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Climate Change - September 13, 1999

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Call John Weeks re: other US
delegates to
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OCDE

ORGANISATION DE COOPÉRATION ET
DE DÉVELOPPEMENT ÉCONOMIQUES

Le Secrétaire général adjoint
The Deputy Secretary General

Handwritten: C. Mira d'Ercole
OECD
ORGANISATION FOR ECONOMIC
CO-OPERATION AND DEVELOPMENT

2, rue André-Pascal
75775 PARIS CEDEX 16
Tél. (33.1) 45 24 82 00

TM(99)249.amf

12 August 1999

Dear Mr. Lawrence,

In connection with the High Level Meeting on Climate Change, to be held 13 September 1999, in Paris, please find enclosed the following background documents:

- Annotated Agenda for the High Level Meeting on Climate Change (COM/ENV/EPOC/ECO/CPE/A(99)75)
- Meeting the Kyoto Targets (COM/ENV/EPOC/ECO/CPE(99)76)
- Involving International Business: Voluntary Agreements and Competitiveness (COM/ENV/EPOC/ECO/CPE (99)77)
- Further Development of the Co-operation with Developing Countries under the Convention (COM/ENV/EPOC/ECO/CPE(99)78)

The meeting will take place at Ministry of Finance, 139, rue de Bercy, 75012 Paris.
Tel: (33-1) 53 18 73 72 - Fax: (33-1) 53 18 97 69 or (33-1) 53 18 37 25 (direct telephone and fax numbers for receiving messages only for the duration of the meeting), meeting room Salle de Commission, Centre de Conférence Pierre Mendès-France. The meeting will start at 10:00 a.m., 13 September and finish by 18:00 p.m. The registration desk will be open from 8h30. You should present this letter at the registration desk and have some form of identification with you, a passport for example.

Mr. Moe also asked me to invite you to a luncheon in connection with the meeting. The lunch will take place at in a private dining room at the Ministry of Finance, at 13:00 p.m., 13 September. It would be greatly appreciated if you would confirm your participation in the lunch to Ms Françoise Michelson, tel.: (33-1) 45 24 89 51, fax: (33-1) 45 24 79 31 or email: francoise.michelson@oecd.org.

If you have any questions concerning the practical details of the meeting please contact Ms. Dorte Pedersen (tel.: (33-1) 45 24 78 80, fax: (33-1) 45 24 78 76 or email: dorte.pedersen@oecd.org).

I look forward to seeing you in Paris 13 September.

Yours sincerely,

Handwritten signature of Marco Mira d'Ercole

Marco Mira d'Ercole

Enc.: 4

The Hon. R. Z. Lawrence
Member-Nominee
Council of Economic Advisers
Washington, D.C. 20500
USA



PARIS

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Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

OLIS : 29-Jul-1999
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ENVIRONMENT DIRECTORATE
ECONOMICS DEPARTMENT

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**ANNOTATED AGENDA FOR THE HIGH LEVEL MEETING ON
CLIMATE CHANGE**

13 September 1999

*To be held at the French Ministry of Finance, Economy and Industry, Salle de Commission, Centre de
Conférence Pierre Mendès-France; 139, rue de Bercy 75012 Paris*

Contact: Mr. Marco MIRA D'ERCOLE (Marco.Mira@oecd.org)

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Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

OLIS : 29-Jul-1999
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PARIS

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MEETING THE KYOTO TARGETS

(Agenda Item 1)

Prepared for the OECD High Level Meeting on Climate Change, to be held on 13 September 1999 at the French Ministry of Finance, Economy and Industry, Salle de Commission, Centre de Conférence Pierre Mendès-France; 139, rue de Bercy 75012 Paris

Contact: Mr. Marco MIRA D'ERCOLE (Marco.Mira@oecd.org)

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Organisation de Coopération et de Développement Economiques
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INVOLVING INTERNATIONAL BUSINESS: VOLUNTARY AGREEMENTS AND COMPETITIVENESS

(Agenda Item 2)

Prepared for the OECD High Level Meeting on Climate Change, to be held on 13 September 1999 at the French Ministry of Finance, Economy and Industry, Salle de Commission, Centre de Conférence Pierre Mendès-France; 139, rue de Bercy 75012 Paris

Contact: Mr. Marco MIRA D'ERCOLE (Marco.Mira@oecd.org)



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Organisation de Coopération et de Développement Economiques
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OLIS : 29-Jul-1999
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**FURTHER DEVELOPMENT OF THE CO-OPERATION WITH
DEVELOPING COUNTRIES UNDER THE CONVENTION**

(Agenda Item 3)

Prepared for the OECD High Level Meeting on Climate Change, to be held on 13 September 1999 at the French Ministry of Finance, Economy and Industry, Salle de Commission, Centre de Conférence Pierre Mendès-France; 139, rue de Bercy 75012 Paris

Contact: Mr. Marco MIRA D'ERCOLE (Marco.Mira@oecd.org)

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Document complet disponible sur OLIS dans son format d'origine

Or. E

The United States Mission to the OECD

***19, rue de Franqueville
75016 Paris***

Number of Pages: 24
(excluding cover sheet)

Date Sent: August 16, 1999
Time Sent: 10:52 AM

TO: Dr. Robert Lawrence
Council of Economic Advisers
Washington, D.C.

