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Elements of a Trade and Climate Code

A Code of Good WTO Practice on Greenhouse Gas Emissions Controls should delineate a large "green space" for measures that are designed to limit greenhouse gas emissions both within the territory of the member country and globally. By a "green space," we mean a policy space for climate measures that are imposed in a manner broadly consistent with core World Trade Organization (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.[1] In other words, there would be a "peace clause" to head off disputes in the WTO between countries that subscribe to this code. If a government does not subscribe to the code, then the code would have no effect on that government's obligations and procedural rights in the WTO.

Within the green space, the greenhouse gas 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. The greenhouse gas code could also explicitly prohibit

1. The question of whether the code has been followed could be litigated. If the code qualifies as a plurilateral WTO agreement, then WTO dispute settlement could be used by code members. If the code is outside the WTO, then a WTO panel could be asked to take it into account as an inter se agreement among the parties. Another approach is to provide for arbitration outside the WTO.

a few greenhouse gas–related measures that might be permitted under some interpretations of existing WTO articles and codes. The sections that follow outline some of the elements of our proposal for a greenhouse gas code.

A. Definitions Applicable to the "Green Space"

1. Trade-Related Greenhouse Gas Measures

Greenhouse gas controls that affect international trade in goods and services are defined to include the following measures, whether enacted by the member national government itself or by subsidiary political units within the member country (e.g., states or provinces):

a. taxes or charges on the volume of carbon equivalent emissions released in association with the production of imported or exported products (goods and services);
b. performance standards expressed in terms of maximum carbon equivalent emissions associated with the production of a designated quantity of the imported or exported product;
c. cap-and-trade systems that require the submission of emission permits in conjunction with imported products, or that distribute such permits in conjunction with exported products, whether the permits are distributed by government free of charge, sold at a fixed price, or auctioned;
d. comparability systems that evaluate the greenhouse gas controls of other WTO members and impose regulatory requirements on imports from, or exports to, another member country that fails to meet the prescribed standard;
e. any other greenhouse gas control measure that directly regulates or raises the landed cost of imported products, or that directly regulates or lowers the free-on-board cost of exported products; and
f. subsidies that finance research and development or physical infrastructure for the production of alternative energy sources with lower greenhouse gas emission characteristics than traditional energy sources; subsidies that finance the sequestration of greenhouse gas emissions; and subsidies for climate adaptation.

2. Like Products

For the purpose of ensuring comparability between imported and domestic products, like domestic products shall be defined as all goods belong-

ing to the same four-digit harmonized tariff system (HTS) code or group of codes and, at the option of the member country that imposes greenhouse gas control measures, the ancillary goods used in making the final domestic products.

B. Exported Products

Because a significant percentage of world production is exported (about 25 percent in 2007),[2] a global system for greenhouse gas control ought to adopt some convention for how exports will be treated in national greenhouse gas accounting. The solution proposed here is to maintain producer responsibility for the climate externalities of exported production, but to allow importing nations to take additional measures, consistent with their national regimes, to address the externalities of consumption. Thus, the rule for exports would be that no greenhouse gas control measure shall accord more favorable treatment to exported products than to like products used or consumed domestically by the member country. In other words, rules akin to the "origin system" for border tax adjustments shall apply to exports of carbon-intensive products, so that trade-related greenhouse gas measures are not waived for exports. Under the "origin system," for example, assuming that the United States and Canada both impose equivalent greenhouse gas controls, steel plate exported from the United States to Canada would be subject to the climate-related controls of the exporting country ("origin"), which in this case is the United States, but normally exempted from the climate controls of the importing country ("destination"), which is Canada. Of course, if Canada imposes more stringent controls than the United States on the production of steel plate, then Canada could apply the incremental regulation to steel plate imports from the United States. By contrast with "destination system" rules,[3] this choice will accomplish two goals: (1) between two countries that both impose equivalent greenhouse gas controls on imported goods, origin system rules will simplify international accounting for emissions; and (2) the origin system will discourage countries from promoting carbon-intensive production for shipment to countries that do not impose greenhouse gas control measures on imported goods, or that impose lighter controls than the exporting country. Although we propose that climate-related taxes or permits on domestic production not be exempted or rebated on exports, it

2. Total world real GDP in 2007 (at market exchange rates) was $54,312 billion, and total world exports of goods were $13,729 billion (IMF 2008b).

3. Under the "destination system," traded goods are subject to the climate-related taxes of the importing ("destination") country and exempted from the climate-related taxes of the exporting ("origin") country. In the case that climate-related taxes are already paid to the exporting country, such taxes will be refunded upon export.

is noted that this rule would have competitive effects. Most important is that exporting firms may be disadvantaged by comparison with firms that produce in a country with weaker greenhouse gas controls.

