

trade hot topics

Trade Solutions in a Global Green Economy: Small and Vulnerable Economies and the Rio+20 Conference

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Background

The green economy concept is gaining importance in international debates. The Rio+20 conference (United Nations Conference on Sustainable Development to be held in Rio de Janeiro, Brazil, in June 2012) will consider the green economy as one of the two major themes alongside the theme of institutional frameworks. The G20 Summit in Mexico this year also has sustainable development and green growth as a key issue on the agenda. But what does the green economy mean at country level? What happens when the green economy concept is operationalised in a global economy? And what are the trade solutions for small and vulnerable economies (SVEs) in such a global green economy?

This issue of *Commonwealth Trade Hot Topics* argues that SVEs have three interrelated reasons for an ambitious outcome at the Rio+20 conference and the most important but often overlooked reasons relate to trade. First, SVEs are affected disproportionately by global environmental changes, e.g. climate change, while they have contributed least to the problem. Hence, global action to avert environmental damages is important. Second, SVEs, due to their size and flexibility, should be well placed to implement green policies that reduce

inefficiencies in their own policies and enhance growth and foster structural transformation and innovation. Thus a green economy roadmap will also be important for SVEs themselves. And third, as explained further in the paper, SVEs are affected indirectly because global environmental trends such as increasing natural resource scarcity (e.g. the demand for energy and water is expected to grow by 40% and for food by 50% by 2030 compared to present levels) will affect the volume and terms of international trade and investment flows which are very important for growth in SVEs. In fact, the relative development position of many SVEs is likely to worsen under business as usual trends (e.g. higher food prices negatively affect SVEs who are net food importing as a group). SVEs have, therefore, serious interest in an ambitious outcome at Rio+20 (and the G20) so that the conference can set the scene for real changes. SVEs will need to seek alliances that can help them achieve such an outcome.

A global green economy

The concept of the green economy is built around an integrated approach that provides new opportunities for economic growth by directing greater investments into sectors that enhance natural capital and generate new sources of employment, while

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reducing environmental risks. According to the Rio+20 zero draft, a green economy 'should protect and enhance the natural resource base, increase resource efficiency, promote sustainable consumption and production patterns, and move the world toward low-carbon development'.

The paper titled *From Growth to Green Growth* available from the Green Growth Knowledge Platform (GGKP)¹ argues that green growth is about making growth processes resource-efficient, cleaner and more resilient without necessarily slowing them. There are a number of ways in which a green economy approach can be good for the environment and for growth. For example, environmental capital can be a complement to other types of capital, although in some cases they will be substitutes. Environmental policies can foster growth by (i) enhancing the effective supply of capital, labour and ecosystem services (i.e. environmental capital); (ii) raising productivity by solving market failures; and (iii) shifting the production possibilities frontier by stimulating green innovation. Of course similar arguments can be made about capital and labour policies, but the point here is that each country should be able to increase growth by addressing inefficiencies in existing environmental policies (which inter alia can be used to enhance environmental capital). A previous Overseas Development Institute (ODI) study examined firm level data in 24 developing countries and found that high productivity and energy efficiency go together at firm level. Further, and important for vulnerable SVEs, smart environmental policies can reduce the vulnerability to environmental shocks.

The operationalisation of the green economy concept has so far been to regard it as part of a *closed economy* perspective. Trade, capital flows and migration are seen only as ad hoc factors, and not central to the analysis (sometimes not even mentioned). Most of the current papers on trade and green growth do not really take a full trade approach towards a green economy. Such papers (e.g. for the inaugural GGKP conference) examine, for example, whether green subsidies are trade distortionary, how environmental regulation affects competitiveness, whether there is carbon leakage from one country to another, or the appropriateness of border tax adjustments. But they do not try to understand whether and how expected global environmental patterns might affect relative development paths of different countries by affecting relative endowments. The latter set of issues seems much more important for SVEs which

due to their inherent characteristics are more open than others.

