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
- China: Energy → Input Costs → Steel
- "Imports from China"
- "Carbon Tariff - BTA"
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

Policy

Excise tax

Exporter

CFCs

Input Costs

Refrigerators

BTA

Refrigerators

Imports have to remain constant
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

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