



International Governance Options to Strengthen Low Carbon Foreign Investment¹

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Effective governance regimes to address climate change as a market failure

Climate change can be considered as a market failure in the sense that market activity is driving global growth in anthropogenic greenhouse gas emissions, increasing their atmospheric concentrations and enhancing the greenhouse effect, with adverse consequences for biological, physical and human systems and net costs into the future (IPCC, 2007; 17). It is a market failure that is inextricably linked with sustainable development and will make it more difficult for countries to achieve the Millennium Development Goals (IPCC, 2007; p. 826-827).

To put economies on low-carbon pathways requires defining the concept of "market failure" in relation to the ability of the market mechanism to achieve specific low-carbon development goals set by the government, rather than in relation to the efficient allocation of resources. Given the ongoing discussion of the financial crisis that began in 2008, the tensions over exchange rate policies, the degree of political influence enjoyed by powerful MNCs, and the failure of the UN Climate Convention process to agree a global climate governance regime, the time is ripe to consider effective governance to achieve low-carbon development pathways.

Governance structures that are currently in place and which can impact the roles that MNCs and FDI play with respect to low-carbon development pathways include:

- International governmental regimes, in particular the WTO regime, economic governance, environmental markets

- Corporate governance, including voluntary industry (or individual corporation) self-regulation, global value chain relationships,

- Multi-stakeholder partnerships

- Domestic governance regimes, from national to local level, particularly investment, taxation, product policies/standards, energy/climate

¹ This thought piece builds on an extensive analysis of low carbon FDI addressing influence of carbon price, TNC structure, drivers and determinants see: <http://www.diplomacydialogue.org/publications/environmental-diplomacy/99-levers-to-enhance-tnc-contributions-to-low-carbon-development-drivers-determinants-and-policy-implications>

² Climate Change FDI Policy Analysis written by Prof Raymond Saner, Director, Diplomacy Dialogue

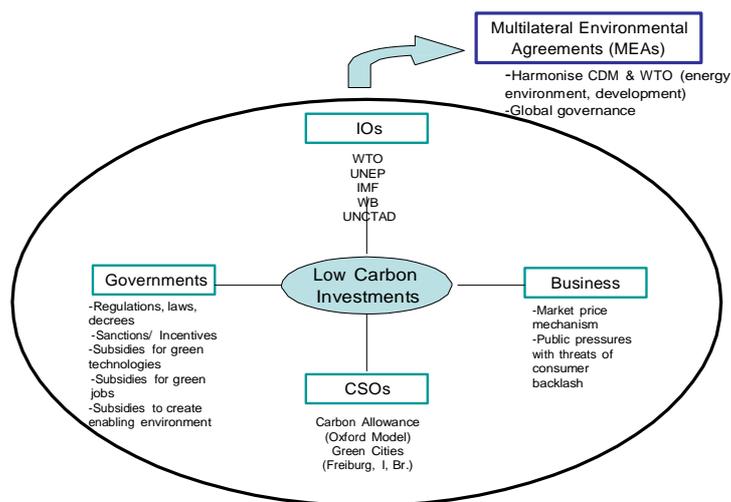
Civil Society Governance schemes be this at grassroots level or through professional associations and think tanks.

Yet we find ourselves in an existential “race between political tipping points and natural tipping points” (Brown, 2009), and it is not clear that the necessary economic governance reforms will be forthcoming in a timely fashion. Speaking in Copenhagen in December 2009, Heads of State seemed to be converging around the aim of limiting the average global temperature increase to between 1.5 and 2°C above the pre-industrial level³, which would require global emissions to peak on a timescale of roughly a decade. Yet global emissions are growing at a rate of 1 – 2% annually, putting us on a trajectory that would at least triple the amount of warming. The global recession has created some breathing space but experts agree that it will be exceedingly challenging, if not impossible, to achieve such a goal, not the least because all of the growth in energy-related carbon dioxide emissions is projected to come from developing countries (IEA, 2009).

Bearing in mind the dangers caused by climate change, aiming at low carbon investment at national and global levels sensible and urgently needed. Low carbon investment could be achieved through incentives and sanctions which can act as drivers and determinants influencing investors and investment flows in the direction towards low carbon investment. As depicted in figure below, low carbon investment could be achieved through at

national levels through government policies, civil society pressures and business decisions by commercial actors. At the same time, business investors like TNCs take investment decisions based on

Figure 1



market and business strategy criteria which can lead to low or high carbon investment.

Attempting to achieve low carbon investment at international levels is on the other hand the aim of multilateral agreements and conventions as for instance the Multilateral Environmental Agreements (MEAs) which on the other hand face the governance impact of other multilateral agreements such as the WTO which either hinder or facilitate the goal of achieving low carbon investment. However, MEAs have had little influence in putting TNCs on low carbon pathways.

