How to Strike a Balance between A Need for Enhanced Unilateral Action and CBDR

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Outline

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- II. The Unilateral Measures at Issue and Potential Challenges to Developing Countries
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I. Background Introduction

- The Kyoto Protocol to UNFCCC imposes quantitative targets and legally-binding commitments on the Annex I country Parties (developed countries) whereas no binding obligations on non-Annex I countries (developing countries)

- Following the Kyoto Protocol, some countries have introduced a **cap-and-trade system** to curb green house gas emissions.

- **Competitiveness** and **carbon leakage** concerns arise when countries implement policies and measures which other countries do not or when policies and measures **differ** between countries.

- In order to address such concerns, **free allowances** (allowances granted for free to emitters under emission trading schemes) are currently in place and **carbon border measures (CBM)** has been much discussed.

- This presentation first addresses **the measures at issue** and identify **the potential challenges to developing countries** and then explores the means to balance the unilateral measures and CBDR.

II. The Unilateral Measures at Issue and Potential Challenges to Developing Countries

1. Free Allocation of Emission Allowances

- One commonly tool to address concerns over carbon leakage is to **allocate** all or parts **of the emissions allowances for fre**e.

- Such free allowances would be targeted at **firms in sectors sensitive to carbon leakage**, in particular **sectors heavily exposed to trade** and **facing considerable cost increases** due to ETS

Potential Challenges to Developing Countries:

- Free allowances may constitute a **subsidy**, potentially undermining the competitive position of any firm competing in any market with the subsidized entities.

- Free allocation of emission allowances could **not provide preferential treatment to developing country actors** either through the guiding principle of the UNFCCC, CBDR, or the practice of the WTO to grant developing countries special and differential treatment.

- **Other risks** including (1) **over-compensation**; (2) differential free allocation between sectors may create **distortions in competition**; and others.

2. **Carbon Border Measures**

- CBM aims at **providing market signals to countries having <u>less stringent carbon emission norms </u>to <u>adopt stricter ones</u>**
- Different ways in which CBM could be imposed, including **carbon border tax**, **<u>Cap& Trade Scheme</u>**, etc. Two typical examples are the EU ETS Aviation Policy; and the US CBM
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2.1 The EU ETS Aviation Policy

- As part of the effort to reduce GHGs emission, **the aviation sector has been included in the EU** ETS since 1 January 2012

(*Directive 2003/87/EC – Scheme for greenhouse gas emission allowance trading; Directive 2008/101/EC – Inclusion of aviation activities in that scheme*)

- **Scope of its Application-**

The scheme applies to **all international flights** arriving at or departing from EU airports, **with some exceptions**, e.g,

e.g., Contingency: Where another State **take comparable measures to reduce climate change impact of flights**, the EU may exclude from the EU ETS flights arriving from that State. (But not for flights taking off from the EU) (Article 25 a Directive 2003/87)

Potential Challenges to Developing Countries

- First, EU's ETS requirements on aviation <u>treat airlines from both Annex I and non-Annex I countries the same</u>, clearly violating CBDR.
- Second, only EU Member States **have the discretion to determine how revenues from the auctioning of GHG allowances** will be spent, thus Non-Annex I countries do **not necessarily benefit from the revenues from the auctioning**.

→The UNFCCC requires developed countries to provide financial assistance to developing countries in line with CBDR, however, the Directive require developing country airlines contribute to climate change mitigation and other activities in the EU…

- Other risks including trade retaliation, extra-territory, etc

2.2 The US Carbon Border Measures

- The stakeholders of the US generally consider an emissions trading scheme would be acceptable **if it included border adjustment measures** that **effectively raise the price of imports from countries** with lower carbon price and lower the price of exports

- This could be done by imposing **a carbon tariff on imports** (or **requiring importers to purchase emission allowances** under the domestic ETSs in the same way as domestic producers) and by **allowing export rebates**

- In its proposed legislation,

the US **requires importers to buy carbon allowances when bringing in commodities in energy intensive and trade-exposed sectors**, (such as steel, aluminium, or cement) from countries that **fail to adopt carbon control programmes similar to that in the US**.

see : ***Title IV of the American Clean Energy & Security Act (ACESA) (2009) as well as sections 775-78 of the Kerry-Lieberman Bill***, dealing with **the International Reserve Allowance Program**.

note: The requirement under these provisions are **for** The border adjustment would **take effect in 2020** under the Kerry-Lieberman Bill to the extent that **carbon-related competitive gaps remain** with other countries and are not covered by the allowance rebates)

Potential Challenges to Developing Countries

- This **carbon price equivalency** approach that is **applied to imports from both developed and developing countries without discrimination** clearly contradicts CBDR and the associated principle of developed country leadership

