



European Economic and Social Committee

REX/267
International trade and
climate change

Brussels, 26 May 2010

OPINION
of the
European Economic and Social Committee
on
International trade and climate change

Rapporteur: **Ms Pichenot**

On 26 February 2009, the European Economic and Social Committee, acting under Rule 29(2) of its Rules of Procedure, decided to draw up an own-initiative opinion on:

International trade and climate change.

The Section for External Relations, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 11 May 2010.

At its 463rd plenary session, held on 26 and 27 May 2010 (meeting of 26 May), the European Economic and Social Committee adopted the following opinion by 154 votes to four with seven abstentions.

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1. **Recommendations**

- 1.1 As an integral part of the Europe 2020 Strategy, any new trade policy must respond to environmental concerns, while avoiding the temptation of reverting to protectionism. It must help develop a more innovative, environmentally friendly marketplace and promote the social welfare of its people. To embody this aim, the EU can lead by example, adopting a different path for its growth and steering it towards a low-carbon model; in this way, it will be able to retain its leading role in efforts to combat climate change. The impact of economic growth, transport and the spread of technologies means that international trade represents one aspect of the debates on climate change and the transition to a green economy which cannot be ignored.
- 1.2 The Committee strongly hopes that any overall conclusion of the Doha round at the WTO will facilitate trade in environmental goods and services by a substantial reduction in tariff and non-tariff barriers. At the same time, the Committee also feels that the EU must lead by example by facilitating the transfer of "green" technologies in its bilateral and regional trade agreements.
- 1.3 With a view to any future trade strategy, the EESC recommends that more research be carried out into the social and environmental impact on climate change, including the management of water issues. It calls on civil society in Europe and in non-member countries to take part in impact studies ahead of bilateral and regional trade negotiations, particularly in the area of sustainable development.

- 1.4 With regard to transport, the EESC supports the adoption of global UNFCCC objectives to cut air transport emissions by 10% and maritime emissions by 20%. The decision to share reduction efforts will also affect the transport sector, since air transport will be gradually included in the Emissions Trading System (ETS) from 2012. A European initiative to identify ambitious energy efficiency objectives in transport by sea would help in these efforts.
- 1.5 Given the uncertainty surrounding the climate change agreement and follow-up measures adopted in Copenhagen in December 2009, provision was made in the Climate and Energy Package that a report would be published in June 2010 using the co-decision procedure with the European Parliament and setting out "appropriate measures" for sectors at risk of carbon leakage as a result of exposure to international competition and/or the additional costs imposed by the EU's CO₂ price. Although the problem is not yet in evidence, carbon leakage may well be an issue from 2013 on. This risk is likely to grow as the EU gradually increases the volume of auctioned quotas and as major non-EU emitting countries stall over the introduction of an emissions trading system or internal tax.
- 1.6 In the short-term, moves to curb the risk of carbon leakage must include, as a matter of priority, an increase in the number of emission quotas allocated free of charge, with actual figures contingent on the progress and outcome of the multilateral climate change negotiations. Free allocation – focusing on at-risk sectors and framed in line with best practice, taking due account both of the need for more open trade and of the additional cost of carbon – must be seen as a transitional solution, based on empirical reasoning, compliant with international trade rules and a low-carbon model.
- 1.7 It will not be possible to justify border adjustment at the WTO if the European Union continues to favour free allocation – the ETS may only be considered to be a tax (and therefore adjustable at borders) if all the quotas are auctioned. The best way forward would be to make use of adjustment mechanisms for a transitional period on a handful of tariff lines where there is a genuine risk of carbon leakage and where all recourse to free allocation has been exhausted. Any adjustments must be highly focused, duly warranted and designed solely to keep any temperature increase to less than 2 C° – which is after all the principal achievement of Copenhagen – if they are to hold water before the WTO's Dispute Settlement Body.
- 1.8 Considering the slow and uncertain progress of the plans to set up emissions trading schemes around the world, the EU Member States will, for a number of years to come, remain among the few countries to have set a price for CO₂. Given the future risk of carbon leakage in a number of European sectors subject to the ETS, the European Economic and Social Committee also recommends a significant increase in long-term investment levels designed to foster the decarbonisation of the economy, and the establishment of a stable and predictable incentive-based framework for the promotion of innovation, research and development in the field of as-yet unmarketable clean technologies.

