Summary of Discussion Points

Presented by the Business and Industry Advisory Committee (BIAC) to the
OECD Competition Committee

“Roundtable on Proactive Policies for Green Growth and the Market Economy”

October, 27-28, 2010

1. Introduction

1. The Business and Advisory Committee (BIAC) to the OECD appreciates the
   opportunity to submit these comments to the OECD Competition Committee for its
   Roundtable on Proactive Policies for Green Growth and the Market Economy. Influenced
   by the economic crisis and initiatives to stimulate “green growth,” the choice,
   implementation and effects of market-based environmental policy instruments has
   become both topical and urgent.

2. BIAC is highly supportive of the Green Growth Strategy and recognizes that
   environmental and economic growth challenges should be addressed in a mutually
   reinforcing manner. BIAC is of the opinion that sustainable, long-term economic growth
   is of fundamental importance for raising the necessary resources for addressing
   environmental challenges. In this respect, BIAC believes that green growth policies are
   needed throughout the world, should be comprehensive and require active involvement of
   all parts of society. Green growth policies should not be confined to “green” sectors, but
should aim at “greening” across sectors and economies. Green growth policies should promote interoperable technologies across the entire energy systems, providing the necessary incentives and platforms for innovation in existing and lower-carbon / higher efficiency technologies. This requires supporting innovation, entrepreneurship and green growth across all sectors, focusing on where improvements that are both economically efficient and environmentally effective can best be achieved.

3. BIAC understands that in some cases government intervention is warranted in the transformation to a greener economy. However, it is important to to carefully consider the types of intervention that are appropriate in a particular (country and sector) context to achieve the objective of a greener growth model, as well as to adequately monitor their implementation and the impact and progress made. For instance, “green taxes” may have a major impact on companies’ competitiveness and may take away scarce resources that could otherwise be invested in research, development and deployment of technology necessary for achieving green growth. Where taxes or other policy instruments are employed, they should be focused on static and dynamic efficiency considerations, based on a solid cost-benefit analysis, be transparent, non-distortive and be both economically and environmentally effective. More generally, BIAC emphasizes the importance of removing barriers to investment and trade and counsels against green trade measures that may give rise to protectionism. Finally, BIAC requests specific attention to the importance of competitiveness losses resulting from asymmetrical environmental policies among various countries.

4. BIAC acknowledges that conventional direct environmental regulation may be well-suited in some particular areas. This may for instance be the case in setting

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1 Part of the factual background on which this paper is based, is drawn from Suzanne Kingston, The Role of Environmental Protection in EC Competition Law and Policy, PhD thesis (2009) and the research cited therein.
pollution limits for specific installations, or “point-source” pollution. Direct regulation may also be the only realistic way of protecting especially precious natural resources, e.g. to preserve biodiversity, endangered species, or special habitats. However, in many other cases, direct Command and Control regulatory methods are not likely to bring about optimal results. In those cases, environmental instruments that create incentives and disincentives for market participants by using the market mechanism are more likely to stimulate markets to function most efficiently. A first reason why this is so, is that many of the markets that are intended to be regulated are subject to market failures, are highly complex and technical and display information asymmetries. As a result, sectoral regulators, competition agencies and legislative institutions may lack the knowledge to optimally regulate the economic activities at issue by the use of direct regulatory measures. This information deficit may result in over- and under-regulation and involve significant costs. Direct regulation may also be less suited to regulate environmental harms caused by diffuse, generalised sources and may fail to offer an integrated solution based on the total effects on the environment. Second, direct regulation may be relatively inflexible in remedying new problems and may lag behind the technical innovations in the industry. Direct regulation may in some cases also disincentivise innovation, because industry may have little incentive to develop more cost-effective ways of reducing pollution that go beyond the legislative requirements in force. A third potential disadvantage of direct environmental regulation is that its effectiveness depends on effective enforcement, which in turn depends on a number of variables, such as policy priorities and resources. Forthly, the effectiveness of direct regulation may be diminished by “regulatory capture” by specific interest groups.

5. In light of the above potential disadvantages of direct, Command and Control regulatory mechanisms, BIAC believes that in many cases the use of economic, market based instruments, such as subsidies for environmental performance and tradable permits,
that are each intended to create incentives and dis-incentives for companies are better suited to remedy environmental problems.

II. General Advantages and Disadvantages of Market-Based Environmental Instruments

6. Very generally, the use of market-based environmental instruments, such as environmental taxes, depends on the valuation of the environmental resources and a “charging” mechanism that attributes costs on those economic actors that damage them. However, one disadvantage of market-based instruments is that they fail to achieve their objectives if the price of environmental goods is priced incorrectly. This may, for instance, result in environmental taxes that chill efficient conduct and that are, on balance, inefficient. In addition, some specific markets and environmental aims do not lend themselves well to the use of market-based instruments. This may for example occur in areas where certain species or habitats are to be protected.

