation should be applied for the second budget period.

FCCC/AGBM/1997/7

English

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1. The emission commitments for each Party mentioned in Article 3.3 shall be established through a process based on the application of specific criteria including, as appropriate, the following:

- (a) Carbon dioxide equivalent emissions per capita of the greenhouse gases listed in Annex B;
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- (c) Gross domestic product per capita;
- (d) Gross domestic product per capita growth;
- (e) Effective emissions in a given time period, defined as the increase in global mean surface temperature at the end of the period, as determined by an agreed climate change model, resulting from both the net anthropogenic emissions of an agreed set of greenhouse gases in each year of that time period and from the initial concentrations of those greenhouse gases at the beginning of the period;
- (f) Projected population growth;
- (g) Emission intensity of gross domestic product;
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- (i) Fossil fuel intensity of exports; and
- (j) Share of renewable energy in energy supply.

*Final Documents
Negotiations*

DISCUSSION PAPER

This paper considers several ways of adjusting our position in the climate negotiations, to help shape a deal at Kyoto.

The paper does not assume that it would be desirable to adjust our position in the climate negotiations. Instead, the paper explores different ways in which we might do so, examining pros and cons. Furthermore, the paper does not attempt to package the discrete elements considered into a larger whole. Based on feedback from principals, larger packages and broader strategies will be developed.

I. TARGETS AND TIMETABLES

Our proposal -- 1990 levels by 2008-2012 and reductions in the five-year period that follows -- has attracted no international support. The prospects that such a target will be sufficient to convince key negotiating partners to accept other parts of our framework (i.e., flexibility and developing country participation) are very slim.

Following are possible compromise approaches on targets and timetables:

A. Accept "differentiated" targets

This is the term used to describe different targets for different Annex I countries. The idea has considerable support from some of our natural allies in the negotiating process (including Japan, Norway and Australia). During the past several months, Climate Convention Chairman Estrada has increasingly been saying that some form of differentiation will be required for an agreement at Kyoto. To date, the EU has opposed "differentiation" labeled as such, although their "bubble" is (in fact) a differentiation scheme.

1. Japanese proposal

The Japanese propose that all Annex I countries reduce emissions 0-5% from 1990 levels by 2008-2012. The precise amount each country must reduce would be determined based on rates of change in population growth, energy intensity and/or per capita emissions. Under the Japanese formula, both the U.S. and Japan would need to reduce emissions roughly 2.5%.

Pros

- Forging common ground with the Japanese could offer strategic advantage within the negotiations.

- Japanese reduction targets are not significantly different than our own. Japanese may have flexibility to move toward us.
- The Japanese proposal constrains the differentiation within a very narrow range, avoiding widely disparate targets for Annex I countries in this round of negotiations.

Cons

- Reductions from 1990 levels in 2008-2012 would be very difficult domestically.
- EU opposes differentiation-by-formula component of Japanese position.
- By accepting the principle of differentiation-by-formula, we could open a Pandora's box of proposals for different targets based on different national circumstances.

2. Differentiation by baseline year

Another approach is to have common reduction targets for all Annex I countries, but allow countries some discretion in choosing a baseline year. For example, Annex I countries could agree to reduce emissions by 7.5%, with countries free to pick any baseline year between 1987 and 1995.

Pros

- Could thread the needle between EU and US positions, meeting the EU's domestic political need to claim "significant reductions" while allowing U.S. to stay at target level we have already proposed.
- Providing some pre-1990 baseline flexibility would be helpful in gaining the support of the Economies in Transition.

Cons

- The 1990 baseline is one of the few points of agreement in the international negotiations.
- Could be attacked as a gimmick by the environmental community, while Congress and industry would need assurance that we were not in fact proposing anything more stringent.

3. Pledge and Negotiate

Another possibility is for each Annex I country to propose its own target, to be included in the agreement. Country A could insist on more from Country B before signing, but the negotiations would focus on individual country commitments, not commitments for Annex I as a whole.

