

Climate Change at the Border

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A disclaimer

NFTC is not an environmental organization. The NFTC approaches climate change policy from the perspective of how it could affect the global trading system. Our goal is to make certain that any climate change effort is done in ways that encourage new trade flows and preserve the viability of the trading system.

Let me add to the disclaimer that we do not endorse a particular approach to domestic climate change policy. This is convenient – since we do not have to get into the weeds to defend a particular approach against another – but it is also a matter of necessity given our membership. Some of our members have endorsed a domestic cap-and-trade system, others prefer a carbon tax, and still others have alternative ideas about how particular industries should be treated.

We are agnostic, except to the extent that a particular proposal may impact trade.

An urgent problem

That said, it is important to step back and recognize that climate change is an urgent problem which needs to be addressed sooner rather than later.

Most of the business community is past the point of arguing over the science of climate change. And the reality is, even if you are one of the few who might argue that with a couple of cold winters, all this talk of climate change is going to fade away, the politics of climate change have moved on.

There is certain to be domestic climate change legislation if not this year than in the next couple of years, and it is likely to be led on a bipartisan basis by President Obama and Senator McCain.

My hope is that NFTC can make a positive contribution to the discussion on climate change and energy by highlighting the potential trade consequences of the policies being considered.

I've had some interesting conversations with environmental groups over the past couple of months. The ones I've spoken with seem to have a good appreciation for the need to take actions that are compliant with WTO rules and that do not diminish the competitiveness of American businesses.

There is recognition that paralyzing the international trading system or destroying American jobs are the surest ways to collapse a climate change regime. The key is to ensure that our climate change policies promote new jobs, new industries, and new trade.

Many solutions

One challenge in discussing climate change policy is that there are so many different approaches.

1) Internationally, there are two sets of UN negotiations, one on the future of the Kyoto protocol and another on other long-term commitments which seek to include developing countries. Not to mention scores of other discussions at the OECD, in the major economies process, through the Asia Pacific Partnership, at the G-8, etc.

2) Domestically, you have proposals at the federal level to create a carbon pricing mechanism, either cap and trade or a carbon tax, as well as other domestic efforts at the state and federal level to encourage renewable energy and discourage carbon consumption through measures like subsidies and fuel standards.

3) There are also cross border efforts, including a proposal to create an integrated emissions trading market between the United States and Canada, and regional efforts between U.S. States and Canadian provinces aimed at curbing emissions.

International climate change negotiations

The reality is that only a successful multinational system that includes large emitters in the developing world is going to be effective in curbing climate change. The challenge is going to be defining success. The United States has already recognized that developing countries will be treated differently than developed nations, and it is likely that developing countries will not all be treated the same.

It is going to be very difficult to compare actions that China has taken at national level and commitments it may make in international negotiations to what Europe or Japan or the United States has done.

So while an agreement may eventually emerge from the UN process, it is hard to envision an outcome -- short of China signing up for binding commitments under something like the Kyoto protocol -- which would deter Congress from considering a border adjustment mechanism as part of domestic climate change legislation.

U.S. domestic climate change legislation

Domestic legislation is inevitable, either to implement an international agreement or in lieu of one. Border adjustment mechanisms may be politically expedient as part of that process, but there are potentially serious consequences which have not been fully explored.

We have concerns over WTO compatibility of an international reserve allowance, depending on how it is implemented. There are also potential competitiveness concerns for downstream U.S. industries of applying a border measure to products like steel.

And while some experts suggest that a border adjustment mechanism with a lengthy implementation period is a useful tool to have in your back pocket to encourage action by

countries like China and India, we have already seen pressure in Congress to shorten the timeframe for implementation in order to allay concerns from affected domestic industries.

As we saw in the last Congress, there are also likely to be other climate change and energy policy efforts. The NFTC released a paper in December of 2007 analyzing potential WTO compliance issues with proposed climate change legislation, which is available on our website.

