

Thinking Ahead on International Trade (TAIT) – 2nd Conference
Climate Change, Trade and Competitiveness: Issues for the WTO

Summary of Discussions for the High-Level Segment¹

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Thinking Ahead on International Trade (TAIT)

The Thinking Ahead on International Trade (TAIT) programme, run by the Centre for Trade and Economic Integration (CTEI) at the Graduate Institute, Geneva, is a 4-year research programme devoted to the analyses of medium-term challenges facing the international trade system in general and the WTO in particular.
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¹ This *Summary of Discussions for egment* contains a brief summary of Round Tables 1 to 7 of the business-government-academic conference **Climate Change, Trade and Competitiveness: Issues for the WTO**. The conference was organised by the CTEI as part of its TAIT programme, in collaboration with the Economic Research and Statistics Division of the Secretariat of the World Trade Organization and The World Bank, and was held at the headquarters of the World Trade Organization on 16th, 17th and 18th June, 2010.

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Introduction

Good morning. It is my task this morning to present a brief overview of our deliberations in the last two days. It is difficult to summarize more than 24 hours of presentations and debates in a few minutes. But I will attempt to provide as unbiased a summary as possible of what seem to be the main themes in the discussion. I am afraid that quite a few arguments and details of discussion will inevitably be omitted, but perhaps they can be rescued in today's debate.

Seven papers were presented and discussed in the conference. Three of them provide essential background for the discussion of the core question posed by this conference – namely, the interaction between climate change policy and trade policy, with particular reference to competitiveness concerns. I will briefly say something first about these three papers. This will be followed by short summaries of the other four. Finally, I will try to give a sense of some of the salient questions that have emerged from our deliberations.

Summary of papers

Background analysis

The first paper, by van der Mensbrugge and Roson, focuses on the impact of global warming on production, demand and trade across regions and sectors. The paper looks at a baseline scenario of business-as-usual and also assesses some alternative policy scenarios directly related to trade issues. Impacts of climate change will have a relatively modest effect on trade in manufactures and services, while agricultural trade could be sharply affected, especially in some regions -- not least because of water stress. Things become much worse after 2050. The authors recognise that the results of their simulations are highly tentative, not least because of assumptions about the effect of emissions on local weather patterns, uncertainty about the relationship between climate change and economic variables, about how easy it will be to adapt to changes in climate, and about what the impact of technological advances might be for the costs of mitigation and adaptation.

In the discussion it was emphasized that models like this could not capture national impacts of climate change adequately, even though the paper recognized that different regions would be affected very differently. National actions could be more important in some cases than international ones, especially since the prospects for effective international action do not look very promising in the near future. Trade policy was not considered a particularly effective instrument for dealing with climate change problems, even though trade opening could have a significant impact in some cases. One way in which trade could help is in diffusing climate-friendly technology.

The second paper, by Mani, focused on the importance of trade and technology, with a particular emphasis on developmental aspects of the challenges posed by climate change. Mitigation measures are more cost-effective in developing countries, suggesting potential for low-carbon growth and environmental benefits linked to development, and the possibility of technological leap-frogging. Existing mechanisms for spreading technology are inadequate. There is an important role for the private sector in making clean energy investments, but an activist supporting stance is required from governments. Trade measures must not be allowed to get in the way of a sound development path. Governments could do a great deal in removing market distortions, such as fossil fuel subsidies and some subsidies on non-carbon energy sources. They also need to improve regulations to provide better

incentives for substitution towards low-carbon technology and to remove tariff, non-tariff and investment barriers that frustrate the attainment of conditions conducive to a low-carbon growth path. In the discussion, emphasis was placed on the particular needs and vulnerabilities of least-developed countries.

The paper by Rutherford uses a computable general equilibrium simulation model to examine some practical issues associated with climate-linked tariffs. The paper also discusses other analytical approaches to understanding the economic effects of climate change and the role of policy in addressing it. Insights gained from modelling depend crucially on the analytical framework adopted. This came out in the discussions around methodological options for assessing the relationship between climate-related policies and their economic consequences. The paper concludes that border tax adjustments are not likely to be an effective policy in stemming carbon leakage. They also raise significant efficiency and equity issues. Carbon leakage is significantly caused by depressed global fossil fuel prices, and involves limited production displacement.

Trade and competitiveness implications

The remaining four papers focused more directly on the trade and competitiveness implications of climate-related policy. The paper by Low, Marceau and Reinaud addressed a range of issues on the relationship between the trade and climate change regimes. In considering carbon leakage and competitiveness, the paper argues for a distinction between aggregate national emission limitations and sectorally defined emission targets. In a world where countries have pre-committed to national carbon constraints, leakage arising from different levels of constraint would not necessarily need a sectoral focus, since adjustments could be made to national targets if leakage affected emissions in a particular sector. Competitiveness concerns, however, inevitably make themselves felt at the sectoral level.

The paper emphasizes difficulties encountered in comparing the effects of policies in the climate change and trade domains because of the different levels at which the policies are applied. Climate-related policies are often applied at the plant or sectoral level, whereas trade policies usually focus on products. There is also a challenge in comparing alternative policy approaches to addressing climate change, as well as the competitiveness consequences of different national policies.

