

## Thinking Ahead on International Trade (TAIT)

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# The WTO and Climate Change: Challenges and Options<sup>1</sup>

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### Abstract

The existing WTO system will come in conflict with the world future ‘system’ of climate policies unless action is taken. This background paper highlights potential areas of conflict and explores options for managing or avoiding future conflict. The paper is based on the much more detailed analysis of key GATT articles, WTO agreements, and the decisions of GATT panels and the WTO Appellate Body contained in the recent book *Global Warming and the World Trading System* (Charnovitz, Hufbauer & Kim 2009).

The Graduate Institute’s **Thinking Ahead on International Trade (TAIT)** programme is a four-year research programme devoted to the analyses of medium-term challenges facing the international trade system in general and the WTO in particular. While founded on scholarship, the analysis is undertaken in association with public and business sector actors. The working method seeks advice and input from the public sector (policymakers, diplomats, international civil servants, and government officials) and the private sector in all matters but especially when it comes to gathering views, prioritising issues and developing action plans to address the challenges identified.

<sup>1</sup> Background paper prepared for **Round Table 3: The WTO and Climate Change: Challenges and Options**, of the Inaugural Conference of Thinking Ahead on International Trade (TAIT): **Challenges Facing the World Trade System**, organised by the Centre for Trade and Economic Integration (CTEI) at the Graduate Institute of International and Development Studies, Geneva, in collaboration with the Economic Research and Statistics Division of the Secretariat of the World Trade Organization.

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# The WTO and Climate Change: Challenges and Options<sup>2</sup>

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## Introduction

Trade and environment intersect in many ways. Aside from the broad debate as to whether economic growth and trade adversely affect the environment, linkages are recognized between existing rules of the World Trade Organization (WTO) and rules established in various Multilateral Environmental Agreements (MEAs). Controlling greenhouse gas emissions (GHGs) promises to be a top priority for both national and international agendas, and special attention has been given to the relationship between the WTO and the emerging international regime on climate change.

### WTO and Environment

The WTO is not a global environmental protection agency; its competence is limited to the trade-related aspects of environmental policies (WTO 2007). However, the international trade regime has recognized the connection between trade and environment for some time. During the GATT era, trade-related environmental issues were often discussed in negotiating rounds. The WTO era has seen important progress in linking trade and environment. The WTO Ministerial Decision on Trade and Environment, adopted in the Marrakesh Agreement that created the WTO, acknowledged the importance of sustainable development and called for creation of the Committee on Trade and Environment (CTE). Since it was established, the CTE has carried out significant technical work.

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<sup>3</sup> Gary Clyde Hufbauer is the Reginald Jones Senior Fellow at the Peterson Institute for International Economics and Jisun Kim is a research assistant at the Institute. The views expressed are their own opinions. This paper was supported by the Graduate Institute of International and Development Studies in Geneva as part of the Thinking Ahead on International Trade (TAIT) research programme, run by the Centre for Trade and Economic Integration.

### The Doha Mandate

At the Doha Ministerial Conference in 2001, WTO members agreed to launch negotiations that would address the nexus between trade and environment.<sup>4</sup> The Doha Declaration includes a negotiating mandate on clarifying the relationship between MEA and WTO rules. Also, to improve market access to environmental goods and service, the Declaration called for negotiations on “the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services.”<sup>5</sup> While WTO members have devoted considerable effort to fulfilling these mandates, like much else in the Doha Declaration, results are yet to be achieved.

Diving into the details, the Doha Declaration adopted on November 14, 2001 lists several objectives concerning trade and environment. Paragraph 31 of the Declaration mandates negotiations on three issues: (i) the relationship between WTO rules and specific trade obligations set out in MEAs; (ii) procedures for regular information exchange between MEA secretariats and the relevant WTO committees; and (iii) the reduction or elimination of tariff and non-tariff barriers to environmental goods and services.<sup>6</sup> To fulfill the mandates described in paragraph 31(i) and (ii), cooperation between the WTO and MEAs is underway (WTO 2009). With respect to climate change in particular, UNFCCC representatives attend the regular WTO CTE meetings and the WTO secretariat attends UNFCCC COP meetings.

Paragraph 32 of the Declaration instructs the CTE to work on: (i) the effect of environmental measures on market access, especially in relation to developing countries; (ii) the relevant provisions of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs); and (iii) labeling requirements for environmental purposes.<sup>7</sup> As mentioned, results are yet to be seen. But gatherings of world leaders, most recently the Group of 20 London Summit in April 2009, and the Group of Eight L'Aquila Summit in July 2009, urgently call for the conclusion of the Doha negotiations.<sup>8</sup>

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<sup>4</sup>See Paragraph 6 of the Doha Declaration, available at [http://www.wto.org/english/thewto\\_e/minist\\_e/min01\\_e/mindecl\\_e.htm](http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm).

