

Climate Change and Trade Regimes: The Quest for Compatibility

Patrick Low,

WTO Secretariat

Centre for International Law, NUS

Distinguished Speaker Series, 13 May, 2010

Stylized Facts and Hypotheses

- Broadly held view that CΔ action needed
 - Incompleteness in international cooperative arrangements on climate change
 - Pressures for national action in rich countries
 - Differentiated carbon constraint policies will result, leading to “leakage”:
 - Environmental concerns
 - Competitiveness concerns
- a potential baptist-bootlegger alliance*
- Risk of trade-related actions to level the playing field
 - Possible threats to both CΔ and trade regimes

Challenges for International Cooperation

- Science, certainty and uncertainty
 - Challenging the fundamental science
 - Debating time-frames for action
- Who is responsible?
 - The stock-flow problem – shadow of history
 - Ability to pay
 - Level of development and growth effects of mitigation policies
 - Relative levels of vulnerability

Leakage

Production and investment decisions in a world of differentiated carbon constraints

- Re-located output may neutralize, reduce or increase carbon emissions
- The competitiveness effects will feed through via:
 - Increased output prices for carbon constrained producers in domestic and foreign markets
 - Relatively carbon-unconstrained investment locations become more attractive
- The severity of these effects is an empirical matter

Leakage and the Trade Angle

Trade and trade-related measures can be brought to bear to reduce leakage

- Charges on the carbon content of products at the frontier (permitted on indirect taxes, including with respect to inputs)
- Offsetting subsidies to constrained domestic producers
- “Unlikeness” and parallel regulatory regimes (GATT Article XX, PPM-based actions)

National Policy Frame for Minimizing Leakage

Tax-cum-subsidy options for minimizing leakage while abating emissions:

- Taxing “bads” instead of “goods” – shifting the tax burden but remaining tax-neutral (possible problem of incentive-compatibility)
- Subsidizing constrained firms to re-tool and apply superior technologies or techniques

Non-Cooperative Trade Policy

Responses: Border Adjustments

- Taxing the carbon content of imports:
 - Regarded as unfriendly
 - May excite retaliation
- Possible legal challenges:
 - “Physical incorporation” issue
 - Precise calculation of carbon content (unless trading partners cooperate, need to know prices, technical coefficients and technology to assess emissions)
 - Public policy (Article XX) defence has to meet certain standards

Non-Cooperative Trade Policy

Responses: Subsidies

- Most economists think there are good subsidies and bad subsidies
- Subsidies broadly defined in WTO as a financial contribution that confers a benefit to a specific industry
- Export subsidies and local content rules illegal
- Two tracks for remedies: countervail or legal challenge
- No WTO definition of non-actionable subsidies, so clear vulnerability to challenge

Non-Cooperative Outcomes: The Bottom-Line Risks

- Trade regime challenged in solving trade disputes against a background of climate policy discord – a compromised trade regime
- Trade action in the absence of prior commitment aggravates tensions over climate change cooperation
- So the potential weakening of two key regimes of international cooperation

Cooperative Solutions

- Optimum outcome is comprehensive agreement on a climate change policy regime, with *ex post facto* agreement on the trade rules
- Reality that “common but differentiated responsibilities” will not lead to uniform carbon constraint policies in all countries, so there will still need to be ways of addressing leakage in both its environmental and competitiveness guises

Leakage Management Under Cooperation

- Acceptance that some countries emit too little to affect outcomes in a significant manner
- Incorporation of resource transfer measures to compensate lower-income countries with mitigation obligations
- Work on adaptation as a trade-off for mitigation obligations
- Facilitate rapid deployment of new technologies at affordable costs
- Perhaps revisit the WTO subsidy rules
- Eschew unilateral trade actions outside a framework of pre-commitment

Thank You