COP27: Has enough action been taken at 'the implementation COP'?

The key theme for COP27 has been to follow through on commitments made at COP26. The climate conference so far has shown some but not enough progress in implementation. While talks are slowly advancing on loss and damage funding and carbon offset markets, we expect more to be done in the remaining days of COP27

Climate change forecasts have been more alarming than ever. Just days before COP27, the United Nations annual climate conference, a report released by the UN Environmental Programme projected that current nationally determined contributions (NDCs, or country pledges that cover agreed policies) will likely result in a 2.4 to 2.6-degree Celsius increase in global temperature by 2100, well above the Paris Agreement's 1.5-degree Celsius goal.

This gloomy outlook emphasises the urgency for governments to act and collaborate. Deemed an 'implementation COP', COP27 has largely been focusing on how governments are going to honour their commitments, and how they can work together to address climate challenges at the global level. While COP27 is still a few days away from its conclusion, here's what the conference has achieved so far.

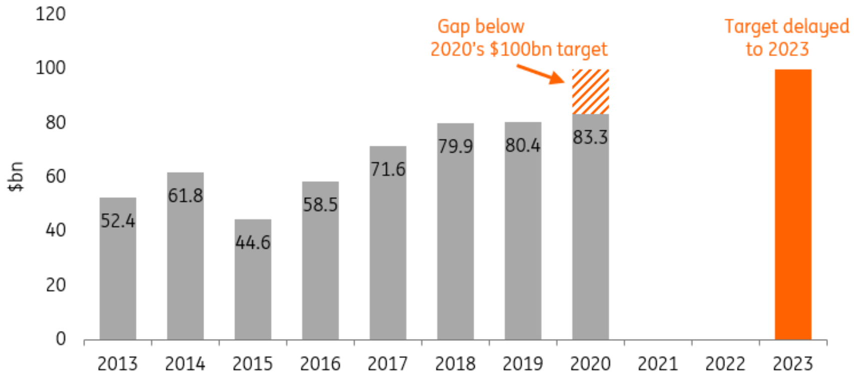
[Four key things to watch out for at COP27]

[Good COP, Bad COP: Separating heat from light at the climate summit]

Slow progress in addressing loss and damage

The issue of loss and damage – which refers to how developing countries are suffering disproportionally from climate change while having contributed little to it – has been taking centre stage at COP27 as it appears officially for the first time on the agenda. Developed countries previously agreed to provide $100bn per year by 2020 to help developing countries mitigate climate change but have been falling short of that target (developed countries collectively only financed $83.3bn in 2020).

Climate finance provided and mobilised by developed countries



Source: OECD

This year at COP27, developed countries such as the US and the UK have announced plans to increase their climate funding to developing countries, but these announcements are likely not going to be enough to reach the $100bn per year target. Moreover, while the UK, for example, pledged to triple climate funding, the money is expected to come from the $13.65mn that the country had already committed to paying, with no extra funding planned.

So far, negotiations on the topic have been hindered by disagreements between developing and developed countries. On Monday, the UN published a draft proposing to either launch a two-year process to establish a funding mechanism to compensate for loss and damage or to delay the decision on what the UN's role would be until 2023. Developing countries including China, however, have requested a loss and damage fund be established at COP27.

The geopolitical situation is not helpful either. Although the US and China have resumed bilateral climate talks, which is expected to boost COP27 negotiations in general, the two countries are divided on climate financing. While China is among the group of developing countries requesting funding, the US has expressed concern about putting money in a fund as this could pose a liability to donors in the event that funds turn out to be insufficient.

And there are reasons to believe it will, as experts claim that $100bn per year is far from sufficient in the long-term to help developing countries mitigate climate change consequences. A recent UN-backed report shows that roughly $2tn per year of investment will be needed by developing countries by 2030 to fight climate change, and half of it will have to come from external financing. The $100bn per year of funding target from developed countries is therefore only a start; a coordinated mechanism will need to be in place for global climate financing to work.

