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TRADE AND CLIMATE CHANGE: A WIN-WIN INTERACTION

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Climate change is today's number one global challenge. Recent COP meetings have made the state of crisis crystal clear and have stipulated the path ahead. We have taken steps forward, but are still falling short in reaching our climate goals. Latest forecasts state that the world will breach the 1.5°C limit this decade. We need urgent and decisive action on all levels. It is high time that the world of trade also takes its responsibility, and makes fighting climate change its number one priority. This will only work if we are all on the same page. Multilateralism is essential to achieve that. We need a powerful WTO that is the main international deliberative body for global trade governance. It should provide a rules-based framework that offers predictability and security for all, and has the full power to settle disputes if they arise. In order for the WTO to enable global sustainable trade and investments fostering the just transition, alignment with other multilateral organizations, such as the United Nations (specifically the UN Framework Convention on Climate Change), the International Monetary Fund and the World Bank, are indispensable.

The WTO must regain strength. There have been serious setbacks in recent decades, with continuous structural and administrative hurdles. MC12 delivered some results, with the adoption of the WTO agreement on fisheries subsidies, and progress on food security, responses to the pandemic, and e-commerce. However, MC13 should surpass this. Reinforced structural cooperation based on open communication must lead to an action-based agenda for trade policy, with concrete proposals in line with climate agreements, the Sustainable Development Goals and the social agenda. Moreover, the WTO secretariat needs to be strengthened to be able to tackle all the challenges and tasks ahead.

The Trade Day at COP28 in Dubai was a true milestone. For the first time, trade was an official topic of a COP meeting. In her speech, WTO Director General Dr. Ngozi Okonjo-Iweala warned that the international community was still well short of reaching the objectives of the Paris Agreement, but added that trade could help to further reduce emissions. The WTO also published a highly relevant paper on trade and climate for that occasion.

Trade can indeed instigate the fight against climate change and social inequality. However, this can only be achieved by making the right strategic choices.

The right to regulate

WTO members worldwide are increasingly fighting climate change through trade-related policies. From 2009 to 2021, members notified the WTO of more than 5,000 measures with climate-related objectives. At the same time, State intervention on climate policy has increased – for example via subsidies – which, in its turn, affects trade. The nexus between trade and climate is complex.

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The EU conceives of trade policy as an important tool designed to contribute to the green transition and achieve the European Green Deal. Recent legislation on deforestation is a milestone initiative in this regard. The USA is supporting the American green transition and sustainable industries with its far-reaching fiscal and subsidies policy mix set out in the Inflation Reduction Act. China is applying a more expansive approach with its Belt and Road initiative, state-owned companies, and generous state aid regime.

The right to regulate is a fundamental governance tool for members that needs safeguarding. In climate policy, this right is as timely as it is indispensable. However, governments must choose their approach with caution. Assuring WTO compliance, and applying an inclusive approach when developing new policies, are of crucial importance.

Discrimination, disturbance of the level playing field, obstructions to international trade, and perceived or actual protectionism are lurking around every corner. The pandemic, leading to supply chain disruptions, apparent over-dependencies, geopolitical tensions, and wars with the weaponization of resources, has led to conservative, nationalistic reflexes by many members. Geopolitical tensions are high, leading to countermeasures and an increase in the number of climate-related disputes brought to the WTO.

Dispute settlement

The WTO is currently unable to resolve these issues and mitigate negative effects. Due to its eroded dispute settlement system, the WTO is paralysed when dealing with conflicts. This needs urgent remediation. If not, tensions will continue to rise, further weakening the rules-based order. A fully-functioning dispute settlement system is the EU's main reform priority for MC13.

All countries will have to step up their climate and environmental efforts to meet global goals. The question is thus not if, but how, these will be designed. Climate policy should not become a new hurdle for international cooperation, and lead to more geopolitical tensions and conflicts. This is why a well-functioning dispute settlement system is indispensable. Simultaneously, we need more alignment and cooperation. The only way to avoid more unilateral measures is to develop global policy. If designed in an inclusive, deliberative way, this is without doubt the most effective and least conflictual way forward. We need continuous multilateral, plurilateral and bilateral dialogue and engagement to address all concerns, align policies and, over time, converge on a global framework.

