



# SEATTLE TO BRUSSELS NETWORK

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## CLIMATE AND TRADE. AN INTRODUCTION TO ISSUES OF CONFLICT AND CONVERGENCE.

Until today, the trade and the climate debate are coexisting with very little overlap. Trade negotiators for the most part are not interested in climate issues; if at all, they are interested in how climate policies and measures might interfere with trade policy's main objective to liberalize trade. Climate negotiators, in turn, have by and large avoided trade policy topics like the plague. There were concerns that broaching such issues would mean contesting the authority of other government departments, that it would overload the agenda of climate negotiations (which might be true!), that it might ultimately create more conflicts than solutions. However there are good reasons to consider the significance of liberal trade policies as well as the footprint of increasing world trade flows in their impact on human-made climate change. This introductory article will sketch out four areas where trade and climate issues converge.<sup>1</sup>

### 1. TRADE LIBERALIZATION FUELS CLIMATE CHANGE

In theory, for quite some time, it has been controversially debated whether trade liberalization would mitigate or aggravate climate change. On relative terms, it can indeed reduce emissions intensity as liberalization fosters the spread of climate-friendly technologies. For instance, today the most energy efficient steel production plants site in Brazil and China, and not in Europe or the United States. However, several empirical studies now seem to prove that, on aggregate terms, the decades-old aim of liberalising trade between countries and creating a free world market indeed fuels climate change.<sup>2</sup> For one, the expansion of markets causes transport emissions. Transnational product chains, which fan out the production of one product to a dozen or more locations across the world, may lower business costs – but in most cases, they also create a volume of traffic that is crazy in climate policy terms. And secondly, trade liberalization increases the overall efficiency of the economy and thus fosters economic growth. This in turn will create “rebound effects” as growth goes along with

increased demand for energy and resources, and hence generates additional emissions.

What could politics do? Rather than helping conventional globalisation to flourish through further deregulation and liberalisation, trade policy should pursue “economic subsidiarity”, which aims at localizing and regionalizing economic activities whenever possible and reasonable. Economic exchanges should preferably be carried out at the local and national level, while exchanges on the continental or global level should have only a subsidiary function – for instance, when specialising the production of energy-intensive goods in places where particularly low-emission production is possible. To achieve economic subsidiarity, transport costs need to be much increased. Policies such as eco-taxes, emissions trading, user fees for the global commons (e.g., maritime levies for freight liners), or other ways to internalize external costs would turn back the unnecessary globalisation of commodity flows and production chains.

## **2. TRADE LIBERALIZATION DISPLACES EMISSIONS**

The fact that trade liberalization on aggregate terms increases emissions is hidden behind national emission statistics that only notify territorial emissions. Yet the globalization of trade flows has brought about a major geographical shift in emission patterns, which only comes to light when emissions embedded in trade flows are analysed. On the one hand, the countries of the global North increasingly import industrial products from the global South, since their own economies specialise in services and knowledge-intensive products. As a result, their territorial emissions fall. In turn, emissions rise in a number of Southern countries – not only because of increased national demand, but also due to increased production for exportation. Several studies have provided compelling evidence of this trend.<sup>3</sup> During 1992 and 2008, all industrialized

countries together have displaced about 1.2 gigatons of carbon dioxide emissions, which is roughly four times the amount of emissions they have reduced during that time on their own territories.<sup>4</sup>

As long as absolute reduction targets do not exist in emerging and developing countries, the displacement of emissions from industrial countries means nothing less than an increase in total global emissions. Yet it still seems a long way to go until all countries will agree to absolute reduction targets. This is all the more the case as reduction targets based on territorial reporting makes emerging and developing countries less willing to commit to emission obligations as long as the responsibility for export-related emissions fully lies on their shoulders. In climate negotiations, therefore, politics should negotiate on a shared responsibility for export-related emissions. Industrialised countries must take on partial responsibility for the export-related emissions of their Southern trade partners and support reduction activities in these countries.

## **3. BORDER ADJUSTMENT MEASURES**

On the climate policy agenda, the instrument of border adjustment measures has been discussed for many years. Border adjustments are measures that aim to level out differences in technical standards or production costs between domestic suppliers and importers. For example, if a certain government introduces a tax on energy consumption or requires a company to install a sulphur emissions filter, this raises the costs for domestic producers. In order to ensure that they will not be outcompeted by competitors from abroad, who do not have to comply to these higher standards in their home countries, the government in question can set up a border adjustment measure. Border adjustment can take various forms, from border adjustment tariffs or border tax adjustments to emissions standards for imports or the inclusion of importers in national emissions trading. As such, border adjustments are both a measure of

fairness (like treatment of importers and domestic companies) and a way to avoid leakage or the relocation of industries due to increased national environmental standards.