- 1.9 If it is to develop a green economy and maintain its leading role in this area, Europe should, in its own interest and in the interest of the climate, retain its very ambitious goal of gradually cutting its emissions by 80% by 2050 with, for example, an intermediary objective of 25 to 40% between 2020 and 2030. The Committee suggests carrying out impact assessments (environment, employment and development) to plan for the transitions between 2020 and 2050.
- 1.10 The fight against climate change requires strong collective public action at both national and European level. In addition to market pressure (ETS), governments must quickly put in place targeted financial and tax incentives and boost R&D investment in clean technologies and services. Local and regional authorities can support the development of clean technologies through the public procurement process.
- 1.11 Consumers – along with producers who emit CO₂ – are also urged to play a role in combating greenhouse gas emissions directly through trade. The Committee calls for harmonisation and greater stability in the methodology used to measure the carbon impact of products, covering all stages of the production process, from conception to distribution. Accordingly, the Committee recommends improving life cycle analyses by boosting methodological research on "carbon accounting." If the introduction of carbon content standards and labelling is to remain a matter for the private sector and decentralised across the EU, it will be essential to put in place a joint framework for measurement and assessment under the responsibility of the Commission or a dedicated agency.
- 1.12 In anticipation of future case law at the WTO's Dispute Settlement Body, the EESC recommends clarifying the extent to which production methods and processes may justify a restriction in trade under the pretext of the environmental exemption¹. It recommends broadening the remit of the WTO's Trade and Environment Committee with a view to examining the legal consequences of the USA shrimp dispute.

2. Globalisation and climate

- 2.1 Recent decades have been marked by an unprecedented expansion of international trade (21% of global GDP in 2007, excluding intra-European trade), albeit there was a 12% fall in 2009 as a result of the crisis. The impact of economic growth, transport and the spread of technologies is making international trade an inescapable element of the climate change debate.
- 2.2 To date, no complete theory has yet been advanced to establish or detail all the ways in which climate and trade intersect and overlap². Researchers use three interlinked variables to

¹ Article XX of the General Agreement on Tariffs and Trade (GATT) provides for the possibility of an exemption from free trade rules if such measures are justified for the protection of the environment.

² *Trade and climate change* (WTO and UNEP, June 2009).

measure trade impacts on the climate and the environment in general: (i) the "scale" effect: trade is instrumental in boosting economic activity and thus, assuming that technology remains constant, increases emissions; (ii) the "composition" effect: as the production mix changes to reflect comparative advantages, higher or lower emissions may be expected depending on the "polluting impact" – or otherwise – of the production sectors in which the countries concerned specialise in the wake of globalisation; (iii) the "technique" effect: under pressure from civil society, with support from business and at government instigation, cleaner, emissions-reducing technologies emerge. European businesses subject to the ETS have helped ensure that the EU has achieved its reduction targets under the Kyoto Protocol.

- 2.3 Taken together, these three trade effects are detrimental in terms of CO₂ emissions, given the sheer volume of trade involved, which cannot yet be offset by the spread of clean technologies. The distance between the various production sites and the end user is not the sole or necessarily the most important factor to be taken into account in the carbon assessment.
- 2.4 However, one specific climate link is the impact of trade on transport³ and, ultimately, on emissions. Today, 95% of the total energy used by transport across the world comes from oil – with the national and international transport sector contributing slightly less than 15% of overall greenhouse gas emissions (GHG).
- 2.5 Most international trade is conducted using maritime transport (90% by weight). It is still among the least polluting transport modes in terms of CO₂ emissions per kilometre and per tonne of transported goods. Nonetheless, the growth forecasts for the sector do have to be taken into account. According to the International Maritime Organisation (IMO), maritime transport emissions could triple between now and 2050, particularly as a result of the increase in South-South trade.
- 2.6 The threat of a water crisis is another grave consequence of climate warming. If no preventive action is taken, by 2020 half of the world's population could face the risk of water shortage. Already over 1.5 billion people worldwide have no access to drinking water or sewage facilities. Furthermore, in some places, agriculture will also suffer from a shortage of water, making trade a strategic element in the pursuit of national interests in the field of energy, climate and food security. By helping ensure the efficient allocation of scarce resources, international trade could help limit global pressure on water resources.