<sup>5</sup>See Paragraph 31 (iii) of the Doha Declaration, available at [http://www.wto.org/english/thewto\\_e/minist\\_e/min01\\_e/mindecl\\_e.htm#tradeenvironment](http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm#tradeenvironment).

<sup>6</sup> Paragraph 31 of the Declaration reads: “With a view to enhancing the mutual supportiveness of trade and environment, we agree to negotiations, without prejudging their outcome, on: (i) the relationship between existing WTO rules and specific trade obligations set out in multilateral environmental agreements (MEAs). The negotiations shall be limited in scope to the applicability of such existing WTO rules as among parties to the MEA in question. The negotiations shall not prejudice the WTO rights of any Member that is not a party to the MEA in question; (ii) procedures for regular information exchange between MEA Secretariats and the relevant WTO committees, and the criteria for the granting of observer status; (iii) the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services. We note that fisheries subsidies form part of the negotiations provided for in paragraph 28.” The full text of the Doha Declaration is available at [http://www.wto.org/english/thewto\\_e/minist\\_e/min01\\_e/mindecl\\_e.htm#tradeenvironment](http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm#tradeenvironment)

<sup>7</sup> See Paragraph 32 of the Doha declaration (available at [http://www.wto.org/english/thewto\\_e/minist\\_e/min01\\_e/mindecl\\_e.htm#tradeenvironment](http://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm#tradeenvironment)).

<sup>8</sup> The full text of the communiqué of the Group of 20 London summit in April 2009 is available at <http://www.londonsummit.gov.uk/resources/en/news/15766232/communique-020409> and for the communiqué of the Group of Eight L'Aquila summit in July 2009 at [http://www.g8italia2009.it/static/G8\\_Allegato/G8\\_Declaration\\_08\\_07\\_09\\_final.0.pdf](http://www.g8italia2009.it/static/G8_Allegato/G8_Declaration_08_07_09_final.0.pdf).

## UNFCCC and Trade

The main objectives of the UNFCCC and the Kyoto Protocol are to combat climate change and to promote sustainable development. Key public officials in the European Union, the United States, China and India have already begun to lay down verbal “markers” on the role of trade measures in addressing climate change. But so far there have not been extensive trade discussions within the UNFCCC and Kyoto Protocol talks. Earlier declarations, echoing the chapeau of GATT Article XX, explicitly acknowledged that measures taken to combat climate changes should not distort international trade. Article 3.5 of the UNFCCC states:

“The Parties should cooperate to promote a supportive and open international economic system that would lead to sustainable economic growth and development in all Parties, particularly developing country Parties, thus enabling them better to address the problems of climate change. **Measures taken to combat climate change, including unilateral ones, should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade.**”<sup>9</sup>

Article 2.3 of the Kyoto Protocol states:

“The Parties included in Annex I shall strive to implement **policies and measures under this Article in such a way as to minimize adverse effects, including the adverse effects of climate change, effects on international trade,** and social, environmental and economic impacts on other Parties, especially developing country Parties and in particular those identified in Article 4, paragraphs 8 and 9, of the Convention, taking into account Article 3 of the Convention.”<sup>10</sup>

At the 13<sup>th</sup> Conference of the Parties (COP) meeting of the UNFCCC in Bali in December 2007, countries agreed to launch negotiations to write a successor accord to the Kyoto Protocol. This negotiating process is supposed to be concluded at the 15<sup>th</sup> UNFCCC COP meeting in Copenhagen in December 2009. As the deadline is rapidly approaching, debate on designing a policy framework for the post-Kyoto era has raged at both national and international levels. While countries have repeatedly affirmed the importance of a successful conclusion in Copenhagen talks, however, a comprehensive deal seems unlikely to be sealed in 2009, due to large gaps between the positions expressed by developed and developing countries.

At an informal group meeting under the Ad Hoc Working Group on Long Term Cooperative Action (AWG-LCA) held in August 2009 in Bonn, India proposed the inclusion of a draft paragraph in the negotiating text, which reads as follows:<sup>11</sup>

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<sup>9</sup> Emphasis added. The full text of the convention can be found at <http://unfccc.int/resource/docs/convkp/conveng.pdf>.

<sup>10</sup> Emphasis added. The full text of the Kyoto protocol can be found at <http://unfccc.int/resource/docs/convkp/kpeng.pdf>

<sup>11</sup> Emphasis added. See TWN Bonn News Update “Unilateral trade measures to protect climate change violate climate treaty – say developing countries,” August 13, 2009.

