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Analysis of the 2009 Copenhagen U.N. Climate Change Conference

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Opportunity at Copenhagen—Nations Should Promote Free Trade at the Climate Conference

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Abstract: *Copenhagen 2009—yet another climate conference. Fortunately, this month’s conference, which had been well on its way to renewing and reinforcing the controversial Kyoto Protocol on global warming, has lost much of its momentum. Worldwide economic downturn, uncertain U.S. climate policies, and the gap between developed and developing countries in climate negotiations have actually produced a potentially positive side effect: the opportunity to enact freer trade policies that promote prosperity and job creation while protecting the environment. Heritage Foundation trade-policy expert Daniella Markheim explains why the members of Copenhagen 2009 should embrace the opportunity to support open markets—and the chance to benefit all nations.*

The 15th Conference of the Parties to the United Nations Framework Convention on Climate Change (UNFCCC) was to be the grand culmination of a two-year effort to extend and enlarge the soon-to-expire 1997 Kyoto Protocol on global warming and establish long-term cooperation in mitigation, adaptation, technology development and transfer, and financing for developing countries. But the momentum behind the race to Copenhagen 2009, the climate conference convening this month, has slowed dramatically as a consequence of the worldwide economic downturn, uncertain U.S. climate policy, and significant gaps between developed and developing countries’ global climate priorities.¹

Congressional consideration of U.S. climate legislation has now been postponed until 2010, and the chance for UNFCCC member nations to reach a comprehensive and binding global climate agreement in Copenhagen this month is dwindling. The United States has been granted a welcome stay of economic execution and some much-needed time for sober evaluation of the impact and merit of climate policies on U.S. prosperity and the environment.

World leaders are now aiming to produce a political agreement on global climate cooperation, rather than one with legal teeth.² While the goal is to craft an agreement that could later become legally binding, changing economic conditions and the fate of U.S. climate

1. Ian Talley, “Senate to Put Off Climate Bill Until Spring,” *The Wall Street Journal*, November 18, 2009, at <http://online.wsj.com/article/SB125850693443052993.html> (December 1, 2009).

2. “U.N., Danish Officials Lay Out Elements For Possible ‘Political’ Deal in Copenhagen,” *BNA Daily Report for Executives*, November 18, 2009.

legislation could ultimately derail the policy outcome in Copenhagen.

Rather than continue to pursue a controversial deal based on the Kyoto model, nations that are serious about addressing environmental concerns would do better to look for solutions that are flexible and economical. Developed and developing countries alike need to avoid protectionist measures that inhibit trade and investment in environmental goods and services, and free their markets from government rules and regulations that inhibit innovation. A set of voluntary best practices that can promote coherence among individual countries' environmental measures, while allowing countries the flexibility to shape policy to meet national needs, would be a positive outcome of Copenhagen.

Opening markets to foster the free flow of goods, services, and ideas can do far more to provide countries with the technology needed to mitigate environmental degradation and adapt to changes in the environment. Even more important, opening markets enables nations to grow and earn the resources they need for sustainable development.

No Consensus on Trade in Global Climate Talks

Kicking off the last two years of global climate negotiations was the "Bali Action Plan," agreed to at the 13th UNFCCC Conference of the Parties meeting in Bali, Indonesia, in 2007. The plan called for significant cuts in global emissions to counter climate change; measurable, reportable, and verifiable emission-reduction commitments on the part of developed countries; and mitigation efforts by developing countries through non-binding "nationally appropriate mitigation actions."³ Additionally, the plan called for economic cooperation between developed and developing nations on global adaptation to changing climate conditions, economic diversification, accelerated technology transfer to support mitigation and adaptation needs, research and

development, and financial assistance for capacity building, mitigation, and adaptation strategies.⁴

Fundamental to the plan—and to the disagreement between developed and developing countries in current negotiations—is the idea that members of the Organisation for Economic Co-operation and Development (OECD) and countries classified as transition economies in Annex I of the UNFCCC are responsible for hard commitments on emissions caps, while OECD countries that also make up Annex II of the Convention are also responsible for substantial transfers of aid to countries not listed in Annex I.⁵

