

DESIGNING WTO-COMPATIBLE BORDER CARBON ADJUSTMENT LEGISLATION

Benefits, Challenges and Recommendations

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After the signing of the Paris Agreement in December 2015, many governments and subnational jurisdictions are intensifying their efforts to adopt measures to reduce carbon emissions. The global momentum to phase out carbon-intensive technologies, transition toward low-carbon economies and hold energy-intensive industries and carbon emitters accountable for their emissions is now greater than ever before. Private actors and industries have put together contingency plans for a low-carbon future and are increasingly prepared to work together with governments to transition as smoothly as possible to environmentally and economically sustainable production methods.

In view of the above, the Government of Canada and Canadian provinces adopted the Vancouver Declaration and are committed to collaborating for a pan-Canadian approach to carbon pricing.

Carbon pricing poses significant challenges to Ontario legislators and Ontario businesses alike. Some of the concerns raised in view of carbon pricing legislation are:

- accurately measuring carbon emissions for individual products;
- addressing problems of competitiveness vis-à-vis imports whose producers do not have to comply with equally strict environmental measures or any environmental standards at all, and can thus afford to be sold at lower prices;
- creating and sustaining the administrative infrastructure to monitor carbon emissions in the cap-and-trade system and to limit and penalize industries that do not comply with their obligations;
- tackling the phenomenon of carbon “leakage” (that is, where the lack of environmental legislation is seen as a comparative advantage and businesses respond to taxation measures by either relocating to jurisdictions that do not impose similar environmental standards or by switching to the production of less carbon-intensive products to avoid taxation, while the products previously produced continue to be imported: the net effect is that carbon reductions in one region are offset by “hot spots” in others, and global carbon emissions remain the same — thus not remedying the problem at all);
- addressing concerns about limitations to consumers’ purchasing power as a result of carbon pricing measures, especially low-income families who feel such legislation impacts them the most; and
- preventing market actors from engaging in arbitrage. This is particularly burdensome in cases of multiple jurisdictions with different currencies, and concerns have been raised with respect to the US and Canadian dollars and the Western Climate Initiative.

Many of these concerns could be addressed through the adoption of border carbon adjustments (BCAs). BCAs are tax measures imposed on identical imports at the border, when the same domestic product is impacted by carbon pricing legislation. Such legislation holds foreign products accountable to the same standards as their domestic counterparts.

Although in the past such measures were seen with skepticism by the World Trade Organization (WTO), there currently exists significant legal and policy space and, more importantly, institutional will to approve carbon-reducing legislation at the WTO level.

The ongoing research of CIGI's International Law Research Program has been exploring the specific legal parameters of BCAs and suggests that the impact of carbon pricing and BCAs at a national level would result in the following positive outcomes:

- these taxes would induce regulatory changes worldwide, as countries seek to shield their industries from loss of competitiveness;
- once a critical mass of countries has adopted carbon pricing mechanisms and BCAs are applied to those that have not adopted similar measures, carbon emissions will likely be significantly lower and carbon-intensive production methods will progressively become less economically sustainable for carbon havens;
- revenues from BCAs can contribute to assistance and incentives for medium- and low-income households to adopt a greener lifestyle; and
- revenues can also be used to help make Canadian cities greener, through funding more parks and local gardens that act as carbon sinks, better public transportation systems and environmental education programs throughout the educational system.

The following policy proposals are recommended to the Government of Ontario regarding BCAs:

- actively participate in and pursue pan-Canadian carbon pricing options, at least on carbon-intensive products;
- explore more regional carbon pricing alliances (for example, by expanding the Western Climate Initiative);
- propose economic and environmental impact assessments on carbon-intensive products;
- initially focus on carbon-intensive products (such as cement, gas and steel) originating from jurisdictions where there is complete lack of legislation on carbon emissions, as it will be easier to adjust the entire domestic price for carbon without requiring rebate mechanisms;
- conduct a study on Canada's and Ontario's overall trade dependency from countries that export the most carbon-intensive products, in order to suggest which products are strategically optimal to target;
- as Ontario has adopted a cap-and-trade system, consider assessing the exact price impact of the cap-and-trade system on the most affected industries and their products. This will help determine the product-by-product (instead of industry-specific) carbon price, and will simplify the application of the BCA at the border for the same imported products; and
- consider the option of a carbon tax, in addition to the cap-and-trade system, that could target, for instance, carbon- or energy-intensive products not affected by the cap-and-trade legislation.

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