

# Decarbonizing Trade Policy

## Options towards a European Decarbonized Trade Policy

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### Introduction

The new European Commission, chaired by Ursula Von der Leyen, has made the environment and climate the central parameters of European policy, both internal and international, for the period 2020-2025. As such, the European Green Deal has set itself the goal of making Europe the *"first climate neutral"* continent by 2050.

It has been five years since the Paris Agreement was agreed. The Paris Agreement outlines the pathway towards carbon neutrality achievement of a balance between anthropogenic emissions by sources and removals by sinks of GHGs in the second half of this century (Article 4.1). This pathway is framed by the Paris Agreement temperature goal to hold the increase in the global average temperature to well below 2°C and to pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels. Thus, the cost of climate policy – which is in no way comparable to the cost of previous environmental policies – is expected to increase as abatement measures gradually extend to ensure a broader decarbonization of the economy over the half of this century.

### Summary

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With the adoption of the Paris Agreement<sup>1</sup>, the international community has formally endorsed a transition toward a more state-centered, fragmented, domestically driven architecture for international climate cooperation. Although the treaty has broadened participation in the collective effort to address climate change, Parties have made pledges to reduce greenhouse gases that differ vastly in timing, nature, and scope, which means different national carbon cost level. Given the modest provisions on compliance and enforcement in the Paris Agreement, moreover, these pledges may see uneven implementation and outcomes. This means heterogeneous national carbon prices (CO<sub>2</sub> taxes, emissions trading schemes, carbon regulatory constraints) leading to competitiveness issue. Because industries, which face carbon cost, operate in international markets, additional costs could lead to carbon leakage. Carbon leakage means job, capital, technologies leakages, which will considerably weaken the economic power of the EU and its social compromise. Competitiveness and carbon leakage will also weaken the commitments framed in Nationally Determined Contributions (NDCs) as the Paris Agreement does not make direct reference to trade or investment.

By highlighting the issues of competitive disadvantage and carbon leakage, the UNFCCC-Paris Agreement climate regime raises questions about the conditions of trade and investments that place it on the margins of the field of competence of the WTO's multilateral trade regime (See Table 1 for WTO Agreements that are relevant for national climate policy action). Moreover, the shift toward a state-centred approach to climate policy holds implications for trade as varieties of national measures, that all parties to Paris Agreement will take, could have international trade, productive effects and huge consequences on national competitiveness and employment.

In a global open economy, heterogeneous and uncoordinated carbon pricing policies would undermine any ambitious climate policy. This will be particularly true for European Union and its European Green Deal. Implementing a trade decarbonized policy is a major political and strategic choice. It means that the international trading system must no longer be structured solely by issues of increasing exports, competitiveness and ecological race-to-the bottom. International trade must help decarbonizing the global economy. In order to do it, trade policy must be re-founded on new set of principles and collective social values, which are the heart of the European model. In fact, if there is an actor, able to advance a trade policy agenda based on decarbonization, and to embark other major emitters, it is the European Union.

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<sup>1</sup> The Article 4.1 states that "in order to achieve the long-term temperature goal (...) Parties aim to reach global peaking of greenhouse gas emissions as soon as possible, recognizing that peaking will take longer for developing country Parties, and to undertake rapid reductions thereafter in accordance with best available science, so as to achieve a balance between anthropogenic emissions by sources and removals by sinks of greenhouse gases in the second half of this century, on the basis of equity, and in the context of sustainable development and efforts to eradicate poverty".