**"Developed country Parties shall not resort to any form of unilateral measures including countervailing border measures, against goods and services imported from developing countries on grounds of protection and stabilization of climate.** Such unilateral measures would violate the principles and provisions of the Convention, including, in particular, those related to the principle of common but differentiated responsibilities (Article 3, Paragraph 1); trade and climate change (Article 3 paragraph 5); and the relationship between mitigation actions of developing countries and provision of financial resources and technology by developed country Parties (Article 4, Paragraphs 3 and 7)."

Yet while developing countries are seeking ways to prevent countries from using border measures against them, the US Congress is seeking ways to address competitiveness concerns and incorporate them into the post-Kyoto treaty.

## **Challenges Facing the WTO**

In this paper, we highlight areas of conflict that the WTO might face – conflicts that might arise in the course of national legislation and international climate talks. We then explore ways to cope with those challenges. We do not try to pronounce on the WTO legality of various policy options debated in national legislation or the UNFCCC. Instead, we refer to our recent book, *Global Warming and the World Trading System*, published in March 2009, which provides detailed analysis of key GATT articles, WTO agreements, and the decisions of GATT panels and the WTO Appellate Body.

### *Fundamental Difference between the Two Regimes*

Despite certain common features and shared views on the importance of sustainable development, fundamental difference exists between the UNFCCC and the WTO regimes. Charnovitz (2003) has pointed out that climate change presents an extreme case of market failure – namely, the failure to build the damage done by GHG emissions into the prices of goods and services – and that a classic role for governments is to correct market failures. Normally, however, governments want great flexibility in the choice of national instruments to correct market failures, because they need to balance the economic characteristics of alternative measures against their political acceptability.<sup>12</sup> By contrast, the trade rules embodied in the GATT and the WTO presuppose a world of market economies, and attempt to discipline government failures that lead to economic distortions with the flavor of mercantilism and protectionism. This fundamental difference entails potential conflicts between the two regimes.

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<sup>12</sup> As a general proposition dating to Arthur Pigou, economists favor product taxes that reflect the environmental damage associated with the making and disposal of individual goods and services. Quite often, Pigouvian product taxes are not politically acceptable.

### *Where Potential Conflicts Arise*

At the 13th UNFCCC COP meeting in Bali in December 2007, countries agreed to launch negotiations to write a successor accord to the Kyoto Protocol and adopted the Bali Action Plan, a comprehensive process to “enable the full, effective and sustained implementation of the Convention through long-term cooperative action, now, up to and beyond 2012.”<sup>13</sup> While the Bali Action Plan requires both developed and developing countries to take action, its requirements differ between the two groups, expressed by the principle of “common but differentiated responsibilities.”<sup>14</sup> Sharp differences in interpretation of this principle have separated the two groups. The United States and other developed countries want binding commitments from all major greenhouse gas (GHG) emitters, notably the BICs – Brazil, India, and China – and their peers among developing countries. In pointed disagreement, India and China assert that “best efforts” are the most they are required to make under the principle of “common but differentiated responsibilities”.

In the absence of parallel commitments, and given the resistance by India and China to accept binding emission targets,<sup>15</sup> some developed countries (particularly the United States) harbor fears that their own stringent GHG control programs will put domestic firms at a severe disadvantage in global markets. This will lead to the “leakage” of production and jobs to firms located in countries that do not adopt equivalent controls. A related concern is that, in the end, domestic action by developed countries will make no difference to climate change if emissions activity simply migrates to other countries and if domestic GHG control policies do not create enough “leverage” to prod China and India and other large but reluctant emitters to take action.

To address these concerns, the United States and other countries are contemplating “corrective” provisions in their national GHG control programs, such as the allocation of free allowances, special exemptions from new controls, and border measures. In particular, border measures that penalize imports from countries that do not take comparable action enjoy broad political support. Production subsidies (through free allocations and exemptions), unilateral trade restrictions (through border adjustments), and performance standards (adopted in the name of GHG controls) all promise commercial friction and stand a fair chance of being challenged in the WTO.

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<sup>13</sup> The full text of the Bali Action Plan (decision 1/cp.13) is available at <http://unfccc.int/resource/docs/2007/cop13/eng/06a01.pdf#page=3>.

<sup>14</sup> The Bali Action Plan requires all developed countries to adopt “measurable, reportable and verifiable nationally appropriate mitigation commitments or actions, including quantified emission limitation and reduction objectives, while ensuring the comparability of efforts among them, taking into account differences in their national circumstances.” For developing countries, the Plan requires “nationally appropriate mitigation actions (NAMAs) by developing country Parties in the context of sustainable development, supported and enabled by technology, financing and capacity-building, in a measurable, reportable and verifiable manner.”

