



Global Warming and the World Trading System

Gary Clyde Hufbauer, Steve Charnovitz, and Jisun Kim • March 2009 • 166 pp. ISBN 978-0-88132-428-0 • \$23.95

Global warming is the most pressing environmental challenge of our time, and how we address it will have far-reaching effects on the world economy. Scientific opinion has coalesced around the view that human activity has added great amounts of greenhouse gases to the atmosphere even though natural forces are also at work.

Before the financial crisis hit the world economy in 2008, optimism prevailed that the United States would soon enact emissions controls—championed by both then-senator Barack Obama and Senator John McCain. Congressional debate on the design of climate change measures was vigorous as experts and the public alike reconsidered their attitudes toward global warming. The severe global downturn, however, has slowed momentum toward climate action both in the United States and internationally. President Obama has continued to stress that climate change is still one of his top priorities, but it remains to be seen whether the United States will enact its own emissions control legislation before the December 2009 United Nations Climate Change Conference in Copenhagen or even before the end of 2010. The Copenhagen summit might result in new and ambitious targets for reducing greenhouse emissions and commit both developing and developed countries to take action, but hard decisions on a harmonized international climate policy will likely be delayed. In the interim, national governments will likely insist on designing their own methods for meeting agreed targets. Under this scenario, trade conflicts due to differences in climate change policies are all but certain.

A major US objection to taking stringent action on emissions controls is a fear that heavy costs would weaken the position of US producers, leading to the “leakage” of production and jobs to foreign firms located in countries that do not equivalently control carbon emissions, such as China and India. Not surprisingly, the severe economic downturn has intensified fears of losing competitiveness. A related concern is that, in the end, US controls will make no difference to climate change if emissions activity simply migrates to other countries and if US controls do not create enough “leverage” to prod China and India and other large but reluctant emitting countries to take action.

To address both leakage and leverage concerns, US policymakers have tried to include specific provisions in their greenhouse gas control bills, such as the allocation of free allowances, special exemptions from the new controls, and border measures. Other countries have done the same in binding legislation (the European Union) or draft proposals (e.g., Australia and Canada).

Hufbauer, Charnovitz, and Kim examine whether the climate policy options policymakers are contemplating are compatible with core principles of the world trading system as set forth in the decisions of the General Agreement on Tariffs and Trade (GATT), the World Trade Organization (WTO), and its Appellate Body. They argue that both import-restrictive measures and export subsidies in the climate bills being considered by Congress stand a fair chance of being challenged in the WTO.

While the WTO allows member countries great flexibility in adopting environmental standards within their territories, the same discretion does not apply in their trading relations with other countries. Potential disputes over trade-restrictive measures could arise under several core WTO provisions: GATT Article I (most-favored-nation treatment), Article II (tariff schedules), Article III (national treatment), Article XI (quantitative restrictions), and Article XX (general exceptions) and the Agreement on Subsidies and Countervailing Measures. If the United States enacts its own unique brand of import bans, border taxes, and comparability mechanisms—hoping that measures that

flaunt GATT Articles I, III and XI will be saved by the exceptions of GATT Article XX—it could cause a drawn-out period of severe trade friction. During these conflicts, some countries will concentrate on winning legal cases rather than fighting the common enemy, global warming.

The political parallel with trade legislation is obvious, in that measures to compensate severely affected industries may be required to forge a coalition prepared to enact controls on greenhouse gas emissions. To address leakage and leverage concerns—both of which are aspects of the broader competitiveness agenda—trade-related rules in the form of border adjustment schemes have gained political support. However, trade measures could easily interrupt the broad agenda of trade liberalization that has proven enormously successful in boosting world economic growth since the Second World War and could also hinder international negotiations to design a global climate framework.

Besides, any performance standards that the United States imposes on foreign firms, and any “comparability” tests it imposes on foreign greenhouse gas control systems, can be turned around and imposed on the United States. For example, the United States might impose its own carbon tax or performance standards on imports of steel rebar products from India, citing an exceptionally high level of carbon emissions per ton of Indian rebar production. In turn, India might impose a duty on all imports from the United States, citing the exceptionally high figure of US per capita carbon emissions compared with the world average.

In addition, trade data show that the largest foreign suppliers to the United States of carbon-intensive goods are countries such as Canada, the European Union, and these countries emit considerably less carbon than the United States both on a national or a per capita basis. Moreover, restrictive US trade measures might serve as an excuse for other countries to erect barriers against imports from the United States but not serve as an effective incentive to convince developing countries to reduce their own greenhouse gas emissions. In 2007 imports from China made up an average of about 11 percent of US carbon-intensive imports in five main product groups combined, accounting for 15 percent of US steel imports, 6 percent of US aluminum imports, practically no US chemical imports, 12 percent of US paper imports, and 19 percent of US cement imports. It is not obvious that these trade shares, by themselves, create substantial leverage for the United States to shape Chinese greenhouse gas policies.

Given the uncertain effectiveness of trade measures, their potential to interrupt trade, and their possible conflict with WTO rules, the authors recommend changes in existing WTO rules that would simultaneously accomplish two goals: create a “policy space” for countries to limit greenhouse gas emissions without sacrificing the competitive advantage of their own industries while preserving an open trading system relatively free of discrimination and opportunistic protectionist measures.

The authors argue that WTO members should attempt to negotiate a Code of Good WTO Practice on Greenhouse Gas Emissions Controls that delineates a large “green space” for measures that are designed to limit greenhouse gas emissions both within the member country and globally. By a “green space” the authors mean a policy space for climate measures that are imposed in a manner broadly consistent with core WTO principles even if a technical violation of WTO law could occur. Measures that conform to the green space rules would not be subject to challenge in WTO dispute settlement by governments subscribing to the code. To encourage WTO negotiating efforts along these lines, the authors recommend that the United States and other important emitting countries should adopt a time-limited “peace clause” into their climate legislation. The peace clause would suspend the application of border measures or other extraterritorial controls for a defined period while WTO negotiations are under way.

The new code should encourage, but not require, members to adopt greenhouse gas carbon taxes, or to auction emissions permits, as preferred greenhouse gas control measures. The reason is that to the extent the award of emissions permits becomes a commercial transaction, the room for subsidies is narrowed, and the basis of comparing emissions costs between activities and across countries is vastly improved.

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