FAX: 202-395-6958
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Attn: Lisa Branch

FROM: Suzanne K. Parker
USOECD Paris

Sender's Telephone: (33) (1) 45.24.74.20
Sender's FAX Tel: (33) (1) 45.24.74.87

Please find attached, information on the upcoming Climate Change meeting which will take place in Paris on September 13.

All our best,
Sue

cc faxed to Noah Weisberger (Ryan Edwards' replacement)

OCDE

ORGANISATION DE COOPÉRATION ET
DE DÉVELOPPEMENT ÉCONOMIQUES

OECD

ORGANISATION FOR ECONOMIC
CO-OPERATION AND DEVELOPMENT

Le Secrétaire général adjoint
The Deputy Secretary General

TM(99)247

Amy
Dear Ambassador,

*Am B
DCM
Gtoagh
→ Milroy
→ Weeks
Dolan*

29 July 1999

2, rue André-Pascal
75775 PARIS CEDEX 16
Tél. 45 24 82 00

OECD HIGH LEVEL MEETING ON CLIMATE CHANGE POLICIES
IN PARIS 13 SEPTEMBER

I refer to my letter to you of 23 June.

Please find enclosed the following background documents:

- Annotated Agenda for the High Level Meeting on Climate Change (COM/ENV/EPOC/ECO/CPE/A(99)75)
- Meeting the Kyoto Targets (COM/ENV/EPOC/ECO/CPE(99)76)
- Involving International Business: Voluntary Agreements and Competitiveness (COM/ENV/EPOC/ECO/CPE (99)77)
- Further Development of the Co-operation with Developing Countries under the Convention (COM/ENV/EPOC/ECO/CPE(99)78)

These papers can also be accessed on OLIS.

We hope that the French version will be available on OLIS on 6 August.

Please note that the meeting will be held at The French Ministry of Finance, Economy and Industry, 139, rue de Bercy 75012 Paris, Salle de Commission, Centre de Conférence Pierre Mendès-France, starting at 10:00 a.m.

To encourage free and open discussions, and as there will be no records taken, only two representatives from each Delegation will be in the meeting room. We are, however, looking for the possibilities of a listening room.

For practical information in August, you can contact either:

Dorte Pedersen in ENV:

or

Anne-Marie Fitzpatrick in SGE:

-- Tel. +33 1 45 24 78 80

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-- Fax. +33 1 44 30 61 83

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-- E-mail: Dorte.Pedersen@oecd.org

-- E-mail: Anne-Marie.Fitzpatrick@OECD.org

I will be back in my office 1 September, and in the meantime I wish you a good vacation.

Yours sincerely,

Th. Moe

Thorvald Moe

Encl: 4

Her Excellency,
Ms. Amy Bondurant
Head of the United States Delegation
to the OECD
Paris

29 July, 1999

**OECD HIGH LEVEL MEETING ON CLIMATE CHANGE
UNDER THE AUSPICES OF THE ECONOMIC POLICY COMMITTEE AND OF THE
ENVIRONMENT POLICY COMMITTEE**

*To be held at the French Ministry of Finance, Economy and Industry
Salle de Commission, Centre de Conférence Pierre Mendès-France
139, rue de Bercy 75012 Paris,*

13 September 1999

Background

1. In the context of the OECD sustainable development initiative, the work on climate change has been intensified in order to assist member countries to respond to the challenges of the implementation of the Kyoto Protocol. The *Progress Report on Sustainable Development* provides in chapter 3 the most recent summary of work carried out since the meeting of COP 4 in Buenos Aires (November 1998)¹. The discussion of the *Progress Report* by the Executive Committee in Special Session (ECSS) on 4-5 May, resulted in the following statement by the Chairman of the ECSS:

"Delegates discussed OECD work on sustainable development. The OECD was widely viewed as being the right place for analysing and modelling the respective costs of various Kyoto flexibility mechanisms to address climate change and the multi-disciplinary issues raised by sustainable development in general. Delegates suggested that members of the OECD's Environmental Committee and Economic Policy Committee meet jointly to discuss the most efficient means of meeting Kyoto emissions goals."

2. This meeting is in response to the ECSS request and is timed to be relevant to negotiations at COP 5. The chairs of EPOC (Ms. Eldrid Nordbø) and Working Party n° 1 of EPC (Mr. Jean-Philippe Cotis) will co-chair the meeting.

Objective of the meeting

3. The objective of the meeting is to enhance the understanding of various positions of member states on the implementation of the Kyoto Protocol, supported by results of the analysis by the OECD Secretariat. This should be accomplished through a structured and open discussion, without aiming at binding conclusions.

Format and date of the meeting

4. The meeting will bring together high level officials from the economic, finance and environment side of national administrations who influence national positions in climate change negotiations. and address three themes:

1. Meeting the Kyoto targets.

1. See: "The OECD Three-Year Project on Sustainable Development: A Progress Report". PAC/AFF(99)1, Paris May 1999.

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2. Involving international business: voluntary agreements and competitiveness.
3. Further development of the co-operation with developing countries under the Convention.
5. Each of the main themes will be introduced by two high level officials, followed by discussion. These introductory statements and the enclosed issues papers prepared by the Secretariat will form the basis for the informal discussion.

