



# Competitiveness Comes to the Fore

Forget about market design...US climate legislation is going to swing on competitiveness issues. **Ross MacWhinney**, Carbon Markets Analyst at Evolution Markets, explores how the debate is shaping up and what's at stake.

*American lawmakers continue to make progress crafting a federal program to cap greenhouse gas emissions. But while debate centers on issues of market design, perhaps the biggest issue yet has made its way to the fore: competitiveness. US industry maintains that taking on carbon caps, while major economies such as China and India do not, will harm their ability to compete in world markets. The result, they say will be bad for the US economy in the long-term. This much is true... competitive issues may prove the toughest nut to crack. This Executive Brief covers the issue, some approaches to addressing it, and the historical underpinnings of the debate.*

## Stirring Hope

In December of 2007 the passage of the Lieberman-Warner climate bill through the US Senate Environment and Public Works Committee provided a brief spark of optimism that was felt literally on the other side of the world. The news arrived as representatives from governments, non-profits, businesses, the media and others had begun to converge in Bali for the United Nations Framework Convention on Climate Change (UNFCCC) Conference of the Parties. The side events that featured US legislative aides were among the most crowded and most dynamic in the conference and, though the official US delegation in Bali stood consistently against emission reduction targets as a successor treaty to Kyoto was being drafted, there was a sense of excitement that progress was actually being made domestically on climate change.

Indeed the enthusiasm for cap-and-trade mechanisms has accelerated in the US in recent years. State governments responding to an extended period of inaction by the federal government are laying the foundations for no less than three regional trading schemes, encompassing 23 US states and three Canadian provinces. Each of the front running presidential candidates have made cap-and-trade mechanisms central to their climate change policies, with one (Senator John McCain) having sponsored one of the more prominent cap-and-trade bills introduced into the Senate (the McCain - Lieberman Climate Stewardship Act).

The Lieberman-Warner bill, which is currently heading to the floor of the Senate, still has a long road ahead of it and there are several features of market design that remain unresolved

and that could serve as deal breakers along the way. Allocation methods, how to handle domestic and international offsets, how auction proceeds should be used, and the role of price control measures are among the biggest outstanding issues. While the carbon trading industry debates market design, however, the major "make or break" issue has emerged elsewhere. The largest potential roadblock for a domestic climate bill is global trade competitiveness, and it is yet to be resolved.

## Climate and Competitiveness

The arguments against the US committing to GHG reductions without similar commitments from China and India revolve around the concepts of "leakage" and competitive advantage. If the US takes on a domestic or global cap on GHG emissions the goods and services generated by US industry may become more expensive, placing goods from unregulated countries at an advantage. This could then force a migration of jobs and industry from the US to countries with no carbon constraints, where the costs of emissions can be avoided. As a result, the US loses jobs, and there is little net reduction in global GHG emissions.

## Industry Proposal

The US House of Representatives Committee on Energy and Commerce recently released a whitepaper focused solely on climate regulation and competitiveness issues. This committee is responsible for crafting climate legislation in the House, and its version will ultimately have to be reconciled with whatever the US Senate passes. The committee white paper reviewed a set of policy options for addressing the competitiveness issue. The options ranged from punitive trade sanctions to designing a cap and trade program that would incentivize developing economies to take on carbon caps. The report's most prominent option is surely a proposal put forth by two major US labor unions (International Brotherhood of Electrical Workers and the AFL-CIO) and the country's largest coal-burning utility, AEP.

The proposal would require importers from "large-emitter" countries to submit allowances to the US government for the emissions associated with "greenhouse gas intensive goods"



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(including iron & steel, aluminum, cement, bulk glass, and paper). The US would require these importers either to purchase "international reserve allowances" from the federal government, or obtain other certified emissions credits from a US program or from other GHG regulatory programs (such as the EU ETS) to cover these emissions. Failure to comply would bar these goods from entrance into the US marketplace. Which countries are designated as "large emitters" is left to the discretion of the President, but the proposal seeks to include large-emitting countries which have not taken "comparable action" to limit their greenhouse gas emissions.

The IBEW, AFL-CIO, and AEP intend that the program be used as a "stick", providing leverage to persuade large emitting developing countries to take on emissions reductions once the US has done so. The stick is so potent, the authors maintain, that the international allowance plan will never actually need to be implemented. The requirements for importers would not enter into force until the sixth year of the bill's life, and three years after the domestic cap begins. The interim period provides time for international negotiations between the US and these large emitters for the universal acceptance of greenhouse gas reduction targets. This interim period also assists the US establish that they have made "good faith" efforts to satisfy World Trade Organization (WTO) requirements.

The group's proposal would serve as a component to larger climate legislation intended to provide protection to US industry against job loss associated with a federally imposed cap on carbon emissions. The plan has already entered the legislative debate, having been incorporated into both the Bingaman-Specter bill (S. 1766) and the Lieberman-Warner bill (S. 2191). It was not, however, part of the draft of the Lieberman-Warner bill that passed through the US Senate Environment and Public Works Committee.

### A Bit of History

While current legislative activity has raised the profile of competitiveness considerations, the issue has long been ingrained in the rhetoric of US climate change policy. This history not only informs the current debate, but also demonstrates that this issue is here to stay.

As the Kyoto Protocol was being developed over a decade ago, US lawmakers reacted to the "Berlin Mandate" which laid the groundwork for Kyoto, requiring developed countries to commit to emissions reductions and exempting developing countries from similar commitments. The 1997 Byrd-Hagel Resolution stated that the US should not join any treaty with

these requirements. Though signed by President Clinton in 1998, the Kyoto Protocol was never submitted to the Senate, was never ratified, and was eventually rejected outright by President Bush in 2001.

For the majority of the period since Byrd-Hagel there has been very little progress on climate legislation and the issue of its impact on international trade has not been engaged in a productive way. As global warming has gained prominence in the public's concern in the past two years, however, more attention has been paid to the issue of competitiveness and carbon constraints.

The Bush administration has maintained a consistent position against mandatory emission reduction targets in domestic and global climate policies. Indeed, the US delegates to the Bali conference resisted significant pressure to include greenhouse gas reduction targets in the Bali roadmap, even forcing an unprecedented extra day of negotiations.

### Major Economies Forum

President Bush has set up an international forum to discuss competition and the climate. His so-called Major Economies meetings have the potential to constructively address the competitiveness issue and to advance the issue in the Bali Roadmap framework. However it is quite difficult to suspend skepticism considering the Bush administration's track record on climate change. Though James Connaughton, Chairman, Council on Environmental Quality, has stated that the process is intended to "reinforce and to accelerate progress in the United Nations", many suspect that the Major Economies meetings could simply be intended to stall, or worse, to sideline the UNFCCC process. The US focus at the Major Economies meeting in late January was on sectoral approaches and aiding technology transfer to developing countries, rather than on national emissions reduction targets.

### The End Game

Protecting US industries is already a major focus in federal climate policies and has the potential to hold legislation back markedly. The recent spread of regional cap-and-trade programs like RGGI, WCI, and MGA has involved governments that do not have jurisdiction over international trade issues. This topic, therefore, was not as prominent in the formation of those plans. It appears that the Bush Administration will not accept leadership on this issue, either leaving it for the next administration or to Congress to negotiate. With initiative finally being taken in Washington on climate policy, this issue will remain at the forefront of the debate.

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