U.S. House of Representatives

Committee on Ways & Means

Hearings on

Policy Options to Prevent Climate Change

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Statement of

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Washington, DC
Mr. Chairman and members of the Committee, thank you for inviting me to testify. My name is Gary Hufbauer and I am a Senior Fellow at the Peterson Institute for International Economics. In May 2008, the Peterson Institute and the World Resources Institute jointly published a book titled “Leveling the Carbon Playing Field.” The book analyzes the intersection between greenhouse gas (GHG) emissions, competitiveness, and international trade.\(^1\) Currently, my colleagues and I are writing a monograph titled “Reconciling GHG Limits with the Global Trading System,” which focuses on US climate policy options and their consistency with the WTO.\(^2\) This testimony reflects findings from both works.

**Major Concerns with US Climate Change Legislation**

Facing rising domestic and international pressures, several GHG control bills have been introduced in the 110\(^{th}\) Congress. The proposals embody two main approaches, namely carbon taxes and cap-and-trade systems. Performance standards are a secondary feature of some proposals. Each system has its own mix of advantages and disadvantages. However, whether the limits take the form of a carbon tax, a cap-and-trade system, performance standards, or some other method, it must be emphasized that serious GHG controls will impose heavy costs on the US economy, and the costs will be concentrated on a short list of GHG-intensive industries and activities. The prospect of heavy costs has raised concerns about the competitive position of US producers and the “leakage” of production and jobs to foreign firms. In the absence of parallel international commitments, US measures might shift manufacturing activity to China and India, among other countries that do not limit GHG emissions. In the end, US controls might make no difference to climate change if emissions activity simply migrates abroad. To address these concerns, US legislators have drafted special provisions in their GHG control


bills such as free allocation of allowances, special exemptions, and border adjustments that would affect both US exports to and imports from countries which do not have comparable climate policies.

**Questionable Effectiveness of Trade Measures**

Trade-related rules, such as an emissions allowance requirement imposed on foreign producers at the US border, have gained political support, both because they address the competitiveness issue and because they arguably create incentives for other countries to join in combating global warming. The logic of this approach is clear. However, it is questionable whether trade measures will achieve the goals sought. Indeed, it is quite possible that trade measures, if imposed by several major countries, will adversely affect the United States.

The United States imports carbon-intensive goods largely from Canada and the European Union -- countries that emit less CO₂ than the United States. China and India, the primary targets of US trade measures, are not large suppliers of carbon-intensive exports to the United States. In 2007, imports from China made up about 11 percent of US carbon-intensive imports in five main product groups combined. For each carbon intensive product group, China accounted for 15 percent of US steel imports; 6 percent of US aluminum imports; practically no chemicals, 12 percent of US paper imports; and 14 percent of US cement imports (see table 1).³

These statistics imply two things. First, trade measures may not provide intended economic relief to domestic industries affected adversely by US climate change policy because US firms are competing mostly with “cleaner” countries; and second, that US trade measures may not create substantial leverage to shape climate change policies of other countries -- particularly China and India.

³ Table 1 does not show US import data from China for chemicals. The value of US import of chemicals from China in 2007 was small, only $13 million.
In proposed US legislation, trade measures are generally imposed on imports unless the trading partner enacts domestic climate policy “comparable” to the US policy. As the trade data mentioned above shows, the largest foreign suppliers to the United States of carbon-intensive goods are countries like Canada and the European Union, and these countries emit considerably less carbon than the United States either on a national basis or a per capita basis. Moreover, the European Union has already enacted more stringent GHG measures than the United States, and Canada may soon do the same. “Comparability” tests imposed by the United States could be turned around by other countries -- starting with the European Union -- to implement similar measures against imports from the United States. This sort of escalation would damage US industries in the global market.

Moreover, a round of global trade restrictions, enacted in the name of climate change, would interrupt the agenda of trade liberalization which has proven enormously successful in boosting world economic growth since the Second World War. The damage to the world economy would be severe. Recall that trade barriers were a hallmark of the Great Depression. Wall Street collapsed first; Smoot-Hawley was passed second.

**Trade Measures and the WTO**

While the WTO allows member countries great flexibility in adopting environmental standards within their territories, the same discretion does not apply in their trading relations with other countries. Accordingly, trade barriers have the potential to conflict with WTO rules. In light of economic history, WTO rules that limit national actions should be counted as a blessing.

