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SOME REFLECTIONS

TIM GROSER, NZ SHADOW MINISTER TRADE

This is not a speech, even indirectly, about climate change. I take as my starting point the political consensus in NZ: namely, there is a real issue with respect to the contribution of anthropogenic, or man-made, greenhouse gas emissions and we need to develop politically sustainable policy responses to it.

I have no expertise in negotiating international environmental agreements, but like most members of the International Policy Council, have a fair bit of experience in negotiating international trade agreements. It is, I would suggest to you, obvious that there are strong similarities and negotiating linkages between the WTO obligations and Kyoto obligations.

WTO and Kyoto: Some Negotiating Similarities – And Some Differences

Both the WTO and Kyoto negotiating processes have what might be called a 'dual face': an international framework of obligations that then need to be turned, country by country¹, into domestic policy. This is why both Kyoto and WTO negotiations are so tough. They matter.

For the most part, while WTO negotiators spend many happy hours in Geneva and other pleasant capitals negotiating non-operational declaratory resolutions which can be changed tomorrow if the politics requires it, traditionally they have reserved their live ammunition for negotiating binding agreements. I suspect we have that in common with those who negotiated the Kyoto Protocol to the UN Framework Convention on Climate Change. Because both sets of negotiation finally involve domestic policy changes, they are both very sensitive and very tough.

The two sets of negotiations also, at least on the surface, share another common problem: operationalising the concept of 'special and differential treatment' in favour of developing countries. In Kyoto jargon, it is called 'common but differentiated responsibilities'. In both cases, this lies at the heart of many of the negotiating difficulties.

¹ For the purists, I am riding roughshod here over the differences between countries, Members and customs territories.

In the trade arena, negotiations were at least simpler when the developed countries had the lion's share of world trade and output. Indeed, earlier generations of GATT negotiators basically put only nominal pressure on developing countries to take on obligations. People complain constantly today about India having average bound agriculture tariffs of over 120%, or Indonesia with an average bound agriculture tariff of around 50%. Well, until recently, no-one really asked them to do very much on their bindings, even though their applied rates are frequently well below the bound rates, which are the basis of the negotiation.

While the structure of the negotiated results in the eight negotiating Rounds to date since 1947 inevitably reflected developed country interests, it was nevertheless of immense benefit to developing countries (at least with respect to the 90% of world merchandise trade that is non-agriculture) that the results were multilateralised through the MFN principle. It is inconceivable that Korea, for example, could have picked itself up from the floor in 1950 and become a great trading nation, without the MFN principle that allowed its export-led development process to gather pace.

It is, I think, astonishing to recall that as recently as the Uruguay Round, and at least until the Blair House agreement between the EU and US settled many final elements, the core group of countries that negotiated the agriculture negotiations were a group of eight countries, only one of which (Argentina) was a developing country. Brazil and India – the political leaders of the G20, the key developing country grouping in the WTO today – simply did not care enough to insist on being involved.

There has been a shift in the tectonic plates here between Uruguay and Doha: a huge transfer of relative economic power to developing countries, matched by an enormous growth of trade amongst them. This means that this is simply not credible in today's Doha Development Agenda to regard the concept of special and differentiated treatment as a minor part of the negotiation. But as you all know, it is proving extremely difficult to get the system to adjust.

There is, however, a crucial difference between the WTO concept of 'special and differential treatment' and the Kyoto concept of 'common but differentiated responsibilities' that goes well beyond the minor difference in terminology.

In the trading arena, reciprocity for trade liberalisation clearly gives a better economic result and helps immensely politically in the process of selling trade liberalisation in developed countries, since all developed countries have substantial numbers in their electorates who are deeply suspicious of trade liberalisation². However, at the end of the day, most Governments know, even if

² A recent poll in the US, for example, indicates that 3 out of 5 Americans believe trade agreements result in the loss of jobs. In NZ, about 40% of New Zealanders were opposed to the recent FTA with China – which guarantees effectively full free trade for NZ exporters in about a decade.

they may have the greatest of difficulty explaining it to their electorates, trade liberalisation will improve the functioning of your own economy, even if undertaken unilaterally.

