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Carbon Control News

December 14, 2009

Carbon Tariff Opponents Point To Predictions Of Low Emissions 'Leakage'

SECTION: Vol. 3 No. 50

LENGTH: 2014 words

Opponents of carbon tariff provisions likely to be included in climate legislation are pointing to recent findings, including an EPA analysis, showing that the adoption of greenhouse gas (GHG) controls by the United States would result in minimal emissions "leakage" to other countries without similar requirements, to argue against the need for such measures.

Proponents of a carbon tariff provision have emphasized the need to prevent emissions increases abroad -- more than its potential to prevent U.S. job losses -- in an effort to avoid criticism that the provision would violate trade law. But recent findings that emissions leakage would be relatively minor under a domestic cap-and-trade program are raising concerns that the push for such tariffs, known as "border adjustments," could be ruled to be unjustifiably protectionist measures.

At the same time, progress in international negotiations, combined with studies showing that production downturns in energy-intensive, trade-exposed (EITE) industries like steel and cement could primarily be addressed without resorting to tariffs, have advocates and opponents of border adjustments predicting that even if they end up in a cap-and-trade law, they may not ever be triggered.

House-passed climate legislation includes a border adjustment mechanism that would be triggered several years after the start of its cap-and-trade program, if certain conditions are met. No companion provision has yet appeared in the Senate, but Finance Committee Chairman Max Baucus (D-MT) has said he will include a border adjustment in the climate legislation his committee expects to mark up early next year. Baucus has said little regarding his plans, but details of the border adjustment expected to be addressed in committee include the year in which it becomes active and the extent of the president's authority to enact or avoid such measures.

Numerous studies, most recently an interagency analysis released earlier this month by EPA, have shown that leakage effects would be relatively minor, and that whatever leakage would occur likely could be addressed through other policies, such as freely allocating allowances to cover EITE industries' direct emissions and allocations to utilities aimed at preventing energy price spikes. The interagency analysis, for example, says that emissions leakage would only be about 1 percent of the total emission reductions expected to occur in domestic industries, if the free allocations policies were implemented (see Dec. 7 issue, p20).

However, a coalition of EITE manufacturers -- including the aluminum, steel, paper and chemical sectors -- have criticized the analysis's findings in a Dec. 10 letter to key senators who requested it. The American Materials Manufacturing Alliance says EPA and other agencies relied on flawed assumptions about their sectors' likely energy efficiency improvements in the coming years and argued that the allocations contained in the Waxman-Markey bill would be insufficient to fully cover their costs. The letter is available at CarbonControlNews.com.

Another recent paper from the Center for Global Development modeled a scenario in which the U.S. and European Union implemented emissions cuts of 17 percent below 2005 levels by 2020 -- the same target as the Waxman-Markey bill -- and found that emissions in low- and middle-income countries would only increase 1 percent. The same paper also found that U.S. EITE firms would see exports decline by 12 percent and output by 4 percent under a cap-and-trade program without allocations or a border adjustment, arguing that concerns about job loss, rather than environmental harm, were the true driver for such policies (see Dec. 7 issue, p5).

Studies from the Pew Center on Global Climate Change and Cato Institute issued earlier this year reach similar conclusions about the likely small leakage effects likely to be observed, and early studies of the European Union's emissions trading scheme have found relatively little leakage resulting from that program going into effect.

"This is why we think that it's better to address the issue through allocation, because . . . those allocations are all coming from within the cap, so you're not blowing the cap, and you don't have the unintended consequences that are very likely to occur by placing border measures," said Timothy Juliani of the Pew Center on Global Climate Change, at a Dec. 9 event hosted by the Washington International Trade Association (WITA).

Nonetheless, industries and labor unions say existing studies are insufficient because there is virtually no historical data to examine that would demonstrate leakage effects, so instead analysts are forced to rely on projections and assumptions of what may happen. Projections based on such modeling, one border adjustment supporter says, are not "the sort of thing that provides enough certainty for domestic industries and workers," which bolsters calls to have a border adjustment available as a "backstop" if free allocations are insufficient.

Another supporter of border adjustments notes that they're needed to provide certainty to industry, even if they are never used. "It's not clear that you ever get to the use of border measures if it would be sufficient to deal with carbon leakage through the free allowances," the source says.

At least 15 Democratic senators -- whose support will be vital if proponents hope to amass 60 votes for cap-and-trade legislation -- have made inclusion of a border adjustment a requirement for them to back such a bill. However, there are some indications that those lawmakers are open to negotiation on the specifics of an adjustment, and are backing away from some of the most strident demands previously outlined from industry and labor, such as the imposition of a border adjustment as soon as cap-and-trade becomes law.

