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## **Sectoral Approaches in Climate Negotiations: Considerations for Developing Countries**

### **Submission by Third World Network**

#### **Summary**

Sectoral approaches present opportunities and risks for developing countries. On one hand, they offer one practical means to integrate national actions on mitigation, adaptation, finance, technology and capacity building. On the other hand – if linked with considerations of competitiveness at the international level – they risk the creation of new trade and economic barriers to developing countries. Avoiding protectionist abuse thus requires an understanding of how sectoral approaches could be used by developed countries to justify new trade restrictions under multilateral, regional or bilateral trade agreements, or through unilateral trade measures.

#### **Sectoral discussions under AWG-KP and AWG-LCA**

In the AWG-KP, Parties are discussing greenhouse gases, sectors and source categories and possible approaches targeting sectoral emissions, including:

- The possible broadening of the coverage of greenhouse gases, sectors and source categories;
- How approaches to limit or reduce the emissions of greenhouse gases from aviation and marine bunker fuels could be used by Annex I Parties as a means to reach their emission reduction targets, taking into account Article 2, paragraph 2, of the Kyoto Protocol; and
- How approaches targeting sectoral emissions could be used by Annex I Parties as a means to reach their emission reduction targets.

In the AWG-LCA, Parties are considering “cooperative sectoral approaches and sector-specific actions, in order to enhance implementation of Article 4, paragraph 1(c), of the Convention”. Article 4.1(c) calls on Parties to:

Promote and cooperate in the development, application and diffusion, including transfer, of technologies, practices and processes that control, reduce or prevent anthropogenic emissions of greenhouse gases not controlled by the Montreal Protocol in all relevant sectors, including the energy, transport, industry, agriculture, forestry and waste management sectors.

Some Parties – including Japan and the European Union – have called for broadening discussions under the AWG-LCA and drawing parallels with discussions under the AWG-KP. Developing countries, by contrast, have distinguished between discussions in AWG-KP (which focus on means for Annex I Parties to meet their obligations), and discussions in AWG-LCA (which focus on technology transfer).

“Sector” and “sectoral approach” have been used to encompass a variety of meanings.

- *Mitigation and adaptation sectors:* A typology of mitigation and adaptation sectors has been developed by the IPCC and used variously in Technology Needs Assessments, National Adaptation Plans of Action and other contexts.
- *Aviation and marine sectors:* The Kyoto Protocol requires reduction of emissions from aviation and marine bunker fuels, working through the International Civil Aviation Organization and the International Maritime Organization”.
- *Industry sectors:* Initiatives such as the Asia Pacific Partnership on Clean Development and Climate (AP6) focus on greenhouse gas emitting industry sectors such as steel; aluminium; cement; coal mining and so on.

References to sectors arise in Articles 3.3 and 4.1(c) of the Convention, and in Articles 2.1(a), 2.2, 6.1, 10.1(b) and Annex A of the Kyoto Protocol.

### Differing approaches to sectoral discussions

Parties have proposed different approaches to sectoral discussions. Japan has promoted domestic target setting on a sectoral basis and “an internationally cooperative approach” to mitigation involving cross-border sharing of best available technologies and practices, focusing initially on four key “sub-sectors”: coal-fired power generation; steel; cement; and road transport. The European Union has offered principles and definitions and suggested deliberations in AWG-LCA cover: 1) Market based approaches incentivising developing countries to participate in global mitigation efforts, including national or international emissions trading, sectoral no-lose mechanisms and sectoral crediting mechanisms. 2) Non-market based approaches such as technology cooperation and/or domestic mitigation policies to contribute to removing barriers, increase technology deployment and enhance technology RD&D – and provide an intermediary step for some developing countries for participation in mitigation actions. Argentina, by contrast, has called within the G77 and China for a development-oriented approach commencing with an evaluation of development objectives in each sector/area as the basis of any discussion of mitigation or adaptation, and associated technology, finance and capacity needs.

### Links between sectoral approaches and competitiveness

Proposals by developed countries for sectoral approaches – particularly Japan and the EU – are motivated in part by concerns that their domestic climate regulations will: 1) reduce the competitiveness of their firms and products in domestic markets; 2) reduce the competitiveness of their firms and products in international markets; and/or 3) cause the migration of energy/GHG intensive industries to developing countries – a tendency referred to as “carbon leakage”.

Just as many developed countries see sectoral approaches as a means to protect or enhance their competitive position, many developing countries see them as a means to challenge or undermine theirs. A principal concern is the potential misuse of sectoral approaches to “tilt the playing field” and to pass on to developing countries the costs incurred by developed countries of implementing their obligations under the Convention and Kyoto Protocol. In particular, concern arises that sectoral approaches may be used to:

- **Establish new international standards.** Sectoral approaches could justify the creation of new international rules or standards on a sector-by-sector basis for energy/GHG-intensive industries that directly impose new and inappropriate costs on products exported from developing countries.
- **Justify trade barriers by developed countries.** Sectoral approaches could justify the imposition by developed countries of new trade barriers on products or technologies from developing countries – for example, by justifying new trade bans, border adjustments or standards that limit trade in energy/GHG-intensive products.
- **Change policies in developing countries.** Sectoral approaches could justify efforts by developed countries to alter the trade-related domestic policies of developing countries – for example, by removing

barriers to markets access for developed country products, or strengthening intellectual property rights over low-emission technologies or climate-resistant crops “owned” by companies in developed countries.

Even if sectoral negotiations prove unsuccessful, efforts by developed countries to negotiate them could be used as evidence that subsequent unilateral measures are necessary, justified and do not constitute disguised restrictions on international trade.

