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Round Table on Sustainable Development

CHAIRMAN'S SUMMARY NOTE OF THE 1-2 JUNE 2005 MEETING OF THE ROUND TABLE ON SUSTAINABLE DEVELOPMENT

CAN TRANSNATIONAL SECTORAL AGREEMENTS HELP REDUCE GREENHOUSE GAS EMISSIONS?

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The Seventeenth meeting of the Round Table on Sustainable Development at the OECD was held at the World Bank, Paris

1-2 June 2005

Can Transnational Sectoral Agreements help reduce Greenhouse Gas Emissions?

The following is a short summary note of the discussion on 1-2 June, issued under the Chairman's responsibility. Please note, in keeping with Round Table procedures, a detailed note of the meeting will not be circulated.

I. Sectoral discussions

Before turning to what role transnational sectoral agreements might play in the future, the meeting heard presentations on five key illustrative sectors – aluminium, cement, steel, power generation from coal and automobiles. The presentations focussed on the structure of each industry, its contribution to overall greenhouse gas emissions and future possibilities. For details of the five sectoral presentations, follow the 'meeting papers' link on the Round Table website (www.oecd.org/SD-roundtable)

Following each presentation, participants discussed the particular characteristics governing each sector:-

- **Aluminium**

It was noted that the following three factors would facilitate the negotiation of an agreement: (1) the global nature of the aluminium industry (75% of aluminium is traded); (2) the high degree of concentration and ownership; and (3) the high level of industry cohesion reflected in membership rate of the International Aluminium Institute (IAI) representing 99% of global production.

Participants noted that the source of the electricity used is the most important determinant of aluminium emissions. Although considerable gains in emissions reductions are available through changes to processes, the major gains required to offset current emissions trends will only be achieved through addressing the efficiency with which electricity is used and its source. The potential for developing on-site electricity production using biomass or wind was discussed but it was noted that using renewable electricity to power smelters is difficult.

Secondary production of aluminium through recycling of scrap was discussed, including incentives for further recycling. Progress on this front would require both government and industry cooperation. It was noted that primary production, which ultimately provides the scrap for secondary production tracks economic performance. It was estimated that the potential currently exists (in terms of available scrap) for global recycling to meet 50% of current demand.

It was noted that aluminium production is shifting into developing countries. This being the case, improved measurement, monitoring and reproduction of data on energy use and emissions in countries such as China, India and Russia would prove a key precursor to any sectoral agreement. It was noted that the IAI has already improved data measurement, monitoring and reporting. Rapid steps to share process excellence with developing countries are required, and should form part of any agreement.

- **Cement**

The impact of the EU Emissions Trading Scheme (ETS) was discussed. It was noted that future carbon costs could result in shifts in the location of production. It was argued that GDP growth of only 2–3% in certain western European countries over the next few years would create sufficient demand for carbon credits to drive the price of carbon to around 20–25USD/tonne. Importing cement into Western Europe would then immediately become profitable resulting in reduced production in Western Europe.

Plant replacement over the next 20–25 years in areas of rapid economic growth, in particular China, would provide a crucial window for stemming emissions growth. More rapid implementation of projects under the Clean Development Mechanism (CDM) could speed up the building of efficient dry-process plants in developing countries. It was noted, however, that the current project-by-project format of the CDM could at best bring about incremental change. In order to bring about transformational change of the magnitude required to offset current emissions trends, it would be necessary to focus on industries at the national level. The cement sector in China would be an obvious candidate for such a focus given the fact that China currently produces 44% of global output.

On the technology front, it was pointed out that work on producing 'low-energy' cement with reduced clinker content has been going on for many years, but the price remains between ten and thirty times higher than standard cement. It was noted that the use of waste fuels was important to reducing emissions.

- **Steel**

The impact of the EU ETS was discussed with views put forward as to the potentially distortionary effect of the inclusion of certain sectors (e.g. steel) and the exclusion of others (e.g. plastic and aluminium). It was noted that differing permit conditions within the EU create problems for steel producers and that moving production outside of the EU can be more straightforward than moving production (and shifting emissions allocations) within the EU.