That is decidedly not the case with respect to 'common and differentiated responsibilities' in the Kyoto context. There are two issues here.

First, there is a very real risk that developing a domestic policy response to the challenge of climate change without a great deal of reciprocity has no guarantee whatsoever that it will 'improve your economy' – as is the case with non-reciprocated trade liberalisation.

There is a huge and legitimate debate taking place in my country right now on the balance of economic risk from climate change policy, particularly with respect to the treatment of agriculture. Before Kyoto took such a prominent place in policy-making, you might have thought, given food price shocks and the relentless growth of demand relative to supply resonating around the world, that NZ, which is a food basket for the world, would see its moral responsibility, as well as its commercial interests, served by stepping up agriculture supply. Not so. If we increase our food production, other things being equal, we increase our emissions, which are measured on a country basis. That is the dominant non-commercial argument being used in NZ right now.

The second major difference between special and differentiated treatment in the two negotiating spheres of the WTO and Kyoto is also crucial. The problem of climate change is truly a 'global' problem. The troposphere is a global phenomenon which does not differentiate between, say, greenhouse gases such as methane and nitrous oxide emitted by a NZ sheep, of which there are some 30 million, and emissions from Chinese sheep, of which there are some 400 million, and no medium term prospect of China taking on Annex-1 type obligations.

Even if we compare Annex 1 with other Annex 1 countries, differences in the design of an Emissions Trading Scheme (ETS), can lead to perverse results in terms of the impact on the global climate.

I fully accept that the European Emissions Trading Scheme is a work in progress. But currently it excludes agriculture, amongst many other European sectors at competitive risk from 'leakage'. In the NZ Parliament, we are currently debating a fully comprehensive – ie all gases, all sectors – ETS that includes agriculture.

Yet if we expose, to continue this example, our sheep meat sector to the costs of an emissions trading scheme, given that there are strictly limited abatement opportunities available with current technologies, is this a rational result for the global climate? Well no, to put it bluntly.

Most of our sheep meat is sold in Europe – historically, around 70% or more of all imports come from NZ. The research that is available indicates that to produce a kilogram of sheep meat in Northern Europe creates four times the volume of greenhouse gases that the same kilogram requires in NZ, even when full transportation costs are taken into account. Thus to the extent that NZ moves ahead of Europe – forget the 400 million Chinese sheep – and production at the margin shifts from NZ to Europe, the global climate problem becomes worse, not better. So much for the hysteria around food miles.

Incidentally, one lesson we are learning very quickly – although I think it was blindingly obvious – is that any policy developed on the basis of hysteria rather than sound analysis, is likely to lead to serious mistakes. Watch what happens to policies around the first generation of biofuels, or ethanol in particular. All credit to the EU for re-examining their assumptions here.

I just hope that if Europe backs off short term, Europeans don't throw out the biofuels baby with the bath-water. I am sure that there is a long term place for biofuels, but using food as the input sure ain't it, to put it bluntly. Ask some of the poor people in Jakarta Selatan what they think of recent price rises – and at least Indonesia is far better placed than many other developing countries with respect to food production. Cellulosic ethanol, produced from tree farms, is clearly the way forward but it is not yet competitive. We need a huge investment in research here.

Doha: Implications for Kyoto Negotiations:

Once again, it appears we are at a critical stage in the WTO Doha Round Negotiations. An agreement on modalities in Agriculture and NAMA, or Non-Agriculture Market Access, seems tantalisingly close. While not sufficient for a political consensus, such a deal will provide the core around which other agreements and understandings in related areas of the negotiating mandate can build.

Having been the Chair of the Agriculture Negotiations at an earlier stage, I am firmly of the view that there is a perfectly acceptable basis on the table for doing this deal. As is always the case, there are probably a dozen or more ways to assemble the elements of a compromise. Negotiators habitually exaggerate the significance of their country's preferred choice. That is fine and natural at the start of a negotiation, but after so many years of negotiation, surely everyone knows roughly what the so-called 'landing zone' of a deal on any of the key outstanding issues is? It is no longer a blank page. The choices are constrained.

