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Task Force 04

TRADE AND INVESTMENT FOR SUSTAINABLE AND INCLUSIVE GROWTH

Mitigating the Green Squeeze: Effectively Navigating New Green Trade Measures

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Abstract

Members of the World Trade Organisation (WTO) are permitted to take actions to protect the environment and advance sustainable development, and there has also been an expectation that members would respect each other's right to regulate. Nowadays, however, the rising prominence of new green trade measures is creating a commensurate increase in trade tensions. There have always been some areas of ambiguity within the realm of climate-related trade policy, for example, regarding trade in carbon. The potential for clashes between trade and climate change regimes has also been highlighted in view of their different principles. The issues being highlighted now include concerns regarding new demands for low carbon compliance, resulting in valid concerns of a "green squeeze" on smaller and poorer producers. Unilateral green trade measures are inducing supply chain shifts now. Coming at a time when the provision of climate finance continues to fall well short of demands, and grant-based aid for trade assistance to developing countries has declined, there are major risks of certain producers' position within value chains becoming jeopardized. This policy brief sets up the context in which the new green trade measures are arising and identifies some of their major issues. It then articulates a proactive agenda for the G20 to work together to change the current dynamics including structured dialogue; a focus on securing resilient value chains; finally, the fulfillment of both climate finance and aid for trade goals.

Keywords: Green trade, carbon border measures, value chains, deforestation regulation, corporate sustainability, due diligence

Diagnosis

All members of the WTO are permitted to take actions to protect the environment and advance sustainable development. But some areas of ambiguity within the realm of climate-related trade policy, as well as the potential for clashes between trade and climate regimes in view of their different principles have been consistently raised (Keane et al., 2010). Nowadays, there is widespread recognition, reflected in deliberations during MC13 as well as COP28 (but not necessarily the outcomes), that greater coordination is needed: to avoid fragmentation of policy, which reduces overall efficiency and increases trade costs, potentially to prohibitive levels that result in exclusionary effects.[1]

Within the coming few years, an increasing share of global trade will be covered by new green trade measures[2]. These measures are being introduced by major economies, to achieve and support their climate change mitigation efforts. However, the spillover effects of these, as well as the methods and approaches taken, are raising major competitiveness concerns. Whilst some of the new policy enacted is argued to be in line with existing commitments by WTO members, some G20 members suggest they are contrary, including most recently China in relation to support within the US Inflation Reduction Act to electric vehicles.[3] Brazil has voiced its concerns, at the highest levels, of a disregard of

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[1] See Kleimman et al., (2023)

[2] This article uses the term ”green trade measures” as a catch-all phrase to refer to new policy measures intended to incentivise greener, lower carbon and more environmentally friendly production and trade.

[3] See WTO (2024).

existing domestic legal frameworks to protect the environment and avoid deforestation, in view of the European Unions (EUs) Deforestation Regulation.[4]

In addition, the types of green trade measures are perceived to be punitive, as opposed to facilitative, and shaping mitigation policy - against the United Nations Framework Convention on Climate Change (UNFCCC) principle of Common But Differentiated Responsibilities (CBDR); these issues have been raised by South Africa in relation to the EUs Carbon Border Adjustment Mechanism – which will require carbon credits to be submitted by 2026, with the EU carbon price as a reference.

Progress on addressing the new issues of climate-related trade policy within the WTO has so far been very limited. Some members provided an update of related plurilateral discussions at the 13th WTO Ministerial Conference (the Trade and Environmental Sustainability Structured Discussions (TESSD)). But not all WTO members support this approach – including some G20 members.

The inability to reach agreement on the need for more coordinated approaches and to therefore navigate more effectively the spillovers arising from climate change policy mitigation policy, is extremely challenging, especially for severely capacity constrained countries. Already, the effects of climate change are materializing earlier than expected and at a greater scale and intensity than anticipated. As pointed out by Lankes et al., (2024) poorer people are affected more severely by the impacts of climate change. The current risk is that the poorest countries (and communities) are disproportionately affected by new green trade measures, which are reshaping the landscape of global trade flows and risk further fragmentation (and inequality).

[4] See Mano (2023).

This is part of the "green squeeze" identified by Keane (2023; 2024). Importers are adopting supply chains now as they reconfigure value chains away from "least cost" considerations to rather more "least risk" of environmental damage and degradation. For the Least Developed Countries (LDCs), a group which barely accounts for 1% of global trade – even a 1% increase in compliance costs results in a transfer of hundreds of millions of Euros. There are new demands for compliance infrastructure and assistance for support for changes to production methods, coming at a time when the provision of both aid for trade and climate finance continue to fall well short of demands.

