Trade Challenges on the Road to Copenhagen and Senate Action

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Trade has not had as high a profile as it should in the debate over Waxman-Markey. Nor has it been a prominent factor in international fora such as the UNFCCC. However, as debate over how to proceed sharpens in the Congress and Copenhagen approaches, trade issues are looming larger – and for good reason. Depending on the trade policies we choose, our actions on climate could have a tremendously positive or negative impact on global trade, jobs, and the global economy.

The United States is hardly the only actor, but the Obama administration has an important opportunity to lead and to persuade Congress both to create new clean energy jobs in the United States and to avoid taking steps that could lead to a green trade war and harm the global economy.

There are several climate policy issues that would impact on international trade. The National Foreign Trade Council, which is a trade association that represents large global companies, has been focusing on two, which I would characterize as the "two sides of green trade":

1. On one side you have the challenge of navigating between policies which threaten to disrupt the international trading system. For example, Waxman-Markey contains border adjustment measures and free allowances aimed at leveling the playing field for U.S. manufacturers who face higher costs from putting a price on carbon.

2. On the other side, there is an opportunity to take positive steps to incentivize the adoption and financing of clean energy technologies to developing countries. Common-sense policies can create high-paying green collar jobs in the United States and around the world, though care must be taken to make sure that incentives comply with global trade rules and spur the creation of new technologies.

Waxman-Markey: The challenge of leveling the playing field

To the extent that Congress has talked about trade in the debate over domestic climate legislation, it has been in the context of if and how to address the competitiveness of U.S. energy-intensive manufacturers and the possibility of "carbon leakage" -- that production of energy intensive products will move from the United States to countries with a competitive advantage because of their weaker regulations.

Until now, the European Union and other countries contemplating cap-and-trade systems have relied on giving away credits for free to energy-intensive industries that are hit hardest by climate policies. U.S. legislation contemplates similar assistance to domestic manufacturing industries including steel, aluminum, cement and chemicals.

Some, lately including economist and New York Times columnist Paul Krugman, argue that it is also necessary to impose a "carbon tariff" or equivalent "border adjustment measure" that would place an additional cost on energy-intensive imports into the United States from countries which have not taken sufficient steps to combat climate change.

The best way to integrate a global climate framework into the international trading system is to encourage an understanding among major emitting countries about the use of trade-related climate measures like emissions allowances and border adjustment measures. Congress has called for such an understanding in the version of Waxman-Markey that passed the House. We believe it is in the world's interest to negotiate an international framework agreement on the use of trade-related climate change measures such as free emission allowances and border adjustment programs.

But even if the world cannot agree on such a framework, it is not in the U.S. economic or environmental interest to impose border adjustments or carbon tariffs on other countries.

They are blunt instruments which are unlikely to incentivize foreign companies to green their production. This will in turn make it more difficult for such a measure to pass muster at the World Trade Organization.

Even if you could design a trade measure that satisfied global trade rules, the threat or imposition of a border measure would cause serious friction with developing countries, who have already threatened to retaliate. This causes us to worry that border adjustment mechanisms would have a negative effect on the global trading system. There is also the possibility that these measures would be used against the United States, which is something that France has hinted at.

For all these reasons, President Obama has said that, in order to create a level playing field for American manufacturers, "there may be other ways of doing it than with a tariff approach."

While we believe that free allowances could also be scrutinized for their compatibility with global trade rules, the reality is that these allowances are substantially less likely to be challenged internationally than a new tariff. As trade expert Gary Horlick points out, "In practice…import restrictions are much more likely to be challenged in the WTO than is financial assistance to producers, such as offsetting costs or giving away permits." He notes that thousands of pages of subsidies are reported to the WTO, but only a handful have been challenged, while countries have raised objections to hundreds of border measures. In short, carrots are easier to swallow than sticks.

Green trade = Green jobs and a cleaner environment

While it is imperative to ensure that competitiveness issues don't threaten the trading system, we shouldn't overlook the tremendous opportunity in climate change discussions to promote green jobs in the United States and around the world.

One way to jumpstart the U.S. clean energy economy is to lower trade barriers to exports of environmental goods and services. U.S. businesses and workers would benefit from the removal of barriers that U.S. exporters face on green goods and services in what is a large and rapidly growing market.

There is also an environmental benefit. The World Bank notes that, "it is widely accepted that trade liberalization of [environmental goods and services] would benefit the environment by contributing to lowering the costs of goods and services necessary for environmental protection, including those beneficial for climate change."

The United States, along with the EU, has proposed an "Environmental Goods and Services Agreement" as part of the Doha Development Round of trade negotiations under the World Trade Organization. We believe the Obama administration should elevate the priority of these negotiations and pursue an agreement on green trade without waiting on the rest of the Doha Round.

Another policy priority should be to make certain that other countries protect the innovation and intellectual capital behind technologies to promote the development of breakthrough innovations that will help address climate change in the future.

Congress has acknowledged the importance of intellectual property protection for promoting innovation and delivering clean technologies to developing countries. But developing countries have staked out positions in the UNFCCC negotiations that would distort trade and weaken global rules on intellectual property. The UNFCCC is not the proper forum for rewriting trade rules, and the new exemptions that are being proposed there would stifle the development of the next generation of clean energy technologies. Ultimately, this will also work to the detriment of developing countries who themselves are building innovative capacity in green technology and who put their own inventors at risk by insisting on loose standards for technology transfer.

There are numerous other incentives that Congress, the Administration and international negotiators are considering which have the potential to create jobs and help the environment. Eco-labeling schemes, clean technology funds, government procurement policies favoring climate-friendly goods, and incentives for research, development and production of clean technologies have all been discussed in various contexts.

NFTC addressed the compatibility of a number of these proposals with global trade rules in a paper released in December 2007. Without getting into detail on each of the specifics, which would take much more time than I have, I would say that policies are less likely to violate global trade rules to the extent that they are transparent, apply the same rules to foreign and domestic entities, do not needlessly restrict trade and are not designed to enhance the export performance of domestic industry.

Based on these criteria, emissions trading may be one of the most WTO-compatible policy instruments available. But details matter. It is too early to draw a firm conclusion, but right now the impact of the subsidies, border measures and other requirements of legislation under consideration here and elsewhere provides good cause for worry that in the interest of short term protection we may be taking steps that ignite global trade conflict and at the same time make it more difficult to achieve our collective climate change goals. This is a situation that we will be watching carefully, and I hope you will be as well.