3. **The potential role of trade in disseminating of climate mitigation and adaptation technologies**

- 3.1 The Intergovernmental Panel on Climate Change (IPCC) has recommended a series of mitigation and adaptation technologies to help resolve climate change issues. Many of these

³ CESE 461/2010, not yet published in the OJ.

technologies are under discussion in the negotiations on environmental goods and services which are currently underway within the WTO, including wind and hydroelectric turbines, solar-powered boilers, solar cells or equipment required to operate facilities and technologies powered by renewable energy.

- 3.2 These negotiations on environmental goods and services held as part of the Doha round may help improve access to climate-friendly goods and technologies. However, in the immediate term, we can only expect limited climate gains from trade liberalisation. For a wide range of products – and renewable energies in particular – tariff barriers are either low or moderate (an average of 2% in rich countries and 6% in developing countries). Conversely, obstacles to investment and non-tariff barriers continue to seriously hamper the spread of such products (not least technical and industrial norms, administrative red tape, the requirement that service providers must have a commercial presence in the importing country and restrictions on the activity of foreign businesses).
- 3.3 With a view to any future trade strategy planned by the Commission for 2020, the EESC feels that this opinion already provides some background data on the declared objective of identifying "trade opening initiatives for sectors of the future, such as 'green' products and technologies, high-tech products and services, and on international standardisation in particular in growth areas." In particular, the EESC recommends that more research be carried out into the social and environmental impact on climate change, including the management of water issues. It calls on civil society in Europe and in non-member countries to take part in impact studies ahead of bilateral and regional trade negotiations, particularly in the area of sustainable development.
- 3.4 International trade can play a role in technology transfer in relation to drinking water (seawater desalination facilities, wastewater reuse and water treatment techniques). This aspect should therefore be taken into account in any separate negotiations on trade in environmental goods and services, as called for by the EESC.
- 3.5 With regard to transport, the EESC supports the adoption of global UNFCCC objectives to cut air transport emissions by 10% and maritime emissions by 20%. The decision to share reduction efforts will also have an impact on the transport sector, since air transport will be gradually included in the ETS from 2012. A European initiative to identify ambitious energy efficiency objectives in transport by sea would help in these efforts.
- 3.6 Greater protection for intellectual property rights is cited time and again as one of the stumbling blocks to the spread of clean technologies and related services. Studies have shown that there has been a substantial increase in intellectual property rights, especially patents, since the end of the 1990s. While it is true that patents in particular make it possible for holders to restrict the availability, deployment and development of technologies that can be used to combat climate change, these recent studies show that intellectual property rights are a key issue in long-term investments and in the development of as-yet unavailable technologies.

Nonetheless, they do not, in the short term, appear to be the most significant obstacle to the spread of clean technologies. The current average cost of patents for marketable technologies remains, if anything, on the low side. It is more important to resolve issues such as weak enforcement of – and poor compliance with – intellectual property rights, which still act as a disincentive to exports to certain countries.

