



Incentive Measures and WTO Rules

Article 11 of the Convention of Biological Diversity (CBD) calls on Contracting Parties to “adopt economically and socially sound measures that act as incentives for the conservation and sustainable use of components of biological diversity”. The Article seeks to address the failures of markets to adequately reflect the value of biodiversity. Such failures arise from the public goods characteristics of many biodiversity components. Since nobody can be excluded from using these components, individuals often have insufficient incentives to conserve biodiversity and use it sustainably. Incentive measures seek to internalise the public-good value of biodiversity into the decision-making of private actors or at least to bridge the profitability gap between unsustainable activities and their sustainable alternatives. A range of instruments is available to achieve this objective:

- *Positive incentive measures* are economic, legal or institutional measures designed to encourage beneficial activities, such as agricultural land set-aside schemes or conservation easements.
- *Negative incentive measures* or disincentives, such as user fees or pollution taxes, are mechanisms designed to discourage harmful or unsustainable activities.
- *Indirect incentive measures* seek to change the relative costs and benefits of specific activities in an indirect way by creating or improving markets for biological resources. Examples for such trading mechanisms are individual transferable fishing quotas, species commercialisation, emissions trading schemes and eco-labelling initiatives.

At the same time, *perverse incentives* can induce unsustainable behaviour that destroys biodiversity, often as unanticipated side-effects of policies designed to attain other objectives. Such “policy failure” can include government subsidies or other measures which fail to take into account the existence of environmental externalities.

Valuation tools quantify the hidden value of biodiversity and are thus an important precondition to the internalisation of this value and – by raising awareness among societal actors of the hidden values of biodiversity – can act as an incentive measure in their own right.

Incentive measures usually take the form of a new policy, law, or economic or social programme. As single measures function

within the broader set of incentives governing human behaviour, the Conference of the Parties (COP) has encouraged Parties to review existing policies to identify and promote incentives for the conservation and sustainable use of biodiversity.

Subsidies are among the measures that can take the form of both positive and perverse economic incentives with regards to biodiversity. As they also have effects on countries’ competitiveness and international trade patterns, the World Trade Organisation (WTO) has set up a regulatory framework that determines the kinds of subsidies that Members can or cannot use under specific conditions. Moreover, when launching the current Doha Round of trade negotiations in Doha, Qatar, in 2001, WTO Members put a number of issues onto the trade negotiation agenda that are directly related to economic incentives to promote biodiversity and to the removal of perverse incentives, notably in the areas of agriculture and fisheries.

This issue brief presents a broad overview of the linkages between the CBD’s work programme on incentives and related developments in the WTO negotiations. It aims to provide stakeholders in the biodiversity community and policy-makers with information about biodiversity-relevant aspects of the world trading system in an effort to enable them to help shape the trade agenda in a way that is conducive to sustainability.

Recent CBD activities on incentive measures¹

The Conference of Parties (COP) has provided policy guidance to the Parties on the design and implementation of incentive measures since its third meeting. Parties, other governments and international organisations have been encouraged to promote the design and implementation of appropriate incentive measures and, for instance, to review existing policies to identify and promote incentives for conservation and sustainable use; to identify perverse incentives and consider the removal or mitigation of their negative effects on biological diversity; and to ensure the adequate incorporation of market and non-market value of biodiversity into plans, policies and programmes, including national accounting systems and investment strategies. To help Parties develop supportive legal and policy frameworks, the COP endorsed a set of proposals for the design and implementation of incentive measures at its sixth meeting in 2002.

COP-6 in April 2002 requested the elaboration of proposals for the application of ways and means to remove or mitigate *perverse incentives*. These proposals were reviewed by the Subsidiary Body on Scientific, Technical and Technological Advice (SBSTTA) at its tenth meeting. In forwarding the results of its work to COP-8, SBSTTA noted that the proposals contain a number of unresolved issues – the text in fact still contains a substantial amount of brackets – and recommended that the COP consider and finalise the proposals.

At COP-7 and the subsequent negotiations at SBSTTA, Argentina – supported by other Parties, in particular Brazil and New Zealand – had raised a number of concerns over the proposals, broadly related to the role of mitigating measures and the use of positive incentives for mitigation. These Parties are concerned that the proposals could be used by Parties to justify the provision of agricultural subsidies, and argued that efforts should first be made to eliminate perverse incentives. In order to accommodate such concerns, language was inserted into relevant COP-7 decisions stating that the implementation of the decisions should not promote incentives that negatively affect biodiversity and livelihoods of other countries.

