

CLI RECOMMENDATION NO. 15

Make Trade Rules Attuned to the Ecological Needs and Interests of Future Generations*

As I discussed in CLI Background Paper No. 10 in Appendix A of this CLI Policy Paper, international trade “disciplines” or obligations are almost exclusively negative, in that they limit or constrain governmental actions. The international trade regime promotes trade liberalization by targeting trade barriers for removal, some of which may include environmental measures. By and large, international trade agreements as currently structured do not establish minimum standards requiring member states (in the case of the WTO) or states parties (in the case of regional trade agreements) to establish a “regulatory floor” so as to protect the climate for current and future generations. Rather, international trade agreements establish an outer level of rigor, a “regulatory ceiling.” Minimum international standards of environmental performance are typically found in free-standing multilateral environmental agreements, such as the Kyoto Protocol.

There are nonetheless a number of strategies that could be employed in future rounds of international trade negotiations, several of which are already under discussion,¹ in some cases in anticipation of further trade talks subsequent to the close of the currently ongoing Doha Development Agenda in the WTO. Such strategies fall on a continuum of proposals or recommendations depending on how vigorously they attempt to mobilize the international trade regime in the pursuit of climate-friendly policies sensitive to needs and interests of future generations. Some, such as the elimination of subsidies on GHG-intensive fossil fuels, fit relatively naturally into the existing trade regime. Others, like authorizing or requiring compensatory duties imposed at the border depending on carbon intensity, might require more conceptual retooling. The first four recommendations below are arrayed roughly from the least to most aggressive proposals. The last two should apply to any recommended changes in trade rules.

A. Eliminate Climate-Degrading Subsidies

Export subsidies create artificially low prices for goods in international trade, in turn distorting markets. The International Energy Agency estimates subsidies on all forms of energy outside the OECD at \$250 billion per year, with non-OECD subsidies for petroleum at over \$90 billion annually.² These subsidies have enormous ripple effects, reflected in depressed prices for products manufactured with fossil-fuel-intensive processes that do not reflect the real costs of production in the form of climate disruption.

The WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement) establishes categories of prohibited (“red box”) and actionable (“amber box”) subsidies. The latter are not prohibited, but can be challenged through the dispute settlement process if they cause injury, serious prejudice, or loss of market access to another WTO Member in a third state. In the WTO Agreement on Agriculture (AoA), WTO Members undertook to reduce trade-distorting subsidies in the agricultural sector. The AoA provides for “blue box” subsidies, which are those that would

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¹ See generally AARON COSBEY, TRADE POLICY TOOLS AND INSTRUMENTS FOR ADDRESSING CLIMATE CHANGE AND SUSTAINABLE DEVELOPMENT (International Institute for Sustainable Development, 2007).

² International Energy Agency, *World Energy Outlook 2006*, available at <http://www.iea.org/Textbase/npsum/WEO2006SUM.pdf> (summary and conclusions).

ordinarily be treated as “amber box,” but also require farmers to limit production. The AoA also has a category of “green box” or permitted subsidies.

1. Subsidies on Fossil Fuels

Elimination of environmentally harmful subsidies on fossil fuels is a “win-win” scenario. Reducing subsidies in the traditional energy sector will promote both economic efficiency and environmental integrity. The WTO system has addressed subsidies since its creation, and the legal and institutional mechanisms for grappling with this problem are already in place. A significant obstacle is lack of agreement on how to define fossil fuel subsidies, impeding firm commitments from WTO member States to new disciplines in this area.

Most fossil fuel subsidies are granted by developing countries. Removing energy subsidies consequently is an area in which developing countries can make a useful contribution consistent with global economic goals, thus overcoming the North-South divide that has bedeviled the Kyoto negotiations. By reducing and eventually eliminating subsidies for conventional energy, developing countries can move their economies toward cleaner, less environmentally harmful technologies consistent with the demands and needs of current and future generations. Most of these subsidies, however, are subsidies to consumers, and their removal would consequently have social policy implications beyond broad-gauge energy policy.

The identification of subsidies from a legal point of view, however, can be difficult. There are, moreover, both international and domestic political and equity constraints on the removal of energy subsidies by countries whose populace may be less well off than in industrialized countries, and which have historically contributed little to the global warming problem.

2. Agricultural Subsidies

Disciplining agricultural subsidies, particularly in industrialized countries such as the EU, Japan, and the United States, is already a component of the Doha Development Agenda. Agricultural subsidies present profound implications for the environment in general, and climate in particular.

