

Harnessing Globalization: Scaling Up Trade and Investment Policy's Contribution to Climate Change Efforts

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Aaron Cosbey
Associate and Senior Advisor, Trade & Investment
Associate, Climate Change & Energy
International Institute for Sustainable Development, Canada
acosbey@iisd.ca

Background

It has been proposed for many years that the rules of international trade and investment should be in harmony with the objectives of the UNFCCC or, at a minimum, that the rules of trade should do no harm to those objectives. The evidence on potential for harm is slim, and has been well-researched.¹ Relatively little has been said, however, about the ways in which the rules of the multilateral trading system (WTO) and other trade and investment law might effectively serve climate change reduction objectives.²

This brief describes four areas of potential for immediate actions:

- Investment law
- Environmental goods & services liberalization
- Non-actionable subsidies for the environment
- Fossil fuel subsidies

Each of these is discussed in turn below. Several of these possibilities are closely related to the WTO's ongoing Doha talks. In a brief concluding section the state of those talks is discussed, with some thoughts as to the implications for climate change action. A summary list of key possibilities is also offered.

Possibilities

1. Investment law

The IEA estimates that some 20 trillion dollars of investment is needed in the energy sector between now and 2030, most of it in developing countries. The challenge from a climate change perspective is to ensure that the bulk of that investment goes into clean energy technologies, rather than locking the world into a disastrous half century of new carbon-intensive energy production.

¹ See Cosby and Tarasofsky (2007), Tarasofsky (2005), Charnovitz (2004), Cosby, Assunção and Saba (2003), Biermann and Brohm (2003), Werksman, Baumert and Dubash (2003), Assunção and Zhang (2002), Wiser (2002), Brewer (2002), Brack (2000), Assunção (2000), Cosby (2000), Campbell (2000), Cosby and Cameron (1999), Petsonk (1999), Werksman and Santoro (1998).

² Note, though, that Doelle (2004) explores the measures that might be legally taken by an individual WTO member state to support its *own* efforts to combat climate change, such as protecting domestic industries from competitiveness impacts associated with domestic regulations. Also, Houdashelt *et al.* (2007) look for ways to link the ongoing trade and climate change negotiations to offer incentives for developing countries to participate more strongly in the latter.

Investment law as written in the myriad bilateral and regional agreements (over 2,500 at last count) has little direct bearing on clean energy investment *per se*. But there are some elements in traditionally-formulated treaties that may serve as obstacles to policies governments might see as desirable to achieve climate change objectives. For example, most investment treaties fail to adequately define expropriation, leaving open the possibility that tough environmental regulations – because they cause economic harm to certain firms – might be challenged as indirect expropriation. A number of such uncertainties should be removed from investment agreements to help foster the spread of clean energy investment.

Perhaps more important, investment law could be used proactively as a tool for the promotion of such investment. The Energy Charter Treaty³ is an example of a specific agreement designed to promote energy investments, though there is no special treatment for clean energy. The principle could be taken further, within the ECT, or as a stand-alone sectoral investment designed to foster clean energy investment. After agreeing on what constitutes such investment, negotiators might seek to assemble a critical mass of unilateral commitments of market access for it, building on the “request-offer” model of negotiation pioneered under the WTO’s General Agreement on Trade in Services.

Such an agreement might also allow for the possibility of investor-state arbitration for clean energy investors, where this does not already exist. Many states already offer such protection to investors (not just in the context of clean energy) under existing investment agreements, but a significant number do not.

Finally, it might set out minimum standards of regulatory regimes that will foster clean energy investment at the domestic level (e.g., IPP purchase legislation, perhaps with preferential tariffs). This aspect would resemble the WTO’s Agreement on Trade-Related Intellectual Property Rights, which obliges signatories to create a regulatory regime that adequately protects intellectual property. Clearly, along with such obligations would need to come an adequately funded program of capacity building to support the mandated regulatory reform.

2. Environmental Goods and Services Liberalization

Another area of potential is the ongoing WTO negotiations on environmental goods and services (EGS). Article 31(iii) of the declaration that launched the

³ The ECT is a treaty aimed at fostering increased energy investment and trade primarily by strengthening investor protection. Its Members include the countries of Eastern and Western Europe, Central Asia, Japan and Australia.

current Doha Round of WTO negotiations calls for: “the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services.” Obviously the idea is to more widely spread the environmental benefits inherent in the trade of such goods and services.