Trade theory however considers explicitly *international economic relations and relative factor endowments across countries* and hence foresees central role for trade and trade policy. Seen in this context a global green economy concept is based on factor price equalisation across countries (e.g. a common price of land, water, energy, capital, and skills across countries). In a *closed* economy, what matters is the relative price of land, water, carbon, pollution, etc., to labour or capital in the same economy. By contrast, in a *globalised* economy, what matters is whether land (or water) prices differ across countries and whether relative factor endowments differ. The comparative advantage of countries changes with shifts in relative prices. In business as usual scenarios, global increases in the demand for natural resources will affect relative prices which will affect global trade and investment. It also means that if one country implements a green (or other) policy, it is very likely that relative prices shift and hence that all countries are affected via the trade and factor price equalisation route. It is in this area where SVEs will be relatively vulnerable in the long term due to their inherent characteristics.

Take land as an example of how factor price equalisation might work. When there are large differences in land endowments leading to differential land prices, open economies and well functioning markets should cause land prices to equalise through trade, investment and migration. An example of this process at work is overseas land deals. With land (and water) not available or with land prices high but the search for food security ongoing, investment and trade has been flowing from arable land (and water) scarce countries (e.g. Saudi Arabia and South Korea) to countries with 'abundant' arable land (especially in Africa where land prices are between one-tenth and one-hundredth of that in the European Union or USA). Over time, and when markets function appropriately, such increased demand should raise the price of land in investment receiving countries while reducing it in land scarce countries. When governed well this should provide growth opportunities for receiving countries.

A further example relates to climate change. Climate change affects agricultural productivity, with different effects in different areas. For example, it

¹ <http://www.greengrowthknowledge.org/Pages/Reports.aspx>

may reduce the productivity in arid areas such as North Africa, but it may increase it in other areas (e.g. North America). This should provide export opportunities for some countries, and higher imports for others. Similarly, a tax or subsidy on carbon use in one country will affect the relative price of carbon worldwide which should alter international economic flows.

Thus, relative endowments and relative prices across countries matter. Hence, using a globalised conceptualisation of the green economy (a global green economy) any factor that affects the prices or endowments of environmental assets anywhere in the world will affect any other country through trade and investment. Of course, in reality interconnections are incomplete and factors of production are not perfectly mobile across sectors and countries, or trade is restricted, but the global effects cannot be disregarded any longer. And this is particularly relevant for SVEs.

Operationalising the global green economy concept for small and vulnerable economies

There are three ways in which SVEs are affected through the presence or absence of a global green economy approach. In each of these pathways, there is a special role for SVEs.

First, SVEs are **affected directly** by global environmental challenges. Climate change is expected to affect SVEs disproportionately through rising sea levels and reduced yields in, for example, Sub-Saharan Africa. Some environmental effects would even call into question the existence of some small island states. While the effects are expected to be severe, the contribution of SVEs to global environmental problems is small. Thus more ambitious commitments globally to a green economy worldwide would reduce the negative direct effects on SVEs.

Second, in the **green (closed-) economy approach**, each country should contribute and should be able to gain, and the scope for SVEs seems particularly large. As argued previously, the development of small states depends proportionally more on discrete actions steering an economy (see e.g. Singapore, Dubai and Mauritius for successful state involvement). SVEs should therefore be able to solve market and co-ordination failures that reduce inefficiencies and promote innovation. Of course there are risks to the implementation of green industrial policies, but there also opportunities for innovation and growth.

Third, SVEs are particularly vulnerable to the **global economic links implicit in the global green economy concept**. While the spotlight might point to the above two channels, it is this third channel which might turn out to be very significant for SVEs in the future. Trade and financial flows are considered, below.