On the one hand, agricultural subsidies may encourage overexploitation of resources and conversion of land from forest to agricultural purposes. While it is difficult to say that agricultural uses are less greenhouse-friendly than maintenance of existing ground cover, the potential for agricultural subsidies to degrade the environment in economically counterproductive ways is significant. On the other hand, the elimination of agricultural subsidies in industrialized countries may very well shift agricultural production toward developing countries, newly industrialized countries, and economies in transition, many of which are repositories of significant forest cover which consequently may be at even greater risk of conversion to agricultural uses.

Trade rules should assure that reductions in agricultural subsidies in Northern countries are accompanied by environmental safeguards, including those to protect the climate, in countries likely to benefit from that action. Admittedly, establishing a cause-and-effect relationship between the elimination of subsidies in one country and enhanced agricultural production in another is difficult to do. One way to overcome this difficulty would be to link progress on this question in the WTO with substantive obligations for non-Annex I countries in subsequent negotiations under the Framework Convention and the Kyoto Protocol.

B. Liberalize Trade in Climate-Friendly Goods and Services

The ongoing Doha Development Agenda negotiations in the WTO include as an explicit agenda item “the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services.”³ A recent World Bank report⁴ endorsed the liberalization of trade in environmental goods and services, including in particular those intended to promote protection of the climate. The theory is that liberalization in this sector promotes a “triple win” outcome, benefiting trade, the environment, and development goals. “Environmental services” include transfers of know-how, consultancy services, and managerial and design features.

Aggressively liberalizing trade in climate-friendly goods and services is a broad-gauge strategy that is likely to promote the integrity of the global climate for future generations. This is also a situation in which the trade regime as currently structured can accommodate a climate-enhancing strategy relatively easily. Further attention to this issue in the WTO and elsewhere can help to encourage the viability of emerging industries in environmental goods and services.

One important unresolved question in this debate, however, is the problem of definition. Some countries are proposing that the WTO establish a list of products that qualify as “environmental goods,” whereas others suggest that environmental projects as identified by designated national authorities would qualify for trade concessions on the goods and services needed to execute the projects.⁵ These are considerations of implementation that are very likely amenable to a negotiated solution in the Doha Development Agenda or subsequently, with salutary effects on the global climate for the benefit of present and future generations.

C. Encourage Climate-Friendly Investments

Trade and investment rules can create policy space for climate-enhancing investments. Some of the vehicles for expanding investments that preserve the global climate are already in place, such as the Kyoto Protocol’s Clean Development Mechanism.

Under the SCM Agreement, certain identified domestic supports were deemed to be “non-actionable” (in effect, permitted) on the theory that they had minimal impacts on trade. These included “assistance to promote adaptation of existing facilities to new environmental requirements imposed by law and/or regulations which result in greater constraints and financial burden on firms.”⁶ These subsidies were further confined to a one-time expenditure of no more than 20% of the cost of adaptation, and even this limited opportunity expired in 1999 when WTO members declined to renew the provision. The WTO Agreement on Agriculture contains similar provisions permitting domestic support for environmental research and development programs⁷ and “infrastructural works associated with environmental programmes.”⁸

Current investments in forward-looking strategies and technologies, particularly those in the energy sector, will help to preserve the integrity of the climate for future generations. Among the possibilities are enhanced deployment of renewable energy, end-use energy efficiency, and carbon sequestration technologies. Enhanced investments in research

³ Doha Ministerial Declaration, WTO Doc. WT/MIN(01)/DEC/1, para. 31(iii) (Nov. 20, 2001).

⁴ The World Bank, *International Trade And Climate Change: Economic, Legal, And Institutional Perspectives* (2008).

⁵ See Matthew Stilwell, *Advancing The WTO Environmental Goods Negotiations* (EcoLonomics Occasional Papers Series No. 08-1, Jan. 2008), available at http://www.ecolomics-international.org/eops_08_1_matthew_stilwell_wto_ctess_environmental_goods_negotiations.pdf.

⁶ Agreement on Subsidies and Countervailing Measures, art. 8.2 (c).

⁷ Agreement on Agriculture, Annex 2 para. 2(a).

⁸ *Id.* para. 2(g).

and development for climate-friendly strategies must be a component of any public policy to preserve and enhance the climate for the benefit of future generations.

As of this writing many of these alternative strategies appear less rather than more attractive from a short-term economic perspective by comparison with existing energy investments largely based on fossil fuels. As with the WTO negotiations on environmental goods and services, progressive strategies that encourage climate-friendly investments by relaxing international trade constraints can have long-term policy payoffs. Threats to the global climate are sufficiently urgent and compelling that an express carve-out from the general prohibition on subsidies is called for, at least in the near term until those alternatives have an opportunity to demonstrate their economic viability.

