TOWARDS A LOW-CARBON FUTURE: CHINA AND THE EUROPEAN UNION

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Cut the Carbon

As the world wakes up to the need for a low-carbon future, the ripple effects can be felt across the global economy. Governments and companies alike are beginning to calibrate decisions on trade, financing and production planning. At this critical time, new strategic decisions are needed to avoid the pitfalls of protectionist instincts. More than ever, there is a need to tap into the benefits offered by globalisation and enhanced cooperation.

Only weeks ago, European Union (EU) trade officials voted informally to remove anti-dumping duties on energy-efficient compact fluorescent lamps from China. A month later, the European Commission proposed delaying the move by a year.

The duties add up to 66 percent of extra tariffs on Chinese imports. Cutting them appears logical since the Union will decide on phasing out less efficient lighting in 2009. China produces eighty percent of the world's energy-saving bulbs, with exports worth $1.5 billion last year. According to the World Wildlife Fund, lifting the duties could help save 23 million tonnes of carbon dioxide in the EU each year.

Quibbling over anti-dumping duties has been the mainstay of recent EU-China trade relations. But the lighting case illuminates how climate change is changing the terms of such debates. The pros and cons have been argued by European, rather than Chinese, actors. Osram, an arm of Siemens, a German company, advocated extending the duties, citing risks to hundreds of jobs in the EU. Philips, a Dutch manufacturer, together with two other lighting companies, welcomed the proposed lifting of duties as supporting an aggressive expansion in the European market for high efficiency lighting. Most of Philips' energy-efficient bulbs are produced outside of the EU, including in China.

As economies integrate, it is commonplace to set the competing needs of producers against those of importers and consumers. Economies

Chinese goods seem to flood western markets: computers, light bulbs, sweaters, T shirts and bras. The instinct is to try to protect home producers. A better plan would be to work with Beijing on producing products for the next industrial revolution – the creation of a low-carbon economy. But that would take real vision and political courage.

like China and the EU are forced to confront difficult trade-offs. Over fifty million sweaters, T-shirts and bras from China were stuck in ports during the so-called 'bra wars' in August 2005 because of protests by French and Italian producers. But in reality, public policy choices will need to be made against a backdrop of globally integrated supply chains and an increasingly complex political economy landscape. Balancing energy security, climate change, employment, and export competitiveness will become a central part of political conversations between governments and their citizens.

The discussion over light bulbs also highlights opportunities for mutual gains for China and the EU in the years ahead. Today, the need to deal with global climate change is driving a new kind of industrial revolution. Tightening global supply of oil and natural gas is also encourging the development of new technologies and higher efficiency. Even the US National Petroleum Council believes it unlikely that the projected growth in demand in the next 25 years will be met.

In short, high prices, supply volatility, import dependency, as well as climate change, are steering new thinking towards a low-carbon future. Central to that vision is the need for enlightened thinking around the potential economic and political benefits – rather than just the costs – of this transition.

COMMON CHALLENGES

The combined power of the EU, the world's largest single market, and China, its fastest growing economy, is formidable. There are unprecedented opportunities to generate the benefits of scale that will help drive down the costs of climate-friendly goods and services for all.

China and the EU are already economically entwined. The EU has been the largest source of foreign direct investment in China; almost triple the volume from the United States. Most foreign investment in China goes to manufacturing – seventy percent – and utilities. China is also the EU's largest source for imported cement, plaster and stone, as well as iron and steel.

The two powers will also face common challenges in energy and climate security for the next quarter of a century. The International Energy Agency (IEA) estimates that both will be importing eighty percent of their oil supply by then. Domestic energy shortages in China three years ago pushed up demands for imported oil propelling international energy prices to twenty-year highs.

Ensuring security of supply – and stability in resource rich regions – is thus paramount for both. China and the EU also need to manage the impacts of climate change, including water stress, shifting agricultural zones and extreme weather. These impacts are likely to affect food, water and human security adversely, with implications far beyond national borders.

With the anticipated closure of power stations because of aging infrastructure and modest demand increases, the EU – and indeed the US – requires a similar level of new generating capacity as China. This means both

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China and the EU will need to avoid locking investment into carbon intensive projects in the next decade, well before technologies like carbon capture and storage become commercially viable. They also have remarkably similar and ambitious energy policies to improve the security of supply through much greater efficiency and use of renewables.

CAPTURING GAINS

These new challenges call for a new kind of leadership. According to the President of the European Commission, José Manuel Barroso, Europe could 'lead the world into a new, or ... post-industrial revolution - the development of a low-carbon economy.' In fact, the EU and China can map the pathways towards a low-carbon economy by strengthening bilateral engagement in energy and climate security. They could start with joint exploration in three areas:

First, rapid diffusion of almost ready to market, climate-friendly technologies is urgently needed in both regions. Embracing diffusion as a policy goal does not mean reducing profit for the innovators or investors that have developed the products. Rather, it is about maximising access at affordable prices, for example, through greater pricing flexibility.

China and the EU could also explore the important lessons from the US Clean Air Act that provides for the mandatory licensing of patented technologies which help to meet its requirements.

Second, the race for radical solutions offers genuine opportunities for China and the EU to embrace new models of technological cooperation. The traditional assumption is that granting temporary monopoly income through patent protection will attract innovation to meet public policy goals. This is often complemented by the use of inducement mechanisms like subsidies, tax credits or direct research.

To meet energy and climate security goals, all the available options should be explored. Governments and companies could, for example, set up a new EU-China Climate Technology Prize Fund to stimulate innovation – along the line of the concept introduced in January in the US Senate by Joseph Lieberman.

Third, encouraging the transition to a low-carbon future requires the removal of tariff and non-tariff barriers to trade in low-carbon, energy efficient and environmentally friendly goods and services. With the Doha Round of negotiations towards a new World Trade Organization agreement in permanent stasis, China and the EU could lead in liberalising trade in low-carbon and energy efficient products. Other options, such as climate-friendly bilateral investment arrangements and mutual recognition, or even joint development of low-carbon standards – could be important to speed these transformations.

LOW-CARBON PIE

In the next quarter century, $20 trillion will be needed for investment in energy supply infrastructure according to the IEA. China alone requires about $3.7 trillion. To avoid locking into carbon intensive options, serious decisions are needed today to ensure a smoother transition to a low-carbon future.

Two rival paths lie ahead. One takes us down the road of old-styled trade, emphasising export interests and the obsessive cultivation of national champions. The other takes advantage of the opportunities offered by globalisation and interdependence to lever win-win solutions that bring not only national economic benefits but also the public goods of energy and climate security.

Ensuring that China gains a sizeable piece of the low-carbon pie is key to the viability of the second path. It would provide incentives for Beijing to play a larger role in the next global deal on climate change. But this will not happen under business as usual; where entrenched interests argue for national preferences and promote the politics of fear towards Chinese investment.

Taking advantage of the powerful dynamics of globalisation to help the move towards a global low-carbon economy, and preserving energy and climate security, will require strategic decisions at the highest level in governments and businesses. Only by considering the long term national interest can policies made in environment, planning, trade, investment and technology ministries become mutually reinforcing in the drive towards a low-carbon future.

Only by presenting an overall political argument for these changes will public support be generated for the type of deep cooperation Europe must build with China. The responsibility of progressive political and business leaders is clear. They must start leading the debate and shaping the foreign policy choices of the future. If they fail, we will see efforts to construct a low-carbon and secure energy future frustrated by the narrow concerns of special interest groups.