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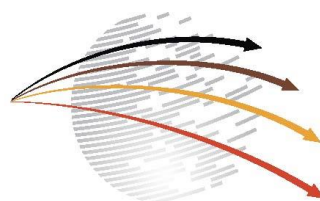
Provocateur Briefing Report

Forum on Development and Mitigation

DEVELOPMENT FOCUS

Trade and Industrial Policy

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M A P S

Mitigation Action Plans & Scenarios

From 27-29 January 2014, over one hundred professionals working mainly in the climate change mitigation field, in Southern contexts, gathered at the Cape Town Waterfront for the Forum on Development and Mitigation (the Forum). The event was hosted by the Energy Research Centre of the University of Cape Town, the Centre for Policy Research in New Delhi, and the international Mitigation Action Plans and Scenarios (MAPS) Programme. As a feature of the Forum nine South African development experts, the 'Development Provocateurs' were invited to participate in the event and write a short reflective piece afterwards. These briefing notes considered the discourse at the Forum from the perspective of each Provocateur's particular area of expertise, looking at shared priorities, disconnects and other points of contact.

This briefing note responds from the perspective of 'Trade and Industrial Policy' by Yash Ramkolowan. The full set of briefings have been compiled into a compendium, available at www.devmitforum.ercresources.org.za and www.mapsprogramme.org.

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TRADE AND INDUSTRIAL POLICY

Trade and industrial policy priorities

The area of trade and industrial policy can neatly be summarized in one word: competitiveness. As Chang (1998) notes industrial policy operates on a continuum of definitions, largely determined by the scope and range of the country's plan for industrial development. Industrial policy may be focused on the development of 'key' sectors to a level at which firms in those sectors are able to successfully compete in both the domestic economy and globally. More broadly, industrial policy may outline general priorities in order to raise a country's overall competitiveness and, therefore, its industrial output. In achieving the desired levels of competitiveness, an array of instruments are used by governments to assist firms, including subsidies, tariff protection, financial and non-financial incentives and government regulations.

The desired outcomes of industrial policy often focus on a range of objectives, including job creation, general poverty reduction and increased foreign and local investment. Policy objectives therefore often result in the design and implementation of instruments that ensure firms achieve certain policy outcomes without undermining their levels of competitiveness. Industrial policy interventions can also often result in unintended outcomes, rent-seeking behavior and continuous lobbying by firms and sectors seeking more protection or subsidies. In this sense, industrial policy can often lead to a waste of limited resources which are used inefficiently. The expected wider economic benefits of industrial policy are then only enjoyed by a limited number of actors in the economy, while the opportunity costs of such industrial policy can be larger than the benefits from supporting such industries.

From a global perspective the role of trade policy is often to support industrial policy plans, but this invariably includes an element of 'global' politicking. In global trade negotiations, countries are likely to compromise on certain aspects of their trade and industrial policy principles in order to ensure that trade negotiations are considered a success, and to support political relations with partner countries. Thus trade policy instruments (including tariffs or duties, non-tariff measures and standards) are used to both support a country's local industrial policy by achieving greater competitiveness for local firms; but also to provide countries with a negotiating platform within the wider geo-political space. In this sense, trade negotiations often lead to sub-optimal outcomes as part of the natural negotiating process.

Countries may also choose to adopt polarized positions based on perceived, and real, trading and political “blocs”; ultimately preventing any positive outcomes resulting from negotiations. From a global trade perspective, a “co-ordination failure” often persists in negotiating platforms. Countries undertake unilateral actions despite the fact that global agreements are likely to produce better outcomes, precisely because countries do not believe that such an optimal outcome is feasible in the negotiating process.

Within this trade and industrial policy paradigm, developing countries are increasingly focused on moving up the production value chain, away from primary resource dependence and often from a low industrial base.

