

Big Green Gaps: Our inability to tackle the messy issues at the interface of trade, development and the green economy

An address by Aaron Cosby, Senior Advisor at the International Institute for Sustainable Development to the 49th Session of UNCTAD's Trade and Development Board in Geneva, September 25, 2012.

This session is framed by the Trade and Development Board's discussion of "the evolution of the trading system and its trends from a development perspective." The more specific focus is the result of Rio+20, where, in June of this year, the nations of the world recommitted to a multilateral agenda on trade and development. While those results are a welcome outcome— indeed, had they not been achieved it would be a grave concern—I will argue that they are insufficient in providing us the guidance we need to manoeuvre in today's evolving trade system. I'll bolster that argument by describing what I think is needed, and close by thinking briefly about where we might find it.

In the run-up to Rio+20 there was hope that the process would produce some sort of international agreement on what policies are and are not appropriate for promoting a green economy. One of the key agenda items at that meeting, after all, was the green economy in the context of sustainable development and poverty eradication. There were legitimate concerns, especially from developing countries, about the trade impacts of environmental measures taken by developed countries in the pursuit of the green economy. Those impacts are of two types:

- The terms of trade impacts of the structural shifts that will inevitably accompany the move toward a green economy—the shift in demand away from environmentally damaging products toward those that are less damaging.
- The impacts of environmental measures taken to deliberately affect trade: border measures, and measures to build up competitive domestic green industrial sectors at the expense of such sectors in other countries.

In the end, the Rio conference did produce some results of that sort in the final outcome document (entitled "The Future We Want"). In paragraph 58, in the section "Green economy policies in the context of sustainable development and poverty eradication," states pledge that such policies should, among other things:

- Be consistent with international law.
- Not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade.

- Avoid unilateral actions to deal with environmental challenges outside the jurisdiction of the importing country.
- Ensure that environmental measures addressing transboundary or global environmental problems, as far as possible, are based on an international consensus.

This is all welcome guidance, but it doesn't get us very far. Consistency with international law—specifically with World Trade Organization (WTO) law, from which the second bullet is taken—is more or less taken for granted; we have well-developed institutions such as the WTO's Dispute Settlement Mechanism that make it their business to address this. International consensus on environmental measures to address transboundary or global environmental problems (as per the last bullet) would be ideal, but at this point all we have is consensus on the desirability of consensus. We need more than this, and we need it urgently.

Why the urgency? For one thing, the pursuit of a green economy is something we are going to see more and more of, for at least three reasons:

- Science is driving policy to create major green markets. This year we saw a thinning and receding of the Arctic ice that shattered all previous records, confirming predictions that melting ice would set off a negative feedback loop of warming and climate change. The science will get more and more irrefutable, and the public demands that arise from it will be tougher to resist.
- There are significant potential spinoff development benefits to a green economy; this is not just an environmental agenda. They include, among others: energy access; energy security; adaptation to climate change; industrial efficiency and competitiveness; and human health and air quality.
- There is growing conviction that there is a rationale for industrial policy, and that it can be successful if done right. We have, of course, many negative lessons from the industrial policy of the past decades, but we also have positive lessons, and an increasing willingness to learn from both.

So we will see more and more measures taken in pursuit of a green economy, supporting goods and services in clean energy, efficient automobiles, organic agriculture, biofuels, and other such sectors. What kinds of measures are we talking about? Definitions are hard to come by in the green economy discussions, but for my purposes green economy policies are measures intended to achieve environmental ends that are also aimed at achieving national economic goals. The measures of interest in the present context are only a small subset: those that have potentially significant trade impacts. While short, the resulting list is packed with controversy:

- Subsidies in all their various forms: tax preferences, cash grants, low-interest loans, loan guarantees, land grants, free allocation of emission permits, feed-in tariffs.
- Local content requirements attached to subsidies.
- Performance requirements as a condition of investment: export requirements, joint venture requirements, technology transfer requirements, local content requirements.

- Border carbon adjustment (the EU's aviation levy is one variation).
- Product carbon footprint labelling.
- Export restrictions for environmental purposes.
- Trade restrictions based on environmental PPMs (e.g., low-carbon fuel standards, biofuels sustainability standards).

It is worth noting that all of these policies are currently in use. Some of these policies, such as green subsidies with local content requirements, are in widespread use. It is also worth noting that some of them are illegal under WTO rules. Many other types of policies, such as border carbon adjustment, occupy a grey area in trade and investment law – we have no consensus on their legality.

But while legality is an important consideration, my interest is less in the legality of these measures than in their propriety, because in an ideal world propriety should determine legality. The key question—unanswered by the Rio conference—is: are they appropriate state behaviour? To answer that, I propose we need to consider two questions:

- First, *are they effective?* That is, can they actually achieve their ostensible goals? Do local content requirements, for example, actually succeed in helping green infant industries mature and thrive? Because, if they do work, then they are a good thing from both an environmental and an economic perspective. Environmentally, we have more competition and innovation in a sector where such things are critically urgently needed. Economically there are national-level benefits in terms of employment. However, if they don't work, then they are bad from both perspectives (that is, there is no economy-environment conflict here). It would have been cheaper to just import the technology, and more of it could have been disseminated.
- Second, *what are the impacts on trading partners?* These can be of two types. One is shifts in consumption patterns affecting exports. We don't want to blunt those impacts, because they are the ultimate objectives of policy, but we do want to cushion the impacts and thus ease the transition. The other type of impact is a diversion of market share from foreign to domestic producers, both in the home market and in third-country markets. From a policy perspective, this is the heart of the issue: what does it cost exporters, particularly those in developing countries, when a trading partner shields infant industries, and encourages those infants to grow into globally competitive exporters?

