



**Council at Ministerial Level, 26-27 May 1999**

**INTERIM REPORT ON THE OECD THREE-YEAR PROJECT ON  
SUSTAINABLE DEVELOPMENT: EXECUTIVE SUMMARY**

**(Note by Secretary-General)**

*This paper presents the Executive Summary of the Interim Report on Sustainable Development, as revised in the light of comments received from several delegations. This paper will be presented at meetings of the IEA Governing Board at Ministerial level (24-25 May 1999) and of the OECD Council at Ministerial level (26-27 May 1999). The full Interim Report will be published under the responsibility of the Secretary-General in June.*

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## EXECUTIVE SUMMARY

### ***The three-year Ministerial Mandate.***

At the Ministerial Council Meeting of April 1998, Ministers asked the OECD to undertake a three-year project on key aspects of sustainable development. This Executive Summary of the *Interim Report* on the OECD three-year project on Sustainable Development provides an overview of the work carried out and planned for the next two years. The last two paragraphs describe the output proposed by 2001 in response to the Ministerial mandate. The table of content of the full *Interim Report*, which will be published in June, is presented as an annex to this Executive Summary.

### ***Key policy questions for OECD governments...***

Governments in OECD countries face a common set of key policy questions. Is economic growth, nationally and globally, leading to excessive exploitation of natural resources and to degradation of the ecosystem? Are increases in material welfare, as measured by GDP, providing adequate employment opportunities, and are the benefits widely shared? In other words, do we risk falling short of achieving major environmental and social objectives?

Important issues for practical policy formation are connected to these questions. What is the right balance between public policy interventions and market solutions in responding to them? Are governments taking a long-term view of their responsibility towards the current and next generations? How can OECD governments show leadership and commitment to address pressures on the global commons? And how can they help developing countries, many of which lack economic resources and local capacities, to move towards comprehensive sustainable development?

### ***...underpin the paradigm of sustainable development.***

The concept of sustainable development offers an integrated framework for addressing such questions. The concept originally derives from the scientific literature where it implies the management of a natural resource in ways consistent with the preservation of its reproductive capacity. It has now acquired a broader meaning, implying that the objectives of increasing economic efficiency and material wealth must take into account social and environmental concerns within an overall policy framework.

The sustainable development framework also incorporates a focus on equity within and across countries (i.e. the here and now), and a long-term focus on the well being of the next generation. The framework calls for policies that can serve multiple objectives and exploit synergies, and requires that a balance be struck when objectives conflict.

*Addressing these questions imply formidable challenges to policy making...*

Formulating policy in a sustainable development framework means incorporating three key elements: a global dimension, linkages and participation. The first element means that some of the problems pertaining to sustainable development — such as climate change — require global solutions. Even though action will be required at the domestic level, international co-operation is needed, as concerns with their perceived competitiveness implications may impede effective policy reform. To be effective, policies must often extend beyond the national boundaries. Success becomes contingent on international co-ordination and negotiations, even when each OECD country should also act domestically.

Linkages between the economic, environmental and social dimensions mean that policy choices can involve difficult trade-offs between objectives that affect different constituencies. More importantly, however, the complementarities among the three dimensions also provide an opportunity for sustainable development to build bridges between the various policy communities, rather than to drive wedges between them. The cross cutting policies and interventions required concern many policy makers, ministries and sectors. They are horizontal policies, beyond the domain of any single ministry or levels of government, where Heads of government may have to exercise overall co-ordination.

Finally, a participatory approach is central to successfully meeting the challenge of sustainable development, both nationally and through enhanced international co-operation. Governments cannot exercise sole responsibility. Other stakeholders such as business, community based organisations and other non-governmental organisations (NGOs) have to become active partners.

*... also reflecting limits of our analytic...*

A key objective of the three year OECD initiative is to make the concept operational for public policies. Our approach considers sustainable development to be a key economic issue. Some types of economic decisions contribute to phenomena such as climate change, biodiversity loss and unsustainable exploitation of some natural resources, as well as to income inequality and high unemployment.<sup>1</sup> The response requires modifying economic incentives to incorporate environmental and social concerns. As a result, policies for achieving sustainable development may sometimes diverge from those directed at maximising economic growth in the short-term.

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1. “The OECD Jobs Strategy: Policies to Create Jobs”, C/MIN(99)9, and “The OECD Jobs Strategy: Assessing Performance and Policy”, DEELSA/ELSA(99)5 and ECO/CPE/WP1(99)3.

