

Brussels **18-06-2004**  
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*Caroline*

Dear Dr. Lucas,

Thank you for your letter of 11 May enclosing the New Economics Foundation Report on "free-riding", and asking me to investigate the possibility of using trade sanctions either to encourage participation in Kyoto or to compensate for the competitive advantages of not doing so.

The New Economics Foundation Report is part of an academic discussion that goes back to the time when it first became clear that the US did not intend to ratify the Kyoto Protocol. The discussion is far from over: I am following it with interest, and consider that the New Economics Foundation has made a thought-provoking contribution to it. But I do not share the conclusion that "it would now be effective, appropriate and legitimate for countries, or groups of them, to use economic measures including trade measures, against other industrialised countries."

The Report bases its case on technical arguments about where we now stand in WTO on disputes involving environmental considerations. Even at this technical level I would contend that the legal issues are more complex than they seem. Instruments such as border tax adjustments and countervailing duties have a very precise function and they can be used only in specific circumstances. WTO Members are not entitled, for good reasons, to use those instruments any time that regulatory divergences between States result in different cost-structures for their industries.

The real issue is about what is likely to be the most effective and appropriate policy for us to follow in all the current circumstances. I am firmly of the view that leading the way, as the EU has resolved to do, is strategically and tactically the course which serves both our own and the world's interests best. To decide on a course of using trade dispute mechanisms would be to risk sacrificing those long term goals for uncertain and short term benefits.

I think it is important to retain a sense of perspective and context. The European Community and its Member States have called upon all the parties to the United Nations Framework Convention on Climate Change (UNFCCC), including the United States, the biggest emitter of greenhouse gases, to live up to their responsibilities under this Convention, which requires industrialised countries to return their greenhouse gas emissions to 1990 levels. We have called upon the United States to strengthen its domestic action to a level which represents an effort comparable to that made under the Kyoto Protocol. Apart from decisions and actions at governmental level, action to reduce emissions by economic partners is relevant, and the Commission sees promising actions being taken in the United States at State and regional level, and being brought forward in Congress.

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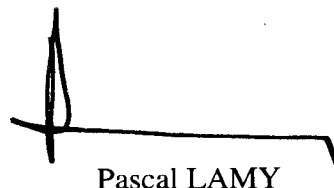
The EU has gone further than the US is currently prepared to go in committing, under the Kyoto Protocol, to achieving an 8% reduction in emissions of greenhouse gases by the period 2008 to 2012 compared with 1990 levels and, in the longer term, we believe that global emissions of greenhouse gases will need to be reduced by approximately 70% compared with 1990 levels. The Kyoto Protocol complements the UNFCCC, and has been ratified by more than 120 countries representing more than 70% of the world's population and including many of the EU's main economic partners.

By taking a lead in our implementation of Kyoto we have consciously accepted the need to begin our adjustment immediately. Our decision to do so is based primarily on our conviction that it is necessary, but the advantages of doing so include local environmental improvements, the scope for seizing the initiative in important new environmental technologies and services, where we could establish an enduring comparative advantage for European firms. There will also be an incalculable benefit to our credibility as an international partner to those countries who will feel the effects of climate change without being in a position effectively to mitigate its causes.

European industry also gains from the stable planning perspective that has been created. The body of legislation which the Community has adopted to reduce its greenhouse gas emissions in a cost-effective manner include Decision 2002/358/EC, approving the Kyoto Protocol and containing the Community's and Member States' greenhouse gas emissions reduction targets for 2008-2012; Directive 2003/87/EC establishing an EU-wide greenhouse gas emission allowance trading scheme; and Decision 280/2004/EC concerning a mechanism for monitoring greenhouse gas emissions and for implementing the Kyoto Protocol. This body of legislation is complemented by the forthcoming Directive which links credits from emission-reducing projects (Joint Implementation and Clean Development Mechanism projects) to the EU emissions trading scheme. None of these legislative measures is conditional on the Kyoto Protocol's entry into force. They provide a clear and certain framework within which companies will contribute to the cost-effective reduction of greenhouse gas emissions.

There is clearly a case for being aware of any adverse effects on our industry and doing everything within our power to minimise these. In that sense it is relevant also to keep under review the scope for action under WTO rules to "level the playing field", though what I have already said makes clear that I do not see the exact inclination of the playing field as being decisive in the sport in question. Rather than setting out on a course which involves an engagement at the level of technical arguments about GATT conformity it would be much better to be able to win the political debate with the non ratifiers of Kyoto by setting a responsible example and achieving consensus through dialogue. You will, of course, be aware that following our recent agreement with the Russians on WTO accession President Putin has clearly stated that Russia would be speeding up its activities to ratify the Kyoto Protocol. This is a very clear and positive commitment, and we are following up this positive signal. It would be counterproductive to contemplate retaliatory action at the same time.

Yours sincerely,



Pascal LAMY