BUSINESSEUROPE

POSITION PAPER

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DISCUSSION PAPER ON TRADE AND CLIMATE CHANGE:

Alleviating the eventual negative impact of EU climate change policies on competitiveness: are trade measures a realistic option?

Introduction

Climate change is a major global environmental threat, which could have profound effects if left unchecked. The European Union has adopted a wide range of measures to reduce carbon dioxide emissions including a commitment to lower greenhouse gas emissions by 20% by 2020. Such policies aim to mitigate the effects of climate change, but they could also undermine the competitiveness of European industry. Moreover, the knock-on effects will not apply uniformly to all industries; certain sectors will be more affected than others.

For some companies and some sectors, EU climate change policies are expected to bring clarity as regards future investment objectives and future international competitiveness strategies. For other companies and sectors, especially some energy-intensive industries, there are real concerns about increasing costs impacting on their global competitiveness.

To truly mitigate climate change and to ensure that the global competitiveness of European industries is not weakened as a result of climate change policies, the EU must actively pursue a multilateral agreement on climate change with all key emitting countries. In addition, the EU must consider the possibility for global sectoral agreements in this field to prevent the risk of carbon leakage and maintain a competitive level playing field for key sectors. Finally, climate change policies and regulations adopted by the EU should be cost-effective to ensure that European products remain competitively priced on global markets.

To address the concerns of these affected sectors, the High Level Group on Competitiveness, Energy and Environment has asked whether the EU should consider introducing trade measures for climate change purposes.

This draft BUSINESSEUROPE position is a response to some of the issues raised in the trade and climate change debate. It presents the following:

1. A position on unilateral trade measures in general and a specific analysis of proposed trade measures designed to mitigate competitive disadvantages or trade measures to coerce trading partners into altering their climate change policies.

2. An overview of business views on the potential effects of climate change measures on industrial users of natural resources.

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For BUSINESSEUROPE, it is imperative to avoid that EU climate change policies have a negative impact on the competitiveness of industrial companies within the EU. To keep the competitive position of European industries intact, it is necessary that effective and timely measures are implemented that correct or better prevent eventual distortions. As this paper shows, unilateral trade measures (as sometimes suggested by different stakeholders) are not an option in this respect. Thus the only alternative is to correct the distortions in an early stage at their source, namely the internal EU climate change policies and related legislation. To this end, developments should be closely monitored and an early warning mechanism put in place.

I. BUSINESSEUROPE OPPOSES UNILATERAL TRADE MEASURES TO ENFORCE NON-TRADE OBJECTIVES

There remains fundamental disagreement within the international community on how to address the issue of climate change. Despite these differences and at the risk of putting some EU business at a competitive disadvantage, the EU has chosen to move forward with ambitious unilateral climate change mitigation objectives. This has led to calls for unilateral trade measures to offset the competitive disadvantages created by EU climate change policies.

Nobel laureate Joseph E. Stiglitz, in *Making Globalization Work***,** argues that energy-intensive exports from the United States enjoy an unfair competitive advantage because the US did not sign the Kyoto Protocol on greenhouse gas emissions. He suggests that EU and Japan ought to restrict or tax energy-intensive imports from the United States, so as to force the US to reconsider its position. The Commission's High Level Group on Competitiveness, Energy and the Environment also debated making similar recommendations.

These proposals are seriously misguided. Trade sanctions will not help to mitigate climate change but rather risk causing considerable damage to the international trading system. Proposals for trade sanctions reflect frustration with the environmental policies of other countries but frustration is neither a reason nor an excuse for bad policy-making. If the EU were to impose trade sanctions against countries that have not signed or are exempt from reduction commitments under the Kyoto Protocol, this is bound to lead to trade retaliation. In turn, this could lead to an escalation of retaliatory measures and, in a worst case scenario, possibly even a global trade war and the collapse of the multilateral trading system, which is so crucial for European competitiveness.

The timing of a possible trade dispute over this issue would also be particularly bad, as the EU is pressing for the conclusion of the Doha Round. Success in the DDA would also be good for the environment because trade liberalisation boosts global economic welfare. This, in turn, will make it easier for emerging economies in particular to sign up to more environmental protection and hopefully to international environmental commitments.

