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CAN BORDER CARBO TAXES FIT INTO THE GLOBAL TRADE REG

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POLICY CHALLENGE

If BCAs are to gain international acceptance, they must be motivated by clear, economically-sound arguments, but the reasons normally put forwar do not seem to persuade critics. For instance, the European Union still nee to convince the world about the appropriateness of the extraterritorial features of the extension of its emissions trading system to aviation. To gain international acceptance, an understanding is needed of the use and design of border carbon measures, perhaps under the auspices of the World Trade Organisation. It might also be

line association. The ECJ dismissed the complaint entirely. The essence of the ECJ finding

3. For a critical discussion of the economic reasonableness of the ECJ decision, see Horn, Henrik (2013) 'The ECJ Judgment on the Extensions of the ETS to Aviation: An Economist's Discontent,' Entwined Report (www.entwined.se).

4. A good source for references to both the policy debate and the academic literature is Tackling Leakage in a World of Unequal Carbon Prices, Climate Strategies, 2009, edited by Susanne Dröge. As an indication of the magnitude of the literature, of the approximately 150 references therein, most address BCAs. There are very few academic studies of the leverage argument, but two recent exceptions are Böhringer, Christoph, Jared C. Carbone and Thomas F. Rutherford (2011) 'The Strategic Value of Embodied Carbon Tariffs', unpublished manuscript, and Helm, Dieter, Cameron Hepburn and Giovanni Ruta (2012) 'Trade, Climate Change, and the Political Game Theory of Border Carbon Adjustments', Oxford Review of Economic Policy 28, 2: 368-394.

5. One such argument holds that it is desirable to preserve the competitiveness of the

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ties, since there are clear trans-boundary adverse effects of emissions.

Another reason why the focus on externalities is not merely a semantic issue is that it suggests a rather different role for border carbon measures than in the conventional arguments. In order for a border restriction to improve economic efficiency, the policy does not need to be an 'adjustment', that is, it does not have to compensate for the lack (or inadequacy) of a foreign climate policy relative to the domestic policy. Indeed, even if the exporting country pursued the same climate policy as the importing country, or if the importing country pursued no policy, there could still be an externality argument for a trade restriction, as long as the exporting country policies do not fully mitigate climate externalities. Hence, from an externality point of view, the legitimacy of border carbon measures does not hinge on the policy being an 'adjustment' that makes the treatment of imported products symmetric to the treatment of domestically produced products. The domestic climate policy will still be important from an efficiency point of view, however, since the more ambitious this policy is, the more likely is it that there will only be small 'reverse carbon leakage' from the increase in domestic production that the border measure induces. An ambitious domestic climate policy may also be important for the sake of WTO legality and political acceptability of BCAs.

Yet another reason why the international externalities motivation is not just a semantic reformulation of the traditional arguments is that it seems to allow for a much broader scope for using border carbon measures: even the countries with the most ambitious climate policies are likely to expose the rest of the world to climate externalities. Consequently, almost any country would be a potential target for border carbon measures.

Finally, without purporting to undertake a legal analysis, it seems clear that it would be incompatible with WTO law to impose a duty on imported products solely to preserve the competitiveness of a domestic industry that is being burdened with the cost of some domestic policy. Nor could a duty be imposed simply in order to prevent foreign consumers and producers from adjusting to the changes in international prices that stem from the imposition of some domestic policy in the importing country, or in order to induce exporting countries to change their domestic policies to the benefit of the importing country. Central to the possibility that WTO judges will accept border carbon measures is instead that they serve to reduce international climate externalities.

CAVEATS

As already argued, basic economic principles suggest a potential justification for why border carbon measures may be desirable from an economic efficiency viewpoint. But the

Environmental Agreements', in Mäler, Karl-Göran and Jeffrey R. Vincent (eds) Handbook of Environmental Economics, Vol. 3 , Elsevier.

8. The effects doctrine is sometimes seen as a special case of the territoriality principle.

Climate externalities may already be internalised through the WTO Agreement

A basic objection against the externalities argument is that it is oblivious to the fact that there is already an international agreement on trade barriers — the WTO. There is a rather strong presumption, also based on economic principles, that when an agreement is negotiated, the parties do not leave anything obvious 'on the table'. This suggests that the parties have not left unexploited any global welfare gains that could be had from unilateral tariff increases. Oddly, the economic literature on BCAs almost uniformly ignores the existence of trade agreements such as the