In addition to direct climate aid, the UN's proposed draft notes that arrangements for funding for loss and damage can also include debt relief, reform of international financial institutions, and humanitarian assistance, among others. These measures can effectively improve the climate financing system and are relatively easier for developed countries to get on board with. Indeed, the IMF and the World Bank have announced at COP27 that countries affected by extreme weather disasters will be able to defer their debt repayments for a maximum of two years.

Complications of developing a more mature carbon market

Although not as popular as loss and damage, Article 6 is an important discussion point at COP27. Article 6, which was finally agreed upon at the COP26 Glasgow summit, addresses the functioning of international carbon markets and carbon trading and discusses how countries can collaborate across borders to meet their climate goals. Yet several issues remain outstanding for COP27. First, despite the agreed-upon principles regarding additionality and performance to enhance the credibility of carbon credits, detailed rules are needed for the carbon market to function. Second, countries still need to decide whether they can modify their authorisations for carbon credits and how to deal with unauthorised credits. Third, while avoided emissions currently do not qualify under Article 6, it will be up to negotiators to decide whether they will qualify in the future.

Discussions on Article 6 have been advancing slowly at COP27, partly because the loss and damage topic is dominating delegates' attention, and partly because of the complexity of designing an effective global carbon market. Yet we could still expect final decisions to be made on the matter, as Article 6 is not as controversial as some of the other issues at COP27.

We could still expect final decisions to be made on Article 6.

Separately, the US has proposed setting up a carbon offset programme – called the Energy Transition Accelerator (ETA) – which would allow private companies to buy a newly created class of carbon credits from projects in developing countries to help cut emissions and accelerate the transition from fossil fuels to renewable energy. Such a programme could transfer large amounts of money from the private sector to developing countries and help with climate financing, but the proposal has encountered resistance.

First, without careful design and successful implementation, the programme is not guaranteed to lead to substantial cuts in emissions. For instance, if a renewable project is planned to be built in a developing country anyway, without replacing fossil fuels, the project would not replace emissions but would nevertheless allow credit purchasers to emit more. Additionally, with the current $2bn carbon offset market remaining unregulated, the ETA would likely face challenges on the regulation front as well. The ETA will likely not be included in COP27's final text, but will likely start to be implemented anyway, led by the US. From a global perspective, there are good reasons to go for one carbon offsetting market, rather than different systems. So it will be curious to see how this plays out.

Few new targets and climate plans revealed

Another topic being watched at COP27 is whether and how countries will revisit and strengthen their 2030 climate targets to be aligned with the 1.5-degree Celsius Paris Agreement goal. We were not expecting an overflow of government announcements at COP27 amid the global energy crisis and fears of economic recessions. Indeed, only 28 countries have submitted an updated NDC so far.

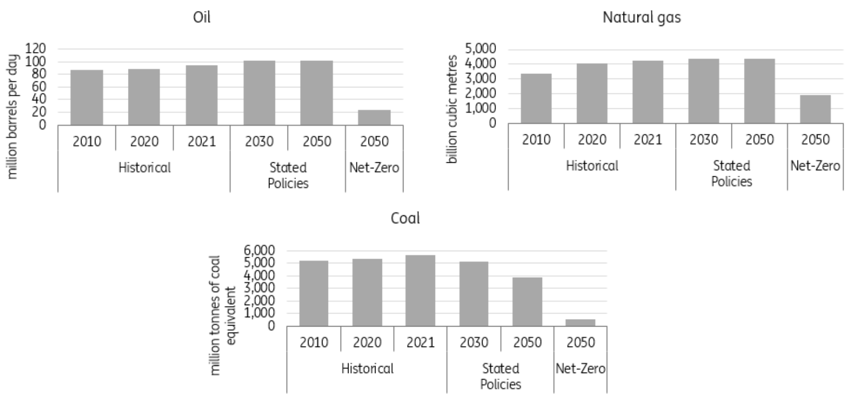
> *Further efforts are needed to push countries to roll out concrete plans to back their climate targets.*

Of these countries, India stands out. The world's third largest emitter is now committed to reducing carbon intensity by 45% below 2005 levels by 2030, up from 33%-35% before. India has also submitted during COP27 its Long-Term Low-Carbon Development Strategy (LTS), which includes plans that range from increasing renewable deployment to electrifying the transport sector to enhancing climate resiliency. However, the submitted LTS appears to be insufficient without specific pathways to achieving its 2030 and 2070 targets. Notably, the document states that India will need coal in the long run. India is proposing to rationalise the use of fossil fuels and close inefficient thermal power. Yet it suggests that although the share of coal-fired power generation will decrease, it will be a gradual process (also discussed later). This is evidence that further efforts are needed to push countries to roll out concrete plans to back their climate targets.