- 3.7 The fight against climate change requires strong collective public action at both national and European level. In addition to market pressure (ETS), governments must quickly put in place targeted financial and tax incentives and boost R&D investment in as-yet unmarketable technologies and services. Local and regional authorities can support the development of clean technologies through the public procurement process.
- 3.8 Given the link between open trade and growth, the issue of the responsibility which businesses and consumers in importing countries have for emissions remains open. Half of all exports from China go to Europe and the USA. Consideration must be given to "carbon accounting" that is not restricted to primary emission sources and upstream sectors but covers every link in the chain, from conception to distribution.
- 3.9 The Committee notes that the geographic fragmentation and highly mobile nature of globalised sectors currently makes it difficult to secure any precise and credible measurement of a product's carbon content. This difficulty, which is perhaps inevitable when a large number of activities and tasks take place at the same time, does not make it easy to put in place trade policies that seek to inform and raise consumer awareness, including private labelling initiatives, environmental labelling and certification. Changes in individuals' behaviour and choice during times of crisis demonstrate that such mechanisms need to be encouraged, albeit, in the Committee's view, they cannot take the place of government regulation, including the taxation of emissions at source. The Committee recommends improving life-cycle analyses and carrying out more research on complex methodological issues, including not only carbon accounting but also the financial aspects of putting in place a modulated system of carbon accounting system for all stakeholders involved throughout the process in the sector concerned.
- 3.10 Any effective environmental policy must be able to differentiate between products on the basis of the production methods and processes used. The transition towards a low-carbon economy will only become a reality if it is possible to determine which products are manufactured using methods producing low GHG emissions. Some techniques should therefore be favoured over others. Giving consumers scope to decide for themselves, on the basis of special labelling, whether to opt for one product or another depending on the environmental credentials (if any) of the production method used would alter the competitive playing field and make it possible to distinguish between two products on the basis of their how they were produced.

- 3.11 In a world where the price of CO₂ varies, the question of product similarity – a key concept for the WTO – cannot be ignored in debates on trade and climate. The EESC recommends clarifying, in anticipation of future case law at the WTO's Dispute Settlement Body, the extent to which production methods and processes may justify a restriction in trade under the pretext of the environmental exemption⁴. It recommends broadening the remit of the WTO's Trade and Environment Committee with a view to examining the legal consequences of the USA-shrimp dispute.

4. **Links between competitiveness and climate**

- 4.1 Trade and climate negotiations work on two different timescales: the former involves very long-term policies and measures, the while the latter is focused more on immediate action. It is the overlap between these timeframes that makes the relationship between trade and climate policy so complex. Climate measures may impact trade in the short time, whereas the effects of trade measures on the climate are only felt over a very substantial timeframe.
- 4.2 In an ideal world, there would be a single, fixed price for CO₂ that would propel the world's economies to higher growth with lower greenhouse gas emissions without discriminating or distorting competition between different countries. As the ongoing climate change debate demonstrates, that ideal world will not emerge overnight. There will be no fixed global price for CO₂ for many years to come, given that it currently varies from EUR 20 to EUR 30 per tonne (depending on the anticipated average across Europe) to zero in the vast majority of other countries or regions.
- 4.3 The EESC recognises that, in this imperfect world, the risks of losing the competitive edge and of carbon leakage (where GHG emitting industries relocate away from countries and regions where CO₂ is taxed most heavily) primarily affect that group of countries that are most committed to CO₂ emission taxation, i.e. Europe. Discussions about drawing up and implementing international sectoral agreements have been ongoing for over a decade now. Given the lack of consensus, this issue is still unresolved; however, it remains an avenue for energy intensive industries to explore further. The development of low cost renewable energy and smart networks would also help limit the risk of losing competitiveness.
- 4.4 The Committee endorses the Commission's proposal⁵ along the lines of its March 2010 declaration which argued that EU business must be able to operate on a level playing field with their foreign competitors. In the short-term, sectors exposed to risks of carbon leakage may receive an additional allocation of free quotas – potentially as much as 100% at the start of the post-Kyoto period (2013-2014).

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See footnote on page 1.

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Directive 2009/29/EC, OJ L 140, 5.6.2009, p. 63.

- 4.5 In the long run, during the phase when all quotas are auctioned, when their price may be considered to be a tax, border adjustment mechanisms could help redress problems with competitiveness loss caused by Europe's emission reduction efforts, which will be much greater than those of its trading partners. Whether in the form of an import tax or a carbon inclusion mechanism at the border, or a requirement that European importers purchase emission credits within the Community emissions trading system (ETS) – also known as the "European carbon market" - these mechanisms would respond to the need to internalise the climate costs of the economic activities of sectors subject to the ETS.
- 4.6 Studies have shown that there was no great loss of competitiveness or carbon leakage during the first two stages of EU ETS implementation. Emission quota allocations between 2005 and 2012 are both generous and, in principle, free of charge⁶. Given the absence of a global carbon market – which would still be the ideal solution – the European Economic and Social Committee supports the emergence of various cap-and-trading systems for emissions rights, based on the European system or other equally effective cap-and-trading systems. It recommends examining all the problems and solutions relating to harmonisation by drawing on regional moves towards integration and taking due account of changing exchange rates.
- 4.7 There will be a risk of loss of competitiveness and carbon leakage during the third ETS phase (2013-2020) which will see the gradual introduction of allocation by auction and an annual reduction in available emissions quotas in order to achieve the 2020 objective of a 20% reduction in emissions compared with 1990 levels. Eventually, 100% of quotas will be auctioned by 2025, with a minimum level of 70% in 2020. Although the 30% emission reduction rate has been maintained, we would do well to review the auctioning thresholds and adjust them in the light of outcomes in the other countries committed under the Copenhagen Accord.

