

Carbon Tariffs: Some Economic and Legal Issues

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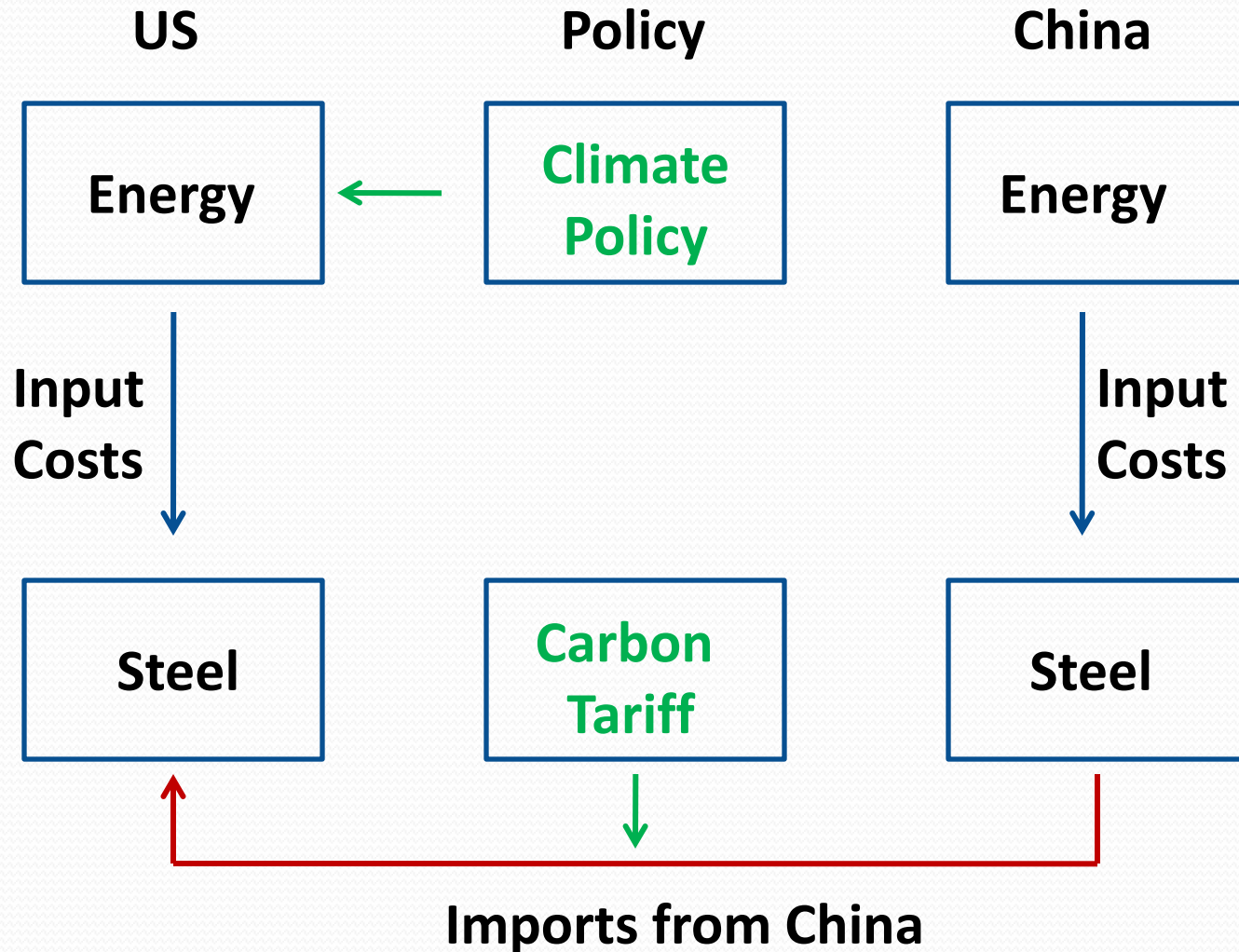
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Why Carbon Tariffs?