Multilateral Conventions (WTO, UNFCCC) as driver and determinants of Low Carbon Investment

³ One outcome of the meeting was the Copenhagen Accord (http://unfccc.int/files/meetings/cop_15/application/pdf/cop15_cph_auv.pdf), a political agreement that roughly 110 governments have since associated with. This agreement expresses the political will to “hold the increase in global temperature below 2 degrees Celsius”.

The trade and climate change communities faced a double negative at the beginning of 2010 – namely no global deal at the Copenhagen climate conference to reduce emissions of heat trapping gases and still no concluding deal at the WTO of the Doha Round which commenced in November 2001. Both multilateral agreements are highly complex and also characterised by high stakes for all parties involved, whether industrialised or developing country.

Attempts to keep the two multilateral agreements and their respective negotiations apart, in the hope of being able to reduce complexities, have not been successful. A growing number of trade and climate change experts, government officials and concerned citizens alike see these two multilateral processes in interaction with each other directly and indirectly. Cross-over linking of concessions is mentioned with increasing frequency and countries take public stances against or in favour of such linkages.

Some pundits warn of an impending collision of two trains rushing towards each other risking collision and collapse of both trains (UNFCCC vs. WTO); while others have pointed out that both trains seem to increasingly become fragmented and broken up into de-coupled wagons and cars. The likelihood has increased that the decoupled wagons go off on different tracks and different speeds risking either collision(s) or ending motionless somewhere in the desert of oblivion.

A substantial number of scholars attribute climate change to market failure observing that the externalities (environmental costs of production) are not included in current market prices and hence environmental damage (CO₂ emissions and environmental pollution) end up being a cost to society rather than being borne by the market actors – buyers and sellers of products and services.

Market failures have also been identified as consisting of structural market failure induced by the lack of competition rules in this field therefore allowing firms to gain monopolistic power. Such monopolistic positions might also be induced by the action of governments or the absence of government intervention. In addition to that, non-market failures might also occur if governments and civil society are not able to create an environment conducive to development .

An important factor on non-market failure can be the inability of governments to perform and to fulfil their role and responsibilities. Further research on this aspect of non-market failure has been done by various scholars who have brought to the fore the importance of governments to manage effectively and efficiently inter-ministerial trade policy coordination (Saner, 2010) and government to economic and SCOs actor trade policy consultations.

While government failure (non-market failure) pertains to shortcomings at national level, market failure points also to disfunctioning of the world economy at global levels. What needs to be added is an analysis of the governance issues between the trade and climate change multilateral regimes, how these conflicts manifest themselves, how they could be solved and what kind of bearing they have on FDI in general and on the goal of achieving Low Carbon investment in specific.

Emerging cross-regime conflicts between trade/WTO and CC/UNFCCC

Disappointed and angry about the failure of the Copenhagen meeting last year, politicians in the United States and the European Union attribute the cause of the failure to the unwillingness of mainly China and India (key emitters of CO₂) to commit to legally binding reductions of their total CO₂ emissions within the UNFCCC context. Three policy options have been proposed namely:

BTADU: Border Tax Adjustment based on Domestic Unrestricted Carbon Content

BTAUFU: Border Tax Adjustment based on Foreign Unrestricted Carbon Content

BTAE: Scenario Efficient Border Tax Adjustment

The intention of such carbon tax would be to ensure competitiveness of producers from countries with high carbon taxes and enforced CC rules in contrast to producers from countries with lax or no CO₂ emission controls who could undercut their competition with lower prices (free of carbon tax). India

has reacted strongly to such carbon tax proposals and threatened to take countries that would use such carbon taxes to the WTO dispute settlement forum.

Other trade policy option could be the use of domestic and export subsidies to provide competitive advantage to local companies or the use of various forms of environmental standards. These environmental standards could have both positive and negative effects on CO₂ depending whether they are used by WTO member countries as means to protect local companies from foreign competitors or whether are intended to raise the level of carbon reduction at global, that is, non-discriminatory levels without causing harm (loss of competitive advantage) to other economic actors. Subsidization could on the other hand lead to imposition of countervailing duties and subsequently to a long drawn out litigation through the WTO dispute settlement process.

Firm location decisions might be influenced by carbon leakage considerations. Production could be considered less costly in a country where emissions are unabated versus a country where emissions are reduced through carbon constraining policies. Such policies in turn can lead to higher production costs and loss of competitiveness, hence could lead to off shoring and loss of jobs and investment.

Trade experts are worried that if governments cannot come to an agreement on rights and obligations within a climate change regime (UNFCCC), then the chances increase dramatically of countries with carbon reduction policies using trade measures to counter perceived unfair price advantages by firms from countries with low carbon reduction policies. Such trade based CC measures would be contested especially by large emerging countries like India and China who would bring the WTO litigation system into a battleground inflicting damages to both sides of the litigation divide and, most importantly and by so doing inflicting potentially irreversible damage to the common good of environmental sustainability.

