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Striking a balance on climate change and global trade

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Last week when the European Union announced plans to impose the first trade restrictions in the world for climate reasons, congressional Democrats announced they will propose similar restrictions as part of their pending $3.5 trillion spending plan. As a former Democratic member of Congress, I have noticed that while the Europeans are specific in what they are seeking, the Democrats are only beginning to consider what precisely they will propose, and whether and how it will be structured to pass muster with the World Trade Organization.

The European proposal for a "carbon border adjustment mechanism" will impose a border levy on imported products that emit more carbon than like products that are made in the EU under tougher emissions standards. This proposal is detailed in the EU's 291-page "Green Deal." The EU aims to be carbon neutral by 2050, and it sees the CBAM as a key to achieving that goal. The EU insists that the proposal is consistent with its WTO obligations. Legally, though, saying does not make it so, and whether the proposed EU measure will turn out to be legal under international trade law is an open question.

In contrast, for now, the Democrats' proposal does not go much beyond labeling what they are envisaging as a "polluter import fee." President Joe Biden's goal is a 50 percent reduction in U.S. carbon emissions by 2030, as compared to 2005 levels, and the Biden administration has expressed support for the notion of a "polluter import fee" as one means of achieving that goal. Yet another open question is whether the Democrats will make a genuine effort to try to shape their legislation to comply with U.S. obligations under the WTO treaty and, if so, whether they can succeed in such an effort.

My former colleague in the House, Sen. Edward J. Markey (D-Mass.), long an ardent champion of climate action, has explained, "The United States and the EU have to think in terms of the leadership that we can provide and the message that we have to send to China and other countries that would take advantage of the high standards that we are going to enact." Agreed. But will this message from the U.S. be one of taking climate action within the WTO trade rules we Americans helped write and have pledged to uphold, or will it be one of taking climate action outside those rules?

The EU proposal may do little in and of itself to curb emissions. The United Nations Conference on Trade and Development projects that it would cut global carbon dioxide emissions by only 0.1 percent. The Bertelsmann Foundation in Germany predicts a cut of only 0.2 percent. The Europeans know this. Their professed principal aim in announcing the first-ever climate-related trade restrictions is to spur their trading partners who have not taken comparable climate actions to join them in doing more, starting with promising to do more and do it sooner in the runup to the next global climate summit in November in Glasgow.

The Biden administration and congressional Democrats share the same aim. By enacting similar trade-related climate restrictions, the U.S. and the EU, through the weight of their combined economies, will surely add to the paltry percentage of emissions cuts predicted now for the EU CBAM alone. But will they have the economic leverage together to inspire many other countries in the world to shift away from their current levels of carbon-dependence? Or would such a shift be more likely to result from focusing more on the increased global cooperation that the EU and the Democrats alike routinely and rightly espouse?

In theory, climate-related restrictions on trade can be crafted to comply with WTO rules, and such restrictions, if they fall within those rules, could help send a price signal that would encourage less reliance on fossil fuels in other countries. That price signal would work best if it were market-based and not sent merely by governmental mandates and subsidies, which could run afoul of WTO rules. If reducing carbon emissions is the goal, that goal would best be achieved by a market-based approach such as a carbon tax.

A carbon tax would have the best chance of falling within the boundaries of WTO rules, which have long permitted border adjustments for indirect taxes on traded products. Of course, domestic politics on both sides of the Atlantic Ocean pose obstacles to a carbon tax. And neither the Europeans nor the Democrats seem much inclined to try to overcome those obstacles by proposing a carbon tax, despite their advocacy of urgently addressing climate change. (While in Congress, I voted for a carbon tax in 1993.)

In identifying and crafting some alternative approach that could be within the WTO rules, my experience since then in judging dozens of WTO trade disputes tells me the Democrats would be well advised to eliminate all considerations of economic motivation from their vocabulary. They should not speak about preserving economic competitiveness as a reason for their proposed actions, and they should halt all talk of "carbon leakage" — the widespread apprehension that imposing higher emissions standards in the U.S. would cause production (and emissions) to shift offshore.

To date, there is little empirical evidence of carbon leakage. As carbon prices increase, carbon leakage may become more of a real concern. But structuring a border levy to prevent the potential loss of economic competitiveness — even if that levy is also enacted for climate reasons — would make it look much more like green protectionism and much less like a real climate measure that could survive legal scrutiny by the WTO.

If what the Democrats are contemplating is truly a climate measure, then its best chance of being upheld by the WTO is if it is structured exclusively as a climate measure and is based solely on climate motivations. It must also be applied to all U.S. trading partners in an evenhanded way that does not constitute arbitrary or unjustifiable discrimination or a disguised restriction on international trade. In part, this means providing our trading partners with what we Americans call “due process” before imposing climate-related trade restrictions on their products.

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Not least, it is difficult to see how, consistently with its obligations under the WTO treaty, the United States could impose a fee on the “pollution” caused by imported products without imposing an equivalent fee on the “pollution” caused by competing domestic products. The Europeans can point for justification to their Emissions Trading System. There is — thus far — nothing comparable in the United States.

The European Union intends to take at least two years to try to get its measure right under the WTO rules before applying it. The Democrats should do the same — if they decide that applying such a restriction on trade is in fact the best way to accomplish their climate goals.

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