Overseas Development Institute

European Development Cooperation Strengthening Programme (EDCSP)

The Need to Reconcile Trade and Climate Change Regimes for Development

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Although climate change is a new trade issue and a formidable challenge that all countries must address, the new European Commission (EC) Communication on Trade, Growth and Development fails to articulate the links between its climate change mitigation policies and its trade and development policy for late industrialisers, including the Least Developed Countries (LDCs). This is despite the development of a climate change mitigation policy that does make explicit reference to LDCs. This raises the issue of policy coherence related to maintaining principles of special and differential treatment between trade and climate change regimes. Other issues are also raised related to country differentiation. Given new indicators of vulnerability related to the physical as well as regulatory effects of climate change on different types of developing countries, the EU must integrate climate change within its trade and development strategy for the coming decades.

Despite the outcomes from the latest round of negotiations, the 17th Conference of the Parties (COP17), held in 2011, in relation to a new global climate change agreement, which includes a second commitment period for the Kyoto Protocol post-2012, there remains a considerable degree of ambiguity in terms of potential conflict areas between trade and climate change regimes. Policymakers need to address the regulatory gaps and potential clashes between the trade and climate change regimes, but also to develop possible synergies between them. The importance of doing this for most late industrialisers is amplified because of their inherent structural characteristics: the limited scale of domestic economies because of small economic as well as geographic size enhances the role of trade as a contributor to growth. This means ensuring a new climate change regime facilitates rather than hinders the process of export diversification, and structural change takes on an added urgency.

The outcome from the COP17 negotiations – the Durban Platform for Enhanced Action – consists of 36 separate decision texts (19 COP decision texts and 17 Kyoto Protocol texts in addition to the Durban Platform). These decision texts cover the continuation of the Kyoto Protocol and the setting-up of the new Green Climate Fund, as the two major outcomes from COP17 (in addition to the Durban Platform agreement itself). Essentially, the COP17 outcome consists of a commitment to agree a new international agreement with legal force under the United Nations Framework Convention on Climate Change (UNFCCC) in the future, but this is not guaranteed.

This uncertainty is not conducive to the design of trade and development strategies that need to adapt to the new trade agenda, which includes climate change. Given that most LDCs to date (many of them in sub-Saharan Africa) have not been able to tap into existing dynamic production networks is clearly of concern. The export profiles of LDCs are typically characterised by high degrees of concentration, with only a few tariff lines accounting for the bulk of exports. This profile makes them most vulnerable to demand-side volatility and other shocks, including climatic ones.

Although there have been successes, the ability of many Low-Income Countries (LICs) to tap into the modern export sector has been limited, and remains at best fragile. The successful experience of the Newly Industrialised Countries (NICs) was used in the 1980s to justify recommendations that other late industrialisers move away from the substitution of imported products for domestic production towards outward orientation in order to benefit from external economies through trade. However, the prospects for external trade have changed, and many of the routes used to industrialise in the past may no longer be viable for late industrialisers today. Efforts to diversify exports by this group of countries have not been totally successful, even under favourable economic conditions and in the absence of climate change.

Changing patterns of demand and supply, given the impact of the Asian drivers on global trade patterns, have to some extent been accelerated by the impacts of the global financial crisis, but they also come at a time of changing North–South trade relations more generally. This includes the proliferation of Regional Trade Agreements (RTAs), in addition to reform of the EU's Generalised System of Preferences (GSP). Our research suggests the significant preference margins available to non-graduates of the EU's GSP once reform has been implemented will remain on only a rather limited basket of natural resource-based exports, some of which may be highly vulnerable to the physical effects of climate change (e.g. fisheries), as well as the regulatory effects of policies to mitigate it (e.g. carbon labelling schemes).

That existing trade instruments did not facilitate structural change in the previous trade environment suggests reform is needed in order to adapt to the new trade environment, which includes addressing climate change. The EU is currently the major export partner for LICs (and LDCs). Therefore, the climate change mitigation policies it implements will have the largest effects on them relative to other developing country partners at the current time. Fortunately, the EC has stated that it will exempt LDCs from punitive measures such as border tax adjustments (BTAs) and enhance market access to LDCs in its Emissions Trading Scheme (ETS) (through excluding other developing countries).[1] This arguably provides LDCs with a unique opportunity to tap into the new trade opportunities that may arise from climate change mitigation policies implemented in the EU. However, the increased complexity of the EU ETS, as has become apparent in recent months (as individual members begin to establish their own schemes), clearly raises cause for concern.

The ETS is the largest purchaser of Certified Emissions Reductions (CERs) obtained from the Clean Development Mechanism (CDM) established under the first commitment period of the Kyoto Protocol. It has clearly stated that it does not consider the outcomes of COP17 to be a new international agreement. Further to the outcomes of COP17, the EU's ETS will continue to purchase CERs from the CDM from 2013 onwards. However, a number of changes have been made to the EU's ETS, including the inclusion of the aviation industry from 2012 and the limitation of the market for CERs to LDCs from 2013. The United Kingdom (UK), Poland and Germany have also decided to set up their own national schemes.

There are concerns that the multiple platforms could make the EU's ETS more complex, costly and insecure. As other developing countries begin to introduce emissions reduction targets and related command and control mechanisms such as their own ETS (primarily in response to international pressure and the threat of punitive measures), these could have subsequent knock-on effects on LIC importers of products covered by such measures. The disjuncture that became apparent between supporters of the Kyoto Protocol and the Long-term Cooperative Action (LCA) track of negotiation at COP16 is intended to be rectified by 2020. But some of the continued obstacles in LCA negotiations include a failure to provide significant additional clarity and positive incentives on CERs obtained from Reducing Emissions from Deforestation and Forest Degradation (REDD+) schemes.

These policy developments mean the potential trade effects of any new international agreement are difficult to assess and will be highly country, product and market specific. This is because changes in trade patterns will be driven both by the effects of climate change on productive structures but also by responses to it by private sector actors and governments through the development of regulatory measures to mitigate further temperature increases. The physical and regulatory effects of climate change will therefore be highly product and value chain specific. The extent to which such measures may support or undermine efforts to diversify productive structures through the realisation of export-oriented growth strategies by late industrialisers therefore deserves much more attention by the EU as it develops its trade and development strategy for the coming decade and as it implements its climate change mitigation policy (see Keane, 2011).

References

EC (European Commission) (2011) 'Scaling up International Finance after 2012'. Commission Staff Working Document SEC (2011) 487 final. Brussels: EC.

Keane, J. (2011) 'Export Diversification and Climate Change: Overcoming the Emerging Constraints'. Trade Hot Topic. London: Commonwealth Secretariat.

Footnotes

1. As referred to in Article 11a (7) of the EU ETS Directive and Article 5(3) of the Effort Sharing Decision, see http:// ec.europa.eu/clima/news/docs/additional_qa_06_01_2011_en.pdf . For information on the LDC limitation to the EU's ETS from 2013, see EC (2011).

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