

# Trade Law and the International Politics of Pricing and Clubs

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# Context

- UNFCCC: Achievements far from adequate when judged in light of the breadth and depth of the climate change problem.
- Extreme difficulties involved in serious bargaining among too many countries with diverse contributions to the problem, interests and capabilities.
- Welcome to the world of **'Climate Clubs'**.

# What are climate clubs all about?

- **What are Climate Clubs?**
- These are the ‘coalitions of the willing’ i.e. a set of countries that are willing to do “more”.
- The purpose is to achieve greater efforts in smaller groups than what is achievable multilaterally.
  
- **What will be the focus areas of these clubs?**
- Various proposals on the table.
- What’s common is the attempt to address the “free-rider” problem – arguably the greatest challenge confronting climate mitigation.



# How to tackle “free-riding”?

- By creating an incentive framework that induces reluctant countries to join and discourage free riding by them.
- How can such a framework be achieved?
- “Carrots” (exclusive benefits for members)
- “Sticks” (penalties on non-members)
  - Trade measures, e.g. **Border Carbon Adjustments (BCAs)**
- **Note:** BCA to tackle **competitiveness** and “**carbon leakage**” concerns has also emerged as a unilateral measure being contemplated by select developed countries (e.g. the US, EU) in the context of their domestic policies on pricing carbon.

# Politics of “carbon leakage” and BCA

- How big is the problem of carbon leakage?
- Well, the jury is still out when judged in light of the existing empirical literature (See for instance, Grubb, et al., 2009, Reinaud 2009, Sijm, et al., 2004, World Bank, 2008).
- That said, domestic political compulsions are a fact of life in the countries that are putting a price on carbon.
- At the international level, developing countries including China and India have expressed their strong opposition against BCA proposals by developed countries:
  - They consider such proposals as ‘**green protectionism**’ on the part of developed countries in the garb of climate action
  - They have hinted at **trade retaliation**
  - Raised voices at the UNFCCC and made formal submissions
- The negotiating text for Paris released in February 2015 also includes options on unilateral trade measures within square brackets.



# What role for trade law?

- Climate folks are nervous whether club approaches would violate the WTO law.
- Why nervous?
- Because the WTO has “teeth” in the form of a Dispute Settlement System which makes the WTO Agreements enforceable.
- By definition, clubs are discriminatory as between members and non-members, whereas the GATT/WTO system has **non-discrimination** as its fundamental principle:
  - Most Favoured Nation (MFN)
  - National Treatment (NT)
- **Can BCAs be WTO compatible?**
- The answer is: we don’t know for sure.
- Several reasons for uncertainty...
  - Can a carbon tax be adjusted at the border?
  - Can a BCA pass muster the National Treatment requirements?
    - Can products be regarded as “non-like” only on the basis of their differing carbon content? (See, Dhar and Das, 2011 for details)



## What role... ..

*contd...*

- Even if the BCA turns out to be violative of any GATT provision, it still stands a chance of being justified under the Article XX ‘General Exceptions’ provisions of the GATT.
  - Article XX allows a WTO Member to deviate from its GATT obligations for serving certain legitimate policy objectives, including environmental ones (XX(b) and XX(g))...
  - ...provided the conditions included in the *chapeau* (i.e. the introductory part) of Article XX are met.
- *Chapeau*: The measure is “not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade.”
- **This is the trickier part.**
- To sum up, **as for WTO compatibility, devil would finally lie in the details of the design and application of the BCA** (See, Dhar and Das, 2011 for details).



# How to overcome the WTO hurdle?

- Several ideas are being floated...
  - Amend the WTO?
  - Go for a WTO declaration/decision?
  - Exploit the waiver provision of the WTO?
- While the attempts to do away with the legal uncertainty have certain merits for sure, whether a potentially WTO-incompatible measure will ultimately end up under the WTO scanner would depend on a host of other **political, diplomatic and economic factors.**
- As one commentator has observed, “(t)he WTO dispute system can never deal with all violations of obligations. Many cases will never be brought; some cases will be settled before there is a ruling; some rulings will be negotiated away; and some rulings will be ignored.”
- Montreal protocol on Substances that Deplete the Ozone Layer, negotiated in 1987, is a case in point.



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# Carrots and sticks: need for a balancing act?

- The success of the **Montreal Protocol** may be attributable to an **effective combination of ‘sticks’ and ‘carrots’**:
  - provision for trade-based disincentives
  - side payments made to developing countries in the form of financial support and technology transfer.
- Since each international environmental problem is distinct, finding the right balance between carrots and sticks will have to be case-specific.
- Given the complexities involved in achieving this balance, club approaches may be much more suitable than the multilateral forum in doing the balancing act.
- As for the trade measures, to avoid overkill, club members could have a spectrum of trade measures to choose from, rather than sanctions only.
- Clubs could first exploit the carrots, keeping sticks as threats and last resort.
- Carrots focusing on finance, and technology transfer and other capacity building support in the club context may be worth exploring further.



# Climate clubs: risks and concerns

- **Fragmentation:**
  - Club approaches are not entirely new in the climate context.
  - Already there exists a plethora of bilateral and plurilateral initiatives giving rise to a decentralized “regime complex” (Keohane and Victor, 2011).
  - More clubs => More fragmentation
  - Concern: such a world could end up undermining the core principles and could lead to policy chaos due to fragmentation and conflicts in laws, defeating the whole purpose.
- **Environmental integrity:**
  - Success of club approaches in achieving the stated objectives would also depend in large measures on their environmental integrity and genuineness of purpose.
- **Trust deficit:**
  - As club approaches are exclusionary, they often suffer from suspicion and trust deficit.
- **Transparency:**
  - Lessons to learn from the increasing outrage against mega-regional trade deals.
- **Legitimacy:**
  - Multilateral fora like the UNFCCC score far better in this respect

# Case for leveraging the UNFCCC for “clubs”?

- In my view, this is a question worth exploring further.
- Legally speaking, there seems to be enough room in the Convention to accommodate a multiplicity of agreements (see Bodansky, 2009).
- One can take cue from the WTO, which was created as an umbrella of a range of agreements – most of which are multilateral, but some are plurilateral as well.
- **Advantages:**
  - **Legitimacy.**
  - Scope for utilizing the already established and/or evolving institutional framework and other resources – **no need to re-invent the wheel.**
  - **Provisions** may be created for non-members of the clubs **to assume ‘observer status’.**
    - Transparency
    - Much needed time and information, creating room for joining later
- After all, **it is not possible to stop climate change and totally transform the world's energy system unless essentially all countries are ultimately involved** (Victor, 2015).
- **It is, therefore, imperative for the club approaches not to vitiate the environment for cooperation.**



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*Thank you...*

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