Unpacking the Wonder Tool: Border Charges in Support of Climate Change

Aaron Cosbey

Competitiveness is one of the potential flashpoints in the run-up to the Bali climate conference. The concern is that strong national measures to reduce greenhouse gas emissions will leave domestic producers at a disadvantage relative to those in countries that do not take similar actions.

Competitiveness concerns are traditionally overblown, although they may be more salient in the face of a truly ambitious post-2012 climate regime (see page 14). Competitiveness is not a concern for all producers, but only for those that are energy-intensive, producing goods that are heavily traded, and based in countries where the energy supply has relatively high greenhouse gas (GHG) emissions. Moreover, there are many positive ways to address competitiveness concerns, international agreement on action probably being the most desirable.

But when international agreement fails, past experience suggests that one fallback is likely to be particularly appealing: some sort of border charge (e.g., a border tax adjustment or BTA) to 'level the playing field' between domestic and foreign producers.

The point of such measures would be two-fold. First, they would encourage all countries to strengthen their efforts to address the global challenge. This, for example, is one of the motivations for the Montreal Protocol's ban on imports of ozone-depleting substances from non-Parties to the Treaty – a trade measure of a different sort. Second, they would level the playing field between foreign and domestic producers, ensuring that the former do not gain market share by dint of their domestic regulatory regime. Ultimately, the point is to make the imposing country better able to pursue its clean development path, a course of action that is much tougher when it entails injury to domestic producers.

Border charges to address environmental issues have been proposed by a number of countries, most recently by several EU politicians and institutions, and in two climate change proposals currently before the US Congress. They respond in part to the increased stringency of proposed future action, and in part to the sheer volume of global emissions that are outside of the current Kyoto Protocol targets (around 70 percent). Three questions that should be asked with respect to such measures are:

- Are they WTO-legal?
- Would they be feasible to administer?
- Would they be productive in the wider efforts to 'export' the EU's clean development model?

WTO Compatibility

There is no definitive answer the first question: would such measures be WTO-legal? In large part it depends on the design of the measure in question, of course. A host of analysis on the BTA question has produced divided opinion, and there will be no final answer outside of a WTO dispute settlement panel. Such measures might well be found to contravene GATT's Article I on most-favoured nation (MFN) treatment, but the question hinges on whether it is permissible to consider the method of production of a good when deciding whether two goods are due similar treatment. Of course, even if a panel rules that climate-related border charges violate MFN, the measures might still be saved by GATT's Article XX – General Exceptions.

Here the WTO's Appellate Body ruling in *US-Shrimp I* gives us some idea of what might be required of a WTO-compatible unilateral measure taken to try to regulate methods of production outside of the implementing jurisdiction. For the sake of the present analysis, two important requirements are:

- The measure must not be based on the regulatory regime in the country of production, but must rather be tailored to the specific circumstances of the exporter. Otherwise clean exporters from countries with lax regulations would be unfairly penalised.
- The measure must only be taken after the failure of good faith efforts to reach a multilateral agreement with the exporting countries that would address the environmental problem in question.

The first requirement will be discussed below, but it can be noted here that it would entail a rather complex regime.

The second requirement is of interest because it seems obvious that a complainant that is Party to the Kyoto Protocol – for example, China – could argue with some force that efforts at a multilateral agreement have *not* in fact failed, and that it is in full compliance with the obligations it undertook under said agreement. It is hard to imagine a WTO panel finding against such an argument, at least during the coverage of the Kyoto Protocol's first commitment period, which runs until 2012.

To summarise: legal opinion on whether climate-related BTAs and other border charges would be found WTO-illegalis divided. But it can be strongly argued that if the measures *are* found to violate MFN, then the GATT's environmental exceptions will not serve to save them. It should be noted that the US proposals are not strictly BTAs, but rather require that foreign producers purchase a certain value of US offsets (Bridges Year 11 No.6 page 16). In part they address the first requirement in that they would be imposed on a shipment-by-shipment basis, and are designed specifically to evade WTO strictures relevant to BTAs. Although a full legal assessment of this strategy is beyond the scope of this paper, it should be noted that the second requirement (good faith multilateral negotiations) is still not addressed. Perhaps the most salient question with respect to such measures concerns their administration.