BUSINESSEUROPE is of the firm view that unilateral trade measures will neither ameliorate the global environment nor strengthen the competitiveness of the European economy. They would be in direct violation of the EU's international trade and climate change commitments and would undermine its credibility on the world stage.

a. A violation of international obligations

First, the EU has committed itself under the Kyoto Protocol to adopt climate change policies in such a way as to minimise adverse effects on international trade. Therefore, border tax adjustment or similar measures would be incompatible with its Kyoto obligations.

Second, the WTO would reject any argument suggesting that the EU could legally compensate its industries through border tax adjustment because the non-ratification of the Kyoto protocol is not a classified subsidy in WTO legal terms.

Third, the WTO itself is quite reluctant to allow trade sanctions as a means to force other countries to follow one's own preferred policies. This makes good sense. It respects the principle of state sovereignty, and reflects concern about extraterritorial measures, in particular if the problem, as in the case of the EU, is self-inflicted. The EU's energy and climate change policies may increase competitive pressures and disadvantages for some energy-intensive industries but these policies were of its own making.

Fourth, the WTO has not had to adjudicate unilateral trade bans or levies designed to protect the "global commons" (in the cases to date one always found a link with the territory of the country taking trade action). Given the seriousness of climate change the WTO would have to evaluate the disagreement between the EU and the US on whether the Kyoto Protocol is the right measure to achieve CO_2 reductions, whether big CO_2 emitting emerging countries should be exempted from any obligations and whether Kyoto signatories themselves achieve the goals they have signed up to. Under these circumstances, it seems unlikely that the WTO would allow an exception to its basic principles to protect the "global commons" against climate change.

Fundamentally, if every member could adjust the regulatory differences it has with other members through border levies or special local taxes on imports, liberal trade would become illusory. Therefore, BUSINESSEUROPE does not believe that the WTO would uphold a trade restriction on US, Chinese or Indian exports that is meant to change their policy on global warming.

b. A loss of EU credibility in the international arena

Traditionally, the EU has opposed unilateral trade actions with the aim of exerting pressure on sovereign states and it should refrain from pursuing such coercive policies today. The EU should seek to convince with argument rather than attempting to coerce with political or economic power. The European business community strongly defends international agreements and international cooperation to address international issues. Consequently, the multilateral trading system should not be taken hostage because there is no global agreement on climate change.

Unilateral trade policy measures to level the playing field will be perceived by our trading partners as pure protectionism. These countries will in turn also retaliate against any measure they perceive to be unfair. To resolve the self-induced competitive disadvantage for some industries, the EU has no other choice than to negotiate a solution at international level.

EU proposals for unilateral measures to pursue environmental goals or mitigate competitive pressures on its energy intensive industries would also undermine negotiating strategies in the WTO. The EU is currently trying to convince other WTO members to abolish non-tariff barriers, such as export taxes or dual-pricing policies on raw materials. It would prove difficult for the EU to convince its trading partners to eliminate their NTBs whilst on the other hand creating new obstacles against exports to the European market.

II. LIBERAL TRADE POLICIES AND CLIMATE CHANGE

Trade policy can also be used in a more constructive approach to contribute, albeit in a small way, to climate change policy. However, current proposals and initiatives by the EU are not always well thought through and often fraught with contradictions. Two clear examples of this are the WTO negotiations on Environmental Goods and the contradictory policies that favour renewable energy resources.

a. Positive incentives for climate change: Environmental Goods

The WTO Doha Round Declaration calls for negotiations on the reduction or elimination of tariffs on environmental goods. The objective is to encourage trade in goods which are beneficial for the environment and thus to encourage the diffusion of environmental goods in the global economy. Negotiations on environmental goods are meant to mimic the successful Information Technology Agreement (ITA) which fostered trade in goods necessary for IT development. Whilst appealing at first sight, BUSINESSEUROPE has voiced strong conceptual and practical concerns with this approach. [1]

First, given the fact that there is no agreed definition of an “environmental good”, the result could lead to unjustified discrimination between products. The EU has for example proposed that insulation panels made of natural fibres should be considered environmental goods whilst insulation panels made of synthetic substances would not be covered, even though both products serve a similar environmental purpose.

Second, the debate on environmental goods could lead to new WTO trade requirements on non-product related process and production methods (PPM) by allowing a WTO member to distinguish at the border between products on the basis of their non-product related PPM. It must not become the role of tariff schedules to deal with issues that have so far not even been discussed, or negotiated on, by the WTO membership. Indeed, there are good reasons for this: PPM obligations would interfere with sovereign decisions of WTO member countries and could encourage discrimination and protectionism, which would fundamentally undermine core WTO principles.