Solutions within WTO rules and agreement

The WTO has general exceptions provisions that allow trade restrictions that would otherwise be inconsistent with mainstream obligations. Such public policy provisions for instance permit restrictions of trade in order to protect human, animal and plant life or health (Article XX (b) and another to conserve exhaustible natural resources. Such measures would have to be used in a non-discriminatory way in both MFN and national treatment sense which in practice would be difficult and most likely seen as opportunistic or illegitimate thereby leading again to prolonged trade dispute settlement process .

Another option could be to renegotiate and re-activate the Trade Related Investment Measures agreement (TRIMS) which came into force in 1995 as part of the Uruguay Round negotiations. TRIMS did not define prohibited FDIs but included a list of local content requirements, trade balancing requirements and export restrictions. WTO member countries were given 90 days to notify WTO of any existing non-conforming measures. There were a total 43 notification by 24 developing countries. After some request for extension of the transition period, all developing countries abolished their notified TRIMS and by 2007, the TRIMS agreement became extinct.

However, since TRIMS was experienced as a useful mechanism allowing developing countries to temporarily protect their own industries in select sectors until they were ready to drop these measures, it could be envisaged that a second generation TRIMS agreement could be negotiated which would allow developing countries time to protect infant industry in the sector of carbon reduction technology and hence make it easier for them to commit to CO₂ reduction targets. Assessing such a re-use and negotiations of TRIMS+ could be guided by UNCTAD whose research on FDI and developing country mandate would make it the appropriate International Organisation to lead such an effort.

Another possibility could be to revisit the TRIPS agreement and to explore ways how to apply similar exceptions as are available for LDCs in the field of health. Faced with the full brunt climate change like inundations, dryness and deforestation exceptions could be considered to allow LDCs to get

access to technology from developed countries in regard to carbon reducing machines through the clause of “compulsory licensing”. Such use of the “compulsory licensing” option could be a leverage for LDCs in their UNFCCC’s adaptation negotiations.

Brazil has called for a Doha Declaration on Climate Change, applying the same logic to the global public good of climate mitigation as was applied in the area of medicines to human health, namely taking full advantage of the flexibility within TRIPS (WTO Agreement on Trade-related Aspects of Intellectual Property Rights) to grant compulsory licenses to critical climate-friendly technologies, and the Group of 77 and China has also called for compulsory licensing under the UNFCCC negotiations.

Another solution could be to bundle three sectors which have so far been treated as separated negotiation for a tri-sector plurilateral agreement namely a) energy (goods and services), b) environment (goods and services) and c) trade and development (Aid-for-Trade, Enhanced Integrated Framework, TRTAs). Developing and especially Least Developed countries have to face multiple challenges ranging from poverty, political instability, lack of supply of exportable products and services to climate change.⁴ LDCs in particular lack continuous access to energy, water, and food and development aid. WTO members have not been able to make much progress within each of the three sectors and, lamentably, have not been able to explore cross-sector concessions which would be beneficial for all parties concerned whether developed or developing.

Solutions outside the WTO context

Trade agreements and negotiations are also conducted outside the WTO context. For instance, rules pertaining to maritime shipping are negotiated within the context of the International Maritime Organization (IMO). Fuel use in shipping is a major source of GHG. Members of the IMO are currently discussing how they could reduce CO₂ emissions. Some members want stringent rules which would apply to all ships whether they are owned by a shipping country located in a developing country or developed country. Members are also discussing solutions entailing emissions trading, use of a bunker levy or trading energy efficient credits based on efficiency performance of ships which could be an interesting example for other sectors to follow who are outside the WTO context.

Free trade agreements (FTAs) and Regional Trade Agreements (RTAs) are supposed to be complementary to WTO rules. However, the proliferation of FTAs has made it difficult to ensure that they do not contradict the respective members’ WTO obligations. Several of the FTAs involving the US and the EU include provisions regarding the environment and climate change. In other words, they go beyond what has been so far agreed within the WTO. The same is true for Bilateral Investment Agreements (BITs) which are most of the time confidential and do not reveal the extent to which FDI is put into relation with low carbon investment and for instance to carbon reducing technology IPs. There is a need for closer scrutiny of all these various trade agreements (FTAs, RTAs, BITs). UNCTAD has many years of experience in researching the field of investment and hence could easily also add low carbon investment to its portfolio.

⁴ Policy options for low income countries covering energy, development and environmental concerns need to be re-positioned in a less ideological frame see e.g. options for Bolivia at: <http://www.globalsubsidies.org/en/subsidy-watch/commentary/bolivia-s-energy-sector-intervention-a-missed-opportunity-economic-devel>