To be specific, when GHG trade measures are mixed with mechanisms designed to alleviate the burden of emission controls on domestic firms, the possibility arises of a collision with WTO rules. Table 2 provides a quick view as to which US climate policy options with respect to imports might be justified
under particular GATT articles. If the United States enacts its own unique brand of import bans, border
taxes, and comparability mechanisms – hoping that measures which violate GATT Articles I, III and
XI will be saved by the exceptions of GATT Article XX – the probable consequence will be a drawn-
out period of trade skirmishes, possibly escalating to trade wars.

One way to determine whether such trade measures in support of GHG emission controls are
compatible with WTO agreements is to let the dispute settlement process run its course. In the end, a
record of decided cases will define the contours of WTO obligations. However, given the
complications and sensitivity of GHG controls, the Appellate Body is unlikely to produce clear
guidelines for several years. Moreover, consigning these decisions to a panel of jurists would put
tremendous stress on the WTO system, which is already under siege.

**Recommendation**

A central issue in designing US climate change policy is how to level the playing field internationally.
Given uncertainties in their effectiveness and possible conflicts with WTO rules, trade measures may
not offer the best approach. Given the fact that large emitting countries -- notably China and India --
are also under domestic and international pressures, the United States might better address
competitiveness concerns by actively engaging in international negotiations. Two forums for
international engagement are relevant: Copenhagen and WTO.

At upcoming negotiations in Copenhagen, to be concluded in December 2009, a post-Kyoto regime is
meant to be agreed. Importantly, both the United States and China -- which are not only the largest
sources of GHG emissions, but the cause of great concern over the outcome of climate negotiations --
are expected to join the international regime. While the post-Kyoto compact may not reach agreement
on uniform international standards, engagement of the United States and China will build significant momentum which could draw stronger commitments from India and other developing countries. In this way, the United States may partly address its own competitiveness concerns.

While the post-Kyoto regime will probably announce new ambitious targets for reducing GHG emissions, and commit both developing and developed countries to take action, national governments will likely be left to their own methods for meeting targets. Under this scenario, conflicts due to difference in climate change policies are all but certain. Consequently, many cases might be brought to the WTO. Rather than consign the crucial decisions to WTO judicial system, in my judgment, key WTO members should attempt to write a new WTO Code of Good Practice on GHG rules. The idea is to define more sharply the policy space for climate control measures that are consistent with core WTO principles, even if a technical violation of WTO law might occur. To encourage WTO negotiating efforts along these lines, the United States and other important emitting countries should adopt time-limited “peace clauses” into their own climate legislation. The “peace clause” would suspend the application of border measures or other extra-territorial controls for a defined period of time (say three years) while WTO negotiations are underway.

Thank you, Mr. Chairman. I will be happy to answer questions.
Table 1 US Imports of Selected Carbon Intensive Products, by Origin, 2007

<table>
<thead>
<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Canada</td>
<td>5,430</td>
<td>17.6%</td>
<td>Canada</td>
<td>7,769</td>
<td>55.7%</td>
<td>Trin &amp; Tobago</td>
<td>1,033</td>
<td>22.6%</td>
<td>Canada</td>
<td>9,509</td>
<td>53.1%</td>
</tr>
<tr>
<td>2</td>
<td>China</td>
<td>4,473</td>
<td>14.5%</td>
<td>Russia</td>
<td>1,467</td>
<td>10.5%</td>
<td>Canada</td>
<td>919</td>
<td>20.1%</td>
<td>China</td>
<td>2,093</td>
<td>11.7%</td>
</tr>
<tr>
<td>3</td>
<td>Mexico</td>
<td>2,530</td>
<td>8.2%</td>
<td>Korea</td>
<td>826</td>
<td>5.9%</td>
<td>Finland</td>
<td>1,063</td>
<td>12.1%</td>
<td>Korea</td>
<td>121</td>
<td>9.1%</td>
</tr>
<tr>
<td>4</td>
<td>Japan</td>
<td>1,794</td>
<td>5.8%</td>
<td>Brazil</td>
<td>655</td>
<td>4.7%</td>
<td>Germany</td>
<td>405</td>
<td>8.8%</td>
<td>Mexico</td>
<td>906</td>
<td>5.1%</td>
</tr>
<tr>
<td>5</td>
<td>Germany</td>
<td>1,704</td>
<td>5.5%</td>
<td>Venezuela</td>
<td>344</td>
<td>2.5%</td>
<td>Mexico</td>
<td>285</td>
<td>6.2%</td>
<td>Colombia</td>
<td>121</td>
<td>7.9%</td>
</tr>
<tr>
<td>6</td>
<td>Korea</td>
<td>1,610</td>
<td>5.2%</td>
<td>Brazil</td>
<td>336</td>
<td>2.4%</td>
<td>Netherlands</td>
<td>230</td>
<td>5.0%</td>
<td>Taiwan</td>
<td>502</td>
<td>2.8%</td>
</tr>
<tr>
<td>7</td>
<td>Brazil</td>
<td>1,415</td>
<td>4.6%</td>
<td>United Arab Em</td>
<td>317</td>
<td>2.3%</td>
<td>Eq Guinea</td>
<td>207</td>
<td>4.5%</td>
<td>Brazil</td>
<td>443</td>
<td>2.5%</td>
</tr>
<tr>
<td>8</td>
<td>Taiwan</td>
<td>1,324</td>
<td>4.3%</td>
<td>Venezuela</td>
<td>190</td>
<td>1.4%</td>
<td>India</td>
<td>129</td>
<td>2.8%</td>
<td>Greece</td>
<td>299</td>
<td>1.7%</td>
</tr>
<tr>
<td>9</td>
<td>India</td>
<td>1,227</td>
<td>4.0%</td>
<td>Argentina</td>
<td>184</td>
<td>1.3%</td>
<td>Indonesia</td>
<td>110</td>
<td>2.4%</td>
<td>Greece</td>
<td>121</td>
<td>1.2%</td>
</tr>
<tr>
<td>10</td>
<td>Italy</td>
<td>1,076</td>
<td>3.5%</td>
<td>Argentina</td>
<td>174</td>
<td>1.2%</td>
<td>United Kingdom</td>
<td>210</td>
<td>1.2%</td>
<td>Thailand</td>
<td>33</td>
<td>2.5%</td>
</tr>
</tbody>
</table>

