Climate policy, Carbon Tariffs and Trade

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Why Carbon Tariffs?

- With no international carbon price, domestic climate policy may affect *competitiveness* of domestic firms.

- Non-universal application of climate policies also creates potential for *carbon leakage*.

- Policymakers argue border adjustments be applied to carbon-intensive imports - Waxman-Markey Bill (2009).

- *Carbon tariffs* or *border tax adjustments* (BTAs), may be allowed under WTO/GATT rules.
Why Carbon Tariffs?

US

Energy

Input Costs

Steel

Policy

Climate Policy

Carbon Tariff - BTA

Imports from China

China

Energy

Input Costs

Steel
Trade Law and BTAs

- Key WTO/GATT Articles:
  
  - Article II.2(a): allows members to place on imports of any good, BTA equivalent to internal tax on like good
  
  - Article III.2: BTA cannot be in excess of that applied to like domestic good, i.e., have to be neutral in terms of effect on trade

- WTO/GATT rules on BTAs not motivated by issues such as carbon leakage, but instead ensuring their impact on trade is neutral and non-discriminatory
Trade Law and BTAs

In principle, nothing to prevent country from applying BTA on imported final good(s) given environmental excise tax on key input, e.g., CFCs in US

- Key is *trade neutrality*, i.e., imports of final good(s) should not be reduced below their level prior to implementation of tax on CFCs

- Current legal debate concerns whether rules allow BTAs on final goods that *embody* energy inputs (WTO/UNEP, 2009)
Trade Law and BTAs

Us: CFCs

Input Costs: Refrigerators

Policy: Excise tax

Exporter: CFCs

Input Costs: Refrigerators

Imports have to remain constant
Trade Law and BTAs

Article II.2(a) interpreted as restricting BTAs to inputs <i>physically incorporated</i> into the final product; Article III.2 interpreted as allowing BTAs to be applied to inputs <i>used</i> in the production process

- GATT <i>Superfund Case</i> (1987) cited as precedent for carbon tariffs - US taxes on imported substances that were end-products of chemicals taxed in the US, were deemed consistent with Article III.2

- Ultimately, clarity on issue will only come with a WTO Dispute Settlement Panel
Possible New Twists

Application of BTAs likely to be industry-specific, thereby creating potential for relative price effects

- Should there be border adjustments for exports as well as imports? Optimal policy requires them, but what of their political feasibility?

- With cap-and-trade, domestic carbon price may fluctuate over time, creating problems for implementation and hence transparency of BTAs

- With free allowances, what is scope for violating WTO/GATT disciplines on subsidies?
Industry Exposure to Climate Costs
Carbon-intensity and trade exposure

BTAs and Agriculture

Waxman-Markey Bill does not directly regulate US agricultural sector – main focus on providing other incentives to reduce GHGs, e.g., offsets

- BTAs will only indirectly affect US agriculture through changes in relative price of energy-intensive inputs
- Policies in other advanced countries may impact agricultural sector via renewable energy sector, e.g., EU standards for carbon footprint of bio-fuels production – may incorporate BTA on imports