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# Climate Policy: Free Trade Promotes a Cleaner Environment

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Regardless of the scientific merit behind doomsday predictions of global warming, President Obama and Congress seem intent on instituting a U.S. policy regime to address the specter of climate change.

The debate on the most effective way to "green" America—cap-and-trade, carbon taxes, tough energy standards and regulations, some hybrid approach, or sticking to open markets—will be a heated one. With affordable green technologies still in development, policymakers need to 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 equally uncertain benefits such measures would bring.

**Costs and Benefits.** The projected cost of a climate scheme on the U.S. economy—evidenced from Europe's problematic climate program and the Kyoto Protocol's failure to affect emissions in signatory nations—illustrate how difficult it is for governments to impose binding climate restrictions without undermining economic growth.[1]

If Congress and the President do embark on such a potentially treacherous course, households and firms will face much higher costs for energy and energy-intensive goods, categories that include virtually every product in our economy. Hard-pressed U.S. consumers and producers will find no relief from artificially inflated prices by turning to lower-cost imports, as the climate change zealots propose to erect trade barriers to raise the costs of foreign products produced under less severe environmental policy constraints.

Some U.S. companies and policymakers may find it fair for the government to prop up domestic businesses, whose profitability will have been destroyed by new climate change regulations, against foreign competitors whose governments have chosen to be less draconian. America's trade partners are unlikely to agree.

Many such trade restrictions could violate World Trade Organization (WTO) 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. Any U.S. restrictions, whether consistent with WTO agreements or not, would undermine development in poorer countries and make it more difficult to achieve a multilateral consensus on the rules of trade that best support environmental objectives.

When all these negative effects are taken into account, it is clear that the adoption of protectionist polices as a part of a U.S. climate regime does far more harm than good and should be avoided.

This paper, in its entirety, can be found at:
*www.heritage.org/Research/TradeandEconomicFreedom/wm2406.cfm*

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**Climate Legislation and Trade.** With little substantive progress in establishing a consensus on global climate policy and developing countries (especially India and China) unwilling to adopt greenhouse gas restrictions that will undermine their economic development, U.S. policymakers are faced with the possibility 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 may take their jobs and flee to countries with less costly business environments.

While such productivity-boosting moves are good for the U.S. economy in the long run, they can impose short-term costs on specific firms and individuals and are a political lightening rod. Unfortunately for those who would attempt to control global climate, such measures also undermine any impact U.S. greenhouse gas restrictions might have on reducing global levels of emissions.

For the advocates of climate change legislation, trade-related measures can potentially counteract the loss of competitiveness that such environmental regulations impose on U.S. businesses and, in theory, compel other countries to adopt similar climate regimes.

Tax credits, subsidies, government loan guarantees, and other policy mechanisms designed to compensate partially for the cost of carbon controls on U.S. firms would then work hand in hand with more explicit tariffs or quotas on imports from countries without comparable environmental restrictions.

The idea that punitive trade measures against carbon-intensive products would motivate countries to implement carbon restrictions depends 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.[2]

Therefore, the most likely result is the imposition of a more bureaucratically feasible one-size-fits-all approach to taxing carbon-intensive products at the border. Unfortunately, such an approach has the perverse effect of penalizing clean foreign producers, who may have higher costs, at the expense of dirtier ones while reducing 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.[3] 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 eco-

1. 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. 08-02, 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* (April 19, 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* (April 20, 2009).
2. Trevor Houser, Rob Bradley, Britt Childs, Jacob Werksman, and Robert Heilmayr, *Leveling the Carbon Playing Field: International Competition and U.S. Climate Policy Design* (Washington, D.C.: Peterson Institute for International Economics, 2008), p. 34.
3. 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* (April 21, 2009).

nomic stress will be particularly great. This, perversely, will likely increase the harm done to the environment: Economic growth increases the ability for developing countries to afford protecting the environment.

Historically, as a nation's prosperity increases, its desire—and more importantly, the resources available—to adopt environmental protections become stronger and result in policies that accommodate the individual needs of the country. Engaging in freer trade can better promote the evolution of good regulations by empowering countries with the economic opportunity to develop and raise living standards.

**Markets Work, Protectionism Doesn't.** Trade measures in carbon-control legislation may appear necessary for protecting U.S. competitiveness and promoting broader international participation in such schemes. However, in reality, such measures will likely create a more hostile trade environment that costs U.S. firms access to global markets.

Even if countries do not file complaints within the WTO or resort to outright retaliation against America for raising trade barriers, protectionism cannot guarantee a cleaner environment. Current efforts to find a multilateral consensus within the WTO on lowering trade and non-tariff 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.

Rather than using trade policy as a weapon, America should keep markets open. Policymakers—regardless of the shape of any final climate bill—should maintain the integrity and freedom of global markets 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.

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