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OECD High-Level Meeting on Climate Change, 13 September 1999

*To be held at the French Ministry of Finance, Economy and Industry
Salle de Commission, Centre de Conférence Pierre Mendès-France
139, rue de Bercy 75012 Paris*

Agenda

10.00	Introduction and welcome ➤ Thorvald Moe, Deputy Secretary General of the OECD ➤ Ms. Eldrid Nordbø, Co-Chair of the meeting, <i>Ministry of Environment, Norway</i> ➤ Mr. Jean-Philippe Cotis, Co-Chair of the meeting, <i>Ministry of Finance, Economy and Industry, France</i>	
10.30	Meeting the Kyoto targets The discussion will be introduced by: ➤ Mr. Jan Pronk, Minister of Housing, Spatial Planning and the Environment, The Netherlands; and ➤ Mr. Seiji Shimpo, Vice Minister of International Affairs, Economic Planning Agency, Japan. <i>Despite agreements on the objectives of the Kyoto Protocol, trends in most OECD countries point to continued growth in emissions. While domestic policies to limit these emissions are under development, they are either not yet in place or insufficient to curb their growth. On the international side, many features of the international mechanisms have still to be resolved, and views differ on the extent to which these mechanisms should be relied upon in meeting Kyoto targets. Discussion may focus on progress to date in the introduction of abatement measures and into the advantages and costs of various policy options.</i> Questions for discussion include: ➤ What types of domestic policies are countries implementing or planning to work towards Kyoto objectives? Are these domestic policies expected to be sufficient to achieve these objectives? ➤ What steps would be needed to facilitate effective policy responses, including the flexibility mechanisms? ➤ How can countries work together to address some of the barriers to implementation, and what role will caps have in this respect?	COM/ENV/EPOC/ECO/CPE(99)76

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13.00	Lunch	
15.00	Involving international business: voluntary agreements and competitiveness The discussion will be introduced by: ➤ Mr. Caio Koch-Weser, State Secretary, Ministry of Finance, Germany; and ➤ Ms. Gwen Andrews, Chief Executive Officer, Australian Greenhouse Office, Australia. <i>Business concerns about the impact on international competitiveness of domestic mitigation policies are an important constraint on government policies. Voluntary agreements are a significant element in the mix of measures to respond to climate, as they are perceived to address competitiveness concerns and the need to accommodate companies' differentiated abilities to respond to climate change. The discussion may address the advantages and disadvantages of voluntary agreements as a means to achieve least-cost reductions in emissions, and their scope for mitigating concerns for competitiveness and leakage.</i> Questions for discussion include: ➤ What is the experience with voluntary agreements at the national and international level in meeting Kyoto targets? ➤ Could voluntary agreements at the international level, including unilateral corporate- or sector-wide agreements, advance the attainment of Kyoto targets? What is the role of governments in their formulation and monitoring? ➤ Will they help to address business concerns about competitiveness and "leakage"?	COM/ENV/EPOC/ECO/CPE(99)77

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16.00	Coffee	
16.30	Further development of the co-operation with developing countries under the Convention The discussion will be introduced by: ➤ Mr. Robert Z. Lawrence, Member-Nominee, Council of Economic Advisors, United States; and ➤ Mr. Fernando Tudela, Coordinator of Advisors to the Minister, Ministry of Environment, Renewable Resources and Fisheries, Mexico. <i>Developing countries have a crucial role to play if the target of stabilising atmospheric concentrations of greenhouse gases is to be met at some stage. Efforts to reduce their emissions may bring additional benefits, e.g. they can also reduce local air pollution and improve energy efficiency, which will enhance economic and environmental performance. At the same time, these countries have legitimate development needs and can point to low emissions per capita as well as to low historical emissions. On this background, the discussion could focus on strategies for integrating climate change goals with the promotion of sustainable development in developing countries.</i> Questions for discussion include: ➤ What are the main elements of a framework for extending commitments to all countries, in particular to developing countries, under the Convention? ➤ Which types of commitments appear to better reconcile international and domestic policy priorities? ➤ What issues should be considered in sharing the burden of climate change commitments at the global level?	COM/ENV/EPOC/ECO/CPE(99)78

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OECD HIGH LEVEL MEETING ON CLIMATE CHANGE

Paris, 13 September 1999

Agenda Item 1

MEETING THE KYOTO TARGETS

Introduction

Closing the gap between emission trends and objectives is a formidable challenge for Annex I countries.

1. Despite agreements on the objectives of the Kyoto Protocol, trends in most OECD countries point to continued growth in emissions of greenhouse gases. While domestic policies to limit these emissions are under development, they are either not yet in place or insufficient to curb their growth. On the international side, many features of the international mechanisms have still to be resolved, and views differ on the extent to which these mechanisms should be relied upon in meeting Kyoto targets. OECD analysis provides insights into progress to date and into the advantages and costs of various policy options.

Emission targets and recent trends

Emission targets are ambitious, especially in the light of recent developments.

2. The Kyoto Protocol calls for emissions of greenhouse gases to be reduced by some 7 per cent on average for OECD countries in 2008-2012, relative to their base level (1990 for most countries), with variations among countries. These targets are much tighter than it seems because of the growth in emissions that would normally occur in the meantime. Relative to a "Business as Usual" scenario, the targets could imply reductions of some 30 per cent on average for OECD countries by 2008-2012.

3. The ambition of these targets is underlined by the significant increases in emissions since 1990. By 1995 (the base of the OECD model simulations), emissions were higher than in 1990 in a majority of OECD countries, and by 1 per cent overall¹. This trend further intensified in 1996, when the growth in

1. This increases to 3 per cent if the transition economies in Eastern Europe are excluded.

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emissions — for a subset of countries accounting for about 75 per cent of total OECD emissions — more than exceeded total growth over the previous five years. Where emissions have fallen, this has usually reflected events and policies of a one-off nature: the output collapse in transition countries and (eastern) Germany, the liberalisation of the electricity industry and the reform of coal subsidy (encouraging a switch to gas) in the United Kingdom.