[1] For a more detailed position on Environmental Goods see: www.businesseurope.org

Third, any WTO Environmental Goods Agreement will inevitably lead to classification problems as customs authorities will need to judge whether or not a good is “environmental” or whether it is on the WTO list of environmental goods. In either case, the beneficial contribution to the environment of such a list of goods would likely be negligible if measurable at all.

In the worst case scenario a WTO Agreement on Environment would lead to new trade complications requiring exporters to produce environmental certificates with their exports – although this would help various certification schemes and well-intentioned NGOs with their own certification schemes to prosper.

In the best case scenario, a WTO Agreement will contain a pragmatic list of agreed “environmental goods” whose contribution to the environment will be limited but which BUSINESSEUROPE can support as a trade liberalising measure. However, business expects the Commission to provide more information on the list of products that will be liberalised to ensure that the leading European products will also be included. If the latter scenario develops, BUSINESSEUROPE also believes that the list should be regularly updated through mandatory review negotiations to address inevitable classification problems. BUSINESSEUROPE reiterates, however, that its priorities for industrial market in the Doha Round are an ambitious tariff cutting formula, sectoral initiatives for willing sectors and real progress on non-tariff barriers.

b. Conflicts over Renewable Resources

Renewable resources are used as raw materials in a wide variety of industrial products and uses. For instance, many renewable materials such as sugar and its derivatives, cereals, oilseeds and animal fats serve the needs of the food and feed industry, the chemical industry and increasingly as a source for renewable energy. Similarly, timber is now increasingly used in the production of bio-energy as well as for its traditional applications.

As a direct result of EU energy and climate change policies, in particular the decisions adopted by the European Council of 9 March 2007 setting mandatory targets on renewable energy, there will be strong demand for renewable resources as well as a potential conflict between food, energy and industrial users of those resources. To mitigate this potential conflict, the EU will need to rethink the policy framework surrounding renewable resources.

European industry successfully competes at a global level, is market-driven and supports the further liberalisation of world trade. But to remain competitive, European industry will need better framework conditions and market driven policies. To address the expected strong increase in demand for renewable resources, BUSINESSEUROPE calls for the EU to adjust trade policies, for instance by eliminating tariffs where necessary, to provide access to raw materials at competitive prices, and to remove other state intervention policies at the border that distort the prices of renewable resources on the European market. The logic behind this change is clear. Since natural resources are critical inputs in many sectors, governments should not employ restrictions on their import or distort production patterns. This means, very concretely, that all trade barriers, in particular import tariffs, import quotas, subsidies and other government-induced distortions at the border that undermine the competitiveness of European business should be eliminated.

Europe has gained world manufacturing and export leadership because it always applied the rule that raw materials should be sold at competitive prices to encourage higher value added production which often creates more jobs and value-added input than direct energy use of raw materials. Industrial tariffs in Europe have an average bound tariff of 4% per cent and most industrial raw materials enter the market duty free. Similar policies should apply to natural raw materials used as inputs for industrial production or energy use. To maintain European competitiveness, trade barriers on natural resources that undermine the competitiveness of European business should be eliminated.

CONCLUSION

The EU has decided to be a leader on climate change. The measures taken because of this could result in stronger competitive pressures on some European industries relative to competitors from third countries which have not developed the same policies to address climate change.

Whilst attractive at first sight, Europe must not make the mistake of resorting to well – intentioned but nevertheless unilateral protectionist measures. BUSINESSEUROPE is convinced that this would backfire and be even more detrimental to the EU's competitiveness over the medium to long term.

Conversely, effective measures to mitigate competitive pressures could include:

First, if an international climate change and energy agreement contained obligations undertaken by the international community, the ill-placed discussion of unilateral trade measures would not arise. BUSINESSEUROPE rejects the temptation to overload trade policy with non-trade issues. Business also expects that the WTO membership to clarify the relationship between Multilateral Environmental Agreements and WTO rules.

Second, market-distorting policies which restrict industry's access to renewable resources put European business at a competitive disadvantage relative to foreign competitors. Both domestic and foreign market distorting policies should be eliminated. In order for the EU to set a good example it should apply a consistent policy of abolishing domestic distortions and insisting on the abolition of foreign distortions in international trade and economic negotiations.