Consequently, while the UNFCCC indicates that all nations share the responsibility of addressing global climate issues, blame for existing levels of carbon dioxide in the atmosphere is placed squarely on the shoulders of developed nations. In recompense, the developed world must not only cap emissions in the future, but must also foot the bill for developing countries' mitigation and adaptation efforts as well. Developing countries are asked only to contribute voluntarily to climate efforts and only to the extent that they are able.⁶

While it may seem fair for the developed world to pay for past emissions, it is less clear why they should also be held responsible for the future emissions of all other countries, including China, India, and other major polluters that have risen from the ranks of the least developed world. This is especially true given that emissions from developing nations began to outpace those

3. UNFCCC, "Report of the Conference of the Parties on its Thirteenth Session, Held in Bali from 3 to 15 December 2007," United Nations, 1/CP.13, at <http://unfccc.int/resource/docs/2007/cop13/eng/06a01.pdf#page=3> (December 1, 2009).

4. *Ibid.*

5. 1992 United Nations Framework Convention on Climate Change, FCCC/INFORMAL/84, GE.05-62220 (E) 200705. Annex I countries include: Australia, Austria, Belarus, Belgium, Bulgaria, Canada, Croatia, Czech Republic, Denmark, European Economic Community, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Latvia, Liechtenstein (added in 1998), Lithuania, Luxembourg, Monaco (added in 1998), Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Russian Federation, Slovakia (added in 1998), Slovenia (added in 1998), Spain, Sweden, Switzerland, Turkey, Ukraine, United Kingdom of Great Britain and Northern Ireland, and the United States of America. Annex II countries include: Australia, Austria, Belgium, Canada, Denmark, European Economic Community, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom of Great Britain and Northern Ireland, and the United States of America.

6. *Ibid.*

from developed countries in 2005, and are forecast to continue increasing seven times faster than those from Annex I nations.⁷

Thus, it is no surprise that the weeks of negotiations running up to the December Copenhagen meeting have been fraught with disagreement. Developing countries' demands that the developed world impose emissions caps of more than double their initial offers, commit to paying billions in aid, and loosen property rights protection for technology goods and services, coupled with their refusal to adopt restrictions on their own economies, are unfeasible, both economically and politically.

In the case of the United States, trying to accommodate such demands contradicts the will of the U.S. Senate. In 1997 the Senate unanimously passed the Byrd–Hagel Resolution, which warned President Clinton not to enter into any global warming treaty that does not include commitments from developing nations, or that causes harm to the American economy. This is still U.S. policy today and should serve as the overarching guideline for not only the conference in Copenhagen, but future negotiations as well.⁸

While much is wrong with the demands of developing countries, their steadfast refusal to accept protectionist measures as part of a global climate agreement, or within the broader context of international trade, is sound.⁹ Unfortunately, the U.S., France, and other nations seem willing to include such measures as part and parcel of their respective domestic climate regimes. Indeed, for the U.S., such provisions are likely to be the only way to entice Members of Congress to sign onto expensive cap-and-trade legislation.

The Role of Freer Trade in Promoting a Cleaner Environment

The evidence linking economic growth to trade freedom is compelling. According to data from the forth-

coming 2010 *Index of Economic Freedom*, countries with freer trade policies experience significantly higher per capita economic growth than countries that maintain trade barriers. The top 10 percent of countries in terms of trade freedom had five-year compound per capita gross domestic product (GDP) growth rates averaging 4.5 percent.¹⁰ By contrast, the 10 percent of countries with the lowest levels of trade freedom had five-year per capita GDP growth averaging just 3.0 percent.¹¹

As economies grow and income levels rise as a consequence of trade liberalization, the desire—and more importantly, the resources available—to adopt environmental protections become stronger and can result in policies that accommodate the sustainable development needs of the country. In contrast, when economic contraction drives families, businesses, and governments to focus resources on the necessities, survival takes precedence over the luxury of capping emissions, retrofitting government buildings with energy-efficient light bulbs, or investing in research for the next best automobile battery. Engaging in freer trade is a fundamental part of a strategy to better promote the evolution of sensible environmental regulations by empowering countries with the economic opportunity to develop and raise living standards.

The positive relationship between trade and the environment can be demonstrated by comparing the openness of a nation's trade regime to how well it protects the environment. An examination of trade freedom scores from the upcoming 2010 *Index of Economic Freedom* and national environmental performance measured in the 2008 *Environmental Performance Index* reveals that countries with freer trade polices also do more to protect the environment. (See Chart 1.)