Pros

- May be only feasible approach, in light of wide range in willingness of Annex I countries to commit to reductions.

Cons

- Would lead to fractured Convention, difficult to explain to public.
- If some Annex I countries pledge significantly less than the U.S., could make domestic implementation and consensus-building more difficult.

“Pledge and negotiate” could be combined with “differentiation by baseline year.” Under such an approach, each country could express its pledge in terms of a baseline year and reduction target of its choosing.

B. Support Specific Reductions in 2013-2017

In his speech, the President proposed reductions from 1990 levels in 2013-2017, without specifying a number. We could propose a specific number for this period.

Pros

- Would be seen abroad as an indication of U.S. seriousness, especially if number were greater than 5%.
- Could put counter-pressure on the EU, whose long-term projections apparently raise concerns about their ability to meet a tough target in this timeframe (because of anticipated growth in eastern Germany and the possibility of future more Warsaw Pact countries joining the Union).
- Would be well-received by the domestic environmental community.

Cons

- Lose an important piece of leverage for any future round of negotiations with developing countries.
- Congressional and business reaction would likely be negative. Some supporters of the Byrd Resolution would oppose our signing up for second budget period before getting a commitment out of developing countries for a first.

C. Exclude Certain Gases from U.S. Proposal

The United States has proposed to include six major greenhouse gases (carbon dioxide, methane, nitrous oxide, HFCs, PFCs and SF-6) in our target. The EU and Japanese proposals do not

include HFCs, PFCs and SF-6. These three gases have very high Global Warming Potentials. (SF-6 is roughly 25,000 times more potent than carbon dioxide.)

We could propose to drop HFCs, PFCs and SF-6 from our target. [According to some estimates, this would allow us to accept a 2-3 percent reduction below 1990 levels in the same 2008-2012 period at equivalent economic cost.]

Pros

- This could help provide the leeway to propose the reduction target we have been under pressure to produce internationally.
- By counting the same sources as the EU and Japan, it would allow for a fairer and more accurate comparative assessment of our proposal.

Cons

- U.S. manufacturers of HFCs, PFCs and SF-6 want these gases *included* in the agreement. (These manufacturers want to establish a regime in which required reductions in these three gases can be traded for reductions in carbon dioxide. They want to avoid a regime which leads to phase-outs targeted narrowly to these gases.)
- Getting other countries to *include* all six gases appears to be an area where we actually made some progress in Bonn. A “comprehensive” approach is a long-standing element of the U.S. position.

- Allowing unregulated growth in these gases would be bad for the environment.
- Note:** If we choose to maintain our current position, we may want to get more mileage out of doing so, both diplomatically and in the realm of public opinion. It seems that our “comprehensive approach” could be earning us some credit, particularly if it can be argued that this makes our proposal stronger than Japan’s.

D. Support an Aspirational Target

We could accept a legally-binding target at roughly the level we have proposed and a more stringent, non-binding target.

Pros

- Could provide a way for EU politicians to claim that “significant reductions” were agreed at Kyoto.
- While ensuring a minimum standard of achievement across Annex I, would provide a vehicle for “greener” countries and environmental groups to continue to prod for steeper cuts.

Cons

- Internationally, this approach is unlikely to be viewed as credible, insofar as one of the defining features of these negotiations is “legally-binding targets.”
- Domestically, could make everyone mad. Congress and much of the business community could be concerned that the non-binding target would translate into additional regulations and possible economic costs down the road. Many environmental groups could be concerned that non-binding targets would have limited meaning.

E. Adjust Methodologies for Sinks

White House and agency staff are intensively examining different opportunities related to the treatment of sinks. Although further work is needed, two options may be promising. They are:

1. Excluding “soil carbon” from the agreement. According to projections, U.S. soils will absorb roughly 30 MMT less carbon in 2010 than they did in 1990. However, methodologies for these calculations are highly uncertain. If “soil carbon” were excluded from the agreement, the U.S. reduction target would shrink by 30 MMT (approximately 7% of the emissions growth from 1990 to 2010).

