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Global Crisis and Climate Change: Will recession undermine climate change negotiations?

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While climate change has been getting attention for nearly 20 years, the connection between climate change and trade is only now being recognised. But the risk of market failure is real due to the current global economic crisis.

UNTIL RECENTLY, only activists, scientists and governments were concerned with climate change and its impact on the future of the global environment. Former US presidential candidate Al Gore's Oscar-winning documentary "*An Inconvenient Truth*" drew wide public attention to the ramifications of climate change.

We may have followed the debates as individuals and taken steps to reduce our carbon footprints — replacing light fixtures with energy-efficient bulbs, changing the temperature settings in our homes or offices, or increasing our commitment to recycling and reusing materials. But we have only recently been devoting sustained attention to how climate change mitigation strategies might impact international trade.

Three Challenges for Global Solutions

The Copenhagen Summit in December 2009 will discuss the replacement for the Kyoto Protocol. Whatever comes out of Copenhagen will likely involve significantly more states following more stringent rules designed to mitigate the environmental damage from global warming and climate change. A global issue like climate change will require global solutions. These discussions in Copenhagen will have a direct impact on the making of trade policy.

Three inter-linked challenges face us in tackling the relationship between climate change and trade. First, the impact of climate change is not evenly distributed across states. Second, the contribution of each state to the problem is different with some states contributing more greenhouse gases and some less. Finally, the ability to invest in mitigation strategies varies across states.

There are three other significant features to note about climate change.

First, its impact is uneven; the poorest people and the poorest countries may end up suffering the most. Developing regions are already warmer, on average, than the developed world. They rely heavily on agriculture, but must deal with a high variability in rainfall totals. Changes to the climate that negatively affect the ability of farmers in the developing world to grow crops will have many economic and trade-related impacts.

Second, since each state contributes different levels of carbon emissions and other sources of climate change, any regime to address the impact will have different rules for different categories of states. These distinctions give rise to potentially unfair outcomes.

Some of the trade implications include a possible environmental “race to the bottom” as firms relocate to states with more lax policies. Firms that face fewer constraints on pollution emissions can set lower prices for goods than those subject to higher costs. To offset this trade advantage, many states are planning a range of state interventions for climate-related trade businesses, including subsidies and direct support.

Some states have obvious barriers to the transfer of mitigation technologies, including high tariff walls. Investment regimes, environmental regulations, intellectual property rights protections or laws regarding energy usage can be crafted to offset perceived unfair trade advantages or to provide a boost to domestic firms.

Under any sort of expanded carbon trading scheme, the issue of competitiveness will be front and centre. Border carbon adjustment schemes will likely vary by country, at least at the outset. We have not yet thought through the implications of different designs. We may need to adjust or revise existing trade rules in the WTO or free trade agreements to account for these kinds of new regulations.

Third, the ability of states to develop, deploy and pay for mitigation strategies varies enormously. Take, for example, the prospect of more extreme weather events. Some states will simply be unable to prepare adequately for such calamities as floods or droughts. Others will be overwhelmed by events when they occur.

Moreover, the very classification of items into environmental goods and services (EGS) categories has not been straightforward. Even if we get these problems straightened out, we have a new set of practical problems in the trade realm, as most schemes for handling goods and services imports and exports are not suitable for accommodating these environmental categories. Instead, products are lumped together in ways that makes it difficult to untangle green goods from non-green goods.

Issues in the Trade-Climate Change Nexus

Three other issues should also be considered in discussing the nexus between climate change and international trade. First, some observers have suggested that climate change disputes could be handled by the World Trade Organization (WTO). After all, the WTO has the best mechanisms already in place for addressing disputes. Since many of the disputes will have trade implications, the WTO might be well-positioned to resolve many of these state-to-state disagreements.

Yet the attempt to do so might well overwhelm the WTO system. There is a significant risk today that the WTO dispute settlement mechanism may be over-loaded because member states and customs territories recognise that it is effective and will result in legally enforceable decisions. Some new mechanism will need to be created to resolve climate change disputes.

A second area of concern is that climate change negotiations are increasingly being led by trade negotiators who cut their spurs at the WTO. There is a risk of mercantilist mindsets and the search for a package deal in Copenhagen in December. If we export the concept that “nothing is agreed until

everything is agreed”, a staple of GATT/WTO negotiations, we are setting the stage for failure in Copenhagen.

Risk of Market Failure

This brings me to my final point. While climate change has been getting attention for nearly 20 years, the connection between climate change and trade is only now being recognised. Most governments traditionally regarded attention to climate change as imposing a cost to economies and an impediment to a focus on economic growth.

With the global economy heading into recession, governments will increasingly focus on immediate threats rather than those that appear over the horizon. As long range issues, climate change and global warming are unlikely to be handled adequately by market mechanisms. We run the risk of market failure. The ability to reach significant binding agreements in Copenhagen may be threatened by the current gloomy global economic outlook.

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