The economic costs of domestic abatement measures

The economic costs of domestic policies could be significant...

4. Much OECD research has gone into estimating the economic costs of implementing the Kyoto targets. According to these estimates, which are similar to those from other research, the economic costs of meeting the Kyoto targets with domestic measures only could be significant (Annex Table 1). These measures could lead to an increase of the price of carbon of about \$190 per ton for OECD countries², ranging between around \$180 in the European Union and \$230 in the United States. Carbon price increases of this magnitude could, in turn, result in a significant rise in the average price consumers pay for energy services and transportation (OECD 1999b, IEA 1999). Estimates of the real income losses for OECD countries — at about 0.5 per cent in 2010³ — would increase substantially if the model assumptions of full wage flexibility and of no costs due to the reallocation of workers were relaxed. In interpreting these estimates, it should be noted that the OECD's GREEN model currently deals with only CO₂ from energy.⁴

...and increase further if targets are not pursued cost-effectively.

5. The economic costs of domestic measures would increase substantially if these targets were not pursued cost-effectively. While the mix of domestic measures most effective in meeting Kyoto targets will differ across countries, "best practice" solutions are likely to share a number of features. These include market and subsidy reform, particularly for agriculture, transport and energy⁵. Other economic instruments such as carbon taxes and domestic tradable permits will also lead to cost-effectiveness. However, if political acceptance requires exemptions to existing heavy emitters, the burden on other sectors will increase, making it more difficult and costly to achieve targets (*cf.* Agenda Item 2). Other instruments may also be required to deal with market imperfections. These may include regulatory approaches, voluntary

-
2. This compares to an international oil price corresponding to about \$150 per ton on carbon in 1995. All estimates of carbon prices (marginal abatement costs) are expressed in 1995 \$.
 3. This is the permanent reduction in the level of real income in 2010 following the adoption of abatement policies. Annual real income costs over the period 2000 to 2010, in terms of deviation from baseline, rise gradually from zero to 0.5 per cent per year.
 4. In other terms, GREEN does not consider either other sectors and gases (i.e. CO₂ from forestry and other greenhouse gases) or local "ancillary benefits" associated to reductions in other pollutants generated from fossil-fuel combustion that could possibly reduce these economic costs.
 5. While subsidies to energy industry — especially coal — have declined considerably over the past decade, they remain substantial. OECD case studies indicate that reform of selected energy subsidies could reduce CO₂ emissions from the energy sector by between 1 and 8 per cent (OECD, 1997).

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agreements, support for R&D, and education and information programmes aimed at accelerating and diffusing climate-friendly technologies and behaviours.

6. Although Kyoto targets apply to emissions a decade from now, few of the domestic policies necessary to meet these targets are in place today (OECD, 1999a). It is often argued that abatement measures should be taken early in order to stimulate technical progress and innovation, leading to reduced abatement later on. On the other hand, if technology improves independently of pressure to reduce emissions, it could be beneficial to wait longer until cheaper abatement technology is available. While OECD analyses—in which progress in energy technology is exogenous—do not allow to assess the relative importance of these factors, they suggest that a gradual phasing-in of action may incur lower costs by minimising the extent to which rapidly changing relative prices force premature scrapping of capital equipment. More generally, a gradual phasing-in of interventions seems needed to bolster the credibility of abatement commitments.

Costs savings from the use of flexibility mechanisms

Costs could be significantly reduced through emission trading ...

7. In the presence of differences in abatement costs among countries, "flexibility mechanisms" as foreseen by the Kyoto Protocol allow to reduce economic costs. These mechanisms include trading among Annex I countries, as well as project-based instruments (Activities Implemented Jointly and the Clean Development Mechanism). The potential of these flexibility mechanisms in reducing the costs of abatement efforts is high. According to OECD analyses, international trading of emissions allowances among Annex I countries would allow achieving the Kyoto targets with a permit price ("marginal costs") of around \$90 per ton of carbon, around 50 per cent lower than average carbon prices under a "no trade scenario".⁶ A lower cost of achieving Kyoto targets would lessen political resistance and allow the setting of more ambitious targets in the future.

...although this would be partly at the expense of higher overall emissions.

8. In part, the economic gains from emission trading are at the expense of higher overall emissions associated with the presence of so called "hot air" in Russia and Ukraine, a feature that was recognised in the initial negotiation. OECD analyses suggest that, due to their output collapse, unconstrained emissions of these two countries may be some 14 per cent lower than their Kyoto commitments by 2010. Even excluding this effect, however, trading among Annex I countries could reduce marginal abatement costs to about \$105 per ton of carbon, around 45 per cent lower than the average costs for OECD countries when using only cost-effective domestic policies.

6. While it is uncontroversial that emission trading significantly reduces marginal costs at the aggregate and individual country level, the distribution of the costs savings among Annex I countries is more ambiguous when considering "total" costs, and would depend on the indicator used (cf. Annex table 1).

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Should emission trading be restricted?

Restrictions on emission trading are advocated for a number of reasons...