5. Europe's response: the Climate and Energy Package and its impact on trade

- 5.1 In view of the risk of a loss of competitiveness and carbon "leakage" arising from gradual moves towards quota auctioning and emissions capping in 2020, the Commission's Climate and Energy Package proposed a two-stage response. The first stage consists of identifying which sectors are at risk on the basis of two criteria: trade intensity (openness to trade from outside Europe) and the impact of the CO₂ price. A preliminary list of "at risk" sectors was drawn up in December 2009 and will be reviewed every five years. Between 200 and

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The first phase of the ETS (2005-2007) was a pilot learning stage which made it possible to establish the price of carbon, the free-trading of emissions quotas across the whole EU and the infrastructure needed to monitor, report and verify the actual emissions levels of the businesses concerned. Phase 2 (2008-2012) coincided with the first commitment period of the Kyoto protocol – the five-year period during which the EU and its Member States must meet their emission targets, as set out in the protocol. An over-allocation of quotas during the first phase led to a collapse in CO₂ prices at the start of the second phase. Over-allocation has continued in a number of sectors during the second stage.

300 sectors⁷ were examined by the Commission. The European Economic and Social Committee recommends that only those sectors which meet both criteria – CO₂ price and trade intensity – should be eligible for a 100% free CO₂ quota allocation from 2013 based on common performance-based indicators. Initial research has identified a handful of sectors where this would apply. On that basis, the Committee notes that only 11 sectors⁸ have met the joint criteria of CO₂ price and trade intensity.

- 5.2 Non-binding and lacking in ambition, the Copenhagen Accord remains far short of the outcome hoped for by the EESC in its November 2009 declaration. Lacking the legal validity of a treaty and taking the form of a declaration, it also failed to resolve the issue of the future of the Kyoto protocol. However, it does have the advantage of providing a good initial basis for registering and comparing national mitigation efforts. In the appendix to the Copenhagen Accord, Europe reiterates its conditional offer to move to a 30% reduction in GHG emissions "provided that other developed countries commit themselves to comparable emission reductions".
- 5.3 In the light of other industrialised countries' level of commitment, Europe could stick to its reduction target of 20%. By so doing, it would opt to limit potential difficulties in terms of loss of competitiveness and carbon leakage for those European sectors subject to the EU ETS. However, this option would not completely eliminate the problem of carbon leakage, and this for two reasons:
- δ Firstly, the reduction targets and commitments for other countries are confined to the appendix to the Copenhagen Accord, without any clearly defined legal mechanism to compare emissions levels between countries.
 - δ Secondly, in spite of the news that a number of carbon markets would be set up around the world (Canada in 2010, Australia in 2011, USA in 2012), there have been continued delays in their start-dates. The expected CO₂ price on these still very limited markets continues to be below the average EU price.
- 5.4 By making its pledge to cut emissions by 30% in 2020 conditional on the efforts and commitments of other countries, Europe has made its moves to foster decarbonisation through increased investment in clean technologies contingent on the adoption of a hypothetical multilateral agreement to prompt a genuine shift in its development path towards a low-