Countries that fail to decarbonize production processes risk losing trade to greener counterparts (Haddad et al., 2024). Viewing new green trade measures from the perspective of micro and small and medium sized (MSMEs) firms and the promotion of resilient value chains (an ambition since Covid-19) - which requires more diversified and less concentrated supply chains – the potential for greater consolidation across larger firms within value chains is even more concerning. In brief, it is not sufficient for any government to wait to see how discussions fare and unfold at the WTO: the private sector is already shifting supply; developing country producers require investments in public policy frameworks and business ecosystem support now.

Recommendations

1. Begin structured and systematic dialogue between trade and climate negotiators amongst the G20; bring on board the LDCs and Small Island Developing States (SIDs).

Since Brazil has proposed a joint effort by the G20 Members to identify concepts and principles that can serve both as guidelines for crafting and enhancing policies aiming to promote sustainability and sustainable development, an obvious accompaniment to this process would be to ensure structured dialogue between trade and climate negotiators within the G20; then subsequently, to bring on board other groups, especially Africa, LDCs and SIDS (there are already some examples to draw on)[5].

All UNFCCC Countries' Nationally Determined Contributions (NDCs) include the role of international trade, but currently the inclusion remains rather more implicit than explicit: symptomatic of the continued absence of systematic and structured dialogue between climate and trade negotiators. This situation is becoming increasingly untenable as recent developments ahead of COP28 indicated – there was a push to include unilateral trade measures within the agenda by the BASIC Countries - comprising Brazil, South Africa, India and China[6]. Similarly, at the 13th WTO Ministerial Conference (MC13) a large group reportedly led by Paraguay (and including Brazil and South Africa) sought to

[5] An example of a similar exercise is here: Aligning climate and trade policy for LDCs and graduates | ODI: Think Change | ODI: Think change

[6] See COP28_BASIC-Agenda proposal.pdf (unfccc.int).

reach agreement across the membership on the trade-climate and development nexus[7]. Finally, action point one of the Trade Ministers Coalition for Climate Change issued at MC13 begins with the need for structured dialogue between climate and trade negotiators[8].

Not all members of the G20 agree with the plurilateral approach to discussing climate related trade policy at the WTO. Only a handful of LDCs and SIDS are members of the TESSD and progress on issues like technology transfer remains limited, with a need to make the issues far more explicit (Keane, 2022). It is unclear if the low level of engagement by LDCs and SIDS reflects capacity constraints to engagement, or a preference to maintain discussions within existing WTO committees. Constructive engagement between G20 members could help to raise the prominence of issues like technology transfers, carbon markets, as well as adaptation to the physical effects of climate change: issues of priority to LDCs and SIDS. The G20 occupies a unique space to tackle these issues and should seek to understand the constraints of capacity constrained countries (e.g. LDCs, SIDS). The result could be, for example, a greater focus on

[7] See Ministerial Declaration on the Contribution of the Multilateral Trading System to Tackle Environmental Challenges, communication from Argentina, Bangladesh, Barbados, Plurinational State Of Bolivia, Brazil, Cabo Verde, Colombia, Ecuador, Egypt, Honduras, Indonesia, Kazakhstan, Panama, Paraguay, Peru, South Africa, Uruguay, Bolivarian Republic Of Venezuela, and the African Group, 29 February 2024 (directdoc.aspx (wto.org)).

[8] As referred to in the Coalition of Trade Ministers on Climate Menu of Voluntary Actions (214b22_96017e7923664af6a2a3ed7a360bdfa3.pdf (tradeministersonclimate.org))

facilitative (rather than punitive) green trade measures, to support not only climate change mitigation but also adaptation.

2. Support value chain resilience building and MSMEs

The G20 should raise the issues regarding unfulfilled commitments on technology transfer to the same level as climate finance. There is a need to respond to new drives to promote low-carbon value chain development, but international support measures are currently wanting. There remain unfulfilled commitments on technology transfer, demands for which are increasing - given the need to decarbonise energy systems (especially in view of CBAMs).

