

Adapting the International Trade Regime to New Challenges: Climate Change

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First, I would like to pay tribute to the International Policy Council – I believe the IPC is the premier, policy-oriented think tank in the world on the relationship between agriculture and trade. I was honoured to be invited in 2005 to be a Member of the IPC, but of course had to resign when I became a Minister. It is a particular pleasure therefore to be invited back to present a paper as the NZ Minister of Trade and the Minister responsible for International Climate Change negotiations. However, all political careers, they say, end in failure. So please don't discount the possibility that at some future point, I may express an interest in rejoining the IPC. I just hope it won't be any time soon.

Completing the Doha Round remains the single most important issue on the international trade policy agenda. NZ is deeply committed to this. But the Doha Round, particularly with respect to agriculture, is essentially building on the Uruguay Round platform – that is what the BIA, or 'Built in Agenda' was all about. Again with respect to agriculture, we were able to achieve in the Uruguay Round a radical re-instrumentation of agriculture policy instruments but only limited liberalisation. The Doha Round is intended to address that deficit. If we cannot achieve that, there will be no result.

But I am acutely conscious that this focus on the traditional agenda, appropriate though it is, should not obscure the vital need to refresh the mandate of the WTO to deal with tomorrow's problems. Here, the interface between the

international trade agenda and the climate change agenda looms larger than any single issue.

Trade and Climate Change: A Ticking Time-Bomb?

I will try to focus here on the positive, but we need to recognise that the trade-climate change linkage, if played out badly, involves major risk. Addressing a previous IPC meeting in Bogor, Indonesia in May 2008 I took the view that it was potentially a 'time bomb set under the WTO system'. Specifically, I had in mind unilaterally imposed border tax adjustments designed to stop what is called 'carbon leakage'.

Behind this technical jargon, I think we all know what the intent of such proposals is. These proposals are intended to prevent the migration of your industries offshore if you impose a price on carbon in your country either through a carbon tax or an Emissions Trading System and important trading partners do not. Such charges are intended to equalise the cost. It is a 'level playing field' argument on steroids.

We are in the middle of the greatest recession since the 1930s and all the people in this room will have learned how the infamous Smoot-Hawley Tariff Act of June 1930 led to an implosion of world trade and ultimately added to misery around the world. Presumably, neither Mr Hawley nor Mr Smoot, when they put in train the process of unilaterally raising US tariffs, thereby prompting retaliation and beggar-thy-neighbour policies, actually intended this.

Similarly, I suspect that those politicians in various countries who today believe there is a simple 'fix' to carbon leakage through unilaterally imposed carbon tax adjustments do not actually intend to put a time bomb under the world trading system. But there is no doubt in my mind that that is the risk.

However, there is a better way through. In reality, the two negotiations – WTO and UNFCCC - have a lot of common ground. If we get it right, we will have outcomes in each that support the objectives of the other. Allow me therefore to step back and contrast the two negotiations.

WTO and Kyoto: The Case for Incremental Change

Let us take stock first of the Doha Round. This is a highly mature negotiation, based on a successful formula that has evolved over eight previous multilateral trade rounds since 1947. We know the system moves too slowly. We know it is about evolutionary, not revolutionary, change, and that can be very frustrating. But we also know it works and has contributed greatly to underwriting global trade and thus global prosperity.

Our problem with the Doha Round today is simply finding a political way to put in place the last, say, 20% of the deal that needs to be negotiated. I still believe we will get there. The cynics have always been wrong in the past – as the Uruguay Round ground painfully to a conclusion, the GATT was everywhere referred to as ‘the General Agreement to Talk and Talk’ and contempt was poured on those still trying to make it work. I believe the cynics will eventually be proven wrong yet again.

By contrast, Kyoto is the first ever attempt to put in place a multilateral agreement involving collective action against anthropogenic, or man-made, global warming. It is easy to pick holes in the international community’s first attempt – just as it is easy to pick massive holes in the early GATT Rounds. With only a little exaggeration, we can say that all the early multilateral trade rounds failed to deal with agriculture, clothing and textiles, services trade,

omitted coverage of many non-tariff barriers and virtually ignored developing countries. In time, all these of these deficiencies were substantially addressed.

