

**“Economic and Legal Analysis of Climate Policy
and Border Tax Adjustments:
Federal vs. State Regulation”**

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Climate Change

- **Climate change is “...greatest and widest-ranging market failure ever seen...” Stern Report (2006)**
- **Despite logic of multilateralism (Paris Agreement), climate policy increasingly common at regional, national, and sub-national levels**
- **Necessarily “second-best” – problem of free-riding by those not in coalition**
- **Irrespective of policy-choice (tax vs. cap-and-trade), proposed unilateral climate legislation often includes border tax adjustments (BTAs)**

Why BTAs?

- Industries accounting for large proportion of emissions will face increased costs
- Typically, legislation targets border measures at carbon-intensive imports – predicated on two concerns about unilateral climate policy:
 - *Carbon leakage*
 - *Competitiveness*
- SB 775 (California) - importers required to purchase permits for CO₂ emissions, exporters exempt (Fowlie, 2017)

Economics of BTAs

- **Interdependence of leakage and competitiveness not a new idea – restatement of “pollution-haven” hypothesis (Copeland and Taylor, 2004)**
- **Policy options analyzed extensively:**
 - ***Environmental economists: solve collective action problem via manipulation of terms of trade (Hoel, 1996; Böhringer et al., 2014)***
 - ***Trade economists: restoring competitiveness vs. meeting WTO commitments (Bagwell and Staiger, 2001)***

WTO Consistency of BTAs

- Are BTAs trade-distorting?
- Imposition of domestic tax on “like” imported goods – allowed under GATT Article II: 2(a) if BTA is equivalent to internal tax
- Position of GATT/WTO established following implementation of VAT by EU, and based on economics of move to *destination-based* tax system
- Non-distorting due to price/wage/exchange rate adjustments (Lockwood *et al.*, 1994)
- BTAs should be *neutral* in terms of trade effects (WTO, 1997) – what does neutrality mean?

WTO/Climate Policy/BTAs

- **BTAs come under GATT Article III: 2 – key issue is whether they are allowable on final goods that embody carbon or use carbon-intensive inputs**
- **Considerable legal analysis of how WTO Panel might rule (Goh, 2004; Pauwelyn, 2013)**
- **May be consistent with GATT Article III: 2 – *Superfund* case (GATT, 1987) cited in support**
- **Could justify under GATT Article XX – i.e., has necessary environmental objective, and is not discriminatory/trade-distorting**

BTAs: Federal vs. State Regulation

- Debate over state-level BTAs being subject to federal legal challenge**
- (Not) facially discriminatory under dormant Commerce Clause, and will (not) satisfy complementary tax doctrine (Ferrey, 2008 vs. Shanske, 2014; Gamage and Shanske, 2017)**
- BTAs could also run up against dormant Foreign Commerce clause (Gamage and Shanske, 2017)**
- However, in absence of WTO ruling on BTAs, not obvious there would be any federal ruling**

Current Status of U.S. Climate Policy

- Federal climate policy unlikely to be enacted anytime soon, and U.S. backing away from international commitments to reduce emissions**
- Imposition of BTAs on U.S., given its withdrawal from Paris Agreement, may provoke retaliatory tariff response by U.S.**
- U.S. may be able to negatively influence China's terms of trade (Böhringer and Rutherford, 2017)**
- Plays into President Trump's view of China competing unfairly with the U.S.**