- 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 arguing border measures be applied to carbon-intensive imports - Waxman-Markey Bill (2009)
- Commonly referred to as *carbon tariffs* – *border tax adjustments* (BTAs) in “GATT-speak”!

Why Carbon Tariffs?

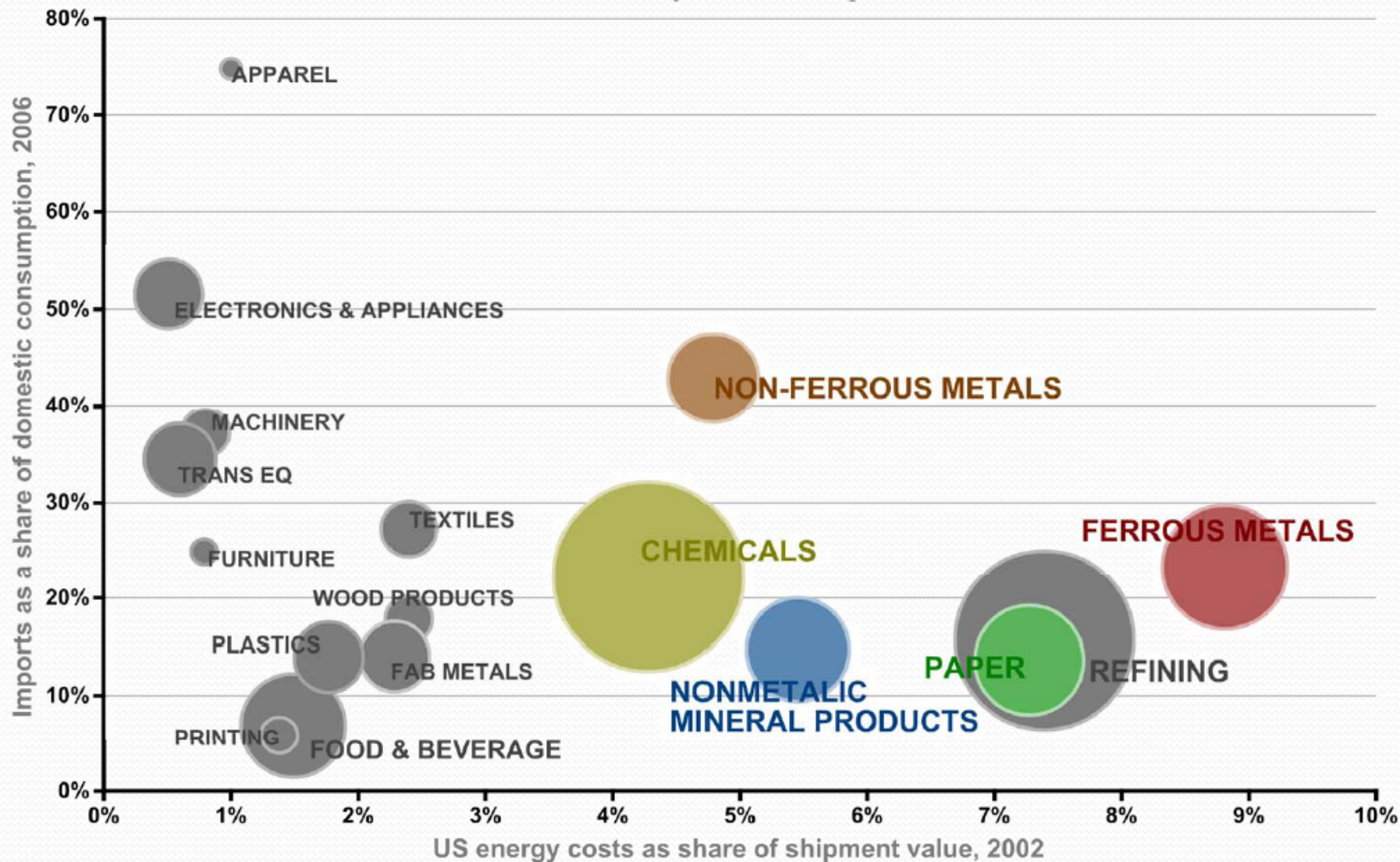


Economic Impact of Carbon Tariffs

- **World Bank (2009) - carbon tariffs will have significant effects on trade and carbon emissions; Dong and Whalley (2009) - find minimal effects**
- **Results sensitive to base for carbon tariff: carbon content of imports vs. domestic production**
- **Disaggregation of manufacturing sector also matters**
- **Irrespective of expected economic effects, considerable debate about their legality**