2. Modified New Zealand Proposal. Under a proposal currently under discussion internationally, 1990 baselines for Annex I countries would be adjusted so as not to penalize countries (like the US) that were engaged in unusually high levels of forestation in that year. This requires further analysis, but could be helpful.

F. Strengthen our Existing Target

Flexibility: Agree to strengthen our existing target either by accepting reductions below the 1990 baseline in the 2008-2012 period or by moving up our timetable for stabilization (i.e. 2005-2012 or even 2005-2015).

Pros

Strengthening our target would help bridge the gap with the EU and gain support from the G-77 for other elements of our proposal. We would get more credit for accepting reductions below the 1990 baseline than for moving the timetable.

Cons

Given that the President has already announced our target and given the economic and political realities associated with it, it is unlikely that we could move far enough to make much of a difference.

Any agreement to reductions below the 1990 level seems improbable in the absence of new and compelling economic analysis that such reductions could be achieved without higher costs.

Opting for a 2005-2012 time frame seems almost equally hard. It might be possible to argue for the 2007-2013 or 2005-2015 possibility by playing both ends of the timetable (i.e. emphasizing the earlier start for environmentalists and the later end for industry).

II. FLEXIBILITY PROVISIONS

Our emissions trading proposals are winning only limited support abroad. Although there are reasonable prospects that Annex I emissions trading will be accepted by the Parties, significant restrictions on such trading are possible. These include (1) provisions requiring domestic emissions reductions to be the "main" means of meeting Party's commitments, (2) provisions limiting to trading to "Parties," and (3) restrictions that may emerge as methodologies for emissions trading are developed after Kyoto. In addition, support for joint implementation for credit is very limited. It appears very unlikely that Parties will agree at Kyoto to joint implementation for credit, except among Annex I countries and with those developing countries who "volunteer" for binding limits.

Note: The SGM model suggests that over 50 percent of U.S. reductions are likely to come from abroad.

- According to the SGM model, 55 percent of our reductions to reach 1990 levels by 2010 are likely to come from Annex I trading and 83 percent from Annex I trading plus non-Annex I reductions. (Two notes: First, the figures are lower if paper tons are not allocated to the former Soviet Union. Second, the model assumes worldwide trading -- not "JI.")

A very rough rule of thumb from the economic models is that every 10 percentage point increase in the share of reductions that must be done domestically (above those that would occur at home without any restriction) raises the domestic permit price by perhaps \$10 to \$20 per ton.

Restricting the share of reductions from international trading and/or JI would raise costs domestically, but would reduce concerns associated with capital transfers abroad.

III. PARTICIPATION OF DEVELOPING COUNTRIES

Our "evolution" proposal -- that developing countries agree to negotiate binding limits as part of a Kyoto protocol -- has no support from other countries and is dead. A weaker version -- under which Parties would decide at Kyoto to begin such negotiations under a document other than a protocol -- has some modest prospects for success. However, the terms for any such agreement are unlikely to be favorable. At this writing, it appears that the strongest possible mandate would be an agreement to aim to negotiate limits of some kind (i.e., not necessarily binding limits) by

2002 or 2003 at the earliest. Even this is far from certain.

In recent weeks, staff for Senator Byrd has been stressing that an "agreement to negotiate" is not satisfactory to the Senator and would not in the Senator's view address the concerns expressed in his resolution.

Other parts of the original U.S. proposal for developing country participation are meeting with somewhat greater success. There is now a reasonable chance that a protocol could include a "volunteers category" -- that is a section providing for non-Annex I countries to volunteer for commitments individually. Such action could give countries the right to participate in the global trading regime.

The current state of play raises two questions:

A. Which would be preferable: an "evolution" provision with a 2002/2003 end-date and soft "aim to negotiate" language, or no "evolution" provision at all?

