

HOW TO STAY COMPETITIVE IN THE WORLD OF CARBON RESTRICTIONS SOLUTIONS FOR DEVELOPING COUNTRIES

WRITES
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Developed countries bound by emission reduction commitments under the Kyoto Protocol, and expecting even stricter emissions targets, have begun to introduce cap-and-trade and carbon tax systems. These raise production costs and undermine competitiveness. Producers from developed countries may relocate their production to countries with no carbon restrictions. To prevent job losses in their countries and an increase of emissions elsewhere ("carbon leakage"), developed countries may use border adjustment measures (BAMs) aimed at adjusting emissions costs and restoring a level playing field for domestic producers. Carbon import restrictions can also act as an incentive for producers from uncapped countries to cut emissions.

The inclusion of imports in an emissions trading scheme (ETS), through a requirement for an importer to surrender emission allowances at the border in the quantity corresponding to the carbon footprint of imported products, is found among recently proposed BAMs in existing and pending ETSs (e.g., the European Union and the United States). Other BAMs may include carbon taxes (i.e., taxes on the carbon footprint of imports) and various carbon-related technical regulations and standards (e.g., carbon labels).

The introduction of carbon-related BAMs will have serious trade implications for developing countries. Given the heavy reliance of developing economies on fossil fuels, industrial products from developing countries commonly have high emissions contents. A requirement to surrender emission allowances, or to pay a carbon tax at the border, would significantly raise the price of carbon-intensive exports from developing countries, especially steel, aluminium, cement, chemicals and paper. This would undermine the competitiveness of developing coun-

tries' exporters and could significantly reduce or even effectively ban their exports to developed countries.

Two categories of solutions for developing country exporters arise: reactive (short-run) and proactive (with long-run effects). Reactive solutions may include cutting production costs to adjust for emissions charges at the border, without increasing prices. Yet cutting costs is not always possible. Another way could be to redirect exports to markets of other developing countries, i.e., to countries in the same region that have no restrictions on emissions. This would further stimulate carbon-intensive production and generate world emissions. It might also lead to "trade diversion", from a more efficient exporter towards a less efficient one. Furthermore, there might be opportunities to evade carbon-related BAMs. Given the administrative and technical problems of tracing emissions in final products, carbon-related BAMs are likely to be imposed only on primary products. If not all developed countries introduce BAMs at the same time, exporters from developing countries might look for intermediate locations for their carbon-intensive primary goods to be processed and exported as final products to countries imposing BAMs on primary and semi-finished products. Owing to cheap, carbon-intensive inputs from developing countries, these finished products would be much cheaper than similar products in the importing country.¹

Proactive solutions, which develop the competitiveness of developing country producers, are preferred in the long run. They include technological changes (including carbon capture and storage), adoption of energy-efficiency measures and a reorientation of a developing country's economy from fossil fuel to renewables.

Making the transition to a low-carbon economy requires substantial financial aid and

GATT

Article XX General exceptions

"Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

- (b) necessary to protect human, animal or plant life or health;
- (d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement, including ...;
- (g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption; ..."

Clean Development
Mechanism*Kyoto Protocol*

The Clean Development Mechanism (CDM) allows a country with an emission-reduction or emission-limitation commitment under the Kyoto Protocol to implement an emission-reduction project in developing countries. The mechanism stimulates sustainable development and emission reductions, while giving industrialized countries some flexibility in how they meet their emission reduction or limitation targets. A CDM project activity might involve, for example, a rural electrification project using solar panels or the installation of more energy-efficient boilers. For information visit <http://cdm.unfccc.int/index.html>



technology transfer from developed countries. Some estimates indicate that developing countries' financial requirements for mitigation and adaptation purposes could reach €100 billion per year by 2020.² Technology transfer could be facilitated by improving the Clean Development Mechanism in a post-Kyoto agreement³ and removing tariffs, and non-tariff barriers, as well as internal taxes on clean technologies, the so-called "environmental goods and services".⁴ Developing countries could take actions to facilitate transition to low-carbon economies. For instance, by adopting voluntary emissions limitations and introducing emissions trading or taxation schemes in certain sectors, developing countries could put a price on carbon, encouraging producers to switch to low-carbon technologies and renewable energy sources.

Furthermore, in parallel to the multilateral negotiations on a new climate change deal, developing countries may want to reach an agreement (separately or as a provision of a post-Kyoto treaty) on non-use or restricted use of BAMs. India made an attempt to include such a provision into the draft post-Kyoto agreement at the Copenhagen climate conference.⁵

Finally, the WTO dispute settlement mechanism provides a forum for developing countries to legally challenge developed country carbon-related BAMs. The unilateral application of measures imposed on process and production methods could run foul of substantive GATT rules. Would a country imposing such measures succeed in justifying them by the environmental exception of GATT Article XX? Measures are to be consistent with the chapeau of GATT Article XX and not bring about arbitrary or unjustifiable discrimination between countries, and not be a disguised restriction on international trade. A BAM, therefore, would have to flexibly take into account different situations in different countries. A different record of historical emissions and emissions per capita, as well as mitigation actions taken by developing countries on a voluntary basis (e.g., closure of old plants intensively using fossil fuels), might call into question the consistency of carbon-related BAMs with the chapeau of Article XX. ■

¹ Cosbey, Aaron. *Border Carbon Adjustment*. International Institute for Sustainable Development, August 2008, p. 5. www.iisd.org/pdf/2008/cph_trade_climate_border_carbon.pdf

² European Commission. *Stepping up international climate finance: A European blueprint for the Copenhagen deal*. COM(2009) 475/3, p. 3. http://ec.europa.eu/environment/climat/pdf/future_action/com_2009_475.pdf

³ de Sépibus, Joëlle. *The environmental integrity of the CDM – A legal analysis of its institutional and procedural shortcomings*. NCCR Trade Regulation Working Paper 2009/41, November 2009. <http://phase1.nccr-trade.org/images/stories/publications/IP6/environmental%20integrity%20CDM%20updated%20version%2020%20October.pdf>

⁴ Wilson, Tim. *The debate surrounding patents and low carbon technology is heating up*. Griffith Hack Clean & Sustainable Technologies Group, 20 April 2009. <http://cleanip.com.au/2009/04/>

⁵ Indian Institute of Foreign Trade, Centre for WTO Studies. *Frequently Asked Questions: WTO Compatibility of Border Trade Measures for Environmental Protection*, p. 40. http://wtocentre.iift.ac.in/FAQ/english/Environment_FAQ.pdf