C. Border Adjustments for Carbon Equivalent Taxes

A member may impose its own carbon equivalent taxes on imported products. The calculation of carbon equivalent taxes may include taxes imposed both directly and indirectly on like domestic products. In calculating the appropriate border adjustment, the member may average the taxes imposed directly and indirectly on like domestic products made by different domestic firms. In assessing its border adjustments, the member shall give tax credit for any carbon equivalent taxes imposed directly and indirectly (and not rebated) on like products by another member country on exports within the same four-digit HTS code or group of codes. The rationale for this approach is to encourage countries to impose their own carbon taxes on production whether for domestic use or export, not rebate the taxes on exports, and instead keep the revenue.

D. Performance Standards on Imported Products

A member shall not impose more burdensome performance standards on imported products than it imposes directly and indirectly on like products made domestically.[4] Prior to imposing performance standards on imported products, a member shall consult with its principal supplying nations. The member imposing performance standards shall periodically engage and pay for a recognized conformity assessor to assess greenhouse gas emissions levels for like products made within the member country itself and by individual exporting firms among its foreign suppliers. In the event that an exporting firm does not furnish adequate information, the conformity assessor may use the best information available to estimate the exporter's greenhouse gas emissions levels.

E. Cap-and-Trade System

1. Permits Distributed Free of Charge

A code member government may distribute a defined quantity of greenhouse gas emissions permits free of charge to firms of its choosing, and

4. By "performance standards" we mean regulations or standards set by a government, usually expressed in terms of maximum carbon equivalent emissions associated with the production of a designated quantity of the good. Under GATT Article III, such performance standards might not be a valid basis for differentiating like products.

such distributions shall not be regarded as a subsidy for purpose of the Agreement on Subsidies and Countervailing Measures (ASCM) unless a distribution is linked to exportation. The member that is distributing permits may designate the method of certification to ensure compliance with stated emissions levels. The permits so distributed may specify the type of greenhouse gas emission (CO_2, CH_4, etc.) and the industry of use. The member country may allow permits to be banked, and the permits may be nontransferable or transferable. However, if permits may be transferred, by sale or otherwise, to another party, no restriction shall be placed on the transfer to a qualifying firm based in another member country.

2. Permits Sold at a Fixed Price

A member may distribute a flexible quantity of greenhouse gas emissions permits by sale at a fixed price; however, the price may be changed from time to time. The permits so sold may specify the type of greenhouse gas emission (CO_2, CH_4, etc.) and the industry of use. No restriction shall be placed on permit or allowance purchases by a qualifying firm based in another member country.[5] The member that is selling permits may designate the method of certification to ensure compliance with stated emissions levels.

3. Permits Distributed by Auction

A member may distribute a defined quantity of greenhouse gas emission allowance permits by public auction. The permits so auctioned may specify the type of greenhouse gas emission (CO_2, CH_4, etc.) and the industry of use. No restriction shall be placed on permit or allowance purchases by a qualifying firm based in another member country. The member that is auctioning permits may designate the method of certification to ensure compliance with stated emissions levels.

5. Under some bills introduced in Congress in 2008, the United States would not allow foreign firms to buy US permits but instead would require them to buy US-issued foreign allowances. However, we expect the global carbon market to evolve toward more flexible and freer permit trading systems. Therefore, permits sold at a fixed price and those distributed at auction are included in an attempt to promote fairness and nondiscrimination in permit trading. In addition, we expect the post-Kyoto regime would allow countries more flexibility in trading various emissions units so countries can meet their emission reduction targets. As a matter of information, under the current Kyoto regime, emissions trading between countries (as set out in Article 17 of the Kyoto Protocol) allows countries that have extra emission units after achieving their commitment to sell those units to countries that are over their targets. Also, through joint implementation or clean development mechanisms of the Kyoto Protocol, the country can earn emissions reduction units to meet its own target.

F. Comparability Assessments of Foreign Climate Regulation

A member's comparability system that evaluates the greenhouse gas controls of other WTO members and assesses charges on imports from, or exports to, another member country that fails to meet the regulations of the originating member, shall observe the following principles:

1. Comparability shall be assessed by an international entity, for example, the compliance committees of the United Nations Framework Convention on Climate Change (UNFCCC). If delegation to an international entity is not possible under the constitution of the government, the assessment of comparability shall be done by an agency independent of the trade and environmental ministries.
2. Comparability shall be determined at the most specific level possible—for example, comparing domestic and foreign firms, industries, and sectors, in that order.
3. Border charges for noncomparability shall be expressed in terms of ad valorem charges per unit of imports or exports, provided that domestic firms, industries, or sectors that do not meet the same standard shall be assessed an equivalent charge.

