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Round Table on Sustainable Development

CHAIR'S SUMMARY

**23rd meeting of the Round Table on Sustainable Development
Competitiveness, Leakage, and Border Adjustment: Climate Policy Distractions?**

**22-23 July 2009
Singapore**

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COMPETITIVENESS, LEAKAGE, AND BORDER ADJUSTMENT: CLIMATE POLICY DISTRACTIONS?

The following is a summary of the discussion on 22-23 July 2009, issued under the Chairman's authority. Please note that, in keeping with Round Table procedures, detailed conclusions will not be circulated.

Leakage is a problem

Emissions leakage is a problem, even though it is of indeterminate size, and it will need to be dealt with in some way. It presents a major political problem for developed countries and could have important social effects if it reflects needless relocation of industries from small communities which rely on those industries.

The political and potential social problems associated with leakage are compounded by the continued shift in emission intensive industries to developing countries. These industries are increasingly located in developing countries because that is where demand growth and commercial opportunities are strongest. Policies to minimise leakage become all the more important in light of these trends.

Global context is important for understanding when and how to respond

Debate over competitiveness and leakage problems and related policy solutions needs to be conducted within the context of international agreement and actions on climate change. These problems have little practical significance in a world where all countries take comparable action climate change. The international community is grappling with how to bring this about. Therefore it is premature for countries to talk about unilateral policy responses such as border adjustment.

It is only when the countries choose to stand outside an international agreement or not to comply with their international obligations that competitiveness and leakage are of real concern. This remains a risk, especially for countries in Europe that have pursued systematic emission mitigation policies in the absence of similar action elsewhere in the world, but it is a risk that does not need to be dealt with at this time.

Competitiveness and leakage also need to be understood as time limited concepts. As the world transitions towards stronger and more comprehensive global action on climate change measures to address these problems are of decreasing importance.

Border measures are not favoured

Border tax adjustment has some merit in that it can be seen as an extension of "national treatment" i.e. treating imported goods on the same basis as domestic production. It may also be useful if used as a compliance mechanism or as a means to address leakage on a sector specific basis. However, taxing carbon at the border may be an impractical and provocative approach to resolving competitiveness and leakage concerns and thus, on balance, it is not favoured.

Border measures could spark a trade war and this is seen as a very real risk given that taxing current emissions at the border would not account for different responsibilities of countries for the stock of greenhouse gases (GHGs) in the atmosphere. It is also likely that border measures would set off trade disputes at the World Trade Organisation, although some see this as a useful mechanism for disciplining policies rather than a risk to world trade.

It is possible to employ other measures to defuse competitiveness concerns of business. Free allocation is one such option and it has the major benefit of not inviting retaliation.

Behind the border measures are preferred but by no means perfect

Behind the border measures are the preferred approach for dealing with competitiveness and leakage concerns. For the most part this means free allocation of emission permits to firms in countries with emissions trading schemes. It could also mean other compensation schemes such as reduced tax burdens through accelerated depreciation for tax purposes.

While border measures may be likely to incite trade disputes, history shows that the most significant forms of retaliation in world trade have been related to subsidies and in this regard the stakes are high. Thus measures taken behind the border need to be carefully constructed so as not to provide export subsidies and incite retaliation.

Deploying assistance behind the border is complicated because its environmental effectiveness is enhanced, in terms of reducing leakage, if it is targeted at industry output. However this enhances the extent to which such measures can be interpreted as subsidies in the context of world trade rules.

These difficulties lead some to question if market based mechanisms, such as emissions trading schemes, complicate matters and whether emissions taxes would not be a less problematic and more feasible means of addressing climate change.

Other approaches for dealing with leakage

Pragmatic solutions are needed to address competitiveness and leakage concerns. In this regard, lessons can be learned from the experience of international trade negotiations where significant incremental progress has been achieved on difficult issues by honing in on key sectors and major markets. The international community could seek to address competitiveness and leakage concerns by focussing on agreements for those sectors and markets that are the source of much of the concern around competitiveness and leakage.

Multilateral effort important to manage the use of trade-related measures

The political imperative to deal with leakage and competitiveness concerns means that unilateral trade-related policies will continue to be part of domestic debates, whether border measures or behind the border measures. This suggests the need for a multilateral understanding on the use of such measures especially to prevent distracting disagreements over consistency with international trade rules.

The international community should recognise that countries are still learning how best to implement domestic emissions controls and how to deal with competitiveness and leakage concerns. Progress will be incremental and governments need some space to develop their policies. In this regard a moratorium on trade disputes over behind the border measures to address competitiveness and leakage concerns could ease the implementation of emission reduction policies. However the parameters of such a moratorium would need to be crafted very carefully to ensure they did not give the green light to protectionist or overtly discriminatory policies.

An international forum such as the OECD might also establish guidelines on best practice for policies to address competitiveness and leakage.

These issues should not distract from the task at hand

A durable, effective and comprehensive international agreement to avoid climate change is the most important task at hand. The better such an agreement is at addressing climate change the less important competitiveness and leakage concerns become. Thus, these concerns and any international debate around them must not distract from delivering a robust post-2012 international agreement on climate change.