



PIIE PETERSON INSTITUTE FOR
INTERNATIONAL ECONOMICS

How to cooperate when the United States, EU and China have very different climate and trade policies

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The macroeconomic implications of climate action

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Roadmap

- Starting Point
- Climate Change Policy in China, the United States, and the European Union
- Policy Spillovers and Frictions
- Unilateral and Bilateral Policy Evolution in Wake of IRA
- Lessons from the WTO
- Steps Forward for the EU, China, and the United States

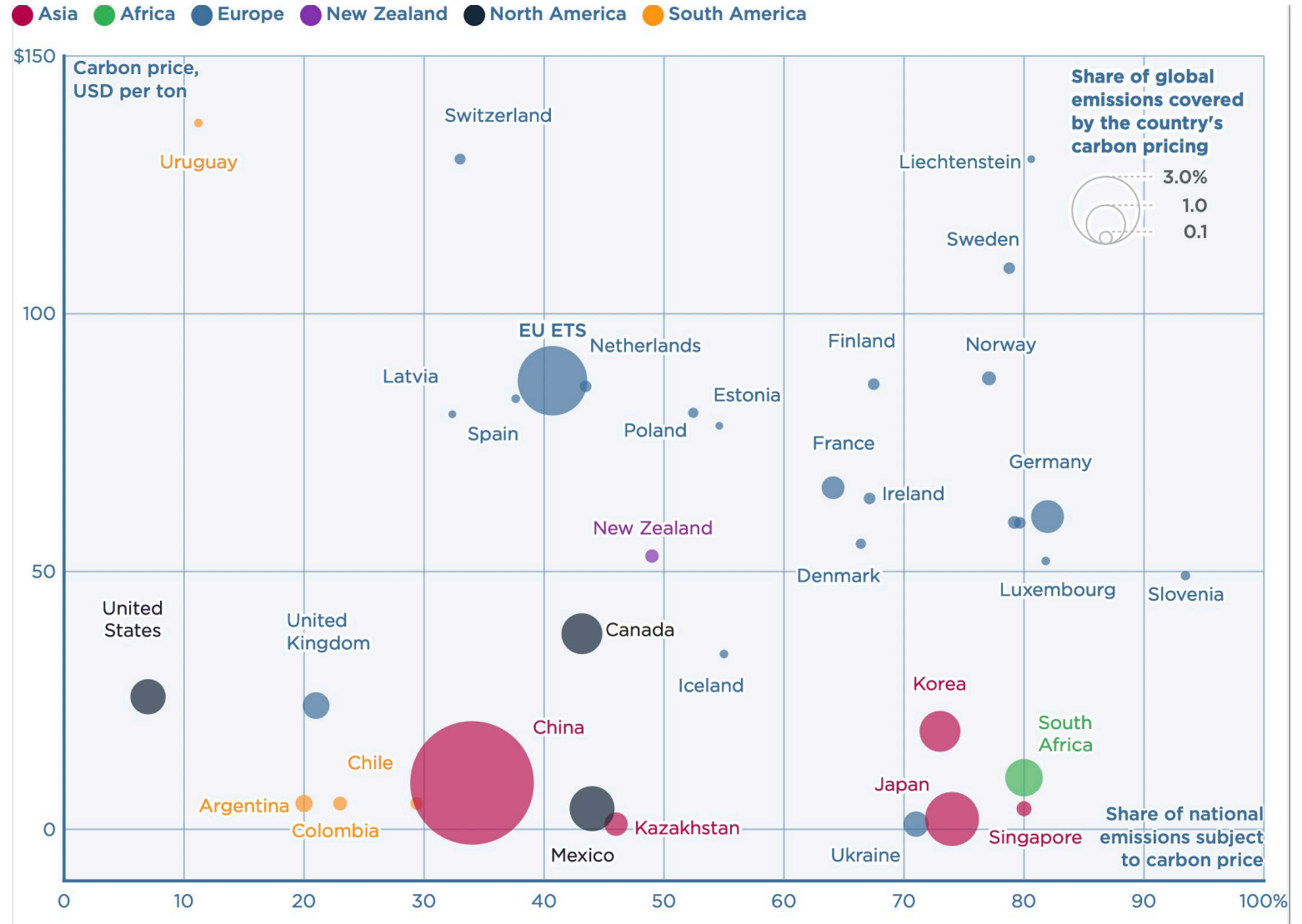
Starting Point

- US, China, and EU: 60% of world economy and nearly half of world emissions
- Their climate policies are not aligned... on the contrary, divergent policies generate substantial frictions
- Easing trilateral frictions can help build a framework to facilitate climate change mitigation while reducing collateral damage to trading system
- It won't be easy.

