

trade hot topics

Eco-labelling: Challenges and Opportunities for Small States and LDCs

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Background

Eco-labelling is a form of sustainability measurement that is intended to make it easy for consumers to take environmental concerns into account when purchasing products. It is frequently stated that the label is valued by consumers as a 'seal of approval' given to goods and services whose production processes have been assessed to be less harmful to the environment than functionally or competitively similar products. The concerns of developing country exporters, that eco-labelling schemes could be a disguised form of protectionist trade policy used to support domestic industries in the countries that implement them, could emanate from the fact that there is no universally accepted standard for the over 400 recorded eco-labelling programmes implemented in 197 countries in 25 different industry sectors. The use of voluntary eco-labelling by large retailers in developed countries, with the support of their respective governments which regard these schemes as complementary to their own national environmental policies, is increasing. The potential for trade disputes arises when eco-labelling criteria include production-related criteria that reflect developed country production preferences and technologies, which are difficult for developing

countries to adopt and therefore impact upon developing countries' export interests.

This issue of *Commonwealth Trade Hot Topics* highlights some of the challenges and also opportunities faced by exporters from small states and least developed countries (LDCs) heavily dependent on export markets where the use of voluntary eco-labelling schemes is continuing to grow, particularly in the agri-foods sector.

It is observed that many of the eco-labelling schemes are voluntarily implemented by large, brand-sensitive retailers seeking, among other things, to project a positive image to their consumer base in an increasingly business competitive environment, or provide a means to differentiate their products from those of competitors. As these schemes can be designed and implemented by any government body, private company, or civil society organisation that has the financial and technical resources to do so, the standard requirements and certification process for obtaining eco-labels tend to be based on domestic environmental priorities and the technologies used in the importing country, which may favour domestic over foreign production processes. The influence on voluntary schemes should not be underestimated as even the present

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mandatory ISO 9000 standard was previously a voluntary programme. These private bodies, which establish their own environmental standards and criteria for labelling, have no direct legal obligation to consider the export interests of other countries, and few incentives to do so.

The 2010 report of the World Trade Organization's (WTO) Committee on Trade and the Environment noted that WTO members are showing a significant interest in eco-labelling measures adopted including their relationship to: the competitiveness implications of these schemes for domestic industry; the cost and market access impact of these schemes for developing countries, particularly small and medium-sized enterprises (SMEs), especially in the context of multiple, overlapping schemes and standards; the potential non-neutrality of carbon footprint methodologies; the lack of a uniform methodology for measuring standards; the risk of discrimination on the basis of non-product related processes and production methods (NPR-PPMs); and the relevance of WTO trade rules, including the Agreement on Technical Barriers to Trade (hereafter referred to as TBT) to this discussion.

Given the increased global awareness of the finiteness of the natural resources, one explanation put forward for the popularity of eco-labelling schemes is that they are one of the least-coercive, market-based mechanisms to improve the global conservation of natural resources. In support of this, there have been recent efforts to improve awareness and use of eco-labelling schemes in emerging markets and large developing countries with financial and technical assistance from multinational organisations and more developed countries being made available for this purpose. The adoption of eco-labelling by competing exporters from emerging markets and large developing countries could increase their competitive advantage over exporters from small states and LDCs at a time when preferential access to European Union and North American markets for small states and LDCs exports has been eroding in recent years. The efforts of poor, small and vulnerable economies to diversify their exports towards lucrative emerging and large developing country markets are consequentially challenged, if eco-labelling in these markets create an entry barrier.

Challenges to market access

For exporters from small states and LDCs wishing to adopt an eco-labelling standard to gain better market access, there will be a number of significant

challenges. First, the schemes themselves are costly to implement. A number of research studies have emphasised that the financial and human resources required to collect and assess the production and output data required to do the life-cycle analysis methodology that is commonly used to develop standards, can have the potential to discriminate against small producers. The application of multiple private schemes in an export market could therefore place a prohibitive compliance burden on exporters, particularly SMEs in small states and LDCs, forcing them to choose to adopt a single standard, the most appropriate choice requiring knowledge of the demand trends of the customers in the market.

Second, as there is no internationally agreed methodology for calculating the environmental impact of a product, the variables used in a life-cycle analysis model are at the discretion of the standards body whose subjectivity on this issue may not provide adequate or accurate labelling. Furthermore, there is also the issue of appropriateness of standards based on this methodology within the context of production systems in small states and LDCs given that they are designed considering the domestic production and environmental realities in countries whose socio-economic structures differ significantly from that of poor and vulnerable economies.

An increasing number of developing countries therefore perceive eco-labelling schemes as constituting unfair trade discrimination and it has been suggested that these measures are a politically expedient substitute for more trade-restrictive instruments such as border taxes or import bans that have become more difficult to implement.

