



Global Policy Coherence 2009

Governance | climate - finance - trade

“Border Carbon Adjustment”

Aaron Cosbey* - Selected Overview and Extract

COSBEY, A. “*Trade and Climate Change: Issues in Perspective*”, Copenhagen Conference Summary, IISD, October 2008

KEY ISSUES

- Border carbon adjustment (BCA) is being proposed in a number of legislative and political fora. They are intended to address competitiveness concerns and carbon leakage, and to help force major developing countries to take on hard commitments in the negotiations over a post-2012 climate regime.
- There is a need for more research on the underlying competitiveness issues, which are important in only a small number of—albeit politically important—sectors, and which may be overstated by top-down economic models.
- The design details of any particular BCA will be key in determining whether it is WTO-legal. Most schemes would face difficulties with the disciplines on non-discrimination. They would then have to rely on GATT’s General Exceptions. The existing case law here suggests that any scheme would have to take account of all sorts of foreign policies in considering whether climate change efforts were comparable to domestic efforts, and it would have to allow individual foreign producers to prove their energy efficiency exceeded the baseline. Both of these requirements would make for complex administration of the scheme. And it would have to be preceded by a good faith attempt to conclude a multilateral agreement, the existing Kyoto Protocol being an example.
- If the scheme covered only basic materials and not manufactures, it would disadvantage domestic manufacturers using those materials as inputs. But covering manufactures would be immensely complex.
- It may be that trade flows would simply re-route to deliver covered goods from countries that are taking strong climate measures, having little effect on the targeted countries.

- It is likely that the reaction of covered countries under such a scheme would be strongly negative, including at a minimum at WTO challenge. The larger question, though, is whether BCA in practice, or even as a threat, would in fact backfire on the objective of bringing major developing countries to the climate change negotiating table to take on binding commitments.

INTRODUCTION

Parties to the UNFCCC and the Kyoto Protocol are currently in talks designed to help shape a climate change regime to follow the Protocol’s first commitment period, which ends in 2012. At this point, the nature of that regime and the commitments it will entail is uncertain. But if the IPCC is to be believed—and its projections are the basis for at least some of the post-2012 discussions—the GHG emissions reductions needed will be significant. This is particularly true in developed countries where cuts of 50–80 per cent by 2050 may be necessary to avoid dangerous levels of atmospheric GHG concentration (IPCC, 2007: Chapter 13).

In response to that challenge, a number of countries are pursuing or considering strong domestic action to address climate change. They are doing this either in anticipation of future regime obligations, as part of their obligations under the current treaties, or out of a desire to address the challenge of climate change irrespective of what might develop at the international level. In those countries, one of the key obstacles to such action is the fear that it may put their domestic industries at a disadvantage relative to producers in countries that do not take similarly strong action. This is typically a developed country phenomenon, occasioned by the fact that in the first commitment period developing country Parties to Kyoto, and any non-Parties, have no hard targets for emissions

reduction, and by the fear that they may avoid such targets in a post-2012 regime.

One policy option that has been repeatedly proposed to deal with such challenges is border carbon adjustment (BCA), a trade measure that would try to level the playing field between domestic producers facing costly climate change measures and foreign producers facing very few. While a BCA could conceivably work in conjunction with any number of domestic climate change regimes, it has been proposed to date as a companion to either a domestic carbon tax or a cap-and-trade scheme. In the case of a carbon tax, a BCA would charge imported goods the equivalent of what they would have had to pay had they been produced domestically, in the manner of a border tax adjustment. Such a scheme might also rebate the paid tax to exporters, ensuring that they are not disadvantaged in international markets. In the case of a cap-and-trade scheme, a BCA would force domestic importers or foreign exporters of goods to buy emission permits based on the amount of carbon emitted in the production process, in a requirement analogous to that faced by domestic producers.