A variety of trade-related measures are available including trade bans, punitive tariffs, anti-dumping duties, anti-subsidy duties, border adjustments and standards and domestic regulations. Of these, two kinds of measures – border adjustments and domestic regulations – could potentially withstand WTO scrutiny and thus be of most serious concern to developing countries. In each case, the terms of any sectoral approach would play a role in defining the terms upon which a developed country could impose trade-related measures on firms or products from developing countries.

### **Border adjustments and sectoral approaches**

Both the US and EU are discussing measures that would require importers to purchase emission allowances as a condition of entry for products into their markets. Under the WTO, countries are permitted to impose “a charge equivalent to an internal tax ... in respect of the like domestic product” (Article II GATT). Drawing on these provisions, developed countries would likely characterize their measures as a WTO permissible “border adjustment” of a domestic cap-and-trade scheme, arguing the charge applied at the border on a GHG-intensive product such as steel or cement is equivalent to an internal tax applied to steel or cement produced domestically. A sectoral approach (e.g. for steel or cement) would contribute to defining the terms upon which any such border measure would be applied. It could define national targets or goals for sectoral emissions reduction, it could define the technologies or approaches reasonably available to an exporter, or it could define the permissible “GHG-content” of products in international trade (and hence the basis of the adjustment). It is likely that a WTO panel would look to the terms of the international agreement when determining whether a national measure is consistent with WTO rules.

### **Standards, domestic regulations and sectoral approaches**

Standards and domestic regulations could also be used to increase barriers to trade in products from developing countries that do not meet energy- or carbon-efficiency standards imposed nationally, or agreed through regional or international processes (including a sector-based agreement). Any agreed sectoral approach is likely to prove relevant in the event that domestic regulations – i.e. technical regulations, standards, labels or other such measures – are challenged at the WTO. Article III of the GATT establishes the “national treatment” rule and requires that the products of exporting countries be treated “no less favourably” than “like products” manufactured in the importing country. In an evaluation both of “like products” and “discrimination” it is likely that a WTO panel would consider the terms of any international agreement relating to trade in the product and/or to measures justifying similar or different treatment. The terms of the sectoral approach could, for example, play a role in determining the extent to which different building materials are considered similar or different, or what would constitute “discrimination” in the treatment of those products in international trade.

### **WTO environmental exceptions**

In the event that a measure is found to contravene WTO rules it would be evaluated against the exceptions set out in Article XX of the GATT, which permit measures relating to the conservation of exhaustible natural resources that are not arbitrary and that take into account the conditions of exporting countries. Any sectoral approach would, again, likely be considered relevant by a WTO adjudicatory body when applying the standards set out in Article XX. In particular, they would likely play into the body’s determination of whether the measure was applied in a manner that constituted arbitrary or unjustifiable discrimination or a disguised restriction on international trade.

### **Conclusion**

When considering discussions of sectors and sectoral approaches, developing countries may wish to carefully evaluate the likely implications for the competitive position of their key sectors in international economic relations. In particular, efforts by developed countries to smuggle competitiveness issues into the UNFCCC negotiations under

the guise of sectoral approaches should be clearly identified by developed countries as running counter to the principle of common but differentiated responsibility and, potentially, risking efforts to advance the negotiations. Any effort to advance the negotiations should be based firmly on common but differentiated responsibility, as well as other relevant provisions of the Convention.

Discussions in AWG-LCA on sectoral approaches should be on the basis of Article 4.1 (c) in accordance with the mandate of the Bali Action Plan. Developing countries, especially in their national climate policies should be able to plan actions including sector by sector, and to seek international assistance (finance, technology and capacity building) for actions on an overall as well as sectoral basis. These national plans should not, however, be subjected to “international harmonisation of standards” by sectors, which would lead to the kinds of problems raised in this paper. Indeed, those who promote this international harmonisation and competitiveness approach are doing a disservice in that a confusion may arise which may give a negative connotation to sectoral approaches as a whole, including useful national-level sectoral policies in developing countries.

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### **Annex: Relevant provisions of the Convention**

When responding to sectoral discussions, developing countries can rely on a number of provisions of the Convention:

The preamble recognizes that “standards applied by some countries may be inappropriate and of unwarranted economic and social cost to other countries, in particular developing countries”. It affirms that “responses to climate change should be coordinated with social and economic development in an integrated manner with a view to avoiding adverse impacts on the latter, taking into full account the legitimate priority needs of developing countries for the achievement of sustained economic growth and the eradication of poverty”. It also recognizes that all countries “need access to resources required to achieve sustainable social and economic development and that, in order for developing countries to progress towards that goal, their energy consumption will need to grow”.

Importantly, Article 2 includes as part of the Convention’s ultimate objective the requirement that stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system should be achieved within a time frame sufficient to enable “economic development to proceed in a sustainable manner”.

Article 3.5 links directly with issues of international trade and competitiveness, stating that:

The Parties should cooperate to promote a supportive and open international economic system that would lead to sustainable economic growth and development in all Parties, particularly developing country Parties, thus enabling them better to address the problems of climate change. Measures taken to combat climate change, including unilateral ones, should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade.

Finally, Article 4.7 states that:

The extent to which developing country Parties will effectively implement their commitments under the Convention will depend on the effective implementation by developed country Parties of their commitments under the Convention related to financial resources and transfer of technology and will take fully into account that economic and social development and poverty eradication are the first and overriding priorities of the developing country Parties.