<sup>15</sup> It should be noted that China recently stated that the year 2050 would be its peak in terms of GHG emissions while a recent research study by Chinese think tank suggested that, with proper policies, emissions could peak in 2030. However, China has not further quantified its emissions trajectory. See “China to Start Cutting CO2 Emissions in 2050,” August 17, 2009 (available at <http://www.environmentalleader.com/2009/08/17/china-to-start-cutting-co2-emissions-in-2050/>)

## **Border Adjustments**

Among the mitigation and adaptation policy options that countries have introduced or considered, several may have trade implications. For example, product or performance standards (e.g., labeling requirements or energy efficiency standards) could easily be operated as technical barriers to imports. Policy options well advanced in legislation entail both overt subsidies in the form of free allowances and quasi-subsidies in the form of exemptions. These are designed to address competitiveness concerns, both for exports and imports. In US draft legislation (but not in Australia), such allowances and exemptions are buttressed by border adjustment mechanisms that would likely discriminate between domestic producers and foreign producers and among different foreign producers. Under the WTO, countries have great flexibility to design environmental regulations that have effects only within their territories. However, the same discretion does not apply to measures that affect exports or imports.

In the absence of clearer guidelines than now exist, it is difficult to predict whether various policy options would be compatible with WTO rules. For example, it remains uncertain whether border adjustments are allowable for carbon taxes or permits that are based on energy consumed or carbon emitted, either in making a product or inputs to the product. It is also unclear whether the Agreement on Technical Barriers to Trade (TBT) would allow standards and labeling requirements based on production and processing methods (PPMs) that do not affect the physical characteristics of the product. The prior record of panel and Appellate Body decisions on these and other climate-related questions is sparse.<sup>16</sup> If the rule book is filled out through case-by-case litigation, it could be years before an overall framework is established. Moreover, case outcomes may depend heavily on how disputed measures are designed and implemented, making for a pretty complicated rule book.

### *US Climate Legislation*

Border measures contemplated in the climate bill passed by the US House of Representatives and currently debated in the US Senate illustrate areas of possible trade friction. In June 2009, the House passed the American Clean Energy and Security Act of 2009 (ACESA, also known as “the Waxman-Markey bill”), sponsored by Congressmen Henry A. Waxman and Edward J. Markey, by a vote of 219-212. This comprehensive national energy and climate bill establishes a cap-and-trade program aimed at reducing GHGs economy-wide by 20 percent by 2020 and by 83 percent by 2050, both targets by reference to 2005 levels.<sup>17</sup> ACESA also contains provisions to enhance energy efficiency, performance and product standards, R&D investment in low carbon technologies, and complementary energy measures. The US Senate is now shaping its own bill. So far, the Obama Administration has taken a hands-off attitude toward the design details of both House and Senate legislation.

ACESA represents a huge step in US seriousness about climate change, but the competitiveness issues that were first vetted when the Kyoto Protocol was debated back in 1997 remain prominent in today’s Congressional deliberations. To level the playing field, the Waxman-Markey bill contains various mechanisms, including the free allocation of allowances, output-

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<sup>16</sup> For details, see Hufbauer, Charnovitz and Kim (2009).

<sup>17</sup> A 2020 binding target for covered entities is a 17 percent cut below 2005 levels.



based allowances to vulnerable industries, and allowance requirements for imports. Agricultural emissions are exempted, while automotive, household heating and air-conditioning emissions are almost given a pass. To alleviate the initial “sticker shock”, about 70 to 80 percent of allowances created by the Waxman-Markey bill would be allocated for free for extended periods of time. Under the emission allowance rebate plan, trade-vulnerable industries are eligible for rebates to compensate both for direct and indirect costs imposed by the bill. If the president so decides, starting in 2020, the international reserve allowance program can require importers of covered goods to purchase permits -- when less than 85 percent of imports in a sector come from “well-behaved” countries (meaning countries that meet one of the criteria listed in the bill).

Beyond the questionable effectiveness of these measures,<sup>18</sup> disputes over border measures could arise under several core WTO provisions: GATT Article I (most-favored-nation treatment), Article II (tariff schedules), Article III (national treatment), Article XI (quantitative restrictions), and Article XX (general exceptions) and the Agreement on Subsidies and Countervailing Measures. Especially when GHG border measures are mixed with mechanisms designed to alleviate the burden of emission controls on domestic firms, collisions could occur. If the United States or any other country enacts its own unique brand of import bans, border taxes, and comparability mechanisms — hoping that measures which flaunt GATT Articles I, III and XI will be saved by the exceptions in GATT Article XX — the outcome could be a drawn-out period of trade friction.

A verbal backlash against potential US trade measures is already mounting in China, India, and even the European Union. The Government of Australia has pointedly rejected the use of border adjustments on imports, although it has proposed extensive allowances and exemptions for trade-intensive industries. Other countries have criticized the measures proposed in the US climate legislation as a new form of protectionism, suggesting that trade sticks could undermine international cooperation in the Copenhagen talks. Backlash talk suggests that trade measures could trigger retaliatory action and that they stand a fair chance of being challenged within the WTO.