The OECD approach also emphasises meeting these concerns at the lowest possible costs, and that these costs should be representative of the *full* costs to society of the various economic activities. It suggests that a number of insights need to be applied at both the macro- and sectoral levels. These include:

- An emphasis on how the “capital base” of our economies — i.e. man-made, natural and human capital — is evolving.
- The importance of science, technology and human resource development in enhancing the productivity of existing capital, or in generating pressures on some types of resources.
- The assessment of the degree of substitutability or complementarity between different assets.

But while these insights offer important guidance to policy makers, they also have limits.

Economic valuation techniques are not easily applied to some ecological resources, like preserving biodiversity, or to social objectives like promoting participation. As a result, they do not allow comparisons of the future benefits of climate change policies, that will accrue to generations with higher levels of material well being, to those of public health, infrastructure and education, that will accrue earlier to individuals who may need help more urgently. Uncertainty, irreversibility and the risk of catastrophic events pose additional challenges for the application of analytic tools to improve present policies on these issues.

*... and measurement tools.*

We also need to improve our capacity to measure and monitor the state of our environment and society, and their interactions with economic development and traditional economic indicators like GDP. The OECD has been at the forefront of the development of environmental indicators and of social indicators, in addition to more conventional and well established economic data and indicators. These indicators cover both the “outcomes” of the development process, and the “inputs” (or assets) that sustain it, with various degree of sectoral and spatial detail. However, such measures have so far had a fairly limited impact on policy making. A challenge for the future is to integrate and make them a practical tool for public policy.

What are some of the obstacles? While full monetary valuation allows consistent aggregation, it requires defining prices for goods that have no markets. While summary indicators of sustainability like “genuine savings” have played a useful role in focusing attention on the sustainability of economic growth, estimates have so far been based on strong assumptions and partial information. Building on efforts underway in other international agencies and universities, the OECD is seeking to develop, and build agreement on, a framework for better integration among economic, environmental and social issues. A number of workshops and conferences are foreseen in this process.

***Practical progress is best pursued on a case-by-case approach, starting from challenges such as climate change...***

The OECD approach suggests that progress towards sustainable development is best achieved through a pragmatic, case-by-case process, starting from a few major threats such as climate change. The Kyoto Protocol, which commits most OECD countries to limit emissions of greenhouse gases, is an historic step that marks their determination to curb climate change, an objective requiring global solutions. Achieving the Kyoto targets will require integrated and cost-effective policies to ensure that decisions to produce, consume and invest take climate goals into account. Domestically, this calls for greater use of economic instruments to deliver consistent price signals — such as subsidy reform, green taxes, “full costs” resource pricing and emission trading — as well as other measures. Internationally, it calls for accelerated diffusion of climate-friendly technology and effective implementation of the international mechanisms such as emissions trading included in the Kyoto Protocol.

OECD work on climate change since the fourth meeting of the Conference of the Parties to the Climate Change Convention (COP4) in 1998 has aimed at assessing progress by countries in implementing domestic mitigation strategies under the 1992 UN Framework Convention on Climate Change; and to analyse and quantify the effects of different implementation strategies. The main findings of this work, summarised in the full *Interim Report*, stress that relative to a “Business as Usual” scenario, Kyoto targets imply a reduction in emissions of some 30 per cent, and that by 1995 emissions of greenhouse gases were generally higher than in 1990 (the base year for Kyoto targets). Few of the domestic policies necessary to reaching these emissions targets are in place today.

Moreover, while the costs of meeting emission targets through domestic measures alone are likely to be significant, international co-operation offers important opportunities to reduce these costs through use of the so-called “flexibility mechanisms”. Economic instruments — such as emission trading and environmental taxes — aiming to achieve emission abatement at least cost will become even more important as more ambitious targets are agreed for stabilising concentrations of greenhouse gases, an objective that calls for the participation of developed and developing countries alike according to their “common but differentiated responsibilities.”

Other key features of climate policies pertaining to the role of technology transfers, of sectoral measures at the domestic level, and of policies to assist non-member countries in addressing global environmental concerns, are taken up in different parts of this Report. The Organisation is committed to strengthening its analytical capabilities and policy dialogue so as to be of best assistance to OECD countries and the international community at large. Analytic reports on climate change policies will be released ahead of the fifth meeting of the Conference of the Parties to the Climate Change Convention (COP5) in 1999 with a follow up for the sixth meeting (COP6).

***...and the sustainable management of natural resources...***

Sustainable development brings a new perspective to concerns over the use of natural resources. In this perspective, a central policy question is whether the earth's ecosystem could sustain the high pressure on natural resources that would result if all countries were to adopt lifestyles similar to those now prevailing in the most economically developed countries. In general, given the considerable scope for substitution among resources, what matters more than absolute scarcity is whether human ingenuity can keep combining man-made, natural and human capital in ways that enable human needs to be met. In some cases, however, the scope for substitution may be limited and absolute scarcity be a matter of concern.