Other types of technology transfer are also needed. This includes in relation to the types of digital platforms and traceability systems that can support producers in meeting new demands for compliance. Brazil is heralded as potentially benefitting from the EU's new deforestation regulation, because it already has traceability systems in place for different types of commodities. LDCs could benefit from new types of knowledge exchange and technology transfer by G20 members to support continued value chain engagement and resilience building. There are some obvious synergies with the Doha Programme of Action which calls for a doubling of Aid for Trade (AfT) as well as an increased focus on digital trade for the LDCs.

It is well recognized that investments needed for compliance can fall disproportionately on smaller, poorer, and less resourceful producers (see Haddad et al., 2024). This aspect of the "green squeeze" requires proactive steps to mitigate; there are many lessons that can be learnt from previous support measures for trade-related adjustment to new standards. This includes the need to ensure public regulatory bodies are supported and their capacity is upgraded, so that donors don't fall into unsustainable practices like subsidizing annual compliance audits.

Lead firms and importers may need further guidance to avoid knee-jerk reactions. For example, to ensure changes in sourcing strategies are informed by facts like full life cycle carbon accounting across the value chain. The G20 could raise the profile of the impacts on producers of supply chain shifts that have occurred already (e.g. the issues with regards the dropping of air freight produce). Supporting the engagement of MSMEs through the broader agenda of resilient value chains - which requires more diversified and less concentrated support – is an important strategic approach to respond to new green trade measures that should be championed by the G20.

3. Champion the fulfilment of both new climate finance and aid for trade goals

A new climate finance goal is currently being agreed. It is well acknowledged within both climate and trade communities that climate finance and AfT often target similar areas, e.g. energy, transportation. Whilst it is inevitable that there will be increasingly blurred lines between the provision of climate finance and aid for trade, it is important to recognise their complementarity. All WTO members will contribute to the 9th Global Aid for Trade Review which is forthcoming in June 2024. The focus on trade mainstreaming at the global review is being interpreted as the entry point for climate change, as it becomes mainstreamed across trade policies and AfT.

Whilst G20 members consider the new climate finance targets, the challenges posed by declines in grant-based AfT assistance for developing countries and LDCs must be acknowledged. The Doha Programme of Action for the LDCs calls for a doubling of AfT from 2018 levels and as calls for a new focus on digitalisation, with obvious links to new demands for traceability systems to support value chain engagement. Support for trade-related adjustment to new green trade measures is urgently needed and AfT has an important to role to play, alongside the provision of climate finance. The EU has indicated its willingness to provide support for adjustment to the CBAM (carbon credits due 2026) and the EUDR (kicking in by 2025), but information on what this will comprise within specific country contexts remains unclear.

Scenario of outcomes

If the suggested recommendations are embraced by decision-makers within the G20, several scenarios could unfold, each with its own set of synergies and trade-offs:

- **Reduced trade tensions**: a de-escalation of trade tensions is urgently needed and the G20 has a critical role to play given the composition of its membership and their different strategic interests. It is surprising that BASIC countries were aligned on the need to address unilateral trade measures ahead of COP28, but not at MC13. The reasons for this must be explored further through constructive dialogue between G20 climate and trade negotiators. Through this process the G20 could play a vital role forward in the navigation of new green trade measures and more supportive outcomes in view of sustainable structural economic transformation. For example, in relation to CBAM there are already monitoring reporting and verification systems for carbon within the UNFCCC framework and negotiations for Article 6 on carbon markets.

- **Reduced policy fragmentation and inequality**: the risks are that without concerted action, smaller and poorer producers along with those unable to make the necessary adjustments to production structures will be shut out of high-value end markets. This is not conducive to the broader objectives of the Paris Agreement. The potential increased consolidation across value chains induced by the combined effects of new green trade measures is contrary to the broader resilience building agenda. This is especially the case in view of producers' needs to use trade as a mechanism for climate change adaptation and export diversification. Poorer producers may become shut out of value chains, reducing their ability to adapt to climate change, through knowledge and technology transfers. A more pessimistic scenario is that environmental degradation increases as producers shift away from high standard markets to ones with lower standards, further undermining the likelihood of achieving the goals of the Paris Agreement.

- **Strengthened multilateral cooperation:** smaller and poorer countries depend the most on the multilateral system to support their trade and development goals. The G20 has a vital role to play in supporting continued multilateralism. Related to the above two points and the recommendations made, the overall outcomes would be strengthened cooperation between the climate and trade regimes, to mitigate the current clashes. Greater coordination between climate finance and aid for trade providers will enhance impacts both in relation to climate change mitigation and adaption.

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