OECD CONFERENCE ON THE ECONOMICS OF CLIMATE CHANGE: 18 SEPTEMBER 2009

SUMMARY BY LORENTS LORENTSEN: CHAIR OF THE WRAP-UP SESSION

1. The Conference brought together high-level experts, policy makers and representatives from civil society to discuss ways to address global climate change mitigation and adaptation issues in an economically efficient manner. The format of the Conference, with lead speakers setting the scene for ensuing discussion panels, was conducive to direct and fruitful exchanges among participants. Each of the three rounds of discussions yielded a number of key messages which were summarised by the respective chairs in the closing session.

2. One of the main messages from the first session **on mitigating climate change** is that in order to keep the cost of action low, a new international policy framework should aim at pricing carbon as widely as possible across countries, gases and economic activities. A useful step in that direction would be the phasing-out of environmentally-harmful subsidies, which alone could lead to a substantial reduction in emissions. Also, the key to the development of a global carbon market is a flexible policy framework that is conducive to the gradual linking of national, regional or sectoral mitigation systems. To ensure a smooth functioning, an eventual linking of emission trading systems (ETS) requires some international harmonisation of features, including the adoption of a common set of tax principles underpinning the treatment of permits.

3. The political will to take significant domestic action appears fairly widespread across both major developed and developing countries, but the differential rates of progress across countries are raising concerns that political economy considerations will prevail and limit both the scope of mitigation action and the move towards a global market. There is a risk that the non-coordinated nature of the initiatives taken in individual countries provides leverage to trade-exposed industries to lobby on competitiveness grounds and to seek outright exemptions from eventual emission caps or free allocation of emission permits. Likewise, fears of free-riding and carbon leakage may be pushing governments who are prepared to take mitigation action towards adopting countervailing duties or tariffs on imports from non-participating countries, so-called border tax adjustments. Each of these options has serious drawbacks. Analysis has shown that exempting specific industries significantly raises the cost of achieving a given target. And, by freely allocating permits (as opposed to auctioning them) governments forego significant revenues at a time when public investment in research to promote low-carbon technology or green infrastructure is needed and public finances are in bad shape. Furthermore, in both cases the incentives of emitters to change behaviour are diminished. Countervailing duties help to prevent carbon leakage, but compared to a cooperative approach, they do so at an extra cost for all parties involved, including those imposing the duties.

4. The economic rationale for these measures is therefore questionable, especially considering the small magnitude of the problem they seek to address. Indeed, drawing from the EU experience with a cap-and-trade scheme, one recent study has shown that the pricing of carbon has had no perceptible effect on the competitiveness trends of specific EU industries such as cement, iron and steel. One reason is that the price of carbon is just one among a large number of factors affecting cross-border competitiveness. In a similar vein, model-based analysis has shown that carbon leakage rates are found to be significant only if a small group of countries take mitigation action. Broadening participation, including by reducing incentives to free-ride, is a better way to address issues of leakage and competitiveness. It was noted that the WTO could play a role in helping to ensure that the various initiatives taken at the national, regional or sectoral levels – including the design and implementation of instruments to meet emission reduction targets – do represent stepping stones rather than stumbling blocks towards the development of a global carbon market.

5. The second session discussed **the economic aspects of adaptation to climate change**. One message that emerged from the discussion is that climate policy is not about making a choice between mitigation and adaptation. Adaptation is essential, particularly in addressing the near term impacts of climate change that are already locked-in. How much adaptation might cost, and how large its benefits might be, are increasingly relevant for making informed decisions. Different approaches are being used to evaluate the set of measures and associated costs for adapting to climate change. One is to rely on case studies involving geographical areas exposed to specific climate risks. For each case study, the costs and benefits of appropriate adaptation measures are assessed for different scenarios regarding the magnitude of climate change, with a view to identify well-targeted, cost-effective sets of responses. A complementary approach consists in evaluating costs and benefits for sectors that are most directly impacted such as agriculture, coastal development, water, health and energy. In many of these areas, there is scope for low-cost behavioural adaptations but infrastructure measures need considerable investment. However, despite the progress achieved in evaluating the cost of adaptation in specific areas or regions, aggregate cost estimates remain highly uncertain since they are sensitive to key assumptions such the share of total investment exposed to climate change risk.

6. In any case, it is clear that adaptation will require the mobilisation of significant private and public financial resources, especially for developing countries, which often tend to be the most exposed. Adaptation is in this respect inter-locked with mitigation. It is thus important that public policies contribute to boost incentives for private actors to take actions in a decentralised manner. Policy instruments to foster a better internalisation of climate risks include the development of environmental markets, pricing of natural resources such as water, and insurance schemes with well designed premiums that reflect the underlying climate risk. Business incentives for effective adaptation can be strengthened via tax breaks, standards and regulation, as well as by information disclosure. Public resources can also be used to leverage private-sector financing, to support research, development and demonstration of adaptation technologies as well as to assist the development of adaptation strategies in developing countries. Some participants expressed the view that public-private partnerships can play a critical role in leveraging additional resources and in enhancing the efficiency of expensive investments in adaptation infrastructure. Setting and scaling up appropriate insurance schemes and innovative public-private financing mechanisms, however, remains a considerable challenge.

7. The third session on **building political support for global action against climate change** focused on the complexities of both the process and issues involved in reaching a broad and meaningful agreement in Copenhagen. Some argued that the negotiations are complicated by the breadth of the issues being discussed and the lack of trust between the parties, which is fed by fears of free-riding and by the fact that relatively few countries are set to fulfil their Kyoto commitments. The latter raises difficult issues of enforcement as well as of measurement and comparability of efforts, with the risk that negotiations get bogged down in details. Yet others noted that the broad elements of a deal that would be ambitious, effective and equitable are fairly well-known and include, *inter alia*, strong mid-term (2020) commitments from developed countries covering all sources of emissions, ambitious mitigation actions from developing countries, a reformed and expanded global carbon market, robust arrangements for monitoring, reporting and verification and provisions for the transfer of financial and technological resources from developed to developing countries with an adequate governance and surveillance structure.

8. While most participants agreed with these principles, some warned about the risks of setting overly ambitious targets, which could undermine the credibility of the process. Others also warned about the idea of pursuing sectoral approaches as an intermediate step towards global carbon market. Past experience with international trade organisations has shown that once in place, sectoral arrangements are very difficult to unwind. More generally, it was suggested by some that closer contacts between the UNFCCC and the WTO would be desirable considering the role that the latter can play, notably on the transfer of technology and protection of intellectual property. Finally, some participants expressed a

concern about the limited degree of support for mitigation action in public opinion. It was suggested that careful communication about the eventual cost of climate change impacts vis-à-vis the costs of mitigation could help provide political support for an ambitious deal. In particular, efforts should be made to dispel the erroneous but fairly widespread perception that moving to a low-carbon economy necessarily implies a drop in living standards.