

Securing climate-compatible trade for development

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Key messages

- Climate, development and trade need to be articulated together for fair and efficient outcomes for all nations.
- Improved trade policies that work for climate and development require strengthened international governance, as well as regional and domestic alignment.
- The ClimXTrade Discussion series seeks to identify entry points and roadblocks to securing climate-compatible trade for development, ahead of COP26.

TRADE IN A CHANGING CLIMATE

To successfully deliver on the 2015 Paris Agreement to hold ‘the increase of global average temperature to well below 2°C above pre-industrial levels’, the current trade system needs to become climate-compatible while still fostering development ([UNFCCC, 2015](#)).

Feedback loops and development

Embodied greenhouse gas (GhG) emissions in traded goods and services worldwide represent 38% of global emissions per year ([Barrett, 2020](#)). GhGs are emitted during production, processing and transport to final consumption sites. All these aspects of trade require energy and resources, which are currently mostly GhG emission-intensive. Given the current ‘carbon’-based economy, unless trade transitions to low GhG intensity via ‘decarbonised’ energy and technologies, trade growth entails increased GhG emissions.

Conversely, climate change can negatively affect the pattern and volume of international trade flows. Increased average temperatures, changes in rainfall patterns, extreme climate events and sea-level rise could all disrupt supply chains through effects on production, infrastructure, transportation systems and distribution networks. These disruptions could increase the costs of trade and reverse the trend in cost reduction in transport. However, trade can also be an adaptation mechanism in the face of climate change – also called ‘market-mediated adaptation’. As new comparative advantages emerge, trade could help countries adapt and diversify their exports, especially for the agriculture sector ([Gouel and Laborde, 2018](#)).

Within the Sustainable Development Goals (SDGs) framework, trade is a key component of development. It underpins several goals as one of the means of SDG implementation, such as SDG 6 on clean water and sanitation, SDG 7 on affordable and clean energy, SDG 8 on decent work and economic growth, SDG 9 on industry, innovation and infrastructure and SDG 17 on partnerships. SDG 8 includes increased aid for

trade for developing countries to promote sustained, inclusive and sustainable economic growth ([UN, 2015](#)).

Synergy between trade, future trade agreements and climate-compatible development is key. This is particularly necessary given that domestic climate policies can shape trade flows positively or negatively internationally. It is necessary to identify aligned spaces – for development, trade and the climate – that can help secure climate-compatible trade for development. There are efficiency gains to be made through the introduction of cleaner technologies and lower-‘carbon’ goods (and services). However, capacity constraints as well as financing gaps must be overcome, and the international support architecture strengthened, including through new agreements and commitments.

International governance

The global trade and climate change regimes – embodied by the World Trade Organization (WTO) and the UN Framework Convention on Climate Change (UNFCCC), respectively – must work more closely together. Effective and operational governance frameworks are needed to deliver both on trade for development and on the Paris Agreement target.

Trade is not mentioned in the Paris Agreement, although commitment to development is reiterated ([UNFCCC, 2015](#)). The last round of negotiations to the UNFCCC (COP25) failed to deliver on several topics, including those relevant from a trade perspective, such as international carbon markets, the long-term process for climate finance and transparency and common time frames for climate pledges (Article 6 of the Paris Agreement) ([CB, 2019](#)). Moreover, emission reduction targets need to include sectors currently excluded from GhG accounting but that play a key part in trade – like aviation and maritime transport ([UNFCCC, 2019](#)). Article 3.5 of the 1992 UNFCCC subscribes to an open economic system that would particularly support developing countries and circumscribes climate measures to those that ‘should not constitute a means

of arbitrary or unjustifiable discrimination or a disguised restriction on international trade' ([UNFCCC, 1992](#)).

The WTO guiding principles of non-discrimination and regulatory sovereignty are enshrined in Articles I and III of the General Agreement on Tariff and Trade (GATT) (1947), and could become at odds with international climate action. For Article XX, most explicitly linked to environmental issues, the WTO's previously operating Dispute Settlement Mechanism (DSM) has over time clarified its scope, notably regarding the criteria or requirements for invoking environmental exceptions and establishing 'sufficient nexus' between the environmental challenge and trade measure applied ([WTO, 2020a](#)). However, at present, the DSM is paralysed ([VoxEU, 2019](#)), and there are major concerns regarding how climate change and trade policy disputes can be addressed.

At the UNFCCC, no specific committee discusses trade. While the two institutions can be observers at each other's fora, enhanced coordination could be strengthened via an already existing body at the WTO. Established in 1994, the Committee on Trade and Environment can formulate recommendations for consideration. However, officially, its scope does not include climate change as a systemic issue – only 'sustainable development and the optimal use of the world's resources' ([WTO, 2020b](#)).