In the case of non-renewable resources, a general trend towards more efficient use implies that the most important issue is not availability, but what to do with the waste streams they generate. In the case of renewable resources, however, many ecosystems are under stress. Even for water — perhaps the most indispensable resource — problems arise because of its uneven geographic and temporal distribution. Managing these resource so as to support sustainable development requires optimising the net benefits to society from current and future uses in the light of both commercial and non-commercial values. This requires internalising negative production externalities, proper management of access to resources, innovative approaches to the collection of resource rent, and reforms of inappropriate support policies. The transition to such practices, however, is likely to give rise to adjustment problems and resistance to change. OECD work in these areas is aiming to present recommendations to Member countries for sustainable resource management and for managing the transition to sustainable use in areas such as agriculture, energy, fisheries and biodiversity.

***...focusing on the instruments available to policy makers to "get prices right"...***

The importance of externalities — the costs and benefits to society of economic activities that are not reflected in their market prices — is not limited to natural resources. A major obstacle in achieving sustainable economic development arises from the presence of external environmental costs and the lack of well-defined property rights for many environmental resources. Open access to such resources free of charge means that producers and users lack the economic incentives to take the full costs of environmental degradation into account. But externalities are also pervasive in other policy areas such as technology, training and education policies, where the divergence between private and public returns may lead to under-investment and depreciation of skills. Thus a key factor in an effective pursuit of sustainable development is correcting for "market failures" and removing — as far as possible — distortions caused by inappropriate policies ("policy failures").

A number of steps may be required to move in this direction. These include:

- The reform of subsidies that are harmful to the environment.
- The use of economic instruments such as taxes and charges for harmful environmental externalities, and incentives for the provision of environmental public goods.
- The creation of markets where they do not exist, e.g. allowing trading in pollution and emission permits where suitable.
- A better appraisal and valuation of external effects.

In other words, those responsible for pollution should be liable according to the “Polluter Pays Principle”, while consideration might be given to remunerating those who use their own resources to meet a demand for environmental public goods. Policies should also be guided by the “precautionary principle”, e.g. the lack of full scientific certainty should not be a reason for postponing cost-effective measures to prevent environmental degradation in the presence of threats of serious or irreversible damage. Economic instruments can be important, in a number of circumstances, to get prices right and to achieve environmental objectives at the lowest costs. Their introduction, however, may meet political resistance to the structural changes in consumption and production patterns they are meant to enhance.

But, as importantly, establishing better framework conditions for sustainable development also requires better *ex ante* integration of different sectoral concerns, as often what appears as a “policy failure” from an environmental perspective may be motivated by social (including sectoral and regional) considerations. It also requires careful policy design, to minimise risks of policy failures, and exploiting opportunities by harnessing market forces. As differences in country and sectoral practices in this area are large, so is the scope for learning from “best practices” through country reviews of economic, environmental and energy policies, peer pressure and policy dialogue.

***... to favour the  
creation and diffusion  
of clean  
technologies...***

Technology will be critical in meeting the needs of current and future generations and in de-linking economic growth from environmental degradation. But appropriate technological change is not automatic, and technologies may also lead to pressures on natural resources, create health hazards and raise difficult ethical considerations. OECD governments have a key role to play as market failures, including information and pricing failure, risk stifling rather than stimulating technologies that may enhance sustainable development. They must improve present framework conditions so as to provide the right incentives and price signals to firms and influence consumers’ awareness and behaviour. They often have a direct role in the financing of the basic research underlying innovation in clean technologies, an area that accounts for about five per cent of public R&D expenditures.

Fiscal and other measures to encourage the diffusion of cleaner technologies exist in several countries but, overall, such programmes are too recent and limited. OECD governments have also an important role in enabling developing countries to take full advantage of existing options for clean production by supporting capacity development. OECD work will aim to formulate recommendations for designing cost-effective innovation policies capable of supporting sustainable development goals. This will include: analysis of the concepts and measurement of eco-efficiency and resource efficiency; work on how innovation and environmental policy instruments can best promote environment-related innovation; in-depth analysis of specific technologies; and case studies with industry of how firms incorporate environmental objectives into their management strategies.