D. Modify Trade Rules to Account for the Relative Greenhouse-Gas Intensity of Fuels

Many impacts on the climate are externalities caused by such activities as fossil fuel use or forest clearing. The costs of climate degradation, in the form exploitation of the global climate as a public good, are typically not reflected in the prices of products in international trade. Those prices in turn do not reflect the true costs of production.

The Polluter-Pays Principle, a fundamental precept of the international law of sustainable development, addresses situations such as this by counseling that “the cost of [pollution prevention and control measures] should be reflected in the cost of goods and services which cause pollution in production and/or consumption.”⁹ One of the purposes of the Polluter-Pays Principle is “to avoid distortions in international trade,”¹⁰ a goal apparently motivated as much by concerns about competitiveness as by the desire to conserve natural resources such as the climate.

One way to offset climate externalities and encourage the internalization of the costs of climate degradation is to apply a compensatory fee to imported goods. Such a policy approach is particularly appealing in situations in which a state has taken domestic measures to reduce GHG emissions, and is attempting to assure the competitiveness of domestically-manufactured goods relative to imports.¹¹

Proposals for border tax adjustments for imports to Kyoto Annex I countries from non-parties such as the United States—a “Kyoto tax”—are based on this theory and have gained some attention internationally. A bill introduced in the U.S. Congress would have imposed countervailing duties on manufactured goods from countries with substandard environmental policies.¹² A variant of this approach is California’s proposed Low Carbon Fuel Standard,¹³ which would distinguish among fossil fuels, including imports, based on their GHG intensity.

⁹ *Guiding Principles Concerning International Economic Aspects of Environmental Policies*, Annex para. 4, O.E.C.D. Doc. C(72)128 (May 26, 1972) [hereinafter OECD Polluter-Pays Recommendation], reprinted in 11 I.L.M. 1172 (1972) and 5 INTERNATIONAL LAW AND WORLD ORDER: BASIC DOCUMENTS V.B.2 [hereinafter “Weston & Carlson”]. See also Rio Declaration on Environment and Development, Principle 16, U.N. Doc. A/CONF.151/5/Rev. 1 (June 14, 1992), reprinted in 31 I.L.M. 876, 879 (1992) and 5 Weston & Carlson V.B.16 (recommending application of Polluter-Pays Principle).

¹⁰ OECD Polluter-Pays Recommendation, *supra* note 9, para. 4.

¹¹ See Aaron Cosbey, *Unpacking the Wonder Tool: Border Charges in Support of Climate Change*, *Bridges*, vol. 11, no. 7, at 15 (Nov.-Dec. 2007). See generally David A. Wirth, *The International Trade Regime and the Municipal Law of Federal States: How Close a Fit?*, 49 WASH. & LEE L. REV. 1389, 1398–1400 (1992).

¹² S. 984, 102d Cong., 1st Sess. (1991) (proposed International Pollution Deterrence Act).

¹³ California Alternative and Renewable Fuel, Vehicle Technology, Clean Air, and Carbon Reduction Act of 2007, Cal. Health & Safety Code §§ 44270–44274.5. See *California Air Resources Board & California Energy Commission, State Alternative Fuels Plan: Committee Draft Report* (CEC-600-2007-011-CTD Oct. 2007); *California Energy Commission, Full Fuel-Cycle Assessment: Well-to-Wheels Energy Inputs, Emissions, and Water Impacts* (CEC-600-2007-004-F June 2007); DAVID CRANE & BRIAN PRUSNEK, THE ROLE OF A LOW CARBON FUEL STANDARD IN REDUCING GREENHOUSE GAS EMISSIONS AND PROTECTING OUR ECONOMY (2007).

Although WTO rules permit application of the Polluter-Pays Principle as a domestic environmental measure, they do not authorize the enforcement of that standard with respect to imported goods through at-the-border measures like fees or duties to offset the costs to domestic industries of pollution control measures.¹⁴ Earlier GATT jurisprudence identified cause for legal concern if the only difference between two products, one domestically manufactured and the other imported, is the method by which they are produced—so-called “process and production methods” (PPMs).¹⁵ Evolving WTO jurisprudence, however, suggests that some of the international trade constraints on PPMs are relaxing over time, so long as they are applied in a reasonable and non-discriminatory manner.¹⁶

As noted in my CLI Background Paper No. 10 in CLI Policy Paper Appendix A, domestic regulatory requirements, such as those on the GHG intensity of fuels, in some instances may be justified by exceptions for measures “necessary to protect human, animal or plant life or health” and “relating to the conservation of exhaustible natural resources” even if they otherwise violate WTO rules. There is, moreover, some sentiment to reexamine the WTO consistency of PPMs after the conclusion of the current Doha Agenda in the WTO, but that is uncertain as of this writing.