9. While trading among Annex I countries would be effective in lowering the economic costs of abatement, arguments advanced by some countries have led to proposals for "capping" their use. Among the arguments used to advocate restrictions on trading are:

- Trade in "hot air" will reduce the environmental effectiveness of the Protocol in the short term, although such effects would cancel out over time due to the "banking" provisions of the Protocol.
- Measurement and other implementation errors are sometimes seen as arguments for "caps" on trade, even though they raise issues for compliance in general rather than for trading in particular.
- The higher costs of abatement efforts in Annex I countries may contribute to the introduction of climate-friendly technologies, hence shifting the technology frontier, although to some extent "caps" will only shift innovation incentives between countries.
- Developing countries may be reluctant to consider emission limits until their per capita emission reach levels similar to those of Annex I countries. Undertaking domestic abatement efforts in Annex I countries may thus encourage developing countries to accept quantitative limits on emissions (*cf.* Agenda Item 3).

...but will increase the costs of meeting Kyoto targets within the timeframe of the Protocol.

10. It is difficult to assess the existence and size of these potential benefits from restrictions on emission trading, and the extent to which such restrictions may end up refraining some countries from ratifying the Kyoto Protocol. Further, these potential benefits should be compared to the associated costs. Within the Kyoto timeframe, restrictions on emission trading would cause marginal abatement costs among Annex I countries to diverge hence implying an overall loss in efficiency. In the case of limits on the purchases of permits, their effects would differ between "constrained" and "unconstrained" countries. "Unconstrained" buyers would benefit from the lower permit price associated with lower demand for permits, while for "constrained" countries the positive effects of lower prices would be more than offset by the need to rely on more costly domestic measures.

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Questions for discussion

11. Participants may wish to address some of the following questions:
- What types of domestic policies are countries implementing or planning to work towards Kyoto objectives? Are these domestic policies expected to be sufficient to achieve these objectives?
 - What steps would be needed to facilitate effective policy responses, including the flexibility mechanisms?
 - How can countries work together to address some of the barriers to implementation, and what role will caps have in this respect?

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Annex Table 1. Costs of Kyoto in OECD regions, 2010

	Change in GDP, per cent		Change in real income ¹⁾ , per cent		Implied carbon price, 1995 \$ per tonne of carbon	
	Without trade	With trade ²⁾	Without trade	With trade ²⁾	Without trade	With trade ²⁾
United States	-0.27	-0.16	-0.33	-0.40	231	92
Japan	-0.03	-0.02	-0.24	-0.19	189	92
European Union	-0.17	-0.08	-0.77	-0.33	181	92
Other OECD	-0.29	-0.18	-0.68	-0.64	228	92
OECD total	-0.18	-0.10	-0.48	-0.34	190	92

1. Changes in real income differ from changes in GDP because of terms-of-trade changes. These arise mainly from a) changes in imported energy prices, and b) changes in domestic prices needed to maintain balance-of-payments equilibrium (e.g. to improve the balance of trade to finance emission allowance purchases). Important influences on these are, on a), the initial structure of trade, in particular the degree of dependence on imported energy and, on b), the price elasticities of demand for imports and exports.

2. Unrestricted trade among Annex I countries, i.e. including trade of "hot air".

REFERENCES

OECD (1997), *Reforming Energy and Transport Subsidies: Energy and Environmental Implications*, Paris.

OECD (1999a), "OECD and Climate Change: Domestic Actions to Limit Greenhouse Gas Emissions", ENV/EPOC(99)6.

OECD (1999b), "Taking Action Against Climate Change: the Kyoto Protocol", ECO/CPE/WPI(99)6. An abridged version "Policy Challenges Arising from Climate Change" is published in *Economic Outlook*, No. 65, June 1999, Paris.

IEA (1999), "Energy and Climate Change: The Challenge", Executive Director's Paper for the Meeting of the IEA Governing Board at Ministerial Level, IEA/GB(99)27.

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OECD HIGH LEVEL MEETING ON CLIMATE CHANGE

Paris, 13 September 1999

Agenda Item 2

INVOLVING INTERNATIONAL BUSINESS: VOLUNTARY AGREEMENTS AND COMPETITIVENESS

Introduction

The business community has promoted voluntary agreements to respond to concerns on international competitiveness.

1. The business community has a key role to play in responding to the threat of global climate change, both through domestic action in Annex I countries and through transfers of climate-friendly technology to less developed countries. In OECD countries, business concerns about the impact on international competitiveness of domestic mitigation policies are an important constraint on government policies. While empirical analysis has found little evidence of significant effects on competitiveness stemming from environmental measures (OECD, 1997b), several governments continue to provide special treatment to heavy emitters, fearing that domestic measures to respond to Kyoto targets may accelerate a shift of industrial capacity to non-OECD regions. In turn, such exemptions reduce the economic efficiency and environmental effectiveness of abatement measures and increase the burden on non-exempted firms if targets are to be met. Voluntary agreements are a part of the mix of measures to respond to climate, and are often promoted as capable to address competitiveness concerns and to accommodate companies' different situations. On this background, this note focuses on the advantages and disadvantages of voluntary agreements as a means to achieve least-cost reductions in emissions, and to mitigate concerns for competitiveness and leakage.

What are voluntary approaches?

Voluntary approaches cover a variety of schemes...