## **Sectoral Approaches in Climate Negotiations: Considerations for Developing Countries**

### **Submission by Third World Network**

This paper identifies some considerations for developing countries arising out of discussions regarding “sectors” and “sectoral approaches” in the AWG-KP and AWG-LCA. It examines potential linkages between sectoral approaches and issues relating to international trade and competitiveness, and the risk that sectoral approaches may be misused to create new trade and economic barriers for developing countries.

#### **Sectoral approaches – risks and opportunities**

Sectoral approaches present opportunities and risks for developing countries. On one hand, they offer one practical means at the national level to organize and integrate actions relating to mitigation, adaptation, finance, technology and capacity building on a sector-by-sector basis. On the other hand – if linked with international competitiveness considerations – they risk the creation of new trade and economic barriers for developing countries. Advancing a development-oriented discussion of sectoral approaches thus requires a careful strategic approach by developing countries.

Elements of a development-oriented agenda are reflected in references in the Bali Action Plan to “cooperative sectoral approaches and sector-specific actions, in order to enhance implementation of Article 4, paragraph 1(c), of the Convention”. In this context, developing countries have focused sectoral discussions on ensuring implementation by developed countries of their existing obligation to transfer technology in “all relevant sectors, including the energy, transport, industry, agriculture, forestry and waste management sectors” (paragraph 4(1)(c)), and on the need for technology transfer to be “measurable, reportable and verifiable” (paragraph 1(b)(ii) Bali Action Plan).

Avoiding undue impacts, in turn, requires an understanding of the climate regime and of rules relating to international trade and commerce – including those established by the World Trade Organization. In particular, it requires an understanding of how different proposals for sectoral approaches, if established in the context of the climate regime, could be applied in the context of multilateral, regional or bilateral trade agreements, or through unilateral domestic actions by developed countries, with the effect of passing on the costs of compliance with the climate regime by developed countries to developing countries – compromising the principle of common but differentiated responsibility and creating adverse effects on the economic and development prospects of developing countries.

#### **Sectoral discussions under AWG-KP**

Issues relating to sectors and sectoral approaches arise in both the AWG-KP and the AWG-LCA. In the AWG-KP, Parties are discussing greenhouse gases, sectors and source categories and possible approaches targeting sectoral emissions. Discussions have covered, *inter alia*:

- The possible broadening of the coverage of greenhouse gases, sectors and source categories;
- How approaches to limit or reduce the emissions of greenhouse gases from aviation and marine bunker fuels could be used by Annex I Parties as a means to reach their emission reduction targets, taking into account Article 2, paragraph 2, of the Kyoto Protocol; and
- How approaches targeting sectoral emissions could be used by Annex I Parties as a means to reach their emission reduction targets.

At the in-session thematic workshop at the recent Bonn AWG-KP meeting<sup>1</sup>, the chair stressed that approaches targeting sectoral emissions differ from the other means to reach emission reduction targets in that such approaches are not currently included under the Kyoto Protocol.

At the meeting, participating experts noted that several sectoral initiatives and voluntary agreements are already in

place, for example, those implemented by the International Aluminium Institute, the International Iron and Steel Institute, the Cement Sustainability Initiative within the World Business Council for Sustainable Development, and ICAO.

Participants noted that any approaches targeting sectoral emissions should complement national emission reduction targets for Annex I Parties but not replace them. Among the approaches discussed were:

- Sectoral technology cooperation through the sharing of information and transfer of technology and best practices;
- Voluntary or mandatory sectoral actions defined in quantitative terms (e.g. standards) or qualitative terms (e.g. adoption of best practices);
- Crediting of sector-specific actions in developing countries, including through 'sectoral CDM', as a means available to Annex I Parties to reach their emission reduction targets; and
- Separate accounting of sectors outside national emissions totals.

Among the key issues discussed were: the definition of the sectors; the need for flexibility and to take account of national circumstances such as national policies; the national energy base and the availability of natural resources; linkages across sectors; and the need for robust methodologies and sufficient data, in particular on mitigation potentials at the sectoral level.

Some participants referred to potential advantages, suggesting that sectoral approaches could help to deliver mitigation benefits, mobilize technology development and transfer, provide frameworks for financing, and simplify complexities associated with project-based cooperation.

A few participants called for broader consideration of the issue by the AWG-LCA. Others, mainly developing countries, noted that the AWG-LCA's mandate on sectoral approaches is focused on enhancing the implementation of Article 4.1(c) of the Convention

### **Sectoral discussions under AWG-LCA**

In the AWG-LCA, Parties are discussing "cooperative sectoral approaches and sector-specific actions, in order to enhance implementation of Article 4, paragraph 1(c), of the Convention", as described in paragraph 1(b)(iv) of the Bali Action Plan. Article 4.1(c) provides that all Parties, taking into account their common but differentiated responsibilities and their specific national and regional development priorities, objectives and circumstances, shall:

Promote and cooperate in the development, application and diffusion, including transfer, of technologies, practices and processes that control, reduce or prevent anthropogenic emissions of greenhouse gases not controlled by the Montreal Protocol in all relevant sectors, including the energy, transport, industry, agriculture, forestry and waste management sectors.

At an in-session thematic workshop at the upcoming Accra AWG-LCA meeting, Parties will discuss "cooperative sectoral approaches and sector-specific actions" to implement Article 4.1(c) as well as "the effectiveness of mechanisms and tools for technology cooperation in specific sectors".