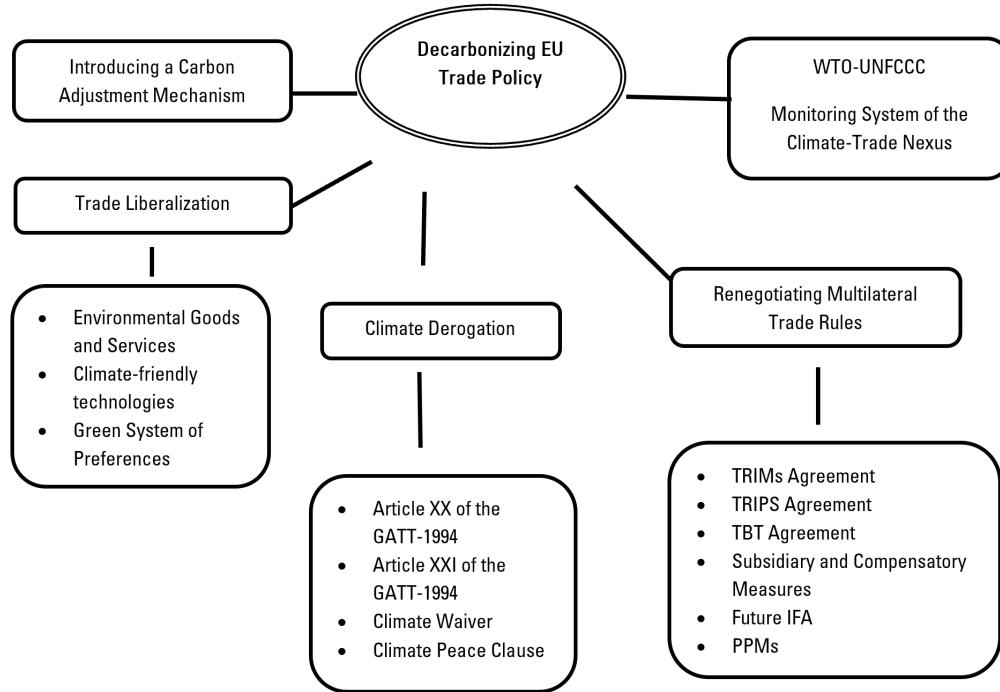
**Table 1: WTO Rules Related to Climate Policies**

| Climate measures  | GATT-WTO related agreements |      |                          |                                       |                        |                                   |                             |
|---|-----------------------------|------|--------------------------|---------------------------------------|------------------------|-----------------------------------|-----------------------------|
|   | GATT                        | GATS | Agreement on agriculture | Subsidies and countervailing measures | Government procurement | Trade investment related measures | Technical barriers to trade |
| <b>Regulatory measures</b>  |                             |      |                          |                                       |                        |                                   |                             |
| Renewable energy regulation   | x                           | x    | x                        | x                                     | x                      | x                                 |                             |
| Energy standard and labels  | x                           | x    |                          |                                       | x                      |                                   | x                           |
| <b>Fiscal measures</b>  |                             |      |                          |                                       |                        |                                   |                             |
| Carbon/energy taxes   | x                           | x    | x                        | x                                     |                        | x                                 |                             |
| Energy subsidies  | x                           | x    | x                        | x                                     |                        | x                                 |                             |
| Border tax adjustment on import   | x                           | x    | x                        | x                                     |                        | x                                 |                             |
| Border tax adjustment on export   | x                           | x    | x                        | x                                     |                        | x                                 |                             |
| <b>Market-based and incentive measures</b>                                  |                             |      |                          |                                       |                        |                                   |                             |
| Market flexibility mechanisms (emission trading, CDM, joint implementation) | x                           | x    | x                        | x                                     |                        | x                                 | x                           |
| Market for low carbon goods and services                                    | x                           | x    |                          |                                       |                        |                                   |                             |
| Government procurement  |                             |      |                          |                                       | x                      |                                   |                             |

Source: composition of the author

The idea that we wish to promote here is that of climate-compatible regulation of international trade, which places the focus on the ways trade policy can be supportive to decarbonization and carbon neutrality. The aim would be to build on the existing climate and trade regimes to create fair, inclusive and effective regulatory mechanisms (See Fig. 1. for details). The expression “climate-compatible regulation of international trade” highlights the central premise of our proposal: the need for cross-institutional cooperation on climate change, i.e, a system of multilateral governance linking the UN Framework Convention on Climate Change (UNFCCC) with the WTO Agreements and regional trade agreements (RTAs).

