OPINION PIECE

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Climate inaction: implications for international trade

The pandemic-related disruption of supply chains and the political imperative to reorient partnerships following the outbreak of the Ukraine war have exposed the vulnerability of global trade to risks originating outside of the economy. Climate-related risks are increasing in frequency, intensity and geographic spread. Unlike the pandemic and the war, we can anticipate and manage them, albeit against a diminishing window of opportunity.

Policies aimed at mitigating climate change and adapting to its effects are occasionally dismissed as "too costly". In a post-pandemic environment of stressed finances for governments, businesses and households, an "expensive and unaffordable green transition" makes an easy target. Such narratives are dangerously short-sighted: delaying climate action bears the much greater opportunity cost of inaction.

Continuing with "business as usual" is becoming visibly more costly, not only in terms of the natural environment, but also in the global economic, financial and trade system. The trade implications of more frequent and intense extreme weather events (EWEs), of gradual climatic changes and of policy adjustments, such as climate-driven taxes and regulation, are already manifesting through multiple channels. EWEs, such as hurricanes and floods, are directly damaging critical infrastructure, including roads, bridges, ports, railway tracks and airports. More frequent disruptions hurt both goods and services trade, such as tourism. Food and agriculture trade is particularly exposed to heatwaves and droughts that can affect crop yields and tempt countries to restrict exports. In May 2022, India – a major wheat producer – banned exports on the grounds of national food security amid a heatwave.

But there doesn't have to be a natural disaster for there to be an economic one: gradual changes in temperature that expose capital equipment and labour to heat stress, or increase cooling costs in storage facilities, can also hurt productivity and disrupt global value chains (GVCs). Economies whose comparative advantage is tied to climatic processes are highly exposed: degraded land and water stress will impact agriculture, while ecosystem damage and shifts in weather conditions will affect tourism in sea or ski resorts. Such processes can shift patterns of comparative advantage and structurally change global trade.

While some risks can be partly managed by diversifying supply chains and building buffer stocks, these strategies have limits and would involve compromising on the fundamental building blocks of the modern trade system: specialization according to comparative advantage, economies of scale, and optimizing of global value chains (GVCs).

And it is not just the physical climatic disruptions that threaten global trade, but also the so-called "transition risks" inherent in the changing strategies, policies or investments needed in the green transition. The uneven pace of climate action across countries has led some governments to consider border carbon adjustment measures involving charges on imports and/or export rebates, to level the playing field among firms subject to different climate-related regulations and taxes. Such measures, while addressing carbon leakage, can unravel trade patterns by incentivizing re-shoring or short-circuiting supply chains.

The risks of inaction highlight the urgent need to redesign our economies in a way that works for the planet and its people, now and for the future. But this is not only a negative story about risks. It is a growth, investment and trade story of change towards a future that is enormously attractive, with more productive economies, healthier societies and more fruitful ecosystems.