The Committee on Trade and Environment

A mediating, rules-based and well-functioning WTO is essential to maintain open dialogue. Members should discuss and share best practices in a transparent way, leading to new, better-aligned measures. This will minimize negative effects and trade tensions. We need to reinforce and expand platforms to exchange information and interact. The Committee on Trade and Environment is essential in this regard. The Committee should become the main global forum to debate, coordinate and design trade-related environmental policy. All issues regarding trade and environmental policy, including measures to implement multilateral environmental agreements, can be discussed here. The Committee on Trade and Environment can also promote sustainable development and climate action through trade. Important plurilateral initiatives that can feed into this are the Fossil Fuel Subsidy Reform, the Dialogue on Plastics Pollution, and the Trade and Environmental Sustainability Structured Discussions. We also need to stir up discussions again on the Environmental Goods Agreement so as to reach actual results.

Certain policy domains have the potential both to be effective and serve as a testing ground for more global alignment. For instance, with circular economy, we can look at global standards on eco-design, product passports, repairability and recyclability parameters. Technical measuring and reporting on environmental and health parameters, such as toxic components or embedded emissions, are other starting points. However, the most urgent and impactful topic is, without doubt, global carbon pricing.

Carbon pricing

Domestic carbon pricing schemes are prevalent, but also extremely diverse. According to the World Bank, over 70 carbon pricing systems exist globally, with varying coverage and prices, ranging from less than US$ 1 to more than US$ 130 per tonne of CO_2-equivalent. Canada has gradually augmented its carbon price under its Greenhouse Gas Pollution Pricing Act, reaching US$ 50/tonne CO_2 in 2021. The EU has its Emissions Trading System (ETS), an effort-sharing mechanism, and a recent policy, the Carbon Border Adjustment Mechanism. The EU's ETS carbon price is around €80/tonne CO_2, and peaked at €100/tonne CO_2 in February 2023. The USA does not have a federal carbon price or tax, but many states implement measures such as direct pricing, fiscal policies or cap-and-trade systems. The California Air Resources Board, which focuses on California's air policy and managing the cap-and-trade system, sets strict emissions standards for a range of state-wide pollution sources, such as vehicles. California has a permit price of around US$ 28. China started its ETS in July 2021. It covers the power sector, and is designed to contribute to China's policy goals of peaking emissions before 2030 and reaching climate neutrality in 2060. The carbon price is around 60 Yuan (US$ 8). Japan has a carbon tax – the Global Warming Countermeasures Tax, currently at 289 Yen/tonne CO_2 (US$ 2) – and an ETS.

It is clear that better alignment between these different schemes can boost their effectiveness, and reduce misunderstandings, counterproductive effects and administrative burdens. In the absence of global systems or better alignment, unilateral policy will unavoidably arise in the coming years. An example of this is the decision of the EU to extend its ETS to the maritime sector. It is a necessary policy measure to include a sector that has dodged its responsibilities for far too long, leading to ever-rising emissions. However, for this policy decision to truly have an effect and uphold fair competition, the maritime sector needs emission pricing on a global scale.

One global system or a single global carbon price in the short term is a naive aspiration. However, this is the ultimate goal. On the way towards it, we need to align existing systems and make them converge as much as possible, so as to lower global emissions and enhance the level playing field for our industries.

Phasing out fossil fuels

Indispensable elements of lowering global emissions include phasing out harmful practices immediately, and replacing them with measures to enhance the sustainable transition. Why do we continue to subsidize large-scale industrial farming over short-chain sustainable agriculture? Why do airlines still pay zero duty on their fuel? How is it possible that we still spend US$ 7 trillion a year on fossil fuel subsidies? This constitutes a rise of US$ 2 trillion over two years, even though governments across the world pledged two years ago at COP26 in Glasgow to phase out inefficient fossil fuel subsidies.

We can only spend the same money once. Let us spend it right.

The historic result of COP28 is a huge stepping-stone towards the fossil fuels goal. The agreement on moving away from fossil fuels is an important step. The only way forward is a way without fossil fuels.

One of the first steps is to stop fossil fuel subsidies, and redirect this money towards investments in the sustainable transition. According to a 2023 World Bank study, governments spend US$ 1.2 trillion a year on potentially environmentally harmful subsidies. Redirecting even a third of these subsidies towards renewable energy and energy efficiency could already lead to an additional 9% of emissions reductions by 2030 (International Institute for Sustainable Development, 2022).