This policy paper is organized as follows. First, we address the issue of a border tax adjustment and its compatibility with the WTO regime. Secondly, the possibility of liberalization of trade in the service of decarbonization is envisaged. In the third section, we deal with the option of reforming multilateral trade rules. This brings us, fourthly, to analyze the possibility of departing from multilateral discipline. The last section, discusses the option of a multilateral climate-trade governance system.

**Figure 1: EU strategic options for a decarbonisation-driven trade policy**

## The Taxation Route and the Issue of Compatibility with the WTO Regime

Competitiveness and leakage issues raise the question of the extent to which a border tax adjustment (BTA) measure would be compatible with the WTO Agreements. This is highlighted by the new European Commission President Ursula von der Leyen who announced plans to couple her ambitious ‘European Green Deal’ with a ‘carbon border tax’. The sparse guidelines from the Commission President herself merely suggest that the measure “*should be fully compliant with World Trade Organization rules*” and “*start with a number of selected sectors and be gradually extended*” (von der Leyen, 2019).

There is no consensus on whether the WTO should adopt a position on climate change or even whether the latter has a place in the WTO regime. The preamble of the Agreement Establishing the World Trade Organization may well state that one of its aims is “*the optimal use of the world’s resources in accordance with the objective of sustainable development*” (GATT, 1995). However, the preamble is purely a declaration of members’ intentions and essentially has an interpretative value for the provisions that follow.

## Understanding what is a border tax adjustment

Border tax adjustment (BTAs) were not considered as an important issue at the time of adoption of GATT provisions. They became a policy issue at the end of the 1960s<sup>2</sup>.

We prefer to use the expression of carbon adjustment mechanism rather than carbon tax adjustment or environmental BTA.

The concept of BTAs reflects the idea that countries may both tax imported products in the same way as they tax domestic “like” products and relieve exported products from domestic taxes<sup>3</sup>. The BTAs aim at neutralising the effect of domestic taxes on international trade. This is why BTAs need to mirror internal taxes on like products. This means that carbon adjustment mechanism should only complement environmental domestic taxes to neutralise their effects on international trade, *i.e.* on the comparative advantage of national producers. Imposing border carbon adjustment on product from “non-regulated countries” or “non-acting countries”, *i.e.* countries that do not regulate carbon emission, do not follow the traditional design of BTAs. This kind of BTAs is based on the structure of the taxes imposed on domestic products and not on the tax system that applies in third countries.

Environmental BTAs’ refers to fiscal measures used to complement domestic (environmental) taxes. Environmental BTAs’ should be distinguished from other fiscal measures or trade barriers applied without corresponding environmental taxes or regulations on domestic goods. This is why, if EU wants put in place a carbon adjustment mechanism it needs to respect the fact that the burden imposed by the implementing country (EU) on imported goods reflects the burden imposed on domestic goods.

## Tax refunds at the borders for exports

The chief obstacle facing a measure that aims to offset the lack of international competitiveness due to internal taxation is the possibility that it may be classified as a “prohibited subsidy” under the terms of the WTO’s Agreement on Subsidies and Countervailing Measures. This will occur if, for instance, it leads to the exemption or remission, in respect of the production of exported products, of indirect taxes in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption (Agreement on Subsidies and Countervailing Measures, annex I, Item (g)).

The WTO regime is noncommittal on the question of subsidies, but it does not prohibit this type of measure in principle. In practice, the problem must be addressed on a case-by-case basis within the scope of the WTO procedure for dispute settlement. Subsidies pose no problem as long as they are not specific to a sector, a company or a product. The EU would define its programme of subsidies in such a way that the refund does not exceed the amount of domestic indirect tax levied. But this does not guarantee the compatibility of such refunds with the WTO regime.

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<sup>2</sup> GATT (1968). Working Party on Border Tax Adjustments, Note by the Secretariat, L/3009.

<sup>3</sup> A. Pirlot (2017). *Environmental Border Tax Adjustments and International Trade Law*, Edward Elgar Publishing, Cheltenham.