Rank	Country	Share of Global Greenhouse Gas Emissions (%) in 2019
1	China	26.4
2	United States	12.5
3	India	7.1
4	European Union	7.0
5	Russia	5.1
6	Japan	2.4
7	Brazil	2.2
8	Indonesia	2.1
9	Iran	1.9
10	Canada	1.5
11	Saudi Arabia	1.5
12	South Korea	1.5
13	Mexico	1.4
14	Australia	1.2
15	South Africa	1.2
16	Turkey	1.0
17	Vietnam	0.9
18	United Kingdom	0.9
19	Pakistan	0.9
20	Thailand	0.9

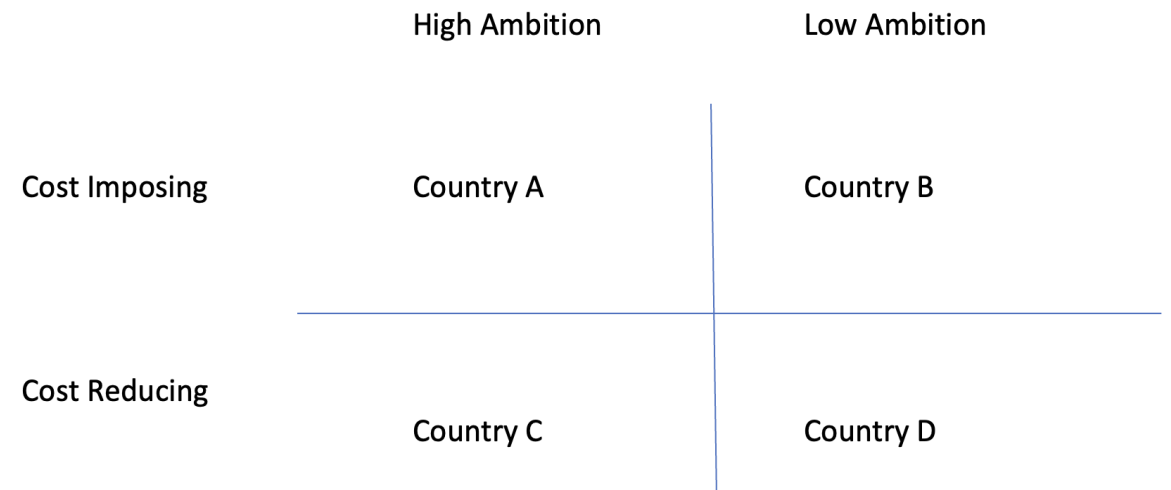
Climate Change Policy in China, the United States, and the European Union

- Some of the same tools are used, but the devil is in the details.
- Subsidies vary in scale, flexibility, and mechanisms.
- Pricing is only subnational in the United States and limited in China.



Policy Spillovers

1. Emissions Externalities (+ ambitious policy helps others)
2. Tradable Industry Competitiveness Spillovers (+/- if cost-imposing/reducing)
3. Learning/Scale Spillovers (+ ambitious policy helps others)
4. Upstream effects (depends on country, time period)
5. Downstream effects (+/-)



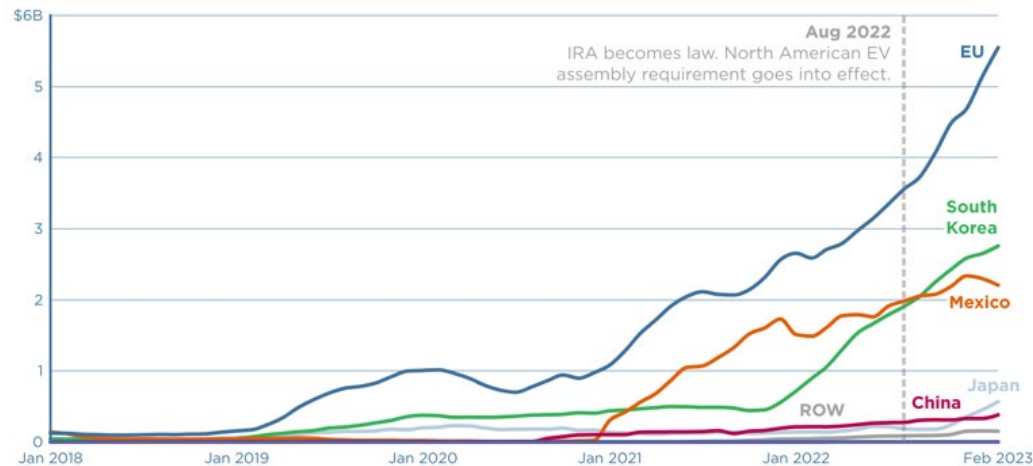
Unilateral and Bilateral Policy Evolution Post IRA

- EU Response: some critiques, some possible policy shifts?
- US Response: implementation decisions, coming political battles?
- US/EU: mini-agreements; green steel deal? other tools?
- US/China: conflicts; is this de-risking or de-coupling?
- EU/China: pragmatism prevails (so far); is this de-risking?

Example of US implementation decision: IRA's “leasing” work around for EVs may help.

