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Dragger or Puller? The Role of International Trade Rules in Achieving Net Zero

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SYNOPSIS

Trade is seen as a vital tool for achieving net-zero emissions. Countries with diverse economic statuses have also adapted their domestic industrial policies and trade policies in the pursuit of combating climate change and promoting the growth of low-carbon industries. While trade enables leveraging comparative advantages and accessing global markets, its proliferation can have dual effects in the context of global climate change. This policy brief aims to explore the role of bilateral and multilateral international trade agreements by examining the trade frictions caused by the global pursuit of decarbonisation and greener industry practices under the existing trade rules and a new trend observed in the recent trade agreements.

KEY POINTS

- The surge in protectionism introduced by major countries has intensified conflicts over green trade in connection with WTO's principles on national treatment and the subsidies.
- GATT and SCM Agreement still provide some flexibility for countries to pursue national climate change-related policy objectives.
- Some recent bilateral trade agreements, such as the EU-New Zealand FTA and Singapore-Australia Green Economy Agreement, show that the international trade regime could potentially restructure the existing market towards a low-carbon economy.
- Since international trade rules can be a dragger or a puller contingent on how they are designed, it is required to meticulously review existing trade rules and ensure alignment between the WTO rules and international climate agreements.

INTRODUCTION

Given the increasing global risks of climate change and the consensus on the necessity for urgent action, the international community now has a common interest in mitigating and adapting to climate change. As of June 2024, more than 140 countries, including the biggest carbon emitters such as China, the United States (US), India, the European Union (EU), and Indonesia, have set their net-zero emissions targets. Among various sectors and tools to help achieve these net-zero targets and combat climate change, trade, associated with approximately 20-30% of global carbon dioxide emissions, has increasingly captured international attention. Greening trade can reduce costs for decarbonisation by accelerating the dissemination of low-carbon technologies, goods and services.

The shared interest in climate change led many countries to pursue activities that balance and integrate the economic, social and environmental dimensions of development through trade policies and introduce similar policies to support low-carbon technologies and industries. However, since the supporting policies may function as protectionism measures for domestic industries, under the existing World Trade Organization (WTO)'s trade rules, several cases of conflict between the WTO rules and domestic green industrial policies have been observed. To address this problem, the recent bilateral trade agreements have included provisions related to the net-zero commitments. In this context, this policy brief discusses the current landscape of international trade rules and the potential role of bilateral and multilateral international trade agreements in achieving net-zero emissions.

ANALYSIS

Friction Related to Green Trade Under the Existing International Trade Treaties

As tackling climate change and the transition towards a low-carbon economy took high priority, there has been a series of legislative initiatives around the world that include programmes or incentive packages to support low-carbon industries. A successful transition to a low-carbon economy at the early stage is expected to not only reduce carbon emissions but also bring economic growth through enhanced business competitiveness in the new industries or markets. Thus, major economies have aggressively implemented green industrial policies and upscaled green investments. According to the WTO Subsidy Database, a diverse array of subsidy measures, including funding, grants, preferential tax treatment, tax holidays, and renewable energy certificates, are implemented to foster the growth of green technology and renewable energy, and the US, EU and China stand out as leaders in this area. However, a growing emphasis on nurturing green industry and reducing carbon emissions with protectionist policymaking in major economies has heightened trade tensions. Faced with tight government budgets, high unemployment, and a sluggish economy, governments may resort to trade protectionist measures in order to safeguard domestic labour markets and industries. Yet, there has been an argument that these national policies and measures violate global trade principles under the WTO rules, such as non-discrimination, no quantitative restriction and no unnecessary barriers. That is, stringent environmental requirements, taxes for carbon-intensive products, and subsidies for low-carbon products may lead to discrimination against exporting/importing countries and products, thereby distorting international trade.