Engaging in freer trade increases the supply and decreases the price of environmental goods and services and is a fundamental part of a strategy to better pro-

7. Ben Lieberman, "What Americans Need to Know About the Copenhagen Global Warming Conference," Heritage Foundation *Special Report* No. 71, November 17, 2009, at http://www.heritage.org/Research/EnergyandEnvironment/sr0071.cfm#_ftn8.

8. *Ibid.*

9. "Special Section: Border Carbon Adjustment," *Bridges Weekly Trade News Digest*, Vol. 13, No. 39 (November 11, 2009).

10. Daniella Markheim and Ambassador Terry Miller, "Global Trade Liberalization Continues, But Risks Abound," Heritage Foundation *Backgrounder* No. 2320, September 28, 2009, at <http://www.heritage.org/Research/TradeandEconomicFreedom/bg2320.cfm>.

11. *Ibid.*

mote the evolution of sensible environmental regulations. Economic growth raises living standards and the demand for environmental protection.¹²

up to 70 percent on climate- and environment-related technologies.¹³ The onus of freeing trade in environmental goods and services is shared by all nations.

Trade Freedom and Environmental Performance Go Hand in Hand

Each dot represents a nation in the 2010 *Index of Economic Freedom*.

Environmental Performance Index



Source: Daniella Markheim and Ambassador Terry Miller, "Global Trade Liberalization Continues, But Risks Abound," Heritage Foundation *Backgrounders* No. 2320, September 28, 2009, at <http://www.heritage.org/Research/TradeandEconomicFreedom/bg2320.cfm>.

Chart 1 • CC7  heritage.org

However, the need on the part of developing countries to reduce market barriers to climate- and environment-friendly products is just as critical. The global market for environmental goods and services is worth between \$550 billion and \$613 billion per year, yet in some countries the bulk of this trade can face tariffs of

Gaining additional access to environmental goods and services through open markets not only supplies nations with products aimed at mitigating emissions, but also helps spread technological know-how around the world. The current call by developing nations to weaken intellectual property protections as a means to obtain technology and to bolster sustainable development, climate mitigation, and adaptation would reduce the level of research and innovation and thus reduce the opportunity for technological advances to improve productivity and growth around the world. Instead, developing countries should focus on eliminating non-tariff barriers to technology trade, strengthen and enforce intellectual property protections, adopt economic and infrastructure reforms that promote innovation, and invest in human capital.¹⁴

The critical mechanism for enabling freer trade in environmental goods and services is the World Trade Organization (WTO). Negotiations on these issues are on the agenda of the current Doha Development Round of global trade talks.¹⁵ Yet, economic conditions, changing policies, and the simple politics of trade are keeping the talks on hold. Nations around the world offer rhetoric about the importance of reviving

12. Studies supporting the positive impact of trade liberalization on incomes and demand for environmental goods include: G. M. Grossman and A. B. Krueger, "Environmental Impacts of a North-American Free Trade Agreement," in *The Mexico–US Free Trade Agreement* (Cambridge, Mass.: MIT Press, 1993), pp. 13–56, and N. Shafik, "Economic Development and Environmental Quality: an Econometric Analysis," *Oxford Economic Papers*, Vol. 46 (1994), pp. 757–773.

13. Tim Wilson, "Undermining Mitigation Technology: Compulsory Licensing, Patents and Tariffs," Institute of Public Affairs and the Australia APEC Study Centre *Backgrounders* 21/1, August 2008.
14. Global Intellectual Property Center, "Promoting Technology Diffusion to the Developing World," U.S. Chamber of Commerce, 2009, at <http://pub.bna.com/ptcj/ChamberPromotingTech.pdf> (December 1, 2009).
15. The World Trade Organization and United Nations Environment Programme, "Trade and Climate Change," 2009, p. 80, at http://www.wto.org/english/res_e/booksp_e/trade_climate_change_e.pdf (December 1, 2009).

the negotiations; however, the longer the Doha Round remains in limbo and the more confrontational and complex international trade becomes, the less likely it is that the talks will be restarted—and the less likely trade will be able to better enable green policies.