These are not easy questions to answer. The answers will depend on the technologies in question, the characteristics of the sector at the national level, the characteristics of the global markets, the context in the home country (the investment climate; the proximity in product space between existing exports and the infant sectors, etc.), the particulars of the measures involved (we have the lessons of practice of decades of industrial policy on which to draw here), and so on.

But they need to be answered, and urgently. And—this is key—we need to agree on some sort of balance point, or balancing mechanism, where the environmental benefits of successful green industrial policy (some of these benefits are global, of course) are set against the negative impacts on trading partners. In other words, *we need to come to some sort of international agreement on what is appropriate behaviour in the pursuit of a green economy.*

The default is to muddle along without such agreement, using the existing (ill-suited) tools from trade and investment law, both international and domestic. There are a number of problems with that course of action:

- We have fundamental uncertainty for policy-makers as to the legality of the tools in their toolboxes.
- Implementing countries do not consider the impacts of these measures on trading partners, even where the affected countries are developing and least-developed countries; there is no international agreement on managing a just transition to a green economy.
- We have widespread use of measures that are WTO-illegal (or possibly WTO-illegal), and the WTO's Dispute Settlement Mechanism (DSM) being called on to adjudicate. But the DSM is ill-suited to this task; its proper role is to decide whether there has been a breach of rules on which we all agree. It is not the right place to bring disputes over measures on whose propriety we have no international agreement. These kinds of disputes are caustic to the multilateral trading system;
- In that same vein, we have the prospect of serious trade frictions both within and outside the WTO. A list of highlights from the last 12 months includes:
 - Anti-dumping and countervailing duties of up to 255 per cent in the U.S. against China's solar cell exports.
 - Chinese determination that six U.S. state-level subsidy schemes for renewable energy are WTO-illegal.
 - U.S. countervailing duties of between 14–20 per cent of Chinese wind towers (Vietnam was also involved).
 - Argentina (joined by Australia and Indonesia) requesting consultations on EU biofuel import restrictions;
 - Initiation of Chinese antidumping and countervail investigations against U.S., South Korean and EU manufacturers of polysilicon—a key component of solar PV.
 - Initiation of an EU anti-dumping investigation (the largest ever, covering €21 billion in trade flows) against Chinese solar modules.
 - China beginning the process of WTO dispute settlement over local content requirements attached to solar energy feed-in tariff schemes in certain EU member states.
 - A WTO dispute panel report in a case brought by Japan, the EU and the U.S. against Canada's (Ontario's) feed-in tariff regime for renewable energy.

None of this is good for the trade regime. And the integrity of the multilateral trading system is fundamentally important, particularly for the least powerful in the system.

So we need to find a place in which to ask the two key questions that determine propriety: What kinds of tools are effective? What are their ancillary effects? We have economic evidence to bring to bear on both of these questions, but we need the political will to do so, and we need the institutional space in which to have that conversation.

Unfortunately, the WTO cannot provide that space. While the Doha Round hangs unfinished, it is impossible in the near term to discuss any significant issues outside of the items in the Doha Mandate. Singapore tried last year to have

a discussion on border carbon adjustments in the Committee on Trade and Environment, but was rebuffed by the members, who were simply not ready for that topic.

There are no other obvious spaces. It is time for an institution such as UNCTAD, or a collaboration of institutions, to create that space—to facilitate a discussion in an explicitly non-legal, non-negotiating framework on the propriety of measures to pursue a green economy. And this needs to be done before the issues at hand become formal trade disputes, at which point productive discussion becomes impossible.

I'll conclude my remarks by framing them in the context for this intervention, which is item 7 on the Trade and Development Board's agenda: *the evolution of the international trading system and its trends from a development perspective*. The evolution in question—the one that I think Rio has inadequately prepared us for—is in our conception of what is and is not appropriate state behaviour. We are increasingly seeing wide acceptance of the tenet that industrial policy, while it has many more negative than positive lessons, can be done successfully.

This is a sea change from the Washington Consensus that prevailed until not so long ago: that states were better to leave aside such practices, since they were doomed to only make things worse, despite all good intentions. In this context, both the move toward a green economy and the policies taken to get there are part of that wider trend, and neither might seem worth discussing separately from the more general discussion on industrial policy. But the special character of the green economy lies in its sheer value as an emerging set of markets, for one thing. Add to that the fact that private sector movement toward a green economy is characterized by enormous unintentional environmental and development benefits, and you have a recipe for industrial policy on a scale that has significant impacts on the trading system.

But this brings us into a state of new uncertainties. Many of the old rules are founded on the Washington Consensus—think, for example, of the prohibition on performance requirements in the Trade-Related Investment Measures (TRIMS) Agreement. Many of the new tools have uncertain legal status—think of aviation levies and border carbon adjustment. And many of the old tools are being extensively employed despite their questionable trade law status—think of subsidies with local content requirements.

And beyond the legal uncertainties are the more fundamental uncertainties: which policies are actually effective, and in what circumstances? And how to agree on the right balance between the positive effects of successful green industrial policy—national economic benefits, global environmental benefits—and the negative effects on trading partners deprived of market share?

In the end, this brings us back to the questions that Rio+20 did not successfully answer in the negotiations on the green economy in the context of sustainable development and poverty eradication:

- What are the implications for developing countries of this new state of uncertainty? After all, developing countries are both practitioners of the new green industrial policy, and bearers of the impacts of such policies in their trading partners.
- And where can we gather as members of the global economic community to move toward a common understanding of the appropriate rules of behaviour in this new unmapped terrain?

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International Institute for Sustainable Development

Head Office

161 Portage Avenue East, 6th Floor, Winnipeg, Manitoba, Canada R3B 0Y4

Tel: +1 (204) 958-7700 | Fax: +1 (204) 958-7710 | Web site: www.iisd.org

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