The discussion in the paper of the scope of WTO provisions in addressing climate change issues emphasizes the evolution of case law towards a more accommodating view of the public policy imperatives arising from climate change and environmental challenges more generally. As with other papers presented at the conference, this paper has a good deal to say about PPMs, border adjustments and subsidies. Particular emphasis is given to ways in which Article XX exceptions have been interpreted more recently to accommodate both environmental and developmental considerations. It is argued that the declared objective in the WTO Agreement of fostering sustainable development is finding expression in the interpretation of public policy exceptions. Considerable uncertainty remains, however, with respect to many interpretative issues.

The paper by Wooders and Cosbey focuses on the economic aspects of climate-linked tariffs and subsidies. It looks in particular at border carbon adjustments and free emission allowances. Empirical evidence on leakage, or the pollution haven hypothesis, is not entirely clear, but there appears to be an issue for some sectors at a certain level of disaggregation. A similar lack of clear empirical evidence mars our understanding of the effects of various climate-related policies, such as the free allocation of emission permits. The paper also discusses whether climate change

policy doubles as industrial policy and concludes that this may be the case in some instances. Cost-effectiveness is a real issue in the case of industrial policy objectives. In the face of uncertainty about how carbon costs imposed by policy are passed through to consumers, and what their effects are on prices and profits, governments are likely to be risk-averse and may over-compensate in addressing competitiveness concerns. This may lead to sectors being granted too many free allowances. Moreover, in many sectors where the EU will grant free allowances there is no case for protection. In the case of border carbon adjustments, welfare losses are likely to occur in all other sectors and countries. Overall, the paper makes a strong case for further economic analysis of the effectiveness of climate change policies and of attempts to manage the competitiveness fall-out of such policies.

The paper by Barret looks at the question of the linkage between climate change and trade principally through the lens of the Montreal Protocol, which was established to protect the ozone layer. The core argument of the paper is that the possibility of applying trade restrictions for effectiveness and enforcement purposes was a key part of the success of the Montreal Protocol. Trade restrictions are a credible threat but have never been used, so the problem of the ozone layer was fixed without harming the trading system. By contrast, the failure to deal with enforcement is a big failing of the Kyoto Convention, which also suffers from its primary focus on targets and timetables rather than a much more specific objective attainable through a defined policy set. Montreal was an integrated agreement in which trade policy was included at the outset, and there was broad-based participation. Resources were made available to allow lower income participants take the necessary actions for compliance, and no poor country could be made worse off. The Protocol is also a flexible instrument.

In discussing the contrast between the Montreal Protocol and efforts at international cooperation on climate change, it was pointed out that several differences are important between the two contexts. The Montreal Protocol was drawn up in a different world, with different power relationships. It dealt with a readily definable problem of immediate concern, where identifiable results were forthcoming in a relatively short time-frame. Side payments were part of the deal and there was pre-commitment on the trade policy front -- it was not a question of the unilateral application of trade measures. Also, perceptions of fairness and legitimacy were key to acceptance of the terms set out by the Montreal Protocol. The situation is not the same with climate change.

The final paper, by Hufbauer and Kim, focuses on what is required to avoid a direct clash between the climate change regime and the trade regime. The starting point is that for the time being bottom-up policy approaches are going to prevail in climate change policy because an international agreement is proving elusive. This becomes a potential source of tension, as quite costly, differentiated carbon constraint policies take hold and have competitiveness consequences that will provoke a clamour for action on the trade policy front. Several ways of dealing with this are identified in the paper. One would be to let WTO dispute settlement decide. This might be the path of least resistance, but it is uncertain. Litigation is not the centrepiece of the WTO system -- rules are. An alternative would be a "code approach" where agreement is struck among a subset of governments, inside or outside the WTO framework, but this would need to be non-discriminatory to retain legitimacy.

Another proposal is to establish an arbitration forum for private firms under WTO rules. Or a negotiation could be launched for a green round, covering such issues as subsidy rules, public and private labels, and border adjustments. Other ideas mentioned in the paper are a time-limited peace clause on climate-related trade actions, a programme for improving impact measurement and transparency with

respect to different climate-relevant policies such as fossil fuel subsidies, and a clearing house for global companies to disclose climate measures, leading eventually to a code of good practices. Another approach might be to establish an entirely new institution that would concern itself with both climate change policy and trade policy.

Some overall observations

It is perhaps invidious to single out a few over-arching themes that emerged from the conference, but by way of conclusion I shall attempt it anyway, and make five points.

- First, many participants lamented a situation in which the trading system might be put at risk by a failure to reach a solid enough agreement internationally on how to manage climate change resulting from GHG emissions. If governments sought trade remedies for unresolved climate change policy differences they would compromise both the trading system and climate change policy itself.
- Second, apart from an argument on the purely economic efficiency case for border adjustments to neutralize differential international carbon constraints, there was a solid weight of opinion opposed to the use of climate-related border adjustments. Their possible use is seen by many as a by-product of failure to secure agreement in the climate change sphere. Objections to such measures are political, ethical, practical and legal.
- Third, many participants referred to the tension in sector-based climate change policy between acting to control carbon leakage and seeking protection from import competition. The former concern should not be allowed to become a surrogate for the latter.
- Fourth, there was a feeling that not enough work had been done on subsidy issues relating to climate change. Subsidies can be good and bad. They can be part of the problem, but also part of the solution. All this needs to be better understood.
- Finally, uncertainty abounds on many fronts. One is the nature of the climate problem itself. Another concerns the economic, political and social consequences of climate change. A third is who should do what about it. A fourth is the impact of alternative policy responses to climate change itself, as well as responses to actions or the lack of them on the part of various governments. Greater cooperation than has been apparent so far will be necessary to disentangle this web of complexities.

Thank you.