COP-7 has also requested the development of proposals for the application of *positive incentive measures* and their integration into relevant policies, programmes or strategies. SBSTTA-10 has subsequently recommended finalising the proposals on perverse incentives in conjunction with the outcomes of the consideration of positive incentives. Draft proposals on positive incentive measures were submitted to SBSTTA-11 for its consideration, but SBSTTA – essentially because of a lack of time in light of the difficult issues involved in the interlinkages between positive and perverse incentives – was unable to go beyond a first round of exchange, and decided to forward the proposed chair's text of revised proposals.

Multilateral trade rules and incentive measures

The WTO provides the forum for the negotiation of international trade rules that also govern the use of various incentive measures. Two WTO negotiating areas are particularly closely linked to economic incentives: agriculture and fisheries subsidies. Negotiations taking place in the Special Session of the Committee on Agriculture have important linkages with the CBD's work on positive incentives for the conservation of biodiversity and its sustainable use as well as on the removal or mitigation of perverse incentives. Equally important are the attempts of WTO Members, in the Negotiating Group on Rules, to develop rules to discipline fisheries-specific subsidies, including those that contribute to over-capacity and over-fishing of fish stocks.

WTO negotiations on agriculture

Agriculture is among the most heavily subsidised sectors in many countries. In OECD countries, almost one third of farmers' income comes from government subsidies and

other support measures.² Domestic support measures involve transfers to the farm sector, either explicitly (as direct payments) or implicitly (in the form of market price support), and can be regarded as perverse incentives from a biodiversity perspective in cases, for instance, where they lead to the conversion of natural habitats to high-tech, intensive agriculture and to subsequent increases in the use of water, pesticides and fertilisers. The reform of domestic support policies could, for instance, impact on biodiversity by leading to changes in the level and mix of agricultural production and inputs.

The agriculture negotiations continue to be politically sensitive and the sticking point in the Doha Round negotiations. In addition to market access and the elimination of export subsidies, the substantial reduction of trade-distorting domestic support is an important item on the agenda of current negotiations in the WTO Committee on Agriculture Special Session.

The WTO Agreement on Agriculture classifies subsidies to the farm sector according to the degree to which they distort production and trade and subjects those different categories – or “boxes” – to varying reduction obligations. Payments directly related to production volumes are considered trade-distorting **amber box** subsidies whose removal is also generally considered positive for agricultural biodiversity. Subsidies under production-limiting programmes or payments that do not require production are contained in the **blue box** subject to certain conditions related to the area and yields, and levels of production and livestock. These payments are capped at five percent of a Member's average total value of agricultural production. Since blue box subsidies are not truly decoupled from production (to receive a subsidy, farmers still have to keep producing agricultural products), they may in theory have similarly negative impacts on biodiversity as amber box subsidies, albeit more indirectly and more restricted. At the same time, blue box subsidies such as land set-aside programmes, probably have an overall positive impact on biodiversity.

Support measures that are “decoupled” from output quantities and prices, and therefore only minimally distort trade, fall under the **green box** and are exempt from reduction commitments under the current Agreement on Agriculture. In order to fall under the green box, support measures must be provided through a publicly-funded government programme and the support in question should not have the effect of providing price support to producers. Examples for green box subsidies are compensation for income loss for producers located in disadvantaged regions, or for producers implementing environmental programs. Agri-environmental programmes can be categorised into three different types: programmes focusing on the retirement of land from agricultural uses for conservation purposes; programmes focusing on improving the environmental performance and production practices on current agricultural land; and programmes focusing on maintaining specific performances or agricultural practices. Payments to farmers under environmental programmes still account

for only a small share of total transfers but have increased since the mid-80s from one percent to three percent of OECD support to producers. In the EU, for instance, EUR 5.5 billion of the EUR 20 billion of green box subsidies notified to the WTO in 2000/2001 were dedicated to environmental programmes, such as control of soil erosion, aid for forestry measures in agriculture, or the conservation of genetic resources in agriculture. In comparison, in the USA just US\$ 291 million of the US\$ 50 billion worth of subsidies were given as environmental payments.³ In the current trade round, green box criteria will be reviewed and clarified, taking into account non-trade concerns such as environment, food security or rural development.

