

# TIME TO GREEN EU TRADE POLICY: BUT HOW?



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“Is trade bad for the environment?” is the simple question that was asked on July 11 to the 110 young professionals and students coming from 25 member States, who were participating to the Budapest European Agora. 40% of them answered yes. 37% answered no and 23% admitted they do not know. These results highlight the complexity of this relation. Time has come to democratise this debate and to put concrete solutions on the table.

This is all the more necessary that the 2019 elections have resulted in a rebalancing of political forces at the European Parliament which will necessitate to review the trade-environment nexus at EU level for several reasons:

- environment protection featured prominently among the political signals sent by the voters;
- it is, by essence, a global public good issue, better dealt with at EU level;
- the EU is seen as having so far exercised a leadership role in this area of global governance;
- trade is one of the few really “federalised” EU competences;
- as such, it remains the main EU lever to influence the global agenda, starting with SDGs

This is confirmed by noticeable developments since the elections, such as the new President of the Commission declaring that she is in favour of border carbon taxes (a first), or by the growing debate on the preservation of the rainforest that have surfaced as a result of the EU and Mercosur’s agreement reached after 25 years of bilateral trade negotiations.

Even if trade measures are not among the “first best solutions” to tackle environmental degradations, revisiting the EU stance in this area appears, both necessary and urgent, starting with climate change related aspects. This is also true about other issues such as biodiversity or ocean governance. It is a highly complex matter, necessitating deep analytical and technical investigations in several areas, new political debates, and search for operational and implementable solutions.

# 1 . THE TRADE/ENVIRONMENT DEBATE

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It has traditionally juxtaposed three schools of thought, which can overlap with each other and which may differ depending on sectors:

- the first side of the economic literature argues that, both trade and growth are inherently beneficial to the environment: following the Kuznet curve scheme, trade openness leads, through specialisation, to a more efficient utilisation of resources, including finite or fragile natural resources; growth leads to an increase of per capita income making homo economicus more disposed to address environmental degradations. Trade also allows for dissemination of green technologies (“technological effect”);
- the second one does not negate these effects, but considers that the gains accruing from more efficient productive systems are superseded by the negative and irreversible consequences of the expansion of international exchange (scale effect) stemming from transport, resulting from the growing multi localisation of production systems and from delocalisations linked to the heterogeneity of environmental conditions of production (carbon leakage, pollution, haven hypothesis and “environmental dumping”).
- the third one, while recognising merits in both approaches, states that the environment benefits of just obstructing trade are too modest compared to their apparent cost in terms of growth reduction. Only a radical transformation of the dominant economic growth model could address its negative impacts on the planet: new measure of growth or efficiencies, better valorisation of natural resources, transition to circular economy, change of diets and consumption patterns....

In theory, these different theses could be reconciled by levelling the global field in a way that internalises environmental externalities. A proper (ie high) carbon price would be, for instance, the most obvious instrument to obtain, on top of regulation, the market driven desired results for limiting CO<sub>2</sub> emissions. A new environment multilateral treaty encompassing and complementing existing multilateral environment agreements (MEAs) could also serve this purpose.

But while valid and worth pursuing in the long term this path is unfortunately not available any time soon. Both urgency and pragmatism advocate for a more diversified strategy if the EU wants to prioritise environmental protection more than in the past.

# 2 . AVAILABLE SECOND-BEST SOLUTIONS

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In the absence of a coherent and effective global system of specific disciplines and instruments able to preserve the environment, several policies and policy instruments are available at EU level to better combine the benefits of trade opening and increased environmental protection. Although they relate to both goods and services, the range of measures envisaged in this note applies to goods (including agriculture) for reasons of simplicity. Some of these measures could apply, mutatis mutandis, to services as well.

## a. Border measures

**Quantitative restrictions:** bans or trade restrictions are prescribed or authorised by various Multilateral Environmental agreements (MEAs) : CITES, chemical and hazardous substances, waste, biosafety etc. and could be expanded in some specific fields through multilateral or bilateral agreements, or even by unilateral measures in the case, for instance, of plastics or waste.