Further, ten years down the track, in say 2018, few would be capable of remembering the difference between them. What matters is the bigger picture of advancing, step by step, the process of international economic integration.

There are many excellent conventional reasons for drawing a deep breath politically and consolidating the huge technical and political undertaking of the Doha Round. Here, I want to give you another strong reason for so doing – it is about the politics of climate change, both domestically and internationally.

In my view, the WTO, like the GATT before it, is the jewel in the crown of multilateral economic cooperation. The relatively open trade and payments system that it underwrites has been an essential precondition to continued economic growth in developed countries since the War and, even more importantly, to the extraordinary spread of the development process to developing countries.

I think it was the distinguished economist Ken Rogoff, former Director of Research at the IMF, who first pointed out that it is hard these days to find developing countries that are not growing rapidly – certainly it does not include our host country, Indonesia, which is growing at around 6%. Indeed, some 105 countries achieved 5% or more real GDP growth in 2007. Earlier, I mentioned Korea. But consider China which has increased its share of world GDP from 5% in 1978 to almost 18% in 2005, based in large part on a comparable export-led strategy. China is almost unique amongst large countries in having a large trade:GDP ratio³. Could China today be lifting hundreds of millions out of absolute poverty without China's ability to exploit the relatively open trading system?

But alongside the strong conventional reasons for bringing the Doha Negotiations to a successful conclusion, I want to suggest there is a new and additional driver for so doing. This is about the politics of climate change.

The first person to make this political observation, at least as far as I know, was none other than Pascal Lamy⁴. As he put it, a successful conclusion to the Doha Development Round would send a powerful positive signal to Kyoto negotiators that, no matter what the difficulties, a genuine multilateral solution to international economic problems remains possible. And, as the Director-General also observed, we should also recognise that any successful conclusion to the Doha Round will have some very positive results for the environment – including facilitating trade in environmentally friendly goods and services, and a whole new set of disciplines on fishery subsidies designed to take some pressure off over-fishing.

Now Pascal was born in France and in my experience, French people are determinedly positive people, putting the best face on most developments, even

³ “Sustainable Leadership for Sustainable Growth: China in the 21st Century”, Professor David Li, Tsinghua University, Beijing April 2008.

⁴ “The ‘Greening’ of the WTO has started”, speech by Director General Pascal Lamy to Yale University, 24 October 2007.

in the face of considerable adversity. It was, after all, Marie Antoinette who, when told that the poor had run out of bread, allegedly said '*Qu'ils mangent du gâteau*'⁵ – let them eat cake.

I was born in Scotland. We invented golf – an exercise in humiliation, frustration and pessimism. So I will make the same point with Scottish logic: if we fail to bring the Doha Round together, when the case here is so compelling, the precedents are so strong, the technical base of multilateral trade disciplines so well understood and tested, what does this tell us about the chances of negotiating a timely successor to the Kyoto Protocol, one which builds on the Kyoto approach to CP1 – Commitment Period 1?

Since most of the IPC people have background in international trade, you are no doubt familiar with the old political economy concept of the 'bicycle theory of international trade'. For those who are not familiar with it, this is the principle that although an expert trick cyclist can remain stationary for some time – and there are many trick cyclists in Geneva working on WTO matters – eventually if the bicycle does not move forward, it will fall backwards. The balance between liberalisation and protectionism is similar. It is very difficult to stay in one spot. And the grave danger here is that if the multilateral system is not moving forward, it risks falling backwards towards unilateralism and protectionism.

For sure, a failure in the Doha Round will be heavily disguised politically and if I have the privilege of being NZ's next Trade Minister come the Election this November, and it falls on my watch, I will be a willing accomplice in this process. But it may not convince everyone. If, more generally, politicians around the world draw the collective conclusion that the WTO is going nowhere, this will change a lot of things – including the politics of climate change.

The pressure to move forward on climate change is unstoppable. If there is no way to advance multilaterally, just as in the trade arena, countries will move unilaterally. It may not always be a positive development.

