Personal view: Coping with Copenhagen

By Paul R. Kleindorfer

Represented by a group of faculty, students and alumni, INSEAD attended the Copenhagen Summit as an accredited Observer. Kleindorfer, who headed up the INSEAD delegation, reflects on what was and was not accomplished at the Summit.

The Copenhagen Climate Summit (COP 15) began on December 7, 2009, on the heels of the pirating of the East Anglia University Climatic Research Unit's email exchanges, and calls of climate sceptics to re-examine the scientific basis for undertaking actions to limit greenhouse gas (GHG) emissions originating from human activity. The debate on this issue lasted only a few hours at COP15, as delegates from the 193 countries represented, noted the all too apparent signs of climate change already affecting many countries, especially developing countries, and the fact that the science underlying climate change - while uncertain - was sufficiently foreboding to warrant immediate and urgent action. With peak oil behind us and the implied necessity to move in any case to new sources of energy, the general reaction of the delegates to COP15 was that not moving ahead with strong actions to avert potentially disastrous consequences to the planet from global warming would not only be imprudent but irresponsible. The

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conference moved on quickly to the expected agenda of what targets could be set, how adaptation strategies could be financed in the developing world and how markets could be used to foster innovation and implement low-carbon targets efficiently.

What was achieved? The heads of state of Brazil, China, India, South Africa and the United States managed, in direct negotiations, to agree on a few principles, as recorded in the so-called 'Copenhagen Accord', which was finalised in the waning final hours of COP15. The Accord itself was not formally adopted by the Conference of Parties, but was merely "noted" by the COP (with all but five countries agreeing to the final wording of the Accord). While disappointing to many of the 193 country delegations for its failure to set specific targets for GHG reductions, the Copenhagen Accord nonetheless represented some important elements of progress.

Let me note a few of these. First, China and the US did come to an agreement of sorts, and the last-minute breaking of the logjam at COP15 by US President Barack Obama and Chinese Prime Minister Wen Jiabao underlined the critical role of China and the US in these negotiations and the basic notion that the 30 or so countries responsible for 90 per cent of global anthropogenic emissions must be the primary countries to agree on practical steps going forward. The idea of "common but differentiated responsibilities" was further refined as part of climate change adaptation, and specifically in respect to discussions of aid to developing countries for adaptation and reforestation, with collective commitments approaching $30 billion for the period 2010-2012 and an agreed target of $100 billion by 2020 to provide funding for "meaningful mitigation actions" in developing countries. Finally, and most importantly, the Copenhagen Accord states that deep cuts in global emissions are required, based on available science, with a view to reducing global GHG emissions to levels consistent with maintaining global temperature increases at less than two degrees Celsius.

As important as these steps are for moving ahead to lower global GHG emissions, there were some real disappointments for business at COP15. The largest disappointment is the continuing uncertainty about what various national and regional governments will eventually do or will be required to do.

The general tone of the discussion at Copenhagen continued to be a portfolio of national approaches to GHG emissions, rather than international agreement on targets, on carbon pricing or other key ingredients that would

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allow businesses with global reach to plan for the future. While this portfolio approach may ultimately be the only feasible approach, it will understandably continue to cast a cloud over new investments, especially in energy-intensive industries.

Moreover, the nature of this uncertainty is lop-sided for European and North American investors in several important respects. The Copenhagen Accord is silent, for example, on border adjustments for carbon content of internationally traded goods (for example, metals and cement) that could be a significant advantage for companies in countries without input-carbon pricing regimes (such as China and India) relative to those operating in countries with such a regime (e.g., the EU). The reluctance of larger developing countries to agree to international audit and monitoring standards further reinforces the misgivings of energy-intensive companies regarding a level playing field on carbon input pricing. Add to this the pressures to move to even more stringent targets (for example, the proposed move to a 30 per cent reduction in GHG emissions, from 20 per cent, by 2020 on the part of the EU), and one can see why business leaders should remain very concerned about the continuing uncertainties regarding non-market drivers of profits after Copenhagen.

Perhaps the most important implication of Copenhagen for business leaders is the importance of improved risk management for companies in every sector going forward. Whether one is a believer or a sceptic on the science of climate change, Copenhagen clearly demonstrates a strong and continuing move forward by the international community, and pressures by an increasingly concerned public from all over the world. These movements and pressures will almost certainly lead to further national and international regulations and commitments in the foreseeable future.

Ready or not, these changes will have huge implications for business. For investors and managers, how well-prepared companies are to digest the uncertainties (political and economic) present in the climate change area will be central to company profitability. For energy-intensive manufacturing, developing new competencies in carbon measurement and trading will be central. For retailers, developing increased visibility and supply chain-wide measurements on energy, carbon and water use will be required to satisfy consumer and NGO demands for this information. For insurers and financial institutions, tracking and pricing the changing nature of weather-related risks and providing appropriate risk management services and risk transfer instruments to companies and governments will provide new challenges and

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new opportunities. Consulting companies are already booking a great deal of business in the sustainability and climate change area. Companies with global reach and significant stakes in emerging economies will be partners in the increased vulnerability of these countries to climate change risks and in the benefits from adaptation strategies. Given the scope of these consequences, business must play an active role to maintain the global economy on a course that continues to facilitate markets and trade, the great levers of wealth. At the same time, we must realise the critical role that political and scientific institutions of the planet will necessarily play in crafting the constraints and incentives that will help the citizens and businesses of the planet move from the current fossil-fuel economy to a sustainable future. More than anything else, the complexity of this task, but also the willingness to confront it and get on with it, are the basic messages of Copenhagen.

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