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Policy Brief

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Now or never

Using the EU's trade power as leverage for a climate deal in Paris

The EU is keen to obtain a new climate agreement that will prevent a temperature rise of more than 2°C at the 2015 United Nations Climate Change Conference, COP21, in Paris. In recent years, it has intensified its climate diplomacy, which is focused on building coalitions, using appealing language ('narratives') and offering financial support. This policy brief questions whether this strategy will be enough and looks at what else the EU could do to increase the likelihood of an 'ambitious and durable legally-binding agreement applicable to all UNFCCC Parties'.[1] The EU currently relies on traditional instruments of 'soft' persuasion and financial aid, but progress in negotiations appears slow. Should consideration now be given to new and additional leverages? We argue that the EU should not shy away from using its trade power in its decarbonisation efforts in other parts of the world by offering benefits to least-developed countries (LDCs) and Small Island Developing States (SIDSs) and threatening large-emitting economies with punitive measures.

Introduction

Despite climate scientists pointing to the urgency of collective action on climate change,[2] in their position for the climate negotiations states balance these scientific warnings with other considerations.

Above all, climate policies can have a big impact on energy choices and, linked to this, countries' economic development. Another key characteristic of climate change is its public good character. All countries, particularly the heavy polluters, argue that others should do more and that they should do less. As a result, countries negotiate endlessly over what each of them ought to do to contribute to tackling climate change (mitigation) and who should pay (finance) for its impacts (adaptation). This means that, like other negotiations, climate negotiations centre around the perceived interests of countries in securing a deal, no matter how urgent the problem of climate change may be.
The EU is one of the powerful blocks keenest to get a climate deal with meaningful emission reduction commitments at the 2015

1 Council of the European Union (2015) Environment Council Conclusions COP21 UNFCCC, 18 September 2015, via http://www.consilium.europa.eu/en/press/press-releases/2015/09/18-counclusions-un-climate-change-conference-paris-2015/.
2 Pachauri, R.K. (2014) 'Climate Change 2014: Synthesis Report', *Intergovernmental Panel for Climate Change* via http://www.ipcc.ch/pdf/assessment-report/ar5/syr/SYR_AR5_LONGERREPORT.pdf.

United Nations Climate Change Conference in Paris, COP21. Of all the big economies, it has the most far-reaching reduction commitment (-40% in 2030 compared to 1990 levels) and for decades climate change has been a priority issue on its international agenda. A big problem at the UN's previous landmark event on climate change in Copenhagen in 2009 was the EU's lack of a real bargaining strategy. It negotiated on the basis of a 'forerunner' position which also happened to be an outlier position. It wanted deeper emissions cuts sealed in hard national commitments, backed up by a proper mechanism for monitoring progress and a sanctions regime for states failing to deliver. This would allow the use of emissions trading at the international level, the EU's preferred instrument for reducing emissions which it uses at home.

In order to allow a carbon market to function well, the emissions ceiling needs to be fixed.[3] In Copenhagen, the EU's position was based on a firm reduction target and a willingness to go further when other major emitters made comparable efforts. This was referred to as a 'leading by example' and was even considered as a negotiating strategy. However, others were neither impressed by the EU's own commitment nor interested in its conditional offer to do more on mitigation.[4]

Developing countries were also not impressed by the EU's proposals on the important issue of climate finance. These proposals were seen as too little and too late.[5] The EU was sidelined and a deal with little substance was sealed between the other big powers.

To avoid being sidelined again in Paris, the EU has invested in cooperating with other countries dissatisfied with the lack of progress on mitigation and adaptation, including the Small Island Developing States (SIDSs) and least-developed countries (LDCs), and a range of progressive countries in Latin America and Africa. By investing in these relationships, the EU aims to temper the North-South divide and point to the common interests in addressing climate change through a global deal.[6] LDCs, for instance, are most vulnerable to the effects of climate change, while climate finance is currently spent mostly in middle-income countries.

