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Reflections on Climate Change and Trade

Let me start with a general comment that is relevant as background to the theme of this book, and then move on to some of the specifics of the interface between trade, the World Trade Organization, and the environment that many of the chapters above have addressed. At the outset, we need to remember that those who work on trade (mostly academics) and those who work on the environment (mostly activists) have traditionally been at loggerheads from time to time.

Why? One important philosophical difference that underlies much of this tension, which I think we tend to forget, is that trade economists are typically considering and condemning governmental interventions (specifically, protectionism, such as the imposition of tariffs and nontariff barriers) mainly as *creating* distortions and harming the general welfare. Conversely, environmentalists are typically dealing with what are best described as "missing markets" (for example, people dump carcinogens into lakes, rivers, and oceans and emit them into the atmosphere, and they do not have to pay for the pollution). Therefore, they see government intervention (for example, the use of pollution-pay taxes or the use of tradable permits) as *correcting* a distortion. It is useful to recall this fundamental difference in the experiences and lifestyles of the people on the two sides of the trade-and-environment aisle, because it underlies and explains, to some extent, the occasional frictions between them.

Of course, trade and the environment are integrally related, and that is why many disputes were coming up at the General Agreement on Tariffs and Trade (GATT)—the most important being, of course, the celebrated dolphin-tuna case between the United States and Mexico. I will return to the important issues raised by the dolphin-tuna jurisprudence and its later reversal in the shrimp-turtle dispute, also involving the United States. But let us start with the problems raised by global warming.

In his comment on chapters 5 and 6, Daniel Drezner points out that, in the past, America has opted for short-run adjustment costs with a view to long-run gain. I do not quite know what he means by "short-run adjustment costs," but

I would simply say that an enlightened hegemon like the United States, when going in for the GATT, certainly did not insist on the developing countries having reciprocal obligations. It simply gave away membership. It was, in fact, getting the developing countries into the GATT while gaining nothing in terms of an immediate, reciprocal opening of markets.

I think the intention was to create more legitimacy for the GATT by increasing membership. Down the road, then, you would have graduation and begin to "collect"—via what is called extended reciprocity or intergenerational reciprocity. There were no short-run costs à la Drezner either. After all, the developing countries at that time, in the mid-1940s, were not important markets anyway; nor were they, by and large, major exporters. They were really small players in world trade, and it was only later, when they had grown, that the usual question of reciprocity would become economically relevant.

So one may ask why this argument does not work with the Kyoto Protocol at the moment. Why are we not willing to play that old GATT game? I think we need to look into this question carefully to get a sense of where the problems might be with how we approach the design of the successor pact to Kyoto—what I like to call Kyoto II.

A key problem, of course, is that there are two big players, India and China, with current and prospective emissions of carbon dioxide that are simply large for India and huge for China. We did not have anything like this at the time the GATT was formed; then, as noted, the developing countries were all little players in trade, for all practical purposes. Exempting India and China from the emission obligations of a climate change treaty today is thus not like exempting the developing countries from trade obligations in the 1940s. Moreover, India and China are not willing to make any payment to get into the Kyoto club, as it were, simply because they feel—and this is where, I think, the real crux comes in—that they did not contribute to past environmental damages.

Now, if one looks at the past environmental damages, it is clear that the accumulated fossil fuel carbon dioxide for 1850 to 2005 shows the damage attributable to India and China is about 10 percent, whereas the countries now belonging to the European Union, Russia, and the United States jointly account for over 60 percent. So you have basically what I have called a "stock" problem,[1] the problem of "past" damage to the environment—for which America and the EU, basically, are particularly responsible. And the solution to this "stock" problem in the Kyoto Protocol, which was devised to bring India and China on board, was to say, "Look, because we were the ones who imposed large losses on the environment in the past, and not you, we will exempt you from any 'flow' obligation for reducing the current damage, no matter how large."

