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Round Table on Sustainable Development

CHAIR'S SUMMARY

**22nd meeting of the Round Table on Sustainable Development
Post-Kyoto Sectoral Agreements: A Constructive or Complicating Way Forward?**

**12-13 March 2009
OECD Headquarters, Château de la Muette, Paris**

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Post-Kyoto Sectoral Agreements: A Constructive or Complicating Way Forward?

The following is a summary of the discussion on 12-13 March 2009, issued under the Chairman's authority. Please note that, in keeping with Round Table procedures, detailed conclusions will not be circulated.

Sectoral crediting is constructive – but complicated

A general theme emerged that sectoral crediting was a potentially constructive element in any post-2012 agreement. It was recognised that there were some difficult issues that would be need to be dealt with, not least how to manage the need for scaling up financial flows with the need for ambitious emissions reductions.

The prototype sectoral crediting agreement presented in the background paper demonstrated how quickly a catch-22 can arise. The value of credits and the environmental benefit they represent is highest if developing country emissions are constrained well below their business-as-usual trajectory – but that constraint is contentious for many developing countries. On the other hand, adopting a no-lose approach and being relatively undemanding about how far below business-as-usual emissions need to fall before credits can be earned can see their value wiped out and little in the way of emissions reductions achieved. There seemed a general willingness to grapple with these sorts of implementation difficulties associated with large-scale crediting even if there was no obvious fix for such issues.

Scaling up financial flows is a crucial benefit of sectoral crediting

The added value of sectoral crediting was clearly seen to be the scaling up of financial flows to developing country mitigation efforts. Participants were open to different approaches to ensure that sectoral crediting could deliver on that value (including reserve price auctions). While such approaches would not be consistent with a purely market-based system, it was pointed out that if climate change is one of the biggest market failures to strike humanity it may be inconsistent to rely on purely market-based systems to rectify it.

Many participants considered sectoral crediting to be a better way of linking payments for emissions reduction performance than existing CDM. It was pointed out that there are currently around 1500 registered CDM projects. If CDM alone were to provide the increase in carbon finance required to fund mitigation consistent with a 450 ppm stabilisation pathway the number of registered projects would, it was conjectured, need to grow to around 15 million per annum. Many comments implied CDM was not up to that challenge.

Some thought that CDM could be scaled up to deliver much larger volumes of capital finance if the right conditions were put in place; i.e. stringent developed country reduction targets. Some industry participants were attracted to CDM because it directly rewarded firms for action to reduce emissions.

Considerable reform of the CDM would be needed. Industry and financial sector participants noted that there were significant risks to investors that today's emissions reductions would not be considered "additional" tomorrow. Further, the CDM currently "tied the hands" of industry in terms of technology choices in the electricity industry, especially in the case of nuclear technology.

The sense was that many preferred the certainty of a scaled up mechanism – sectoral crediting – to the uncertain success of a reformed CDM which would rely much more on the market, providing the

means for scaling up financial flows. CDM would not necessarily be abandoned but could be substituted by sectoral crediting where possible.

Anything beyond sectoral crediting likely a bridge too far at this time

There was only limited support for a sectoral emissions agreement which introduced both compliance costs and rewards for reducing emissions. Many felt this was a bridge too far in terms of the second commitment period of the Kyoto Protocol when it comes to politics and the principle of common but differentiated responsibilities (CBDR), though it was suggested that such an agreement could be revisited in the context of a third commitment period.

There were divergent and often directly conflicting views on the merits of binding sectoral emissions agreements. For example, it was suggested that common standards would be needed across global industries to ensure that firms would not unfairly lose profitability or relocate production simply to avoid emissions regulations. At the same time, others believed that common standards would not adequately account for differences in national circumstances and could, therefore, result in unfair loss in profitability or unnecessary relocation of production.

Although views were divergent, discussion was constructive. Participants engaged on the difficult trade-off between common regulatory standards and national circumstances with a view to finding a constructive middle ground. Some suggested, for example, that differentiating standards according to regional best practice might be one way forward. While differentiation is a difficult issue – some see the only relevant differentiation being between Annex 1 and non-Annex 1 countries – there was a clear desire amongst participants, including industry, to account for differential circumstances.

It was suggested that international post-Kyoto sectoral agreements should not be about addressing competitiveness and leakage issues. Those who took that view also suggested that: competitiveness issues should be dealt with using domestic measures; benchmarks or common emissions standards did not respect CBDR; sectoral agreements were about creating opportunities not sanctions; leakage issues are overstated and should not be a focus in climate discussions.

Some suggested it was simply not politically feasible to expect developing countries to take on anything resembling an emissions target or standard at this time even if the target were within a single sector.