U.S. Climate Legislation Laced with Protectionist Measures

While President Obama and much of Congress are intent on instituting a U.S. policy regime to address climate change, the debate on what path best greens America—cap and trade, carbon taxes, tough energy standards and regulations, some hybrid approach, or sticking to open markets—has been a heated one. With affordable green technologies still largely in development, policymakers recognize that the economic cost of limiting U.S. production of greenhouse gases on U.S. consumers and companies will be high: high enough to question whether the costs are worth the questionable benefits such measures would bring. Projections on the cost of a climate scheme on U.S. jobs and the economy, evidence from Europe’s problematic climate program, and the Kyoto Protocol’s failure to drive falling emissions in signatory nations illustrate how difficult it is for governments to impose binding climate restrictions without undermining economic growth.¹⁶

If Congress and the President do embark on such a potentially treacherous course, households and firms will face much higher costs for a wide range of energy and energy intensive products—from consumer and industrial goods to agricultural products. Hard-pressed

U.S. consumers and producers will find no relief from artificially inflated prices by turning to lower-cost imports, as trade barriers raise the costs of foreign products produced under less-severe environmental policy constraints.

Yet, with little substantive progress so far in establishing a consensus on global climate policy and developing countries—especially India and China—understandably unwilling to adopt greenhouse gas restrictions that will undercut their economic development, U.S. policymakers are faced with the concern that companies facing higher costs under unilateral climate restrictions will find it much harder to compete with foreign competitors with lower business costs. Consequently, American firms may fail, or, as many policymakers fear, may take their jobs and flee the U.S. to countries with less costly business environments.

Some U.S. companies and policymakers may find it fair for the government to prop up domestic businesses; however, America’s trade partners are unlikely to agree. Explicit tariffs or quotas on imports from dirtier exporters, free or discounted emissions allowances, tax credits, subsidies, government loan guarantees, and other policy mechanisms designed to help compensate for the cost of carbon controls on U.S. firms could violate World Trade Organization rules and lead to legal sanctions against the U.S. Even if some of the proposed measures hold up against legal scrutiny in the WTO, the potential for nations to retaliate against U.S. trade measures is very real.

The cost of retaliation will be borne by America’s families and businesses. Trade is a mainstay of the U.S. economy, accounting for about a third of U.S. GDP and underpinning about 40 percent of U.S. jobs. Even in the face of global recession, the U.S. remains the world’s top exporter of goods and services—a position that would be lost as key trade partners adopt similar trade restrictions against U.S.-made goods.¹⁷ Moreover, these measures would raise costs and erode the competitiveness of U.S. exporters, many of whom depend on imports of

16. William W. Beach, David W. Kreutzer, Ben Lieberman, and Nicolas D. Loris, “The Economic Costs of the Lieberman–Warner Climate Change Legislation,” *Heritage Foundation Center for Data Analysis Report* No. CDA08-02, May 12, 2008, at <http://www.heritage.org/Research/EnergyandEnvironment/cda08-02.cfm>; Open Europe, “Europe’s Dirty Secret: Why the EU Emissions Trading Scheme Isn’t Working,” August 2007, at <http://www.openeurope.org.uk/research/etsp2.pdf> (December 1, 2009); European Environment Agency, “Greenhouse Gas Emissions Trends and Projections in Europe 2008,” October 2008, at http://www.eea.europa.eu/publications/eea_report_2008_5 (December 1, 2009); and Ben Lieberman, “What Americans Need to Know About the Copenhagen Global Warming Conference,” *Heritage Foundation Special Report* No. 71, November 17, 2009, at <http://www.heritage.org/Research/EnergyandEnvironment/sr0071.cfm>.

17. Daniella Markheim, “Energy Cap and Trade Threatens American Prosperity,” *Heritage Foundation WebMemo* No. 2488, June 16, 2009, at <http://www.heritage.org/Research/EnergyandEnvironment/wm2488.cfm>.

raw materials or intermediate goods to complete their products.

Coercing the World to Clean Up

For many advocates of climate change legislation, trade restrictions are not only the means to counteract the loss of competitiveness that such environmental regulations impose on U.S. businesses, but also a way to compel other countries to adopt similar climate regimes.