The European Union, in its submission on cooperative sectoral approaches for AWG-LCA in Accra, offers a set of principles and definitions for sectoral approaches and suggests that deliberations should cover proposals including:

- Market based sectoral approaches giving incentives to developing countries to participate in global mitigation efforts. There are various types of market related sectoral mechanisms which could be explored, among others national or international emissions trading, sectoral no-lose mechanisms and sectoral crediting mechanisms.
- Non-market based sectoral approaches such as cooperative approaches based on technology cooperation and/or domestic mitigation policies could contribute to removing barriers that are specific to certain sectors, increase technology deployment and enhance technology RD&D in key sectors in developing countries – and provide an intermediary step for some developing countries for participation in mitigation actions.

Developing countries, by contrast, have made a clear distinction between discussions taking place in the AWG-KP, which focus on means for Annex I Parties to meet their obligations, and discussions taking place in the AWG-LCA, which focus more specifically on technology transfer.

### “Sector” and “sectoral approach”

The terms “sector” and “sectoral approach” are not formally defined in the Convention or Kyoto Protocol. Among other things, the term “sector” has been used to encompass:

- *Mitigation and adaptation sectors:* The Convention and Kyoto Protocol refer variously to “economic sectors” or “greenhouse gas emitting” sectors and to sectors requiring adaptation to the impacts of climate change. A typology of mitigation and adaptation sectors has been developed by the IPCC and used variously in Technology Needs Assessments, National Adaptation Plans of Action and other contexts.
- *Aviation and marine sectors:* The Kyoto Protocol provides that “Parties included in Annex I shall pursue limitation or reduction of emissions of greenhouse gases not controlled by the Montreal Protocol from aviation and marine bunker fuels, working through the International Civil Aviation Organization and the International Maritime Organization, respectively” (Article 2.2).
- *Industry sectors:* A number of initiatives have focused on significant greenhouse gas emitting industry sectors. The Asia Pacific Partnership on Clean Development and Climate (AP6), for example, focuses on: cleaner fossil energy; renewable energy and distributed generation; power generation and transmission; steel; aluminium; cement; coal mining; and building and appliances.

Parties have also proposed different approaches to address climate objectives on a sectoral basis. For example:

- Japan has promoted domestic target setting and “an internationally cooperative approach” to mitigation involving cross-border sharing of best available technologies and practices. They propose an initial focus on four key “sub-sectors”: coal-fired power generation; steel; cement; and road transport.
- Norway has focused on means to address emissions in the aviation and marine sectors through “cap-levy-and-trade” or emission trading approaches. It argues that aviation and marine transport should be considered separately, but that targets for each should be included in the Kyoto Protocol.
- Argentina, on an informal basis within the G77 and China, has called for a more development-oriented approach commencing with an evaluation of development objectives in each sector or area as the basis for any discussion of mitigation or adaptation, and associated of technology, finance and capacity building.

Among the most active proponents of a binding international approach to sectors is Japan. Drawing on materials distributed at climate meetings held in Bangkok and Bonn, the Japanese approach involves:

- *Domestic target setting:* Economy-wide emission goals would be estimated by accumulating sector-based mitigation potentials that could be achieved by implementing best available technologies and best practices.
- *Internationally cooperative sectoral approach:* Mitigation would be supported by cross-border sharing of best available technologies and best practices, in accordance with common but differentiated responsibilities and respective capacities.
- *Prioritizing “key sub-sectors”:* Initial efforts would prioritize “key sub-sectors” in terms of effectiveness and practicalities, focusing on candidates such as power (e.g. coal-fired power generation), industry (e.g. steel and cement) and transportation (e.g. road transportation).
- *Loans and grants:* Japan has proposed supporting a sectoral approach with finance through their “Cool Earth Partnership” of USD10 billion over the next five years (much of which would be in the form of loans).

Japan argues that a sectoral approach:

- Is comparable and fair means to set quantified national emission reduction targets, and contribute to enhance their measurable, reportable and verifiable actions;
- Would not replace quantified national emission reduction targets;

- Allows effective and efficient sector-based mitigation actions; and
- Is effective in addressing carbon leakage.

Japan has promoted a sectoral approach outside the UNFCCC process through a Paris Workshop on Sectoral Approaches (8 May 2008), at the 24-28 May 2008 G8 Environment Ministers Meeting and at the 8 July 2008 G8 Meeting in Toyako, Hokkaido.

### **Links between sectoral approaches and competitiveness**

Proposals by developed countries for sectoral approaches are motivated – at least in significant part – by concerns about competitiveness. They reflect the concerns (expressed particularly by energy-intensive industries and organized labour) that the costs of complying with new domestic regulations, carbon taxes or cap-and-trade systems will:

- Reduce the competitiveness of their firms and products in domestic markets;
- Reduce the competitiveness of their firms and products in international markets; and/or
- Cause the migration of energy intensive industries (e.g. chemical, steel, cement) to developing countries – a tendency referred to as “carbon leakage”.<sup>2</sup>

Among other things, sectoral approaches are likely seen by some developed countries as:

- A practical way of breaking the mitigation challenge into manageable parts;
- A means to proactively address competitiveness, technology, finance and other concerns on an industry-by-industry basis;
- A means to establish new mitigation targets, goals or other commitments for developing countries;
- A means to secure “measurable, reportable and verifiable” mitigation actions by developing countries;
- A means to gain new competitive advantages by their firms and/or avoid competitive disadvantages resulting from climate change and response measures; and/or
- A justification for unilateral trade measures against developing countries in the event that multilateral negotiations are, in their view, unsuccessful.

Just as many developed countries see sectoral approaches as a means to protect or enhance their competitive position, they are seen by many developing countries as a means to challenge or undermine theirs. Developing countries are appropriately concerned that binding, international-level agreements on a sectoral basis could adversely affect their competitive position in international economic relations.

