

# Implementing Sustainable Development

KEY RESULTS 2001-2004



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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT



Between 2001 and 2004, OECD work on sustainable development focused on indicators and peer reviews; on obstacles to reducing environmentally harmful subsidies and to the further use of environmentally related taxes; on social aspects of sustainable development; and on policy coherence and integration. The range of OECD activities undertaken over this period has looked at the “interface” between the environment and the economy on the one hand, and between the economy and society on the other.

## **Environmental-economic interface**

*Environmental performance* has improved in several respects since 1990, and OECD countries continue to set targets for further improvements. Environmental protection costs have also risen throughout this period. They amount to about 2% of GDP or more in countries that have set comparatively demanding standards. However, these could have been reduced by at least 25% through the greater use of more cost-efficient instruments in many countries. Alternatively, more ambitious environmental objectives could have been achieved for little or no additional cost.

This potential benefit has not been exploited partly because of the lack of integration of environmental and economic concerns in policy making. Concerns over the social consequences of environmental policies and political economy considerations have also increased costs as they have led to exemptions or lower requirements granted to some of the most polluting activities. Abatement costs could rise markedly in the future as standards become stricter, thus reinforcing the need to use cost-efficient options in coming years. This is particularly the case with the reduction of greenhouse gas emissions where policies capable of meeting objectives – at least cost – become increasingly urgent for most OECD countries as the target date of the first commitment period under the Kyoto Protocol (2008 to 2012) approaches.

The strengthening of the environmental pillar of sustainable development has come at a cost to the economic pillar, as a direct consequence of choosing relatively inefficient policies. In some cases, the costs may also have been the consequence of setting overly ambitious environmental objectives. Unfortunately, the failure of countries to systematically analyse costs and benefits of environmental protection policies makes it difficult to identify such cases.

The vast majority of OECD countries do not subject *environmental protection laws* to a systematic review of their economic consequences. Moreover, there have been instances when cost-benefit analysis has been poorly integrated into policy decisions. In contrast to the lack of systematic economic assessments of environmental programmes, the integration of environmental concerns in public decision-making processes at the project level is better established. All OECD countries have procedures for environmental impact assessments of large projects, usually combining scientific evaluation and extensive public consultation, before a final decision can be made. While countries are increasingly using strategic environmental assessment, much remains to be done to ensure that sectoral policies (such as agricultural and energy policies) take into account their environmental consequences.

*Regulation* has remained the main instrument to control pollution or resource extraction over the past decade in most of the environmental areas, including greenhouse gas emissions. While the form of regulations will influence their abatement costs, there is ample evidence that even flexible regulations are a costly way to deal with environmental problems. Regulatory instruments typically result in very different marginal abatement costs across emitters, as different plants vary in the extent to which they can reduce emissions. Evidence reported in OECD Economic Surveys showed that regulations based on the mandated use of a particular technology (particularly in the areas of renewable energy and recycling) entailed very high costs and discouraged cost-saving innovations.

*Voluntary agreements* have been used to control air-pollution, limit greenhouse gas emissions, improve energy efficiency and fuel efficiency of cars, reduce packaging waste, control pesticides and nitrate discharges from the farming sector. These agreements can be useful in revealing information on abatement costs, in disseminating information on environmental costs and impacts, and in establishing the infrastructure (e.g. certified emission accounts) required for the introduction of alternative policies. However, because of asymmetries of information between the government and the industry, the latter can often limit the targets under these agreements to easily achievable levels. The environmental effectiveness of voluntary agreements aimed at reducing specific environmental pressures is often questionable and their economic efficiency is generally low.

While all OECD countries use some kind of *environmentally related taxes* to reduce abatement costs and raise revenues, a number of countries have substantially extended their use since the early 1990's, with environmental tax revenues amounting to about 2% of GDP. Several OECD countries have introduced environmental tax reform, often on a revenue-

neutral basis (e.g., combining increases in energy taxes with reductions in social security contributions).

The revenue from environmentally related taxes increased significantly in some countries between 1994 and 2001, but proceeds have declined by an average of 8% since 1999. About a third of this fall is due to lower revenues from reduced sales of petrol, as a consequence of higher prices. This highlights that significant behavioural changes can be achieved through the application of appropriate tax rates — or through tradable permit systems that create similar price incentives.

The most widely used environmentally related tax instruments, carbon taxes and water-pollution charges, are also the least likely to reduce emission and discharges at the lowest economy-wide cost because they are generally levied at different rates across sectors. In many cases, the most pollution-intensive activities are exempted from the tax. Similarly, agriculture generally pays little or no taxes on its discharges, even if it costs much less to reduce nitrogen runoffs in that sector than elsewhere.

While there is little evidence that environmentally related taxes have reduced international competitiveness significantly, this conclusion must be qualified by the many exemptions and tax rate reductions currently granted to sectors most exposed to international competition. As industry usually pays very modest amounts in environmental taxes, significant impacts on competitiveness would not be expected. Moreover, competitiveness concerns must be balanced against the main goal of environmental reforms: to protect the environment by way of encouraging alternatives to harmful products/processes.