The idea that punitive trade measures against carbon-intensive products would motivate countries to implement carbon restrictions depends critically on the ability to measure carbon intensity in imports, and on the level of trade that would be affected by U.S. policy. Countries may not export enough carbon intensive products to the U.S. for trade measures to drive nations to adopt carbon restrictions.

More problematic, because production processes, energy sources, and capital stock vary by country, industry, and even by product, the information needed to accurately tax imports for carbon content would be very difficult to obtain.¹⁸ The most likely result is the imposition of a more bureaucratically feasible one-size-fits-all approach to pricing carbon-intensive products at the border. Such an approach has the perverse effect of penalizing those clean foreign producers in a country, which may have higher operating costs, at the expense of dirtier ones, and reduces the incentive to better internalize the cost of carbon in traded goods.

Moreover, energy standards and regulations may run up against trade rules that dictate that domestic and foreign firms should be treated identically and may create technical barriers to trade disallowed under WTO agreements. Punitive trade measures, direct subsidies, tax credits, government loans, and other government support programs could violate WTO rules against subsidies and countervailing duties.¹⁹ Trade measures that

treat countries differently undermine the non-discriminatory basis for global trade that has helped promote prosperity around the world.

The gains from trade include economic growth and rising incomes in all countries. For developing countries—which would likely be hardest hit by trade restrictions in climate legislation—the economic stress will be particularly great. This, perversely, will likely increase the harm inflicted on the environment rather than reduce it. Economic growth increases the ability for developing countries to afford protecting the environment.

The Way Forward

Trade liberalization, private market solutions to environmental issues, and sound, pro-market regulations are fundamental to addressing climate and environmental issues. The U.S. and other nations should:

- **Open markets and implement broader economic reform.** One part of the real solution to reconciling international trade and environmental policies—finding a multilateral consensus within the WTO to lowering trade barriers against trade in clean technologies—will be more difficult as climate-related trade disputes rise. Worst of all, the general contraction in trade that protectionism would induce will only make developing countries poorer and less willing and able to address environmental concerns in multilateral climate talks. The Obama Administration should commit to and aggressively pursue a substantive, comprehensive trade agreement that includes trade liberalization in environmental goods and services in 2010.
- **Develop a voluntary climate code that reflects the best practices in national environmental policy.** While a comprehensive global pact is the only way to truly address borderless environmental issues, the chance for such a deal is a long way off. Even without the economic worries of today, the chasm between developed and developing countries is unlikely to be bridged any time soon. Instead, countries should work toward determining a voluntary set of guidelines that can promote coherence and transparency in national climate and environmental policy regimes while recognizing that nations will—and should—continue to act in their own self-interest. With this

18. Trevor Houser *et al.*, *Leveling the Carbon Playing Field: International Competition and U.S. Climate Policy Design*, Peterson Institute for International Economics, Washington, DC, May 2008, p. 34.

19. Alina Syunkova, “WTO—Compatibility of Four Categories of U.S. Climate Change,” National Foreign Trade Council, December 2007, at <http://www.nftc.org/default/trade/WTO/Climate%20Change%20Paper.pdf> (December 1, 2009).

goal in mind, in 2010 the Administration should convene a forum of nations willing to engage in objective and meaningful dialogue about the shape and substance of voluntary guidelines—and then promote these rules as the best and fastest approach to aligning international concerns regarding the environment.

- **Veto climate legislation that relies on protectionism.** Trade measures in carbon control legislation may appear necessary for protecting U.S., European, or other country competitiveness and promoting broader international participation in such schemes. However, such measures will likely only create a more hostile trade environment that shuts down access to global markets. Rather than using trade policy as a weapon, America and the world should keep markets open. The Administration should clearly state its opposition to any protectionist measures that find their way into U.S. climate legislation and veto any bills that include them. The integrity and freedom of global markets should be protected as a means to transfer clean technologies, keep international investment flowing, and promote economic growth and prosperity in the U.S. and around the world.

Conclusion

Rather than continue to pursue a controversial climate change deal based on the Kyoto model, governments that are serious about addressing the environmental challenges they face today should instead look for simpler and already existing solutions. Developed and developing countries alike need to avoid protectionist measures that inhibit trade and investment in environmental goods and services. They should implement policies that promote innovation without distorting markets, and define a set of voluntary best practices that can promote coherence among different countries' environmental measures, while allowing countries the flexibility to shape policies that support their individual needs.

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