

Climate Policy, Carbon Tariffs and Trade

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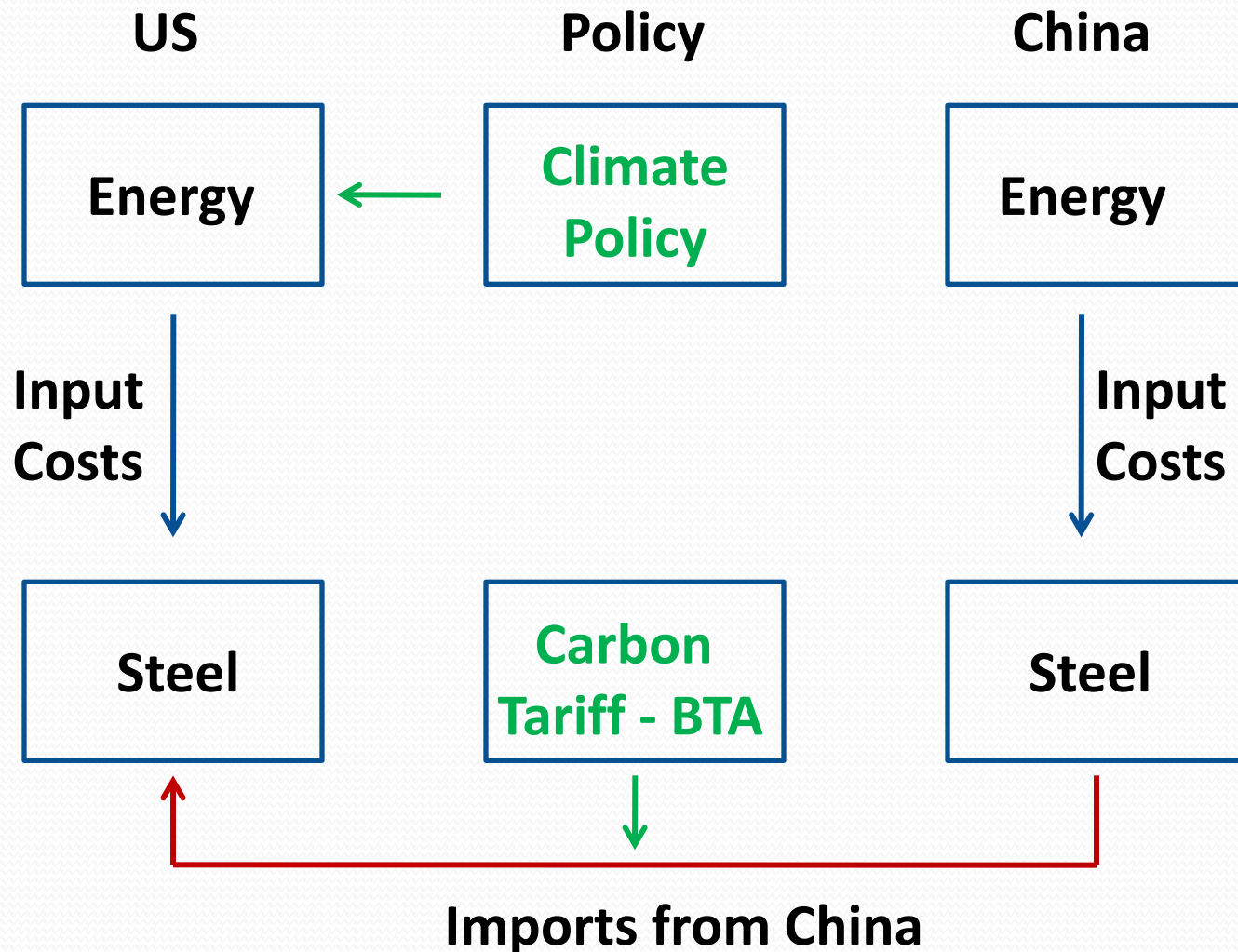
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Why Carbon Tariffs?

- 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 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?