To date the negotiations have centred on trying to come up with workable definitions of both environmental goods and environmental services. The former has been the most contentious; is a good environmental because of its end use (e.g., a heat pump, in which case we have the problem of dual use), or because of the way it has been produced (e.g., organic produce), or because of its characteristics in use (e.g., a hybrid vehicle)? These last two categories would involve the WTO in effect acting as an ecolabeller, deciding which goods are “green” enough to warrant listing, and presumably updating that list as the bar is raised in any particular sector. This is not a traditional WTO role, and not one that many would welcome.

There are two ways in which climate change objectives might be served by these negotiations. First, specific goods/technologies useful to combating climate change might be listed as “environmental.” This could cover goods such as certain types of biofuels, which in their end use replace GHG-forming fossil fuels.⁴ Or it could cover technologies such as equipment for clean coal burning. In fact the EC has suggested that the definition of environmental goods be related to the objectives of multilateral environmental agreements (such as the UNFCCC/Kyoto), but that proposal was not as specific as what is being contemplated here, and has not made much headway.⁵

For many such goods/technologies there would be no problem of dual use – the possibility that trade preferences might be given to goods that not only serve environmental purposes, but might also be traded to be used in other ways as well. The challenge would be to get agreement on which goods/technologies should so benefit, but that is probably an entirely surmountable obstacle. It might be beneficial to express this proposal as a call for coherence with MEA objectives more generally, such that the goods/technologies supporting other MEA objectives might also benefit. Thoughtful analysis would need to go into making this call – there might also be drawbacks to such an approach.

⁴ See Coelho, Suani Teixeira (2005) “Biofuels: Advantages and Barriers,” UNCTAD/DITC/TED/2005/1. Geneva: UNCTAD.

⁵ See the EC submission on Environmental Goods of July 5 2005 (TN/TE/W/56), where it is proposed that one of the two principles that should guide the definition of environmental goods should be: “They contribute to the fulfilment of national and international environmental priorities including Multilateral Environmental Agreements, the Millennium Development Goals (in particular on access to safe water and sanitation), Agenda 21 and the WSSD Plan of Implementation.” (para. 2)

The second area of potential in the EGS talks is in relation to the CDM. The idea would be to have technologies imported for a specific CDM project defined as environmental, and therefore benefit from low tariffs and fewer non-tariff barriers. This is a different approach from a listing approach, since the given technology would not be accorded special status in normal trade, but only when it was imported for a specific CDM project. The definition problem would not be an issue in this case, being fairly black and white.

One might ask why states could not simply unilaterally lower tariffs on such imports. The answer is that it would be a violation of the GATT legal principle of non-discrimination. A state could not grant a lower tariff to a technology involved in a CDM project, while failing to do so for the same technology destined for use in a non-CDM project. Thus, there is a need to pursue some sort of waiver, and the EGS talks seem the ideal place to do it, given that the mandate for negotiation exists, and the talks are ongoing.

The problem with the CDM approach would be its limited scope, relative to the need for widespread adoption of low-carbon technologies. While the CDM has a broad array of project types and associated technologies, it is not nearly as broad as the full gamut of technologies needed for a transformation of the world's energy regimes. Energy efficiency, for example, is very poorly represented in the CDM roster as a project type. On the other hand, the recent CDM Executive Board guidance on programmatic CDM gives some indication that the mechanism may in fact be able to evolve to something more comprehensive than its present formulation, in which case the CDM approach might have distinct value.

3. Non-Actionable Subsidies for the Environment

A third area of promise is the WTO's Agreement on Subsidies and Countervailing Measures (SCM Agreement). During the Uruguay Round of multilateral trade negotiations, there was space created in the SCM Agreement for what were known as *non-actionable* subsidies, or subsidies which would be considered acceptable, and beyond challenge in the WTO. These fell under three basic categories: R&D expenditures, environmental protection and regional development. The last of these is not so important in the present context.

The SCM Agreement was very specific about the nature and scope of the non-actionable subsidies. For example, the allowable environmental subsidies were only to be used to help existing facilities adapt to new environmental regulations, and among other requirements had to be a one-time expenditure of no more than 20% of the cost of adaptation. The R&D subsidies were limited to

not more than 75% of the costs of industrial research, or 50% of the costs of pre-competitive development activity, and only certain types of costs were covered.

Nonetheless, this provided a small window – mostly available to developed countries with the wherewithal to exploit it – for supporting particular types of R&D, and supporting incurred costs from stronger environmental protection. That window closed in 1999, when WTO members failed to renew the relevant provisions.⁶ Arguably the mandate of the rules negotiations currently underway in the Doha talks cover the review of whether and how these types of flexibilities should be re-instated, but there has been no discussion to date on this subject.