### **Concerns about competitiveness and trade**

The specific linkages between sectoral approaches, competitiveness and trade will depend, in large part, on the specific nature and scope of any agreed sectoral approach. There is, nevertheless, a range of general issues that should be considered by developing countries when engaging in discussions of sectoral approaches.

A principal issue is the potential use of sectoral approaches to “tilt the playing field” and to pass on to developing countries the costs incurred by developed countries of implementing their obligations under the Convention and Kyoto Protocol. In particular, concern arises that sectoral approaches may be used to:

- Justify efforts by developed countries to alter the trade-related domestic policies of developing countries – for example, by removing barriers to markets access for products and technologies produced by developed countries, or strengthening intellectual property rights over low-emission technologies or climate-resistant crops required for adaptation that are “owned” by companies in developed countries; and/or

- Justify the imposition by developed countries of new trade barriers on products or technologies from developing countries – for example, by justifying new trade bans, border adjustments or standards that limit trade in energy- or GHG-intensive products such as steel or cement or impose other trade-related barriers.

Sectoral agreements may affect competitive conditions and trade in a number of ways:

- They could directly establish new rules or standards at the international level for GHG-intensive industries, imposing costs on products exported from developing countries;
- They could provide a justification for measures taken by developed countries at the national level to impose costs on exports from developing countries at the border or through internal regulations (e.g. by bolstering arguments that the developed countries' measures are consistent with WTO rules, or justified by WTO environmental exceptions); or
- They could, even if sectoral discussions ultimately prove unsuccessful, support the argument by developed countries that unilateral measures are necessary, justified and do not constitute disguised restrictions on international trade.

A number of developed countries have already proposed new trade-related measures to address climate change. America's Climate Security Act, for example, would require importers to buy allowances to cover the costs of the greenhouse gasses emitted during the production of products imported by them. These provisions would apply in the context of a United States domestic cap-and-trade system, and would cover exports from countries that lacked a similar system or were failing to apply best available technologies.<sup>3</sup> Similar provisions have been proposed in European legislation. These measures (as well as protecting industries in developed countries) are designed to operate as a "stick" to encourage larger developed countries to reduce their emissions in the context of a new multilateral climate agreement, on the basis that their failure to do so may result in unilateral trade measures by developed countries.

### **Possible trade-related measures**

Broadly speaking, developed countries have a range of potential trade-related measures that could be applied to restrict access to their market and alter the conditions of competition:

- *Punitive tariffs or quantitative* measures could be imposed to ban or limit market access for products that are seen as harming the climate or failing to internalize the costs of climate-related environmental measures.
- *Anti-dumping duties* could be applied to the exports of foreign producers drawing on the argument that their goods that are produced in a manner that does not internalize the full (carbon-related) costs of their production, are exported at below their normal value and cause material injury to competing domestic industries. This seems to be the basis of "environmental dumping" arguments.
- *Anti-subsidy duties* could also be applied drawing on the argument that the failure by a government to impose suitable regulations, carbon taxes or carbon cap-and-trade systems constitutes a financial contribution that confers a benefit on industries or regions which causes an "injury", "serious prejudice" or a "nullification of benefits" expected from the GATT.
- *Border adjustment* of a domestic regulation or system that applies equally to foreign and domestic products (such as that proposed in America's Climate Security Act). Such a border adjustment could include the application of domestic carbon taxes to imported products or require the purchase of domestic carbon credits or other forms of emission allowances as a condition of entry into the market.
- *Standards and domestic regulations* could be used to increase barriers to trade in products from developing countries that do not meet energy- or carbon-efficiency standards imposed nationally, or agreed through regional or international processes (including a sector-based agreement).

Of these, two kinds of measures – border adjustments and standards/domestic regulations – are most likely to withstand WTO scrutiny and thus of most serious concern to developing countries. In each case, the terms of any sectoral approach would play a role in defining the terms upon which a developed country could impose trade-related measures on firms or products from developing countries.

## **Border adjustments and sectoral approaches**

As noted, both the United States and EU are publicly discussing “border adjustments” – i.e. a tax, permit or other charge – designed to internalize the GHG-related costs of products entering their economies. Under the WTO, countries are permitted to impose border adjustments under certain circumstances. Article II of the GATT provides that GATT rules about maximum ceilings for tariffs do not prevent a WTO Member from:

...imposing at any time on the importation of any product ... a charge equivalent to an internal tax ... in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part.

Drawing on these provisions, WTO Members could characterize their competitiveness measures as a WTO permissible “border adjustment” of a domestic cap-and-trade or carbon tax scheme. They would argue that the charge applied at the border on a GHG-intensive product such as steel or cement is equivalent to an internal tax applied to steel or cement produced domestically.<sup>4</sup> If such a scheme does not discriminate between products from different exporting countries, and does not discriminate between domestic and imported products then it could conceivably be permissible under WTO rules.

A sectoral approach (for example for steel or cement) would contribute to defining the terms upon which any such border measure would be applied. Among other things, it could define national targets or goals for emissions reduction in a specific sector, it could define the technologies or approaches reasonably available to an exporter, or it could define the permissible “GHG-content” of any product in international trade (and hence the basis of the border adjustment). The effort to negotiate such a sectoral agreement – even if unsuccessful – would likely be used to support claims that the subsequent unilateral measures were not “arbitrary” or “unjustifiable” for the purposes of WTO environmental exceptions (discussed below). Regardless of the specific measures defined, it is likely that a WTO panel would look to the terms of the international agreement when defining whether a national measure is consistent with relevant WTO rules.

