

doi:10.1017/S1474745609990218

Global Warming and the World Trading System

by Gary Clyde Hufbauer, Steve Charnovitz and Jisun Kim

Washington, DC: Peterson Institute for International Economics, 2009

International efforts to produce a 'beyond Kyoto' climate change agreement have reached a fever pitch. With the new Obama Administration in the United States now committed to addressing the threat of global warming and the associated problems of melting polar ice, sea level rise, changed rainfall patterns, and increased intensity of windstorms, the negotiations have taken on a new priority.

In the wake of the Copenhagen Conference in December 2009, officials are hard at work determining how best to measure and monitor emissions of CO₂ and other greenhouse gases, structure incentives to protect carbon 'sinks', and identify targets and timetables for emissions reductions. They are debating how to reinvigorate the fundamental principle of 'common but differentiated responsibility' so as to engage all nations (particularly the emerging economic powerhouses such as China and India) in the global effort to control emissions. Serious discussions are also underway about who will pay for emissions reductions, what sort of 'burden sharing' makes sense, and how best to support, through funding and technology transfer, the participation of developing nations in a new global climate change regime.

At the national level, the United States Congress has taken up the issue of climate change in earnest. While it seems likely that the United States will soon adopt some sort of 'cap and trade' program of emissions allowances that will effectively put a price on the release of greenhouse gases, a number of core issues remain to be worked out. The most notable example is the percentage of the carbon allowances that will be allocated to polluters, versus the percentage that will be auctioned off. Debate also continues over a top-tier goal of President Obama: the elaboration of a broader portfolio of incentives to promote alternative energy and shift the nation on to a Clean Energy trajectory.

Europe's Emissions Trading System (ETS) continues to develop, putting a price signal on greenhouse gas emissions from an ever-growing number of industries. The ETS, in effect since 2005, has led to a 9.3% reduction in emissions below 1990 levels across the 27 EU states during the first phase, which lasted from 2005 to 2007. The core of the plan is a tradable emissions allowance system that covers the energy sector and a number of other industries. Carbon prices under the allowance system have gone up and down, reaching a high of approximately 35 €/ton, with more recent prices around 12–14 €/ton. EU members have also agreed to a renewable energy standard of 20% by 2020 and have invested substantially in research and development to develop energy-efficient technologies.

Australia, Japan, and Canada have also begun to control emissions with varying degrees of enthusiasm. Australia recently postponed the start date of its 'cap and trade' scheme, which aimed to achieve a 5–15% reduction in greenhouse gases below 2000 levels by 2020. Japan has put in place a voluntary emissions trading scheme, but the new Democratic Party leaders are promising a more robust approach to emissions control with targets likely to be much more stringent than the 15% cut from 2005 levels upon which the prior Liberal Democratic government had agreed. Japan has

historically emphasized the role of renewable energy and other advanced technologies, including more environmentally friendly vehicles as the central feature of its emissions reduction strategy. But the new government has re-opened the debate over the mechanisms that will be used to reach the established goal. Despite acknowledging the dangers of climate change at a federal level, Canada has adopted a decentralized approach to addressing emissions. The provinces have agreed to varying reduction targets. At the leading edge, both British Columbia and Quebec embraced carbon taxes and began collecting payments in July 2008 and October 2007 respectively. Other provinces, notably Alberta, are implementing much more modest emissions control plans.

Difficult negotiations lie ahead before China can be expected to commit to emissions limits. China, however, has taken a series of actions that make such a commitment possible in the near future. Chinese government officials have analyzed what would be needed to reduce emissions on a sector-by-sector, industry-by-industry, and even company-by-company basis in terms of funding, capital investment, and technology. Beijing clearly recognizes that it must play a more significant role in world-wide policy efforts. The Chinese leadership knows that China has benefited from globalization more than any other nation, and wants to avoid becoming the object of trade measures for failing to share the burden of responding to climate change. More importantly, they recognize that many of the actions taken to reduce greenhouse gas emissions will also cut local air pollution (a growing source of social unrest), improve energy efficiency, and modernize China's industrial infrastructure, making China's manufacturers more competitive in the global marketplace. President Hu and his leadership team also want China to be a player in the burgeoning 'cleantech' sector. Already, China is home to some of the world's leading producers of wind turbines, solar panels, electric cars, and cutting-edge batteries. The top Chinese officials know that demanding domestic energy efficiency and emissions control regulations will help to spur innovation.

Other developing countries, including India and Brazil, have begun to recognize the logic of stepping up to the climate change challenge. With their cooperation, it seems likely that a new 'beyond Kyoto' climate change agreement will be reached in the next couple of years – putting a price on global greenhouse gas emissions and establishing the most far-reaching program of global-scale environmental policy cooperation to date.

But, while the pace of climate change activity has picked up, a further set of issues critical to the success of efforts to control emissions over the longer term has just begun to come into focus. Policymakers have not yet resolved how to ensure that the emerging climate change regime does not conflict with or detract from efforts to keep markets open and promote trade liberalization. Gary Hufbauer, Steve Charnovitz, and Jisun Kim have thoughtfully addressed this problem in a recent book. In *Global Warming and the World Trading System*, the PIIE (Peterson Institute for International Economics) team identifies the trade issues critical to global warming negotiations, carefully discussing relevant Global Agreement on Tariffs and Trade (GATT) obligations and potential points of tension between trade and environmental goals. They highlight possible policy approaches to harmonizing efforts to control climate change while maintaining World Trade Organization (WTO) norms and disciplines.