## An import tax as a border adjustment mechanism

The feasibility of a border adjustment measure presupposes that it is compatible with the principles of trade multilateralism, in particular Article III of the GATT 1994 relating to national treatment<sup>4</sup>. If the EU were to introduce such a measure it would need to be specific regarding the three following themes, though this would be no guarantee of compatibility.

### The basis of the tax

The CO<sub>2</sub> tax could only be applied to basic high-emission products or those that are very sensitive to electricity prices. But a border tax adjustment is only permitted in the case of so-called taxes “on the product”, as in the case of VAT. It cannot be applied to so-called taxes “on production” or “on the producer”. The WTO regime is considered to address primarily regulations aimed at products rather than production. Thus, tax on the latter cannot normally be adjusted at the borders.

### The effects of the measure

GATT/WTO jurisprudence has always concluded that the volume of trade has no bearing when it comes to adherence to the provisions of Article III of the GATT. The only factor to be considered is whether or not competition distortion occurs. Similarly, even the existence of a minimum tax differential is enough to establish discrimination between like products. The “Korea – Taxes on alcoholic beverages” panel concluded that the WTO regime does not tolerate a “minimum taxation amount” and that the requirements of Article III of GATT run counter to a measure that favours domestic products, even if trade is not disrupted or the measure has not yet been implemented.

### The similarity of products

The GATT/WTO texts lack criteria that would make it possible to decide whether or not two or more products are similar, or “like”.

Two doctrines come into conflict here. The first states that products obtained using different production processes cannot be considered as “like products”. The second doctrine considers that likeness depends on physical properties, nature and quality, on end-uses, on consumers’ tastes and habits, as well as on the tariff classification of products. In this case, the production process used to make these products does not come into consideration when assessing their likeness. GATT/WTO jurisprudence tends to favour the latter of the two doctrines.

However, the debate is not over, since according to the Appellate Body, the notion of similarity must be examined on a case-by-case basis depending on the context and circumstances. This grants panels a discretionary margin when weighing up the criteria to be used and their respective importance.

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<sup>4</sup> The key objective of the GATT-WTO regime is to promote the liberalization of trade in goods. It sets a number of trade principles, most notably the most-favoured nation (MFN) obligation, i.e. trade measures imposed by a member shall not discriminate between different trade partners. Neither shall they discriminate against imported goods from other members vis-à-vis ‘like’ domestic goods (national treatment obligation).

A last challenge facing the BTA is the permit allocation system. Auctioning may be a prerequisite for a border tax adjustment. In fact, the EU ETS which until now is built upon the free allocation of permits might be associated to a subsidy. Therefore, if the European Union wants to introduce a BTA, it must review its permit allocation. The EU dilemma is evident: a low carbon price will have no effect as an incentive to a transition toward a low carbon production, whereas a high carbon price raises the issue of competitiveness and carbon leakage.

The main conclusion regarding the carbon adjustment mechanism is that only a dispute settlement on the question of using a carbon tax to fight against climate change is likely to resolve the issue of targeted trade measures favouring climate change mitigation. The trading regime and jurisprudence of the WTO would allow in theory for the creation of targeted trade measures favouring the fight against climate change. But there is no guarantee that it will result in a definitive solution that is in line with the measure's climatic aims.

For diplomatic purposes and in order to be compatible with the principles of multilateral cooperation, the EU must avoid formulating its trade policy using terms like "competitiveness" or "carbon leakage" or "competitive advantage". The EU must develop an advocacy centred on safeguarding the climate, achieving SDGs, and/or providing a global public good (a low-carbon atmosphere).

The adoption of a border adjustment measure is an extremely complex device, firstly, to put in place and, secondly, in order to be compatible with WTO provisions. Add to this the geopolitics of carbon as future emitters are, and will increasingly, be developing and emerging countries. Both WTO's Special and Differential Treatment and UNFCCC's principle of common but differentiated responsibility afford a special status that complicates the use of trade policy instruments when dealing with these nations. This is reinforced by the provisions of article XXXVII.1.c of GATT 1994, which prohibit "new fiscal measures" from being imposed upon them. Faced with developed countries' initiatives, emerging economies, non-emerging DC's and LDC's will attempt to ensure that a prohibition on a carbon tax on import be included in any future agreement. A way to overcome this pitfall could be that the counterpart of adopting carbon-oriented trade policy measures would be to provide technical assistance to DCs' and LDCs' to implement green industrial policy<sup>5</sup>.