Despite the backlash talk, ten US senators sent President Obama a letter, urging the President to support the border measures included in the Waxman-Markey Bill. In the letter, they noted:<sup>19</sup>

“Recently, the World Trade Organization (WTO) and the United Nations Environment Program issued a report confirming that WTO rules do not override environmental measures. This reflects the reality that the international community will look at border adjustment measures in the context of international global warming goals. Failure to do so would further elevate doubts about the legitimacy of our international trading system.”

Striking a more cautious note, in August 2009, four prior US Trade Ambassadors (Clayton Yeutter, William Brock, Susan Schwab and Carla Hills) sent their own letter to the US Senate, outlining principles that should be observed as the Congress crafts its climate legislation. The

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<sup>18</sup> See Houser et al (2008).

<sup>19</sup> For more details, see a letter (dated on August 6, 2009) to President Obama, signed by ten US senators (available at [http://brown.senate.gov/imo/media/doc/ClimateChange\\_Manuf.pdf](http://brown.senate.gov/imo/media/doc/ClimateChange_Manuf.pdf)).

letter is a significant document authored by seasoned statesmen, and for that reason is reproduced as Annex A to this paper.

## What are Options?

In June 2009, the WTO and the United Nations Environment Programme (UNEP) released a joint study, *Trade and Climate Change*, the first comprehensive study done by the WTO Secretariat that examines the nexus between trade and climate change. When this report came out, some newspapers printed misleading headlines, such as “WTO: Some trade limits OK to stop climate change.”<sup>20</sup> The headlines were based on a statement in the report which reads:

“the general approach under the WTO rules has been to acknowledge that some degree of trade restrictions may be necessary to achieve certain policy options as long as a number of carefully crafted conditions are respected. WTO case law has confirmed that WTO rules do not trump environmental requirements.”

It is true that the WTO does not play the role of “Doctor No.” Recent Appellate Body rulings show a growing sympathy with environmental concerns. However, the statement above should not be interpreted to mean the WTO will issue a hall pass to any trade restriction implemented in the name of environmental protection. Rather, attention should be placed on the phrase stating that “as long as a number of carefully crafted conditions are respected.” The report emphasizes that compliance with the WTO rule book heavily depends on specific design features. Unfortunately, but understandably, the report does not seek to answer which policy options would pass muster under the WTO rule book, and how climate change policies can best be crafted to be consistent with WTO principles.

At the release event for the WTO/UNEP report, Pascal Lamy, Director-General of the WTO, said that an international agreement on climate change should come first before the WTO would begin work on determining the WTO compatibility of trade measures related to climate change. He emphasized that the relationship between trade and climate change would be best defined by an international accord on climate change that embraces all polluters.<sup>21</sup> Lamy asserted that WTO members want trade addressed as part of an overall post-Kyoto treaty, and they do not want a separate Geneva-based WTO negotiation on permissible trade-related climate measures.<sup>22</sup>

With this background in mind, we turn now to several options. Some are mutually exclusive, but some could be pursued on parallel tracks.

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<sup>20</sup> See “WTO: Some trade limits OK to stop climate change,” Frank Jordans, Associated Press, June 26, 2009 (available at [http://sify.com/news/fullstory.php?a=jg3hzidjibif&title=WTO\\_some\\_trade\\_limits\\_OK\\_to\\_stop\\_climate\\_change&tag=WTO](http://sify.com/news/fullstory.php?a=jg3hzidjibif&title=WTO_some_trade_limits_OK_to_stop_climate_change&tag=WTO) ).

<sup>21</sup> See “Lamy Sees Room for Climate Change Border Measures under WTO rules,” *Inside US Trade*, July 3, 2009.

<sup>22</sup> *Ibid*

### UNFCCC Approach to Trade Issues

The climate regime itself could act multilaterally to create norms on trade and climate. In fact, recently there has been some movement to do so. For example, the post-Kyoto regime may establish nonbinding principles for the use of trade measures for climate change and those principles could be considered by a WTO panel when a dispute arises.<sup>23</sup>

However, given the wide differences of opinion between countries, it is unlikely that parties to the post-Kyoto accord will adopt binding rules that define a trade framework which is broadly satisfactory to WTO members. Current compliance mechanisms within the UNFCCC and Kyoto Protocol are not designed to deal with trade issues, and in any event they are weak. These features are likely to persist in the post-Kyoto era.<sup>24</sup>

The WTO as an institution might prefer that a trade-related dispute pertaining to a MEA be resolved within the relevant MEA before landing on the WTO's doorstep. However, it is WTO members, not the WTO as an institution, that decide the forum for bringing disputes. It seems likely that many WTO members will want to use the tried and true machinery of WTO panels and the Appellate Body when they bring disputes.