*... and to help non-member countries in establishing policy frameworks for sustainable development.*

While global economic integration has the potential to promote more efficient resource use and higher material welfare, it may also amplify and/or redistribute environmental and social pressures towards non-member countries.<sup>2</sup> This requires establishing in these countries the economic, legal and regulatory frameworks necessary to ensuring compliance with social and environmental safeguards. The OECD is engaged in a dialogue with non-members on how to meet this challenge in a number of areas. There is a need to identify the key features of effective national strategies for enhancing sustainable development, building on experience to date. This requires deepening in-country dialogues, strengthening local capacities and participation, and clarifying the linkages between the social, environmental and economic objectives of sustainable development.

OECD countries also should strengthen the coherence between their trade, investment, environment and development policies. The OECD is working to find ways of involving major non-members in efforts to address global environmental concerns, such as climate change, biodiversity, water availability and desertification. These challenges are closely related, and will need to be addressed together. A good way to integrate environmental and development goals is to enable non-member countries to take full advantage of cleaner production technologies, an area where the International Energy Agency (IEA) and the OECD are working actively together. A collaborative process among international organisations has led to agreement on a working set of “core indicators” to monitor progress of developing countries towards a range of economic, environmental and social objectives. Work is continuing to improve the quality of existing data, and a joint review of the progress achieved is planned in the spring of 2000.

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2. “Trade, Investment and Development: The Challenges of Policy Coherence in a Global Economy”, SG/LINKS(99)1/REV1 and “Trade and Investments and the Developing World”, ECSS(99)7.



***The OECD is committed to helping Member countries to face up to these challenges through a major horizontal project...***

The OECD is committed to helping Member countries address fundamental sustainable development issues, in response to the three-year mandate from Ministers adopted at the OECD Council Meeting of April 1998. The challenge, for the Organisation as much as for Member governments, is to move beyond a narrow, sectoral approach to important policy issues to one geared to greater *ex ante* integration. The response of the Organisation has involved the development of an horizontal project, which involves most OECD Directorates and close co-operation with the OECD affiliates, the International Energy Agency (IEA), the Nuclear Energy Agency (NEA), the European Conference of Ministers of Transport (ECMT) and the Development Centre. To enhance the co-operation with other international organisations such as The World Bank, The World Trade Organisation, UNEP, UNCTAD and UNDP, and to provide intellectual stimulus to OECD efforts, an *OECD Round Table on Sustainable Development* was established in the summer of 1998. The Round Table gathers, in a personal capacity, officials from Ministries of the Environment and of Finances, from the above-mentioned international organisations, and from business and NGOs.

***...that will aim at substantive outputs for the meeting of OECD Ministers in 2001.***

The three-year horizontal project on Sustainable Development is expected to lead to three types of documents:

- A *Policy Report* to Ministers, providing recommendations on policies for enhancing sustainable development. This will draw flexibly on other documents prepared in the process.
- An *Analytical Report*, with inputs prepared by different Directorates and working groups, with an advanced draft to be prepared by end-2000 (a provisional outline of this Report is provided in Table 1).
- A series of *Background Reports* also prepared as documentation for workshops and conferences, developing in more detail some of the components of the OECD work.

It is suggested that the *Policy* and *Analytical* Reports be reviewed by *ad-hoc* joint committee, gathering officials from capitals in the economic, environment and social fields. Review of other products, including those prepared as inputs to the horizontal projects by the different OECD Directorates and working groups, will continue through the various committees and working parties of the Organisation. Based on this documentation, a joint meeting of Ministers of Finance, Environment and Social Affairs is envisaged as an integral part of the Ministerial Council Meeting in 2001.

**Table 1. A Provisional Outline of the 2001 Analytical Report on Sustainable Development*****Part A. The Outlook for Sustainable Development***

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***Part B. A Policy Framework for Sustainable Development***

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3. Measurement
4. Institutions and Decision Making
5. Enhancing Framework Conditions for Sustainable Development
6. Technology and Sustainable Development

***Part C. Policy Responses: Key Issues***

7. The management of natural resources
8. Responding to climate change

***Part D. Policy Responses: Sectoral and Local approaches***

9. Energy
10. Transport
11. Agriculture
12. Local approaches

***Part E. Globalisation and Sustainable Development***

13. Trade, Investment and Sustainable Development
14. Strategies for Enhancing Sustainable Development in developing and non-member countries

*This outline of the Analytical Report is, at this stage, tentative; it may be adjusted in the course of 2000, in the light of the substantive outputs produced for the various committees and working parties. In any case, it is proposed that chapters of this Analytical Report be presented to sectoral committees and working parties in the course of 2000. An ad-hoc committee will vet the Analytical and Policy Reports early in 2001 in preparation of the 2001 Ministerial Council Meeting.*

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