

Achieving Consensus: Multilateral Trade Measures in Post-2012 Scenarios

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Are there multilateral agreements within the WTO that might further the objectives of the climate regime? Is there potential within a post-2012 climate regime for agreement on trade measures that would help advance those same objectives? This paper will address these two questions.

Multilateral trade measures in the trade regime

The background note to this event says, with respect to this session: the multilateral trade regime potentially has the capacity to create the necessary incentives and an enabling environment to address climate change challenges. I think this is right.

But first we need to define the scope of the discussion. Trade measures are usually taken at the national level, and so the term “multilateral trade measures” might be confusing for some. In this brief paper I’ll talk about two classes of policies: trade measures taken at the national level for which we have agreed multilateral rules on usage; and agreement at the multilateral level on trade rules within the WTO body of law.

Multilaterally agreed trade policy

To take the latter first, the most obvious type of policy in this category is liberalization of trade in environmental goods, for which we have a mandate under the Doha Work Programme. Of course there is no perfect match between environmental goods however defined and goods that achieve climate change objectives, but there is nonetheless some overlap. In order to keep this discussion brief and focused I will ignore this important point and proceed as if the two were synonymous.

As most of you know, the negotiations on this issue have been stalled over definitions of environmental goods. My comments on this impasse start from the observation that what the WTO is trying to do is create an environmental standard – a definition of a good that because of its environmental attributes will receive special treatment. I won’t go into the well-travelled debate over whether environmental goods should be defined by their PPMs, their product characteristics, or inclusion in certain projects or certain environmental areas. But I will observe

that the WTO is the wrong body to create an environmental standard. The WTO is not a standards organization, and it is not an environmental organization, so what on earth is it doing creating an environmental standard? In no small part the current impasse, which has various countries pitching definitions that suit their national economic interests, derives directly from the fact that trade negotiators should not be making environmental standards. As it does in the case of technical barriers to trade and sanitary and phytosanitary standards, the WTO should refer to standards created by bodies with legitimacy and expertise in the relevant area. At a minimum it should be asking for outside assistance in elaborating principles and guidelines by which to choose the preferred items, as it asked for expert assistance in crafting rules on IPRs.

While it is appropriate for trade policy makers to consider how they might contribute to environment and climate objectives, and while the EGS negotiations are an obvious answer to the problem, it is not clear exactly what impact a successful conclusion to the talks will have. The answer to this question obviously depends in the end on the scope and depth of the agreement, but I must say I would be surprised if the results were particularly significant in terms of their final impact.

I can think of other initiatives, however, that might hold more promise. Primary among them is work to lower or eliminate trade-distorting fossil fuel subsidies. This would be a monumental accomplishment, given the enormous climate change impact of our current fossil fuel use, and the significant barriers that these subsidies pose to alternative energy investments. I would also argue that we may need flexibilities in the Agreement on Subsidies and Countervailing Measures to support climate-friendly R&D, and to support climate friendly retrofits to existing installations, even if such support is specific, and injurious to foreign producers.

It has also been argued that we may need reform of the TRIPS Agreement to reduce the barriers that patents on climate friendly technologies might create for technology transfer, particularly to developing countries. On this last item I have some reservations. There are, of course, existing flexibilities in the TRIPS Agreement that some argue are already sufficient. Others have argued that climate friendly technologies are selling into a competitive market, where patents do not constitute the same kind of barriers they do in concentrated sectors like pharmaceuticals. But certainly it is worth exploring further whether there is any scope for contributing to climate change objectives in this area.

Multilateral agreement on national-level trade measures

The demise of the Lieberman-Warner border carbon adjustment proposals in the US Senate is not the end of the prospect for unilateral trade measures aimed at levelling the carbon playing field. The new administration will undoubtedly implement some form of cap and trade regime, and the opinion from the beltway is that no such regime will pass without a border carbon adjustment scheme. The EU, for its part, has been making noises about such instruments for almost a decade, and is toying with the idea of making them part of the third phase of the ETS. The Business Council of Australia is pushing for such measures, and they will no doubt soon be

considered in other OECD countries that contemplate strong domestic actions, such as Canada, New Zealand and Japan.

Is there any scope for multilateral agreement within the WTO on when and how such measures could be used? The history of the trade and environment debates suggests not. Among developing countries they are widely seen as simply the latest in a long series of new protectionist barriers to developing country exports – barriers that spring up as traditional tariff barriers are successfully lowered.

Such suspicions are often misguided knee-jerk dislike of legitimate environmental measures, but it is hard to make that argument in this case. Border carbon adjustment is always primarily discussed as a solution to competitiveness problems, and only secondarily as a solution to leakage – the environmental issue. As well, these measures are often discussed for use by some of the world's worst climate slackers, with the most significant historic and current responsibility for climate change – (e.g., the United States) – and for use against some of the countries least responsible for historic total or current per capita emissions, and who are doing a great deal more at the policy level to address climate change than most OECD countries – (e.g., China). This does not help persuade developing country policy makers of the green credibility of such measures, I'm sure. It would be an extremely steep uphill battle to have any sort of agreement on the use of such measures in the WTO. At the end of the day, however, anything is possible in a trade negotiation if you want it badly enough to pay for it.

Multilateral trade measures in the climate change regime

Are there lessons from the Montreal Protocol that can guide us as we consider whether to incorporate similar trade provisions in a climate change regime? That will depend in the first instance on the type of trade measures we are considering, and the objectives we have in mind. I'll assume that we're talking about trade measures built into the climate regime that can address the competitiveness problem, and address leakage.