Trade

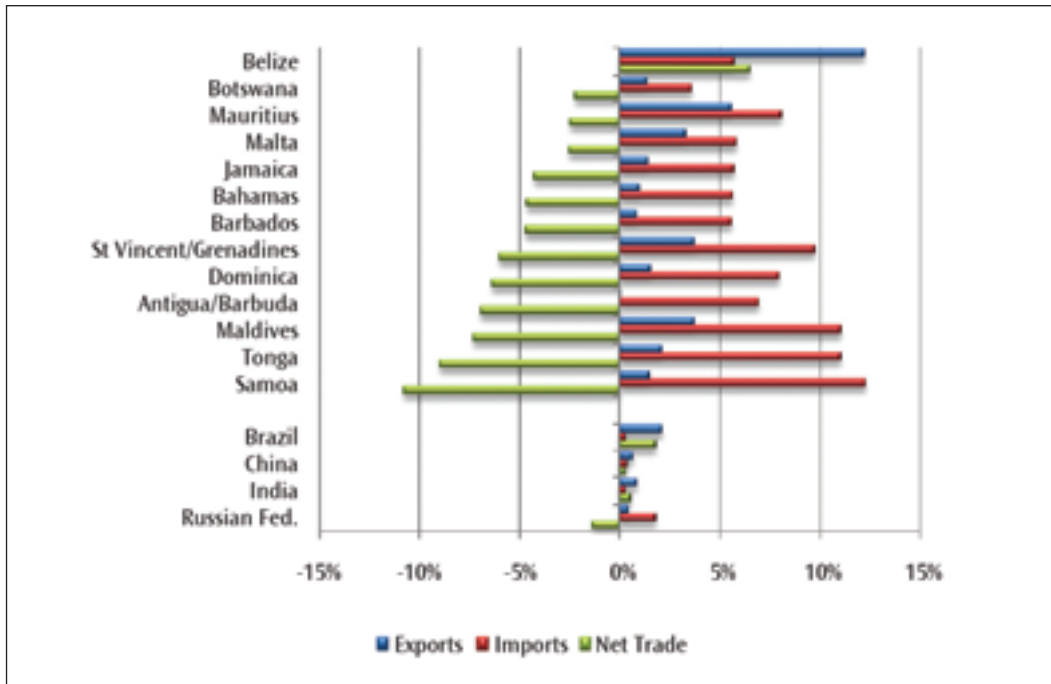
Global pressures on the world's natural resources are severe. Demand for water, energy and food is expected to increase by half in the coming two decades (see e.g. UN global sustainability panel, 2012; or consultations for the European Report on Development 2011/2012) and in a business as usual scenario without significant innovation (i.e. failure of the green economy concept) this will increase the demand and eventually the relative price of land, water and ecosystems. Consequently, the relative price of food, which relies increasingly on scarce resources, may also continue to increase.

It is argued here that such business as usual factors will affect SVEs in particular. SVEs are relatively open to the global economy and especially with respect to food imports. Commonwealth SVEs with relevant data include Samoa, Tonga, Maldives, Antigua and Barbuda, Dominica, St Vincent and the Grenadines, Barbados, The Bahamas, Jamaica, Malta, Mauritius, Botswana and Belize.

Small states have relatively little availability of arable land and therefore rely on virtual land and water imports, that is, imports of commodities such as cereals that embody a lot of land and water. Globally, pressures on land and land prices derive from the need to feed a growing and increasingly rich population as well as the need for renewable energy such as biofuels which are also land intensive. Of course, some SVEs might gain. Guyana and Belize have arable land, Trinidad and Tobago has oil, but as a group SIDS (small island developing states) — and especially the sample of 13 Commonwealth small states which report data—are net food and energy importers (see Figures 1—2). Price elasticities for SVE imports also tend to be low so that an increase in import prices will lead to a higher import bill.