The biggest hole in the UNFCCC is obviously its limited participation in real emissions reductions. The 17 year-old Annex I/non-Annex I dichotomy is outdated, but the current climate architecture doesn't easily allow for changes. I cannot imagine a successor agreement to Kyoto for the second commitment period beyond 2012 that replicates the central feature of Kyoto – namely that only Annex 1 countries – and not even all of them - have an obligation to reduce their net emissions. If there is to be any successor agreement to Kyoto, that has to change.

This is partly a political necessity but it is more than that. Only half of all current emissions now come from Annex 1 countries. What's more, that proportion is falling rapidly with the growth in the emerging economies. The problem is global. And at least from NZ's perspective, we can define the goal: to stabilise global emissions at no more than 450 parts per million of CO₂ equivalent. If we don't have broader participation, there is no possibility of reaching that goal – forget even more ambitious targets such as 350 parts per million.

Of course this is very difficult for developing countries – even if they did receive large amounts of financing for mitigation and adaptation. Faced with these obvious difficulties of finding a multilateral way through, I get the sense from reading academic literature and public debate that a lot of effort is going into planning and designing unilateral responses where climate change and trade intersect without even looking to see how the multilateral system can provide effective courses of action.

We have Pascal Lamy to thank for pointing out that we can't look to the WTO to establish a new climate change regime – that's the job of the UNFCCC and frankly, the challenge is too urgent. At the same time, there is a lot of talk about

the impediments that current trade rules may put in the way of countries trying to take ambitious mitigation action. That would be a serious concern if it were true. To find out, we need to take a step back and focus on the fundamental principles of the GATT and the WTO.

First, let's take a look at the trade rules that can help countries shift to low-carbon economic development. Liberalising trade in environmental goods and services is a no-brainer: it's a win-win-win for traders, the environment and developing countries. Investment liberalisation is going to be essential for enabling technology transfer. Reducing environmentally harmful subsidies will have climate impacts through discouraging fossil fuel use and encouraging globally optimal efficient patterns of production. Sustainability standards could play a useful role in cutting through the confusion and doubt around the climate benefits of biofuels.

On the climate side we are looking at the WTO to see if its architecture can help us. Under the current Kyoto framework, there's no way to capture the wide range of mitigation action already undertaken by developing countries. New Zealand is one of several countries that have been working on the idea of creating a reporting format for climate change commitments. The point is to capture different national circumstances, inspired by GATT schedules. This is underpinned by the important UNFCCC principle of "common but differentiated responsibilities and respective capabilities" – a very similar concept to the WTO concept of 'special and differentiated treatment', though rather more extreme in its current application. Not only would it improve transparency, but it would also facilitate the negotiation to be had around comparing actions by different countries.

Carbon Footprinting

Beyond trade architecture, you'll be aware that in Europe there's a groundswell of interest in climate change-related standards, driven by the retail sector, environmental groups - and local producers. Unfortunately, some of the standards have been based on bad science and flawed concepts such as food miles. There needs to be greater international understanding about climate change-related standards: the development of an ISO standardised methodology for carbon footprinting is a good way to start. It's the opportunity to show that we need a science-based standard that looks at the whole life cycle of a product and not just how it gets to the market.

New Zealand is leading a comprehensive carbon footprinting programme to help our producers measure, manage and reduce GHG emissions through a product's entire life cycle. This is going to have a much bigger impact on greenhouse gas emissions than any arbitrary standard in export markets which would risk shifting production to nearer but less efficient producers. Not to mention that such a shift would increase, not decrease, emissions as more carbon intensive agriculture production in third countries replaced less carbon intensive food production in NZ. And importantly, sophisticated carbon footprinting will help position New Zealand producers to meet the demands of our overseas customers for information on the climate change effects of production.

While I'm talking about carbon footprinting, I can't help but note that it's curious that we mainly hear about it in connection with food products. Agriculture makes up about 14% of global emissions, but manufacturing and industrial processes also add up to 14%.

You have to wonder sometimes, why there isn't as strong a push for carbon footprinting non-food goods – why focus on an already very trade-distorted sector? One is tempted to conclude it's got something to do with keeping protectionism up to date.

Agriculture Emissions and Food Security

More generally, there is no doubt in my mind that any global solution to anthropogenic induced climate change will have to involve far greater attention to agriculture. This is a far greater issue for NZ than for any other Annex I country – some 50% of our total GHG emissions come from agriculture. That is not, as I emphasised above, because NZ is underperforming in terms of emissions intensity of its agriculture sector. On the contrary, our carbon footprint per unit of output stands up very well to international scrutiny. The size of our agriculture emissions is a function of the size of our agriculture output. NZ is a food basket for the world – some 90% of the food we produce is exported.