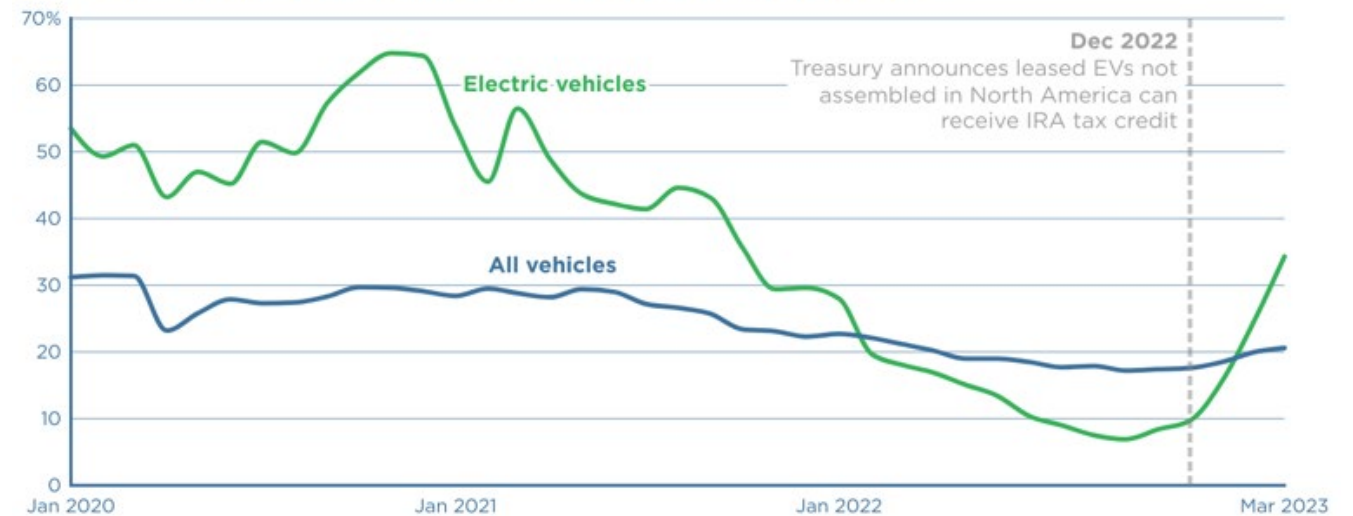
US imports of electric vehicles from the EU and South Korea have continued growing despite the IRA

Value of US electric vehicle imports, 12-month trailing sums, billions of USD, 2017-23 (year to date)



US electric vehicle leases have increased since the eligibility for IRA tax credits was expanded

Leases as a share of all new vehicles entering US market by vehicle type, 2020-23, percent



Source: Bown, Chad P. 2023. “Industrial policy for electric vehicle supply chains and the US-EU fight over the Inflation Reduction Act,” PIIE Working paper 23-1, May.

Steps Forward, Focusing on the EU, China, and the United States

First, why these jurisdictions?

Key Principles:

1. Climate change paramount priority
2. Policy and system diversity inevitable => frictions inevitable
3. Gains from trade large and rules-based system of high value today
4. More policy alignment would be very helpful => nudge world in that direction

⇒ Return to reciprocity of GATT, driven by a common external threat (climate change)

⇒ Move to a (more) cooperative equilibrium

Lessons from the WTO and New Guardrails (1)

Current Subsidies Rules

- Prohibited (domestic content, export) v. Actionable (others)
- Role of remedies
- Current risks: possible IRA impacts, not suited to NMEs

Reforms

- Acknowledge role of subsidies but seek to minimize spillovers
- Make responses to subsidies legitimate and routine (w/ evidence, sunsets)
- Reject and dismantle national content provisions

Lessons from the WTO and New Guardrails (2)

Current Border Measure Rules

- Market Access Commitments, MFN
- National Treatment and Non-discrimination
- Current risks: EU CBAM may be challenged

Reforms

- Greenlight nondiscriminatory CBAMs
- Make explicit link between CBAMs and equivalent domestic cost-imposing policies
- Move toward greater policy alignment

Lessons from the WTO and New Guardrails (3)

Current Export Restriction Rules

- Limits on use of quantity restrictions (is the good “essential”?)
- No limits on equivalent export taxes (except China per WTO accession)
- Current risks: national security; trade weaponization due to monopsony power

Reforms

- Commit to no export restrictions on climate-related goods
- In turn, this helps limit impulse toward subsidies and discriminatory policy

Role of Dispute Settlement

Current Issues

- Dysfunctional (at present)
- *Slow*, limited (in general)
- Designed to prevent trade wars

Handling prior issues is a prerequisite to reform.

Cannot be done à la carte: All three guardrail issues need to be tackled jointly, as policies are interrelated.

Concluding Thoughts and Questions

- What about the rest of the world?
- Greater policy alignment makes this so much easier; how do we encourage that?
- Time is of the essence; how to best push forward climate cooperation?
 - Can we learn from the international tax agreement?
 - Are there ways to make more effective carrots? Sticks?
 - What are the best forums for action?



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