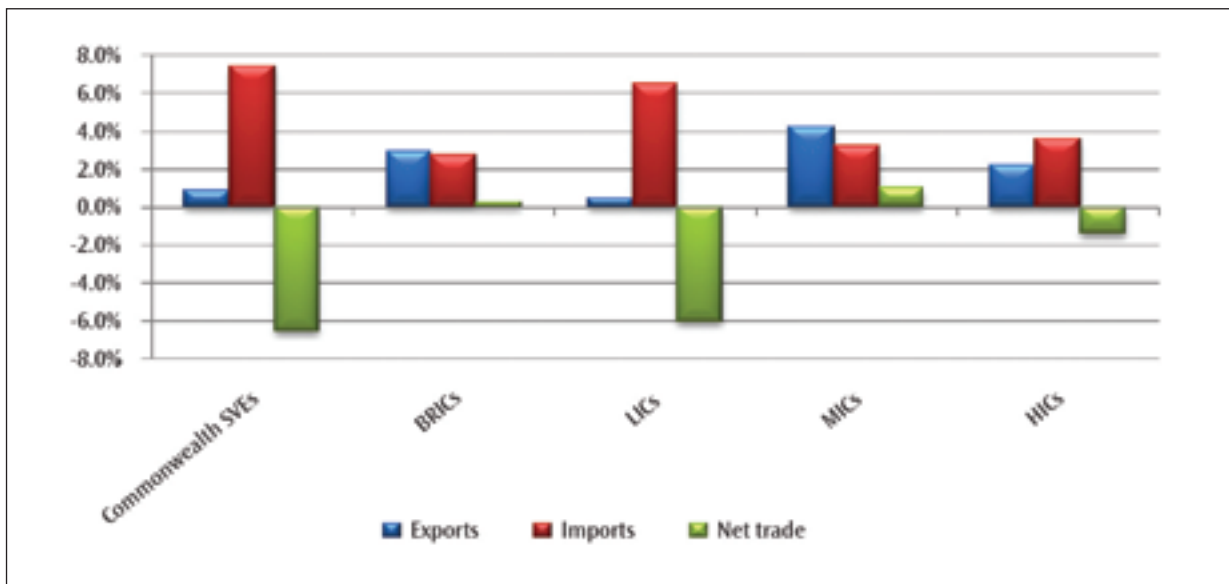
By contrast, many small states depend on high-elasticity exports such as tourism and these are being affected by higher resource prices. For example, if the price of fossil fuel increases (either because of a tax on fossil fuel, or because of increased scarcity of energy sources), the demand

Figure 1: Food trade and food trade balance as percentage of GDP, 2010, by country



Source: UN Comtrade, WDI

Figure 2: Energy trade and energy trade balance as percentage of GDP, 2010, by country group



Source: UN Comtrade, WDI; energy is SITC 33–35, oil, gas and electricity

for tourism (in volume and value terms) which depends on fossil fuels through long-haul flights will decrease. Thus fossil fuel taxes may affect exports of services from remote island states by changing the comparative advantage of tourism in small states. Increased transport costs may also affect exports of sugar and bananas.

There are opportunities for small states who can manage to position themselves in high growth markets. Some small states (e.g. Barbados, Mauritius) have developed a financial services sector which can develop financial activities linked to the

green economy, such as spot markets for different qualities of fresh water. Others may specialise in transport of water and energy or related products. Some small states (e.g. Lesotho, Swaziland, Nepal) are well positioned now or for the future to export hydropower to large neighbours. Those countries that govern these export activities well can transform their economies structurally. G20 countries can help by offering innovative preferential schemes for SVEs and other poorer economies including derogations from border tax adjustments.

Financial flows

Small states are characterised by the small size of their domestic markets, limited natural resources and labour supply, a high degree of economic concentration and openness to trade, and high transport costs due to their peripherality. Many of these intrinsic characteristics already weaken the locational advantage crucial for attracting foreign direct investment (FDI) inflows.

Global environmental challenges can threaten or stimulate such flows, depending on government policies. Increased demand for food should lead to more investment in those areas that have sufficient arable land, fresh water, and high quality ecosystem services. The need to address carbon space necessitates investment in renewable energy sources which frequently requires land and water. This is a tall order for SVEs: they lack land in absolute and per person terms, and they often lack large quantities of water, so they need to act to address this gap. On the other hand, they have opportunities for renewable energy (e.g. geothermal, solar, tidal wave power), for enhancing ecosystems (they are complementary to tourism activities) and for developing financial activities mentioned above.

