Climate policy, Carbon Tariffs and Trade

Ian Sheldon
(Ohio State University)

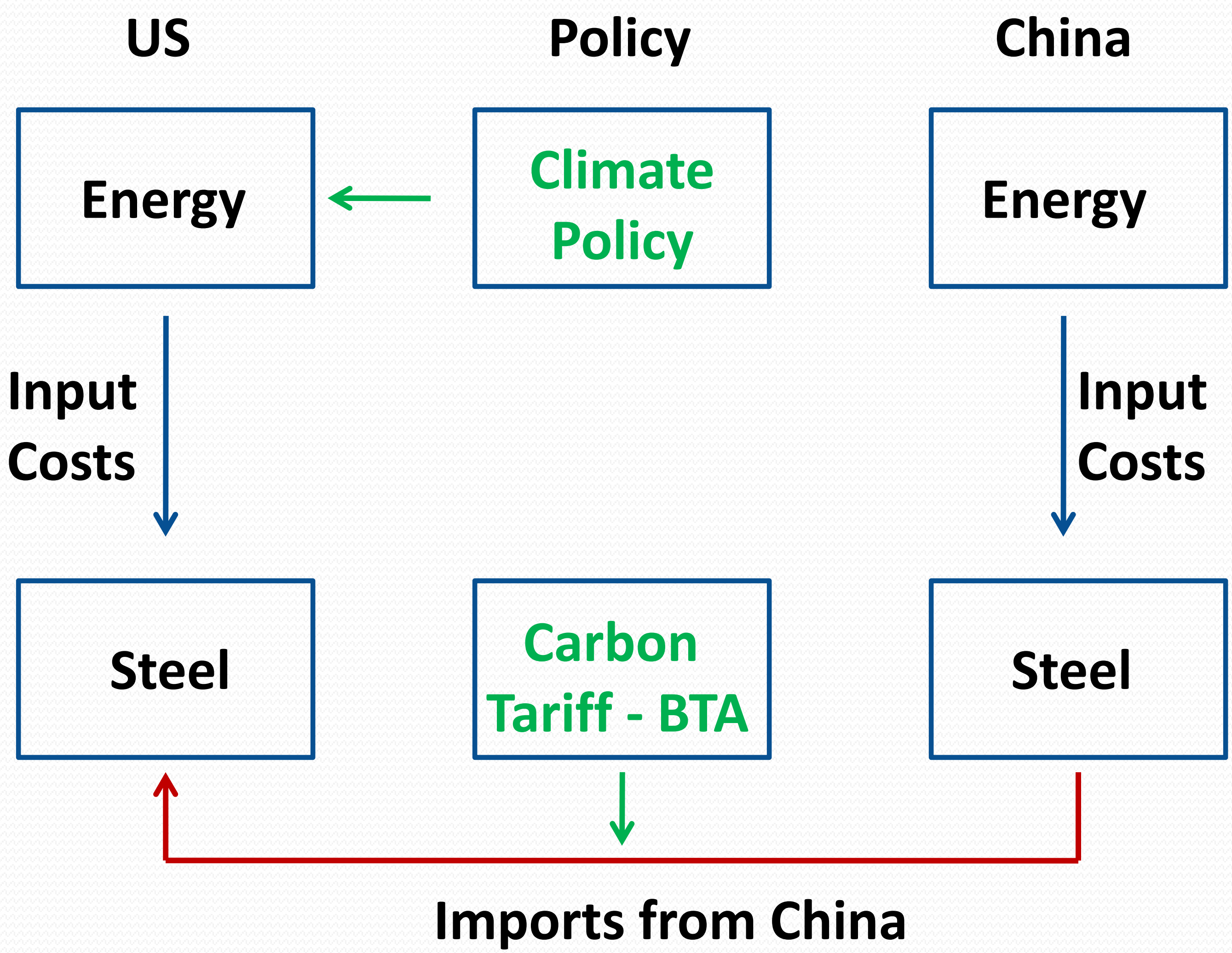
Presentation prepared for "Alternative Energy, the Environment and Trade", Policy Education Program, University of Guelph, Guelph, ON, Canada, September 8, 2010

THE OHIO STATE UNIVERSITY
DEPARTMENT OF
AGRICULTURAL, ENVIRONMENTAL, AND DEVELOPMENT ECONOMICS
aede.osu.edu

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?



