Towards a Trade Regime that Works for the Paris Agreement

KASTURI DAS, HARRO VAN ASSELT, SUSANNE DROEGE, MICHAEL MEHLING

Achieving the goals of the Paris Agreement on climate change requires support from the international trade system. The ways in which international trade policy could support climate policy, including legal changes at the World Trade Organization, procedural changes in institutions and practices, and use of plurilateral and regional trade agreements, are examined here. While it may be difficult to agree upon the legal changes, the procedural changes and plurilateral and regional agreements offer a clear way forward in the short to medium term.

The adoption of the Paris Agreement on climate change in December 2015, followed by a detailed rule book for its implementation in December 2018 in Katowice, ushered in a new era of multilateral cooperation under the United Nations Framework Convention on Climate Change (UNFCCC). The new regime confirms the transition towards a more bottom-up architecture for international climate cooperation, centred around a system of national climate pledges called nationally determined contributions (NDCs). These NDCs, however, differ widely in ambition, nature, and scope, and in absence of strong centralised enforcement, will likely face uneven implementation. Moreover, even if all nations deliver on their promises, current pledges will not keep global warming “well below 2°C” above pre-industrial levels,” the limit specified in the Paris Agreement (UNFCCC 2016). The question then is how to strengthen actions so that emissions drop sharply once the Paris framework takes effect in 2020. This will require considerable reductions of fossil fuel use, widespread improvements in energy efficiency, a significant scale-up in the production of renewable energy, and enhanced access to clean energy technologies. Advancing such a multi-pronged agenda calls for unprecedented efforts across all areas of socio-economic activity. It also requires support from other international regimes, as rules that are working at cross-purposes may hamper climate action.

Role for Trade

Policy and regime coherence are particularly important in the context of the international trade system. This is due to multiple interlinkages between the trade and climate regimes. In a globalised world, trade influences emission patterns worldwide. Trade in carbon-intensive goods can potentially undermine national climate protection, while reducing trade barriers for low-carbon goods and technologies can make a significant contribution to climate goals.

Conversely, stronger climate action through NDCs will require a major overhaul of domestic policies and measures, and can have significant trade effects. In implementing their respective NDCs, countries can take various trade measures, such as removing or reducing tariffs on environmental goods and services, implementing carbon pricing, developing technical standards for low-carbon products, transferring low-carbon technologies, and so on. As carbon pricing systems and other carbon constraints keep proliferating across the globe, trade measures like border carbon adjustments (BCAs) on carbon-intensive imports from climate-laggard countries are also increasingly being debated with a view to levelling the competitive playing field. At the same time, there are concerns that such trade-related climate measures could be misused for protectionist purposes.

Subsidies can also help a country or region meet climate goals by rapidly building its clean energy sectors. However, as the Canadian province of Ontario, and more recently, India, have realised the hard way, certain kinds of subsidies can run afoul of the World Trade Organization (WTO) rules, thereby curtailing the space for climate action. Strikingly, while recent years have seen a surge in WTO disputes specifically targeting clean energy support, subsidies to support the consumption and production of fossil fuels have, by and large, escaped WTO scrutiny, notwithstanding their size and environmentally and socially harmful effects.

These various interlinkages underscore the importance of exploring the ways in which trade policies and frameworks can create a favourable environment for advancing the objectives of the Paris Agreement. Unsurprisingly, options to improve the coherence between the climate and trade regimes have repeatedly been discussed in the literature (that is,
Hufbauer et al 2009; Epps and Green 2010; Bacchus 2016). The recent changes in the geopolitical context necessitate revisiting these options (Mehling et al 2018), and call for distinguishing between policy options that are promising in the short term and options that may only be feasible in the longer run.

In this article, we explore how the international trading system could help contribute to achieving climate goals. Our suggestions are based on a systematic assessment of 22 policy options found in the literature (for details, see Das et al 2018). We distinguish three types of general options (that is, options applicable to a variety of issues at the intersection of climate and trade), namely (i) adopting legal changes at the WTO; (ii) pursuing procedural changes in institutions and practices; and (iii) using plurilateral and regional trade agreements. In addition, a subset of options focuses specifically on the issues of (iv) border carbon adjustments and (v) fossil fuel subsidies. We have tested these options through interviews with 26 experts, including government officials, representatives of intergovernmental organisations, researchers, and consultants from different corners of the world. Figure 1 summarises our findings, highlighting the short to medium-term feasibility of the options. Based on this analysis, we put forward a set of options for policymakers working at the interface of trade and climate change to consider in the short to medium term, that is, the next 5–10 years.