Climate finance should also flow to enhance promising activities to address the otherwise harmful effects of global environmental pressures on the relative position of SVEs. A good example is Reducing Emissions from Deforestation and Forest Degradation in Developing Countries (REDD). This should benefit countries with forests such as Guyana, Papua New Guinea and Cameroon. There has indeed been special attention to the plight of SVEs in the start-up phase of climate funds. The purpose of such climate finance is to provide a global public good (a better environment) and so it should in the long run be funded in addition to existing aid. Because small states will need to undertake significant adjustments to changing trade and investment patterns and promote structural transformation, this would need aid for trade.

Possible positions for SVEs at Rio+20

In the global green economy, SVEs could follow a three pronged approach. Of course SVEs need to act at home. They need to set the right rules, reduce inefficient resource use, promote green innovation and protect ecosystems that are vital to some of their major economic activities. However, their main interest at Rio will be to reduce global

environmental pressures because this will affect them directly and indirectly (e.g. high food and energy prices).

What would an ambitious Rio plan look like? Building on the Barbados and Mauritius meetings on sustainable development, SVEs now need to spell out what the global community must do at Rio+20:

- (i) **Common and differentiated responsibilities.** It is unlikely there will be one set of rules and commitments for all — a well established set of principles since Rio 1992. At Rio+20 it would be useful to have a register of each country's contribution to the green economy commensurate to the level of development and previous pressures on natural resources. It is particularly important that the G20 countries that are responsible for 85 per cent of GDP and nearly all of the level and changes in environmental pressures bear their responsibilities and make plans to increase resource efficiencies substantially. SVEs could look to establishing coalitions with like-minded countries as they did during the climate change negotiations in Durban, South Africa, in 2011 and argue for establishing ambitious commitments with legal force.
- (ii) **International governance arrangements.** SVEs often lack a strong voice in negotiations so they need global bodies that could support their views. At the World Trade Organization (WTO) one country has one vote. While some have proposed a WTO-style agreement on global environmental rules to protect environmental global public goods relevant to safeguard development and this seems inevitable in the very long run, it is important that the Rio process makes some first instalments on sustainable development governance frameworks. It could help upgrade the UN Environment Programme (UNEP) and give it the task of assessing country registers so that a global body can promote ambitious environmental policies. Some groups such as the EU seem to be willing to support this idea, given their recent speeches.
- (iii) **Free trade.** Given that SVEs do not possess all the natural resources required to satisfy their food needs, they are heavily dependent on free access to natural resource in other countries through virtual trade in natural resources, or trade in commodities. Thus SVEs have a strong interest in a set of strong, non-discriminatory rules governing (virtual) trade in natural resources.

They will also need to play an active role in ensuring the WTO establishes a set of rules banning export restrictions that threaten food security in small states. They may also want to seek innovative preferences (and derogations from any new schemes such as border tax adjustments) due to their inherent characteristics.

- (iv) **Adequate pricing and valuation of ecosystem services worldwide.** This could involve the abolition of distortionary subsidies (e.g. for fossil fuel, or unusually input intensive agriculture) that do not take into account externalities on the environment, and promotion of the adequate valuation of ecosystems such as forests or coral reefs. This will help to reduce pressures on global natural resources, while providing incentives for attracting finance in green activities (including in SVEs). It could also support efforts by SVEs to move into renewable energy activities. Support mechanisms may also be needed in the transition phase, supporting social development goals through re-skilling and re-engineering affected sectors or groups of people.
- (v) Further, SVEs could argue for a number of **highly specific activities** relevant for them, such as joint action to deal with ocean acidification, protection of coral reefs, and overfishing.

Some positioning is already taking place. For example, shortly after the publication of the zero Rio+20 draft, the UK argued that governments can and must provide the framework for green growth, through reducing or removing environmentally harmful subsidies, getting price signals right, standards and voluntary approaches, and valuing natural resources, and developing indicators of green growth. SVEs would do well to spell out their long-term ambitions for an effective Rio+20 outcome because they would have most to lose from an ineffective Rio+20.