Relevance of WTO law

Government instruments, such as environmental taxes, cap and trade emission schemes, countervailing duties and specific industry regulations that are used to support national sustainability goals, have been investigated by the international trading regime's dispute settlement system for their potential to violate the system's non-discriminatory rules. The GATT panels in the 1980s and 1990s as well as a WTO panel in the 1990s have sought to clarify the balance to be achieved with the implementation of such domestic environmental measures, allowable under GATT Article XX, with their potential to affect market access.¹ However, it is not clear whether these rules can apply to voluntary eco-labelling

schemes because they are implemented at the discretion of private entities, and consumers have the option to purchase eco-labelled as well as non-labelled products thus making it difficult to prove overt market discrimination.

There are further legal requirements governing standards setting and labelling established in the TBT Agreement. The TBT Agreement differentiates between technical regulations (mandatory measures) and standards (voluntary measures) with the provisions concerning the preparation, adoption and application of standards, contained in Article 4 (hereafter referred to as the 'Code of Good Practice') for the Preparation, Adoption and Application of Standards. While the TBT mainly applies to government policies, TBT Article 4 requires that WTO members take 'reasonable measures' to ensure that non-governmental standardising bodies operating within their territories are complying with the TBT Code of Good Practice. Therefore, Article 4 does indicate that member governments do have a responsibility in providing some level of oversight of the design and implementation of private eco-labelling schemes. This is further elaborated in Article 8 which requires that WTO members take 'reasonable measures' as may be available to them, to ensure that non-governmental bodies within their territories which conduct conformity assessment procedures comply with the provisions of the TBT. Furthermore, member governments are required to not take measures which have the effect of, directly or indirectly, requiring or encouraging such bodies to act in a manner inconsistent with the provisions of the TBT. While the TBT's Code of Good Practice can therefore apply to non-state criteria-setting bodies, the Code is not mandatory, and nothing in the Code of Good Practice requires that non-state actors provide deferential treatment to developing country members. In addition, there is an issue of whether the non-state actors such as private firms are standardising bodies within the context of the TBT, and further work is being done within the WTO to clarify this issue.

Despite the potential for private eco-labelling initiatives to create market access barriers and violate the measures under the TBT Agreement, there has been reluctance on the part of countries whose trade has been affected to challenge these schemes. One argument put forward is that by challenging these standards and labelling schemes that are based on criteria that are NPR-PPM, such challenges may in turn legitimise the use of NPR-

PPM criteria within the WTO. By identifying a specific group of NPR-PPM measures as being either discriminatory or trade restrictive, there is therefore implicit acknowledgement that *not all* NPR-PPMs are WTO inconsistent *per se* (Gandhi, 2006).

Opportunities for economic growth and development

Although eco-labelling standards challenge market access for exports from poor and vulnerable economies, there is evidence that eco-labelling can also be an avenue for gaining access to niche markets in which a premium price is paid for 'green' products. For some producers, eco-labelling can present an opportunity to add value to existing products, expand reach in existing markets, or maintain market share in a competitive environment through product differentiation and therefore provide these exporters with potential to enhance their export earnings. In some instances however, research has indicated that market intelligence with regard to the relative demands of buyers and relative costs of the schemes is as important as achieving a given eco-labelling standard in order to obtain higher product prices. Elsewhere, it also noted that it would be premature to assume that achieving higher prices would increase producer profitability, because yields may have to be decreased to ensure that certification standards are met. Even when premium prices are not achieved, there is also evidence to suggest that changing the production process to meet the demands of the new standard could lead to higher yields and better quality products, as the improved business organisational structures sometimes required bring better access to credit and insurance for producers.

There is consensus, however, that the economic value of adopting an eco-labelling standard seems to lie in the security of market access that results from achieving such a standard, rather than an immediate price and profit increase. This security comes not only from providing a distinct, differentiated product in a competitive market, but also the added security of improving the

¹ GATT Article XX(b) permits members to implement measures that are necessary to protect human, animal, or plant life, and Article XX(g) permits members to implement measures that relate to the exhaustion of natural resources as long as the measures are made effective with restrictions on domestic production or consumption. Such measures must also satisfy the *chapeau*, which proscribes measures that are applied in a manner that results in 'arbitrary or unjustifiable discrimination'. See General Agreement on Tariffs and Trade (GATT 1947) arts. XX(b), (g) available at http://www.wto.org/english/doc_e/legal_e/gatt47_02_e.htm.

viability of continued economic activity through better management of resources. Given the structural challenges that small states and LDCs face in diversifying out of their traditional export sectors, sustainably managing current economic activity is a priority.