Linkages and intersections with climate change mitigation policy

There is a range of ways in which trade and industrial policy align with climate change, as well as a number of areas where there is an intersection between different policies. Brewer (2007) highlights the various intersections between trade policy and climate change including:

- border measures, non-tariff barriers to trade, product labeling and standards
- investment and technology transfer issues, including that of climate-friendly goods and services;
- international climate change technology cooperation agreements;
- subsidies for renewable energy and energy efficiency goods and services; and
- government procurement

Within industrial policy there has been a concerted shift towards a focus on both the general ‘greening’ of industries, but also a specific sector focus on the development of green industries, though there is often both a cross-cutting and sectoral overlap between these two aspects of green industrial policy (Schwarzer, 2013). This focus has been driven increasingly by a boom in green industries, and their potential to drive development, with the United Nations Environment Programme (UNEP, 2011) estimating that the potential value of investment in the broadly defined green economy amounts to anything between US\$ 1 trillion and US\$ 2.5 trillion per year.

Schwarzer (2013) suggests that ‘green’ industries are effectively infant industries, displaying characteristics of normal infant industries and subject to the same industrial and trade policy interventions in promoting and supporting these industries. However, an inability for many economies to effectively price environmental externalities leads Schwarzer (2013) to term the green industrial policy focus as a second-best alternative over the first-best option of pricing in these externalities.

Pricing mechanisms, whether through a direct tax or through a market-based system, require that firms internalize the costs of emitting carbon in production and supply processes. For many carbon-intensive sectors and firms, this can result in a significant cost burden, forcing them to limit production (rather than switch to more carbon efficient processes). Firms are also likely to pass through a large part of this cost downstream (ultimately to the consumer), especially in sectors with little competition. For these reasons the efficient use of pricing mechanisms is often politically unfeasible. This, together with the practical feasibility of accurately and efficiently pricing-in externalities often forces governments to make use of ‘watered-down’, non-punitive pricing mechanisms together with regulations and incentives (such as direct subsidies) that encourage firms to reduce emissions. Firms are thus incentivized to change production techniques and invest in carbon efficient processes as the costs of switching are reduced and the cost of maintaining inefficient processes is raised.

‘DevMit’ and policy alignment

‘Development’ is defined in various, often contentious ways, with development used as an all-inclusive word for economic growth, poverty reduction, more equitable access to resources and more inclusive participation in economic activities for marginalized communities. Thus development policies focus on achieving a wide range of objectives and the often narrow focus of trade and industrial policy (improving the competitiveness of domestic firms and sectors), suggests that these policies cannot completely fulfill the developmental agenda.

While trade policy is often developed and implemented on a much larger scale, and often directed using a top-down approach, the ultimate goals can nevertheless support some developmental objectives. In supporting the development of competitive industries (and supporting non-competitive industries), both trade and industrial policies play a significant role in “development” through encouraging industrialization, the formation of new industries, creating jobs and promoting investment. Possibilities for an even greater interfacing between climate change, development and industrial policies present themselves through a better articulation of the intended outcomes of what may at first seem to be contradictory policies.

Better policy integration

As noted by Cosbey (2013), there are a number of rationales for focusing on industrial policy as a mechanism for supporting and encouraging firms and sectors to develop ‘greener’ goods and adopt practices that reduce carbon emissions. These include accounting for externalities and spillovers, addressing market imperfections, supporting infant industries and learning by doing, addressing inherent technology biases and reducing the risks associated with innovation. While there is a clear rationale for adopting green industrial policy, a number of issues (specifically relating to the tension between a country’s industrial development and mitigation commitments) give rise to policy incongruence when such a policy is formulated and developed.

South Africa’s various development policies, including the Industrial Policy Action Plan (IPAP) and the National Development Plan (NDP) provide examples of such policy incongruence in South Africa’s efforts to produce an effective and credible development and mitigation policy. Both plans speak to the development of and focus on the green economy, specifically in the development of renewable energy and energy efficiency industries and technologies. However, both plans also identify a range of sectors and industries to support and grow, which are often both carbon and energy-intensive. These include industries such as mineral beneficiation, developing upstream petroleum capabilities and metals fabrication. Thus, while South Africa’s policy suggests a focus on green development and industries, such carbon-reducing interventions are undermined by support for carbon-intensive sectors. While it may be possible to combine these two approaches to lead to better developmental outcomes than would be achieved by focusing on either individually, this is only likely if the tradeoffs between the two approaches are explicitly acknowledged and managed.

