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Energy Cap and Trade Threatens American Prosperity

Daniella Markheim

As the debate on climate change legislation moves forward, Members of Congress are diligently carving out exceptions and special benefits for favored groups of voters. Of course, higher energy costs will hurt all of their constituents, but Members are working hard to soften the blow for those whose political support they enjoy or need.

Of singular concern is ensuring that U.S. firms hurt by the higher energy costs that Congress itself mandates will face minimal competition from foreign companies not hamstrung by similar domestic policy constraints. Knowing that the costs associated with cap and trade will send hard-pressed U.S. consumers and producers to lower-priced imports, some legislators seem keen on trade barriers as the easy solution—thereby raising the costs of foreign products and making them less competitive in the U.S. marketplace. For these legislators, the potential risks of global warming trump all other policy concerns, including the long-term prosperity of Americans. From their point of view, if protectionism in U.S. cap and trade becomes the standard for other countries to follow—or ignites a trade war with countries refusing to trade economic growth for curbs on emissions—all the better.

Lower Economic Growth: A Desirable Outcome? Despite the sentiments of certain Member of Congress, the question remains: Is protectionism via cap and trade truly desirable policy?

For more than six decades, tariffs and non-tariff barriers against international trade have been falling around the world, enabling more and more countries to enter global markets, grow, and prosper. Reversing that progress in an attempt to lower greenhouse gas emissions will lead to a contraction of international trade that will leave everyone worse off.

Such a contraction of world economic activity may well be the key goal of the environmentalist movement, which sometimes measures progress not in terms of economic growth but rather in its absence. Unfortunately, fewer opportunities to trade will result in lower economic growth rates and rising poverty—reversing the development gains seen in even some of the world's poorest countries.

Some U.S. companies will, of course, welcome barriers against trade. Businesses whose profitability will have been destroyed by new climate change regulations will no doubt find it hard to compete against foreign rivals whose governments have opted against environmental policy restraints.

The cost of such barriers, unfortunately, 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

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as key trade partners adopt similar trade restrictions against U.S. made goods.[1]

Managing Trade through Climate Legislation. For the advocates of climate change legislation, trade-related measures are considered the best method to counteract the loss of competitiveness that such environmental regulations would impose on U.S. businesses. Such protectionist measures would then compel other countries to adopt similar climate regimes—or so such advocates hope.

In addition to explicit tariffs or quotas on imports from countries without comparable environmental restrictions, other policy mechanisms designed to compensate partially for the cost of carbon controls on U.S. firms could be enacted, such as free or discounted emissions allowances, tax credits, subsidies, and government loan guarantees.

All of these measures would raise costs for American consumers and further hurt the competitiveness of U.S. exporters who depend, as many do, on imports of raw materials or intermediate goods in manufacturing their finished products.

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—is the fact that the information needed to accurately tax imports for carbon content would be very difficult to obtain.[2] 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. Unfortunately, such an approach has the perverse effect of penalizing clean foreign producers (who may have higher costs) at the expense of dirtier ones, 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. Such rules may also create technical barriers to trade disallowed under World Trade Organization (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.

Increasing Environmental Risk. The gains from trade include economic growth and rising incomes in all countries. For developing countries—those that 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 done to the environment rather than reduce it.

Historically, as a nation's prosperity increases, the desire—and more importantly, the resources available—to adopt environmental protections become stronger, resulting in policies that accommodate the individual needs of the country. In contrast, economic contraction drives families, business, and governments into survival mode, where the value of human life takes precedence over the luxury of capping emissions. 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.

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1. Calculated from World Trade Organization, "World Trade 2008, Prospects for 2009," appendices I and II, March 23, 2009, at *http://www.wto.org/english/news_e/pres09_e/pr554_e.htm#appendix_chart1* (June 12, 2009).
2. Trevor Houser *et al.*, *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* (June 12, 2009).

Climate Legislation Should Not Limit Trade. Trade measures in carbon control legislation may appear necessary for protecting U.S. competitiveness and promoting broader international participation in such schemes. However, such measures will likely only create a more hostile trade environment that costs U.S. firms access to global markets. Even if countries do not follow America's lead on limiting trade in their own climate machinations or file complaints within the WTO or even resort to outright retaliation against America for raising trade barriers, protectionism cannot guarantee a cleaner environment.

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.

Rather than relying on prohibitive trade measures to mitigate the cost of cap and trade on the U.S. economy, policymakers 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 the U.S. and around the world.

—Daniella Markheim is Jay Van Andel Senior Trade Policy Analyst in the Center for International Trade and Economics at The Heritage Foundation.