OPTIONS FOR CLIMATE-COMPATIBLE TRADE

Trade rules

Trade policies need to be aligned with climate goals, and trade rules can be used proactively to support countries in their transition to a climate-compatible economy. However, so far, environmental obligations have tended to be side agreements to the WTO, such as multilateral environmental agreements (MEAs), which comply with the most favoured nation principle of the GATT's Article I noted above. One such example is the Agreement on Climate Change, Trade and Sustainability (ACCTS), whose negotiations were launched in September 2019 by New Zealand with Costa Rica, Fiji, Iceland and Norway, and which offers a potential blueprint to update trade rules to step up to the climate challenge ([MFAT, 2019](#)). But, generally, while North–North agreements have made substantial progress in integrating trade and the environment and, more recently, trade and climate change (including through the ACCTS open plurilateral trade agreement), developing countries – especially the poorest and most vulnerable – tend to trade under preferential regimes that lack such ambitious forms of coordination.

Some of the major trade-related issues that developed and developing countries must tackle in alignment with the Paris Agreement and ahead of COP26, which the UK will host in 2021, are as follows:

- **energy:** subsidies, standards and labelling

- **land use:** agricultural subsidies for sustainable production and carbon sequestration; trade in forestry, carbon offsetting
- **competitiveness issues:** carbon leakage (low-cost imports from high-carbon emitters) and Carbon Border Adjustments (BCAs); embodied carbon in trade (addressed through border carbon measures); technical barrier to trade carbon labelling issues
- **technology transfer:** Trade-Related Aspects of Intellectual Property Rights agreement/intellectual property rights restrictive or facilitative of low-carbon technologies; trade-related investment measures
- **carbon trading:** how should trade in carbon be classified? Carbon markets require strong institutional foundations.

Production

The production aspect of trade is facing renewed challenges owing to climate change because it needs to deliver on both mitigation and adaptation issues. Indeed, the climate emergency introduces another dimension to the need for economic transformation of production in developing countries. In addition to the movement of resources for production from low- into high-productivity activities, there is the need to include the movement from high- into low-climate-impact and resilient activities.

On the mitigation side, the reduction of GhGs associated with production involves reform of the production processes and the technology involved. More efficient and productive firms should embed lower GhG intensity (i.e. carbon equivalent emissions per unit of output) but will fail to curve down emissions if their action is not part of a wider endeavour. Greener technologies (including energy power) have the possibility to reduce the climate change effect of production without reducing its levels.

When it comes to adaptation, given the potential for increased disruption in supply chains worldwide, enhancing adaptation, robustness and resilience to climate shocks – sudden as well as slow onset events – is pressing. This issue is compounded by the scale and complexity of supply chains.

Consumption

In closing the emission gaps to achieve the 2°C target, changes in consumption will be key. In the same way that public and private standards introduce quality requirements in products, environmental and climate standards reflect consumers' concerns in the production and post-consumption processes. However, carbon certification and verification processes are substantially more complex ([Krishnan and Maxwell, 2020](#)). In order to comply with the standards, retailers and producers need to be more involved upstream in the production processes of the inputs used along the chain.

This issue is gaining more traction as, for example, the ACCTS dedicates a sub-stream of negotiations on the issue of eco-labelling and mechanisms to support its uptake and implementation. But within these discussions, developing countries actors must be part of the response so that new eco-label standards do not contribute to a 'green squeeze' that could impose additional costs on production or processing and ultimately reduce gains for developing country suppliers. Therefore, it is important that these discussions are brought into the multilateral trading system, specifically, the Committee on Trade and Environment as supported by the UK, which will co-chair COP26 ([FCO, 2020](#)).

A RESEARCH AGENDA FOR CLIMATE-COMPATIBLE TRADE FOR DEVELOPMENT

Given the considerations outlined above, we intend to articulate the three dimensions of climate, development and trade together in view of changes that would foster fair and efficient outcomes for all.

This includes:

1. taking stock of the current climate, development and trade nexus, including what has worked so far;
2. critically reviewing the policy space within climate and trade regimes (including support for developing countries' Nationally Determined Contributions implementation via trade)
3. exploring options for tools and pathways for climate-compatible trade for development options (e.g. BCAMMs, limiting fossil fuel subsidies, carbon and sustainability certification, expansion of exceptions in GATT Article XX, reduction in tariffs).

These research areas are being addressed through a series of ClimxTrade roundtable discussions held virtually by ODI over 2020/21, including forthcoming public events such as:

Conversation with Negotiators, September 2020

Climate Change, African Trade and Development Trajectories, November 2020

For more information and to be added to the participant list for closed roundtable events please email: l.pettinotti@odi.org.uk

See also: [Securing a Climate-Compatible Trade Regime and Supporting Sustainable Economic Transformation](#); [Enhancing Resilience within Global Value Chains: The Implications of COVID-19 for Climate Change Adaptation and Mitigation Policies](#)