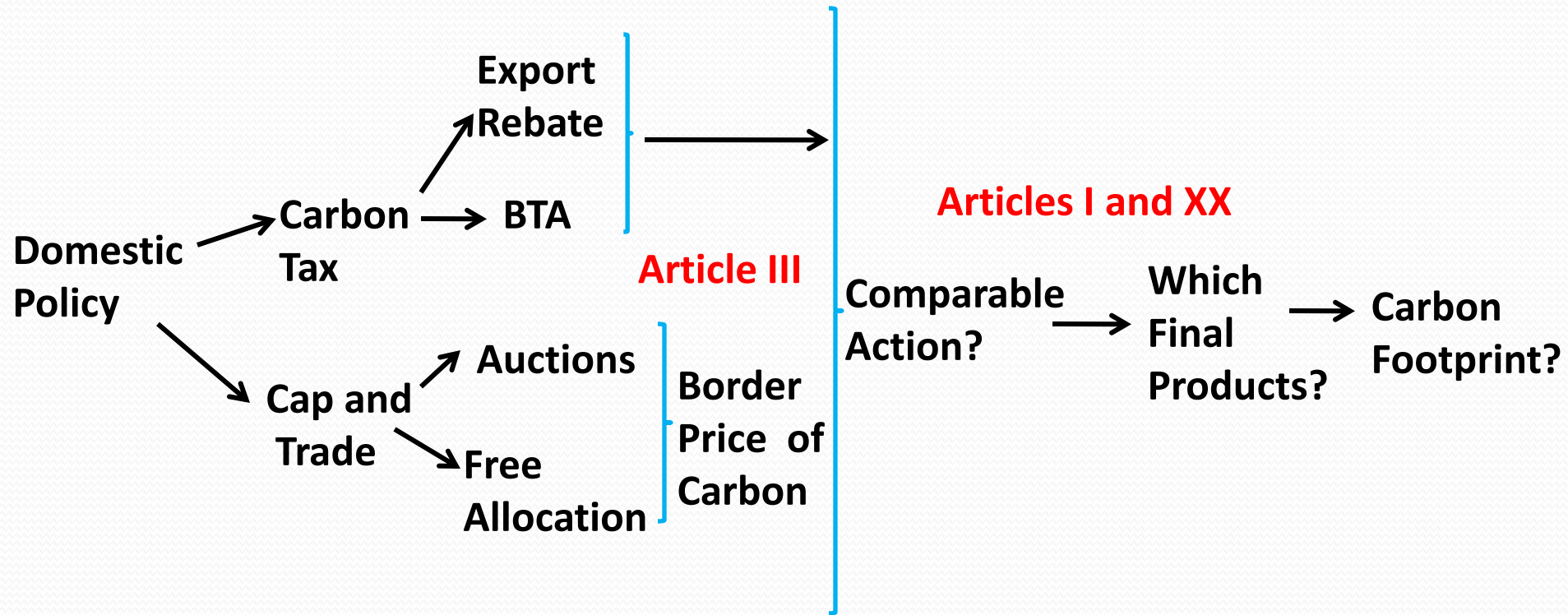
Industry Exposure to Climate Costs

Carbon-intensity and trade exposure



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

Some Potential Legal Issues



Potential for WTO challenge:

GATT Article I (Most Favored Nation)

GATT Article III (National Treatment)

GATT Article XX (General Exceptions)