### Case-by-Case Approach

A straightforward way to determine whether disputed trade measures in support of GHG emission controls are compatible with WTO agreements is simply to let the WTO judicial process run its course. Eventually, following this approach, the Appellate Body will establish a record of decided cases that define the contours of WTO obligations. One shortcoming of the case-by-case approach, however, is that it could take a long time before clear guidelines become apparent. A big WTO case can easily take three years to run the full course -- from consultations, to a panel decision, and finally a ruling by the Appellate Body. As trade battles are fought, some countries may become more devoted to winning legal cases than to fighting the common enemy, climate change.

Another shortcoming of the case-by-case approach is that some countries, faced with an adverse ruling, may come to question the legitimacy of WTO pronouncements on a subject as contentious as climate change. If the Appellate Body is too lenient on trade-related climate measures, by according users of unilateral subsidies and barriers excessive deference, that could open the door to opportunistic protectionism and rent-seeking behavior. If the Appellate Body is too strict, countries may ask why the WTO is injecting itself as an opponent of GHG controls designed to save the planet. Either way, the case-by-case approach will put great pressure on the WTO system.

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<sup>23</sup> The Appellate Body referred to extra-WTO norms in the *United States-Shrimp* case by considering the Rio Declaration on Environment and Development. See Appellate Body Report, *United States – Import Prohibitions of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted on November 6, 1998.

<sup>24</sup> Well before the current round of negotiations, the Swedish National Board of Trade (2004) suggested that the scope was limited for “forum shopping” between the dispute settlement systems of the WTO and the Kyoto Protocol, both because questions of trade effects were not a subject of the Kyoto Protocol and because the WTO had exclusive jurisdiction to address violations of its own rules.

### Code Approach

Key WTO members might negotiate a new code as a plurilateral agreement under Annex 4 of the WTO agreement. The code would create policy space for climate measures that are imposed in a manner broadly consistent with core WTO principles -- even if a technical violation of WTO law might occur. Measures that conform to this code would not be subject to challenge in WTO dispute settlement by governments subscribing to the code. Although such a code would require consensus of all WTO members to be formally added to the WTO agreement, this consensus might be politically possible because it would not limit the rights of non-subscribing WTO members. Our book outlines possible elements of a new code in detail (Hufbauer, Charnovitz, and Kim 2009).

However, if negotiating a code as a WTO plurilateral agreement proves politically impossible, because non-subscribing members fear the precedents that would be set, then a group of like-minded member governments could negotiate a code outside the WTO. The advantage of acting outside the WTO is that non-participating countries could not block the negotiations. Of course, with an extra-WTO code, WTO dispute settlement mechanisms would not be available for enforcement. But that might not be a serious disadvantage because other forms of dispute settlement could be adopted.

As a plurilateral agreement inside or outside the WTO among like-minded countries, the code would not apply to countries that did not subscribe to it. The purpose of such a code would not be to regulate legal relationships between code members and non-members, but rather for participating governments to agree in advance to a framework for trade-related climate measures in order to head off disputes among those governments. The code approach would minimize the risks for exports of participating countries, and might to some degree limit the extent of subsidization through free allocations and exemptions.

However, the code approach has its own drawbacks. To maximize its effectiveness, the code should include the major emitting countries: the United States, the European Union, Japan, Brazil, India and China. This would not be an easy task, owing to the large difference of opinion on appropriate GHG controls between developed and developing countries. In practical terms, a code that emphasized sector standards and implicit carbon pricing might start out with very limited membership, perhaps just the United States, the European Union, Japan, and a few other advanced countries. In response, developing countries, speaking under the auspices of the Group of 77, might write their own code for climate and trade measures. Predictably, a G-77 code would emphasize the cumulated historical record of national emissions and current per capita levels as a basis for imposing trade restraints. The result of two conflicting codes could be a huge split between WTO members, with considerable damage to the world trading system.

### Amendment or Waiver

Another idea being floated, even stronger than a plurilateral code, is to amend GATT articles and other parts of the WTO legal text to accommodate environmental controls. Within the WTO, legal text can be amended only by a consensus of members, which means that no member objects to the change. This is a difficult process.

A slightly less demanding approach would ask WTO members to approve a waiver to WTO obligations for trade commitments written in a climate agreement. A waiver, unlike a revision of the text, does not require a consensus among WTO members, but it does require approval from at least three-quarters of members.<sup>25</sup> Whether this route has much promise largely depends on the extent of overlap between signatories to the climate agreement and the WTO membership. If a significant number of WTO members do not sign the climate accord, the prospects of a waiver seem slight.