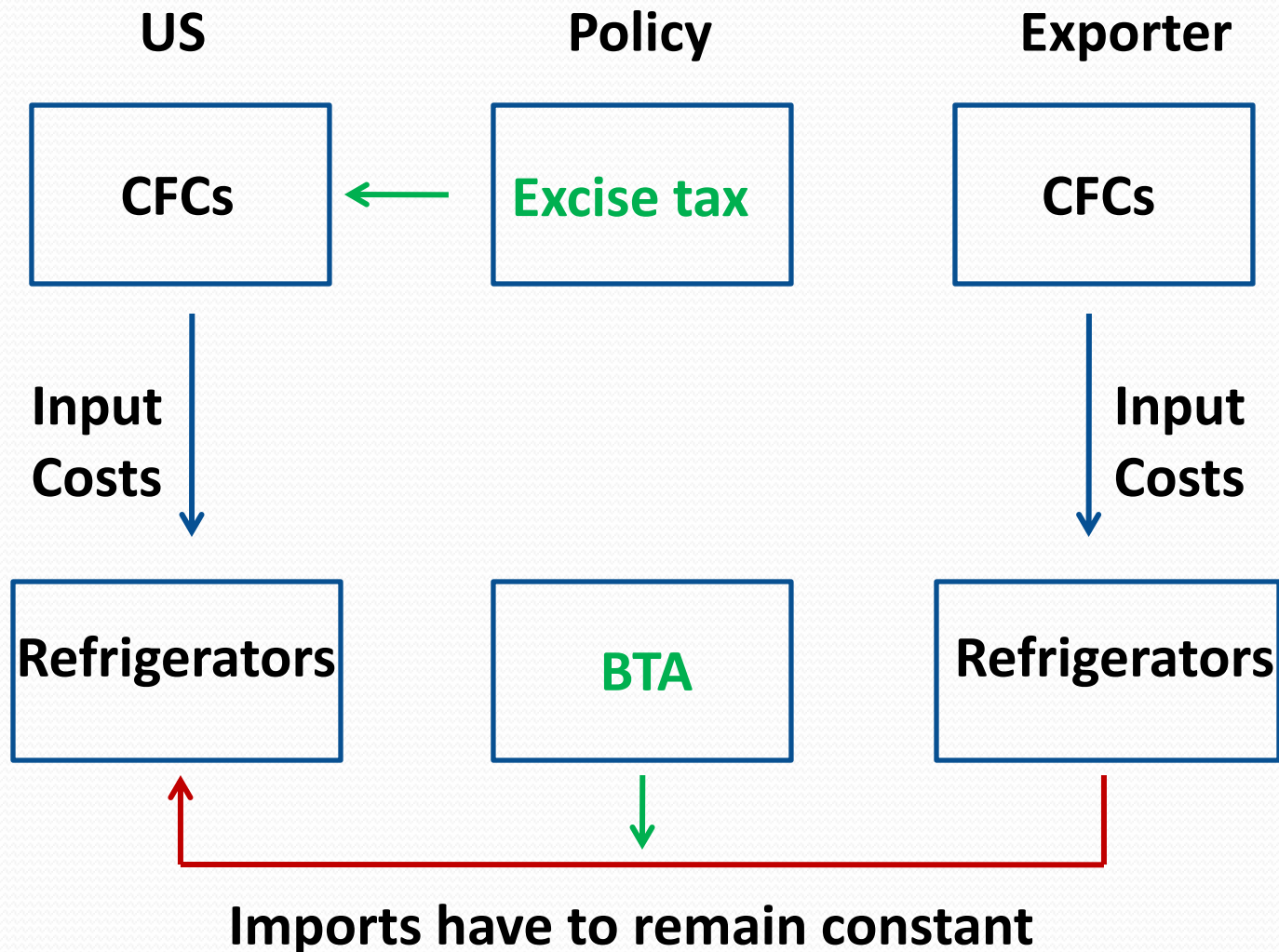
Trade Law and BTAs

- 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



Trade Law and BTAs

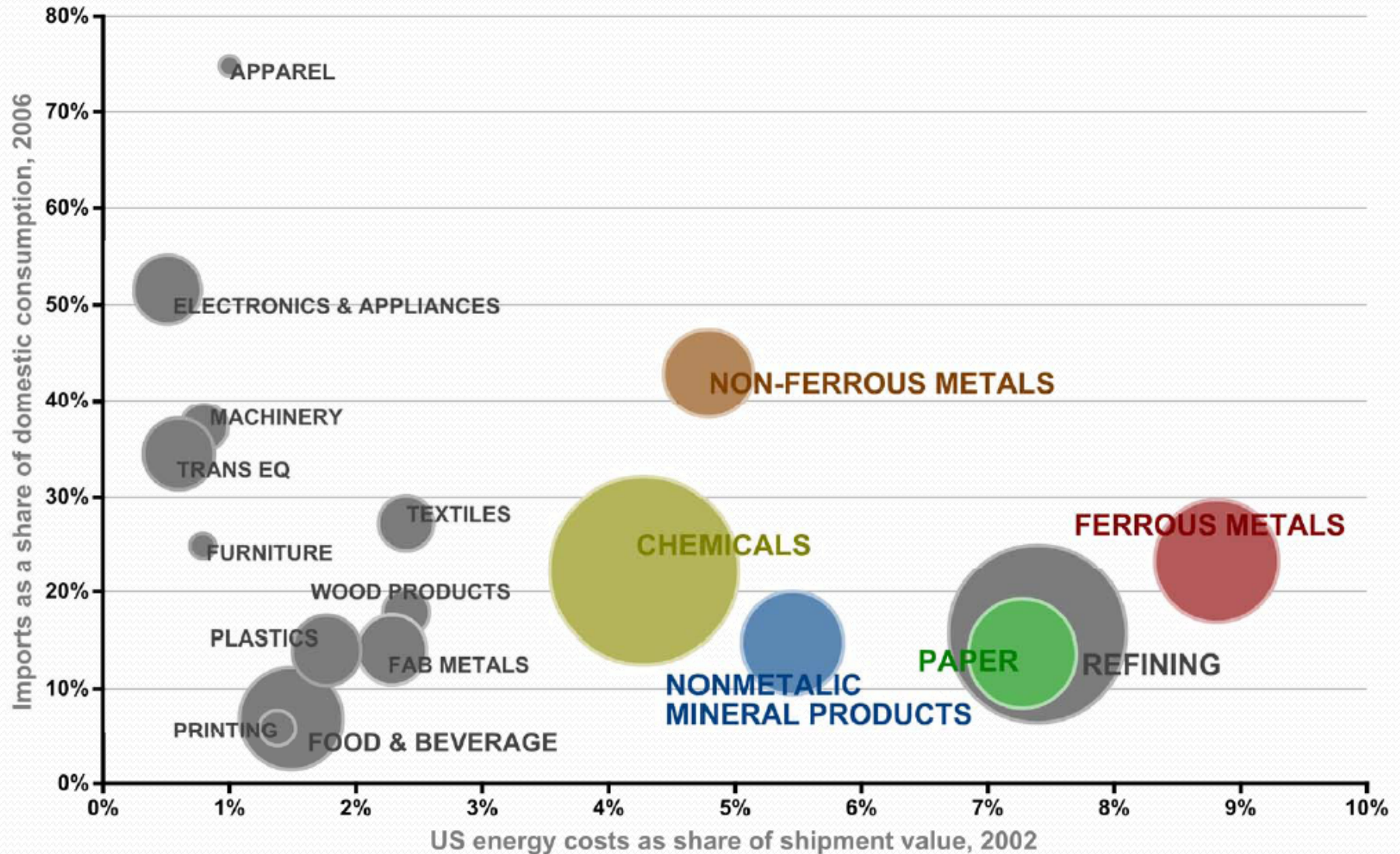
- Article II.2(a) interpreted as restricting BTAs to inputs *physically incorporated* into the final product; Article III.2 interpreted as allowing BTAs to be applied to inputs *used* in the production process
- GATT *Superfund Case* (1987) cited as precedent for carbon tariffs - US taxes on imported 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



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

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**