



The Voice of OECD Business

BIAC Talking Points

The Economics of Climate Change

15 October 2008

General considerations

- BIAC welcomes the OECD focus on the economics of climate change. The Organization can play an important role in contributing fact-based economic analysis to current discussions on climate change so that policy makers can take decisions based on sound economic analysis. Our general views on the economics of climate change were summarized in the paper we submitted to the OECD Council Ministerial in June 2008.
- In view of the Copenhagen climate change summit at the end of 2009, the timing of this OECD project is critical. We therefore encourage the OECD to consider additional research and fact-based analysis as a high priority. In the context of the UNFCCC negotiations of post-2012 frameworks, it is important to inform policy makers on the options available and their implications.
- We believe that it is particularly important that the OECD portrays a consistent message and that the outcome of the project on the economics of climate change be duly reflected in climate-related work in other parts of the Organization. In this context, we welcome the fact that the OECD paper underlines the costs of ambitious policies in a pragmatic fashion and the necessity of a cost-effective mix of policy instruments, including voluntary sectoral initiatives, and takes a more real-world view of technology issues. It is important that climate change policies and economic growth are not seen in conflict to each other.

BIAC comments

- We note that the focus of this project is on climate change mitigation. We recommend that the paper should make reference to the importance of adaptation, which can in some settings be a cost effective alternative when integrated with mitigation policies.
- We recommend that in its analysis of climate change mitigation policies, the OECD should take into account the issue of resource allocation broadly and consider the implications (including potential lower emissions in an economic slowdown) of the economic downturn, taking into account falling energy prices and the credit crunch as well as other global challenges, such as food security. In the discussion on carbon markets, the OECD should analyze the connection between the financial crisis and activities of financial sectors as well as implications for resources available for innovation.
- The numbers used as reference in the report do not always correspond to the average IPCC estimate.¹ The average IPCC scenario is less dramatic and, hence, the references are based on one of several less likely scenarios. The use of secondary references, e.g. economics literature rather than natural science-based sources can alter policy decisions. We note, for example, that the Stern Review is quoted several times. The consequence is potentially large, e.g. on the consideration of adaption versus prevention. There is no broad consensus about the 450 ppm CO₂ (550 ppm CO₂e) goal.
- We recommend that the OECD further underlines the importance of adequately addressing the issue of reliable and consistent data as a fundamental precondition to designing and implementing successful and cost-effective greenhouse gas (GHG) emissions reductions. The availability of reliable and consistent data across sectors and countries is essential to allow for global policies to be identified, implemented and properly enforced. Sector-specific data can play an important role in this area and should be duly considered. Where the document recognizes that the lack of information or asymmetric information can be an obstacle and that unpredictability can be costly, there is no assessment of how this issue could be addressed. Existing technology tools (such as advanced decision support software) allow for measurement of indicators in a consistent manner by analysing how activities affect directly or indirectly the level of GHG emissions of that entity.
- The cost estimates are on the assumption that all major countries take effective measures to reduce their emissions. Furthermore, they are rather optimistic in that they assume smooth adjustment to a global price-based policy approach.

¹ See on the topic of temperature change IPCC *Technical Summary* p. 70, table TS.6 <http://www.ipcc.ch/pdf/assessment-report/ar4/wg1/ar4-wg1-ts.pdf>, and *IPCC Assessment Report* p. 749 and p. 799 <http://www.ipcc.ch/pdf/assessment-report/ar4/wg1/ar4-wg1-chapter10.pdf>

-
- The report correctly mentions that price-based instruments will not be sufficient and need to be complemented by other ways. In particular, a “global carbon price” will not be enough in and of itself to marshal and direct the needed financial resources, or guarantee societal and consumer behaviour changes that will be required to attain large reductions in GHGs. Moreover, as the report recognizes, attaining a “global carbon price” will be politically and practically difficult, if not impossible. We recommend further highlighting this message throughout the report and to underline the importance of a comprehensive policy approach.
 - BIAC underlines the importance of an overall conducive policy environment and incentives for innovation. We welcome the additional chapter on the importance of supportive technological policies. However, in addition to R&D, the OECD paper should refer to the huge potential of energy efficiency, which was underlined by many IEA studies and which can lead to major greenhouse gas emissions reductions.² Concrete international cooperation activities, such as the Asia Pacific Partnership, can play an important role.
 - In order to achieve ambitious climate change objectives, the development and implementation of innovative technologies will be indispensable. BIAC believes that technology should be given increased attention and will be more critical than carbon pricing if implemented successfully. Pricing alone will not lead to increases in energy R&D expenditure. The private sector has a key role to play in developing, promoting and commercializing technology and bears significant investment risks. Private sector dynamism and an overall policy framework that is conducive to innovation should therefore be a top priority.
 - With regard to expectations for technology uptake and deployment, the analysis should reflect that there are numerous factors that will determine pace and cost, such as infrastructure, permitting and social acceptance. This is true for key technologies such as nuclear, carbon capture and storage (CCS) and some renewables.
 - The role of standards, information instruments as well as measures to promote technological innovation should be carefully analyzed. However, while standards have a role to play, we would like to underline that they will need to be implemented with caution. Standards can easily become obsolete if technology advances more quickly than standards are being reviewed.
 - In the case of cap & trade, it should be born in mind that there are large consequences for the cross-country distribution of costs, depending on the features of sectoral and economy-wide trading schemes and whether these schemes are integrated. A certain degree of carbon price uncertainty is inherent in cap & trade systems. We recommend that the OECD carefully analyzes effects of trading schemes on innovation as companies can accomplish goals by buying emission rights rather than invest in R&D. The paper