But if the problem with agriculture is largely confined to my small country amongst Annex 1 countries, that is decidedly not the case once developing countries are brought into the equation.

Generally, GHG emissions from agriculture average around 27% for all developing countries – in the case of India agriculture accounts for 21% of India's emissions; for Brazil it is 58%; for Uruguay it is 85% of total emissions. Brazil and Uruguay are like NZ – highly efficient food exporters performing a vital role in world food markets.

I think this is very important. If you accept that there will not be a successor agreement to Kyoto without fuller participation from major developing countries – that is certainly my view – the international community must come to grips with this problem of agriculture. I have spent my professional life in the problems of world agriculture trade, culminating in chairing the WTO Doha Agriculture negotiations. Like others in this room with a similar background, I am acutely conscious that if developing countries feel international commitments

will threaten, rather than enhance, their food security, that is the end of the matter. For developing countries, the exigencies of climate change negotiations will never trump food security. Get that political judgement wrong and you will get everything wrong.

What we know is this: food production needs to at least double in the next forty years while, on the other hand, global greenhouse gas emissions need to reduce by at least 50%. There isn't enough mitigation potential in other sectors for agriculture not to be part of the solution.

At the intersection of agriculture and climate change, trade has an important part to play. As agricultural patterns shift, trade will become increasingly important for food security. It has been shown as the climate causes shifts in agricultural production, the costs are lessened when food can flow freely across borders. One study looked at projections for agriculture up to 2060 and found that with trade liberalisation, global impacts due to climate change were reduced. What is more, a hundred million fewer people would be at risk of hunger. Land is a finite resource, so it needs to put to the most efficient use. We will need to achieve the best possible global production patterns for agriculture that will meet both food and climate needs.

I do see some early signs of a greater awareness amongst climate change negotiators of the importance of agriculture. My senior advisers certainly welcomed the increased attention given to agriculture as a sector at the last round of UNFCCC negotiations in Bonn. Two points stood out from the discussions: agriculture does have a role in contributing to global mitigation efforts, especially in developing countries, but its potential can't be unlocked without a large scaling-up of investment in research and development

But this is just a beginning. We need to fully take account of its roles in food production and in providing the livelihood for a very large proportion of the

world's population. We will need to design our climate measures to create the right price signals for agriculture producers.

Agricultural Mitigation: The Case for Greater Research

Far greater research into the problems of agriculture emissions is an indispensable part of any sustainable political response to climate change. It is a simple fact of life that research dollars on climate change follow the priorities of the developed world. Absent New Zealand, agriculture emissions are simply not important enough amongst developed countries to attract the research dollar.

As a consequence, there is a huge mismatch around the world between the actual importance of agriculture emissions on a global basis and the effort being made to find technological solutions that would allow expansion of food production and reduction of agriculture emissions. Greenhouse gas emissions from agriculture are comparable to those from electricity and heat. Agriculture needs a technology revolution as profound as that for energy.

That is why New Zealand is establishing a virtual world research centre on agricultural greenhouse gas mitigation. The idea is to draw together international researchers and funding in a cohesive approach to finding collective solutions to this challenge. The New Zealand Government is in the process of putting substance behind that proposal. My task is to try to attract political attention and expressions of interest around the world in working with us.

Climate Change and Trade Rules: The Need for Coherence

Trade rules have the potential to support climate change and agriculture objectives. But some work I've seen recently takes a rather legalistic approach to the interface between trade rules and climate change policies, and I'm concerned that it could have a chilling effect on governments' choices of climate change instruments.

There's a range of issues emerging from countries' responses to climate change, and as yet, no international regime to address those issues – apart from high level guidance by the Kyoto Protocol. Adding to that, their interaction with trade rules is unclear. On emissions trading, for example: are carbon credits a good, a service or something else? What happens if international trade in carbon credits is established outside the Kyoto rules? Is that subject to any rules anywhere? Is free allocation of AAUs a subsidy, and if so is it actionable? Or prohibited? Are all incentives for climate-friendly behaviour subsidies?

