

Trade and Environment Interactions: Governance Issues

Summary of the 35th Round Table on Sustainable Development¹
28-29 June 2017

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The 35th OECD Round Table on Sustainable Development gathered a group of trade, environmental and legal experts to discuss governance issues arising from the interactions between trade and environment, and how trade settings could better support climate goals. This note reflects views heard at the Round Table, which was held under the Chatham House rule. A background paper for the discussion is available [here](#).

Chair's suggestions for future work

A number of policy-relevant issues and priorities for further work were discussed that OECD committees, governments and other organisations could investigate to progress knowledge in the area of trade and environment:

- Precise technical barriers, if any, to using trade rules to limit trade in goods benefiting from environmentally harmful subsidies, and how they could be addressed.
- The extent of government support for fossil fuel exports through export credit schemes, and how this support could be phased out.
- Comprehensive assessment of how trade rules could be actively geared to improve environmental outcomes, including potentially through limits on the use of unilateral trade remedies against environmental goods, and “clubs” of countries collaborating on trade measures to drive climate mitigation.
- Further work on how regional and bilateral trade agreements could be “greened”, including non-environmental provisions with environmental impacts.

Main messages

- The systemic transformation implied by the Paris Agreement and Sustainable Development Goals will require all policy domains, including trade, to proactively contribute to improved environmental outcomes. The trade regime should not be expected to serve as a panacea for environmental challenges, but greater attention to social and environmental issues may help build public support for international trade.
- Different mechanisms are open under the WTO system to limit trade that benefits from environmentally harmful subsidies, and WTO rules on subsidies are strict, but participants were unable to identify a relevant case under the WTO dispute settlement system, or a case of unilateral measures having been applied with respect to relevant imported goods. Barriers

¹ This summary does not reflect the views of the OECD Secretariat or its member countries. The RTSD is grateful to i24c, an initiative of the European Climate Foundation, for its support.

appear to be political rather than technical. The fact that many government export credit systems continue to be dedicated in large part to fossil fuel exports further demonstrates the tensions at play. The prospect of using regional or bilateral trade agreements to limit environmentally harmful activities may be more promising, along with other international processes such as the G20's fossil fuel subsidy peer review process, or state aid policies.

- The WTO system already successfully accommodates environmental measures in a number of ways; fears that the WTO will block environmentally related trade measures may be overblown. However, more could be done to advance environmental goals. Examples include accelerating negotiation of the Environmental Goods Agreement, launching negotiations on additional plurilateral agreements in specific environmental areas such as climate change, and increasing emphasis on incentives and flexibility under the WTO system to “bring countries along” through technical assistance and capacity building. The proliferation of unilateral trade remedy cases related to environmentally friendly imports that benefit from government support (e.g. the imposition by governments of countervailing or anti-dumping tariffs on imports) may have a detrimental environmental impact by raising prices and potentially reducing consumer choice; governments might reconsider their use on a unilateral or plurilateral basis.
- Regional and bilateral agreements are also relevant to gearing trade rules to actively promote environmental outcomes, but many existing environmental provisions have little practical impact. The environmental impact of trade agreements is determined by more than dedicated environmental provisions or chapters. There is therefore a case to assess how non-environmental provisions with environmental impact could be “greened”.
- There are a number of trade measures that “clubs” of countries could implement to drive climate mitigation. Examples include agreement on non-actionable environmental subsidies (i.e. subsidies that countries would agree not to challenge), lowering of tariffs and addressing certain non-tariff barriers related to environmental goods and services. Approval of other WTO members may be required, depending on whether their rights or obligations under the WTO system are impacted by the proposed arrangements. Agreeing to use border carbon adjustment is another possibility, but remains contentious on technical as well as political grounds. Participants emphasised that policies that distinguish between products on the basis of production and process methods (PPMs) are permissible under the WTO; countries have in fact introduced such measures related to fuel-quality standards, for example.
- Using the international trading regime to improve environmental outcomes may entail risks from both a trade and environment perspective if not well managed. Governments should be targeted and strategic in promoting environmental goals through the trade regime. Capacity building is likely to be required to help trade experts make policy or adjudicate cases on environmental issues.

Overview of points heard at the Round Table

What role for trade in advancing environmental objectives?

Trade rules can be pursued with a view to improving environmental outcomes multilaterally through the WTO, through plurilateral, regional and bilateral agreements, or through domestic trade laws. They can support environmental goals by prohibiting environmentally harmful activity (e.g. through restrictions on trade) or permitting activities that support environmental objectives. The

Convention on International Trade in Endangered Species of Wild fauna and Flora is an example of the former, but such examples are rare.