One source points to the Dec. 3 letter to President Obama from Sen. Arlen Specter (D-PA) and eight others, noting that it only calls for a border adjustment to take effect "by a date certain" if international climate agreements are not in place, but does not specify how quickly that should happen. The source also notes that the senators' priorities for an international climate agreement includes only requirements that advanced developing countries take "increasingly ambitious actions" to limit and eventually reduce their emissions. "That is far from the line that the carbon intensive industries have taken," the source notes.

There is virtually universal agreement that border adjustments are at best a fall-back approach to dealing with leakage and competitiveness issues, with proponents and opponents of the measures saying that an international agreement on climate change that requires action from major developing countries would be the best way to handle those concerns. However, there is little expectation that climate-related trade issues will be discussed during the Copenhagen negotiations that opened last week. "I wish it were going to be addressed because that would mean the Copenhagen talks were further along," Andy Shoyer, a partner at law firm Sidley Austin, said at the WITA event. "They could only engage in such tough negotiation if there was already substantial agreement."

Observers are cautiously optimistic that the Copenhagen climate talks will produce a "politically binding" agreement that would be signed by the U.S., China and other participating nations to lay the ground work for a treaty to be finalized next year.

It remains an open question whether border adjustments, which would require importers of certain goods to purchase carbon allowances to cover the emissions released during foreign production, would be able to pass muster before the World Trade Organization (WTO).

Proponents say such measures are allowable under WTO rules because of an exception in Article XX of the General Agreement on Tariffs and Trade (GATT) that allows countries to pursue unilateral trade measures aimed at environmental or conservation goals, which they say would include efforts to prevent emissions increases from firms relocating to countries without emissions policies or to encourage those countries to sign an international climate treaty.

Trade rules do not allow countries to impose border adjustments aimed primarily at protecting domestic jobs, though, and there are some worries that statements from lawmakers indicating job protection is their goal -- which can become evidence in WTO proceedings alongside the text of legislation -- could come back to haunt them in a potential future trade dispute. "Legislative history can become tricky," acknowledges one trade lawyer who supports the use of border adjustments. "But it's also hard to put the brakes on the political process and say [to lawmakers], 'Don't tell your constituents you're protecting their jobs because WTO doesn't like that.'"

The Waxman-Markey cap-and-trade bill, which passed the House in June, includes a border measure that would kick in no sooner than 2020 for sectors the president determines are experiencing carbon leakage effects that are not being mitigated by the free allocations to EITE industries that it provides in the early years of the program.

At the WITA conference in Washington, Jeremy Preiss of United Technologies Corp. (UTC) wagered "a round-trip, first class ticket to Copenhagen" that the Waxman-Markey provisions would be ruled a violation of WTO rules. "We can talk in the abstract about the academic exercise of a border measure that would meet the requirements, but I'm confident the border measure in Waxman-Markey would not survive scrutiny at the WTO because the provision is likely to be unjustifiably discriminatory in application and insufficiently focused on the environmental goal," said Preiss, who noted that he would oppose even a perfectly designed border adjustment because of its potential to antagonize trading partners, among other reasons.

Preiss also said multinational corporations like UTC would face unfair disadvantages if a border adjustment were put in place, because the adjustment requires import allowances to be purchased based on average emissions across a sector in another country, rather than on the emissions from particular firms. For example, Preiss said UTC facilities in China operate based on the same environmental standards as in the U.S., but imports from those facilities still could be hit with a border adjustment when brought into the U.S.

The approach outlined in Waxman-Markey is based on a proposal first circulated in 2007 by American Electric Power (AEP) and the International Brotherhood of Electrical Workers (IBEW), but Waxman-Markey modifies its border adjustment to focus primarily on the need to prevent carbon leakage. The AEP-IBEW plan placed more emphasis on the need for border adjustments as a way to compel other nations to sign on to an international climate treaty, a source says.

While Waxman-Markey contains negotiating objectives for U.S. involvement in talks under the United Nations Framework Convention on Climate Change (UNFCCC), it does not directly tie the potential imposition of a border adjustment to participation in a new climate treaty. Although absence of participation in a treaty is one prerequisite that could trigger imposition of border adjustments against another country, the bill says the purpose of the measure, known as the International Reserve Allowance Program, is to be designed "in a manner that minimizes the likelihood of carbon leakage as a result of differences between" compliance costs for U.S. firms in the cap-and-trade program and costs faced by firms in foreign countries.

Designing the program in that manner likely would constrain the extent to which border adjustments could be put in place, says another trade lawyer supportive of the AEP-IBEW approach. "If leakage is the . . . stated policy objective, and if the measure that you're taking goes well beyond what would address carbon leakage, then I think there would be a significant question about WTO consistency," the lawyer says. -- Nick Juliano

LOAD-DATE: December 14, 2009

LANGUAGE: ENGLISH

PUBLICATION-TYPE: Newsletter

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