The secondary production of steel through recycling was discussed. It was noted that recycling of steel is currently at full capacity in terms of the availability of scrap. Over the next ten years, steel consumption is set to rise by 40%, and by up to 80% in some developing countries. This will in time generate more scrap which can then be recycled.

Data availability was discussed. Whilst the private sector generally has excellent data on the sector, this is not available to governments, nongovernmental organisations or the general public. However it was noted that, were an agreement to be negotiated, the private sector would provide the required data to governments for negotiation purposes.

- **Coal-fired electricity generation**

The point was made that carbon capture and storage provides the long-term key to reducing emissions from this sector. It is therefore important that new plants, especially those built in countries undergoing rapid growth, are constructed in such a way that they allow for retrofitting of capture and storage technology at a later stage. Reducing emissions from the electricity sector is often a good way to target emissions because it is an upstream sector.

It was noted that improving the efficiency of coal-fired power stations leads to a broad range of pollutant and GHG emissions reductions. Reductions in local air pollution will generally be concomitant benefits

alongside greenhouse gas emission reductions. The barrier to such efficiency improvements is often the cost of maintenance rather than the initial outlay. This could be a prime focus of a reformed CDM. Demand for electricity in developing countries is so high that all plants are being used, no matter what their efficiency. In India over the next 7 years 100 gigawatts of additional electricity will be installed to meet demand, 70% will be from coal. India currently has a portfolio of 90 CDM projects, but to date there has been no substantive technology transfer. It was noted that Combined Heat and Power (CHP) plants offer tremendous scope for improving efficiencies, although they may be less effective in warmer climates.

The role of regulation in the US as an impediment to investment in the best available technology was noted. Electricity generation is regulated more heavily in some states than others, and in certain states the regulatory commissions do not allow the introduction of costly new technologies without the endorsement of federal regulators.

- **Automobiles**

The argument was made for dealing with automobile emissions in an integrated way through seeking a combined approach between fuel producers, the automobile sector, governments and consumers. The practical difficulties of achieving this were noted.

The commercial realities of the sector were underlined. European companies are not making significant profits whilst US companies are losing money. The huge cost of developing new models was also stressed. It was noted that fiscal measures from governments had a role to play in this area.

It was noted that voluntary agreements will not deliver the necessary reductions in this sector. Such agreements were necessarily constrained by the least ambitious player and would not achieve the transformational change required to alter current emissions trends.

II. Transnational Sectoral Agreements

In turning to the potential and difficulties posed by transnational sectoral agreements, it was agreed that it would be useful to focus the discussion around four key questions:-

- Who would be the parties to any sort of an agreement, and what would be the relative roles of governments and businesses?
- What would be the incentive to take part in an agreement to reduce emissions intensity – particularly if you were a company in a developing country?
- What sort of information would be needed to make any sort of intensity-based agreement work?
- Are there any areas where R&D cooperation would make sense and again, what would be the respective roles of governments and businesses?

The meeting then turned to explore the ‘framework conditions’ for might need to be in place to permit the successful negotiation of a transnational sectoral agreement (TSA) in each of the chosen sectors. It was acknowledged that understanding the incentives for industry, developing countries and developed countries would be important to negotiating any agreement.

There was general agreement that a TSA would need to:-

- be compatible with existing institutions and mechanisms such as the Kyoto Protocol, emissions trading and CDM, benefit from lessons learned and in no way prejudice the negotiating position of countries under the FCCC.
- bring together a critical mass of companies.
- have sufficient country coverage.
- create some sort of level playing field globally to ensure that national policies were not distortionary.
- environmentally meaningful and credible.
- recognise the development goals of developing countries.
- promote R&D.

- **Aluminium**

It was argued that any agreement would need to be voluntary and binding. Targets would need to be performance based and related to measurable, verifiable output. Such an agreement would accelerate best practice sharing that is already occurring. It was noted that market-based mechanisms are already facilitating technological transfer. Producers systematically use Best Available Technology (BAT) regardless of location.

It was argued that government involvement would not be essential to the negotiation of a meaningful agreement. However, industry is conscious that involving government could facilitate effective monitoring and enforcement, and better relations with regulators.