A preliminary consideration is to what extent it is the trade regime's role to tackle environmental issues: is the environment predominantly a matter for environmental policy? Should the focus be on removing inadvertent barriers to environmental action that arise from the trade regime, or can a more proactive role be envisaged? Do we risk seeing the pursuit of protectionist agendas under the guise of environmental protection, or encumbering trade agreements with broader economic and social considerations that may be better addressed elsewhere? At the same time, the WTO's dispute settlement system is designed to help guard against protectionist measures, and bilateral or regional trade agreements increasingly include investment and other clauses.

How governments respond to these questions will determine the scope of action on environment from the trade perspective. There is a case and expectation for strong action given the fundamental transformation implied by the Paris Agreement and Sustainable Development Goals. All policy domains, including trade, are implicated in the required, systemic shift. The significant economic changes required could become legitimate considerations for countries that envisage improving their trade relationships. As an example, the EU has adopted a mission-oriented approach to innovation policy; could trade policy follow a similar path? Continuing to operate in silos and failing to recognise that the distinction between trade, environment and social interests is increasingly blurred risks enhancing public discontent about trade, unless remedied. The title of the EU-Canada Comprehensive Economic and Trade Agreement (CETA) is a nod to this approach (although the French government is establishing an expert committee to consider its environmental impact, which may bring lessons for future trade agreement discussions). Proactively addressing environmental issues could improve legitimacy and public acceptance of trade agreements. Trade measures should not, however, be seen as a panacea for environment, as many damages to the environment – in particular the global climate – are best addressed through dedicated domestic measures.

Participants disagreed whether the international trade regime can advance further than countries have been willing or able to unilaterally, or whether the focus should be on moving forward on both the international and domestic fronts simultaneously. Should domestic trade policy be the focus? One advantage of transcending domestic policy is that it can help guard against national-level lobbies. One participant raised the example of the use of EU state aid rules as a mechanism to challenge support to fossil fuel industries, absent which many clean tech companies would lack an avenue to challenge government support to their incumbent competitors. A further advantage would be to help address environmental challenges that governments cannot solve unilaterally, such as climate change.

Using trade rules to limit trade in goods benefiting from environmentally harmful subsidies

Assuming political will to gear the trade system to more proactively support environmental goals, the WTO system offers different mechanisms to limit trade that benefits from environmentally harmful subsidies. Enforcement of prohibited subsidies through the WTO dispute settlement system is one of these, but to participants' knowledge there has never been a dispute brought against fossil fuel subsidies under the WTO dispute settlement system. There are a number of possible explanations for this. Certain countries that may have an interest in mounting a challenge, such as members of OPEC, have only recently joined or are not yet members of the WTO. The principle of "like products" may limit the scope of potential action because it may be difficult for a fossil fuel exporter to challenge production subsidies that support a different fuel. For example, an oil exporter could not challenge domestic support for coal despite the fact that both products supply energy, because they are not "like" products.

There may be a perceived issue of mandate; the WTO's mechanisms to challenge government subsidies are aimed at measures that cause injury to competitors through trade distortion rather than those that are detrimental to the environment. Finally, participants noted that there may be an element of "people who live in glass houses shouldn't throw stones"; governments that provide support for fossil fuels production and use in their own jurisdictions may be reticent to take action against foreign governments for fear of retaliation.

The use of countervailing measures to offset injury to domestic industry from subsidised imports under the Agreement on Subsidies and Countervailing Measures (SCM Agreement) is an additional avenue. Similarly, it appears that there are no cases of unilateral measures having been applied with respect to imported goods benefiting from fossil fuel subsidies. Fossil fuel incumbents are often large, multinational companies with activities across multiple jurisdictions, meaning that they may be less likely to seek the application of unilateral measures such as countervailing duties against imports from other countries. It is not clear how consumer subsidies might be considered to have an adverse impact on a complaining state's products under the SCM Agreement (and therefore be actionable), given that they encourage greater consumption of a product.