These, certainly, were the objective of the major trade provisions under the Montreal Protocol – provisions which banned trade in ozone depleting substances (ODS) with non-Parties to the Protocol. It would have been impossible to construct a system to reduce Parties' consumption of ODS if the system had not been closed. That is, if Parties' reductions in ODS use were simply wiped out by the import of additional ODS from non-Parties, the system would not work.

But at the outset, a word of caution: the specifics matter a lot. Just because the Montreal Protocol successfully used trade measures to address competitiveness and leakage concerns does not necessarily mean there is potential for the UNFCCC to do the same. There are also trade measures in the Basel Convention and the CITES treaty, but few would suggest that they are relevant to the UNFCCC context since they are so different in their objectives and application. So we need to be careful not to be over-quick in transplanting the Montreal Protocol experience into the UNFCCC context.

I see two key differences between the Montreal Protocol and the UNFCCC that give me some pause in thinking about UNFCCC-sanctioned trade measures to deal with competitiveness and leakage. First, it was easier under the Montreal Protocol. Second, the context is fundamentally different. But I also see important lessons, and I'll finish by drawing those out.

It was easier under Montreal Protocol:

The Montreal Protocol focused on a good, or rather a small set of goods, that the world wanted phased out. In the first place, this meant that a much smaller economic stake was in play than under the UNFCCC, which covers pretty well every conceivable economic sector. It's true that the sectors vulnerable to competitiveness impacts under a post-2012 climate regime are a small subset of the whole economy— covering such areas as cement, aluminum, iron and steel, pulp and paper, oil refining and ceramics. But these easily dwarf the size of the ODS-producing sector affected by the Montreal Protocol.

In the second place, the Montreal Protocol avoided the complex matter of calculating the embedded undesirables in traded goods. In fact the Montreal Protocol had a mandate to cover goods that were manufactured using ODS, but which did not contain ODS in their final form. But on the advice of the Protocol's Technology and Economic Assessment Panel which argued that the necessary calculations would be far too methodologically complex, the Parties rejected operationalizing this provision.

The context is fundamentally different; the analogy is wrong:

Under the Montreal Protocol, the issue was free-riding non-Parties, whose unchecked efforts would wreck the integrity of the regime. If it was not a closed system, then it would be fundamentally unworkable. The UNFCCC for the most part *has* a closed system. The issue is not non-Parties so much as it is Parties with less stringent commitments. (The US as a non-Party to the Kyoto Protocol is, of course a problem. But most analysts expect the US to be part of any post-2012 regime.)

The fundamental question with which we are now wrestling is: what is the appropriate level and form of responsibility for non-Annex I Parties post-2012? We are still far from agreement. Yet Annex I Parties are considering trade measures to force their preferred answer to the question. In the Montreal Protocol context, by contrast, there was international consensus on a (differentiated) timetable for phase-out among the Parties. There was never a question of using trade measures on other Parties to force them to take on an accelerated timetable of phase out, which is the proper analogy.

Wrapped up in all this is the fact that we have explicit agreement under the UNFCCC that developed countries are to take early action and to help developing countries to take action, given Annex I's historical responsibilities and its stronger capacity. And note that this action has not yet been taken in earnest in many, if not most, Annex I states – a fact that adds political heat to the context. Like it or not, GHG production is connected to economic development in a way that ODS production never was, and this is recognized repeatedly in the Convention's Article 3.

The differences between the Montreal Protocol and the climate change regime matter a lot. In the context of the UNFCCC and Kyoto Protocol negotiations on a post-2012 climate change regime, they matter enough that I'd bet anyone at this event a fine bottle of champagne that we will not see any agreement in a post-2012 climate change regime to use trade measures as a way to address competitiveness or leakage issues as between Parties. Non-Parties would be a rather different matter (and if Annex I Parties push hard enough for trade measures within the UNFCCC, we may in fact have a large crop of non-Parties to deal with).

But then how should the UNFCCC address the issues of leakage and competitiveness? Or should it at all? Two lessons at least stand out from the Montreal Protocol experience. First, recall that the Montreal Protocol rejected the idea of trying to calculate embodied ODS in traded goods as too methodologically complex. I think this was a wise decision. Second, recall that the Montreal Protocol created the Multilateral Fund, which was dedicated to meeting the incremental costs incurred by developing country governments and firms in complying with their phase out obligations. This instrument, which was key to the decision of developing countries to sign on to a timetable of mandatory phase out, is an excellent guide to action on climate change.

But note that, here again, the differences are important. The incremental costs of action on climate change are much higher than they were in the context of ozone depletion, and well beyond the reach of public coffers. Note the contrast between the UNFCCC's Secretariat's estimate of \$200 – 210 billion by 2030—this is the annual incremental amount needed to bring 2030 emissions down to 2004 levels—and the annual expenditure of the World Bank's Clean Technology Fund, an admirable achievement, but which comes in at some \$2 billion per year over five years.

The proper direction for action is dedicated work to catalyze private sector investment in the development and dissemination of new technologies for mitigation and adaptation. A huge and mostly ignored part of this challenge will be in creating the right domestic conditions for such investment to materialize, and this involves the difficult work of regulatory reform, legal reform and fiscal reform in host states. That is, we have massive flows of public investment going into projects, and to some extent that addresses the problem of commercialization and economies of scale. And we have a number of good agreements on public supported technology development. But the missing link, if we want incremental investment at levels anywhere near the levels estimated by the UNFCCC Secretariat, will be efforts to facilitate private sector investment by reducing barriers and increasing incentives at the domestic level.

Here there is potential for a multilateral solution, perhaps led by the UNFCCC and in combination with those who are expert in the field such as the World Bank's ESMAP programme, to really make progress in addressing the underlying issues that will determine developing country ability and willingness to take meaningful action on climate change. That is an indirect and difficult road to addressing competitiveness and leakage, but it may be the only road that leads to success.