Environmental damage is often a by-product of *subsidy policies*. OECD countries provide an estimated USD 400 billion in subsidies every year — about three quarters of these subsidies go to agriculture, one tenth to transport, and the rest to fisheries and forestry, energy production and manufacturing. While there has been a shift towards less environmentally harmful support in agriculture since the mid-1980s, progress has been slow. Agricultural support that is potentially harmful for the environment amounts to about USD 235 billion per year. Most of the USD 6 billion in fisheries subsidies in OECD countries goes to general services — some of which supports research, management and enforcement activities that can benefit the environment. However, some expenditure on general services supports fisheries infrastructure and enhancement programmes that can contribute to over-fishing. Estimates of energy subsidies range between USD 20 and 80 billion per year. Subsidies to coal and peat production are among the most harmful to environment, with OECD countries' support to coal industry estimated at about USD 5 billion per year.

Against this background, the OECD has recommended fundamental changes in policy settings concerning:

- **Regulations.** OECD recommends that less emphasis should be placed on regulations as mounting evidence shows that these can prevent companies from using the most efficient ways to reduce their emissions and thus increase costs for society. In some cases, however, regulations are the most appropriate instrument to control pollution.
- **Voluntary agreements.** In view of the lack of effectiveness and efficiency of voluntary agreements, the OECD recommends reassessing such practices.
- **Environmentally related taxes and tradable permits.** The OECD recommends that greater use should be made of transparent taxes or tradable emission permits that concentrate abatement in activities where emissions can be cut at the lowest cost. However, these instruments will only be cost efficient if they cover all sources of any given type of pollution. As a result, the OECD calls for the removal of current exemptions from carbon and water pollution taxes in the most pollution-intensive activities.
- Where taxes and tradable permits have adverse social consequences, these should be addressed through the standard social security system, for example, by adjusting the way support payments are calculated or by introducing new support instruments.
- **Subsidy reform.** Countries need a multi-pronged strategy to overcome obstacles to subsidy reform. They need to recognise the range of options available to meet societal objectives, and that subsidies are generally inefficient tools for achieving employment or other social policy goals.
- Countries should also target existing subsidies better and improve programme design, in order to improve the efficiency of subsidies aimed at correcting environmental problems — even though these may violate the polluter pays principle.
- The OECD recommends that structural impediments and rigidities in the legal and administrative framework should be addressed in order to reduce environmentally harmful subsidies.
- Countries are encouraged to increase transparency of subsidy policies as this can make subsidy reform politically easier for governments.

- ***Cross-border environmental problems.*** The OECD recommends taking advantage of international agreements that allow abatement to be concentrated in areas where it can be obtained at lower cost.

## Social-economic interface

The OECD has stressed the importance of a well functioning ***social protection system*** for addressing social problems and for maintaining conditions that facilitate both economic growth and environmental sustainability. Assuring the sustainability of social protection systems requires confronting a range of long-term pressures through policies specific to each phase of individuals' lives. This perspective links concerns about sustainable development at the global level with that of preserving social cohesion with well designed programmes within each country.

Sustainable development is cross-cutting by nature and poses a fundamental challenge to the government structures. OECD countries have confronted this challenge in different ways and taken steps ranging from the establishment of new institutions to foster integration to the allocation of new responsibilities to existing bodies to improve the degree of coherence and integration of their policies.

On the social-economic interface, Economic Surveys have focused on the ***sustainability of retirement income systems*** in OECD countries, and on ways of improving living standards in developing countries. Many OECD countries have already taken steps to assure the financial sustainability of public pension systems. In countries where progress has been slow, the OECD has recommended specific measures to accelerate the pace of reforms in ways that do not compromise income adequacy in old age.

In particular, the OECD has called on these countries to remove incentives that artificially shorten working lives. This includes, for example, eliminating opportunities to withdraw from the labour force permanently at an early age via unemployment, disability or special benefit schemes and raising the standard age of pension entitlements. This is especially important in those OECD countries where pension outlays could rise by 7 percentage points of GDP or more from 2000 to 2050.

With reference to ***living standards in developing countries***, the OECD notes that the improvements that have characterised most of these countries since 1990 have proved elusive in Sub-Saharan Africa. In other regions, improvements in living standards have been accompanied by strong export performance, which in part reflects falling protectionist barriers in the

OECD countries and specific measures to open up OECD markets to the least-developed countries. However, developing countries still face difficulties in accessing OECD markets for their agricultural products because of trade restrictions and domestic agricultural support. The OECD strongly encourages Member countries to reduce support to agriculture.

Living standards in developing countries have also been raised through greater emphasis on poverty alleviation in development assistance and through measures to make aid more targeted and efficient. The OECD recommends further moves in that direction. Especially important is targeting assistance to health improvement in the least developed countries. For example, welfare in Sub-Saharan Africa could increase by USD 30 billion or more, if the loss of life years caused by malaria and AIDS could be reduced by two-thirds. It is worth noting that Sub-Saharan Africa receives just over 20% of bilateral development assistance, yet only a fraction of this assistance is targeted at improving health conditions.

## **Further work**

There is a demand for the OECD to continue to do work on sustainable development and to raise the visibility of this work. Areas identified for further work include obstacles to reducing environmentally harmful subsidies and to further use of economic instruments; sustainable resource use including material flow accounting, decoupling of environmental pressures from economic growth and resource productivity; and emerging issues as appropriate.

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