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BTA Administration

Would climate-related border charges be feasible to administer? They would require several rather difficult calculations. They would first probably need to establish the extent to which a foreign government was in fact taking measures comparable to those of the domestic government. Given the fact that a raft of different policy instruments can be employed to reach the same environmental goal, this calculation would be extremely difficult. Depending on the design of the measure, it might need to establish the actual quantum of difference between the two regulatory efforts, so as to be able to derive the proper value of the border charge.

If, in accordance with the Appellate Body ruling in US-Shrimp I, the tax regime was applied not to countries but to individual producers, the calculation would need to establish, almost on a shipment-by-shipment basis, the GHG footprint of the goods in question – a daunting prospect given the reality of today's global value chains, coupled with the widespread data constraints that exist in most countries. Even given the ability to perform this calculation (cost issues aside for the moment), the taxing country would then need to make the judgement described above, to decide at what level the shipment would need to be taxed, given the relative GHG-intensity of the shipper as compared to domestic producers.

The cost and complexity of a regime capable of carrying out these calculations is likely to be well out of line with the potential benefits that it might deliver. It is worth noting that there would be enormous scope in the course of such calculations for political considerations to contaminate the objectivity of the final result – an expansive stage on which protectionism might masquerade as environmentalism.

Political Repercussions

Would such measures be productive in the wider efforts to achieve international consensus on a climate regime? The exceptionally virulent reactions to the unilateral US measures that featured as part of the shrimp-turtle and reformulated gas disputes in the WTO, and even to the Appellate Body rulings in US-Shrimp that cleared the way for such measures given certain conditions, suggest that developing countries would not respond well to the prospect of having such measures applied to their exports. Given that agreement on any post-2012 regime is highly dependent on developing countries as willing partners engaged as part of a win-win collaboration, trade measures as sticks should probably be considered only as a last resort (if at all). Otherwise the poisoned atmosphere they would create would almost certainly frustrate progress.

The concerns that make border charges appealing are important. They need to be addressed where they are real, and dispelled where they are not. And there may be a place for well-designed trade measures in the mix. But there is, at least, a need for more serious analysis to better understand the options available, and their full implications in terms of legality, feasibility and wider political repercussions.

Aaron Cosbey is Advisor, Trade and Investment, and Associate, Climate Change and Energy, at the International Institute for Sustainable Development (IISD) headquartered in Winnipeg, Canada. This article draws on Chapter 6 of 'Climate and Foreign Policy', an IISD report prepared for the Danish Ministry of Foreign Affairs.

World Bank: Border Taxes Could Violate Trade Rules

The *International Trade and Climate Change* report released by the World Bank in October 2007 found that carbon taxes do not hurt countries' international industrial competitiveness. However, these policies have often been accompanied by increased exports by energy-intensive industries, lending weight to the notion that the subsidies and exemptions that most countries have granted to affected industries are overcompensating. Of specific energy-intensive industries in OECD countries, only the cement sector has seen trade reduced by the imposition of a carbon tax.

The report also noted that border tax measures on products from countries that do not have carbon restrictions would potentially risk violating WTO rules, and raise issues related to process and production methods (PPMs). Simulation analysis suggested that the 'Kyoto tariff' on US imports that some European leaders have called for could reduce US exports to the EU by about 7 percent, or even more as trade is diverted to countries that do not face the additional duties.

On the other hand, the report found energy efficiency standards – implented by many developed and developing countries – to be more likely to hurt industrial competitiveness. The metal and transport equipment industries were found to be particularly affected by such requirements.

Liberalising trade in low-carbon goods, including via the WTO, could be beneficial, the World Bank suggested, proposing a focus on specific sectors that could yield quick benefits, such as renewable energy and energy efficiency technologies.

For the climate regime, the report singled out efforts to develop a uniform approach to the pricing of greenhouse gas emissions as the most important priority. It identified a number of tariffs and non-tariff barriers in developing countries as huge impediments to the transfer of climate-friendly technologies, and encouraged them to strengthen intellectual property protection to stimulate the diffusion of clean technologies.

In addition, the report examined whether OECD countries' climate change policies had resulted in 'carbon leakage', i.e. the relocation of energy-intensive industries to developing countries. While the study pointed to a gradual shift of energy-intensive production to the latter – partly due to climate change mitigation measures in developed countries – it also noted that the trend was not pronounced.