Will there be an agreement to phase down all fossil fuels?

While Russia's invasion of Ukraine has led countries to ensure short-term energy security by switching to more coal consumption, it has also prompted them to make more efforts to switch to renewable energy. As such, the International Energy Agency's (IEA's) most recent World Energy Outlook suggests for the first time under its Stated Energy Policy Scenario that demand for fossil fuels will see a definitive plateau this decade.

Global fossil fuel demand under different scenarios



Source: International Energy Agency, ING Research

However, the plateau of fossil fuel demand is not enough. The IEA's Net Zero Scenario requires a deep decline in fossil fuel consumption, with the demand for coal needing to fall by 90% (unabated coal demand to fall by 98%), oil by 75%, and gas by 55% by 2050.

At COP26, almost 200 countries pledged for the first time to phase down the use of unabated coal and end inefficient subsidies on fossil fuels, although these 200 countries notably did not include China and India. At COP27, China expressed that it would need to continue relying on coal production to ensure grid stability; India also stated in its LTS that it needs coal to "guard against a lack of adequate and reliable energy." Since it remains uncertain how much of the coal production in China and India will be abated, the continuing reluctance of the world's two largest coal consumers to substantially phase down coal means limited effects of the global coal pledge reached at COP26.

India, on the other hand, is pushing to include in the final text of COP27 a phase-down of all kinds of fossil fuels. The EU has stated its support for India's proposal, but only if this does not weaken any of the commitments already made on coal. But we would expect oil-producing countries – and poor countries in regions such as Africa – to oppose this proposal, which makes the chances of it being included in the final decision uncertain. While it is still subject to change, a first draft of the overarching COP27 decision reportedly did not include phasing down fossil fuels.

Corporate sustainability commitments grabbing more attention

With a flurry of announcements from corporates to reach net-zero emissions, there is a growing concern about companies making pledges without releasing concrete action plans. During COP27, an UN-backed organisation published a report recommending how corporates can avoid greenwashing based on inaction and inaccurate claims. These recommendations include coupling long-term pledges with short-term science-based targets, addressing Scope 3 emissions, prioritising deep emissions reduction over purchasing carbon credits, increasing climate action transparency and accountability, as well as transitioning from fossil fuels to renewables.

The report affirms the mounting trend that companies will increasingly be held accountable – by investors, regulators, and now international organisations – for not only their pledges but also their strategies and actions.

Conclusion and what to expect from the final days of COP27

Although discussions have been advancing slowly, which is not completely abnormal at COP conferences, we could still see important agreements made by parties this Friday toward the very end of COP27.

On financing for loss and damage, we would expect some final decision to be made, as this is the single most important topic of COP27. The optimistic case is that countries agree to establish a fund and an official entity to manage and oversee funding flows; the less optimistic case is that countries leave the decision to COP28.

The longer countries delay climate action, the deeper and faster we will need to cut emissions to reach net-zero emissions by 2050.

And while we think that agreements on the details of Article 6 could be reached, we are less confident that countries will, on a large scale, agree to phase down all kinds of fossil fuels, given the global energy crisis.

Understandably, most of the above-mentioned issues are complex in nature, and it is hard to get every country on board. But we must keep in mind that the longer countries delay climate action, the deeper and faster we will need to cut emissions to reach net-zero emissions by 2050. Compromises and timely collaboration have become critical to keeping global warming under control.

Authors

Coco Zhang
ESG Research
coco.zhang@ing.com

Gerben Hieminga
Senior Sector Economist
gerben.hieminga@ing.com