



The Voice of OECD Business

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## **BIAC Views Concerning OECD Work on Trade and Climate Change**

### **I. Introduction**

There is broad agreement within the OECD business community that climate change is an urgent challenge requiring concerted action by all sectors of society. For business it is vital that policy makers develop an effective global response that is based on a sound understanding of the economic implications of climate change and climate change policies, and that engages the central contribution of the private sector in this regard.

Thanks to its economic expertise as well as its evidence-based and multi-disciplinary approach, the OECD is ideally placed to advance the understanding of the economics of climate change, thus providing an important contribution to the international climate change debate. We are encouraged that the Council at Ministerial Level provided high level support in June for the OECD's horizontal project on the economics of climate change.

Trade liberalization and co-operation on climate change cooperation are essential to sustainable development. Both developed and developing countries have shared interest in finding workable, synergistic solutions to these challenges. Thus, we believe that the OECD Trade Committee can and must play an important role in advancing the international debate on effective policies for addressing the climate change challenge.

In this submission, BIAC reaffirms business support for a co-operative long term global policy framework involving all major emitting countries and appropriate to national circumstances to address the climate change challenge. Further, we highlight the importance of advancing understanding of the positive role that open markets for trade and investment can play in supporting climate change policies as well as the need to find practicable solutions that are preferable to unilateral trade measures promoted for climate change purposes. We call on the OECD to speak out strongly against unilateral trade measures to support climate change policies. Finally, we provide suggestions on how the OECD Trade Committee can help advance international policy consensus concerning trade and climate change through analyses and policy recommendations.

### **II. Support for a global climate change framework**

BIAC regards an effective global framework as the first best solution for addressing policy challenges associated with climate change. We are encouraged that the UN Climate Change Conference in Bali last December opened negotiations to develop a post-2012 framework

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involving the UN Framework Convention on Climate Change (UNFCCC) and the Kyoto-Protocol at the UN Climate Change Conference in Copenhagen in 2009. The time between now and the Copenhagen Conference will be critical for efforts to reach an agreement that includes as many countries as possible and in particular all major Green House Gases (GHG) emitters.

BIAC calls on the OECD countries to engage constructively in the negotiations to frame post-2012 actions under the UN Framework Convention on Climate Change. In that context, it is important that trade and climate change policies be pursued as mutually supportive of one another. Although concerns about carbon leakage are quite important, they should be addressed through multilateral co-operation and trade policy must not be used to coerce countries to apply climate friendly policies. Rather, the OECD countries should pursue dialogue, diplomacy and partnerships for win-win approaches. The OECD has to play an important role in supporting member countries by providing empirical evidence about the economics of climate change.

### **III. Business concern about unilateral trade measures to combat climate change**

Unilateral trade measures to combat global warming and maintain competitiveness are under consideration in some OECD countries. Politicians have proposed using trade measures such as carbon taxes on imports, border tax adjustments for imports, “carbon footprint” labels, and the extension of domestic emissions trading systems to imports. The basic aim of these measures is to respond to perceived carbon leakage arising from differentiated climate policies and to address the competitiveness concerns of domestic industries.

BIAC is concerned about the significant risks and impacts associated with unilateral trade measures, which are unlikely to resolve competitiveness challenges and carbon leakage, and that will almost certainly undermine climate co-operation and sustainable development. BIAC is of the firm view that unilateral trade measures will neither improve the global environment nor strengthen the competitiveness of OECD industries, companies and firms. Unilateral measures are likely to be considered a violation of international trade and climate change commitments, could trigger trade protectionism, could damage the integrity of international environmental treaties and make it more difficult to achieve a much needed global post-Kyoto agreement on GHG emissions reductions. In the following paragraphs we present our concerns in detail.

#### ***III.a) Impact of unilateral trade measures on competitiveness of domestic industries***

It has been argued that unilateral trade measures can offset competitive disadvantages that domestic industries are facing on international markets because of costly domestic mitigation policies. However, in BIAC's view the overall impact of trade measures on domestic competitiveness is more likely to be negative than positive. Some domestic companies may benefit in the short term from the extra protection provided by trade measures that add costs to imports at the border. However, the initial advantage of protection for domestic companies will over time likely turn into a competitive disadvantage as companies that are partially shielded from competition tend to be less innovative, less active in seeking new business opportunities and less eager to reduce excessive costs than companies that are exposed to effective international competition.