7. It is sometimes argued that market-based environmental instruments are objectionable because they would afford the possibility to damage environmental goods to those that can pay for it, or more fundamentally, because participation in the “markets” for these types of economic instruments should not be reserved to economic actors whose existence depends on growth and profit. BIAC respectfully disagrees with these views and believes that market-based environmental instruments, if well-structured and tuned to the particularities of the regulated activities, can contribute significantly to remedying environmental problems and may be more effective than traditional Command and Control mechanisms. However, BIAC does appreciate that market-based instruments do require a regulatory framework and supervision and therefore entail costs. These costs
should play a role in devising the optimal way of regulating activities that may have a negative impact on the environment.

8. Market-based environmental instruments however often enjoy significant advantages. First, internalising externalities, i.e. the cost of pollution, and charging those costs to the polluting actors (rather than imposing those cost on society), may be be more effective and efficient than direct regulation. Indeed, often the regulated entities have the best information that allows them to achieve a given environmental result in the least costly way. Also, market-based instruments avoid the “time-lag” problem that direct legislation faces, may be more flexible and reward the internal efficiency and innovation of firms. Finally, BIAC notes that market-based instruments tend to be more “democratic” in that they increase the participation if firms, which in turn may alleviate enforcement and informational problems.

III. Types of Market-based Environmental Instruments

9. In economic terms, environmental damage and overexploitation of environmental resources can be viewed as a negative externalitiy, i.e. a situation where one actor’s conduct has a negative effect on another’s utility or profit, resulting in “overpollution.” Market-based environmental instruments seek to tackle this problem by internalising negative environmental externalities into market participants’ decisions. A common element of each of the environmental instruments is placing a price on pollution, either by public institutions (in the case of environmental charges and taxes), or by market participants (in the case of tradable performance standards). As a consequence, these instruments create economic incentives and disincentives and thereby steer companies’ conduct. In theory, they provide an economically efficient, welfare-maximising way of achieving environmental objectives.
10. Environmental taxes increase the price of the environmentally harmful products and, in doing so, internalise the product’s environmental cost. Firms are then expected to base their profit-maximising pricing and output decisions on the cost of the product that includes environmental costs. Examples of environmental taxes are pollution charges, charges for water use and noise charges. In 2006, in the EU, revenues of environmental taxes represented 2.6% of GDP. In contrast to taxes, environmental subsidies lower the cost of engaging in environmentally desirable behaviour. Environmental subsidies tend to be used particularly to promote cleaner technologies, such as renewable energy sources. One example are “feed-in tariffs” that support renewable energy source producers.

Thirdly, tradable performance permits afford polluting companies a limited number of pollution rights, which can be traded to other polluters in the event that the owner of the permit pollutes less than allowed by the permit. The most well-known emission trading system is the system for the reduction of greenhouse gas emissions that was set up by the 1997 Kyoto Protocol.

IV. IV Some General Considerations for Setting Up Market-Based Environmental Instruments

11. While BIAC believes that there is no unambiguous ranking of environmental policy instruments, it submits that the following general considerations are particularly important in designing and structuring market-based environmental instruments like environmental taxes, subsidies and tradeable permits, to compare their relative benefits and to allow a rational choices between them.
12. First, it is important to evaluate and estimate as rigorously as possible the estimated static and dynamic gains of the economic incentive scheme at hand, together with the impact the instrument will have on companies’ short and long term efficiency and innovation potential. For instance, the choice between a pollution tax-regime and a system of tradable permits may depend on several complex factors, including the market structure and other market-specific factors, the pre-existing regulatory environment, abatement costs, the ability of the tax regime to correctly tax the most damaging pollution sources, the way the two systems affect technological change and the timing of new technologies more generally, the uncertainty about costs and benefits, the transaction costs associated with the trading systems and many more factors.

13. Second, with a view to developing more efficient market-based environmental instruments in the future, BIAC is in favour of additional empirical research about the impact that existing (and future) environmental instruments have had on the environment, as well as the critical factors that determine the success of programs to achieve their aims. This type of research should go hand in hand with studies on the impact of these programs on companies, in particular their innovation potential.

14. Third, BIAC believes that there is a positive correlation between the desired technological changes and process innovations on the one hand and the use of flexible market-based instruments on the other hand. As a result, these instruments should preferably be designed to allow for sufficient flexibility (in terms of timing and other relevant factors) and a broad set of compliance alternatives.

15. Fourth, BIAC is in favor of simple, non-ambiguous and transparent criteria and formulae as a basis for market-based environmental instruments. Indeed, simplicity and transparency are likely to significantly reduce the uncertainty and transaction costs associated with these systems.
16. Fifth, in the design of market-based instruments, specific attention should be given to monitoring and enforcement mechanisms, which are key to establishing high compliance levels. In this regard, BIAC counsels cost-effective, efficient monitoring mechanisms with minimal administrative burdens for companies. Moreover, these systems should be as non-intrusive as possible and be applied in a non-discriminatory manner, thereby avoiding unlevel playing fields for companies.

17. Sixth, it is important to concentrate on the political feasibility of market-based environmental instruments and the capabilities of the private sector to make the markets that these environmental instruments establish, work. This includes studies into the way companies are equipped internally to exploit the cost savings associated with the measure at hand and their strategic focus. In BIAC’s view, this implies an open and thorough dialogue with the economic entities that are to be regulated with a view to defining the optimal components of future market-based environmental programs.