Clean financing

Some 60% – 80% of world trade relies on trade finance, such as trade credit and insurance, and guarantees. The financial sector thus plays a key role. However, it continues to dodge its responsibility. This is unacceptable. An ambitious just transition policy framework needs a financial sector that supports the same goal. If the financial sector chooses the path of sustainable transition in a resolute, ambitious and transparent way, this creates security for investors. Investments and industry will then automatically follow. A sustainable financial sector can boost transition in a way that nothing else can. It is essential that all financial stakeholders work towards the same goal, avoiding harmful loopholes.

There is a leading role here for public finances and government institutions at all levels. Green and social government procurements are highly important, and can have a huge leveraging effect. They are currently underdeveloped. The IMF, World Bank, European Investment Bank (EIB) and national public banks should further green their investment policies. Semi-public stakeholders such as export credit agencies cover US$ 2.5 trillion a year, and should stop financing or backing environmentally and socially harmful projects straightaway. They should redirect their means to projects in line with the just sustainable transition. Private actors need to follow suit. High degrees of transparency, and clear legislative and administrative frameworks, are imperative to avoid greenwashing and counterproductive investments.

Import tariffs

More sustainable trade and the lowering of global emissions can also be supported by reviewing the counterproductive systems of import tariffs. These tariffs can support the sustainable transition, but only if they are applied with that transition in mind, which is currently not the case. Import tariffs are lower for carbon-intensive industries than for clean ones. While coal and crude oil have average tariffs of 1.6% and 0.8% in the top ten importing markets, renewable energy equipment have average tariffs of 3.2%.

This is both absurd and bad policy. It leads to stranded assets and obstructing the green energy landscape. Huge and direct changes are possible on the ground by reversing current policy, making the business case for renewable energy, and discouraging fossil fuel investments. Better bilateral, plurilateral and multilateral coordination among trade partners will only amplify this effect. We urgently need coordinated proposals in that regard.

Supporting Least Developed Countries (LDCs) to leapfrog

LDCs suffer the triple inequality of the global climate change equation. They are least responsible for causing climate change, hardest hit by its consequences and least equipped to mitigate and adapt. It is the responsibility of developed countries to support LDCs and allow them to leapfrog environmentally harmful technologies. Transparency, data exchange and sharing best practices are the first steps. It is crucial for developing countries to participate in this process from the start, so they can co-shape policy. It is also crucial, so that measured and tailored support can flow their way, not only via financing trade in sustainable goods and services, or direct investments in green projects and infrastructure, but also via technology transfers, technical assistance, and administrative and legislative support.

Most of the green transition’s technologies are patent protected, and originate in developed countries. Developing countries are often unable to finance and import green technology, hindering their transition to a low-carbon economy. The WTO can contribute here by removing the barriers to technology transfer caused by TRIPs[1] rules, which prohibit the free flow of renewable energy and energy efficiency technologies. Another interesting instrument to consider is the *debt-for-climate swap.* These allow a debtor developing country to get a debt pardon and use the money owed to finance climate change, adaptation and mitigation projects. A long-term swap mechanism could be made operational within the framework of the G20 Debt Service Suspension Initiative, combined with rechannelling the IMF Special Drawing Rights.

To reduce misconceptions about sustainability legislation and make sure it reaches its goals, initiating countries should ensure that all global partners can manage the systems and understand that they are intended to lower global emissions. It is critical that the guiding principles should always be to retain mutual benefits and interact with LDCs, while applying a case-by-case approach.

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[1] TRIPs: Trade-Related Aspects of Intellectual Property Rights

Opinions vary widely about the effects of the Carbon Border Adjustment Mechanism (CBAM) on LDCs. While the EU Commission claims that CBAM effects on LDCs will be limited, LDCs themselves fear the Mechanism. The EU needs to raise awareness and provide support. All international revenues collected via CBAM should preferably flow directly back to the international community. This would reduce negative consequences, debunk protectionism allegations, and lower global emissions. LDCs should receive the highest and most targeted contributions via direct investments, technical assistance, technological transfers, and administrative support.

Democratic oversight

This parliamentary conference is of key importance with regard to transparency, communication and democratic legitimacy. The joint European Parliament and IPU Parliamentary Conference on the WTO is an essential platform. The parliamentary dimension should be reinforced further, and parliamentarians should be more involved in WTO decisions. Let this paper and the associated discussions be another plea to WTO members to acknowledge these facts and act upon them.

There is clearly momentum for a deeper connection between trade policy and the climate agenda. We ought to grasp the opportunity to make sure that sustainable trade fulfils the role it can and should in reaching a cleaner, healthier and socially just planet for all.