2. Voluntary approaches are commitments by firms to improve their environmental performance beyond legal requirements. Their use in environmental policy evolved as a response to changes in the nature of the environmental problems confronting governments — with attention shifting from local to global problems

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and from "end-of-pipe" to preventive measures — and to the increasing administrative burden of regulatory instruments. They may be differentiated by whether commitments are set by industry, without any involvement of public authorities (*unilateral commitments*); by public authorities (*public voluntary programmes*), with firms agreeing to the standards developed by environmental agencies; and or by both (*negotiated agreements*). Common elements of these schemes are that a firm's decision to abate is not *de jure* required and that commitments do not apply to all firms (Carraro and Leveque, 1999). Thus, their effects are difficult to assess and monitor.

...with potential
benefits and
drawbacks.

3. The use of voluntary approaches in environmental policy is, however, controversial. In general, pollution abatement is costly and firms may be expected to "voluntarily" incur these expenditures only when these are offset by additional benefits, for example higher sales associated with improvements in the environmental reputation of firms, or to avoid more costly regulations or new environmental taxes. When the "threat" of alternative actions is credible, voluntary approaches may be more cost-effective than command-and-control instruments — as the choice of the abatement strategy is generally left to the firms¹. They may also generate "soft effects" in terms of raising awareness, sharing of information and experience between firms, and sharpening incentives to innovation. Potential drawbacks include low environmental effectiveness, incentives to "free ride" by firms, distortions in competition and market entry, and "regulatory capture".

Voluntary approaches at the national level

There is evidence
of pervasive use of
voluntary
agreements at the
national level...

4. Voluntary approaches are extensively used in OECD countries. A recent survey (OECD, 1998) highlights distinct regional patterns, with a prevalence of negotiated agreements at the local level in Japan, of negotiated agreements between national governments and coalitions of firms in the European Union, and of unilateral commitments and public voluntary agreements in the United States. These cross-country differences also characterise voluntary approaches targeted to climate change. Around 350 voluntary approaches specifically related to CO₂ emissions were in operation in 1997 (OECD, 1997), with large differences across countries in the coverage of these agreements, the ambition of their targets, and the existence of enforcement threats. In some European countries, the introduction of voluntary approaches occurred against the threat of implementing carbon-energy taxes (e.g. Switzerland). In others, voluntary approaches were launched as complements to carbon-energy taxation, with taxes reduced for signatories of voluntary schemes (e.g. Denmark and the Netherlands).

...but their
environmental
effectiveness is

5. While relatively few evaluation studies of these schemes exist, the available information on the performance of voluntary agreements suggests that their environmental effectiveness is generally low (OECD, 1998). This generally reflects the central role of industry in target setting — leading to goals with low levels of

1. However, in the case of collective agreements, firms may be attributed identical targets (rather than concentrating abatement where costs are lowest), which reduces cost effectiveness relative to the use of economic instruments.

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generally low... ambition — uncertainty over the regulatory threats, and poor monitoring and transparency². Safeguards — such as the involvement of third parties in target setting, monitoring and reporting — and the existence of credible sanctions for non compliance can prevent these shortcomings but they add to the complexity of voluntary approaches bringing them closer to regulatory solutions. Performance in terms of administrative efficiency also varies, as savings in costs for monitoring and enforcing tend to be offset by the extra costs in providing technical assistance and information to participating firms. On the strength side, these schemes seem to have generated positive “soft effects” in a number of cases.

... and they do not address concerns on competitiveness. 6. Voluntary agreements at the national level do not appear to allay concerns about the competitiveness and leakage effects of unilateral actions needed to reach a given emission target. In general, instruments that are most cost-effective in achieving environmental targets will also minimise adverse consequences on international competitiveness. In this respect, economic instruments will generally outperform voluntary agreements. While it is sometimes argued that domestic actions on climate should not imply “significant disadvantage to any group of .. industries” (BP Amoco, 1999) this ignores that all abatement measures will have implications for the international competitiveness of specific firms and industries. In this respect, the fuel and energy-intensive sectors are those most exposed to some of the competitiveness-consequences of unilateral abatement measures, depending on their carbon intensity, the possibility of translating higher costs to higher prices, the price-elasticity of demand and the share of trade with non-Annex I countries (OECD, 1997). While temporary exemptions to heavy emitters may be introduced to ensure greater acceptance of these climate measures, these will generally reduce their economic efficiency and environmental effectiveness, putting less energy intensive industries at a comparative disadvantage.

International voluntary agreements

International voluntary agreements are relatively rare... 7. The promotion of voluntary approaches at the international level may allow extending abatement efforts beyond national borders. Few initiatives of this kind exist in OECD countries. The most common are “unilateral commitments” of multinational companies that span the range of their operations in different countries, without any collaboration or oversight by governments. These schemes generally include initiatives to diffuse information on “best abatement practices” to suppliers; to apply internally state-of-the-art technologies and process; to agree on commitments to reduce emissions by participating firms in the countries where they

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2. A comprehensive evaluation study of 18 European schemes found that lack of monitoring data, ambiguity in the formulation and lack of intermediate targets prevented evaluation in two thirds of cases (OECD, 1998).
 3. Examples include targets for reducing own emissions of greenhouse gases by 10 per cent (from 1990 levels) by a number of energy companies (Amoco, 1999; Shell, 1999).
 4. One example of an initiative including recommendations for action in a number of these areas is the “Safe Climate, Safe Business” project undertaken by British Petroleum, General Motors, Monsanto and the World Resources Institute.

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operate³; and to develop sequestration and carbon-free technologies⁴. In some cases, participating firms have established pilot "trading schemes" between companies to achieve their own emission reduction targets (Shell, 1998).