A counterpoint to political resistance against caps or targets was that they could have developmental benefits by locking in low cost as well as low carbon energy growth pathways. Caps could also help to lift financial flows to the energy sector, which would be a crucial component of many countries' development priorities.

It seemed that while developmental benefits from caps might be accepted as a general point there is an underlying scepticism about whether adequate financial flows would emerge. In this connection some participants pointed out that establishing robust post-2012 architecture was a matter of trust which would need to be established piece by piece.

Technology standards built from the “bottom up” could engender confidence and trust by providing practical and achievable implementation pathways, but even so there is some resistance to such standard-setting approaches in case they create targets, especially those that do not adequately reflect national circumstances and the concept of common but differentiated responsibilities.

Integrating industry perspectives and resolving competitiveness concerns is very difficult

There is a disconnection between the practical reality of business and private sector actions and the global politics of climate change. Business operates in a transnational environment and will be where many emissions reduction initiatives take place. Private interests also own and develop most emissions reduction technologies. Further, industry will be best placed to decide which technologies to employ to reduce emissions. They should not have their hands tied.

The importance of a truly global approach was reinforced by the fact that industry investing on 50-year horizons – lock in of both sub-optimal technologies and locations – could lead to inequitable and inefficient outcomes. It was argued by some that there was no strong basis in business practice for differential regulation of global companies from country to country. It was also suggested that in the context of some industries such as steel the distinction between Annex 1 and non-Annex 1 countries had no practical meaning outside of international politics. Others echoed this point by noting that for industries like cement the majority of world investment, production growth, and installation of clean industrial technologies is taking place in developing countries such as China.

Some were quick to point out that the nature of the problem of climate change is of market failure and a coordination problem and as such is inherently political. This does not diminish the need for governments to listen carefully to firms but does mean that the appropriate perspective is from government rather than industry.

Industry also highlighted that their capacity to reduce emissions and to remain competitive while doing so hinges on government policies. For example, in some countries using some waste products as a fuel substitute to reduce CO₂ emissions in the cement industry is either prohibited or economically and environmentally costly due to inadequate domestic waste collection systems. Thus there is a practical need for firms and governments to work together domestically as well as in the context of international arrangements.

Vast improvements needed in MRV

Many of the ideas around sectoral agreements presume a degree of measurement, reporting, and verification (MRV) that does not currently exist. It was agreed that MRV will need to be a major priority both at Copenhagen and beyond. MRV will be especially important for ensuring compliance and enforcement.

In this connection both industry and government cautioned that the work by many industries to date – such as the CSI's "Getting the Numbers Right" programme – needs to be adequately incorporated into future MRV arrangements wherever possible.

It was pointed out that the successes of the cement industry – in terms of an approximate 80% using the same spreadsheet to measure CO₂ emissions – show that common industry measure and performance metrics is possible, at least for some industries if not for all.

Transnational sectoral technology cooperation (such as the Asia-Pacific Partnership) which focuses on deploying technologies rather than top-down targets, as in sectoral-wide no-lose agreements, would help to ensure more robust MRV.

Technology

The ability of a sectoral agreements to expedite the uptake of low-emission technologies was considered an important aspect mainly in terms of the finance that such agreements might provide to close the gap between conventional technologies (especially electricity generation) and higher cost but lower emission technologies.

There were, however, some differences of views on the role of sectoral agreements in lifting the uptake of low-emission technologies. Some participants suggested that technology transfer and uptake is about finance and risks around returns on investment rather than other barriers to transfer of technologies such as informational or regulatory barriers. Others suggested that know-how and access to technology is more important than financing.

This difference of views regarding technology and sectoral agreements has important implications. Those who perceive finance to be the most important issue tend to be averse to the idea that governments might use technological determinism to “pick winners”. On the other hand, those who see access to technology as the most crucial issue see that governments should cooperate to ensure that all countries can access best practice knowledge and technology.

Discussion also touched on whether sectoral agreements could incentivise necessary research and development as well as deployment of emission reduction technologies. Most comments related to carbon capture and storage (CCS) and some participants were sceptical about the capacity of sectoral agreements to incentivise necessary financial flows to such frontier technologies. It was suggested that a global public private partnership is needed to drive CCS research and pilot projects forward.

Progress needs to focus on building agreement step-by-step

It is generally accepted that sectoral agreements will be complicated and can cause difficulties but that the degree of complication can be handled effectively if solutions are built up piece by piece. It was argued that the considerable detail on sectoral agreements exemplified in the meeting’s background paper was not necessary to obtain a reasonable level of agreement on sectoralism at Copenhagen. The key was to open the door to long term development of sectoral approaches and industry-government cooperation. That could be done by including sectoral approaches in the language of COP 15 decisions. Further elaboration of these sectoral approaches could be completed later. Indeed, some cautioned not to inflate expectations about what Copenhagen can deliver in practical terms.