Global Warming and the World Trading System serves as a valuable primer for those wishing to understand the current state of play in integrating trade and environmental policymaking. In examining all of the GATT articles applicable to environmental regulation, the authors explain how core trade rules and the principles of 'national treatment' and 'most favored nation' might come into tension with climate change regulatory strategies; furthermore, they explain how the exceptions permitted by GATT Article XX might be invoked to accommodate greenhouse gas emissions control efforts. They assess the relative merits of carbon taxes versus emissions allowance trading systems from a perspective of consistency with the international trading system. They also consider how certain approaches to emissions allocation might conflict with the subsidy rules of the WTO.

Beyond their discussion of existing rules, the PIIIE authors analyze the status of energy and climate change policy in critical jurisdictions, paying special attention to issues at play before the US Congress and the workings of the EU ETS. They discuss the problems that plagued the ETS in its early years and review the EU member states' adoption of national allocation plans. They also examine ways in which various jurisdictions are responding to the competitiveness concerns that inevitably emerge when climate controls differ from jurisdiction to jurisdiction.

This review leads the PIIIE authors to predict 'multiple collisions' between climate change regulations and trade rules. They highlight a wide range of possible policy clashes, and explain how recent dispute resolution decisions might shape thinking in new cases arising from climate change programs that run afoul of GATT requirements. They analyze, for example, how national efforts to rebate carbon charges on exports might fare under WTO scrutiny, and review prospects for countervailing duties that might be imposed on imports from nations that 'free ride' on the greenhouse gas emissions controls of others.

In trying to forecast how future clashes might be resolved, the authors offer useful insights on the complex world of WTO jurisprudence. But too often they obscure the bottom line with suggestions that the future direction of WTO case law is 'not clear' or 'remains to be seen'. One might quibble with their inadequately argued conclusion that any effort to impose trade penalties on countries that fail to share the burden of a global response to climate change would not be justified under Article XX. Indeed, it seems quite likely that the United States Congress (without any sense of irony about the United States' own foot-dragging on climate change until very recently) and perhaps the EU will adopt a structure of trade sanctions to discipline climate change scofflaws. If structured carefully – guided by the strictures laid out by the Appellate Body decision in the *Shrimp Turtle* case – such sanctions might well be allowed to stand by a dispute resolution panel. Moreover, the WTO itself, in a report co-sponsored by the United Nations Environment Programme, recently concluded that border tax adjustments to level the playing field between goods bearing carbon charges and imports that do not might well be GATT permissible.

Ultimately, Hufbauer *et al.* argue that there are three basic approaches to the impending clash between climate change policy and trade rules: (1) resolving issues through dispute resolution on a case-by-case basis, (2) negotiating a way to integrate climate change policies and the trading systems requirements, and (3) finding ways to bring norms from international environmental agreements into the trading system as a

guide for minimizing tensions. The authors quite rightly dismiss option number one. Dispute resolution is likely to generate a process of integrating trade and environmental policies that is cumbersome, slow, and inconsistent. Within the category of ‘negotiated’ solutions, they conclude – quite probably correctly – that amending the WTO to authorize a waiver from GATT obligations and other WTO provisions for climate change policies would be too difficult. They offer more hope that a ‘green space’ might be created within the WTO structure, perhaps by means of a new Annex 4 code, offering some flexibility for national efforts to reduce greenhouse gas emissions. They also see some value in seeking guidance from the officials implementing any new climate change treaty for WTO interpretations of how far Article XX exceptions should go.

Perhaps the most promising of the options identified is the idea of a new ‘Code of Good WTO Practice on Greenhouse Gas Emissions Controls’. The PIIE team offers a draft of such a Green Code in Chapter 5 of their volume, spelling out when and how trade-related greenhouse gas trade measures or border tax adjustments might be permitted, how to define ‘like products’ in the context of climate change regulations, and what sorts of emissions allowance allocation schemes might be seen as legitimate (and not a subsidy). These practical suggestions offer the most far-reaching program yet put forward for ensuring that a new climate change regime can co-exist with the international trading system. The ideas presented are thoughtful, carefully grounded in trade law and WTO precedent, built on sound understanding of environmental policy (promoting market mechanisms rather than command and control regulations), and properly limited. As a result, the PIIE Code offers a readymade frame for discussion as policymakers bear down on the need for a practical way to integrate emissions controls and trade obligations.

Global Warming and the World Trading System represents the best tradition of the Peterson Institute for International Economics. It takes on a hard problem at a critical juncture and offers insightful analysis as well as practical policy solutions that promise to advance understanding and policymaking at both the national and global levels. Much more work needs to be done to ensure that the world community succeeds in responding to climate change while promoting trade liberalization, but a starting point for the requisite conversation is now available.

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doi:10.1017/S147474560999022X

Trade and the Environment: Fundamental Issues in International Law, WTO Law and Legal Theory

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Oxford: Oxford University Press, 2009

Under the rules of the World Trade Organization (WTO), WTO members can adopt trade-related measures aimed at protecting the environment, subject to certain carefully crafted conditions. The three trade and environment cases brought under the WTO dispute settlement mechanism to date (the *US–Gasoline*, *US–Shrimp* and *Brazil–Retreaded Tyres* cases) have confirmed WTO members’ ability to adopt