- An evolution provision, however soft, could generate momentum internationally toward the participation of developing countries and help keep this issue on the agenda. It could be part of our explanation at home of the steps we are taking to engage developing countries.
- On the other hand, the terms of the mandate could become a constraint -- e.g., no *sooner* than 2002/2003. They could also underscore the unwillingness of developing countries to participate, while providing no benefit with Senator Byrd and his allies. Even getting a soft mandate would require a fair amount of diplomatic effort and perhaps concessions.

B. Is the U.S. prepared to return from Kyoto without any form of evolution provision but -- instead -- with an agreement on a "volunteers category" and plans to persuade key developing countries to "volunteer" before any protocol became binding in the U.S.?

- Bilateral discussions with key developing countries may bear more fruit than talks in the highly-politicized atmosphere of the Climate Convention. Success with a few key countries could help significantly both to address the environmental need and to respond to domestic political concerns.
- However, this approach could be viewed as inadequate by many at home and bad faith by many abroad. Could be especially difficult if no major developing countries indicate an interest in volunteering at Kyoto. The sequencing could be awkward, if we are asking key developing countries to sign onto commitments (e.g., in 1998 and 1999) before we decide to make our Kyoto commitments binding on ourselves.

Negotiations

DRAFT 10/30

DISCUSSION PAPER**I. State of Play**

Reports from Bonn suggest we are in deadlock. No country has come forward to support the U.S. target; support for joint implementation is very limited; our position on developing country participation has won no backers. At the same time, no other proposal (EU, Japan, G-77) seems headed for consensus support.

Currently, the bidding is as follows:

- There is potential for common ground with a group of non-EU Annex I countries, including Canada, Australia, New Zealand, Japan and the FSU. None of these countries have embraced the EU targets. However, none have embraced our calls for developing country participation either. Several are insisting on "differentiated targets."
- The EU is seeking to claim the moral high ground with its steep reduction targets. It disputes vigorously our claim that their targets are unachievable and has held briefings in Bonn to explain how they plan to achieve their targets. The EU is not joining our call for developing country participation.
- G-77 has united disparate elements (small island states, OPEC) behind a proposal with steep reduction targets (the EU numbers plus a 35% reduction from 1990 levels in 2020) and "compensation" proposal (under which Annex I countries would pay the G-77 for lost revenues associated with meeting any target). Key developing countries (e.g. China, Brazil and India) emphatically reject our proposal that they agree at Kyoto to negotiate emissions limits in the future.

II. Strategy

There are, in concept, three possible outcomes for Kyoto: (1) a deal on substance; (2) a deal to keep process going despite no deal on substance; (3) no deal at all (breakdown). Our general strategic objective is to secure the first outcome on desirable terms, the second if a good deal isn't possible, and to avoid the third. Note that a hybrid of the first and second outcome is also possible -- a very limited deal on substance and an agreement to keep the process going.

To try to achieve our desired ends, there seem to be two main tactical alternatives to pursue, though the calendar dictates that, to the extent we think both make sense, we will have to pursue them simultaneously rather than in sequence.

Coalition with non-EU Annex I countries. Given the wide gap between us and both the EU and the G-77, one approach would be to try to forge a coalition with non-EU Annex I countries (e.g., Japan, Canada, Australia, New Zealand, FSU, Eastern Europe), then approach the EU and, if any ground for compromise existed to permit a broader Annex I coalition to form, try to move out to embrace the developing countries. Building such a non-EU coalition would arguably put us in stronger position to strike a deal either on substance or process. And even if no deal proved possible, we would probably do better in the breakdown scenario if we were part of a larger grouping than if we were alone.

Pursuit of common ground with EU. An alternative approach would be to deal directly with the EU to try to build a compromise package that would move us out of our current stalemate.

The G-77. It is unlikely that we'll be able to make any real progress with developing countries unless and until we have built some basis for agreement with other Annex I countries. Even then it isn't clear that we'd be able to make much headway. But, again, given the constraints of the calendar, this doesn't mean we shouldn't be exploring whatever G-77 avenues might be available.