Border adjustment measures were first discussed in the European Parliament in 2005 as a potential means to push a reluctant USA to engage in more stringent climate policies. After the USA under George W. Bush had refrained from signing the Kyoto Protocol in 2001 and failed to take any domestic climate policy measures, the EU looked for ways to pressure the USA into taking climate protection seriously. However, such measures never came to life.

Whenever border adjustments have been discussed in developed countries, such as in draft US climate bills during Barack Obama's first legislative period in 2007/8, this has always created distrust on the side of developing countries, who fear them as a new form of green protectionism. Many developing country governments believe they have a right to catch up with fossil-based development and consider it unfair if their exporting companies are treated like domestic producers in industrialized countries; they don't see it as unfair if advanced companies from the global North face higher environmental standards and costs, while emerging companies from the global South continue to produce according to weaker standards at reduced costs. In 2011, when the European Union mandated foreign airline companies to acquire EU emissions trading allowances, more than 20 developing and developed country governments reacted with protests.

There is also discussion on whether border adjustments can be made compatible with WTO law. For in principle, WTO law does not allow for differentiated treatment of imports according to their process and production methods. At the same time, however, WTO law allows governments to apply like treatment to imported products as to national products. The general view is that, although the actual policy design would be highly complex<sup>5</sup> and would run the risk of being disputed

at the WTO's appellate body, border adjustment measures can be made WTO compatible.

Where they have been applied, in international environmental agreements such as in CITES or the Montreal Protocol, trade policy measures have proved an important building block in improving the effectiveness of these agreements. Political leaders must now decide whether, in the mid- to long-term, border adjustments (as well as more rigorous forms of trade sanctions) should be more widely embraced as a tool to help regulate trade in climate-damaging goods and services. For the future, once countries have made sufficient progress in eliminating CO<sub>2</sub> from their industrial production, one might even envisage a gradual trade ban on products that continue to be produced with the aid of fossil fuels.

#### **4. TRADE POLICY AND SUSTAINABLE TECHNOLOGY TRANSFER**

In the last – and formally still lasting – Doha Round of the WTO, the rapid liberalisation of environmental goods and services has been negotiated. The idea was that liberalizing trade for, among others, certain climate-friendly technologies, such as wind turbines, energy efficient pumps, or photovoltaic cells, could help advance the broad-based application of these technologies. However, academics disagree on whether liberalisation is really an important condition for the diffusion of climate-friendly technologies. It seems other factors are more important, such as the transfer of know-how, capacity building, technical assistance, and financial support. There is growing evidence that the abolition of tariffs only speeds up the diffusion of those goods that are at the last level of the innovation chain, i.e. goods that are ready for the market. For technologies at an earlier innovation level – i.e. technologies that are not ready for the market or not yet competitive in terms of price – initiatives such as knowledge exchange, joint research and development, and incentive programmes are

more effective. The problem is that increased liberalisation and deregulation may abolish not only tariffs but also non-tariff barriers to trade, which could render the necessary introduction of those climate and energy standards and incentive systems difficult.

In any way, local or national production will be more climate-friendly, whereas increased world trade in climate-friendly goods and services will lead to a higher volume of traffic and transport emissions. How much globalization, how much inter-continental trade in goods can we still allow if emissions should be brought down to a 60-80% reduction globally? Instead of shaping the global economy with production chains from one hemisphere to the other, therefore, trade policies for sustainable technology transfer should rather help building up production capacities in developing countries. This may require new regulation on intellectual property rights. For instance, an Insurance Fund for Climate Protection Technologies could financially compensate researchers and developers of climate-friendly technologies while at the same time mandating them to make their findings publicly accessible for broad-scale application.<sup>6</sup> Thus, climate and energy innovations would be available to human beings as a global public good. In addition, new regulations for foreign investments could help in transferring production capacities to the countries of the global South. Up to now, bilateral and regional investment agreements have essentially aimed to deregulate investments and at the same time to protect foreign investors. It is high time to create a framework to make foreign investment genuinely work in the interest of climate protection. Foreign investments could be subjected to a thorough climate impact assessment. Moreover, foreign investors could be obliged to engage in joint ventures and local-sourcing policies.

1. This introductory article rests, among others, on a more detailed study by the author: Santarius, Tilman (2009): Climate and Trade. Why Climate Change Calls for Fundamental Reforms in World Trade Policy. German NGO Forum on Environment and Development/ Heinrich Boell Foundation. Bonn/ Berlin.
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