**Prospects for Legal Changes**
Against the backdrop of the recent proliferation of WTO disputes targeting domestic support and policy measures related to clean energy, proposals to reform the WTO often entail legal changes. We have considered four key avenues for legal changes, namely (i) amending the WTO agreements to accommodate climate change measures; (ii) a “waiver” that temporarily relieves WTO members from their legal obligations under the WTO agreements when pursuing climate action; (iii) the adoption of an “authoritative interpretation” clarifying the scope of WTO rules in relation to climate policies; and (iv) the introduction of a time-limited “peace clause” pursuant to which WTO members will not challenge the climate policies of other members.

These four ways of bringing about legal changes involve complex political processes and are hard to implement in practice, at least in the short to medium term. The requirement of reaching a consensus among all WTO members makes reaching even basic agreement on pursuing any of the options dealing with legal changes for climate purposes difficult, let alone adopting them. The dearth of precedents for legal changes under the WTO—an amendment relating to public health under the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) being a notable exception—attests to the major procedural complexities and political hurdles to any such changes. In the current political climate, with trade relations eroding and outright conflicts simmering between major economies, these barriers are all but insurmountable in the near term.

But, this also raises the more fundamental question of whether there is a need for legal reform at the WTO to promote climate objectives in the first place. Arguably, flexibilities that are already available under current WTO law could be sufficient for members with a genuine—rather than a protectionist—intent to advance climate action. Furthermore, the legal changes could also carry some risk of backfiring against their intended objectives. Expressly specifying anything may ignite dormant debates on what is permissible, and narrow down the already existing wiggle room for WTO member countries.

Furthermore, the difficulties involved in implementing legal changes at the WTO do not mean all options to make trade work for the climate have been exhausted. Here, we elaborate seven potential ways forward that we consider to be feasible in the short to medium term. Pursuing these options could pave the way for

### Figure 1: Options and Their Potential Feasibility in the Short to Medium Term

<table>
<thead>
<tr>
<th>Legal changes at the WTO</th>
<th>Procedural changes in institutions and practices</th>
<th>Actions under plurilateral and regional trade agreements (RTAs)</th>
<th>Border carbon adjustments (BCAs)</th>
<th>Fossil fuel subsidies</th>
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<td><strong>Low feasibility</strong></td>
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*PERSPECTIVES*

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<td>• Amend text of the WTO agreements to explicitly accommodate climate measure</td>
<td>• Ensure climate-related technical expertise in WTO dispute settlement panels</td>
<td>• Intensify efforts under plurilateral approaches, particularly the Environmental Goods Agreement</td>
<td>• Amend WTO Agreement text to allow for BCAs</td>
<td>• Promote technical assistance and capacity-building related to fossil fuel subsidies</td>
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<td>• Adopt a WTO waiver for BCAs</td>
<td>• Enhance coordination between WTO and UNFCCC through more intensive use of existing forums</td>
<td>• Include climate-friendly provisions in RTAs under negotiation and in future RTAs</td>
<td>• Adopt a WTO waiver for BCAs</td>
<td>• Strengthen transparency of fossil fuel subsidies through enhanced disclosure</td>
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<td>• Adopt an authoritative interpretation of WTO provisions</td>
<td>• A temporary “peace clause” for trade-related climate measures</td>
<td>• Review and renegotiate RTAs towards contributing to the Paris Agreement’s implementation</td>
<td>• A temporary “peace clause” for BCAs</td>
<td>• Pledge and review of fossil fuel subsidies</td>
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longer-term initiatives to better align the trade and climate regimes, including through legal changes at the WTO.

### Using Existing Forums

While changes to trade law may be difficult to achieve, procedural reforms are more feasible. One option in this regard is to systematically strengthen coordination between the WTO and the UNFCCC through the more effective use of existing forums.