Calendar. Starting tomorrow, we have a series of high-level diplomatic meetings with a broad range of countries. Key meetings include:

October 31: Tarullo/G-8 sherpas

October 31 - November 10: Talbott Asia trip (New Zealand, Australia, Indonesia, China, Japan, Korea)

November 1-7 (approximately) -- M. Kimble in Europe

November 4: Wirth & Eizenstat/EU Troika

[November 6: VP/Prescott]

November 8&9: informal climate change ministerial in Tokyo (two dozen key countries)

mid November: Zedillo State Visit

late November: APEC leaders meeting

The Kyoto conference opens less than five weeks from today.

III. Main Issues

Target:

- differentiation: countries would adopt different target and timetables, based on formulae (with criteria such as per capita emissions, energy efficiency, population growth); negotiated targets for each country; or common reduction targets with a choice of baseline years.
- second budget period reduction:
- earlier start of budget period;

- move our baseline forward;
- FSU and Eastern European issues: EIT baselines; paper tons

Flexibility

- restrict trading;
- restrict JI;
- banking and borrowing,
- EU bubble

Developing countries

- evolution
- volunteer budget commitments
- triggering only key countries, etc.

IV. Possible Packages for Substantive Deal

A. Form Non-EU Annex I Coalition

The primary strategic objective here is to broaden the base of support for the U.S. proposal; pressure the EU to come toward the targets supported by a bloc of other Annex I countries; and (if we are not able to seal a deal at Kyoto) define a favorable means for continuing the negotiations in the years ahead. To accomplish this, we will need to create several high-level diplomatic channels with key countries in the next two weeks; use Talbott visits to key countries; use the Tokyo ministerial; and use a significant fraction of leaders' time at APEC.

This strategy could lead to (a) a Kyoto agreement, based upon negotiations between the U.S.-led bloc, on the one hand, and the EU and G-77 countries on the other; or (b) a process agreement to continue discussions.

TARGET: Roughly at levels we have proposed. To bring others on board, we would likely need to:

- allow some form of differentiation. This could be on the basis of a defined formula (e.g. the Japanese proposal, which varies commitments depending on population growth, energy efficiency and per capita emissions), different negotiated levels for each country, or common reduction targets with a choice of baseline years.
- support Russians on "paper tons" and support EIT on 1987 baseline year
- support some (scaled-back) form of New Zealand sinks proposal

FLEXIBILITY: Unlimited Annex I trading and worldwide joint implementation for credit.

DEVELOPING COUNTRY PARTICIPATION: Support Japanese suggestion for review of commitments of both developed and developing countries, perhaps during next several years. Article 10 “volunteers category.” [WHAT IS ARTICLE 10??]

B. Shape Deal that Could Gain EU and G-77 Support

TARGET: To gain EU support, we would at a minimum need to support targets that appear more stringent than those we have proposed. (EU politicians need to be able to market the Kyoto agreement as significant reductions.) We might also need, ultimately, to agree to reductions that are in fact more stringent. Options include:

Annex I countries reduce emissions by 7.5% by 2008-2012. Countries could choose any baseline year between 1987 and 1995.

10% reductions from 1990 levels in second budget period (2013-2017)

Start budget period in 2005

FLEXIBILITY: Unlimited Annex I trading. EU bubble. Joint implementation (a) within Annex I and with other countries who have accepted binding limits [on the assumption that several key developing countries could be persuaded to accept some kind of not very restrictive formula, such as per capita emission limits], or (b) with all countries, assuming no developing country acceptance of a binding formula.]

DEVELOPING COUNTRY COMMITMENTS: To gain commitments from key developing countries -- even the commitment to negotiate -- we would need to offer something they find attractive. To date, we have not done so. Theoretical possibilities include:

- new and additional money and technology (unlikely in the extreme).
- a formula emissions limit that would not appear to limit their growth potential. Treasury was going to work on possible alternative formulas that might fit this bill. We need some analysis here. One theoretical possibility that developing countries might be most interested in is a formula that was keyed to per capita emissions, but we need analysis on what such a limit would mean substantively -- e.g., if it doesn't amount to *any* kind of restraint, it probably wouldn't do us much good.