Such policy incongruence is often a result of the cherry-picking of development sectors. There is significant debate in industrial policy as to whether general industrial support interventions produce better and more effective outcomes than narrowly selecting a range of sectors to protect and support. For effective mitigation, a comprehensive green industrial policy is required, rather than piece-meal interventions, which will result in the introduction of effective mitigation activities alongside the development of, and continuous support for, high-carbon emitting industries. The need for a climate mainstreamed and fully integrated approach to industrial policy is especially important in a South African context, which has a relative resource advantage in high-carbon fuels and is likely to rely heavily on these resources over the short- to

medium-term. The question, in such a scenario, is how to effectively support a holistic approach to green industrial development.

Understanding the winners and losers

The development / mitigation interface appears to place significant emphasis on evaluation and assessment of projects, programmes and policies – but it is not clear if there is sufficient focus on identifying the winners and losers, and identifying the opportunity costs, any interventions. As with all interventionist policies, industrial and trade policies create opportunities for rent seeking, and often create a clear set of winners and losers. This is especially true for any policy interventions that focus on the development of new ‘green’ sectors. Support for these sectors is likely to draw both public and private funding away from other, higher emitting, industries. The opportunity costs of any intervention or instrument need to be clearly understood and weighed, with a clear identification of which sectors and firms are likely to benefit and those which are likely to lose out.

Developing a business case for development and mitigation

Development and mitigation are often presented as having significant costs to firms, industries and economies. While this may be true in the short-term, there is also a possibility for significant long-term gains from adopting mitigating activities that also have a positive impact on development. This includes the potential efficiency gains for firms and the resulting increase in competitiveness that this entails. The introduction of pricing mechanisms within countries and border tax adjustment measures between countries increasingly validates the benefits to firms and industries of adopting mitigation activities. The need is to therefore demonstrate that the short-term costs of mitigating actions are increasingly justified by the changing external environment faced by firms and the potential long-term gains in efficiency and competitiveness. The, often abstract, long-term scenarios for climate change mitigation policies are usually presented without highlighting how firms can possibly benefit from employing mitigating activities in the short-term.

The role of NAMAs

Closely related to policy development and creating a business case for mitigation is the role of Nationally Appropriate Mitigation Actions (NAMAs) in promoting both development and mitigation activities. The exact way in which developed nations will fund NAMAs in developing countries, and indeed the exact definition and meaning of NAMAs is yet to be fully defined and conceptualized. Nevertheless, it is possible that such programmes and policies can and will play a significant role in ‘industrial development’ by directly or indirectly supporting the development of green industries, particularly for developing countries.

Focusing NAMAs on policy priorities that have the dual objectives of enhancing industrial development, while at the same reducing a country’s greenhouse emissions, may be especially attractive from an industrial policy perspective in developing countries. NAMAs may also further the mitigation and development ‘business-case’, especially where the costs of interventions are particularly high, and would not meet private investment criteria. Well defined NAMAs with a concretized funding model for these programmes and projects can further drive the incorporation of mitigation goals into developing countries’ industrial policy. In this sense, NAMAs can play an influential role in directing and enhancing a country’s industrial programme, both from a development and a mitigation perspective.

Aligning mitigation to the changing trade negotiations paradigm

Trade policy and international negotiations have traditionally focused on a multilateral, WTO-centric approach to reducing global barriers to trade, both in terms of product duties and in the form of non-tariff measures. These negotiations have, to a large extent, been successful in reducing overall tariff barriers between countries, aided through the proliferation of bilateral trade agreements focused on tariff reductions. More recently, however, trade negotiations at a global level have entered a period of stasis, with few fundamental reforms being agreed in order to further reduce trade barriers and stimulate trade in both goods and services.

