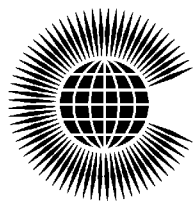


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## **TRADE, CLIMATE CHANGE AND SUSTAINABLE DEVELOPMENT: KEY ISSUES FOR SMALL DEVELOPING COUNTRIES**

Paper by the Commonwealth Secretariat\*

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## CONTENTS

<b>INTRODUCTION</b> .....	1
<b>ISSUES FOR MINISTERS</b> .....	2
<b>CLIMATE CHANGE CHALLENGES IN SMALL DEVELOPING COUNTRIES</b> .....	3
<b>TRADE AND DEVELOPMENT CHALLENGES OF SMALL DEVELOPING COUNTRIES</b> .....	4
<b>TRADE AND CLIMATE CHANGE ISSUES IN SMALL DEVELOPING COUNTRIES</b> .....	4
Transport Regulation, International Tourism and Services .....	5
The ‘Food Miles’ Debate .....	5
Standards and Labelling for Energy Efficient Goods/Technologies .....	6
The Liberalisation of Environmental Goods and Services .....	6
New Technologies and Innovation .....	6
The Agriculture Sector.....	7
The Fisheries Sector.....	7
The Forestry Sector.....	8
Energy-Intensive Sectors .....	8
<b>CONCLUSIONS</b> .....	8

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# **TRADE, CLIMATE CHANGE AND SUSTAINABLE DEVELOPMENT: KEY ISSUES FOR SMALL DEVELOPING COUNTRIES**

## **INTRODUCTION**

The interface between trade and climate change – both from the perspective of mitigation and adaptation – has entered the international high-level policy arena. The interests and concerns of developed and large emerging economies in this area have received significant attention. However, the prospects and perspectives of smaller developing countries – including small and vulnerable economies, least-developed countries, and small island developing states – remain obscure. For smaller developing countries to understand the opportunities and challenges they face with regard to climate change and trade policy, and to make informed policy choices, they need solid background information and an inclusive debate involving relevant stakeholders from their regions.

2. In response to the Lake Victoria Commonwealth Climate Change Action Plan, and discussions by Commonwealth Finance Ministers in October 2007, as well as the outcome of the Informal Meeting of Trade Ministers on Climate Change on the occasion of the 2007 UN climate conference in Bali, Indonesia, the Commonwealth Secretariat and the International Centre for Trade and Sustainable Development (ICTSD) are implementing an initiative that seeks to explore new and rapidly emerging policy concerns that need to be considered by trade, finance and climate policy-makers and stakeholders in developing countries, to ensure that their economies are ready to address the challenges and take advantage of the opportunities. This work will support developing country members of the Commonwealth – especially the African, Caribbean and Pacific countries, small and vulnerable economies (SVEs) and least-developed countries (LDCs) – in understanding the opportunities and challenges they face and make informed and strategic decisions.

3. The document was prepared on the basis of a more extensive policy paper which will be published later in the year. The policy paper was produced with contributions from several experts and institutions in both developed and developing countries. It was presented and discussed at an expert meeting held on 23 June 2008 in Geneva, and further discussed at a pan-Commonwealth stakeholder dialogue in September 2008 organised by the Commonwealth Secretariat and the International Centre for Trade and Sustainable Development, and hosted by the Ministry of Finance and Economic Development of the Republic of Mauritius.

4. This paper considers some of the key inter-linkages between trade, climate change and development concerns in small developing countries. These countries are highly dependent on trade and often have a high degree of export concentration which makes them particularly vulnerable to international market fluctuations. They also face stark impacts from climate change, both because of the physical impacts they face in their most significant economic sectors, and the limited capacity that they have to cope with the changes and adapt accordingly. It is clear that adaptation to climate change by small

states lies in building more resilient, more diversified, and more productive sectors, in order to reduce the vulnerability of small economies to climate change impacts. The paper reviews emerging trade and climate change concerns of small developing countries, in order to initiate wider international debate on the needs of these highly vulnerable countries. Concerns include: the implications of emission cuts in the transport sector; the 'food miles' debate; energy efficiency labelling and standards; technology transfer; biofuels; and the impact of trade on adaptation needs and measures.

## **ISSUES FOR MINISTERS**

- Have assessments been carried out at the national level concerning the impact of climate change in key trade sectors (goods and services)?
- What have been the key constraints to deepening analysis and action on climate change adaptation within key trade sectors?
- Have policies already been advanced that will build greater economic resilience in the face of climate change?
- What concrete steps would you wish to see the Commonwealth and other international institutions take to support further work in this area?