**Tariff modulations:** incentivising trade in environmentally friendly goods and technologies (lowering trade barriers on environmentally related goods) or penalising trade if it is unfriendly, can be achieved through tariff modulation. Ongoing Environmental Goods Agreement (EGA) negotiations at the WTO aim at specific tariff reductions, and this approach is also available to bilateral agreements or to unilateral action. The main difficulty lies in the technicalities of the measure of the environmental friendly/unfriendliness character of goods (for example water consumption of washing machines or carbon footprint of electricity powered cars or biofuels). Moreover, the elimination of Local Content Requirements (LCRs), notably LCRs weighing on goods related to the energy and/or ecological transition, would be a necessary step towards better global diffusion of environmentally related technologies.

**Border carbon adjustment (BCA):** this instrument would equalise the taxation of the carbon footprint of imports with the domestic one in order to avoid carbon leakage resulting from delocalisations or to address competitiveness concerns. Since 2008, the European Union has had several opportunities to delve into the question of the desirability of such measures. A communication of the European Commission assessing the risks of carbon leakage published on the 26<sup>th</sup> of May 2010 confirmed the early desire of the Commission to move forward in this direction. The Commission had already identified most of the challenges facing BCAs implementation, notably stating that : “the inclusion of imports per se into the ETS would need to be very carefully designed to ensure that it is fully compatible with WTO requirements” and that “It could be hard to implement a system which sought to define in detail the carbon content of each individual category of goods, but such precision might be required: this suggests that the system could at best only be envisaged for a limited number of standardised commodities, such as steel or cement(...)” (COM(2010) 265 final - Analysis of options to move beyond 20% greenhouse gas emission reductions and assessing the risk of carbon leakage).

Despite repeated efforts, notably those of Commissioner Laszlo Kovacs, this was never followed up. The main difficulties lie indeed in their high cost of implementation notably resulting from complexities of the measurement of the carbon content of production. They also lie in the knock on effect on EU exports in case such a system is also adopted by EU’s trade partners. How to account for carbon pricing and climate regulation in the exporting country? What will be the treatment of trade in case imports have a lower carbon content than comparable domestic production? And what would be the difficulties stemming from the specificities of the European Emission Trading System (ETS) with, in particular, its free allocations as compared to a more straightforward carbon tax?

**Environmental tariff:** in order to avoid the pitfalls of BCAs while keeping an incentive to level the playing field, this option consists in imposing a simple tariff on all imports from countries that do not respect, de facto or de jure, international environmental agreements, starting with the 2015 Paris agreement (Nordhaus option). Such a tariff could be graduated and modelled on the existing EU GSP (General System of Preferences), and should not penalise clean producers in foreign countries.

## b. Subsidies

Just as tariffs, subsidies protect producers from foreign competition or provide them with a comparative advantage; they can result in more or less favorable results for the environment.

**Fossil fuel or fishing subsidies:** both are examples of harmful subsidies where multilateral or bilateral disciplines are favoured by the EU, but where more decisive action could be taken, including via countervailing WTO regulated measures.

**Green subsidies:** international trade rules allow for subsidies in some areas such as research, regional or other legitimate policies. A similar waiver in the WTO lapsed in the 90's, which the EU, together with major trade actors could propose to review in order to foster policies aiming at protecting the environment.

**Agricultural subsidies:** the WTO system of “boxes” classifying subsidies according to their more or less trade distorting impact (“red”, “amber”, “green”) could be used to take in account also their environmental, negative or positive, impact on agricultural production practices.

## c. Bilateral (or plurilateral) trade agreements

Such agreements can be used to promote environment friendly policies (pro circular economy, green procurement, greener supply chains, for example deforestation free timber sectoral decarbonisation endeavors). A large number of Regional Trade Agreements like the United States–Mexico–Canada Agreement (USMCA), or the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) contain environmental provisions, from non-binding objectives to ambitious obligations under existing MEAs, or going beyond MEAs provisions. Some recent EU bilateral agreements (Japan, Mercosur) already go as far as transforming the voluntary nature of the Paris agreement into binding commitment in disposing that its implementation is an “essential element” which, if breached, can result in the suspension of the agreement.