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**

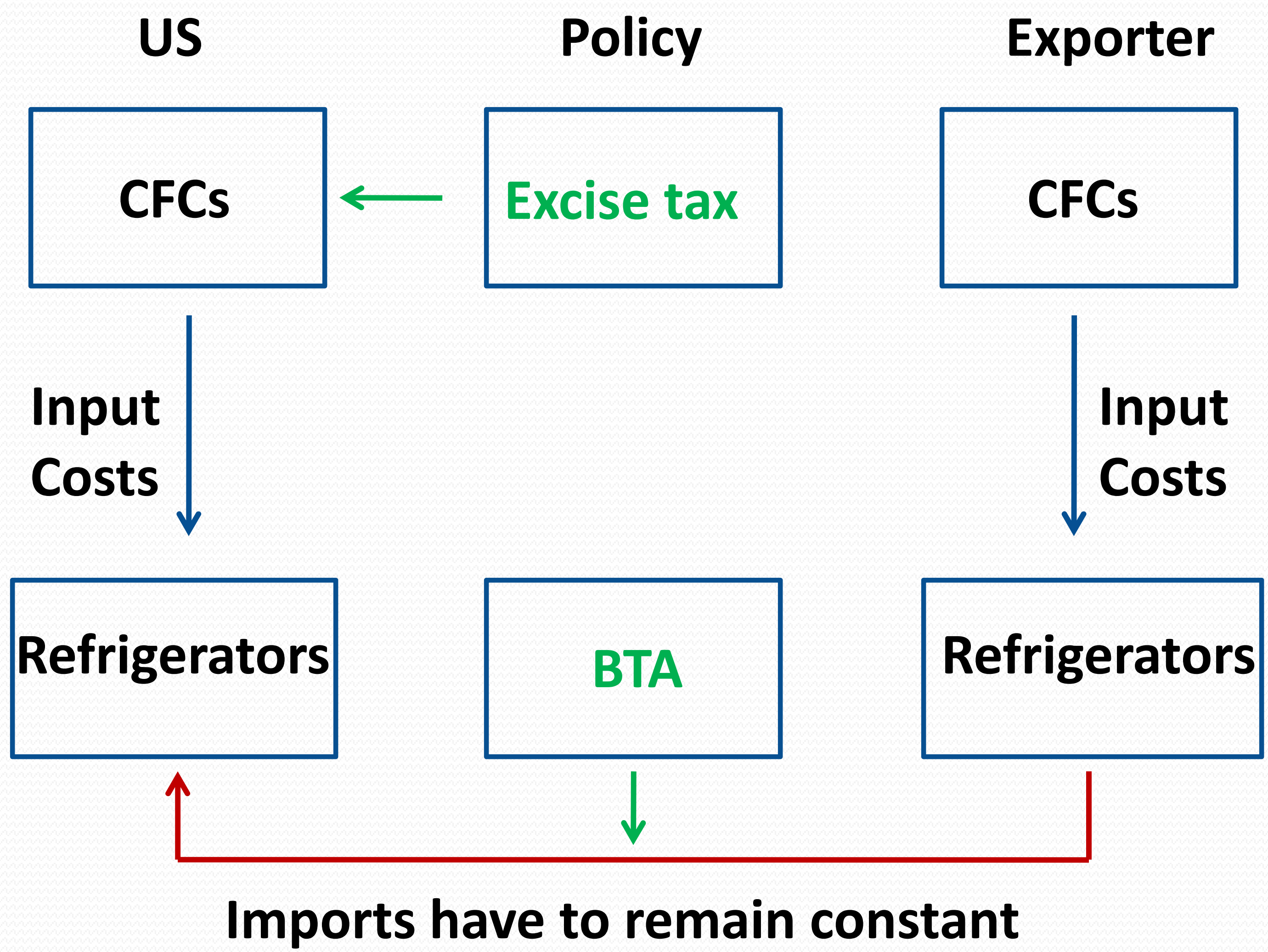
Trade Law and BTAs

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



Trade Law and BTAs

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

- **GATT *Superfund Case* (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**