### *Stick to Your Knitting*

Rather than embark on a major modification of WTO rules, the members might decide to stick to the environmental topics flagged in the Doha mandate. Two were prominent: reducing trade barriers to environmental goods and services, and the dissemination of intellectual property rights with a bearing on climate change.

Trade barriers have been identified among the biggest impediments to the dissemination of low-carbon energy technologies and associated services worldwide. The threshold challenge is that internationally agreed definitions for environmental goods and services do not exist. Consequently, many countries have put forward their own lists of environmental goods and services. The Special Session of the Committee on Trade and Environment (CTE) has tried to nail down a list but it has not yet reached agreement.

Environmental goods are found in a wide range of industrial and trade classification nomenclatures. Under the Harmonized System (HS) of tariff nomenclature, environmental goods are often lumped together with unrelated products. Moreover, many goods have dual uses. There is also the issue of process and production methods (PPMs) -- can products be considered “environmental” based on the way they have been processed or produced? Finally, and perhaps most important, each country has different export interests.

While the WTO has no definition of environmental goods, the OECD, APEC, and World Bank have drawn up their own lists. Even though there are differences in product coverage, those lists have served as useful sources for studying the possible consequences of trade liberalization. To improve market access to environmental goods and services, members of the WTO would need to start by agreeing on the definition. Lists proposed by the OECD, the APEC, the World Bank, and the UNFCCC may be the answer.<sup>26</sup> Negotiations on tariff reduction in environmental goods might move faster if separated from the broader talks on Non-Agriculture Market Access (NAMA).

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<sup>25</sup> An example is the 1955 waiver granted to the United States. The waiver allowed the United States to be exempt from its obligations under the provisions of Article XI (general elimination of quantitative restrictions) to the extent necessary to apply the restrictions under its Agricultural Adjustment Act. The waiver lasted almost about 40 years and was abusively used to restrict imports of sugar, peanuts and dairy products until the Uruguay Round.

<sup>26</sup> For the lists of the OECD and APEC, see Steenblik (2005); and for the World Bank list, see World Bank (2007). The UNFCCC (2009) summarized information by about 70 non-Annex I parties in their technology needs assessments (TNAs) and national communications (NCs), and identified mitigation technologies that those non-Annex I parties want the most.

Another piece of WTO turf is the technology transfer debate, which revolves around intellectual property rights (IPRs). Strong protection of IPRs has the potential to stimulate technology innovation but can also hinder technology transfer. While the BICs have asked for easier access to patented clean energy technologies and have proposed compulsory licensing regimes, the United States and other developed countries are vehemently opposed.

The WTO contains an agreement on trade-related aspect of intellectual property rights (TRIPS). The TRIPS agreement states its objective in Article 7:<sup>27</sup>

“the protection and enforcement of intellectual property rights should contribute to the promotion of technological innovation and to the transfer and dissemination of technology, to the mutual advantage of producers and users of technological knowledge and in a manner conducive to social and economic welfare, and to a balance of rights and obligations.”

The Doha Declaration mandated the CTE to work on “the relevant provisions of the Agreement on Trade-Related Aspects of Intellectual Property Rights.” Cosbey (ed. 2008) argued that the TRIPS agreement can foster technology transfer owing to so-called “TRIPS flexibilities” -- provisions that allow for certain limitations and exceptions to IPR protections. Of course many technology companies take exception to this interpretation. In our view, denial of patents and compulsory licensing by developing countries would spark the same sort of counterproductive friction as import penalties by developed countries. But these matters are clearly grist for “business as usual” negotiations within the WTO framework.

### Peace Clause

At a much lower level of ambition than a code, amendment or waiver – and perhaps even lower than the reduction of trade barriers on environmental goods and services or the resolution of IPR issues, key WTO members may consider adopting time-limited “peace clauses” in their national climate legislation. The “peace clauses” would suspend the application of border measures on imports, and other extra-territorial controls, for a defined period of time – at least three years -- while UNFCCC and WTO negotiations are underway.

The great advantage of the peace clause approach is that it buys time. One disadvantage, as the WTO itself experienced with respect to the peace clause over agricultural subsidies adopted in the Doha Round, is that negotiations might not move with energy or speed. A second disadvantage is that, during the peace clause period, the urgency of limiting GHG emissions might be diluted. Some developed countries might go easy on their own GHG controls, out of competitive concerns. Some developing countries might feel less pressure to flatten their GHG trajectories.

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<sup>27</sup> The full text of the TRIPS agreement is available at [http://www.wto.org/english/docs\\_e/legal\\_e/27-trips.pdf](http://www.wto.org/english/docs_e/legal_e/27-trips.pdf).