International trade rules should be modified expressly to permit at-the-border measures designed to protect the global climate for present and future generations. Existing jurisprudence relating to “safe havens” for environmental measures, as I discussed in CLI Background Paper No. 10, ought to be sufficient to assure that such measures will not be abused. In addition, coordinated international efforts to harmonize domestic policies on such questions as carbon taxes in existing multilateral fora created by the FCCC and the Kyoto Protocol will tend to reduce or eliminate trade distortions that could arise from unilateral measures tied to the relative greenhouse-gas intensity of fuels

E. Link Multilateral Standards for Climate Protection and Trade Rules

As coordinated with the ongoing multilateral negotiations on climate, WTO members should act to identify a broader scope of required domestic interventions, specifically with the goal of protecting the integrity of the climate for present and future generations. The international trade and investment regime, in institutional settings such as the WTO, is unlikely to address this need in a serious manner. Instead, the FCCC and Kyoto Protocol are the obvious institutional fora in which to take up multilaterally agreed and coordinated national commitments.

The Doha Agenda is currently considering mechanisms for coordinating the obligations in multilateral environmental agreements (MEAs) with international trade rules.¹⁷ This issue has been under consideration since the creation of the WTO in 1995, through its Committee on Trade and Environment, with inconclusive results as to the relationship between MEAs and trade rules. The Doha negotiators, however, have a mandate to consider only the effect of trade rules as between parties to an MEA. They cannot alter existing rights and obligations of non-parties and, consequently, do not have the authority to modify substantive WTO law.

Because the obligations in the UNFCCC and the Kyoto Protocol, perhaps unlike some other MEAs, can be implemented with minimal if any concerns for conflict with international rules, the international climate regime to

¹⁴ United States—Taxes on Petroleum and Certain Imported Substances, para. 5.2.3–7, BASIC INSTRUMENTS AND SELECTED DOCUMENTS (34th Supp. 1990) 136, 27 I.L.M. 1596 (1988) (discussing Polluter-Pays Principle).

¹⁵ *E.g.*, United States—Restrictions on Imports of Tuna, BASIC INSTRUMENTS AND SELECTED DOCUMENTS 155 (39th Supp. 1993) (panel report not adopted by GATT Council and hence not GATT law).

¹⁶ *E.g.*, United States—Import Prohibition of Certain Shrimp and Shrimp Products, WTO Doc. WT/DS58/R ¶¶ 116–119 (Oct. 12, 1998) (Appellate Body report).

¹⁷ Doha Ministerial Declaration, *supra* note 3, para. 31(i).

date has not been the subject of serious controversy from a trade policy perspective. In any event, progress in assuring a presumption of consistency between multilaterally-agreed commitments forged in the climate regime and international trade rules will likely benefit the goal of preserving the integrity of the global climate for present and future generations.

F. Rigorously Evaluate Trade and Investment Agreements for Climate Impacts

One of the principal difficulties in assessing the environmental impacts of a trade agreement is that the proposed action—the international trade agreement itself—typically involves large-scale interventions in domestic economies and the relations among them, a setting in which it is difficult to establish the cause-and-effect relationship between the intervention on the one hand and its impacts on the other. For example, as discussed above the elimination of agricultural subsidies in the United States can be expected to have both positive and negative environmental effects.

Unfortunately, the National Environmental Policy Act does not apply to trade negotiations or trade agreements,¹⁸ and the United States applies environmental impact assessment methodologies to trade negotiations only as a matter of internal Executive Branch policy.¹⁹ Besides the United States, other countries such as Canada have conducted their own environmental assessments of trade agreements, and the EU has conducted sustainability impact assessments. International organizations like the Organization for Economic Cooperation and Development, the United Nations Environment Program, the North American Commission for Environmental Cooperation, and the WTO itself, along with non-governmental organizations such as the World Wildlife Fund and academic institutions like Tufts University and the University of Manchester, have contributed to elaborating methodologies for conducting such an analysis, including both *ex ante* (prospective) and *ex post* (retrospective) assessments.

Before they are adopted, any new international trade rules, such as those on agricultural subsidies, should be subjected to vigorous advance (*ex ante*) scrutiny to assure their consistency with the goal of protecting the global climate for present and future generations. Consistent with best practice standards, these assessments should be transparent in the sense of providing opportunities for public participation, should draw on the best available technical methodologies, and should be subject to external peer review by leading experts in the field

¹⁸ *Public Citizen v. United States Trade Representative*, 5 F.3d 549 (D.C. Cir. 1993).

¹⁹ Executive Order No. 13141, 64 Fed. Reg. 63,169 (Nov. 18, 1999); Final Guidelines on Environmental Reviews of Trade Agreements, 65 Fed. Reg. 79,442 (Dec. 19, 2000).