Thus, a decarbonization trade policy cannot and should not be based solely on a border adjustment measures. The reflexion should be widened.

## The Option of Trade Liberalization

The EU could draw up a trade offer for developing countries that would reflect their climate concerns and constraints. This option calls for a new balance to be established between trade rights and obligations.

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<sup>5</sup> D. Rodrik (2014). "Green Industrial Policy", *Oxford Review of Economic Policy*, 30(3), 469-91 and World Bank (2012). "Green Innovation and Industrial Policies", in World Bank, *Inclusive Green Growth: The Pathway to Sustainable Development*, World Bank, Washington DC.

However, there is no evidence about the positive effects of trade liberalization and free trade agreements (FTAs) in terms of environmental protection and decarbonization. The development of EU's Green Deal should be an opportunity to build on European trade policy on values different from those of "free and undistorted competition", "competitiveness" and the "dismantling of trade barriers". In 2015, the European Commission suggested a *Trade for All strategy*, which aims at promoting transparency, sustainable development and human rights as key aspects when negotiating new trade agreement<sup>6</sup>. This strategy needs to go beyond goodwill declaration. One way to do this is to think market access and trade liberalization as levers for decarbonization. Two options could be considered. The "decarbonisation" or "energy transition toward a low carbon society" could be added as a global social value of free trade in the era of global climate change.

The first refers to the fact that climate regime recognizes the need for technology transfers (Article 4.5 UNFCCC, Article 10 Paris Agreement). The Paris Agreement states that the means of implementation have to be provided by industrialized countries to developing and Less Developed countries. The WTO negotiations, including the TRIPs Agreement and the talk on environmental goods and services (EGS), could be linked in order to facilitate technology transfers. The EU could take the lead on this topic by promoting an agreement on the protection of IPRs for climate-friendly technologies<sup>7</sup>. This will be the first step towards freeing international transfers or trade of these technologies. Given the role of trade in the faster dissemination of technologies, the EU will need to strengthen its trade policy in this respect.

As an active member of the *Friends of EGS*<sup>8</sup>, the EU's aim is to ratify a plurilateral agreement on the liberalisation of trade in green products, services and technologies. As things stand, negotiations have come up against the problem of definitions and the classification of environmental good and services, the inclusion of production methods and processes in the scope of negotiations, the inclusion of non-tariff barriers, how liberalisation should be approached (list approach, project approach, integrated approach) and how to deal with products that also have non-environmental uses. It is important not to lose sight of the fact that the aim is to combat climate change and not to offer new opportunities for trade liberalisation. Furthermore, total liberalisation of trade in EGS would concern only a marginal volume of trade and goods that already have very low average tariffs. In addition, there is no strong potential for the liberalisation of trade in low-carbon goods to contribute to climate change objectives.

The second option would involve setting up a "Generalised System of Preferences Plus" (GSP+) or "Green System of Preferences", which would benefit those Developing and Least Developed Countries that embark in ambitious climate policy to combat CO<sub>2</sub>. In this new GSP, trade preferences are granted in return for the transfer of climate-friendly technology and sustainable investment. The EU must use its 'market power' to encourage its trading partners to take collec-

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<sup>6</sup> See <http://www.europarl.europa.eu/legislative-train/theme-a-balanced-and-progressive-trade-policy-to-harness-globalisation/file-trade-for-all-strategy>

<sup>7</sup> This agreement or at a lesser extent WTO 'Ministerial Declaration' is comparable to the Doha Declaration in the TRIPS Agreement and Public Health adopted in 2001. As a long-term strategy, the EU could propose an amendment to TRIPS Agreement to allow WTO Members to exclude key climate technologies – to be defined – from patent protection.