## **Standards, domestic regulations and sectoral approaches**

Any agreed sectoral approach is also likely to prove relevant in the event that domestic regulations – i.e. technical regulations, standards, labels or other such measures – are challenged at the WTO. Article III of the GATT establishes the “national treatment” rule and requires that the products of exporting countries be treated “no less favourably” than “like products” manufactured in the importing country. In the event that a domestic regulation in a developed country is challenged on the basis that it limits exports from developing countries, a WTO panel may be asked to evaluate whether domestic and foreign products are “like” and, if so, whether there is “discrimination”.

One key issue is whether a product such as steel produced using a GHG-intensive process or production method (PPM) would be considered “like” one that is produced using a GHG-efficient process? If they are found to be alike, then discrimination between domestic and imported steel would contravene WTO rules. If they are not alike, then different treatment (e.g. a label noting GHG-intensity in production) would be permissible. Typically, developing countries have argued that products are alike if they are physically similar – i.e. steel is steel – and so discrimination based on PPMs (unless they affect the physical character of the product) is not permissible. Though jurisprudence under the GATT supported this view (e.g. the Tuna-Dolphin case), jurisprudence under the WTO is significantly less clear, with the WTO Appellate Body stating they must take into account “all pertinent evidence” focusing on the competitive relationship of the products in the marketplace.<sup>5</sup>

A second issue is whether the domestic measure constitutes “discrimination” between like products. WTO rules permit different domestic measures for imported and domestically produced products. The principal issue is whether the measure results in treating the imported product less favourably in terms of its opportunities to compete in the domestic marketplace. The adjudicatory body will look both at any explicit differences set out in the measure on paper (de-jure discrimination) as well as any discriminatory effect in practice (de-facto discrimination). A WTO adjudicatory body would look to the measure and specific facts of the case to determine whether imported products are treated less favourably.

In an evaluation both of “like products” and “discrimination” it is likely that a WTO panel would consider the terms of

any international agreement relating to trade in the product and/or to measures justifying similar or different treatment – including any sectoral approach agreed in the context of the UNFCCC or otherwise. The terms of the sectoral approach could, for example, play a role in determining the extent to which different building materials are considered similar or different, or what would constitute “discrimination” in the treatment of those products in international trade.

### **WTO environmental exceptions**

In the event that a measure is found to contravene either WTO rules on border adjustments (Article II) or on national treatment (Article III), or to contravene other relevant GATT/WTO rules – for example, the “most favoured nation” rule in Article I, or the ban on quantitative restrictions in Article XI) – then the measure would be evaluated against the exceptions set out in Article XX of the GATT.

Among other things, Article XX permits measures relating to the conservation of exhaustible natural resources that are not arbitrary and that take into account the conditions of exporting countries. In applying any such provisions, it seems likely based on previous practice that a WTO adjudicatory body could take into consideration a range of factors including<sup>6</sup>:

- Whether the implementing country had made serious, good faith, across-the-board efforts to reach a negotiated solution with exporting countries in order to resolve issues relating to international competitiveness and/or related environmental issues before imposing unilateral measures (including, potentially, their good faith participation in relevant multilateral negotiations). Efforts to negotiate sectoral agreements, or negotiate with “major economies” or to provide technology or finance on a sectoral basis would likely be relevant to a decision by a WTO adjudicatory body as to whether a measure is justified.
- The extent to which the measures reflect and take into account the different conditions which may occur in the territories of those other countries, and the comparability of efforts to work with those countries. A WTO adjudicatory body would look to the sectoral agreement as evidence of efforts to negotiate with countries covered by the measure, as well as how effectively the sectoral agreement or any associated domestic measure reflects the different situations of importing countries.
- The transparency and predictability of the process, the availability of review of decisions, the provision of formal, reasoned decisions in writing and other factors associated with due process.
- The relevant provisions of related international agreements – for example, the Climate Convention and Kyoto Protocol’s provisions calling on developed countries to take a lead in addressing climate change, provide supportive measures such as technology transfer and financial assistance, and explicitly call for efforts to minimize adverse effects on international trade and the economic prospects of developing countries.

Any sectoral approach would, again, likely be considered relevant by a WTO adjudicatory body when applying the standards set out in Article XX. In particular, they would likely play into the body’s determination of whether the measure was applied in a manner that constituted arbitrary or unjustifiable discrimination or a disguised restriction on international trade.

### **Conclusion**

When considering discussions of sectors and sectoral approaches, developing countries may wish to carefully evaluate the likely implications for the competitive position of their key sectors in international economic relations. In particular, efforts by developed countries to smuggle competitiveness issues into the UNFCCC negotiations under the guise of sectoral approaches should be clearly identified by developing countries as running counter to the principle of common but differentiated responsibility and, potentially, risking efforts to advance the negotiations. Any effort to advance the negotiations should be based firmly on common but differentiated responsibility, as well as other relevant provisions of the Convention.

Discussions in AWG-LCA on sectoral approaches should be on the basis of Article 4.1 (c) in accordance with the mandate of the Bali Action Plan. Developing countries, especially in their national climate policies should be able to plan actions including sector by sector, and to seek international assistance (finance, technology and capacity

building) for actions on an overall as well as sectoral basis. These national plans should not, however, be subjected to “international harmonisation of standards” by sectors, which would lead to the kinds of problems raised in this paper. Indeed, those who promote this international harmonisation and competitiveness approach are doing a disservice in that a confusion may arise which may give a negative connotation to sectoral approaches as a whole, including useful national-level sectoral policies in developing countries.