G. Noncompliance Measures for Climate Commitments

Members of the code could agree to allow other code members to impose trade measures on them in response to noncompliance with international commitments. For example, country A could agree that countries B and C could impose additional tariffs if country A is adjudged by an independent international arbitral panel or a UNFCCC institution as not in compliance with A's own international legal climate commitment. The idea behind such a provision is that, if most of the major climate emitters sign on, they could jointly police each other's commitments and thereby give confidence that other countries will be taking reciprocal measures. The workability of such an approach assumes that the existence of this agreement would effectively stop country A from complaining to the WTO about B's and C's tariffs on A.

H. Preferences for Least-Developed Countries

In applying greenhouse gas control measures, member countries may choose to omit equal coverage for least-developed countries, and such preferences shall not be considered to violate the WTO agreement. Code members may also choose to exempt small developing countries that are

de minimis exporters. With either approach, however, governments are not obligated to offer such a preference.

I. Climate Subsidies for Sequestration and Alternative Energy Sources

A "peace clause" should be in place among members to forestall WTO challenges to qualifying climate-related domestic subsidies. Qualifying subsidies would be for research and development[6] on alternative energy and sequestration, physical infrastructure[7] for sequestration, and the production and transport of alternative energy for domestic use or export.[8] This latitude for qualifying domestic subsidies would be subject to two bright-line exclusions: First, such subsidies shall not be contingent upon the use of domestic over imported goods; and second, such subsidies shall not be contingent upon exportation. If a subsidy is given to production of fuel or equipment that is exported, then the subsidizing member shall affirmatively establish that the subsidized export replaces a traditional energy source in the importing country that emits a greater quantity of greenhouse gas per unit of energy, taking into account the entire production process for both the alternative and traditional energy sources.[9] Subsidies reported to the WTO under ASCM Article 25.3 shall include a calculation of their anticipated greenhouse gas effects. All subsidies allowed under this peace clause and an evaluation of their results in terms of reducing greenhouse gas emissions shall be reported every two years to the WTO's Committee on Subsidies and Countervailing Measures.[10]

6. Article 8.2(a) of the ASCM made certain research subsidies nonactionable, but that provision has expired. Note also that research services are covered by the GATS.

7. As noted above, government grants for "general infrastructure" are excluded from the ASCM.

8. In other words, the proposed peace clause would provide more legal certainty that generally available climate subsidies would not be challenged in WTO dispute settlement. Our proposed subsidy peace clause provision does not cover subsidies that are specific under ASCM Article 2.

9. Our intention is not to encourage export subsidies. Rather, this sentence acknowledges that developing alternative energy sources is crucial to reduce greenhouse gas emissions and mitigate climate change. Hence, it is very important to promote alternative energy sources both domestically and globally. By "affirmatively establish," we mean that the exporting member country government shall make public a credible statement from the importing member country government.

10. Sadeq Z. Bigdeli (2008, 87–88) has offered a thoughtful suggestion that the WTO committee set up a subsidiary body to collect and analyze energy subsidy data. Authority to do so exists under ASCM Articles 24.2 and 24.5.

J. Climate Subsidies for Adaptation

The peace clause would also extend to environmental adaptation subsidies to firms taken in response to multilateral climate commitments. Under such a peace clause, qualifying subsidies could not be challenged in the WTO as a prohibited or actionable subsidy or countervailed. The now-expired carve-out for such subsidies in the ASCM could be incorporated by reference. That provision permits "…assistance to promote adaptation of existing facilities to new environmental requirements imposed by law and/or regulations which result in greater constraints and financial burden on firms, provided that the assistance:

(i) is a one-time non-recurring measure; and

(ii) is limited to 20 percent of the cost of adaptation; and

(iii) does not cover the cost of replacing and operating the assisted investment, which must be fully borne by firms; and

(iv) is directly linked to and proportionate to a firm's planned reduction of nuisances and pollution, and does not cover any manufacturing cost savings which may be achieved; and

(v) is available to all firms which can adopt the new equipment and/or production processes."[11]

K. Climate-Unfriendly Subsidies

As part of the Doha Round agenda, governments have been negotiating to discipline fishery subsidies. The consensus to include this item in the round was remarkable. The principle in the Agreement on Agriculture of limiting domestic subsidies for trade and budget reasons was extended to fisheries for reasons of resource sustainability. The WTO negotiations on fishery subsidies provide a precedent for action to address other subsidies that adversely affect the environment. In the context of climate, for example, the Code might commit parties to cease (or curtail) government subsidies that promote deforestation.

11. ASCM Article 8.2(c).