These are important questions because they go to the heart of both economic efficiency and environmental effectiveness. New Zealand asks itself, how can an efficient agriculture producing country that prices carbon into that sector remain competitive against a less efficient producer that doesn't? It's a particularly acute issue for New Zealand. We can see that a shift in production away from New Zealand would not only cause economic damage but would be a net addition to global warming – the carbon leakage part of the argument.

I don't pretend to have complete answers, but my point is that we don't have time to wait for perfect responses. Scientists tell us the climate challenge is increasingly urgent and economists tell us that – notwithstanding the current recession - early action is much cheaper than delay. So we seem to have two options: we can avoid measures that are potentially subject to challenge and wait for dispute resolution over first movers; or we can take measures that may

lack legal certainty, by making sure to design them according to GATT/WTO principles.

There is a legal dimension to this: some climate change policies might be potentially open to challenge in the WTO. But there is also a political dimension: even if a climate change response is theoretically up for challenge, what is the real risk of a case being taken? How might countries frame a trade-off between national and global good? Is climate change mitigation a higher global goal that might, in a political sense, trump concerns about trade rules?

The Case for a Peace Clause

In any case, risking a trade war over a climate agreement would be absurd. So I've been very interested to read about ideas for a 'peace clause'. This might for a time, create a space for climate measures to be implemented in a manner broadly consistent with core WTO principles even if technically there might be room for doubt about WTO consistency. This could be very useful for early movers, while a comprehensive climate change regime was being established. The idea is that a category of measures would temporarily not be subjected to challenge in WTO dispute settlement by governments agreeing to show restraint. This could be combined with agreement to notify such measures to the WTO. These are early thoughts on the issue. Making something workable out of them is a question of confidence and political will.

There are other approaches. One proposal is to negotiate a new WTO trade and climate code. The substance of the proposal is excellent. But let's be realistic: seven years of the Doha Round hasn't even managed to produce agreement in the not-so-complicated environmental goods and services negotiation. The first Kyoto commitment period is already 18 months old and measures are being implemented as I speak. A completely new WTO agreement would just take too long.

The more practical route would be to look at what can be achieved soon, through political declaration language in the Doha outcome and through something similar in the climate change outcome. A peace clause wouldn't be for all time. It would be overtaken eventually by dispute settlement outcomes, and by the enlargement of the pool of countries which take on emission reduction commitments. The increasing comprehensiveness of the global climate regime in subsequent commitment periods will reduce the pressure for governments to feel they need to consider unilateral action to protect their firms' competitiveness. But at this stage it could be a political signal to give governments more confidence that they will be able to meet legitimate concerns from exposed industries about competitive disadvantage. Then, once the new climate change agreement was fully in place, any outstanding trade rules issues could be discussed jointly with the WTO

I do not want to convey the impression that such an approach in the WTO would be straightforward to negotiate. On the contrary, there is a culture that has developed in Geneva whereby sensible, pragmatic problem solving has been overtaken by often myopic concerns about 'balance'. So expect heavy sledging. Nevertheless, I believe there is an over-arching strategic need to move in this direction and I cannot see a better alternative. Frankly, the alternative is unilateralism or failure on both trade and climate change fronts.

I am also conscious that if we cannot move forward with model agreements at the multilateral level, governments negotiating bilateral and regional free trade agreements could consider leading the way by including a peace clause in those agreements.

Conclusion

So to return to the beginning, what do countries need to do to adapt the international trade regime to the climate challenge? At the multilateral level the answer is obvious: conclude the Doha Round including the trade and environment package. Liberalisation will promote trade in the goods and services needed for low-carbon development pathways. Freed from subsidies, agriculture will move towards globally rational and efficient production patterns. Freer movement of goods will enhance food security. Without subsidies, demand for fossil fuel alternatives and complimentary technologies will increase. The development benefits that will flow from the Round will strengthen developing countries' ability to adapt to climate change and take on mitigation commitments. And the economic benefits to developed countries will enhance our ability to mitigate our emissions and to help those who cannot adapt to climate change on their own.

Two years ago Pascal Lamy argued just that – concluding the Doha round, he said, was the best thing the WTO can do for climate change. But now as we approach Copenhagen seemingly at a faster pace than Doha, we have to change the terms – the best thing we can do for the Doha Round is to conclude a climate agreement this year – or at least a solid framework agreement on which negotiations after Copenhagen could build. The best thing we can do for both the world economy and the climate is to conclude them both, soon.