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**Annex 1**  
**Selected provisions of the UNFCCC referring to sectors** (emphasis added)

**Article 3.3**

The Parties should take precautionary measures to anticipate, prevent or minimize the causes of climate change and mitigate its adverse effects. Where there are threats of serious or irreversible damage, lack of full scientific certainty should not be used as a reason for postponing such measures, taking into account that policies and measures to deal with climate change should be cost-effective so as to ensure global benefits at the lowest possible cost. To achieve this, such policies and measures should take into account different socio-economic contexts, be comprehensive, cover all relevant sources, sinks and reservoirs of greenhouse gases and adaptation, and comprise **all economic sectors**. Efforts to address climate change may be carried out cooperatively by interested Parties.

**Article 4.1(c)**

Promote and cooperate in the development, application and diffusion, including transfer, of technologies, practices and processes that control, reduce or prevent anthropogenic emissions of greenhouse gases not controlled by the Montreal Protocol in **all relevant sectors, including the energy, transport, industry, agriculture, forestry and waste management sectors**;

**Annex 2**  
**Selected provisions of the Kyoto Protocol referring to sectors** (emphasis added)

**Article 2.1(a)**

Each Party included in Annex I, in achieving its quantified emission limitation and reduction commitments under Article 3, in order to promote sustainable development, shall:

- (a) Implement and/or further elaborate policies and measures in accordance with its national circumstances, such as:
- (i) Enhancement of **energy efficiency in relevant sectors** of the national economy;
  - (ii) Protection and enhancement of sinks and reservoirs of greenhouse gases not controlled by the Montreal Protocol, taking into account its commitments under relevant international environmental agreements; promotion of sustainable forest management practices, afforestation and reforestation;
  - (iii) Promotion of sustainable forms of agriculture in light of climate change considerations;
  - (iv) Research on, and promotion, development and increased use of, new and renewable forms of energy, of carbon dioxide sequestration technologies and of advanced and innovative environmentally sound technologies;
  - (v) Progressive reduction or phasing out of market imperfections, fiscal incentives, tax and duty exemptions and subsidies **in all greenhouse gas emitting sectors** that run counter to the objective of the Convention and application of market instruments;
  - (vi) Encouragement of appropriate **reforms in relevant sectors** aimed at promoting policies and measures which limit or reduce emissions of greenhouse gases not controlled by the Montreal Protocol;

(vii) Measures to limit and/or reduce emissions of greenhouse gases not controlled by the Montreal Protocol in the **transport sector**;

(viii) Limitation and/or reduction of methane emissions through recovery and use in waste management, as well as in the production, transport and distribution of energy;

## Article 2.2

The Parties included in Annex I shall pursue limitation or reduction of emissions of greenhouse gases not controlled by the Montreal Protocol from aviation and marine bunker fuels, working through the International Civil Aviation Organization and the International Maritime Organization, respectively.

## Article 6.1

For the purpose of meeting its commitments under Article 3, any Party included in Annex I may transfer to, or acquire from, any other such Party emission reduction units resulting from projects aimed at reducing anthropogenic emissions by sources or enhancing anthropogenic removals by sinks of greenhouse gases **in any sector of the economy**, provided that:

(a) Any such project has the approval of the Parties involved;

(b) Any such project provides a reduction in emissions by sources, or an enhancement of removals by sinks, that is additional to any that would otherwise occur;

(c) It does not acquire any emission reduction units if it is not in compliance with its obligations under Articles 5 and 7; and

(d) The acquisition of emission reduction units shall be supplemental to domestic actions for the purposes of meeting commitments under Article 3.

## Article 10(b)(i)

All Parties, taking into account their common but differentiated responsibilities and their specific national and regional development priorities, objectives and circumstances, without introducing any new commitments for Parties not included in Annex I, but reaffirming existing commitments under Article 4, paragraph 1, of the Convention, and continuing to advance the implementation of these commitments in order to achieve sustainable development, taking into account Article 4, paragraphs 3, 5 and 7, of the Convention, shall:

...

(b) Formulate, implement, publish and regularly update national and, where appropriate, regional programmes containing measures to mitigate climate change and measures to facilitate adequate adaptation to climate change:

(i) Such programmes would, *inter alia*, concern **the energy, transport and industry sectors** as well as agriculture, forestry and waste management. Furthermore, adaptation technologies and methods for improving spatial planning would improve adaptation to climate change; and ...

## Annex A: Sectors/source categories

Energy

Fuel combustion

Energy industries

Manufacturing industries and construction

Transport

Other sectors

Other

Fugitive emissions from fuels

Solid fuels

Oil and natural gas  
Other  
Industrial processes  
Mineral products  
Chemical industry  
Metal production  
Other production  
Production of halocarbons and sulphur hexafluoride  
Consumption of halocarbons and sulphur hexafluoride  
Other  
Solvent and other product use  
Agriculture  
Enteric fermentation  
Manure management  
Rice cultivation  
Agricultural soils  
Prescribed burning of savannas  
Field burning of agricultural residues  
Other  
Waste  
Solid waste disposal on land  
Wastewater handling  
Waste incineration  
Other

### **Annex 3**

#### **Selected provisions of the UNFCCC relating to competitiveness and trade**

##### **Preamble**

...

*Noting* that the largest share of historical and current global emissions of greenhouse gases has originated in developed countries, that per capita emissions in developing countries are still relatively low and that the **share of global emissions originating in developing countries will grow to meet their social and development needs**,

...

*Acknowledging* that the global nature of climate change calls for the widest possible cooperation by all countries and their participation in an effective and appropriate international response, **in accordance with their common but differentiated responsibilities and respective capabilities and their social and economic conditions**,

...