8. One of the few examples of "negotiated agreement" between business and governments at the international level is that between the European Automobile Manufacturers Association (ACEA) and the European Commission, signed in July 1998 (ACEA/EU, 1998). With this agreement, ACEA commits itself to:

- Achieve a 25 per cent reduction in CO₂ emission from new cars sold in the EU market (140 g/km); and to
- Introduce car models with emissions of 120 g/km or less by 2000.

This agreement foresees intermediate targets (in 2003), a joint review of its implementation by the Commission and ACEA and an annual report to the European Parliament. These commitments are however conditional on a number of factors: i) equivalent efforts being made by non-EU producers; ii) availability of improved fuels in line with the new EU standards; and iii) policies that do not hamper the penetration of fuel efficient technologies.⁵

...but may have a role in extending abatement efforts to other countries.

9. By extending abatement efforts beyond national borders, these schemes may reduce the scope for leakage, although not concerns on competitiveness vis-à-vis non-participating firms⁶. Private initiatives with an international focus may increase business awareness and diffuse information on good practices. When they include targets for own emissions, it is however difficult to assess whether these represent additional achievements relative to a "business as usual scenario". To increase their environmental effectiveness, voluntary approaches at the national level are sometimes combined to other domestic measures (e.g. carbon-tax reductions for firms reaching voluntary targets). At the international level, limited experience exists on how to combine voluntary agreements with instruments such as international emission trading so as to provide an effective "threat" for non-compliance.

5. According to the European Commission, the achievement of these targets for all new cars sold in the EU will contribute, in the event, to about 15 per cent to the total emission reductions required under the Kyoto Protocol.

6. More generally, this possible competitiveness effect is only one of the channels for carbon "leakage", and probably not the most important one. Carbon "leakage" can be generated through in two ways: i) the international non-energy market, reflecting losses in market shares and possible reallocation of foreign direct investment of energy-intensive industries away from countries undertaking unilateral abatement; and ii) the international energy market, reflecting increases in energy use in countries not undertaking abatement (the lower the supply elasticity of energy production, the higher the fall in energy prices, and the stronger the increase in energy demand from non-Annex I countries). OECD model analysis suggests that the second channel is very influential, and that when energy supply is relatively elastic, the rate of "leakage" will be fairly moderate for values of trade elasticities on non-energy markets in the usual ranges (OECD, 1999). Voluntary agreements as those discussed in the text will be ineffective to deal with "leakage" on energy markets.

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Questions for discussion

10. On this background, questions for discussion may include:
- What is the experience with voluntary agreements at the national and international level in meeting Kyoto targets?
 - Could voluntary agreements at the international level, including unilateral corporate- or sector-wide agreements, advance the attainment of Kyoto targets? What is the role of governments in their formulation and monitoring?
 - Will they help to address business concerns about competitiveness and "leakage"?

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OECD HIGH LEVEL MEETING ON CLIMATE CHANGE

Paris, 13 September 1999

Agenda Item 3

FURTHER DEVELOPMENT OF THE CO-OPERATION WITH DEVELOPING COUNTRIES UNDER THE CONVENTION

Introduction

*Participation of
developing countries is
needed to respond
effectively to climate
change...*

1. Developing countries have a crucial role to play if the ultimate objective of the climate change convention — preventing anthropogenic interference with the climate system — is to be met at some stage. These countries also have a vital stake in the achievement of this objective, as they are the most vulnerable to the consequences of climate change. At the same time, the objective of containing greenhouse gas emissions may be perceived as competing with other domestic priorities, including poverty reduction and sustainable economic and social development. Little progress has been achieved in the development of a framework for abatement commitments that addresses this trade-off in a way that is acceptable to all countries. On this background, this note focuses on strategies for integrating climate change goals with the promotion of sustainable development in developing countries.

The context

*... as emissions from
these countries are
growing rapidly.*

2. Historically, most emissions of greenhouse gases have occurred in OECD countries, while developing countries have contributed only marginally. A global shift in the sources of emissions of greenhouse gases is however underway. This is projected to further intensify in the future. According to OECD analysis, the share of emissions originating from non-OECD countries may rise — under a “Business as Usual” scenario — from around 45 per cent today to 60 per cent by 2020, with India, China, East Asia and Latin America accounting for the bulk of this growth (OECD, 1999a).

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3. In this context, action by OECD countries alone will be insufficient to stabilise atmospheric concentrations of greenhouse gases. OECD analysis suggests that extending the Kyoto commitments of Annex I countries beyond 2012 would only delay by around one decade the year when atmospheric CO₂ concentrations approximately double compared to the level prevailing in pre-industrial times. The economic costs for Annex I countries from extending in time their commitments could also increase significantly, and emission trading between them would become less important in reducing these costs.

Global climate change goals and national development needs

International co-operation should promote integrated responses to domestic and global priorities on climate...

4. Projected paths of greenhouse gas emissions in developing countries reflect population growth, rapid increases in living standards and energy use. Assisting developing countries in meeting their development needs in the most energy efficient manner is therefore important for sustainable development, and a key component of efforts to control carbon emissions globally (OECD, 1998). Some win-win policies exist. For example, efforts to improve energy efficiency in developing countries will not only allow to reduce emissions of greenhouse gases, but also to reap beneficial environmental impacts locally ("ancillary benefits")², and to improve economic efficiency and energy security.

... as well as to other global environmental concerns...