Trade Law and Border Tax Adjustments

- Issue of legality first arose in 1960s, when EEC adopted harmonized VAT system with taxes on imports and tax rebates on exports
- Debate as to whether in violation of then GATT
- US believed exports to EEC were subject to a trade barrier, while exports from EEC received a subsidy
- No dispute settlement initiated, but GATT Working Party on BTAs established in 1968

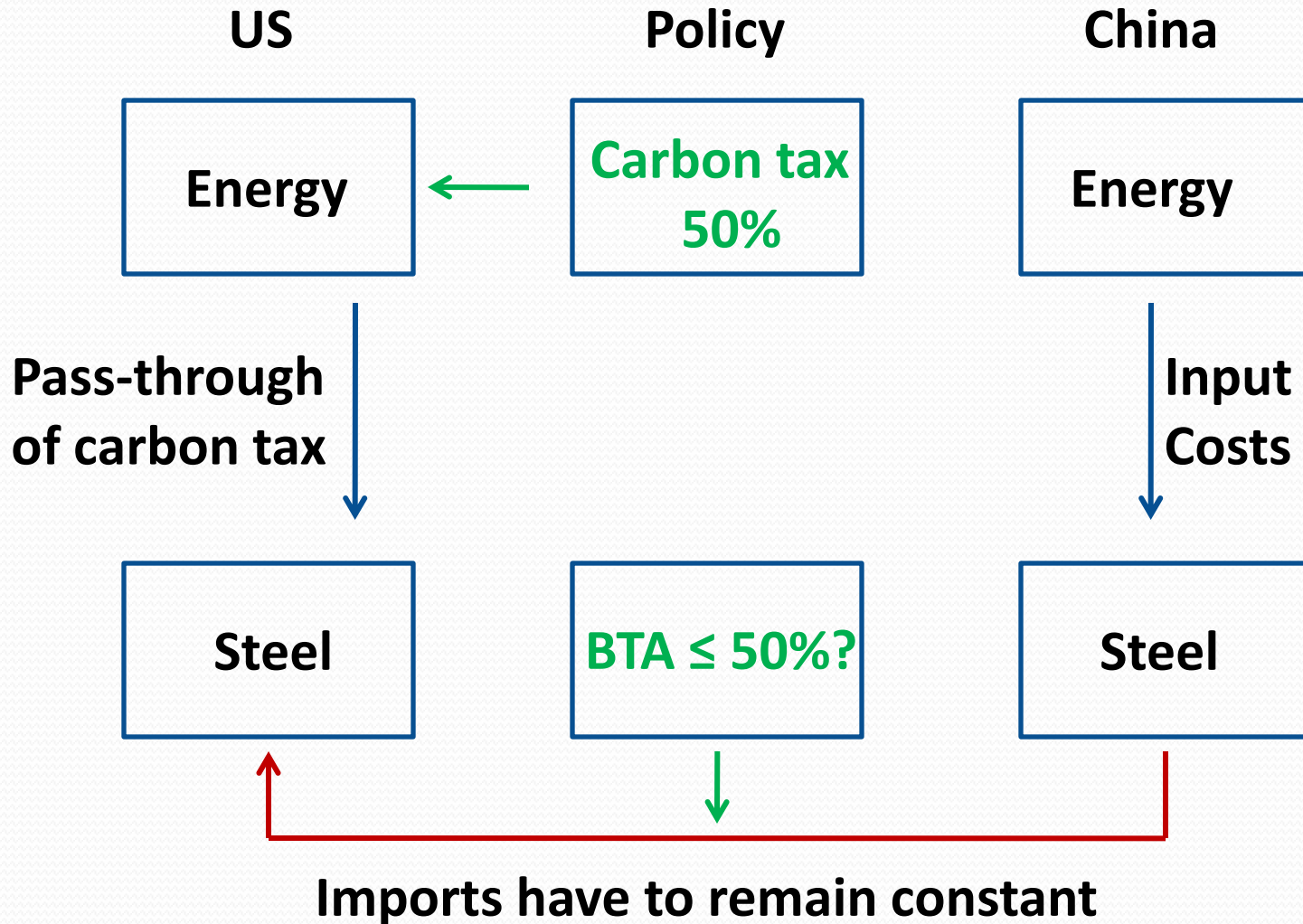
Trade Law and Border Tax Adjustments

- **GATT (1970) defined BTAs as enabling:**
“...imported products sold to consumers to be charged with some or all of the tax charged in the importing country in respect of *similar* domestic products...”
- **Objective of BTAs is:**
“...to ensure *trade neutrality* of domestic taxation...and thus to preserve the *competitive equality* between domestic and imported products...”
- **Taxes subject to BTAs include VAT and excise duties**