## **CLIMATE CHANGE CHALLENGES IN SMALL DEVELOPING COUNTRIES**

Relative to people living in developed countries, populations in developing countries are more vulnerable to, and will be more adversely affected by, climate change because they have fewer resources to adapt: socially, technologically and financially. Such impacts will have far reaching effects on the sustainable development of developing countries including the attainment of the Millennium Development Goals and other internationally agreed development goals by 2015. In terms of regional impacts of climate change, examples of major projected impacts are outlined below.

2. Africa, where most LDCs are located, is projected to be hard hit by increased water-related stresses such as droughts which could reduce yields from rain-fed agriculture by 50 per cent. This could severely compromise food production and security. Projected sea level rise is likely to affect low lying coastal areas with large populations.

3. Likewise, most parts of developing Asia will likely see decreased freshwater availability; and coastal areas with large populations are likely to face increased floodings from sea surges or rivers (such cities as Kolkata and Mumbai, India; Dhaka, Khulna, and Chittagong; and large areas of Bangladesh).

4. SIDS are expected to be most adversely affected by sea level rise exacerbating inundation, storm surge, erosion and other coastal hazards, thus threatening vital infrastructure, settlements and facilities that support the livelihood of island communities. Coastal resources (such as fisheries) are projected to be adversely affected due to impacts like beach erosion and coral bleaching. Water availability in many small islands in the Caribbean and the Pacific is expected to become insufficient to meet demand during low-rainfall periods by the middle of the Century.

5. The Secretariat of the United Nations Framework Convention on Climate Change (UNFCCC) has estimated that by 2030, developing countries will need US \$28–67 billion in funds to enable adaptation to climate change, corresponding to 0.2–0.8 per cent of global investment flows, or 0.06–0.21 per cent of projected global GDP in 2030. But current global funding for adaptation is a fraction of this figure and access to these funds for developing countries is often lengthy and complex. In addition, financing flows to developing countries to enable them to undertake response measures (including technology transfer) to climate change also fall far short of what is required.

6. Achieving sustainable levels of development, characterized by conditions of economic and social equity, remains the fundamental foundation for undertaking effective societal responses to trade and climate change adaptation. Policy approaches to trade and environment challenges – including on climate change adaptation – are premised under both the UNFCCC and WTO regimes on a clear recognition of the right to development and the need to ensure that such right is promoted and effectively achieved.

## **TRADE AND DEVELOPMENT CHALLENGES OF SMALL DEVELOPING COUNTRIES**

7. Small developing country export profiles are typically characterized by high degrees of export concentration, with only a few product tariff lines being exported. Three main products – mineral fuels, oil, and clothing – represented almost 50 per cent of total export revenues in 2005 for over half of the 50 LDCs and in around 15 LDCs, their dependence on a few exported commodities is above 90 per cent. As the WTO notes, “very few LDCs have a diversified export structure that could evenly spread the risks inherent in international market fluctuations.”

8. A combination of factors stemming from SVEs’ (especially SIDS’) vulnerabilities to natural disasters, externally-driven economic shocks, the loss or erosion of trade preferences and macroeconomic instability, among other things, seem to contribute to SVEs’ trade volatility and generally less-than-stellar trade performance in recent years. Some SVEs, especially among the SIDS, have sought economic diversification strategies, expanding into eco-tourism and health tourism (health services plus tourism) and in offshore financial services while others are exploring niche markets for goods. For other SVEs, however, agriculture remains the dominant economic activity to supply both domestic (with respect to food products) and export markets (with respect to agricultural commodity products such as spices, vegetables, cut flowers and high quality coffee and cocoa).

9. In the light of their trade-related challenges, and the impacts that climate change is having and will have on the trade competitiveness and economic development prospects of LDCs and SVEs, including SIDS, it is clear that the key towards effective climate change adaptation by these countries lies in building domestic economies that are resilient, diversified, and more productive in sectors that are not as vulnerable to climate change impacts.

10. Further trade liberalization in the sense of further increasing levels of tariff openness by LDCs and SVEs, including SIDS, to imports would not necessarily be the appropriate ‘climate-adapted’ trade policy response to climate change, for two reasons: (i) LDCs and SVEs, including SIDS, already generally have very open trade regimes, with international trade (both import and export) playing major roles in their economic profile; and (ii) such further liberalization, when placed in the context of the trade policies and measures being applied by their main trading partners (mostly developed countries), might not result in economic diversification but rather further specialization and dependence on agricultural and mineral commodity exports.

## **TRADE AND CLIMATE CHANGE ISSUES IN SMALL DEVELOPING COUNTRIES**

11. Issues that have emerged as being of particular concern to developing countries relate to the trade and competitiveness implications of emission cuts in the transport sector; the ‘food miles’ debate and carbon footprint of global trade more generally;

standards and labelling in the area of energy efficiency, the diffusion through trade of climate-friendly technologies, technology transfer, intellectual property issues, biofuels and biofuel certification schemes, as well as the impact of trade on adaptation needs and measures. Many of these policies and measures considered in response to climate change have crucial bearings for developing countries, despite their small contribution to global warming and limited capacity to respond.