Moreover, any unilateral trade measures applied would likely have to be relatively drastic in order to lower domestic demand for GHG intensive imports sufficiently enough to provide an

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economic incentive for countries of origin to invest in more effective GHG -reducing technologies. However, the more drastic the trade measure is, i.e. the more it increases the import price of a product, the more it also becomes a real additional cost factor that threatens the international competitiveness of those domestic companies which are using imports for their production process. The overall impact of unilateral trade measures on the competitiveness of the domestic industry will likely be negative also because in most economies companies that need relatively GHG intensive imports as production inputs are likely to constitute the clear majority over those who are independent from these imports.

Therefore, unilateral trade measures are unlikely to offset competitive disadvantages caused by mitigation policies in home countries. They may even further reduce the competitiveness of domestic industries in the long-run and through this not only impact negatively on domestic jobs and economic growth.

### **III.b) Incompatibility of unilateral trade measures with existing trade and climate change conventions**

BIAC believes that unilateral, discriminatory trade measures in the name of climate change are incompatible with countries' obligations under the Kyoto protocol and the Rio Declaration and that the outcome of any WTO dispute settlement procedures concerning unilateral trade measures to combat climate change would be uncertain at best.

The Kyoto Protocol does not envisage any trade sanctions. It explicitly states that parties are to implement Kyoto policies and measures in such a way as to minimize adverse effects on international trade. Principle 12 of the Rio Declaration on Environment and Development explicitly calls for countries to avoid unilateral measures.<sup>1</sup> The WTO does not permit trade sanctions as a means to force other countries to follow a given country's preferred policies. It respects the principle of state sovereignty, and reflects concern about extraterritorial measures.<sup>2</sup> Furthermore, the WTO Agreement on Technical Barriers to Trade tries to ensure that regulations, standards, testing, and certification procedures do not create unnecessary obstacles to trade. The agreement says that procedures used to determine whether a product complies with rules must be fair, equitable and not give domestically produced goods an unfair advantage.

So far the WTO has not had to adjudicate unilateral trade bans or levies designed to address climate change. In the cases to date, there has always been a link with the territory of the country taking trade action. Given the seriousness of climate change, the WTO would have to evaluate any disagreement, for example, between the EU and the US, on whether: (a) the

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<sup>1</sup> The principle reads as follows: *“States should cooperate to promote a supportive and open international economic system that would lead to economic growth and sustainable development in all countries, to better address the problem of environmental degradation. Trade policy measures for environmental purposes should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade. Unilateral actions to deal with environmental challenges outside the jurisdiction of the importing country should be avoided. Environmental measures addressing transboundary or global environmental problems, should, as far as possible, be based on an international consensus.”*

<sup>2</sup> This approach is captured, for example, in one sentence from the Appellate Body's Shrimp/turtle ruling (US-Shrimp): *“However, it is not acceptable, in international trade relations, for one WTO Member to use an economic embargo to require other Members to adopt essentially the same comprehensive regulatory program, to achieve a certain policy goal, as that in force within the Member's territory, without taking into consideration different conditions which may occur in the territories of those Members.”*

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Kyoto Protocol is the right measure to achieve GHG reductions; (b) major GHG emitting emerging countries should be exempted from any obligations; and (c) Kyoto signatories themselves do in effect achieve the goals they have committed to.

In these circumstances it seems unlikely that the WTO would accept an exception to its basic principles. The WTO will probably not uphold a trade restriction on imports that is meant to change the policy of the exporting country on global warming. Still, some observers believe that recent WTO rulings, such as in US-Shrimp and EC-Asbestos, have increased the possibility that a climate change trade measure or border control, e.g., one based on non-product production and process measures (PPMs), might be found compatible with WTO disciplines under certain circumstances. Consequently, the likely outcome of any WTO dispute settlement procedures concerning unilateral trade measures to combat climate change would be uncertain at best.

### ***III.c) Political risks***

In addition to the legal considerations and uncertainties, policy makers must fully take into account the considerable political risks that are associated with unilateral trade measures to combat climate change.

At the United Nations Climate Change Conference in Bali in December, Trade Ministers meeting informally agreed that trade restrictions are undesirable, as they run the risk of retaliation, and further complicate trade liberalization. BIAC fully shares this assessment. Whatever the motivation for unilateral trade measures, trading partners may view such actions as protectionism. Governments may, in turn, choose to retaliate against any measure they perceive to be unfair. Fundamentally, if every WTO 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.

