

Global Warming and World Trade Policy

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GLOBAL WARMING
AND THE WORLD TRADING SYSTEM

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Goals of Project

- Explain trade dimension to climate policy
- Explicate WTO law and identify potential conflicts from new climate measures
- Solutions to head off looming collisions

How Climate and Trade Intersect

- Competitiveness (unlevel playing field)
- Carbon Leakage
- Leverage Against Free Riders

Competitiveness Effects of Climate Policy Change

- Sector/industry (e.g., chemicals)
 - More imports, fewer exports
- Economy-wide
 - Δ income, investment, jobs
- Don't forget effects of inaction

“Leakage”: Three Concepts in Play

- Outward movement of investment, production to less regulated countries (“job leakage”)
- Amount of emission reduction in carbon-constrained country offset by outward movement of GDP
- Incoherence of climate regime from growth of carbon emissions in China, India, etc.
Developing countries responsible for 2/3 of future emissions

Optimal Climate Policy

- Needs to be at global level with global participation
- Large reduction in carbon/GHG emissions
- Much higher global price on fossil fuel
- Urgent need for cleaner energy justifies technology subsidies

Carbon Tax *Versus* Regulation

- Regulation is in form of Cap-and-Trade
- Both carbon tax and Cap-and-Trade could be effective policies in *single* world economy and polity
- Given current world economic and political realities, there are arguments for both tax and regulatory approaches

Why Cap-and-Trade Dominant

- “Cap” provides politicians huge amount of government-controlled property rights to auction or allocate
- Dodge uncapped sectors
- “Tax” is politically unpopular
- “Trade” provides business opportunities to climate trading business interests

Transborder Challenges of Cap-and-Trade

- Trade” provides vehicle to build support for climate policy in developing countries. But good governance challenge
- Cap: Allocating emissions from transport
- Producer country vs. consumer country (how to treat imports and exports)
- Recognizing offsets from other countries

Competitiveness: The Challenge in Capped Economies of Competing with Uncapped Economies

Sectoral. Steel, chemical, cement put at disadvantage in exports and imports

National- Higher energy costs and the effect on real income and growth

What is Appropriate Response
to Competitiveness Problems
Stemming from Unequal Carbon
Prices in Countries Engaged in
Trade?

Policy Options to Address Competitiveness

- Domestic subsidies (e.g., free allowances)
- Internal taxes applied at border
- Import charges applied at border
- Export rebates
- Product standards based on carbon footprint of production
 - When applied to imports
 - Sectoral

Policy Options to Address Leakage

- Domestic subsidies (e.g., free allowances)
- Internal taxes applied at border
- Import charges adjusted at border
- Export rebates
- Product standards based on carbon footprint of production.
 - When applied to imports
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Responding to Regime Incoherence

- Multilateral measures to encourage cooperation
 - Lower targets for developing countries (CBDR). Legitimacy vs. Efficacy
 - Technology transfer
 - Official or private financing
- Multilateral measures to discourage free riding
 - Trade measures against particular countries

Overview of Applicable WTO Law

Chapter 2



WTO Law Discussed in Book

- General Agreement on Tariffs and Trade (GATT)
- Agreement on Subsidies and Countervailing Measures (ASCM)
- Agreement on Technical Barriers to Trade (TBT)
- We examine WTO rules and case law thru 2008

Key GATT Rules

- Article I Most-Favoured-Nation (MFN)
- Article II Concessions/ border adjustment
- Article III National treatment
- Article XX General Exceptions (b) (g)

GATT Article XX

- Chapeau- prohibits arbitrary or unjustifiable discrimination or disguised restriction on international trade
- List of approved policy purposes (closed list)
- (G) “relating to the conservation of exhaustible natural resources ... in conjunction with restrictions on domestic production or consumption”

WTO Rules on Subsidies

- ASCM Articles 1, 2: Definition of subsidy and specificity
- Article 3 Prohibited subsidies – export subsidy (and domestic content subsidy)
- Article 5 Outlaws actionable subsidies that cause adverse effects (“serious prejudice”)
- Article 8 Nonactionable subsidies. Expired

Chapter 3:

Examines WTO Status of Climate Measures:

- Tariffs, charges on imports
- Internal carbon taxes
- Export rebate of emission allowance
- GHG performance standards
- Subsidies to affected industries
- Trade Sanctions
- Transport emission charges
- UNFCCC provisions, existing or new

Carbon Measures on Imports

- Regulatory costs of domestic measures cannot be offset by taxes on imports
- Border: Charges for energy, pollution?
- Internal: Is carbon footprint a factor for “like” product?

Carbon Charge: Policy Space

- GATT Art. II:2(a) allows “charge equivalent to internal tax... in respect of an article from which the imported product has been manufactured or produced in whole or in part”
- Domestic carbon tax alongside import charge on “articles” (e.g., coal) used in foreign production
- Based on certificate

“Performance Standards” on Products

- GATT Art. III and XX
 - Like products, less favorable treatment
- TBT Agreement-
 - Within scope of TBT? Mexico v. US *Tuna*
 - Regulations shall not be more trade restrictive than necessary to fulfill a legitimate objective.