Trade Law and Border Tax Adjustments

- In principle, nothing to prevent country from applying BTA for taxes on energy used in production of steel
- Key is *trade neutrality*, i.e., imports of steel should not be reduced below their level prior to energy tax
- *Pass-through* of energy tax to downstream steel industry is critical – depends on industry structure, and technology
- Potential challenges under GATT Article III

Trade Neutrality and BTAs



Trade Law and Border Tax Adjustments

- Article III obliges WTO members not to discriminate against imports in applying internal regulations
- Key language in Article III states imported products:
“...shall not be subject directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products...”
- 20% BTA applied on imported diesel fuel to adjust for a 20% domestic excise tax on diesel fuel would be consistent with Article III
- Can BTAs be applied to embodied inputs?

Trade Law and Border Tax Adjustments

- Key issues: (i) what products are being compared for *likeness*? (ii) can imported and domestic products be compared given differences in amount of energy embodied in final product?
- *GATT Superfund Case (1987)* – challenge to US taxes on imported substances that were end-products of chemicals taxed in the US
- Given tax on imported substances was equivalent to tax borne by domestic substances, Panel deemed measure consistent with Article III

Trade Law and Border Tax Adjustments

- Even if BTAs found inconsistent with Article III, possible to justify under Article XX
- Justification for measure has to satisfy 2-tier test:
 - (1) ...necessary “to protect human, animal or plant life or health...” or relating to “conservation of exhaustible natural resources...”
 - (2) ...measure is “not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade...”
- However may still violate Article XX

Trade Law and Border Tax Adjustments

- **Impact on domestic firms large relative to reduction in emissions - “stealth protectionism”**
- **Not allowing exporters to show level of emissions**
- **Exporting country cannot be required to implement market mechanism such as cap and trade**
- **Failure to recognize impact of stage of development on cumulative emissions**
- **Failure to make good-faith efforts to engage in negotiations with exporting countries**

Further Potential for WTO Challenge

- As well as satisfying GATT Articles III and XX, any BTA must also satisfy GATT Article I
- If BTA is applied to a *like* product (steel), based on a country (China) not having a *comparably effective* climate policy - WTO might rule it is discrimination
- Even if differential treatment is permitted by WTO, it will be difficult to determine which countries actually have comparably effective climate policies

Conclusions

- **Connection between trade and environmental policy not a new issue – significant debate since early-1990s in economics literature**
- **Legal issues also not new, although only a ruling on carbon tariffs in presence of domestic climate policies will resolve legal uncertainty**
- **Climate policies present additional layer(s) of complexity to problem of determining appropriate BTAs – there is “*some new wine mixed with old wine in new green bottles*”!!**

Papers and Bulletins

- S. McCorriston and I.M. Sheldon, “Market Access and WTO Border Tax Adjustments for Environmental Excise Taxes under Imperfect Competition”, *Journal of Public Economic Theory*, 7 (September) 2005
- S. McCorriston and I.M. Sheldon, “Export Competition and the Remission of Domestic Environmental Taxes”, *International Tax and Public Finance*, 12 (September) 2005.
- I.M. Sheldon, Border Adjustments and US Climate Policy: Are they Legal?” *Andersons Policy Bulletin*, December 2009.
- I.M. Sheldon, “Climate Policy and Border Tax Adjustments: Some New Wine Mixed with Old Wine in New Green Bottles”, *Estey Centre Journal of International Law and Trade Policy*, forthcoming

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