### **Transport Regulation, International Tourism and Services**

12. The travel and tourism sector is the key economic sector for SIDS in terms of earnings and jobs. Indeed, many SIDS are highly dependent upon revenue earned from tourist arrivals and through tourist-related activities. Tourism earnings account for a significant share of the foreign exchange earnings in most SIDS. Further, with regards to the Caribbean, travel and tourism accounts for 14.8 per cent of GDP, 12.9 per cent of employment and 14.6 per cent of total exports. Oceania also has a similar economic profile with GDP shares of 11.7 per cent, employment 12.4 per cent and exports of 16.9 per cent. However, for both regions ten-year forecasts (to 2018) by the World Travel and Tourism Council (2008) suggest declining contributions to GDP and employment but not to exports.

13. The regulation of emissions from international transportation would potentially mean raising costs for moving goods and people around the globe, with implications for international trade. Certain service sectors such as tourism are likely to be affected by new emissions cuts in the international transport sector. Developing countries situated in remote locations, such as SIDS, would be particularly affected by higher transport fuel prices. Current discussions on emission cuts in this area need to consider this fact, and the principle of common but differentiated responsibilities taken into account.

### **The 'Food Miles' Debate**

14. The world trade in fresh fruits, fruit products, vegetables and vegetable products has more than doubled over the past two decades between 1982-1984 and 2002-2004. Developing countries export a third of the total trade, of which eight countries account for two-thirds of the total. The social and economic benefits of this trade to developing nations are crucial as it generates income and jobs.

15. Developing countries had managed to capture high-value niche markets in developed countries by air-freighting fresh produce during the northern Winter. Overall, the exporters operating in warmer climates often produced products with lower carbon emissions as compared to their counterparts in developed countries, which produce out-of-season vegetables in a highly mechanised fashion in greenhouses using large amounts of carbon-intensive fertilizer input. Existing carbon labelling schemes have failed to include not just air, road and sea transport-related emissions, but to look at the total carbon emissions through the supply chain and evaluate how to reduce these at each stage of the chain to achieve a carbon neutral rating. Under a differently designed scheme, the small developing-country producers may have been the ones to benefit.

## **Standards and Labelling for Energy-Efficient Goods/Technologies**

16. Many recent high-level analyses have demonstrated there is a very substantial cost-effective potential to improve the energy efficiency of end-use equipment, which if realised would bring large-scale benefits in terms of reduced energy-related greenhouse gas emissions, lower cost energy services and lower energy dependence. This potential is particularly important for developing countries with high energy import bills, be they LDCs or remotely located small island developing states.

17. However, widely available and cost-effective, end-use technologies are still relatively under-utilised because of numerous market barriers limiting their deployment. Governments are increasingly recognising the need to overcome these barriers through direct policy measures. The most widely deployed policies are mandatory minimum energy performance standards (MEPS) and energy labelling, both of which have been highly effective instruments to improve equipment energy performance.

## **The Liberalisation of Environmental Goods and Services**

18. Trade liberalisation is considered to be one vehicle to the diffusion of climate-friendly technologies. Developed country producers and exporters have proposed, at the WTO, to single-out environmentally friendly technologies, and among these, climate friendly technologies, and ask countries to bring down tariff barriers to aid their diffusion. Many developing countries are, however, reluctant to make such blanket commitments under the current failing Doha trade round. These countries concerned that they might, unintentionally, end up liberalising far more goods than just those with an environmental end use. They are also concerned about competition for their own small and medium-sized enterprises (SMEs) or possible future companies producing the same goods as well as loss of government revenue from import duties.

19. A carefully tailored liberalisation package, that duly takes into account both import and export interests of developing countries could contribute to facilitation access to goods and technologies of relevance to climate change mitigation and adaptation. However, trade liberalisation by itself may not be sufficient to promote the diffusion of climate friendly goods. A whole host of complementary measures - regulatory, capacity building, financial and technology-related - will be required.

## **New Technologies and Innovation**

20. Development and transfer of technology has emerged as a basic building block in the crafting of a post-2012 global regime on climate change. A range of technologies needed for mitigation and adaptation to climate change have already been identified. Several barriers to access to these technologies have been identified. The UNFCCC has recognised that least developed countries, countries in Africa and small island developing States have “specific needs and special situations” in regards to technology transfer. Many of the tools found useful in other contexts, therefore, may be inadequate and even

counterproductive for these countries, which have lower levels of development and other distinctive circumstances.

21. In the climate change negotiations, intellectual property issues have become a bone of contention. Initial research indicates that intellectual property is not necessarily the bottleneck for the present generation of technologies. This may change as new technologies are developed, and a better understanding is also needed on a sector by sector and technology by technology basis.