Cap-and-Trade in WTO Rules

- Implicates WTO rules at the interface of imports or exports
- Requirements on importers- import charge or internal regulation?
- Country specific rules would be MFN violation (FTA exception ?)

How Subsidy Rules Govern Emission Allowances

- Is free allowance a “subsidy” under ASCM?
- Grandfathering, phase-ins not subsidy
- We claim that free allowances are WTO law “subsidy”
 - “Government revenue that is otherwise due”
- If a subsidy, then subject to:
 - ASCM Art. 3; If specific, Art. 5 and Part V

Rebate of Energy Tax on Export

- Export rebates available for indirect taxes
- Conventional wisdom is that energy taxes or pollution taxes are not indirect
- New rules in ASCM Annex II (& note 61) may provide greater policy space
- Do “indirect taxes” now include taxes on energy used in production process?

Free Allowances is a Subsidy under WTO Rules

- Grandfathering, phase-ins not subsidy
- Our book explains why free allowances are WTO law “subsidy”
 - “Government revenue that is otherwise due”
- If a subsidy, then subject to:
 - SCM Art. 3; If specific, Art. 5 and Part V

Policy Recommendations

- 1. Avoid WTO dispute settlement
- 2. WTO Negotiations
- 3. Adopt Copenhagen principles on trade
- 4. 3-year Moratorium on border measures
- 5. Code of Good WTO Practice
 - Inside WTO as plurilateral agreement
 - Outside WTO, among like-minded WTO Members

1. Avoid WTO Disputes

- Avoid adjudicating climate disputes in WTO tribunals
 - Time-consuming, causes uncertainty in markets
 - Stress on WTO whether climate measure upheld or struck down (non-implementation)

2. WTO Negotiations

- Doha Round or in WTO Bodies
 - Define WTO “green spaces” for climate through an official WTO Code
 - Add Climate to Doha Agenda?
 - Harmonized Tariff Schedule
 - Sectoral Agreements

3. Climate Negotiations COP 15

- Developing country caps + no unilateral trade measures (pp. 74, 99)
- Non-binding Principles on the use of trade measure for climate change
 - Pascal Lamy suggestion on “signal” to WTO

4. Moratorium on Unilateral Measures

- Moratorium (p. 100) on use of climate border measures on imported products
 - Would last from 2009 to 2012 (3 years)
 - US Congress should lead by example
 - Provide space and time to negotiate legal or non-binding agreements

Chapter 5

5. Code of Good WTO Practice

- Agreement of like-minded WTO Members
 - Critical mass of major emitting economies
- Code signatories agree to a “Peace Clause” on challenges of climate measures **that conform to the Code**
- Code conveys no obligations or rights to non-signatories

Key Provisions of Code

- Although auctions preferred, emission permits given freely are not “subsidy”
- No emission allowance or carbon tax rebate on exportation. “Producer responsibility”
- OKs import measures based on comparability with international entity to assess
- Policy space for certain clean energy subsidies
- Prohibit climate-harmful subsidies

Conclusions

- WTO rules do impose constraints on design of trade-related climate measures
- U.S. measure consistent with Art. XX is possible, but measures against US also possible
- Assumption that climate subsidies do not violate ASCM is unjustified

House-Passed Bill

- American Clean Energy and Security Act (H.R. 2454)
- Trade provisions added in Committee Amendment at 3:47am
- Said to reduce emissions by 17% in 2020 as compare to 2005 levels
- Being sold to public as jobs bill
- Competitiveness concerns dealt with through free allocation of emission allowances

“Leakage” under House Bill

- Section 762. Carbon leakage means “any substantial increase (as determined by the Administrator) in greenhouse gas emissions by industrial entities located in other countries if such increase is caused by *an incremental cost of production* increase in the United States resulting from the implementation of this title”

- To induce foreign countries to take substantial action with respect to their greenhouse gas emissions. Sec. 761
- International negotiations (including on noncompliance). Sec. 765
- President to establish International Reserve Allowance system by 2018 if negotiations unsuccessful (subject to Congressional disapproval)
- President to determine for each industrial sector whether 85 percent of US imports come from countries that are parties to international agreement or that have GHG intensity equal or less than US.
- If not, then EPA in 2020 to impose international reserve allowance on imports set equal to price of domestic emission allowance. Will exempt a country that meets above conditions, is LDC, or small emitter.
- Purpose of program is to minimize likelihood of carbon leakage resulting from difference in compliance costs.

WTO Violations

- Art. II:1
- Art. XI
- Art. I
- Art. XX might not cover because mixed purpose and procedures
- SCM Art. 5