- **Cement**

Any agreement between key players in the cement sector would need to be voluntary and binding. The credibility of the agreement would be very important and it would therefore need to involve meaningful targets that would lead to emissions reductions. The agreement would need to bring together a critical mass of players, with the larger companies taking the lead in of setting objectives.

Government involvement would be important for this sector. Governments would need to ensure that there was no contradiction between national targets and the TSA targets. TSAs could accompany national targets and inform national policy, helping governments identify sources of GHG reductions and building national allocation plans.

- **Steel**

Standardised methods for comparing efficiencies across plants needed to be established. One way to improve efficiency and cooperation on a global basis would be through an improved CDM.

The efficiency of steel plants is closely linked to overcapacity in the steel industry. The view was expressed that the best place to discuss steel sector emissions would be within the confines of the OECD steel capacity talks. The industry does not want governments to act simply as observers to any process.

- **Coal-fired electricity generation**

Correct framework conditions for this sector would include the need for long-term policy signals from governments and improved mechanisms for bringing together major players and governments for

negotiating purposes. The Coal Industry Advisory Board which brings together industry representatives predominantly from within the OECD could provide one such mechanism. It was noted that recent discussions in this forum have included the issue of whether every new coal-fired power station should be built so as to allow for retrofitting of carbon sequestration facilities.

- **Automobiles**

Discussions highlighted the high degree of difficulty involved in establishing correct framework conditions for an agreement within this sector. It was argued that such conditions would include an integrated approach to participation, and agreement on measurable, binding targets on performance. Discussions should not target technologies. A first step might represent agreement on common targets. This would not constitute in itself an 'agreement' but would represent a huge achievement in terms of the current status quo. This discussion could take place within an 'advisory committee' which would bring together company and business sector leaders.

- **The Role of Governments**

There was broad agreement that governments do have a role to play in the setting up of any TSAs. A discussion followed on what any such role might entail.

Possible roles for government were as follows:-

- incorporating TSAs into national targets.
- linking TSAs and any trading under them to other emissions trading schemes
- provision of administrative and technical assistance to industry both at the stage of constructing the agreement and in measuring and monitoring it once in place.
- assistance with data gathering
- facilitating better technology transfer through CDM reform

The meeting debated whether industries or governments were best placed to initiate action. The point was made that industry should not wait for governments to fix a firm framework for the post -2012 period before taking action themselves. Any sectoral initiative could feed into the post -2012 framework once this is put in place. Governments could engage in these initiatives without prejudice to their negotiating positions post-Kyoto. There was discussion as to whether industry could be expected to engage meaningfully without clear long-term policy direction from governments. Industry needed more than 'encouragement and support' from governments which needed to engage with each other internationally when, for example, fixing targets.

On the issue of developing country engagement, it was agreed that little incentive currently exists. A credible threat of future government regulation would be required in order to incentivise business engagement. The growing importance of corporate responsibility within developed countries was discussed and it was argued that there exists a growing awareness that the long-term health of companies will depend on early action across the geographical scope of their operations. This was seen as giving grounds for hope that industry might take the lead in engaging their private sector counterparts in developing countries.

The ways in which governments could facilitate technology transfer within the sectors under review received considerable attention. It was broadly accepted that the rate of progress in implementing projects under the current CDM has been too slow although its defenders pointed out that the mechanism was only just getting off the ground. It was stressed that the CDM should not be viewed as a stand-alone mechanism, but as part of a broader financial engineering package. Alone and with current funding levels it would not

be sufficient to achieve technology transfer on the scale required to bring about substantive change. It was agreed that the key challenge at the current time is how the CDM can be scaled up to the point where it can make a significant impact on emissions. It was accepted that more projects are needed in key sectors where current investment programmes will significantly influence emissions levels for the next 25 years. Power generation from coal in China and India was cited as one key sector. It was pointed out that the modernisation of plants would not currently qualify for CDM funding as this is considered to be a business as usual improvement.

The significant gap between R&D needs and funding was explored. The urgent need for more public investment in carbon capture and storage capacity was stressed. The lack of mechanisms for the creation of collective R&D was identified as an area requiring action. The forthcoming G8 meeting was cited as a possible forum at which this issue might be progressed.