### **The Agriculture Sector**

22. Agriculture currently contributes significantly to the economy of many developing countries. On average, agriculture contributed about two percent of the GDP of developed countries in 2004, and 11 percent for the developing countries, with an average of 40 per cent for Africa. Agriculture is unarguably the most vulnerable sector to climate change. However, this vulnerability is not only caused by the vagaries of climate, but by its interaction with other developmental challenges. In the low-latitude regions, where most developing countries are found, even moderate temperature increases are likely to result in declining yields for the major cereals. This could increase the risk of hunger in many parts of the world. Simulations for sub-Saharan Africa estimate that countries such as Sudan, Nigeria, Somalia, Ethiopia, Zimbabwe, Chad, could lose cereal-production potential by 2080 across all emission scenarios.

23. Food security is a function of food availability, food access and food utilization. Climate change could directly or indirectly impact on these three pillars of food security. While the impacts of climate change on food availability and access are well known and documented, fewer studies have examined its impacts on food utilization. It is estimated that in 2080 about 768 million people will be undernourished. Most of the undernourished will be in the developing countries, particularly in sub-Saharan Africa and South Asia, where crop production is projected to decline considerably.

### **The Fisheries Sector**

24. Fisheries provide more than 2.6 billion people with at least 20 per cent of their average per capita animal protein intake. In 2004, an estimated 41 million people worked as fishers and fish farmers, the great majority of these in developing countries. Net fishery exports by developing countries grew from US \$4.6 billion in 1984 to US \$16.0 billion in 1994 to US \$20.4 billion in 2004. There has been a doubling of the share of fish trade in both total GDP and agricultural GDP over the past 25 years (FAO 2006).

25. Today, 25 per cent of marine fish stocks are overexploited and depleted; over 50 per cent are fully exploited. The critical situation of many marine fisheries could be worsened by the effects of climate variability and change on fisheries in coastal and estuarine waters, although non climatic factors, such as overfishing and habitat loss and degradation, are mainly responsible for reducing fish stocks. Several countries, including a large number of developing countries and LDCs that depend on fisheries for food

security, employment, and government revenues, present a high degree of vulnerability to climate change.

### **The Forestry Sector**

26. Forests play a particularly critical role in the mitigation of global climate change through carbon sequestration, the maintenance of hydrological cycles and increased ecosystem resilience. In fact, forests contain 80 per cent of all the carbon stored in terrestrial vegetation, which in turn, contains more carbon than in the entire atmosphere.

27. In terms of their development benefits, forests play an essential role for poverty eradication, providing livelihoods for nearly 90 per cent of the 1.2 billion people living in extreme poverty worldwide. Developing countries produce about 25 per cent of the world's industrial wood products (i.e. sawn wood, panels, wood pulp, paper) and almost 90 per cent of its fuelwood.

### **Energy-Intensive Sectors**

28. Currently, the focus on large emitters in current discussions about sectoral approaches, with particular emphasis placed on Brazil, China, India, Mexico and South Africa, has taken attention away from the concerns of small developing countries. While small developing countries do not face mandatory emissions cuts, there is possibility that expanding the scope of sectoral approaches for broad based participation can facilitate more informed discussion of a post-Kyoto framework.

29. Given that many are resource-rich, small developing countries could view emissions mitigation under sectoral approaches as an opportunity to upgrade export capacity from raw mineral products to finished goods. Participation in a sectoral approach regime could mark the entry of resource-rich small developing countries into energy-intensive industries. The use of “best-available technologies” through the sectoral initiative conforms domestic production to international standards, essentially linking an individual market to the global value chain.

### **CONCLUSIONS**

30. For LDCs, SVEs and SIDS, climate change will have an impact on key economic sectors including agriculture, fisheries, tourism, oil and mineral exports. For them, adaptation to climate change will mean building highly resilient economies that are diversified, internationally competitive and less vulnerable to climate change impacts than is currently the case. Yet, we know these policy challenges have proved difficult to address in the past.

31. The diversification of economies and implementation of measures that respond to collective international efforts towards the creation of a low-carbon world economy are key development concerns for small developing countries, and ones that will require an effective strategic response at the highest levels of national economic planning and resource allocation.

32. Investments in adapting the economy to climate change are a financial burden that has been imposed on small developing countries. With effective support there are many positive opportunities for small developing countries in working towards a low-carbon, highly efficient and competitive place in world trade. This support is yet to be forthcoming. To date, most of the analysis on trade and climate change issues has focused on the concerns of larger developed and developing countries. It is hoped that the work of the Commonwealth Secretariat and the International Centre for Trade and Sustainable Development in this area will help to generate wider international debate on the unique challenges that small developing countries face in addressing trade and climate change concerns.