5. Scope for synergies also exist when addressing climate change and the other global issues such as biodiversity loss and desertification that are covered by multilateral environmental conventions (OECD, 1999b). These challenges are closely related. Desertification and deforestation contribute directly to increasing the concentration of carbon in the atmosphere and to loss of biodiversity. Conversely, climate change may significantly affect the productivity and integrity of ecosystems reinforcing drought or floods in many part of the world. OECD work is exploring the implications for development co-operation stemming from the need to address these issues in a coherent way.

...with implications for all sources of development finance.

6. Responding to global climate change goals and to national sustainable development needs has implication for all sources of development finances.

- The largest share of financial resources for development already comes from domestic sources and increasingly from the private sector. Policy efforts to mobilise these financial resources should focus on providing the private sector with a stable and attractive investment climate. Opening key industrial sectors, such as energy, to private capital can accelerate investment in energy-efficient infrastructure, but also requires a conducive legal framework, a clarification of the roles of the private and public sectors, and a clear definition of investors' right and liabilities.
- Official development assistance (ODA) have been shrinking for a number of years, and with the exception of the poorest developing

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2. Economic estimates alone of the human costs of such pollution, in the form of respiratory diseases leading to premature death, range from 0.5 to 5 per cent of GNP in the case of China (OECD, 1998).

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countries now accounts for a marginal share of developing countries' GDP. Rather than being seen as a leading source of finance for investment in cleaner technologies, ODA should concentrate on addressing the human, institutional and technological capacities that are necessary to take advantage of climate-friendly production techniques.

- The Clean Development Mechanism could reinforce support to priority investment in areas as urban pollution control, rural electrification and forest management. At the same time, the mechanism does not in itself contribute to the resolution of the principal impediments to investments, and some of the lessons learned from past experience in development co-operation — such as the need for involvement of local stakeholders and of “soft” as well as “hard” technology co-operation — could be valuable for its development. (OECD, 1998)

Extending commitments to developing countries

A framework to extend commitments to countries...

7. Limited progress has been achieved to date in building a multilateral framework within which to define abatement commitments by all countries, taking into account the specific needs and circumstances of developing countries. The UN Framework Convention on Climate Change recognises the right of developing countries to pursue development strategies even if this will increase their emissions. A challenge is finding ways to implement the principle of “common but differentiated responsibilities” while satisfying basic equity considerations.

... might include both non-quantified and quantified commitments differentiated by country...

8. For developing countries, several types of commitments with different capacity to accommodate their development priorities are possible, and there may be scope for phasing in over time commitments with different degree of stringency (OECD, 1999c).³ Non-quantified commitments might include agreement to implement particular policies and measures. Among quantified commitments, absolute limitations of emission levels, as agreed by Annex I countries, would penalise countries with strong demographic increases. Reductions in the *growth rate* of greenhouse gases emissions relative to a baseline with unchanged policies — rather than absolute reductions — are less stringent, but may be inappropriate in the presence of high uncertainty about economic growth, energy-mix and efficiency. Proposals for indexing the abatement commitments to actual economic growth performance may facilitate the integration of two objectives that are often perceived as conflicting (economic growth and emission abatement), but offer less certainty on the reduction of emissions that could be achieved. Targets for specific sectors are another option.

3. Criteria for differentiating the timing and nature of country obligations might include responsibilities for cumulative emissions, ability to pay for mitigation policies (i.e. income per capita), and opportunities to reduce emissions in a cost-effective manner (i.e. energy intensity of production).

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Incentives for developing countries to participate

Incentives to developing countries to participate in global efforts...

9. Global participation in efforts to stabilise emissions of greenhouse gases will require adequate incentives to countries with a lower "capacity to pay" and most exposed to the consequences of climate change. These include the "self interest" of avoiding the damages of climate change, local "ancillary benefits", and opportunities for exports, new market developments and technology transfers. Among the "incentives" that may translate into immediate financial flows to the benefit of developing countries are:

- Financial flows associated to trading of emission permits (including those through the Clean Development Mechanism), which will benefit countries with lower abatement costs; and
- Additional financial transfers to compensate those developing countries that would be worse off even after trading.

...have implications for economic costs.

10. Providing adequate incentives to developing countries will however affect the costs elsewhere. These costs will depend importantly on how emission allowances are distributed among countries. Precisely because of its influence on costs, this is a contentious issue. Some notion of equity will be required to induce participation from countries ranging from very rich to very poor. The OECD Secretariat has produced scenarios to illustrate the costs involved for different regions under a few stylised rules for the allocation of permits (OECD, 1999a). One such rule is the gradual convergence of per capita emissions among countries. Another rule entails freezing the countries' shares of emissions at their 2010 level ("grandfathering").

11. These scenarios — incorporating different targets for concentrations of greenhouse gases, different assumptions on the use of emission trading, and the two rules for the allocation of emission allowances described — above point to a number of findings:

- First, costs vary significantly according to the degree of ambition of the emission constraint and the allocation rule.
- Second, trading among developed and developing countries would be important to reduce these costs and would generate large financial flows to developing countries. Trading also makes aggregate costs less dependent on the distribution of allowances.
- Finally, side payments can be used to improve the situation of those non-Annex I countries that would be worse off after trading.

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Questions for discussions

12. Participants may wish to address the following questions:
- What are the main elements of a framework for extending commitments to all countries, and in particular developing countries, under the Convention?
 - What types of commitment appear to better reconcile international and domestic policy priorities?
 - What issues should be considered in sharing the burden of climate change commitments at the global level?

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