The gravitational centre of agriculture negotiations is the G-6 group, consisting of Australia, Brazil, the EU, India, the US and Japan. The G-20 group of developing countries – formed just before the Cancun Ministerial Conference in 2003 and led by Brazil, China, India and South Africa – has also become a major player in the negotiations, pushing for an end to export subsidies and significant reductions in domestic support, while facilitating market access for developing countries.

Other important groupings include the Cairns Group of agricultural exporting countries (Australia, Canada, Brazil, New Zealand, South Africa and other Latin American and Asian countries) – the strongest supporters of reducing agricultural subsidies – and the G-33 – a group of developing countries that seek flexibilities for developing countries to address concern around food security, livelihood security and rural development in the face of agricultural liberalisation.

The EU, Japan and Switzerland – as members of the G-10 – would like to maintain a higher degree of protection of their domestic agriculture sector. They highlight the ‘multifunctional’ role of agriculture, arguing that agricultural activity also addresses so-called ‘non-trade concerns’ such as environmental protection, food security and rural development. For instance, they point out that specific traditional farming practices play an important role in creating site-specific biodiversity, soil properties and landscape amenities, and that these high nature value farmlands would be taken out of production first when producer prices decrease.

WTO fisheries subsidies negotiations

Inadequately designed subsidies to fishing industries have been widely recognised as one of the key economic drivers of overexploitation of fisheries resources by contributing to significant overcapacities of fishing fleets in particular in developed countries.⁴ The total level of fishing subsidies is estimated to amount to at least US\$ 15 billion per year, constituting about 20 percent of industry revenue.⁵ In recent years, the international community has recognised the urgency of addressing the negative impacts of fisheries subsidies. The Doha Declaration adopted in 2001 mandates governments

to clarify and improve WTO disciplines on fisheries subsidies, taking into account the importance of this sector to developing countries as part of the Doha round of trade negotiations (para. 28). This mandate was further elaborated in the Hong Kong Ministerial Declaration, adopted at the last WTO Conference in 2005, which calls specifically for the prohibition of certain fisheries subsidies that contribute to overcapacity and over-fishing. The Declaration also stresses the need to take into account the importance of the fisheries sectors for the development priorities, poverty reduction, and livelihood and food security concerns in developing countries.

Under existing WTO rules, fisheries subsidies fall under the general provisions of the Agreement on Subsidies and Countervailing Measures (ASCM). The ASCM prohibits subsidies that are contingent upon export performance or upon the sale of domestic over imported goods. It also includes a category of actionable subsidies, which are not prohibited per se, but can be challenged through the dispute settlement system in case of adverse effects on the interests of other Members. The Agreement initially identified certain non-actionable (permitted) subsidies under Article 8, but those provisions lapsed in 2000 and have not been renewed; therefore, outside of the Agreement on Agriculture, no category of explicitly permitted “green box” subsidies currently exists.

The fisheries-specific subsidies disciplines are being negotiated in the WTO Negotiating Group on Rules. The “Friends of Fish” group, including Australia, Argentina, Chile, Ecuador, New Zealand, Philippines, Peru, Norway, Iceland and the US, has pointed to the ‘win-win-win’ nature of curbing fisheries subsidies: good for the environment, good for development, and good for trade. They argue that current rules are inadequate to deal with fisheries subsidies and in particular with negative impacts arising from production distortions that arise from the technical capacity of fleets – as a result of government subsidies to the fishing industry – to fish more fish than is sustainable. Brazil has defined “production distortion” as “any negative effect a fishery subsidy may have on the sustainability of fishing resources”. Japan and Korea had put up the strongest resistance to negotiating disciplines specifically for fisheries subsidies, arguing that the principal cause of stock depletion was inadequate management of fisheries resources rather than subsidies and that the trade-distorting effects of fisheries subsidies should be discussed as part of the broader negotiations under the ASCM. Despite the initial resistance, the countries, joined by Chinese-Taipei, have slowly come to acknowledge the need to at least address subsidies deemed to directly cause serious harm to the resources, including for capacity enhancement and those that indirectly benefit vessels engaged in illegal, unreported and unregulated (IUU) fishing.