In the WTO, the Committee on Trade and Environment (CTE) offers the institutional setting for elaborating the relationship between trade and environmental measures to promote sustainable development. The CTE can also make recommendations on whether any modifications of WTO provisions are required to accommodate environmental concerns. Although climate change is not explicitly part of the CTE’s agenda, several issues relating to climate change, such as the environmental benefits of removing trade restrictions in the energy and forestry sectors, and the effect of energy efficiency labelling on market access, have been discussed in the CTE in the past. The CTE is open to all WTO members, as well as observers from intergovernmental organisations, including the UNFCCC Secretariat. However, there is still much scope to increase engagement with the UNFCCC Secretariat and, more generally, debating the substance of trade-related climate policies.

In the UNFCCC context, the parties created an “Improved Forum on the Impact of the Implementation of the Response Measures,” which allows them to share information on, and facilitate the assessment of, the negative impacts of climate policies, including potential effects on trade (Chan 2016). Although some trade-relevant discussions over the years have taken place in the context of the item on “response measures,” which allows them to share information on, and facilitate the assessment of relevant domestic measures on climate change. In the absence of legal reforms, any such “mandatory” inclusion of climate-related technical expertise in the Organisation’s dispute settlement panels. Panels already have ample discretion to seek information and technical (that is, economic, linguistic) advice from any individual or body. This discretion may be particularly helpful in the climate change context, considering the multi-disciplinary nature of the challenges involved. Given that, in the past, panels have requested expert advice from other international organisations, a panel could conceivably seek advice from the UNFCCC Secretariat as well.

Even though expert advice is generally advisory in nature and not binding on the relevant dispute panel, expert input could presumably play an important role in climate-related WTO disputes. By helping to clarify the technicalities of the climate measures under scrutiny—that is, their likelihood to contribute to greenhouse gas emission reductions—expert advice could strengthen the role of climate considerations in the dispute resolution process while ensuring that the measures under scrutiny truly contribute to climate objectives.

In theory, the inclusion of climate change expertise in WTO dispute panels could be accomplished under the existing WTO rules. But, in practice, this could be made more challenging by the ongoing impasse regarding the WTO’s Appellate Body: The Trump administration in the United States (US) is staunchly opposed to the appointment of new appellate body judges, arguing that the forum has consistently overstepped its remit with aggressive interpretations of existing rules. If the impasse continues, the body runs the risk of getting paralysed by December 2019 because it will not have the three judges required to sign off on rulings. However, given that the appellate body impasse has not stopped WTO members from initiating new disputes, or halted the ongoing work of the WTO dispute panels, we believe this option is still worth considering for ongoing and future climate-related disputes.

### Climate Expertise in Disputes

In the absence of legal reforms, it is likely that any conflict between the trade and climate regime will surface in the WTO’s dispute settlement systems, as has already happened in several cases related to clean energy and biofuels (Droege et al 2017).

Should that be the case, there is a window available under the WTO’s Dispute Settlement Understanding to include climate-related technical expertise in the Organisation’s dispute settlement panels. Panels already have ample discretion to seek information and technical (that is, economic, linguistic) advice from any individual or body. This discretion may be particularly helpful in the climate change context, considering the multi-disciplinary nature of the challenges involved. Given that, in the past, panels have requested expert advice from other international organisations, a panel could...
to voluntarily provide a gradually increasing amount of information on (the impacts of) their climate-related trade measures or trade-related climate measures. Members could also raise climate-related queries during Trade Policy Reviews (TPRs) of other members. In this way, the mechanism could enhance transparency regarding climate-related trade measures, which helps to build trust among WTO members that such measures are not being used for protectionist purposes. Importantly, various instances of environment-related disclosures are already found in TPRs. According to the 2017 edition of the annual environmental database published by the WTO Committee on Trade and Environment (WTO 2017a), out of the 20 countries whose TPRs were carried out in 2015, as many as 19 had incorporated environment-related information. Fossil fuel subsidies are also being addressed by some WTO members during TPRs. Broadly, the WTO membership appears to be increasingly open to environmental- or climate-related queries and revelations on a voluntary basis. Hence, the TPRM window appears to be a low-hanging fruit worth pursuing.

**Plurilateral Efforts**

Multilateral initiatives to address climate and trade interactions are challenging mainly due to the time-consuming process of decision-making involving many WTO members (164 at present). Given these challenges, advancing climate change objectives among a smaller group of like-minded WTO members through plurilateral agreements is an avenue worth exploring. Once a critical mass of WTO members gets on board, the WTO rule book provides scope to “multilateralise” the so-called “inclusive” plurilateral agreements that extend benefits to all nations on a “most-favoured nation” basis (Draper and Dube 2013). One notable example of such an agreement is the 1996 Information Technology Agreement, whose membership grew from 29 to 82, comprising the major trading nations in this area.