Besides involving the considerable risk of a spiral of trade protectionism, unilateral trade measures would also seriously damage the integrity of international environmental treaties. It is difficult to understand how OECD countries could sign an international environmental agreement, recognizing common but differentiated responsibilities, and then impose border tax adjustments on trade with those countries.

Moreover, provocative unilateral trade measures would represent an obstacle in creating the appropriate international dynamics within which to agree a post-2012 climate change framework.

## **IV. Open markets help to address the climate change challenge**

### ***IV.a) Trade and investment liberalization are essential to enable climate change policies***

Open rules-based trade and effective climate change policies should not be seen in opposition to each other but rather as being mutually supportive. International trade and investment play essential roles in the transfer of best-available technology.

Open trade and investment regimes generate competition and thus stimulate innovation, as well as the global diffusion and implementation of clean and cost effective technologies that will be critical for addressing climate change problems in an effective way. The world environmental technology market is valued at 550 billion euro per year and it is growing.

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Leading companies are innovating, and looking to commercialise their climate friendly technologies in growing markets such as India, China, Brazil and other rapidly industrializing countries. Thus, climate and trade regimes that are harmonious and reinforce each other would create a significant business opportunity for environmental goods, services and technologies.

Trade and investment also contribute to wealth creation and through this help in particular developing countries to bear the potentially high costs that may be associated with climate change policies. Further, cross-border trade and investment significantly widen consumer choice and therefore act as a channel for more widespread use of environmentally friendly products and services.

Thus, trade and investment liberalization are critical to support policies designed to address climate change in very meaningful ways. The successful conclusion of the WTO Doha Development Round would represent a major step forward provided it would lead to genuine trade liberalization across all major negotiating areas agriculture, industrial goods and services. A conclusion of the WTO Doha Development Round DDA with meaningful results would also send the positive signal that governments can successfully co-operate to strengthen central elements of the global economic system. Such a signal may contribute to a global political atmosphere conducive to successful global negotiations about a post-Kyoto agreement.

#### ***IV.b) Examples of trade policy issues that are particularly relevant to climate change issues***

While international trade and investment liberalization across all sectors can substantially support the achievement of climate change policy objectives, there are some specific trade policy issues, which seem to be particularly relevant to the climate change debate. For BIAC it is essential that the trade policy in these areas be used in constructive approaches and partnerships to contribute to climate change policy. We would like to draw the OECD's attention to BIAC views concerning three such trade policy issues, namely the protection of intellectual property rights, the WTO negotiations on environmental goods and services as well as policies that favor renewable energy resources.

##### *Upholding intellectual property right protections*

Upholding intellectual property rights will be vital to driving the innovation, which will create the technologies that can help to address climate change. In some countries, questions have been raised whether existing provisions of the WTO TRIPS agreement need to be re-examined in order to facilitate the international transfer of climate change technologies, especially to the developing world. Such calls fail to appreciate that the nature of the market for climate change technologies would make such measures unnecessary and counterproductive. Within the market for climate change technologies, a number of firms and substitutable technologies compete. Thus, it is robust protection of intellectual property rights that will provide the incentive for competing technologies to be created, rendering a possible TRIPS exemption counterproductive. Additionally, many of the core technologies used within climate change products have already passed out of patent, so that access to them would not be enhanced by a TRIPS exemption.

##### *Environmental goods and services*

The WTO DDA agenda 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

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the environment and thus to encourage the diffusion of environmental goods in the global economy.

The United States and the European Union have jointly proposed that the negotiations remove barriers to trade for a number of environmental goods and services based on a specific list of climate-friendly technologies identified by the World Bank. A recent World Bank report on trade and climate change finds that removing tariffs and non-tariff barriers for four basic clean energy technologies in 18 of the high emitting developing countries could result in trade gains of up to 13%. The potential for expanding this initiative beyond a small subset of technologies and countries is clear.

BIAC supports the removal of barriers to trade for environmental goods and services as this would contribute to lower costs and increased global access and use of these products. However, we also recognize that there are a number of practical concerns with regards to its implementation. The negotiation process has demonstrated that it is difficult to define environmental goods, and the absence of an agreed product list could lead to unjustified discrimination among products. Therefore, BIAC favors the approach to develop a pragmatic list of “environmentally-friendly” goods and services rather than generally defining what is environmentally friendly and what not. Further, BIAC remains opposed to any new WTO requirements that would be based on non-product related process and productions methods (PPMs), which would force governments to interpret tariff schedules with regard to issues that have not been discussed or negotiated by the WTO membership. PPM obligations would encourage discrimination and protectionism, interfere with sovereign decisions of WTO member countries, and would hence fundamentally undermine core WTO principles.