A package might include Article 10 “volunteers category” and review of commitments for all parties at COP-4 (in 1998). We would work hard between now and Kyoto to get several major developing countries, especially China, to sign on by offering per capita emissions limits under Article 10.

V. Process Deal

At the same time that we are trying to piece together a substantive agreement for Kyoto, we need to be working on a process deal that would keep the parties talking, in one forum or another, and avoid a breakdown.

We need guidance from State on the different options here. For example, one option might be to extend the negotiating process under the Berlin Mandate. Another might be to develop a new negotiating mandate, with somewhat different parameters. We need to understand in very short order what the options are and how we might best pursue them tactically.

The most difficult issue here will likely be developing country commitments. As at Berlin, we will face widespread resistance to our efforts to add new developing country commitments to the agenda for any future discussions.

Negotiations

**OFFICE OF TIMOTHY E. WIRTH
UNDER SECRETARY
FOR GLOBAL AFFAIRS**

'97 OCT 7 PM 1:13

**DEPARTMENT OF STATE
2201 C Street, N.W.
Room 7250
Washington, D.C. 20520
Phone: 202-647-6240 Fax: 202-647-0753**

TO: Sperling Climate Working Group Members (See Addressees Listed)

FROM: Timothy E. Wirth

DATE: October 7, 1997

FAX: _____

Number of Pages (including cover): 5

COMMENTS: Reporting Memo from Under Secretary Wirth on the
two day climate meeting in Honolulu on October 3&4.



United States Department of State

*Under Secretary of State
for Global Affairs*

Washington, D.C. 20520-7250

October 7, 1997

SENSITIVE BUT UNCLASSIFIED
MEMORANDUM

TO: Sperling Climate Working Group:

NEC - Gene B. Sperling
CEQ - Kathleen A. McGinty
NEC - Daniel K. Tarullo
WH - Todd Stern
CEA - Janet L. Yellen
Treasury - Lawrence H. Summers
State/E - Stuart E. Eizenstat

FROM: G - Timothy E. Wirth

SUBJECT: Some Possible Momentum

The U.S. hosted a two day climate meeting in Honolulu October 3 to 4 for the Ministers from Japan, Australia, Canada and New Zealand (NZ sent representatives). We discussed many of the technical issues in the negotiation, and I think made some real progress. But you need to know the outcome in two central issues:

1. The EU Bubble: We all agreed that it was time to raise to a more public profile the many problems with the EU "Bubble." Attached is the problem list developed in our discussions. The fact is that the "Bubble" allows the EU to maintain the fiction of real cuts at a deep level, giving political heartburn to the rest of us. And the Bubble makes it extremely difficult to come to consensus among Annex I countries on Targets and Timetables and, therefore, in effect prevents a common joint position on the need for Developing Country participation.

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We all thought that the time had come for us to raise questions about - not attack - the EU Bubble, and to do it in a somewhat concerted fashion, touching the attached points (see page 4). I said that we'd have to clear this, but it seemed right to us (Wirth, Pomerance, Hambley, Reifsnnyder).

2. Developing Countries. Of even greater interest was the Japanese proposal that a Kyoto Mandate be explicitly tied to the outcome of the Berlin Mandate. In effect, Japan is proposing that we would agree in Kyoto to Targets and Timetables, but this agreement would be tied explicitly to agreement by all parties on an early starting and ending of negotiation on required emissions limitations by developing countries "evolution").

Their proposal was offered by Japan's leading climate point man, Ambassador Tanabe, in the absence of Environment Minister Ohki who had to return to Japan. When queried about the "linkage" between the proposed protocol and a "Kyoto Mandate," Tanabe reasserted that the two should be viewed as a "package." Although it is unlikely that this package in Japanese views would incorporate all of the rigor which we anticipate, their proposal nevertheless represents an important step which we should be able to work with as our own position evolves.

