

Is There Anything New about Border Tax Adjustments and Climate Policy?

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Why Border Tax Adjustments?

- With no international carbon price, domestic climate policy may affect *competitiveness* of domestic firms, i.e., lost profits and market share (WTO/UNEP, 2009)
- Non-universal application of climate policies also creates potential for *carbon leakage*
- *Border tax adjustments* (BTAs) could be applied to carbon-intensive imports
- Is this a novel regulatory issue, or just “old wine in new green bottles”? (Lockwood and Whalley, 2008)

Trade and the Environment

- Carbon leakage already embedded in literature on “pollution havens” (Copeland and Taylor, 2004)
- Carbon taxes with import/export tariffs on traded goods may be precluded by trade rules (Hoel, 1996)
- Suppose tariffs are negotiated while maintaining *market access* (Bagwell and Staiger, 2001)
- However, BTAs for domestically imposed excise taxes already allowed under WTO/GATT rules

Basic Logic of BTAs

- **Old principle dating back to Ricardo:**

“...In the degree then in which (domestic) taxes raise the price of corn, a duty should be imposed on its importation...By means of this duty...trade would be placed on the same footing *as if it had never been taxed...*” (Sraffa, 1953)

- ***Destination basis* of taxation – no effects on trade (Lockwood, de Meza and Myles, 1994)**
- **US raised issue of legality in 1960s after EEC adopted VAT with taxes on imports/tax rebates on exports**
- **GATT Working Party on BTAs established in 1968**

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., has to be *neutral* in terms of effect on trade
- **Current legal debate about whether rules allow BTAs on final goods that embody energy inputs (WTO/UNEP, 2009)**

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

Trade Neutrality and BTAs

- **Mattoo *et al.* (2009) show impact on trade is sensitive to basis for BTA, i.e., *carbon content of imports vs. carbon content of domestic production***
- **WTO/GATT rules on BTAs *not* motivated by issues such as carbon leakage, but instead to ensuring their impact on trade is neutral and non-discriminatory**
- **This depends on factors such as market structure, demand conditions, technology, and the definition of trade neutrality (Poterba and Rotemberg, 1995; McCorrison and Sheldon, 2005; 2005b)**

Conclusions

- **Connection between trade and climate policy not new – trade and environmental economics literature in 1990s**
- **Legal issues also not new, although only a ruling on BTAs in presence of domestic climate policies will resolve current legal uncertainty**
- **Trade neutrality of BTAs at industry level already addressed in literature**
- **Climate policies do however, present some new twists to problem of determining appropriate BTAs**

Possible New Twists

- Application of BTAs likely to be industry-specific (Houser *et al.*, 2008), thereby creating potential for relative price effects (Dong and Whalley, 2009)
- 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 (WTO/UNEP, 2009)
- With *free allowances*, what is scope for violating WTO/GATT disciplines on subsidies? (Bordoff, 2008)