Carbon Tariffs:
Some Economic and Legal Issues

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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?

US

Energy

Steel

Input Costs

Policy

Climate Policy

Carbon Tariff

Imports from China

China

Energy

Steel

Input Costs
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

Domestic Policy
- Carbon Tax
- Cap and Trade
- Free Allocation
- BTA
- Export Rebate
- Auctions
- Border Price of Carbon

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
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

US
Energy

Pass-through of carbon tax

Steel

Policy
Carbon tax 50%

BTA ≤ 50%?

Imports have to remain constant

China
Energy

Input Costs

Steel
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


Web page: [http://aede.osu.edu/programs/Anderson/trade/](http://aede.osu.edu/programs/Anderson/trade/)