

## GLOBAL ENVIRONMENTAL POLICY AND GLOBAL TRADE POLICY

BY JEFFREY FRANKEL



## OVERVIEW

Global efforts to address climate change may be on a collision course with global efforts to reduce barriers to trade. This paper discusses the broad question of whether environmental goals in general are threatened by free trade and the WTO, before turning to the narrower question of whether trade policies likely to be included in various national efforts to address climate change are likely to come into conflict with WTO rules.

## DISCUSSION

With different countries likely to undertake different levels of climate-change mitigation, the concern arises that carbon-intensive goods or production processes could shift to countries that do not regulate greenhouse gas (GHG) emissions. This so-called “leakage” phenomenon is viewed as problematic—by environmentalists because it would undermine emission-reduction objectives and by industry leaders and labor unions because it could make domestic products less competitive with imports from nations with weaker GHG regulations. Thus, various trade measures—including provisions for possible penalties against imports from countries viewed as non-participants—are increasingly being included in major climate policy proposals in the United States and Europe.

These concerns represent the latest and most prominent manifestation of a broader set of fears about the impacts of free trade and globalization. Do favorable “gains from trade”—including the environmental improvements that sometimes come with economic growth and the benefits of greater openness and technology transfer—outweigh the potential for adverse impacts, if free trade spurs countries and firms to seek competitive advantage through lower environmental standards? A number of studies have found that the impacts of trade on pollution are more beneficial than detrimental, though this is less true for CO<sub>2</sub> emissions.

In any case, the widespread impression that the WTO is hostile to environmental concerns seems to have little basis in fact. The WTO’s founding articles cite environmental protection as an objective; environmental concerns are also explicitly recognized in several WTO agreements. A review of recent WTO rulings finds support for the principle that countries not only have the right to ban or tax harmful products, but that trade measures can also be used to target processes and production methods (PPM), provided they do not discriminate against foreign producers. The question then, is how to address concerns about leakage and competitiveness in a way that does not run afoul of WTO rules and avoids derailing progress toward free trade and climate goals alike.

## KEY FINDINGS &amp; RECOMMENDATIONS

Future national-level policies to address climate change are likely to include provisions that target carbon-intensive products from countries deemed to be making inadequate efforts. These provisions need not violate sensible trade principles and WTO rules, but there is a large danger that in practice they will. The kinds of provisions that would be more likely to conflict with WTO rules and provide cover for protectionism include the following:

- *Unilateral measures applied by countries that are not themselves participating in the Kyoto Protocol or its successors.*
- *Judgments as to findings of fact that are made by politicians, vulnerable to political pressures.*

- ▶ *Unilateral measures that seek to sanction an entire country, rather than targeting narrowly defined energy-intensive sectors.*
- ▶ *Import barriers against products that are further removed from the carbon-intensive activity, such as firms that use inputs that are produced in an energy-intensive process.*
- ▶ *Subsidies—whether in the form of money or extra permit allocations—to domestic sectors that are considered to have been put at a competitive disadvantage.*

By contrast, border measures that are more likely to be WTO-compatible include either tariffs or (equivalently) a requirement for importers to surrender tradable permits aligned with the following guidelines:

- ▶ *Measures should follow a multilaterally-agreed set of guidelines among countries participating in the emission targets of the Kyoto Protocol and/or its successors.*
- ▶ *Judgments as to findings of fact—which countries are complying or not, what industries are involved and what are their carbon contents, what countries are entitled to respond with border measures, or the nature of the response—should be made by independent panels of experts.*
- ▶ *Measures should only be applied by countries that are reducing their emissions in line with the Kyoto Protocol and/or its successors, against countries that are not doing so, either as a result of the latter's refusal to join or their failure to comply.*
- ▶ *Import penalties should target fossil fuels and a half-dozen of the most energy-intensive major industries: aluminum, cement, steel, paper, glass, and perhaps iron and chemicals.*

## CONCLUSION

A multilateral regime is needed to guide the development of trade measures intended to address concerns about leakage and competitiveness in a world where nations have different levels of commitment to GHG mitigation. Ideally, such a regime would be negotiated along with a Kyoto successor that sets emission-reduction targets for future periods and brings the United States and major developing countries inside. But if that process takes too long, it might be useful in the shorter run for the United States to enter into negotiations with the European Union to harmonize guidelines for border penalties, ideally in informal association with the secretariats of the United Nations Framework Convention on Climate Change and the WTO.

## AUTHOR AFFILIATION

**Jeffrey Frankel**, *James W. Harpel Professor of Capital Formation and Growth*, Harvard Kennedy School

## ABOUT THE HARVARD PROJECT ON INTERNATIONAL CLIMATE AGREEMENTS

The goal of the Harvard Project on International Climate Agreements is to help identify key design elements of a scientifically sound, economically rational, and politically pragmatic post-2012 international policy architecture for global climate change. It draws upon leading thinkers from academia, private industry, government, and non-governmental organizations from around the world to construct a small set of promising policy frameworks and then disseminate and discuss the design elements and frameworks with decision-makers. The Project is co-directed by Robert N. Stavins, Albert Pratt Professor of Business and Government, John F. Kennedy School of Government, Harvard University, and Joseph E. Aldy, Fellow, Resources for the Future. Major funding for the Harvard Project on International Climate Agreements is provided by a generous grant from the Climate Change Initiative of the Doris Duke Charitable Foundation.

**Project Email:** [climate@harvard.edu](mailto:climate@harvard.edu)

**Full paper available at:** <http://belfercenter.ksg.harvard.edu/publication/18647>