<sup>8</sup> The Friends of EGS Group of countries comprises: Canada, the EU, Japan, Korea, New Zealand, Norway, Switzerland, Chinese Taipei and the United States.



tive climate action. EU ‘market power’, must be used to promote norms and standards for ambitious collective decarbonization. This option should be combined with the threat of restrictive measures with regard to access to the European market, particularly for goods that are carbon intensive or produced using carbon intensive processes. This option could be used when negotiating RTAs’. It could be also introduced in the trade and development framework toward CAP Countries. The geopolitics of carbon in the next decade is clear: the major emitters are, and will be, developing countries. A policy option is to seriously consider to merging or establishing an integrated framework for EU trade and development policies.

## The Option of Overhauling Current Agreements or Negotiating new ones

There are two main arguments in favour of reforming WTO rules: (1) During the Uruguay Round negotiations (1989-1993) and when the WTO was created (1995), problems related to climate policy and structural, regulatory and governance challenges associated with decarbonization did not exist, and; (2) the case-by-case nature of WTO disputes does not provide institutional guidance for the implementation of an ambitious climate policy.

What are the main rules to reform? How the EU could proceed?

Regarding the first question, as a key player in international trade and climate negotiations, the EU could take leadership on the issue of reforming multilateral trade agreements, or to a lesser extent, to propose reforms of some multilateral trade rules. The most WTO agreements and rules for the interaction between climate and trade policy as they regulated specific aspects of trade in goods and services are presented in table 2.

**Table 2: WTO Agreements and Rules to Reform to build a Decarbonization Trade Policy**

|   |   |
|---|---|
| <b>TRIMs</b><br><b>Agreement on Trade-Related Investment Measures</b>                     | <ul style="list-style-type: none"> <li>• Some nationally determined contributions address national employment and industrial policy strategies (green industrial policy, investment in new energy, local content requirements)</li> <li>• TRIMs related to decarbonisation should be non-actionable and excluded from the prohibition of TRIMs</li> </ul> |
| <b>TRIPS</b><br><b>Agreement on Trade-Related Aspects of Intellectual Property Rights</b> | <ul style="list-style-type: none"> <li>• Article 8 should stress on measures related to climate-friendly technologies and consolidate Members’ right to adopt measures to promote sustainable development goals policies</li> <li>• TRIPS shall facilitate transfers of climate-friendly technologies</li> </ul>  |
| <b>TBT</b><br><b>Agreement on Technical Barriers to Trade</b>                             | <ul style="list-style-type: none"> <li>• Climate-related rules, technical regulations</li> <li>• Guidelines and rules for characteristics of products or production process and methods (PPMs’)</li> <li>• Guidelines on standards, labels and technical norms: efficiency standards and sustainable development criteria</li> </ul>                      |
| <b>SCM</b><br><b>Agreement on Subsidies and Countervailing Measures</b>                   | <ul style="list-style-type: none"> <li>• Defines subsidies and disciplines on countervailing duties</li> <li>• Changes in categorisation of subsidies</li> <li>• Climate policies may include subsidies for low-carbon energy, low-carbon technologies</li> </ul>   |

Source: Composition of the author

The option of overhauling WTO rules will start by *changing the provisions of the Agreement on Subsidies and Countervailing Measures*. This agreement requires clarification or amendments so as to make its provisions compatible with the aim of combating climate change, or so as to create a category of subsidies that are compatible with the fight against climate change. The second component of this strategy relates to examination of the issue of energy standards and labels. Many countries have already drafted such standards and norms. At WTO level, this issue falls within the scope of the Agreement on Technical Barriers to Trade. Overhauling this agreement would provide a lever for the implementation of more ambitious climate policy objectives through the establishment of environmental and energy standards for products and production processes.

The EU must invest in the negotiation on a future Investment Facilitation Agreement in order to introduce sustainable development criteria in international investment framework and agreements. This negotiation constitutes an opportunity for the EU to advance the project of a Sustainable Investment Facilitation Agreement dedicated to attract climate-specific investment. Such an agreement could help economic diversification in some economies which is one of the ways to adapt to climate change and to enhance resilience of Least Developed Countries and Most Vulnerable Economies. It can also help financing effort to diversify into green economic activity.