General Agreement on Tariffs and Trade (GATT) and WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement) are two representative international trade treaties. GATT seeks to reduce or eliminate tariffs, quotas, and any other trade barriers by requiring member states to apply non-discriminate tariffs and restrictions on goods from all member states. While GATT exclusively addresses trade in goods and leaves domestic measures such as subsidies, investment, services, technical regulations, and standards beyond the purview of its general exceptions, the SCM Agreement establishes rules and procedures in using subsidies and countervailing measures by WTO members to offset the injury caused by subsidised imports. Under the SCM agreement, subsidies are divided into two categories: prohibited subsidies and actionable subsidies. Specifically, subsidies contingent upon export performance and domestic use over imported goods are prohibited (Article 3) because they could harm other countries' interests and affect trade.

Under these rules, tensions over the trade of green products have intensified since around 2010, and the national government's policies to support green industries sometimes went through the WTO dispute settlement process. In 2010 and 2011, the US, EU and Japan contested China's subsidies for domestic wind turbine manufacturers, particularly in connection with the SCM Agreement Article 3 on the local-content requirement and Article XVI of GATT on the notification of the subsidies. Following WTO consultations between these parties, China removed its measures. Also, in 2018, the US filed a complaint against India's five export subsidy measures, and the WTO panel prohibited these measures. Finally, the dispute, alongside other outstanding issues between the US and India under the WTO, was resolved in 2023 through an agreement to reduce retaliatory tariffs on specific US agricultural products. Additional examples include a conflict between Japan and Canada about Canada's measures affecting the renewable energy generation sector in 2010, between China and the EU about the EU's renewable energy measures in 2012, and between the US and India about India's measures relating to solar cells and solar modules in 2013.

Are International Trade Treaties Barriers to Achieving Net-Zero Emissions?

The examples of conflict over green products and subsidies underscore the existing international trade treaties may hinder countries from leveraging subsidies to develop their domestic green industries. Moreover, in today's controversies over green subsidies and green trade barriers, such as the US Inflation Reduction Act and the EU's carbon border adjustment mechanism, there is a risk of escalating conflicts at the intersection of climate, trade, and industrial policy. Despite the potential benefits of international trade, such as facilitating the exchange of environmental goods and services, technology transfer, and investment in green sectors and low-carbon technologies, such limitations could impede policy goals for achieving net-zero emissions.

Nevertheless, scrutiny of the GATT and SCM Agreement reveals that WTO rules provide adequate flexibility in favour of national climate change policies. Article XX of GATT enables the incorporation of exceptions to obligations under this agreement. Two subparagraphs, (b) measures necessary to protect human, animal or plant life or health and (g) measures relating to the conservation of exhaustible natural resources, within Article XX are specifically pertinent to climate change. In this context, measures like trade restrictions can be implemented to reduce a country's carbon emissions from carbon-intensive products, even if such measures prima facie violate WTO rules. Furthermore, not all subsidies are prohibited under the SCM Agreement. The agreement applies only if subsidies are specific. The conditions for specificity cannot be found if eligibility for the subsidy is based on objective, neutral criteria that do not favour certain enterprises over others. Moreover, support for general infrastructure and the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or remission of such duties or taxes, are admissible. These exemptions could be particularly beneficial for countries seeking to impose border trade measures on carbon or provide grants for improving electricity networks. In brief, there is still room for individual countries to assert their right to regulate or support tradable goods to pursue climate-related regulatory goals.

In addition to the current flexibility, the agreements need to be updated with provisions that allow some measures to help achieve global net-zero emissions in order to strengthen the international community's momentum towards the low-carbon economy. Remarkably, given that the latest GATT revision was made almost three decades ago, the definition and types of environmental goods need to be updated. Of course, this is not an easy task. For example, the international community has struggled to reach a consensus decision on the Environmental Goods Agreement (EGA), initiated in 2014, but it is still deadlocked. In the negotiation process, the fundamental challenges include countries' inability to reach an agreement on which green goods would be covered and eligible for tariff exemptions under the EGA, as well as issues related to protectionism. Nevertheless, this negotiation is important because tariffs usually do not grant preferential treatment to green goods compared to their non-green counterparts unless agreed upon by countries. To effectively promote access to and encourage the use of green technologies, international trade consensus is needed to establish low tariffs on green products.