- Developing countries suffer from what might be called **an "excessive attribution of responsibility"** arising from both direct and indirect leakage, as the current system assigns responsibility for emissions based on **territorially-based production** rather than **the final demand or consumption** of goods and services. i.e., this amounts to "**requiring producers in developing countries to subsidize developed countries' domestic transition to green economy through border imposts**"

- Overall, Unilateral border measures, insofar as they merely seek to **<u>level the competitive playing field</u>,** are also fundamentally incompatible with the climate regime's burden-sharing prinicple of CBDR

III. How to Strike a Balance between Unilateral Measures and CBDR

- As discussed above, unilateral measures may not be compatible with the CBDR
- The efforts to address both carbon leakage and competitive disadvantage must still be compatible with CBDR
- Before exploring the options to make Unilateral Measures compatible with CBDR, first discuss the principle of CBDR
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3.1 The Concept of CBDR

The components

- common responsibilities
- differentiated responsibilities

  a. Prior to Rio: based *on different capabilities and needs*

  b. Rio-: + the emergence of *historical responsibilities*

UNFCCC -Balance of commitments (Art 4.7)

COMMON

- Mitigation (voluntary, DCs)
- Info exchange and provision
- Cooperate in ToT, R&D, adapation, GHG sink and reservoir mgt

CBDR
Equity
Capabilities

Sustainable development
PRINCIPLES (Art 3)

DIFFERENTIATED

- Mitigation (mandatory)
- Financing UNFCCC implementation
- Financing adaptation
- Technology transfer
- Detailed info

Legal Status

- **A principle in international climate regime**

a. the UNFCCC and its Kyoto Protocol, as well as several COP and CMP decisions, contain numerous references in preambular and operational text to 'equity' and the related principle of CBDR

b. There is agreement that CBDR form **a fundamental part** of the conceptual architecture of the climate change regime and must therefore **guide interpretations of the obligations of the Parties** as stipulated under the UNFCCC. (India proposal)

□ Implications

- Developed countries must **<u>take the lead</u>** in climate change mitigation activities;

- CBDR is predicated upon <u>differentiation in favor of **all** developing countries</u>, based on

a. *different historical contributions* to global climate problems (Developed Countries are responsible for 75% of historical emissions between 1850-2008)

c. *different financial, technological and structural capacity* to tackle this global challenge

d. and ***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 economic development needs***

3.2 How to Strike a Balance between Unilateral Measures and CBDR

- The efforts to address both carbon leakage and competitive disadvantage **must still be compatible with CBDR**.

- **The best option** to address this concern is to reach a global, comprehensive deal **that would put a price on carbon emissions**, thereby creating incentives for transition to low-carbon economy.

- It seems such multilateral agreement is difficult to reach at this moment, the **unilateral national mitigation schemes are still necessary**. In this case, efforts must be made to strike the balance between Unilateral Measures and CBDR.

Two type of Options are available, including

A. Exemption:

Exempt all non-Annex I country actors (e.g., flights/exports) from inclusion in the ETS ,

i.e., the Unilateral Measures only put burden on Annex I countries

B. When the unilateral measures impose mitigation burden on non-Annex I countries, the following options are suggested:

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1. International agreement to establish principles and guidelines for:

a. how comparable effort should be judged and measured

b. when and how the CBM could be applied

c. how embodied carbon should be measured

d. how free allowances should be allocated

- In case such political solution is not possible, seeks **harmonisation (or at least linking) of ETSs**
- Both international agreement and harmonised ETSs should **be consistent with CBDR** and the combined UNFCCC and WTO requirement to avoid "**arbitrary or unjustifiable discrimination or a disguised restriction on world trade**". (article 3 of UNFCCC)
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2. Revenue channelled back to the affected developing countries

- It is logical that the revenue earned from a domestic carbon tax or cap-and-trade scheme should be **recycled domestically** to assist with the transition to a low-carbon economy
- Yet, it would go against the CBDR to **require developing countries' producers or other actors** to <u>**subsidize**</u> industrialized countries' domestic transition
- Hence, we need to <u>**recycle the revenue from carbon tariff or other carbon equalization measures**</u> back to affected developing countries
- the revenue could be recycled either through <u>**a multilateral fund for technology transfer to developing countries**</u>, or <u>**sent directly back to the exporter's host country to assist in the low-carbon transition**</u>

3. Other Compensatory Measures

- Transfers of low-carbon technologies and financial resources to developing countries, helping developing countries achieve a rapid transition to a green economy, may allow the unilateral measure to partially or fully respond to CBDR

4. The Beneficiary also Pays

- Unilateral border adjustments should be designed in ways that are mindful of the benefits and costs of both direct and indirect carbon leakage and consider the development needs of developing countries
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- Switch to consumption-based accounting on the basis of the beneficiary pays principle and force consumers to take some responsibility for the emissions associated with their consumption.

Selected References

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Thank you