It has been said that every Climate Change Bill in Congress is, by definition, also a Trade Bill. I have not studied them individually, but my understanding is that most involve, in one way or another, border tax adjustments to avoid 'carbon leakage'.

The logic here is easily explained. It is no longer tenable politically for most politicians, at least in developed countries, to do nothing about climate change. There is a phoney debate about 'the science is settled'. Well, even a trawl through the IPCC's own documents reveals a mass of issues where they themselves indicate further research is needed. But the core issue is clear: we simply cannot afford to take the risk of doing nothing about anthropogenic

⁵ I acknowledge the deep controversy here, including the possibility that it was actually an observation about brioches.

greenhouse gases. This is, one could say, the precautionary principle on steroids.

So countries are either implementing or planning emissions trading schemes. That means confronting head on the issue of 'leakage' – the risk I referred earlier to losing internationally competitive industry, including agriculture, to less competitive countries simply because their industries are not currently subject to the cost impositions of an emissions trading scheme. The argument, as I emphasised earlier, becomes even stronger if that loss were to a country that will produce more greenhouse gas emissions, because it is further away from best practice internationally.

There are therefore many proposals for the imposition of border taxes on imports on goods from non-Kyoto compliant countries. There are many similar proposals doing the political rounds in Europe.

One can take the sunny view that this is just a negotiating device, designed to put pressure on countries that are not required, during Commitment Period 1, to take on comparable obligations. Well fine, if it works. But what if it doesn't work as a negotiating tactic? In military affairs, wise voices observe that solutions via armed force are problematic – violence is not like a water tap. It is very difficult to turn off, when you have turned it on.

I frankly worry that in the absence of a full commitment to resolve these issues calmly through international negotiations, crude unilateral solutions may be tried.

Make no mistake about it. The idea of unilaterally imposed border tax adjustments is a time bomb set under the WTO system, if indeed ever carried through. One wonders, for example, how you would ever negotiate an agreement to allow 'other duties and charges', in the language of Article II (GATT 47) to be legally imposed on top of bindings to match domestic carbon charges. I am not going to speculate on this other to recall an old joke in the Uruguay Round where a senior negotiator asked God if there would ever be a result in the Uruguay Round negotiations in his lifetime. God asked the negotiator 'are you referring to your lifetime or mine?'

There are other possibilities – new technical regulations around PPMs, or Processing and Production Methods. The jurisprudence here is immensely complicated. Whether this could be justified in terms of the National Treatment provisions of Article III, or the General Exceptions provisions of Article XX would no doubt make a fascinating seminar topic.

I don't dismiss the possibility that Article XX (g), which deals with conservation of exhaustible natural resources provided such measures are made effective in conjunction with restrictions on domestic production, might provide legal cover. I have seen it argued that the Shrimp/Turtle case might provide some cover for

import restrictions on imports from countries that do not follow the importing country's environmental policies – in this case, it was the protection of turtles through turtle extrusion devices. But even if this were a robust interpretation of one stand-alone Panel case, this is not a negotiated result. It would be a very slender legal reed on which to advance an entirely new, and certainly deeply divisive, set of restrictions on vast areas of world trade. In my view, this could prove explosive, both with respect to the WTO and Kyoto negotiations⁶.

So, ladies and gentlemen, the stakes here are very high. The WTO system has long grappled with the twin impulse to move unilaterally on trade issues and advancing multilateral solutions. As an outsider to the Kyoto negotiating process, it looks to me as if the same underlying issue faces this closely related area of multilateral negotiation.

If we get a mixture of hysteria and populism governing the policy response, you can be certain there will be tears. I am sorry to end on such a predictable note, but if there were ever a case for the old saying 'let cool heads prevail', it applies here.

Thank you.

⁶ The IPCC itself recognises this: "To date, WTO case law has not provided specific rulings on climate related taxes. Any proposed border tax adjustments would need careful design and also take WTO law into account" [*emphasis added*]. IPCC Fourth Assessment Report.