1. This was in a center-page *Financial Times* op-ed article in August 2006.

Now, the problem is that, in so designing the Kyoto Protocol, its framers were trying to kill two birds with one stone. And, of course, that stone is not something palatable—to mix metaphors—to the U.S. Congress. The U.S. Senate virtually unanimously rejected Kyoto in 1997 because its members thought that India and China were going to be free riders, when in fact the free ride was being provided because they had not been riding for almost a hundred years while America had been! I think that the general feeling instead was that these countries were being let off simply because they were developing countries, presumably on a progressive taxation ground; but progressive taxation has become increasingly a hard sell (though the Barack Obama administration may well restore it to some respectability).

In sum, India and China were *not* free riders. Rather, their governments were saying to the Western nations: "Look, you have done a lot of damage. You've got this 'stock' liability for past emissions. And you cannot just get us to accept significant 'flow' liability for current emissions while you do nothing significant on the stock side."

Thus, I have always felt that the Kyoto Protocol was doomed, in a way, because it really could not be effective, as designed, until we addressed this particular basic issue clearly and directly in a transparent manner—forgoing the fudge that mixed up the stock and the flow dimensions of the obligations. And I think this problem is going to afflict Kyoto II as well. Frankly, what we are negotiating so far shows little willingness on the part of today's rich, developed countries to accept the notion that they must pay for past damages; and so it would be little short of ethical nonsense for them to ask India and China to accept much larger flow obligations.

Now, this unwillingness to face up to the liability for past carbon emissions is rather strange, in the sense that the United States has already accepted,[2] in its domestic environmental practice, the superfund approach under which, for hazardous waste, liability has been assigned, in eligible industries, for past damages, even when the pollution was not regarded at the time to be harmful. America is a nation that thrives on torts; indeed the Democratic Party does also, and it cannot be denied that America has actually accepted the superfund approach in its own environmental policy.

So, in my judgment, for us to go around saying that India and China have to accept obligations on the flow side—which I think is perfectly appropriate—while doing nothing like a substantial superfund for past carbon emissions on the stock side, is to invite condemnation as a superpower play by nations, both the EU members and the United States, that are no longer quite the superpow-

2. I noted this in my 2006 *Financial Times* article.

ers that they were once. You really need to walk on two legs and not just on one leg.

I see statements all the time, from even Al Gore and Bill Clinton, about the desirability of China and India accepting flow obligations. But unless I have missed something, neither has publicly acknowledged the need for a substantial superfund for the U.S. stock liability. So much for their environmentalism: self-serving for the United States, not cosmopolitan and just.

Now, the same problem arises in trade negotiations because India, and several developing nations, say to America, "How can you have to this day sizable trade-distorting agricultural subsidies, and then expect us to open our agricultural sector to competition from such subsidized exports by you?" In fact, the Doha Round multilateral trade talks collapsed in August 2008 precisely because India claimed that nearly two-thirds of its people were in the farming sector, most were subsistence farmers, and the United States had only 2 million, often large, farmers with much larger subsidy support. So, India wanted a special safeguards mechanism that, in my view, was excessively cautious, citing our subsidies. Remember, of course, that the United States itself had introduced special safeguards against China; and that nothing works better to get protection than to allege, often without any basis, that the exporters are "unfairly" subsidizing exports to us. Yet, when the talks collapsed, the U.S. trade representative and an obliging media, and Congress in turn, zeroed in on India as the rejectionist culprit.

So, as one draws analogies between trade and the environment, it is necessary to remember that unless America brings to both negotiations, each of which is extremely important, the notion that it cannot just impose what it wants on others, often to its presumed advantage regardless of the others', it is likely to meet with failure. Charles Kindleberger famously called the United States an "altruistic hegemon." I fear that it has increasingly tended in recent years to become a selfish hegemon.

I should add that it is not just the United States that is a problem. I see little attention being paid to the stock problem in Europe either. As then–senator Obama said about Senator John McCain: He is a good man; it is just that he does not get it. Thus, when I was in Florence recently, and Tony Blair was in the chair and talking about what he was doing on the environment, Kishore Mahbubani, myself, and others from the developing countries drew his attention to the superfund idea. He continued through the session as if he had heard nothing. As then–senator Obama would have said: Prime Minister Blair just does not get it. But unless he, Gore, Clinton, and others do get it, do not expect that Kyoto II can be signed and ratified by India, China, the United States, and European Union.