Their implementation and impact could be better monitored via upgraded Sustainability Impact Assessments. This could be done in several ways, such as regular measurements of the environmental impact of new trade flows resulting from these agreements, opening impact assessment findings to public scrutiny via specific surveillance mechanisms involving NGOs, or even reviewing the content of an agreement if its impact is found to be negative.

## d. Non trade-related measures

- **Norms, standards, certification, labelling**

EU wide norms, standards, certifications and conformity assessments are, of course, the main regulatory tool to ensure the compatibility of production systems with environmental protection (as it is done, for instance in the sanitary or phytosanitary field) insofar as they are also imposed on imports and controlled at the EU external borders.

Additional measures could be envisaged using EU's market-powers, in the continuum of EU REACH regulation (n°1907/2006) on the use of chemical products, or Timber regulation (EU regulation n°995/2010), that requires EU traders who place timber products on the EU market for the first time to exercise "due diligence" (information, risk assessment and risk mitigation). The EU could, as suggested during the election campaign, directly place foreign companies exporting to the EU under certain obligations linked to environment and biodiversity protection.

Similar effects could accrue from moving from "fair trade" to "green trade" by establishing more stringent labelling or traceability requirements about carbon footprints (or production methods such as fishing) which would allow consumers to make a better informed decision.

- **Transport**

Regulating emissions from air and maritime transport, may have positive effects on carbon embodied in trade. The United Kingdom has recently set a zero-emission target for the ships built after 2025. It aims at prohibiting access to British waters to the most polluting ships and therefore at encouraging manufacturers to quickly adopt low carbon technologies. The United Kingdom, and the European Union if it decides to follow this example, could play a leading role in the pursuit of the goal of 50% reduction in emissions from shipping by 2050 as it was set in 2018 by the members of the International Maritime Organisation.

Even though they do not belong to the usual trade policy arsenal, these measures could help spread better environmental standards all along the value chains while avoiding inter-state more confrontational approaches.

## 3 . WTO COMPATIBILITY

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The Marrakesh Agreement, establishing the WTO in 1994, disposes in its preamble that trade opening should allow for the "optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development".

Article XX of the GATT allows for exceptions in favour of trade measures aimed at protecting human health, animals and the conservation of exhaustible natural resources.

Unless the WTO rules applying to measures such as those mentioned above are renegotiated, their feasibility is, as it should, conditioned by their compatibility with the existing WTO legal framework. It leaves open a rich field of controversy (and fees) among trade lawyers given that the WTO rulebook and its interpretation by the dispute settlement system allow for a policy space within which trade restrictions for the purpose of environment protection, if not explicitly allowed by MEAs, are available under some conditions which have often been litigated.

From famous decisions on shrimps and turtles in the 1990s to decisions on retreaded tyres in the 2000s, and to the December 2018 tuna-dolphin determination, the interpretation of these restrictions by the Appellate Body has evolved with time and with the growing international consensus in favour of environment protection towards an easier recognition of their legitimacy .

For instance, two products, one climate friendly and another not, can now be treated differently trade wise, as long as this is done fairly.

In a nutshell and to the risk of oversimplification, a trade measure aiming at protecting the environment, is now WTO compatible under two conditions to be appreciated on a case by case basis:

- that its trade impact is proportionate to the environmental damage it is meant to address;
- that it does not discriminate in favour of domestic producers (“no arbitrary or unjustifiable discrimination”).

Most, if not all measures suggested above could fit with these conditions provided they would be carefully calibrated.

## CONCLUSION .

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Greening the EU trade policy and its instruments covers a large scope of possibilities which could be rapidly explored by the new EU governance resulting from the 2019 European elections. Each of them will necessitate deeper expertise than it exists today, and likely heated political debates, as new trade agreements or measures will be proposed by the new EU Commission.

This will apply, if and when Brexit happens according to the existing exit agreement, to the next EU-UK trade regime which remains to be negotiated. A good and timely occasion, it seems, to build a new international benchmark agreement between partners sharing the same pro-trade and pro-environment convictions.

What will remain true is that trade regulations or measures can only bring a marginal benefit, or offset marginal costs, whereas in many cases intra EU wide regulations or carbon pricing remain more efficient policy tools.

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