BCAs have typically been touted as means to address competitiveness concerns, as noted above. They might play at least two other useful roles. One is to avoid what is known as carbon leakage. That is, if strong domestic action causes firms to relocate to other countries, or to lose market share to those countries, then the emission reduction achieved at home is simply offset to some extent by an increase in emissions abroad. The fear in fact is that they will be more than offset, as production moves to low-standard jurisdictions. While it is closely related to competitiveness, carbon leakage is a distinct concern, focusing on the effectiveness of environmental policy. A final justification for a BCA is that it might act as an effective threat to encourage developing countries to take on hard commitments in the climate change negotiations—in the manner of trade sanctions, or threats of trade sanctions.

Like trade sanctions, BCA proposals have been greeted with some scepticism—even antagonism—by exporters to which they are likely to be applied. They argue that such measures amount to unfair protection of domestic industries in developed countries—precisely the sort of protection that the multilateral system of trade was designed to discourage.

Discussion on BCAs is particularly relevant at this time. They have been proposed in two bills before the U.S. Senate, both of which involve a cap-and-trade scheme and both of which foresee BCAs as part of the regime. The Lieberman-Warner Bill, which eventually failed to pass the U.S. Senate but which will likely inform whatever future climate change legislation is passed, would have seen a Federal Commission certify countries that are not undertaking strong climate change efforts, triggering the requirement that their goods in key sectors would

have to buy into the domestic cap-and-trade scheme. It is widely understood that China would be one of the key targets. In Europe as well there is talk of similar requirements. The EC-mandated High Level Group on Competitiveness, Energy and Environmental Policies proposed BCA in its second report in 2006. The second draft version of the EU's third-phase ETS contained a BCA, but that has since been dropped. A succession of senior French politicians has called for some sort of BCA, most recently with a focus on China as well. In Canada, while the federal government is not yet considering a BCA, it was called for in a recent analysis by two prominent Canadian academics (Courchene and Allan, 2008).

As the prospect of meaningful national-level action on climate change becomes more likely, and while the state of the post-2012 regime remains undefined, the calls for the use of such measures are bound to increase in volume. And policy-makers are bound to listen. As such, more in-depth analysis is needed to assess the pros and cons of such measures. This section is a first step toward that sort of analysis. (...)

CONCLUSIONS AND RESEARCH AGENDA

While the existing research has not demonstrated a significant risk of emissions leakage or loss of competitiveness resulting from national climate policy, there is considerable momentum towards the adoption of BCAs, particularly in the U.S. but also in Europe. As such, more work is needed to adequately underpin the decisions policy-makers will be making in the near future on the implementation of BCA schemes.

Additional basic research is needed on competitiveness, to identify which sectors are vulnerable and to what extent. Any policy aimed at addressing leakage and competitiveness concerns, whether a BCA or domestic cost containment mechanism, will need to identify the losers from climate policy in order to target relief.

Research is also needed on the design of BCA schemes. In the final event, is it possible that BCAs can meet all of the goals set for them—blunting competitiveness impacts, reducing emission leakage and applying leverage to foster more stringent climate policies in major developing countries? Can they also manage to be WTO-legal and administratively feasible?

There should also be more research on the available alternatives to BCAs, and their effectiveness at meeting the goals set out above.

Finally, there needs to be more thought given the wider implications of BCA schemes, along the lines of the geopolitical discussion above. At the end of the day, would such schemes foster or frustrate progress in the ongoing international climate change negotiations? The discussions on this question, where

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they are happening at all, are taking place in absence of serious input from developing countries. Given what is at stake, this needs to change.

While it is difficult to imagine how either the UNFCCC or the WTO might take up issues of leakage and competitiveness formally (outside of the WTO's Dispute Settlement Mechanism, of course), these issues will surely be a part of upcoming discussions both in the climate negotiations and in Geneva. Even if a successful climate agreement is reached at COP-15, these issues will not go away as countries will be moving at different speeds and in different ways to address climate policy. Both the trade and climate communities need to be thinking about these linkages now.

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