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In accordance with Article 10a(15) of Directive 2003/87/EC, "a sector or subsector shall be deemed to be exposed to a significant risk of carbon leakage if the sum of direct and indirect additional costs induced by the implementation of that Directive would lead to a substantial increase of production costs, calculated as a proportion of the gross value added, of at least 5 % ; and the intensity of trade with third countries, defined as the ratio between the total value of exports to third countries plus the value of imports from third countries and the total market size for the Community (annual turn over plus total imports from third countries), is above 10 %." These sectors are : the manufacture of starches and starch products, the manufacture of sugar, the manufacture of other non-distilled fermented beverages, the production of ethyl alcohol from fermented materials, the manufacture of paper and paperboard, the manufacture of refined petroleum products, the manufacture of flat glass, the manufacture of hollow glass, the manufacture of ceramic tiles and flags, the manufacture of cast iron tubes, and lead, zinc and tin production. If we add to these two criteria the criterion of an additional cost of 30% or trade opening in excess of 30%, the list will be extended to include 16 other sectors or a total of 27 sectors.

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Commission Decision of 24.12.2009, notified under document C(2009) 10251) (1), OJ L 1, 5.1.2010, pp. 10-18.

carbon model and thus reduce its emission levels by 75% by 2050. Irrespective of any conditions or objectives of this type, USA and China consider the gradual decarbonisation of the economy to be a one-sided process of bottom-up investment and innovation. In one sense, the Copenhagen Accord is a gamble on technology. This is a gamble which Europe must also take on.

- 5.5 If it is to develop a green economy and maintain its leading role in this area, Europe should, in its own interest and in the interest of the climate, retain its very ambitious goal of gradually cutting its emissions by 80% by 2050, with, for example, an intermediary objective of 25% to 40% cuts between 2020 and 2030. The Committee suggests carrying out impact assessments (environment, employment and development) to plan for the transitions between 2020 and 2050.
- 5.6 Establishing this intermediary objective must be accompanied by regulatory and taxation measures which promote increased investment in research and development in clean technologies. As highlighted in the European Commission's *Europe 2020 Communication*⁹, R&D spending is less than 2% in Europe, compared to 2.6% in the USA and 3.4% in Japan. This is primarily due to low levels of private investment. These low R&D expenditure levels are out of step with the EU's goals (3%) and do not reflect the importance of climate issues. To give this objective practical shape, the Committee suggests carrying out impact assessments (environment, employment and development) to plan for the transition to the next stage in 2020 and subsequent stages (2030, 2040, 2050).
- 5.7 In both cases – the timid or the bold option – there is a risk that, for a number of years to come, EU Member States will be among the few countries to have set a price for CO₂ (at a sensible level) through an emissions trading system. Without abandoning its major multilateral ambitions for future meetings of the Conference of the Parties (COP) in Mexico (2010) and India (2011), Europe must not run the risk of neglecting "bottom-up" research, innovation and investment policies. However, by pinning all its hopes on the impact of the carbon market, the EU runs the risk of neglecting other policies that could be useful in promoting research, innovation and investment. Already, when compared with Asia and America, it is clear that the various recovery plans launched in Europe have failed in this regard.
- 5.8 The European Economic and Social Committee recommends adopting a circumspect and pragmatic approach to the way it tackles carbon leakage. Already widespread, free allocation should continue to be promoted in line with the EU's strategic choices. It will not be possible to justify border adjustment at the WTO if the European Union continues to promote free allocation – the Community emissions trading system (ETS) may only be considered to be a tax (and therefore adjustable at borders) if the quotas are fully auctioned. The best way forward would be to make use of adjustment mechanisms for a transitional period on a

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COM (2010) 2020 *Europe 2020: A strategy for smart, sustainable and inclusive growth*.

handful of tariff lines where there is a genuine risk of carbon leakage and where recourse to free allocation has already been exhausted. Any adjustments must be highly focused, duly warranted and designed solely to keep any temperature increase to less than 2 C° – which is after all the principal achievement of Copenhagen – if they are hold water before the WTO's Dispute Settlement Body.

- 5.9 In the medium term, an approach of this kind will require the provision of consistent funding for a European mitigation policy. Such a policy is already underway via pilot projects on carbon capture and storage and including a committee designed to monitor investments and the sharing of intellectual property. Transitional adjustment measures will only be credible if they are backed up by innovation policies geared towards identifying sustainable development solutions.

Brussels, 26 May 2010.

The President
of the
European Economic and Social Committee

Mario Sepi