Memorandum:

<table>
<thead>
<tr>
<th></th>
<th>EU-27</th>
<th>OECD</th>
<th>Total Imports from World</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value (mill. US$)</td>
<td>7,643</td>
<td>19,728</td>
<td>30,909</td>
</tr>
<tr>
<td>Share (%)</td>
<td>24.7%</td>
<td>63.8%</td>
<td>100.0%</td>
</tr>
</tbody>
</table>

Notes:

a. US General Imports based on general customs value. US general imports represents goods that arrive in the United States from foreign countries, whether such goods enter consumption channels immediately or are entered into bonded warehouses or Foreign Trade Zones under Customs custody.

b. SITC 3 digit (672, 673, 674, 675, 676, 677, 678, 679)

c. SITC 4 digit (6841, 6842)

d. SITC 5 digit (51111, 51112, 51113, 51122, 51123, 51124, 51211, 52251)

e. SITC 3 digit (641,642)

f. SITC 4 digit (6612)

Source: USITC Interactive Tariff and Trade database website (available at http://dataweb.usitc.gov/, accessed on September 17, 2008)
<table>
<thead>
<tr>
<th>Restriction on Imports</th>
<th>Justified under GATT Articles?</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Article I (MFN)</td>
<td>Article II (Tariff Schedules)</td>
</tr>
<tr>
<td>Import ban (quantitative restriction)</td>
<td>Status Unclear</td>
<td>(Covered under Article XI)</td>
</tr>
<tr>
<td>Additional or punitive tariff</td>
<td>No because: Punitive tariff may differ between partners</td>
<td>No because: Violates bound tariffs</td>
</tr>
<tr>
<td>Anti-dumping or countervailing duties</td>
<td>No. Under present GATT rules, even if the exporting country does not restrict its carbon emissions, the social cost of carbon cannot be labeled as dumping or a subsidy. The failure to impose a carbon tax, or otherwise internalize the full price of carbon, does not currently give other WTO members the right to impose penalty duties on imports. In addition, such measures would violate the SCM and Antidumping Agreement for which no Article XX exception would be available.</td>
<td></td>
</tr>
<tr>
<td>Carbon tax</td>
<td>No if: Foreign countries are treated differently</td>
<td>Not violated. Carbon taxes can be justified as an &quot;internal tax&quot; under GATT Article III:2 and thus can be adjusted at the border.</td>
</tr>
<tr>
<td>Cap-and-trade system with applicability to imports</td>
<td>No if: Foreign countries are treated differently</td>
<td>A violation could occur if imported products are treated less favorably than like domestic products</td>
</tr>
<tr>
<td>Carbon performance regulation applied to products and the production process</td>
<td>No if: Foreign countries are treated differently</td>
<td>A violation could occur if imported products are treated less favorably than like domestic products. The TBT Agreement may also be implicated</td>
</tr>
</tbody>
</table>

a. Cells are in shadow when the referenced GATT articles are not likely to be relevant to the restriction in question.