

*PREDECISIONAL DRAFT
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SUBJECT: Kyoto

We are within reach of a deal at Kyoto. Most of the developed world (including the EU) wants one. The biggest stumbling block is indifference or outright opposition from China, India and key OPEC members (including Saudi Arabia).

This memo sketches the deal that may be available. It then asks: (1) how do we get it? and (2) do we want it?

I. THE DEAL

A. Targets

Outside the EU, most of the developed world supports targets in the area we proposed. Within the EU, most countries are willing (some are eager) to scale back their target to roughly 5%-10% below 1990 levels by 2010.

There are three ways to get a deal:

1. Some form of differentiation. This could involve a "pledge" or "schedule" approach (in which targets for each country are negotiated individually); two or three different targets, from which countries could choose; a uniform reduction for all countries with a choice of baseline year; or the Japanese formula.
2. Specific reductions in the second budget period. Anything greater than 5% would help get a deal.
3. Reductions below 1990 levels in the first budget period.

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No decision should be made on the third option until the Kyoto ministerial (December 8-10). (Confidential instructions will not hold.) However, we should decide whether we want to explore either of the first two options during the first week at Kyoto (December 1-7). If our delegation simply reiterates the current U.S. position for the first week, others will shape possible compromises and we may leave more work than realistically can be accomplished for the last 72 hours.

B. Developing Country Commitments.

At Kyoto, developing countries may agree to: (1) a "review of commitments" for the world as a whole in 1998 (this could lead to a negotiating mandate); and (2) an opt-in mechanism, under which developing countries could sign up individually for binding targets. More than this is not possible. Even this is not certain.

Negotiations on this issue are driven by the low priority most developing countries attach to climate change, perceptions that the developed world failed to follow through on promises made at Rio, and opposition from key countries.

C. Flexibility

At Kyoto, we can win agreement on Annex I emissions trading (assuming we give the EU its bubble). We can win support for joint implementation among Annex I countries and with developing countries who have opted individually for targets. We can likely get agreement for the Parties to consider joint implementation for the world as a whole at the completion of the pilot phase, in 2000.

Whether more is possible is not now clear. Discussions with the Brazilians and other members of the G-77 will clarify any opportunities associated with G-77 endorsement of the Brazilian "Clean Development Fund."

II. HOW DO WE GET IT?

Following are key elements of a gameplan:

A. Push II. We should use all diplomatic resources available to spread the gospel of emissions trading and joint implementation. The next few weeks offer a relatively rare opportunity: attention to these issues from developing world leaders and finance ministers. Few of these leaders or ministers have any idea that emissions trading/ji could contribute new and additional money and technology to their economies. APEC is obviously an important opportunity. In addition, USG officials at senior levels should call counterparts and we should consider hosting a

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small meeting of developing country finance ministers on this topic.

2. Build bloc of non-EU Annex I. With minor exceptions, our common ground is more important than our differences. Our goal should be a common position, or close to it, by the beginning of the Tokyo ministerial. This may require us to accept some form of differentiation (and allow the Russians the sell some of their "pre-budget period paper tons").

3. Hold firm with EU. At least through the EU Summit (December 5), we should continue to press the EU hard on the realism of its target and rationale for its bubble. Opposition to the bubble is widespread; we should not offer our support without significant concessions.

4. Neutralize opposition from key OPEC countries. Recognizing constraints imposed by events in Iraq, we must find ways to ensure that important OPEC countries do not stand in the way of a deal. Saudi Arabia is key.

III. DO WE WANT IT?

In all likelihood, yes. An agreement at Kyoto would cause more businesses to consider carbon emissions in long-term decision-making. New R&D money would be unleashed. Additional incentives would be provided for developing countries to engage on this issue, bringing closer (perhaps) the day that key developing countries adjust their emissions paths. An important part of the legacy the President wishes to leave on this issue would be complete.

The biggest danger is domestic backlash. Critics will charge we have given up too much (binding targets requiring steep reductions) for too little (especially from the developing world). But in the absence of domestic regulatory proposals with bite, critics will not get traction. As we advance a package of tax cuts, federal r&d, credit for early action and related items, momentum on this issue will slowly build.

That said, we are not far from our bottom line. As we approach the close of Kyoto, too big an adjustment on the target, or too little progress on other parts of our framework, should cause us considerable pause. Prudent planning requires us to think through the steps we will want to take, quickly, if key elements in the negotiations fail to coalesce.