A New Trend: Bilateral and Plurilateral Trade Agreements with the Commitment to a Low-Carbon Economy

Whereas WTO's international trade rules have not changed for a long time, countries tried to make trade greener through bilateral and plurilateral agreements. Some recent trade agreements between two countries or among several countries show that the international trade regime could potentially restructure the existing market towards a low-carbon economy by incentivising the parties to alter their practices to be more aligned and collaborative in achieving climate change mitigation goals and sustainable development. Particularly, some nations have incorporated provisions to enhance net-zero commitments in their agreements and facilitate trade and investment in green technologies, goods, and services.

The EU member states have been front-runners in linking trade and sustainable development by consistently including relevant provisions in their modern trade agreements. Under the various agreements, the EU member states and their trade partners are supposed to effectively implement and enforce international environmental agreements and advocate for sustainable trade in natural resources, such as a shift to a resource-efficient economy and deforestation-free supply chains. More recently, the EU incorporated low carbon issues in its approach to trade and sustainable development in the European Commission's communication, titled *The Power of Trade Partnerships: Together for Green and Just Economic Growth*, in June 2022. The Comprehensive Economic Partnership Agreement between Indonesia and the European Free Trade Association states (Iceland, Liechtenstein, Norway and Switzerland), signed in December 2018, serves as a notable example of how countries can drive carbon reduction in the supply chain through trade measures. This agreement includes a separate chapter about sustainable development and several articles requiring sustainable management of agriculture, forestry and fishery. In specific, it encourages the adoption of sustainable practices in palm oil production in Indonesia including stopping deforestation, aiming to prevent economic activities from damaging the environment and removing carbon sinks. Furthermore, the EU-New Zealand Free Trade Agreement, signed in July 2023, contains a dedicated article on fossil fuel subsidy reform stipulating that the two Parties aim to reform and progressively reduce fossil fuel subsidies (Article 19.7).

Besides the EU, the Singapore-Australia Green Economy Agreement, signed in October 2022, was designed to expedite the transition toward net-zero emissions by outlining joint initiatives such as the development of a list of environmental goods and services and cooperation for green shipping and sustainable aviation. It also includes efforts to facilitate the flow of green and transition finance and emphasises promoting business engagements in trade and investment within green sectors.

CONCLUSION

Countries often employ trade agreements and industrial policies to pursue economic gains. Yet, this unilateral approach has resulted in the imposition of trade barriers on green goods and escalated trade tensions. The trade tensions will likely persist, leading to more disputes in the green industry. The absence of a collective commitment to liberalise trade in environmental goods and services, coupled with the increasing adoption of protectionist measures, could undermine efforts towards achieving global net-zero goals. Therefore, the current international trade agreements need to incorporate obligations that drive transformative change, which eventually requires better political alignment and greater political will. Besides, bilateral trade agreements are expected to play an important role in moving to a net-zero economy. While multilateral trade negotiations have not been advanced, bilateral agreements have increasingly gained popularity as a tool for developed nations to extend their net-zero agenda beyond their borders. They can be also used for seeking peaceful solutions to these challenges. In conclusion, since international trade rules can be a dragger or a puller contingent on how they are designed, it is required to take a meticulous review of existing trade rules and to ensure alignment between the WTO rules and international climate agreements.

WHAT TO LOOK OUT FOR

- Rise in the inclusion of clauses pertaining to climate change and achieving net-zero emissions in bilateral and multilateral trade agreements
- The increase/decrease in protectionism for low-carbon industries in both industrialised and developing countries
- Green trade tensions and trade disputes over green subsidies

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