Main issues in current climate negotiations

Paris will largely cover the same issues as Copenhagen: mitigation, adaptation and climate finance, as well as how hard, or legally binding, commitments on these issues will be. Other related issues on the agenda will include: loss and damage; how commitments will be monitored, reported and verified; a compliance mechanism; technology development; capacity-building; and a global stocktake.[7]

By 1 October 2015, 147 Parties had communicated their Intended Nationally Determined Contributions (INDCs) on mitigation and adaptation, which are generally considered their 'pledges'. As demonstrated in a recent synthesis report by the United Nations Framework Convention on Climate Change (UNFCCC),[8] these aggregated INDCs will not prevent a more than 2°C temperature rise, the overall objective for the climate deal. They are, moreover, essentially voluntary and some of the commitments made by developing countries are conditional on the availability of climate finance. It is also not clear

3 Otherwise the price of Emission Trading Scheme (ETS) credits will inflate each time governments change the ceiling.

4 Van Schaik, L., and Schunz, S. (2012) 'Explaining EU Activism and Impact in Global Climate Politics: Is the Union a Norm- or Interest-Driven Actor?', *Journal of Common Market Studies JCMS*, 50(1).

5 Maas, E., Van Schaik, L. and Kamphof, R. (2015) 'The EU and Colombia: Climate Partnership beyond Aid and Trade', Clingendael Policy Brief, August 2015.

6 Ibid.

7 Ad Hoc Working Group On The Durban Platform For Enhanced Action ADP (2015) Informal Note, Draft Agreement, http://unfccc.int/resource/docs/2015/adp2/eng/8infnot.pdf.

8 UNFCCC (2015) 'Synthesis report on the aggregate effect of the intended nationally determined contributions', http://unfccc.int/resource/docs/2015/cop21/eng/07.pdf.

whether countries will want to automatically copy and paste their pledges into a legally enforceable global agreement, which is what the EU would prefer. Most likely, therefore, additional bargaining chips will be needed in Paris to strike a deal that is more in line with what the EU wants.

The EU's options to step up influence

The main question in the run up to Paris is whether the EU's current strategy will be enough to strike a deal with credible long-term commitments. There is a risk that the emerging economies will return to their trenches, and that a North-South divide will re-emerge. It is also unlikely that the US will sign up to any hard commitments, which can always be used as an excuse not to commit by China and other big polluters. What leverage does the EU have to end up with a deal and real commitments that will be implemented, even in the absence of a fully-fledged compliance regime, which is unlikely to be included in the deal? How could the EU become a stronger negotiating partner in the heat of the UNFCCC COP21, where friendlier 'wish-list' diplomacy is unlikely to deliver?

Roughly, the EU has four general instruments it can use to influence others:

1. Persuasion and diplomacy: convince others by using good arguments and a sound diplomatic outreach campaign
2. Issue linkage: linking different international agenda's by using (grand) bargaining chips
3. Financial assistance (aid)
4. Trade benefits or the threat of trade measures or sanctions.

The first instrument of **persuasion and diplomacy** is already used by the EU. Increasingly it focuses on adjusting the EU's language and positioning towards others and on coalition-building around the main issues of mitigation, adaptation and finance.

With regard to the potential for **issue linkage**, there are two questions. What issues could or should be taken into consideration? Is it too late to identify and negotiate a grand bargain in which unrelated and contentious issues are traded-off? In terms of disputed issues on the international agenda, not many cover both the EU on the one hand and the emerging economies and the US on the other.

When negotiations are framed as a North-South divide, a trade-off could perhaps be established between the desire of Organisation for Economic Co-operation and Development (OECD) countries for high levels of intellectual property rights (IPR) protection and developing countries' preference for IPR rules to be relaxed. However, relaxing IPR rules is likely to make new investments in technological innovations, which are badly needed to further accelerate the transition to a zero carbon economy, less attractive. In our view, therefore, realistically little can be expected from issue-linkage at this stage.

A specific form of issue linkage, or rather exchange, is option three – to step up **financial assistance (aid)** in return for support to the EU's mitigation preferences. In the past, this was how the EU fostered progress in climate negotiations. The instrument has its pitfalls, however, and, with changing international power relations, it has become increasingly irrelevant. With a few exceptions, EU member states have been generally unwilling to offer the amounts promised in terms of 0.7% GNI official development assistance (ODA).[9] The issue of climate finance is also extremely sensitive and the LDCs have little to offer in terms of emission reductions. The EU and member states are also no longer keen to support middle-income countries where economic growth figures exceed their own. The EU in general has been unable to really use climate finance as a strategic bargaining chip, partly because it is not the EU but its individual member states that provide the finance. Moreover, climate finance alone is not expected to tempt all developing countries.