The prospect of using regional or bilateral trade agreements to limit trade that benefits from environmentally harmful activities is perhaps more promising. The proposed fisheries provisions in the Trans Pacific Partnership (TPP) provide an example. The TPP prohibits subsidies that negatively affect overfished stocks, or that are provided to a vessel listed by a state or relevant organisation for illegal, unreported or unregulated fishing. Fisheries subsidies are also being discussed in the WTO as part of the Doha round, with the possibility to challenge subsidies without having to prove adverse trade effects, i.e. on environmental grounds alone. Banning subsidies for environmental rather than trade effects would represent a "game-changing" shift in the WTO context, but in the fisheries context remains subject to the ability of countries to reach agreement on difficult issues such as definitions of overcapacity and illegal fishing.

There is a question whether prohibition of environmentally harmful subsidies under WTO rules more generally as beneficial for both trade and environment would require a new mandate, i.e. political will among members to negotiate to this conclusion. The history of the discussion on fisheries subsidies which emerged in the context of the Committee on Trade and Environment, could be instructive in this context.

Ultimately, the barriers to using the trade system to challenge environmentally harmful subsidies appear more political than technical. The challenging political economy of environmentally harmful subsidies is likely to have implications for any further action under the WTO. Some groups of countries such as the Friends of Fossil Fuel Subsidy Reform have already been active in trying to get the issue on the WTO agenda.

A further misalignment in trade policy is that government export credit systems that support national exporters competing for overseas sales continue to support fossil fuel-based technologies. This issue would need to be addressed as part of any comprehensive reform.

Gearing trade rules to actively improve environmental outcomes

Emphasis is often placed on the constraint that multilateral trade rules represent from an environmental perspective, but a number of participants stressed that the WTO already successfully accommodates environmental measures in a number of ways. For example, around a third of specific subsidies notified to the WTO under the requirements of the SCM Agreement are climate-related. Very

few, if any, have been challenged as of trade concern under the agreement. WTO cases confirm that governments can “condition” preferences afforded to developing countries under the Generalised System of Preferences with environmental requirements or standards. Where governments implement domestic standards that are consistent with an international standard negotiated outside the WTO framework – including environmental standards – such standards are presumed to be WTO-consistent even if they restrict trade.

Beyond the issue of environmentally harmful subsidies discussed above, there is room to use existing WTO rules more proactively to environmental ends and help build momentum for improved environmental outcomes. Greater use could be made of the international standards exception noted above. Governments could introduce environmental terms and conditions as part of ongoing General Agreement on Tariffs and Trade (GATT) tariff negotiations, for example in the agriculture sector. Bringing the negotiation of the Environmental Goods Agreement on the liberalisation of trade in environmental goods to successful conclusion is an obvious further example of how the WTO can facilitate environmental objectives. The WTO’s enforcement system is particularly appealing when compared to that of multilateral environmental agreements. The WTO has already concluded an agreement eliminating import duties in the IT sector (Information Technology Agreement) that benefits from the WTO’s broader dispute settlement and transparency regimes – although what constitutes an environmental good may be less objective than information technology products, and has so far proved more challenging to negotiate.

Additional plurilateral agreements led by a subset of like-minded WTO members could advance policy in specific environmental areas such as climate change (see below). Increased emphasis on incentives and flexibility under the WTO system could also be beneficial. The Trade Facilitation Agreement, which entered into force in February 2017 and aims to simplify, modernise and harmonise export and import processes, represents a departure from previous trade practice in enabling differentiation between countries, and providing for technical assistance and capacity building. The Agreement opens the door to more co-operative, tailor-made approaches that could support enhanced environmental ambition under the WTO system, taking into account differing country capacities and through a plurilateral “coalition of the willing” route. The EU’s Forest Law Enforcement, Governance and Trade Action Plan, which focuses on the legality of trade (in illegally-logged timber products) as opposed to enforcement of higher environment standards, could also serve as a model.

Regional and bilateral agreements also have a role to play. Many environmental provisions in these agreements currently have little practical impact, or are poorly monitored and enforced. Provisions beyond those dealing directly with the environment, such as investment or subsidy provisions, can also have an environmental impact. Further work is needed on how trade agreements could address non-environmental provisions that may have negative environmental impacts. The French government has decided to establish an expert committee to assess the environmental impact of the EU-Canada CETA, spurred by civil society and public concern about potential downward pressure on national environmental policy stringency from mechanisms in the agreement (e.g. investor-state dispute settlement, programme to harmonise regulation). One participant flagged the possibility of parties agreeing to limit emissions arising from an FTA or ensure carbon neutrality.

Unilateral trade remedy cases related to environmentally friendly imports that benefit from government support are proliferating (e.g. the imposition by governments of countervailing or anti-dumping tariffs on imports). While “legitimate” under trade law, such cases are likely to have a detrimental environmental impact by raising prices and potentially reducing consumer choice. There

may be a case for governments to reconsider the use of unilateral trade remedies in cases concerning environmental goods, or agree to parameters to limit their use.

