

The Inclusion of Border Carbon Adjustments in Preferential Trade Agreements

Policy Implications

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Outline

- Background
 - Preferential Trade Agreements (PTAs)
 - Border Carbon Adjustments (BCAs)
- Border Carbon Adjustments in Preferential Trade Agreements
 - Implementation Options
 - Legal Implications

Preferential Trade Agreements

Free Trade Agreements (FTAs), if approached with care, can build on WTO and other international rules by going further and faster in promoting openness and integration, by tackling issues which are not ready for multilateral discussion and by preparing the ground for the next level of multilateral liberalization.

European Commission 2006

Border Carbon Adjustments

- Purposes:
 - Addressing Competitiveness and Carbon Leakage Concerns
 - Pricing all emissions associated with domestic consumption
 - Enticing all nations to adopt commensurate emissions pricing policies

PTAs and Climate Change

- Tariff Reductions – tariffs reduced for same industries concerned with competitiveness impacts of carbon pricing
- Climate Provisions in PTAs – some moves to include climate provisions in new PTAs

Design of BCAs

- Processes and Production Methods (PPMs)
- Best Available Technology (BAT)
- Predominant Method of Production (PMP)
- Average emissions of the importing or exporting country

Implementation Options

- BCA rates less than MFN tariffs
- BCA rates greater than MFN tariffs - Rules of Origin
- Negotiations with largest trading partner

Magnitude of BCAs

■ Studies:

- Dong and Whaley – 0.35% to 2.9% (carbon price from \$25 to \$200, using emissions intensity of importing country)
- Center for Global Development – 7% (importing country intensity) to 40% (exporting country intensity) – high carbon price
~ \$300/tonne
- IISD – 8% for steel sector @ \$20 per tonne

Example: BCAs Applied to Steel and Aluminum imports to the EU from China

	Aluminum	Steel
Existing MFN Tariffs	6.5%	1.7%
BCA using Chinese emissions intensity @ \$20/tonne	6.8%	12.7%
BCA using EU emissions intensity @ \$20/tonne	0.4%	1.1%

BCA Rates Above MFN Rates - Rules of Origin

- Ordinary part of PTAs
 - set amount of value added (VA) needed to receive preferential rates
- BCAs are analogous
 - could set an amount of VA that requires BCA rate to be imposed rather than the MFN rate

Negotiations with Largest Trading Partner

- Many of key products imported from just a few nations – for example, in 2010:
 - Five countries made up almost 50% of EU imports of raw iron and steel
 - Three countries made up 50% of EU imports of products of iron and steel
- Benefits of PTAs likely outweigh the carbon costs

BCAs Legal Issues in the Multilateral Context

- The use of BCAs is controversial (e.g. inclusion of aviation in EU ETS) but very likely
- WTO compliance is questionable
 - PPMs, extraterritoriality, implementation issues
 - Justification under environmental exceptions uncertain and will depend on the case

Rationale for dealing with BCAs under PTAs

- Makes PTAs more sustainable - contributes to climate change mitigation
- May involve top GHG emitters
 - bilateral FTAs/economic partnership agreements between e.g. EU/US/Australia/Japan and China/India/Russia/South Korea/South Africa
- Can stimulate non-Annex I countries to reduce emissions
- Reduces the risk of trade retaliation and WTO challenge
 - RTAs under GATT Art. XXIV benefit from a substantial regulatory leeway
- Can facilitate the formation of global climate regime
 - clusters of bottom-up arrangements with gradual regulatory approximation

Incentives for PTA partners to accept

- Trade-offs with trade concessions and concessions in other policy areas (investment, migration, political issues...)
- Link to national development priorities
- Clean-technology transfers and technological aid
- An alternative: ETSs in all partner-countries and mutual acceptance of emissions allowances and climate laws and standards

Negotiations will depend on the objectives, nature and scope of a PTA, and on the negotiating power of a party which is interested in emissions-related provisions.

Relation to WTO rules

- PTAs are a separate trade regulatory system, but subject to compliance with the WTO system
 - GATT Article XXIV for goods trade
 - GATS Article V for services trade
 - Enabling Clause for developing countries' PTAs
- These WTO provisions allow liberalisation of trade on a non-MFN basis

WTO Legal Hurdles of BCAs in PTAs

- Except for MFN - all other WTO rules regulating the application of BCAs must be followed.
- AB in the *Turkey-Textiles* case: The violation of WTO rules applicable to BCAs may only be allowed if the PTA could not have been concluded, had the provisions on the application of BCAs not been included in the agreement.
- Subject to the “internal requirement” for regional liberalization contained in GATT Article XXIV:8: “substantially all the trade”.
- Recourse to Article XX is inevitable?
- But likelihood of WTO challenge is low!

Design-specific Legal Issues

1. BCAs rates are above MFN rates
 - *Rules of origin: WTO members are free to design RoOs in their PTAs as they want.*
 - *Prohibited tariff rates in excess of bound tariffs: Violation of GATT Art. II*
2. BCA rates are less than MFN rates but above zero:
 - Provided the inclusion of BCAs in a PTA is found to satisfy “the essentially all the trade” rule, such a BCAs design would not face legal hurdles.

Conclusions

- PTAs - increasing in prominence
- BCAs – important tool for managing competitiveness impacts of climate policies
- Most effective options for implementing BCAs in PTAs:
 1. Negotiating with largest trading partner
 2. BCA rates below MFN rates
 3. BCA rates above MFN rates - rules of origin