#### Trade and renewable resources

Renewable materials such as sugar and its derivatives, cereals, corn, soybeans, 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 energy and climate change policies in a number of countries, demand for renewable resources will grow, posing challenges in the form of competition among food, energy and industrial users of those resources. To mitigate these conflicts, OECD members should approach policy frameworks for the use of renewable resources for energy within a realistic and integrated approach informed by considerations of science, cost-effectiveness, and environment. The impact of subsidies on trade, competition, demand, commodity prices and sustainability should be given due attention.

As one possible way to address the expected strong increase in demand for renewable resources for energy or climate change, BIAC calls on OECD members to adjust trade policies (for example, by eliminating tariffs where necessary) to provide access to raw materials relevant to climate or energy at competitive prices. This also includes removing other State intervention policies as trade barriers (in particular import tariffs and import quotas), subsidies and other government-induced economic distortions. In addition, OECD members should ensure that standards and regulations guiding product attributes do not act as arbitrary impediments to trade.

#### **IV.c Trade and transportation**

An emerging issue in the context of the debate on climate change and trade is the carbon footprint of internationally traded goods. Supermarket chains are increasingly using labels to inform consumers about the distance that a product (e.g. food) has been transported from

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the location of production until it reaches the consumer. The underlying argument is that the larger the transported distance the higher is the CO<sub>2</sub> emission associated with the transport and the more environmentally unfriendly is it to buy the internationally transported product.

As WTO Director General, Pascal Lamy stressed in his speech to Trade Ministers in Bali in December 2007<sup>3</sup>, empirical evidence suggests however, that this argument can be wrong. One reason for this is that internationally traded goods are mostly transported by ships which represent a much more carbon-efficient mode of transport than train, road or air transport. Moreover, transport is not the only factor that impacts on a product's carbon footprint. The CO<sub>2</sub> emissions of production and processing also need to be taken into account. When this is done then the carbon footprints of many internationally traded products compare quite favourably with domestically produced products even when the product from abroad has to be transported large distances to reach the consumer. For example, Mr. Lamy quotes studies which indicate that a Kenyan flower that is air-freighted to Europe emits 1/3 of the CO<sub>2</sub> of flowers grown in Holland and that some fertilizers produced in the United States and transported to Europe can generate 13% less CO<sub>2</sub> than fertilizers produced in Italy.

The ongoing debate about carbon footprints of internationally traded goods has the potential to impact significantly on the acceptance of these products by consumers and to further fuel policy discussions about potential trade policy responses to the climate change challenge. BIAC would find it useful if the OECD would help framing the debate by providing fact-based evidence and sound argumentation concerning carbon footprints of traded products and possible trade policy responses.

## **V. BIAC suggestions for OECD work**

The OECD project on the economics of climate change provides an important opportunity for the Organisation. The OECD should use its expertise as well as its evidence-based and multi-disciplinary approach in order to advance global policy makers' understandings of the economic implications of alternative climate change policies to combat climate change.

Trade policy issues should be an important integral part of the OECD work on the economics of climate change. BIAC calls on the OECD to support multilateral co-operation to address climate change positively and to **speak out strongly against unilateral trade measures** to combat climate change. We look to the OECD to elaborate the indispensable supportive role of open and rules-based trade to climate change solutions.

Further, we believe that the OECD could make a very valuable contribution to the climate change debate by providing analysis and policy recommendations on how trade and investment liberalization across all sectors can contribute to achieving climate change objectives. One important element of this is how enabling frameworks for trade and investment foster **diffusion and application of new technologies**. We believe that many aspects of the recently concluded OECD project on trade and innovation are highly relevant for this discussion.

We believe that additional OECD analysis and recommendations on how open markets can help support climate change policies should include discussion concerning the protection of **intellectual property rights, environmental goods and services** as well as policies for trade in **renewable resources**. Further, we would find it very useful if the OECD would

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<sup>3</sup> WTO News – “Lamy: Doha could deliver double-win for environment and trade”, 9 December 2007

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provide evidence based arguments concerning the discussion on **carbon footprints** of internationally traded goods.

BIAC appreciates the opportunity to provide views on this paramount issue and is prepared to more detailed comment on the various aspects summarized in this paper.