While there is now broad agreement among Members about the need for fisheries-specific subsidies disciplines, divisions on how to structure the rules persist. The Friends of Fish and

Brazil advocate for a broad ban of fish subsidies with certain specified exceptions – for example for fisheries management or social programmes to assist fishermen in the transition out of the industry. Others, particularly Japan, Korea, Chinese-Taipei as well as the ACP (African, Caribbean and Pacific) Group of States and small and vulnerable coastal economies prefer a “bottom-up” approach which would require Members to draw up prohibited subsidies on a case-by-case basis.⁶

Non-subsidy incentives

WTO Members at the Doha Ministerial Conference included in paragraph 31(iii) of its Declaration a mandate to negotiate on *the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services*. **Environmental goods and services (EGS)** could include environmental technologies and/or environmentally preferable products, although they remain to be defined in the WTO. Proponents believe that increasing access to and use of EGS could contribute to improving environmental quality in both developed and developing countries, and possibly provide an incentive for trade in goods produced, used and/or disposed in an environmentally friendly manner. Talks on environmental goods in the Committee on Trade and Environment Special Session have been split between mainly developed countries, who have been advocating for enhanced liberalisation of a list of environmental technologies, and primarily developing countries who have argued that few of the listed products are of export interest to them. As an alternative, several others support the “environmental project approach” proposed by India, which would temporarily liberalise market access for certain goods and services used in approved “environmental projects”. The links between this process and the CBD talks was pointed out at SBSTTA-11, where Parties struggled with whether such trade could act as a positive incentive for biodiversity conservation and sustainable use.

Eco-labelling of products which have been produced in an environmentally-friendly manner has been proposed as another “positive incentive” to encourage environmentally-friendly production. However, several developing countries have raised concerns in the WTO that eco-labels – and developed country public and private environmental standards more broadly – could act as disguised barriers to trade insofar as developing country producers can not afford the higher standards and more stringent rules of production. Developing countries are particularly concerned over the use of process and production methods (PPMs) as labelling criteria, i.e. labels based on how the product was made such as organic agriculture products, fearing that any references to environmental PPMs could open the door for other PPM-

distinctions, such as labour standards. Labelling requirements are on the CTE agenda as an issue for “particular attention” (although not for negotiation) under paragraph 32(iii) of the Doha mandate. Little progress has been made so far and discussions have largely stalled.

Concluding Remarks

The above discussion has highlighted important linkages between the CBD work on incentive measures and the ongoing WTO negotiations. Against this background, synergies need to be drawn upon and coordination ensured between WTO negotiations on the green box and CBD talks on positive incentive measures. The same is true for WTO fisheries subsidies negotiations and the CBD’s work on the removal or mitigation of perverse incentives.

Not every governmental support payment that allegedly serves environmental purposes will be economically sound and environmentally effective. Hence, on the side of the WTO, a clarification of criteria in this regard will help the CBD in the long run as it will legitimise those environmental payments that are well-designed.

Conversely, the CBD work can help clarify what “well-designed” means in terms of effective and targeted biodiversity protection. The proposals on positive incentive measures are an attempt to provide such criteria. They already reflect the useful proposals made in the pertinent discussions and literature on how to “trade-proof” agri-environmental payments – that is, on how to design payment schemes that avoid or minimise adverse trade effects. Moreover, CBD proposals on positive incentives are of a general nature and they do not preclude further research and conceptual work on operationalising the criteria presented and design effective and targeted payment schemes. Such research is needed on the agriculture and the fisheries sides, as well as on trade in biodiversity products and on eco-labelling.

Endnotes

- ¹ A comprehensive presentation of CBD activities on incentives is available on the CBD website at <http://www.biodiv.org/programmes/socio-eco/incentives/incentives.asp>
- ² This section draws from: *CBD Technical Series No. 16: The impact of Trade Liberalization on Agricultural Biological Diversity. Domestic support measures and their effects on agricultural biological diversity.*
- ³ WTO Documents G/AG/N/EEC/51 (European Communities - Domestic support, 4 November 2004), and G/AG/N/USA/51 (United States - Domestic support, 17 March 2004)
- ⁴ UNEP (2004) *Analyzing the resource impact of fisheries subsidies: A matrix approach*, United Nations Environment Programme.
- ⁵ Schorr D (2004) *Healthy fisheries, sustainable trade: Crafting new rules on fishing subsidies in the World Trade Organization*, WWF.
- ⁶ For a compilation of WTO Members’ submissions in the fisheries subsidies negotiations, see http://www.trade-environment.org/output/theme/tewto/fisheries_submissions.pdf, ICTSD, March 2006.