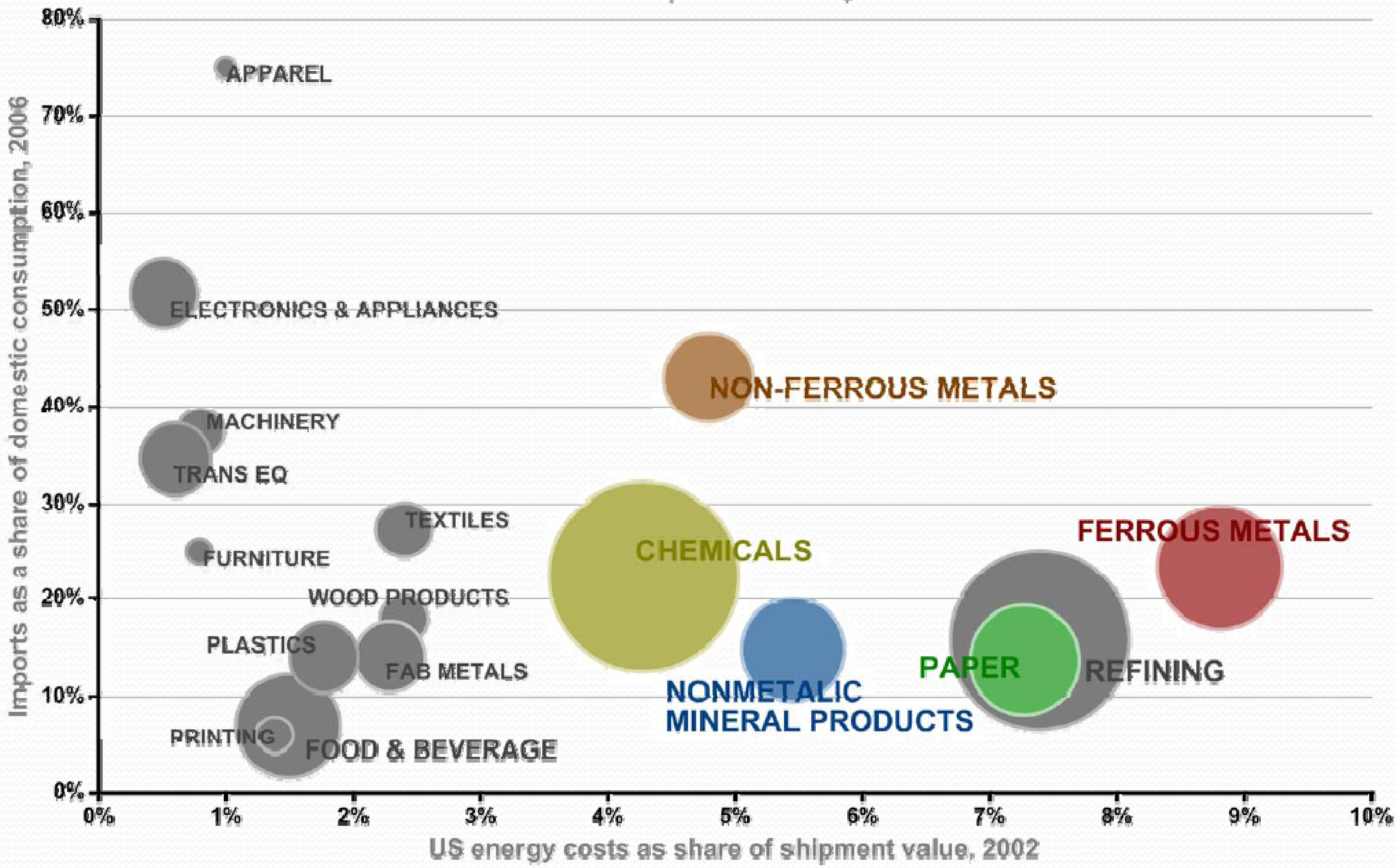
Possible New Twists

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



Source: BEA, EIA and CSA estimates. Circle size indicates 2002 US CO2 emissions

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