(Comment: This may represent a significant move by Japan - clearly they are trying to find a consensus. At the morning session, Tanabe (in Ohki's presence) supported a much watered-down evolution formulation, claiming this stance was necessary to bring developing countries on board and in view of Japan's "neutral" stance as COP-3 host. In effect, he told us that we would have "to go it alone" on evolution as we had proposed it. Tanabe's distinct change in approach in the afternoon session followed strong interventions on this topic by ourselves, supported by the Australian and Canadian ministers. We will have to see if Japan continues to toe the line on this critical issue in the coming weeks. End Comment.)

The Japanese also invited us to an informal discussion at the Ministerial level to be held in Tokyo November 8-9, following the last formal negotiating session. This would

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include The Troika (Luxembourg, Netherlands and the U.K.), Germany, Canada, Australia, New Zealand, China, India, Indonesia, Brazil, Tanzania, Russia and probably a few others.

Momentum gathers.

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Problems with the European Bubble:

1. Relationship to trading - Why don't the EU countries each make a commitment and then trade?
2. Accountability - Who is responsible for measurement, achievement and accountability?
3. Example for Developing Countries - Some Annex I countries going up 40%!
4. Reality of Deductions - Are we getting real reductions or paper from East Germany (while Germany continues to subsidize coal)?
5. Relationship to Developing Countries - As long as there is no agreement among Annex I countries on QELROS, then it is impossible for us to jointly take on the developing countries.
6. Enlargement - How will new EU members be brought into the Bubble?
7. Basic Fairness - The Tanabe arguments. (Tanabe asks how France, whose situation in his view is comparable to his own country's, escapes with only a five percent cut under EU burden-sharing when the EU proposes a fifteen percent cut for Japan.)
8. Political High Ground - The EU has grabbed the political high ground among the greens, making other Annex I countries defensive - but the EU position is founded on a sand base. This has to be at least exposed and questioned.

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United States Department of State

Bureau of Oceans and International
Environmental and Scientific Affairs

Washington, D.C. 20520

Negotiations**URGENT**

DATE: 10/24/97 '97 OCT 24 AM 10:27

NUMBER OF PAGES TO FOLLOW: 1FAX TO: Todd SternTELEPHONE: ----- FAX: (202) 456-2215OFFICE: White House

FAX FROM: Rafe PomeranceTELEPHONE: 647-2232 FAX: 647-0217OFFICE: OES, Department of State

MESSAGE:

TODD:

THE SPERLING GROUP NEEDS TO REACT TO THIS TODAY. I HAVE FORWARDED
A COPY TO STEINBERG. PLEASE CALL ABOUT HOW WE DO THIS.

RAFE

by Amb. Tanabe

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Post Kyoto Process

1. The Conference of Parties, at its third session,

In accordance with Article 7, paragraph 2, subparagraph (a), of the United Nations Framework Convention on Climate Change,

Agrees to start a new process to review the obligations of the Parties and the institutional arrangements under the Convention and the Protocol, in the light of the objective of the Convention, the experience gained in its implementation and the evolution of scientific and technological knowledge.

2. This process will,

(a) decide on commitments by all non-Annex I countries concerning limitation of GHG emissions through such a way as improvement of energy efficiency by the Meeting of Parties in 2002,

(b) consider appropriate ways and means to assist non-Annex I countries with the view that non-Annex I countries which make efforts in limitation of GHG emissions through such a way as improvement of energy efficiency should be granted with favorable terms and conditions in financial and technical assistance from Annex I countries,

(c) review the adequacy of the commitment by the Annex I countries by the Meeting of Parties in 2002 in the light of the latest scientific knowledge and technological development and reflect results of the review in setting legally binding quantified emission reduction targets by Annex I countries for the second budget period starting in 2013.