9 Organisation for Economic Co-operation and Development (2015) 'Development aid stable in 2014 but flows to poorest countries still falling', http://www.oecd.org/dac/stats/development-aid-stable-in-2014-but-flows-to-poorest-countries-still-falling.htm. See also Kamphof, R., Spitz, G. and Boonstoppel, E. (2015) *Financing development now and in the future*, Amsterdam: Kaleidos Research.

The additional climate finance could benefit the LDCs and SIDSs in particular, but the emerging economies are no longer very interested in aid and are, in light of their economic forecasts, unlikely to make policy changes in exchange for support.
On the contrary, these emerging economies might be more interested in connecting climate change to extended **bilateral investment dialogues** and **trade agreements** with the EU. This brings us to option four, which we discuss in more detail in the next section.

Using the EU's trade power to obtain a climate deal

It is noticeable how quiet the EU has been recently about using its trade policy to further its climate objectives. This merits more debate as we believe the EU could use this instrument to push for more stringent and inclusive sustainable development paragraphs in free trade and investment agreements (or more political partnership and cooperation agreements) combined with climate finance from public and private partners. This would be in line with the values behind the recent EU Trade and Investment Strategy,[10] which aims for a more 'responsible' strategy that protects the environment and incorporates sustainable development in trade and investment agreements. Furthermore, the EU and its member states are currently reviewing their Aid for Trade strategy by using the opportunities offered by Economic Partnership Agreements (EPAs) to support developing countries, in line with the Sustainable Development Goals (SDGs).
In this way, measures to reduce poverty and tackle climate change are going hand in hand.
However, simply offering trade benefits might not be enough. The question needs to be asked whether punitive trade measures should also be on the EU's agenda. There are obviously political risks in raising the possible use of border measures to further the EU's climate change preferences but, if the EU is truly serious about its international climate policy agenda, this is probably the only instrument that will ensure it is taken seriously.
A possible key reason for the EU acting below the radar is the diplomatic tensions that emerged with the US and the emerging economies when the EU sought to include international flight emissions in its domestic emissions trading scheme in 2012. This followed years of international inaction on including aviation (and maritime) emissions in international talks on climate change, either through the UNFCCC, the International Civil Aviation Organisation (ICAO) or the International Maritime Organisation (IMO). Reactions by China, the US and many other G20 countries were so hostile that the EU eventually postponed the measure. This was generally understood as a test case for the bigger question of setting a carbon price on goods entering the EU.
The aviation emissions saga illustrates the political sensitivity of (proposing) a border measure, let alone inaugurating an EU carbon taxation system that seeks support from other major greenhouse gas (GHG) emitters. This could well lead to a complete trade war between the EU and its so-called Strategic Partners (the US, Brazil, China, India, Japan, Canada, Mexico, South Africa and South Korea), or at least those without a carbon policy. The EU might also be unwilling to lose face a second time over a unilateral move, even if it could be justified from a climate change perspective.
Nevertheless, with the UNFCCC COP21 approaching, trade measures regarding decarbonisation (e.g. carbon pricing) are gaining more attention and a key question is whether the EU should allow others to bully it. The recent Carbon Pricing Watch from the World Bank (2015), supported by Germany and France, is pointing in this direction. An interesting global consortium consisting of private partners is joining their call for carbon pricing, with more than 1,000 multinational companies along with countries such as China and Russia signalling their support for carbon pricing

10 European Commission (2015) *Trade for all: Towards a more responsible trade and investment strategy*, http://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153846.pdf.

at a UN Climate Summit in New York in 2014.[11] This might lead to a debate on what to do with carbon pricing and emission trading. At the same time, it might put the EU on the defensive given the low carbon price in the emissions trading scheme currently used for big industries within the EU. This trading scheme is still the biggest international system for trading CO2 emission allowances and is currently followed by other countries and regions.[12]