As GHG emissions are related to the so-called products and process methods (PPMs)<sup>9</sup>, the EU could take the lead of a like-minded countries group or ask to create a Working Group within the WTO to tackle the issue of non-product related PPMs as WTO regime considers *a priori* WTO-inconsistent any regulation applicable to PPMs that are not “*physical*” inputs into a product.

## The Option of Exemption from the Multilateral Trade Rules

Exemption from the multilateral trade rules is related to Article XX of the GATT 1994.

The purpose of Article XX is to control the conditions under which Members may pursue or seek to achieve non-trade objectives. Paragraphs (b) and (g) on measures to “protect human, animal or plant life and health” and measures relating to the “conservation of exhaustible natural resources” may be invoked in the context of climate change. The aim under paragraph (b) would be to demonstrate that a tax would be a necessary additional measure to ensure the effectiveness of the tradable emission permit system or, under paragraph (g), that it relates to the conservation of exhaustible natural resources which could be affected by climate change. Furthermore, plans to introduce a border adjustment measure would have to fulfil the two conditions under the “chapeau” of article XX. The measure: (a) must not constitute a means of

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<sup>9</sup> The purpose of including PPMs in the context of decarbonization policies is to incorporate the carbon cost of production in the price of products so as to give an incentive to both producers and consumers to limit the use of carbon intensive unfriendly products.

arbitrary or unjustifiable discrimination between countries where the same conditions prevail; and (b) must not constitute a disguised restriction on international trade.

Two observations can be made. First, it would seem more “rational” to head towards justification under the terms of article XX, which offers the means to set up border adjustment measures compatible with the WTO system, than to seek compatibility with Article III (*i.e.* non-discriminatory treatment). Once again, only the dispute settlement system is likely to be able to resolve the problem. But, the outcome of any action cannot be anticipated. Second, Article 3.5 of the UNFCCC prohibits the use of trade measures in attaining its objectives. So, before any proposition it is necessary to clarify the links between the WTO regime and that of the UNFCCC.

Regarding the second question, reforming WTO rules requires building consensus among State Members. So, if the EU wants a decarbonizing trade policy it must offer something to others State Members. However, if building a consensus on reforming WTO rules is too difficult, two options are available. These options need also a consensus to be effective, but, as they are time-limited, State Members may be more willing to consensus.

These two options are:

(1) **Negotiating climate waiver**<sup>10</sup> due to the “exceptional circumstances” created by climate change. This involves starting a procedure under the terms on Article IX.3 of the WTO Agreement. In fact, Article IX.3, “in exceptional circumstances” and in the framework of a Ministerial Conference, authorises a Member to request a waiver concerning its obligations under the WTO Agreements. It must prove that climate change measures that it intends to implement fall into the category of “exceptional circumstances”. Once this has been done, the member must embark upon a consensus building strategy in order to have the request accepted by the Members of the WTO, since the recognition of “exceptional circumstances” concerning a measure taken by a Member is based on their appraisal.

(2) **Introducing a climate peace clause.** “Peace Clause” refers to Article 13 of the WTO’s Agreement on Agriculture. Another temporary peace clause was made at Bali Ministerial Conference (2013)<sup>11</sup>. A same time-limited peace clause for taking actions against trade-related climate measures could be negotiated. It would not focus only on climate-related subsidies<sup>12</sup>. It would commit WTO members to wait before challenging national climate measures or refrain from using countermeasures that restrict trade in WTO dispute settlement.

These two options could be taken until 2030 (end date of the SDGs) and be the subject of an evaluation as part of the evaluation of the SDGs.

<sup>10</sup> See for details J. Bacchus (2017). “The Case for a WTO Climate Waiver”, *CIGI Special Report*, CIGI, Ontario.

<sup>11</sup> It stipulated that no country would be legally barred from food security programs for its own people even if the subsidy breached the limits specified in the WTO Agreement on Agriculture.