*Recognizing* that States should enact effective environmental legislation, that environmental standards, management objectives and priorities should reflect the environmental and developmental context to which they apply, and that **standards applied by some countries may be inappropriate and of unwarranted economic and social cost to other countries, in particular developing countries**,

...

*Recognizing also* the need for **developed countries to take immediate action** in a flexible manner on the basis of clear priorities, as a first step towards comprehensive response strategies at the global, national and, where agreed, regional levels that take into account all greenhouse gases, with due consideration of their relative contributions to the enhancement of the greenhouse effect,

...

*Affirming* that responses to climate change should be coordinated with social and economic development in an integrated manner with a view to avoiding adverse impacts on the latter, **taking into full account the legitimate**

**priority needs of developing countries for the achievement of sustained economic growth and the eradication of poverty,**

...

*Recognizing* that all countries, especially developing countries, need access to resources required to achieve sustainable social and economic development and that, ***in order for developing countries to progress towards that goal, their energy consumption will need to grow*** taking into account the possibilities for achieving greater energy efficiency and for controlling greenhouse gas emissions in general, including through the application of new technologies on terms which make such an application economically and socially beneficial,

## **Article 2**

The ultimate objective of this Convention and any related legal instruments that the Conference of the Parties may adopt is to achieve, in accordance with the relevant provisions of the Convention, stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system. Such a level should be achieved within a time frame sufficient to allow ecosystems to adapt naturally to climate change, to ensure that food production is not threatened and ***to enable economic development to proceed in a sustainable manner.***

## **Article 3.5**

The Parties should cooperate to ***promote a supportive and open international economic system that would lead to sustainable economic growth and development in all Parties, particularly developing country Parties,*** thus enabling them better to address the problems of climate change. ***Measures taken to combat climate change, including unilateral ones, should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade.***

## **Article 4.7**

The extent to which developing country Parties will effectively implement their commitments under the Convention will depend on the effective implementation by developed country Parties of their commitments under the Convention related to financial resources and transfer of technology and will take fully into account that economic and social development and poverty eradication are the first and overriding priorities of the developing country Parties.

## **Annex 4**

### **Selected provisions of the Kyoto Protocol relating to competitiveness and trade**

#### **Articles 2.3 and 2.4**

3. The Parties included in Annex I shall strive to implement policies and measures under this Article in such a way as to minimize adverse effects, including the ***adverse effects of climate change, effects on international trade, and social, environmental and economic impacts on other Parties, especially developing country Parties*** and in particular those identified in Article 4, paragraphs 8 and 9, of the Convention, taking into account Article 3 of the Convention. The Conference of the Parties serving as the meeting of the Parties to this Protocol may take further action, as appropriate, to promote the implementation of the provisions of this paragraph.

4. The Conference of the Parties serving as the meeting of the Parties to this Protocol, if it decides that it would be beneficial to coordinate any of the policies and measures in paragraph 1(a) above, taking into account different national circumstances and potential effects, shall consider ways and means to elaborate the coordination of such policies and measures.

#### **Article 3.14**

Each Party included in Annex I shall strive to implement the commitments mentioned in paragraph 1 above in such

a way as to **minimize adverse social, environmental and economic impacts on developing country Parties**, particularly those identified in Article 4, paragraphs 8 and 9, of the Convention. In line with relevant decisions of the Conference of the Parties on the implementation of those paragraphs, the Conference of the Parties serving as the meeting of the Parties to this Protocol shall, at its first session, consider what actions are necessary to minimize the adverse effects of climate change and/or the impacts of response measures on Parties referred to in those paragraphs. Among the issues to be considered shall be the establishment of funding, insurance and transfer of technology.

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<sup>1</sup> The following discussion draws directly from Report of the Ad Hoc Working Group on Further Commitments for Annex I Parties under the Kyoto Protocol on the first part of its fifth session, held in Bangkok from 31 March to 4 April 2008 (FCCC/KP/AWG/2008/2, 15 May 2008)

<sup>2</sup> This phenomena is often discussed using the term “carbon leakage”, a term that describes how when a greenhouse gas-intensive industries moves from a developed to a developing country (without emission caps) there may be no significant change in greenhouse gas emissions (the products will still be produced and exported to the developed country), but that that developed country’s emissions will go down as the associated emissions will now occur outside its jurisdiction in a developing country.

<sup>3</sup> America’s Climate Security Act (Senate bill 2191) was introduced by Senators Lieberman (Connecticut, Independent/Democrat) and Warner (Virginia, Republican), and has been reviewed favorably on 5 December 2007 by the U.S. Senate Environment and Public Works Committee. The other major proposal is that introduced by Senators Bingaman (New Mexico, Democrat) and Specter (Pennsylvania, Republican) (Senate bill 1766). Each proposal requires the purchasing of emissions allowances for products imported from countries determined not to be making sufficient efforts to address climate change.

<sup>4</sup> *Id.*, at page 3

<sup>5</sup> *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, AB-2000-11, WT/DS135/AB/R (2001) (Report of the Appellate Body), at paragraphs 101-103

<sup>6</sup> See, for example, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, AB-1998-4, WT/DS58/AB/R (1998) (Report of the Appellate Body). See also WTO Appellate Body Report: *United States – Import Prohibition Of Certain Shrimp and Shrimp Products* – Recourse to Article 21.5 of the DSU by Malaysia, AB-2001-4, WT/DS58/AB/RW (notably in this case, the WTO Appellate Body clarified its decision in the initial Shrimp decision by stating that the regulating/importing country need not actually reach agreement with exporting countries, but rather must make ongoing serious, good faith efforts to reach a multilateral agreement).