Could a “club” of countries use trade measures to drive climate mitigation?

If proposed arrangements for a climate “club” impact rights or obligations of WTO members outside the club they would require the approval of other WTO members. Two types of club commitments can be envisaged. First, agreement on non-actionable environmental subsidies through, for example, a revived and revised SCM Agreement Article 8 (Identification of Non-Actionable Subsidies), or agreement to allow local content requirements attached to subsidies or trade-related investment measures for climate- (or environment-) related measures. Such measures would need a great deal of circumscription to guard against abuse, for example by making them time-bound. Club members could also agree on the use of border carbon adjustment, together with carbon accounting methodologies, and on the scope and modalities of carbon pricing mechanisms. Participants disagreed on the scope of such measures and on their effectiveness vis-à-vis existing measures to mitigate competitiveness impacts of carbon pricing.

There are other types of club commitments that would not need WTO approval, as they would not impinge on the WTO rights of non-club members. These include agreement on elimination or reduction of fossil fuel subsidies targets, for example through pledges, reporting or review mechanisms; common product efficiency standards for consumer and industrial products; and lowering of tariffs and addressing certain non-tariff barriers related to environmental goods and services, such as regulatory barriers. Capacity building for least-developed club members to help exporters meet environmental standards, agreement on the public nature of intellectual property derived with public research funds and agreement on international co-operation in research and technology transfer are also relevant.

No such climate clubs have yet emerged, let alone implemented trade measures to support their ambition. Some coalitions are starting to form, however, such as the Carbon Pricing Leadership Coalition. Whether there is a role for trade tools in existing coalitions is not clear. The climate agenda could be raised more specifically in the context of the EGA agenda as a starting point, or greater emphasis given to the potential role for key countries as champions to drive the agenda forward.

Border carbon adjustment is a contentious potential measure. There are questions over whether governments have access to enough information to support such measures – although participants noted that measures on only a small number of energy-intensive products such as steel and aluminium may be sufficient. It is also unlikely to be a question of coming up with a single global standard of sustainability. Others noted that border carbon adjustment may be a defensive or adversarial starting point from which to drive global ambition, as opposed to a more positive agenda focused on diplomatic pressure through increased climate ambition in club countries. Border carbon adjustment would also implicitly undo the notion of common but differentiated responsibilities under the UNFCCC. There remains little evidence on the scope of carbon leakage, and hence the problem to be remedied, although more stringent policies may increase risk. Border carbon adjustment could provoke new industries designed to “game the system” (e.g. by re-labelling or re-routing of products). Some argued that standards on the carbon intensity of key industrial products for which climate policies would have a material impact. Such an approach was adopted with respect to conflict diamonds, and the WTO accepted a waiver. However, there are greater commercial interests at play in fossil and carbon-intensive industrial activities, which may result in greater resistance. There is some discussion that California is considering implementing a border carbon adjustment mechanism for post-2020, which would generate valuable lessons on these and other issues.

Do risks arise from using the international trading regime to improve environmental outcomes?

Closer integration of trade and climate regimes could have negative as well as positive implications from an environmental perspective if not well managed. Taking environmental issues up more proactively in trade agreements may raise questions of accountability and the ability of trade experts to make decisions or adjudicate cases on environmental issues. Environmentally-related domestic trade measures imposed by strong trading partners could run afoul of the WTO's special and differential treatment provisions or the UNFCCC's principle of common but differentiated responsibilities (a "might is right" effect). Linking the environmental agenda with the trade agenda may risk prioritising protectionist measures over environmental goals and is likely to be a slow route given the pace of international trade negotiations. Plurilateral, regional or bilateral measures may be more expedient.

There is also potential for adverse impacts on the trade side. For example, there may be a risk of detracting from major trade issues that are not yet resolved, such as unfair competition through agricultural support measures. There may be an expectation that the trade system should address a host of other, "non-core" trade measures, or fear that environmental requirements could act as a break on free trade.

Nevertheless, the transformation implied by the Paris Agreement and SDGs will mean that trade – like other policy areas – will need to positively resolve tensions with these ambitious objectives. Certain impacts on the trade regime may be inevitable, but care should also be taken to protect the important role of trade in promoting growth in a way that is climate-consistent. Being targeted and strategic in promoting environmental goals through the trade regime will likely assist.