<sup>12</sup> G. Hufbauer et al. (2009). *Global Warming and the World Trading System*, Peterson Institute for International Economics, Washington.

In addition to Article XX and introducing either a climate waiver or a climate peace clause, it is possible to argue derogation based on GATT's Article XXI<sup>13</sup>. The EU could opt for an “*authoritative interpretation of WTO provisions*”<sup>14</sup> related to climate change as a collective security treat. Climate change is not only an “*exceptional circumstance*” (WTO Agreement's Article IX.3) and it is not only a security treat for European countries. It is a global or collective security issue. The EU could advance the argument that, in order to provide collective or global climate security, countries that do not implement ambitious climate policies will be submitted to trade measures that restrict the access of their goods to the European single market.

This strategic bargaining could be sustained by a major institutional innovation related to the transfer of custom revenues provided by a carbon adjustment mechanism to DCs' and LDCs' to help them to decarbonize their trade and production system or to allow them to buy best available green technologies.

## The Option of an UNFCCC-WTO Monitoring System

The last strategic option that the EU can take concerns to consolidate a cross-institutional cooperation aiming at climate-compatible regulation of international trade. This option involves creating a joint WTO-UNFCCC monitoring system of the trade-climate nexus.

Given the huge difficulties regarding any legal and substantial changes at the WTO, it is possible to focus on procedural changes in trade and climate-related institutions. Improving the institutional framework on trade-related implications of climate policy-making would limit the potential of conflicts as the UNFCCC-WTO Committee would have for main task to make trade and climate regime mutually supportive in order to decarbonize the multilateral trading system.

The remit of this Committee would be four-fold:

- 1) To set forth a list of climate measures which are compatible with the WTO regime and frankly address the PPMs' issue. Energy and carbon tax, mandatory and voluntary standards, labelling and certification schemes, the sale and transfer of emission permits within or between groups of countries, trade-distorting tools of green industrial policy (local-content requirements, tariff protections, subsidies) all these provide example of measures that need to be addressed by this monitoring system.
- 2) To elaborate climate-related standards and labels and to harmonize sustainability standards and their associated methodologies in order to reduce international transaction costs, especially for green products and technologies. As in the Special and

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<sup>13</sup> GATT's Article XXI “Security Exceptions” states that, “Nothing in this Agreement shall be construed (...) (b) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests (...) (c) to prevent any contracting party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security”.

<sup>14</sup> See D. Kasturi, H. van Asselt, S. Droege, M. Mehling (2018), *Making International Trade System Work for Climate Change: Assessing the Options*, Climate Strategies.

Differential Treatment in the Trade Facilitation Agreement, the issue of climate-related standards and labels must be accompanied by compulsory programs of capacity-building to assist countries and exporters to meet those standards.

- 3) To remove any ambiguities that may cause conflicts relating to standards and jurisdiction (competence) between the Convention and the Paris Agreement, on the one hand, and the WTO Agreements, on the other. If this work were to result in clauses and rules that specify links to the WTO Agreements, clauses that do not form part of the WTO regime, these would not legally bind panels or the Appellate Body, but would serve as a point of reference for the decisions they may be required to make.
- 4) To advance the issue of building an international regime of carbon taxation as BCA and similar tools are a response to heterogeneous carbon pricing across national economies. If all internationally traded goods were priced to internalise climate costs, then trade flows would be climatically neutral and there would be no rationale to restrict trade on carbon grounds.

The purpose of this policy paper was to present the strategic options, from the most technical to the most political, available to the EU in order to converge trade policy and climate policy.

The new European Commission has adopted an agenda, the realization of which involves proactive climate diplomacy and a convergence of interests between EU Member States. It is with this double condition that the strategic options, reviewed in this analytical note, can go beyond political declaration and be materialized. In fact, transforming the global trade and investment governance in order to put it at the service of decarbonization is a major political and strategic choice. It needs a strong diplomatic push, a multi-track (bilateral, regional and multilateral) proactive economic diplomacy supported by a great coherence between EU member states because it could and it will lead to trade conflicts.

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