To summarize very briefly, we believe that subsidies for renewable energy are very likely to violate the WTO Agreement on Subsidies and Countervailing Measures, that government-administered eco-labeling schemes in H.R. 6 may violate the WTO Agreement on Technical Barriers to Trade, and that energy efficiency requirements and standards are likely to violate GATT Article III on national treatment.

Our paper suggests that other measures, including a cap-and-trade system, CAFE standards, and government procurement proposals, may be more likely to be found WTO compliant.

Others like the Peterson Institute, Jason Bordoff at the Hamilton Project and Brookings, have also done great work analyzing WTO compliance issues with various policy proposals.

Ultimately, we believe that any climate change action that affects trade or our trading partners is likely to be challenged at the WTO, and that compliance is impossible to predict, though efforts should be made to make sure that domestic legislation will survive the challenge.

Potential for trade retaliation

Regardless of WTO compliance or noncompliance, one of our major concerns is the potential for U.S. trading partners to retaliate outside of the WTO if the United States were to impose a carbon cost on imports from developing countries which we deem have not taken “comparable action.”

This could be particularly problematic if the U.S. were to impose a border adjustment mechanism on countries like Brazil, China or India even if they were in the process of taking steps to curtail its carbon emissions.

This is not an argument to do nothing, but legislators and the administration must recognize the potential for retaliation and appreciate that developing countries are likely to indicate that they are playing responsible and appropriate roles in cutting emissions, and might take issue with sanctions which suggest that they are not.

Moving forward

Given the potential for WTO litigation and retaliation outside of the WTO, we would hope that the Obama administration devote as much time and energy to reaching a multilateral agreement through the UN Framework which includes binding commitments for developing countries.

Recognizing that an international agreement that satisfies Congress's definition of "comparable action" is unlikely, we hope that Congress and the President will fashion domestic policies that aim to comply with WTO rules and do not adversely affect the competitiveness of U.S. industry.

At the same time, we concluded in our paper that international law in this area is relatively unformed, which suggests that there is an advantage to acting sooner rather than later. The first proposals are more likely to become the foundation on which WTO rules will be based in the future. As with U.S. dumping law, any U.S. legislation could become a template for other countries, so we should be mindful of the potential for our policies to be used against us abroad.

2009 Predictions

First, a domestic carbon pricing system will take a while, certainly longer than this year. Congressional staffers suggest that legislation will be difficult. There are questions about jurisdiction, given trade and potential revenue-raising measures. And this is one area where the current economic crisis will delay action – adding an additional cost to energy is going to give a lot of members pause in this environment.

At the same time, other pieces of climate change and energy legislation could move fairly quickly. In this sense, the economic crisis presents an opportunity for a green recovery, and there has already been some talk about new funding for R&D, as well as peeling off pieces of prior climate change bills – like subsidies and standards – to pass as part of the stimulus process.

Second, international negotiations are likely to produce an outcome that will encourage tension between the United States and the developing world. The fact that countries like China and India will be treated differently than the U.S. in the international context virtually guarantees that Congress will seek to level the playing field in ways that could disadvantage businesses from those countries. The outcome of the Conference of Parties in Copenhagen in December could motivate Congress to look harder at domestic legislation next year.

Third, climate change will be a hot topic at the WTO. Lamy has called for a discussion of issues outside the scope of the Doha Round, and I would expect climate change to be high on his and President Obama's agenda. There is also an opportunity to liberalize trade on environmentally friendly goods and services by building on the US-EU proposal for an Environmental Goods and Services Agreement, which could be done at the WTO or through another forum.

Fourth, climate change will affect the debate over TPA in the U.S. The NFTC believes that there will be a discussion about TPA next year on its merits (and we have put out a draft TPA bill to contribute to the discussion), but the Council on Foreign Relations as well as some environmental groups have proposed a "Climate Authority" bill similar in structure to TPA. Given the trade issues inherent in policies to address climate change, I think inevitably this would lead into a broader discussion about trade authority.

It's going to be a busy year.