The Environmental Goods Agreement (EGA) is an “inclusive” plurilateral agreement under negotiation that has significant potential to advance the climate agenda, and that has also made some concrete progress. However, efforts to reach a deal on the EGA ground to a halt in December 2016, when participants, including the European Union (EU), US and China failed to find a landing zone (ICTSD 2016). Policymakers with a shared interest in supporting climate action under the aegis of the WTO could seek to revive the stalled EGA negotiations.

An inherent challenge of the EGA process is the lack of agreement on the definition of environmental goods. Many so-called “environmental” goods have dual or multiple uses, raising questions on whether eliminating trade barriers for these products delivers environmental results. Another question is how to define “environmentally preferable” products. These questions have led to lengthy and heated debates as to which goods should be listed under the EGA, as negotiations follow a list-based approach. To conclude the EGA negotiations, it is imperative that policymakers focus on resolving such fundamental issues and arrive at a landing zone, keeping an eye on the environmental implications of the agreement. New plurilateral agreements or cooperative engagements focusing on specific issues, such as border carbon adjustments and fossil fuel subsidy reform, could also be explored.

**Regional Trade Agreements**

Yet another avenue for advancing the Paris Agreement’s implementation is leveraging regional trade agreements (RTAs) between countries, including the so-called “mega-regional” trade agreements involving major trading partners. Compared with the multilateral trade system, such an approach allows for bargaining and opportunities for policy experimentation at a relatively small scale with like-minded countries. This could be done by incorporating climate-related provisions in RTAs undergoing negotiation, as well as in future RTAs (Gehring et al 2013; van Asselt 2017). This was done, for instance, in two recent free trade agreements signed by the EU with Japan and Singapore.

The RTA format could allow trade partners to align standards and regulations with a view to supporting the Paris Agreement (Morin and Jinnah 2018) and reducing transaction costs for companies. Merging the creation of new markets for climate-friendly technologies with a deepening of trade relations can potentially bring about additional economic benefits. Countries could also possibly review and renegotiate existing RTAs for this purpose. The recent renewal of the EU–Mexico Free Trade Agreement, which aimed at updating the deal signed in 2000, is a case in point (Financial Express 2018). Given that renegotiating RTAs, in general, may be a politically difficult proposition for some countries, their renegotiation for climate purposes alone may not be a highly plausible option. Instead, including climate-friendly provisions in new RTAs is arguably easier to accomplish.

**Border Carbon Adjustments**

Countries looking to lead on climate change tend to face political pressure from domestic constituencies when climate action is uneven across trading partners. Border carbon adjustments can help level the playing field and prevent emissions leakage, which occurs when climate action in one region merely shifts emissions elsewhere. They can do so by either imposing a tax or other carbon constraint on imports based on carbon content, or by exempting exports from domestic carbon constraints, or a combination of both. Not only can this alleviate concerns about emissions leakage, but it also creates an incentive for climate-laggard nations to adopt more ambitious climate policies (Holzer 2014; Mehling et al 2017; Mehling et al 2018).

BCAs have been periodically proposed, but they have also proven politically controversial in the past. Developing countries, in particular, have viewed this instrument with suspicion, seeing in it a potential channel for green protectionism. The divisiveness of BCAs makes any changes within the WTO regime that require consensus or approval from its membership all the more challenging. Given the current gridlock in multilateral trade negotiations, any meaningful progress on BCAs is, therefore, more likely to emerge at a regional level, with clubs
of like-minded countries advancing the concept on a reciprocal basis (Das 2015).

By working together on the design and implementation of BCAs (Cosbey et al 2019; Mehling et al 2017), such groups of countries could ensure that this approach avoids becoming a disguised form of protectionism. They could agree on accepted features of a BCA, such as the methodologies to determine the carbon content of traded goods and ways to calculate the adjustment for differences in climate policy ambition. Other agreed features could include the geographic and sectoral coverage, the timing, and the use of revenue from BCAs. One option to address the concerns of developing countries, for instance, would be to earmark the related revenues for climate finance transfers to developing countries (Grubb 2011).