The impact of climate policies, such as carbon pricing and border measures on international trade can be substantial, with Mattoo et al (2009) estimating that border taxes (based on the carbon content of imports) is likely to be significantly negative for middle and lower-income countries. Climate change policies are also likely to raise non-tariff barriers to trade, with developed countries often more likely and able to impose standards on production and inputs for imports than developing countries. Climate change mitigation policies are therefore likely to have a significant impact on trade negotiations. And this impact is expected to increase as the extent and severity of mitigation policies increase.

The rise of 21st century mega-regional agreements

While climate change policies are likely to have a strong impact on trade flows at regional and global levels, current global negotiating platforms (such as the WTO) afford little focus to environmental or climate change issues. So-called 21st century regional negotiations by a select number of major developing and developed countries are increasingly being used as an avenue to bypass stagnation in trade negotiations at the global level. The most prominent examples of these negotiations include the Trans-Pacific Partnership (TPP), currently being negotiated by as many as 14 countries including the USA, Mexico, Singapore and a number of other countries in the Americas and East Asia region. Similarly, the Transatlantic Trade and Investment Partnership (TTIP) currently under negotiation between the USA and the EU could result in deep integration between regions that account for more than 40% of the World's trade in goods. While not immune from criticism regarding the secretive nature of these negotiations and the accommodation of vested interests, these negotiating platforms increasingly point the way forward for deeper global integration.

These agreements are likely to go far beyond traditional trade agreements, focusing on deeper integration and the harmonization of a range of policy issues, including government procurement, competition policy, investment, as well as those relating to the environment (Baldwin, 2011). Such negotiations, if successfully completed, have the potential to redefine global trade systems and policies and eventually draw in a far larger number of countries as the benefits of these agreements become clearer, and the costs of sitting out of such agreements grow. The development of these 'mega-regional' trade agreements may provide the ideal platform for the elevation of climate change matters into trade negotiations. Given a similar sense of stagnation in climate change negotiations, molding climate change discussions within the mega-regional framework may also serve as the best path for overcoming global apathy to making firm commitments on emissions reductions.

Global value chains and the importance of Multinational Companies

The development of regional and global value chains and the increasing importance of multinational companies, together with the development of 21st century trade agreement negotiations suggests that focusing mitigation policies on firms operating within these value chains may be more important (and potentially more successful) than trying to negotiate a globally acceptable climate change deal. Heede (2014) suggests that just 90 firms are responsible for almost two-thirds of cumulative global carbon and methane emissions between 1751 and 2010. The concentration of a large proportion of

carbon emissions amongst a few firms also suggests that targeting firms within multilateral or regional negotiations, or even through direct policies, may result in better outcomes than current global discourse and negotiations around climate change.

Conclusion

There are real and strong links between climate change mitigation, development and trade and industrial policy. These links are, however, not often well-articulated or defined within existing policies and plans. Better integration of mitigation and development goals into trade and industrial policy requires a refinement in the discourse around mitigation and development, but, at the same time, a clear acknowledgement that an ad hoc industrial development approach to mitigation is not beneficial in the long-run.

Applying and implementing carbon emission targets that are sufficiently able to mitigate the negative impact of climate change is, however, likely to require a fundamental shift in both consumption and production patterns. The way in which industrial policy is defined would therefore have to be inherently and thoroughly redefined in order to establish a comprehensive and holistic approach to developing a green industrial policy. Such a fundamental shift will require the clear identification of winners and losers and will necessitate very difficult choices in policy support options for industries that have traditionally been well subsidized.

Avenues for wider policy discourse, that allow policy makers and evaluators from different fields to develop new approaches and potentially collaborate, such as that provided by the Development and Mitigation Forum, are useful and appropriate. Within this Forum, there was a clear articulation of commonalities between development and mitigation, with a number of “bridges” built between these two policy agendas. However, from a wider perspective there appeared to be little focus on how similar ‘bridges’ could be built to other policy spheres. This is particularly true of industrial policy, where competitiveness, opportunity cost and the identification of winners and losers appears to play a much bigger role in policy formulation than either mitigation or development.

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