SVEs could also try to engage with the preparations for the G20 Summit in Los Cabos (which takes place just days before the Rio conference) which has sustainable development as a core agenda item. In particular, SVEs could ask the G20 Summit (i) to acknowledge the urgency and scale of the environmental challenges for growth in all countries, especially the poorest and most vulnerable; (ii) to ensure a proper framing of the debate on green growth that includes the relative position of SVEs in the emerging global context where environmental challenges could be particularly harmful for SVEs; and (iii) to draw up action plans and partnerships for inclusive and sustainable growth between the G20 and non-G20 countries such as SVEs.

International Trade & Regional Co-operation Section at the Commonwealth Secretariat

This Trade Hot Topic is brought out by the International Trade and Regional Co-operation (ITRC) Section of the Economic Affairs Division (EAD) of the Commonwealth Secretariat, which is the main intergovernmental agency of the Commonwealth — an association of 54 independent states, comprising large and small, developed and developing, landlocked and island economies — facilitating consultation and co-operation among member governments and countries in the common interest of their peoples and in the promotion of international consensus-building.

ITRC is entrusted with the responsibilities of undertaking policy-oriented research and analysis on trade and development issues and providing informed inputs into the related discourses involving Commonwealth members. The ITRC approach is to scan the trade and development landscape for areas where orthodox approaches are ineffective or where there are public policy failures or gaps, and to seek heterodox approaches to address those. Its work plan is flexible to enable quick response to emerging issues in the international trading environment that impact particularly on two highly vulnerable Commonwealth constituencies — least developed countries (LDCs) and small states.

Scope of ITRC Work

ITRC undertakes activities principally in three broad areas:

- It supports Commonwealth developing members in their negotiation of multilateral and regional trade agreements that promote development friendly outcomes, notably their economic growth through expanded trade.
- It conducts policy research and consultations increase understanding of the changing of the international trading environment and of policy options for successful adaptation.
- It contributes to the processes involving the multilateral and bilateral trade regimes that advance the more beneficial participation of Commonwealth developing country members, particularly small states and LDCs.

ITRC Recent Activities

ITRC's most recent activities focus on assisting member states in the WTO Doha Round and the Economic Partnership Agreement (EPA) negotiations involving the African, Caribbean and Pacific countries (ACP) the European Union (EU), undertaking analytical research on a range of trade policy and development issues, and supporting workshops/dialogues for facilitating consensus-building on issues of Commonwealth members' interest, exchange of ideas, and disseminating results from informed analysis.

Selected Recent Meetings/Workshops supported by ITRC

- 27-28 March 2012: Experts Group Meeting on Investment Negotiation Framework for Developing Countries (South Asia Region), held in Colombo, Sri Lanka
- 26 March 2012: Symposium on EU Trade Policy and the Way Forward for Sri Lanka, held in Colombo, Sri Lanka
- 2 March 2012: Commonwealth Secretariat- OCTA consultation on PACER Plus Arrangements, held in Nadi, Fiji
- 26 - 28 February 2012: Workshop on Enhancing the Role of Government Ministries and Institutions in the Effective Implementation of Trade Policy Agreements held in St. Kitts & Nevis
- 3-4 February 2012: Cost of Economic Non-Cooperation to Consumers in South Asia, held in Kathmandu, Nepal
- 10 - 12 January 2012: Experts Group Meeting on Investment Negotiation Framework for Developing Countries (for the Caribbean Region), held in St. Lucia
- 20-21 October 2011: Commonwealth Investment Experts Group Meeting for the African region held in Kampala, Uganda
- 26-27 September 2011: Workshop on Elements of a Pro-Development Doha Round Result held in Hampshire, UK
- 19-21 September 2011: Panel Discussion on "The Doha Round and Multilateralism: Stakes for LDC's and SVE's" at the WTO Public Forum held in Geneva, Switzerland
- 18 July 2011: ACP/COMSEC/OIF/UNEP Joint Meeting on Environment, Climate Change and Trade held in Brussels, Belgium
- 07 July 2011: Brainstorming Session on "Negotiating Better" for Trade Negotiators from Small States held in London, UK



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