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Statement of

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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 110th 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

[1] Houser, Trevor, Rob Bradley, Britt Childs, Jacob Werksman, and Robert Heilmayr. 2008. *Leveling the Carbon Playing Field: International Competition and US Climate Policy Design.* Washington: Peterson Institute for International Economics and World Resources Institute.
[2] Charnovitz, Steve, Gary Clyde Hufbauer and Jisun Kim. 2008 (forthcoming). *Reconciling GHG Limits with the Global Trading System*. Washington: Peterson Institute for International Economics.

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 CO_2 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[a]

Rank	Steel[b]			Aluminum[c]			Chemicals[d]			Paper[e]			Cement[f]		
	Country	Value (mill. US$)	Share (%)	Country	Value (mill. US$)	Share (%)	Country	Value (mill. US$)	Share (%)	Country	Value (mill. US$)	Share (%)	Country	Value (mill. US$)	Share (%)
1	Canada	5,430	17.6%	Canada	7,769	55.7%	Trin & Tobago	1,033	22.6%	Canada	9,509	53.1%	Canada	387	29.2%
2	China	4,473	14.5%	Russia	1,467	10.5%	Canada	919	20.1%	China	2,093	11.7%	China	246	18.6%
3	Mexico	2,530	8.2%	China	826	5.9%	Korea	556	12.1%	Finland	1,063	5.9%	Korea	121	9.1%
4	Japan	1,794	5.8%	Germany	655	4.7%	Brazil	405	8.8%	Germany	906	5.1%	Mexico	116	8.8%
5	Germany	1,704	5.5%	South Africa	344	2.5%	Venezuela	285	6.2%	Mexico	858	4.8%	Colombia	105	7.9%
6	Korea	1,610	5.2%	Brazil	336	2.4%	Netherlands	230	5.0%	Japan	502	2.8%	Taiwan	99	7.5%
7	Brazil	1,415	4.6%	United Arab Em	317	2.3%	Eq Guinea	207	4.5%	Korea	443	2.5%	Brazil	39	2.9%
8	Taiwan	1,324	4.3%	Venezuela	190	1.4%	India	129	2.8%	Indonesia	299	1.7%	Greece	36	2.7%
9	India	1,227	4.0%	Argentina	184	1.3%	Argentina	110	2.4%	United Kingdom	219	1.2%	Thailand	33	2.5%
10	Italy	1,076	3.5%	Bahrain	174	1.2%	Mexico	95	2.1%	Brazil	210	1.2%	Sweden	25	1.9%
Memorandum:															
	EU-27	7,643	24.7%		1,246	8.9%		459	10.0%		3,231	18.0%		111	8.4%
	OECD	19,728	63.8%		9,716	69.6%		2,047	44.7%		14,769	82.4%		751	56.7%
	Total Imports from World	**30,909**	**100.0%**		**13,958**	**100.0%**		**4,579**	**100.0%**		**17,917**	**100.0%**		**1,324**	**100.0%**

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 2 US Climate Policy Options on Energy Intensive Imports [a]

Restriction on Imports		Justified under GATT Articles?				
		Article I *(MFN)*	**Article II** *(Tariff Schedules)*	**Article III** *(National Treatment)*	**Article XI** *(Quotas)*	**Article XX** *(Exceptions)*
Import restriction applied to penalize "foreign emitted carbon" (measure applied *only* against imports)	*Import ban (quantitative restriction)*	***Status Unclear***		***(Covered under Article XI)***	***No because:*** Violated	***Yes.*** If any provision or restriction on imports can be justified under Article XX, it is permitted even though it violates other GATT rules. Recourse to an Article XX exception is scutinized carefully and the burden of proof is on the country seeking to invoke the exception. The measure has to qualify under a specific exception in Article XX, such as Article XX(g) as a measure relating to the conservation of natural resources. In addition the measure must meet the test in the Article XX chapeau, namely, that the measure is not applied in a manner that constitutes arbitrary or unjusifiable discrimination or as a disguised restriction on international trade.
	Additional or punitive tariff	***No because:*** Punitive tariff may differ between partners	***No because:*** Violates bound tariffs	***No because:*** A similar tax is not applied to domestic goods		
	Anti-dumping or countervailing duties	***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.				
Competitive provision applied as an extension of domestic US climate policy (measure applied *both* to domestic production and imports)	*Carbon tax*	***No if:*** Foreign countries are treated differently		Not violated. Carbon taxes can be justified as an "internal tax" under GATT Article III:2 and thus can be adjusted at the border.		
	Cap-and-trade system with applicability to imports	***No if:*** Foreign countries are treated differently		A violation could occur if imported products are treated less favorably than like domestic products		
	Carbon performance regulation applied to products and the production process	***No if:*** Foreign countries are treated differently		A violation could occur if imported products are treated less favorably than like domestic products. The TBT Agreement may also be implicated		

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

Source: Adapted and updated from Pauwelyn, Joost. 2007. *US Federal Climate Policy and Competitiveness Concerns: The Limits and Options of International Trade Law*. NI WP 07-22. Nicholas Institute for Environmental Policy Solutions. Duke University