A key element of such cooperation would be a reciprocal pledge not to contest measures imposed by one participating country of the Paris Agreement against another. With trade relations already frayed, and nationalist retreatment by countries such as the US, spilling over into climate cooperation, calls for BCAs have increased again in recent years. A measure which, only a decade ago, would have been considered politically too risky, BCAs may thus find new appeal among like-minded countries. Over time, these groups could expand, becoming a catalyst for broader and eventually multilateral action, and thus making BCAs redundant.

**Fossil Fuel Subsidy**

The adverse environmental, economic and social implications of the sizeable subsidies handed out by governments for the production and consumption of fossil fuels are increasingly clear (Jakob et al 2015; Jewell et al 2018). Although estimates by different international organisations vary, even the most conservative amounts are huge. For instance, an estimate by the Organisation for Economic Co-operation and Development pegged fossil fuel subsidies at $373 billion in 2015 (OECD 2018). As the main international organisation to discipline subsidies, attention has been drawn to the potential role of the WTO in addressing support to fossil fuels. However, as of now, no fossil fuel subsidy has ever been challenged under the WTO dispute settlement system (Verkuilj et al 2019).

The WTO’s disciplines on subsidies have thus far failed to address fossil fuel subsidies. Yet, putting fossil fuel subsidies on the international trade agenda could build support for the development of rules to phase them out in the longer run. A small group of WTO members has already taken the first steps in this regard. Fossil fuel subsidies are already addressed by some WTO members in the context of TPRs, and a group of 12 countries adopted a ministerial statement in 2017 signalling their intent to develop WTO rules on fossil fuel subsidies (WTO 2017b). More generally, subsidies at the WTO have been the focus of attention: WTO members are aiming to reach an agreement in 2019 on another form of environmentally harmful subsidies, namely fisheries subsidies. Moreover, complaints about Chinese subsidies show that government support for domestic industries remains an issue WTO members are eager to take on (Reuters 2019).

However, any initiative requiring consensus among all WTO members will be challenging in the short to medium term.

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term. This would rule out amending the Agreement on Subsidies and Counter-vailing Measures to include fossil fuel subsidies under the category of “prohibited” subsidies. Instead, a way forward would be to gradually expand the group of countries willing to address fossil fuel subsidies in the WTO to include members responsible for sizeable subsidies (such as China, the EU, India, and the US). Moreover, members can help increase transparency by voluntary notification of fossil fuel subsidies, and by continuing to include such subsidies in TPBPs under the TPRM. Doing so would help clarify the scope of the problem, while gradually building support for new rules.

Aligning Trade and Climate Change

We have outlined a set of policy options towards making the international trade system more supportive of climate action under the Paris Agreement. We argue that legal changes at the WTO appear to be difficult in the near future, particularly in the current geopolitical climate of trade wars among key members like the US and China, and the ongoing impasse regarding the appointment of new appellate body judges.

The low prospect of legal changes in the WTO does not mean, however, that all possibilities for the trade system to work for climate action are exhausted. It only means that other policy options need to be explored. Indeed, options that focus on ushering in procedural changes in the institutions and practices in the WTO and the UNFCCC appear to be politically more promising in the short to medium term. There is also ample scope for plurilateral agreements among a subset of like-minded countries under the aegis of the WTO; such agreements could potentially be multilateralised once a critical mass is reached. The plurilateral EGA still holds the potential to contribute towards climate goals if key players such as the EU and China gain the political will to resume the stalled negotiations. Another prospective option is to exploit the scope for leveraging regional trade agreements, with the EU setting an important precedent by increasingly integrating climate considerations in their new free trade agreements.

Our call for prioritising some policy options that would help to implement the Paris Agreement’s climate goals in the short term goes hand-in-hand with a call to keep all options on the table. In the end, improving the interplay between the trade and climate regimes will be a dynamic process: starting with the low-hanging fruit that is feasible in the short term can make other options more feasible in the medium and longer term.

In times of trade conflicts, negotiators and policymakers need to remain flexible and draw on fresh approaches to keep talks going. This situation, in which international cooperation on trade could suffer from a prolonged and worsening malaise, is likely to meet with increasing calls for aggressive climate action. We regard it as an imperative for the trade and climate regimes to be better aligned as they move forward.

NOTE

1 For a full explanation of our methodology, as well as a list of interviewees, see Das et al (2018).

REFERENCES