One reason for the low price of carbon in the EU's emissions trading scheme is concerns over competitiveness by EU companies that compete globally. A border measure could address (and equalise) the costs of carbon released by production processes elsewhere, i.e. the 'imported carbon footprint' of the EU. This option was discussed back in 2009 when such a carbon equalisation mechanism was supported by several EU member states (including France) and the European Parliament. Alas, the EU could not use the mechanism as it was not backed by a majority of member states. It was feared that it would provoke a trade war in the context of the World Trade Organization (WTO). Others argued that imposing a border measure equal to the EU's domestic carbon price would be compatible with WTO rules, but this would assume no carbon policy at all in the countries of origin. With other countries now having to submit a type of carbon policy through their INDCs, introducing such a mechanism could prove more difficult technically. At the same time, none of the INDCs seems as ambitious as the EU's mitigation policy. Moreover, if commitments made in Paris are not legally binding it is far from certain that they will be transposed into national policies and legislation. Of course, the EU hopes that in Paris a negotiated outcome with legal force will be agreed, an EU demand that was honoured at the Durban climate negotiations in 2011. If the commitments remain voluntary, the EU could threaten with trade measures if the commitments are not followed up by actual mitigation policies.

If and when to use the trade power instrument?

The question is: Should the EU threaten trade measures if countries refrain from including a meaningful commitment or do not follow up on their commitments after Paris? It is clear that overall the current INDCs put forward for negotiation are not ambitious or hard enough to achieve the 2°C limit. (Indeed, it has been argued that even the EU's own reduction target is not ambitious enough in this respect.) In our view, the main problem is that they are essentially *voluntary* commitments. One strategy could be to frame them as real emission reduction commitments and to rely on a mechanism of 'naming and shaming' to lock them in. However, will this work for China and India, or Brazil for that matter?

We believe the EU could strive to include language on being able to consider trade measures when others do not make a comparable effort or where they simply do not honour their INDCs after Paris. Raising this point just before or during the Paris negotiations might spoil the atmosphere, but would increase the likelihood of the EU being included as a serious player in the talks. On trade, the EU is already playing a key role in taking forward negotiations for an environmental goods agreement with other major WTO members.[13] This would facilitate trade in green technologies and air pollution control and contribute to combating climate change. Therefore, raising this issue might not be entirely inconsistent with the EU's global trade role. By linking UNFCCC negotiations from 30 November to 11 December with the forthcoming tenth

11 http://www.worldbank.org/en/news/feature/2014/09/22/governments-businesses-support-carbon-pricing.

12 European Commission (2015) 'Factsheet: The EU Emissions Trading System (EU ETS)' http://ec.europa.eu/clima/publications/docs/factsheet_ets_en.pdf: "National or sub-national systems are already operating in Australia, Japan, New Zealand, Switzerland and the United States, and are planned in Canada, China and South Korea."

13 European Commission (2015) 'Trade for all: Towards a more responsible trade and investment strategy'.

session of the WTO ministerial conference (to be held in Nairobi from 15–18 December 2015) the EU and member states could play a key role in solving and linking global challenges and global agreements in the realm of the SDGs. One idea would be to aim to include (trade) sanctions on environmental goods in the WTO dispute settlement system on the basis of the UNFCCC COP21 agreement. The interface of climate change and trade is increasingly becoming more relevant and an increase of economic activity would inextricably be linked with higher levels of greenhouse gas emissions.[14]

Now or never

Conditions for a deal in Paris are only slightly better than those in the period leading up to the Copenhagen Summit. Despite its overall decrease in power in relation to world politics, the EU itself is better positioned, with its broader climate diplomacy action plan reaching out to progressive states across the globe. At the same time, progress is slow and the positions of key players in the negotiations are still worlds apart. There is also a risk that recalcitrant states, such as Venezuela and Bolivia (or, in the past, Saudi Arabia and Russia) will systematically spoil the negotiations process by questioning agendas and procedures.

To avoid scenarios in which the French Presidency and the EU could lose control, we believe this is the moment for the EU to be bold and use its position to play power politics. This is the moment to link climate change with trade instruments and 'own' the agenda. Just raising the possibility of trade measures for major emitters and trade benefits for LDCs and SIDSs might be enough to keep others keen and interested in working towards a meaningful deal in which the EU could use 'only' its instruments of persuasion, issue linkage and the offer of climate finance. Even if it does not resemble the EU's ultimate dream of a legally binding agreement with hard targets, the shadow of trade measures could make a deal with voluntary commitments more credible. This in turn could benefit both the climate and the EU's overall standing as a foreign policy force to reckon with.

14 See also Leal-Arcas, R. (2013) *Climate Change and International Trade*, Cheltenham: Edward Elgar Publishing.

About Clingendael

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