Options for Commonwealth small states and LDCs

• *Seek greater involvement in the design of methodology behind labelling schemes*

It matters whether the environmental criteria-setting body is a state or non-state actor, and whether they are located in a developed or developing country. Not surprisingly, developing country criteria setting bodies would take into consideration the production culture and economic interests of their constituents. If international standards of eco-labelling are to be developed in a fair and transparent manner, based on robust science and measurement methodologies, and that such standards be applied equitably across products, producers and countries, then developing countries need to have a greater involvement in the design of these standards. One study notes that the methodology behind the only public standard published to date, the PAS 2050:2008, imparts a bias against labour-intensive production systems that are typical of developing countries because it does not include production of capital goods in its definition of product life-cycles, resulting in an artificial shrinkage of the footprint of goods produced by capital-intensive methods. Horticulture farmers in Africa have been commended for their hard work to not only meet international standards but to also fight to have the use of carbon labelling by retailers in Europe, and to receive recognition for the environmentally friendly farming methods used by African farmers and acknowledgement of the positive contribution of horticulture to improving the livelihoods of rural populations.

For policy-makers in developing countries, a further solution would be to take a more proactive approach and introduce standards and labelling schemes themselves, pre-emptively meeting future regulations from developed countries. The Indian carpet industry found the certification process, validating that their goods were not produced from child labour, in order to be accepted by the European consumers, to be an expensive one. Hence the Indian Government interceded and launched a labelling scheme that

exporters could afford and importers would accept (Nanda and Ratna, 2010).

• *Advance the DDA Work Programme on Labelling Schemes*

The multilateral trading agenda has recognised the importance that labelling schemes are playing in global trade flows. While Paragraphs 31 and 32 of the Doha Declaration Work Programme focuses on trade and the environment, Paragraph 32 specifically instructs the WTO's members 'to give particular attention to the effects of environmental measures on developing and least developed countries and to instances where the elimination or reduction of trade restrictions or distortions would benefit trade, the environment, and development'. There is need for far-reaching discussions on how the WTO should address the market restrictions faced on account of voluntary environmental standards, including eco-labelling schemes, that may not be bound by the rules in the TBT.

Conclusion

Producing goods and services by recognised environmentally sustainable practices could earn producers a premium price in export markets where consumers are willing to pay this premium. Growth in consumer demand in large emerging markets in the global South has not yet shown an accompanying strong demand for eco-labelled products, but this could change given the recent efforts being made which were mentioned earlier. Branding opportunities offered by eco-labelling schemes can therefore assist with market penetration in an increasingly competitive marketplace, but multiple schemes do create problems for exporters of limited resources from poor, small and vulnerable economies.

A possible solution to having multiple labelling schemes which confuse both consumers and producers is to have a single national government scheme. Such a scheme would also have to take into consideration the impact of eco-labelling on market access for products originating from other countries, as outlined in the WTO's TBT Agreement. Another argument put forth, particularly by environmentalists, for having a national, compulsory scheme is that carbon labelling is not an effective tool of climate change mitigation policy, if not widely implemented.

The effects of carbon labels on agri-food producers from poor and vulnerable economies

strongly depend on label and measurement design and are therefore difficult to predict. What is a probable certainty is that if eco-labelling is perceived as an efficient tool to satisfy a consumer demand for more environmentally friendly products, then the design of labels will reflect the interests and technological biases of the designers. This may not favour the exporting interests of small states and LDCs. As such, eco-labelling, even though for the most part currently voluntary and privately implemented, can be coercive for many poor, small and vulnerable countries which face significant challenges in reducing their dependence on a few export commodities, but whose exports are concentrated in specific markets where eco-labelling schemes are prevalent, such as the EU.

For many developing countries to effectively participate in the design of eco-labelling standards, it would probably be more cost-efficient to do so as regional criteria-setting entities, such as the African Organization for Standardization (ARSO). Because of their regional scope, these criteria-setting bodies and organs advance the interests of geographic regions rather than specific countries. These regional bodies would require financial and technical assistance to design schemes that support their own environmental objectives given their own regional development strategies.

There are a number of important consequential issues that are linked to standards and certification schemes that exporters from poor and vulnerable countries should seriously consider before joining or designing such schemes. First, there should be systems of checks to ensure that the processes in the scheme do contribute to the sustainable ecological management of the resources that are being utilised. Second, for the certification scheme to be attractive to producers, it should create opportunities for commercial success and provide better business opportunities than would be available in the absence of the scheme. This can be through better and more stable market access, by providing a premium price for the product, and/or improving productivity yields because of better management practices and business models introduced by the scheme. Finally, the certification scheme should contribute towards economic development of the communities which are dependent upon and are situated near the natural resource; this could include investment in creating diverse economic activities and reducing the dependence on the natural resource.

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