Now, let us turn to the problem raised by the notion—fashionable in Congress these days—that if India and China do not accept green house emissions obligations, America would impose a "border tax," better called an import duty, that is equal to the carbon tax that they are not imposing in sync with America's. This is, of course, like the idea that the French floated against the United States, saying they would tax American exports to the EU because America had not signed the Kyoto Protocol. This issue, of course, takes us back to the tuna-dolphin case in 1991 at the GATT. When tuna-dolphin came up, the environmentalists were terribly upset that the United States lost the case. At that time, I happened to be the economic policy adviser to Arthur Dunkel, the director-general of GATT. And so I was consulted by the legal adviser, Frieder Roessler, on the ongoing case and what the position of the GATT Secretariat should be. The focus at the time was whether specific process and production methods (PPM) should be allowed to be prescribed for import eligibility—that is, could the United States specify that tuna should be allowed to be imported only if purse-seine nets that also caught dolphins were not used?

Coming from the economic side, I felt that PPMs, as a general case, should not be allowed to be so used to regulate the entry of imports because they could thus be used to discriminate against specific suppliers while appearing to be nondiscriminatory. After all, those involved in international trade have all been brought up on the famous apocryphal example (based, however, on a real case) of imported cheese being taxed by Germany if it was produced by cows grazing at 4,500 feet and above, with bells around them and under Alpine conditions. This was obviously aimed at Swiss cheese, although, in principle, if Tanzania were to satisfy the conditions, Tanzanian cheese would be equally subjected to the same high tariff. The use of the PPM could then defeat the intent of nondiscrimination required by the GATT.

So we were coming at the PPM issue from the trade side, because the GATT was a trade institution. And we did not really think of the environmental aspect specifically at that particular point (except that, if the issue fell under Article XX, greater leeway was permissible).

Thus the position we took was that the legitimation of a free use of PPMs to regulate imports would open the door to the indiscriminate use of de facto discrimination in trade among different suppliers, undercutting the basic principle of nondiscrimination underlying the GATT. Anybody could say the way you produce something, no matter how or why, is unacceptable. We could not see how de facto discrimination could be contained; it could proliferate hugely.

But the shrimp-turtle decision years later, by the Appellate Body of the World Trade Organization, basically reversed the dolphin-tuna jurisprudence, ignoring our caution. It meant that we would now be opening the floodgates for all

kinds of PPM prescriptions that would afflict anyone, on any issue (though we had also argued that the situation would be asymmetrical between weaker and stronger nations because it was unlikely that the weaker nations could take on the stronger nations in this essentially arbitrary fashion—a worry that has also been expressed by prominent nongovernmental organizations in the developing countries).

I was among the few who thought that this decision was ill judged, revealing the weakness of an Appellate Body where familiarity with legal jurisprudence and practice is not a requirement for an appointment. Now, I would simply say that the chickens have come home to roost against the United States itself. The French plan to tax imports from the United States because the United States had not signed on to the Kyoto Protocol was exactly the kind of thing I had predicted. And now the United States, which has among the lowest gasoline prices in the world, absurdly believes that, instead of being subjected to PPM restrictions itself on grounds of inadequate energy prices, it can put import taxes on such PPM grounds against India and China.

And, frankly, what would then prevent India from discriminating against U.S. exports on the ground that the United States does not have a superfund? I could go on endlessly. This way lies chaos, just as I had argued to Roessler, and to Dunkel, during the dolphin-tuna panel's deliberations.

I think America needs to be very careful about not going down the route that has been opened up by the U.S. legislation and the World Trade Organization's ruling in support of it in the shrimp-turtle case. If America goes down that legislative route, it is likely to be the loser in the end—certainly on energy and the environment. Thus, Congress needs to be told that this is a game everybody can play.