## Annex A

Source: World Trade Online ([www.insidetrade.com](http://www.insidetrade.com), link requires subscription)

August 18, 2009

The Honorable Jeff Bingaman  
Chairman, Senate Energy & Natural Resources Committee  
United States Senate  
703 Hart Senate Office Building  
Washington, DC 20510-3102

*VIA FACSIMILE*  
202-224-2852

Enclosed is a Statement of Principles on Climate and Trade that we, as former U.S. Trade Representatives, respectfully submit for your consideration. We hope it will be useful as you craft legislation on this very challenging issue. As you well know, it is important to carry out that task in a way that will encourage other nations to follow our lead.

All of us have confronted similar challenges in the trade arena over the past three decades. Since it is imperative that actions taken on climate change be compatible with global trade rules we hope our Statement will be of value as you proceed with your deliberations.

Respectfully,



Clayton Yeutter



William Brock



Susan Schwab



Carla A. Hills

## STATEMENT OF PRINCIPLES ON CLIMATE AND TRADE

As former U.S. Trade Representatives we offer this Statement of Principles to U.S. policymakers grappling with the issue of curbing greenhouse gas emissions.

Climate change is a global environmental challenge. To meet it the world will need an extraordinary degree of multilateral cooperation. The locus of international negotiations will be the UN climate regime, but other multilateral and regional organizations can and should play complementary roles. For example, the Doha Round negotiations under the auspices of the World Trade Organization (WTO) seek to liberalize trade in environment-friendly technology and services. If successful, these negotiations will make a positive contribution to the climate change picture in that the new products, technologies and services will be more broadly adopted throughout the world.

There are a number of instruments available to governments in addressing the hazards of climate change. Much of what might be done can take place without significantly impacting the multilateral trading system or requiring the amendment of existing trade agreements. But some climate-related policies could have an adverse effect on global trade, transborder investment, or even on intellectual property rights.

As policymakers here and elsewhere craft measures for climate change it will be important to do so in a manner consistent with international rules, including those governing trade. The WTO accords, constructed over more than half a century by the U.S. and other major trading nations, are a useful reference for action in the climate arena. Those who are negotiating global climate change accords will find it helpful to review how trade agreements affecting scores of countries have been successfully concluded.

By working together officials dealing with climate change should be able to design a regimen that avoids disguised protectionism, the use of impermissible subsidies, improper discrimination, or costly economic distortions. That in fact should be the fundamental objective of the Copenhagen Summit, to be held in December. Legislative or regulatory actions, taken by us or any other participant nation between now and the Summit, should foster and facilitate achievement of that objective, not detract from it.

There are two basic approaches to limiting harmful emissions: carbon taxes and cap-and-trade programs, the latter having been selected by the House of Representatives in its recent legislation. Our global competitiveness will obviously be affected by how we structure either of these programs, and by whether we act unilaterally or persuade our major trading partners to proceed in a similar way. We have an opportunity to focus on the latter challenge as we and other nations prepare for the Copenhagen meeting.

We need not, however, ask that everyone confront the challenge of greenhouse gas emissions in the same way. Nor should we insist that everyone do it our “our way.” This is not a situation where the “best path” is at all clear. And even if we can eventually discern the optimum



path for the U.S. that path may not provide a “one size fits all” outcome for many other countries. One of the great strengths of the GATT/WTO over the past 60 years is that fundamental trade rules to which all member nations agree do not preclude creativity in approaching challenges, nor require identical policies or actions in doing so.

The American public is obviously concerned about the potential “leakage” of production and jobs if other countries refuse to participate in a global program, or agree only to emissions reductions unsatisfactory to us. Those are legitimate concerns, but the Congress needs to give the Administration the authority, flexibility and support to negotiate mutually satisfactory outcomes with the recalcitrant nations. A “stick approach,” unilaterally applied through legislation, is, in our view, destined to fail. One cannot legislate what must be negotiated.

As former U.S. Trade Representatives we do not endorse a particular set of policy choices to deal with climate change. Nor do we wish in any way to discourage our government and other governments from taking steps to reduce greenhouse gas emissions. We do recommend that policymakers with responsibility for this issue consult closely with their trade officials in order to achieve policy coherence. It is particularly important to do so between now and the Copenhagen Summit. Otherwise we run the risk of reaching a climate change agreement incompatible with trade rules that have contributed greatly to our economic growth over the past six decades – and other nations may do the same.

Finally, each of us can attest to the value of our having an agreed set of negotiating objectives, established through coordination with key Congressional committees, as we negotiated trade agreements during our respective tenures. We believe that model serves the country well so we respectfully suggest a similar approach for climate change negotiations.

Based on our own past experience as U.S. trade negotiators we stand willing to assist the Congress and the Administration in any way possible as the world confronts this complex international issue.

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