The potential here is to renew the flexibilities formerly provided in the SCM Agreement's Article 8, and revise them such that, among other things, they were useful as support for climate-change related R&D, and for supporting industrial transformation to low carbon paths, accelerating capital turn-over cycles. Of course this would have to be done while bearing in mind the ultimate objective of the SCM agreement – to prevent the unfair use of such subsidies for trade-distorting purposes.

It is unlikely that a reform of the flexibilities could be narrowed only to serving climate change objectives, and other objectives would also need to be respected (including regional development, for example). Developing countries in fact refused to renew the Article 8 exceptions in Seattle precisely because they wanted a much broader approach to policy flexibility. Here again there is an existing negotiating mandate, though not as straightforward as in the case of EGS, that could be used in the context of the current talks, to insert some flexibilities for countries desiring to support economic transformation in line with the objectives of the UNFCCC.

4. Fossil Fuel Subsidies

Fossil fuel subsidies are classic examples of economically and environmentally perverse instruments. Their negative effects have been well enough documented as to need little description, but the central problem is that they encourage the use of the very fuels that most directly contribute to climate change. In the process they reduce the attractiveness of investment in alternative technologies. And yet they persist, with energy subsidies overall in 2005 amounting to \$250 billion, some \$90 billion of which was devoted to oil products alone.⁷

⁶ Renewal was supported by a number of countries such as Venezuela, Canada, the European Community, Korea, Czech Republic, Turkey and Hong Kong China. It was opposed by the U.S., India, Brazil, Thailand, the Philippines and New Zealand.

⁷ IEA's World Energy Outlook 2006.

One of the key difficulties faced by the few countries that have sought to reform energy pricing is the fear of going it alone, and the certain backlash from consumers and industries grown accustomed to cheap energy. Yet the purpose of the WTO is precisely to tackle such problems at the multilateral level. The WTO (and the GATT before it) was established to facilitate multilateral agreement on mutually beneficial reforms that could not be undertaken by countries in isolation.

By way of precedent, the WTO has been involved for almost a decade now in an effort to reduce or eliminate economically and environmentally damaging fisheries subsidies. Negotiations on this subject are a part of the ongoing Doha Round of talks. As with these talks, a key difficulty in any talks aimed at curbing fossil fuel subsidies would be coming to consensus on a definition of subsidies. A high level declaration of intent by the G-8 to collectively address the problem of fossil fuel subsidies would be a welcome first step, as would reference to the WTO as the proper institutional setting in which to do so.

Closing Thoughts

Action on trade policy to support climate change goals takes place in the context of WTO negotiations that seem to be perpetually teetering on the brink of grand failure. If such failure indeed materializes, it may mean an inability to use the WTO as a forum for pursuing action that would benefit both the trade and climate change regimes.

But note that, for one thing, the definition of failure on the minds of most is that the Doha Round may need to wait until 2010 for real progress to be made. Few analysts believe that it will simply dwindle into obscurity; most fear at worst a postponement. Note also that a postponement of this type might give rise to a new *modus operandi*, wherein the WTO negotiators focus on discrete initiatives (such as aid for trade) that have the ability to deliver results outside the context of an omnibus multilateral deal. Several of the possibilities described above might be amenable to such an approach. Finally, there is scope to pursue some trade policy initiatives in the context of the burgeoning regional and bilateral deals that are proceeding despite (or because of) the lack of multilateral progress. Where such scope exists it is noted in the list of key possibilities below.

Key possibilities:

1. ***International investment law focused on promoting clean energy investment.*** This could happen either within the current Energy Charter Treaty, or as a *sui generis* agreement.
2. ***Multilateral fund for supporting domestic reform on clean energy investment in developing countries.*** As a necessary complement to any obligations under a new international agreement, developing countries could access funds to help bring their regulatory regimes up to agreed standards.
3. ***Agreement on non-actionable subsidies for the environment.*** This sort of agreement would depend critically on action within the WTO regime; countries could not go “beyond the WTO” regionally or bilaterally.
4. ***International agreement to reduce fossil fuel subsidies.*** Such an initiative would have to gain political momentum originally from outside the trade regime completely. While the WTO would serve as an ideal locus for action thereafter, other fora (e.g., regional action plans, the UNFCCC) are also possible.
5. ***Liberalization of trade in environmental goods and services.*** This could easily be pursued outside the WTO in regional/bilateral deals. In fact APEC has made headway in this area, but has been waiting on multilateral progress.
6. ***International action to end trade in illegally logged forest products (avoided deforestation).*** Not discussed above, agreement in this area would involve trade measures, legal obligations and significant financial and technical support for countries committed to supply-side actions.