² See e.g. *Worldwide Trends in Energy Use and Efficiency Key Insights from IEA Indicator Analysis*, http://www.iea.org/Textbase/Papers/2008/Indicators_2008.pdf

should also mention that a sectoral benchmark approach without cap & trade can be effective by promoting innovation by the private sector.

- The OECD correctly underlines that the costs of incomplete country coverage of GHG mitigation policies appear to be large. More detailed analysis on the implications of major emitters joining or not joining would be helpful. In this context, it should be emphasized that if not all major developing countries take effective measures, the cost of tackling climate change would be significantly higher. The estimated cost without these major emitters should be described, and the importance of clarifying the burden of each country should be stressed. Without the participation of all major economies, a carbon price mechanism would face considerable challenges.
- The question of how to incentivize major non-OECD economies (e.g. China and India) to participate in global reduction targets should be considered as a priority. Put simply, without significant participation from these countries, any GHG-mitigation initiative will fail. The report mentions, but does not sufficiently highlight, the need for policy stability and predictability for business long-term investments.
- The analysis should assess the extent to which market-based instrument revenues could provide an opportunity to reduce or eliminate economically distortive taxes in other areas, and what practical experiences have already been gained in this regard. How these policies are implemented matters greatly to the economy - the predicted effects range from sharply negative to opportunities for "win-win" changes.
- The statement that leakage rates are negligible should be qualified. While the overall percentage may not seem high, the implication for specific industries can be considerable and competitiveness concerns need to be duly addressed taking into account sectoral and regional considerations. International sector-wide initiatives have the potential to allow larger emissions cuts to be achieved at a lower overall cost than would be possible by a country coverage excluding major emitters.
- Multilateral trade is a fundamental vehicle for the dissemination of innovative technologies. Recent difficulties in the Doha Round negotiations, and protectionist pressures in some countries could hamper trade flows, and we suggest the analysis explore this further. While the OECD underlines the negative consequences of the implementation of border tax adjustments (high administrative costs, risk of trade retaliation), BIAC urges the OECD to adopt a stronger statement and recommend clearly against the consideration of these measures. Border tax adjustments will undoubtedly lead to retaliatory measures, which in turn will raise costs and delays and work contrary to cost effective measures and broader implementation. BIAC addresses this issue in more detail in its recent paper on trade and climate change, which we would also like to bring to the attention of the Economics Department.

Proposed next steps

- The cost of incomplete country coverage of mitigation policies underlines the need for wide policy action across the major emitters. We would therefore welcome additional analysis on the environmental and economic implications of different scenarios with or without major emitters, including China and India. We would also welcome additional work on incentives for major non-OECD economies to join a future climate change agreement.
- Further work on leakage and competitiveness issues would be helpful. Such analysis should focus on specific sectors and assess economic, environmental and regional implications of leakage.
- Continued work should reflect the political realities of differentiated emissions trading programs – although such measures are being increasingly deployed, they differ in significant ways in terms of targets, coverage, safety valves and the use of auctioning. These differences introduce additional challenges for companies operating in globalized markets (notably energy markets).
- We welcome the inclusion of analysis of the potential contribution of the forest sector and land-use more broadly, including the impact on food prices. We encourage the OECD Agriculture Committee to become increasingly involved in this area.
- BIAC would welcome additional work on the analysis of the contribution of innovative technologies and processes, underlining the role that the private sector plays in this area and the importance of innovation-friendly enabling policy and implementation frameworks. In this context, equal attention should be given to the issue of technology dissemination through private investment.