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Trade implications of GHG pricing

Carbon pricing – more broadly and appropriately called greenhouse gas (GHG) pricing to encompass methane and other GHG emissions beyond CO₂ – is seen by many policymakers as a critical tool for driving down emissions and creating incentives for individuals and businesses across all sectors to move toward a clean energy future. Some 46 nations now impose a price on GHG emissions, either through carbon charges or emissions allowance trading systems – and dozens more are exploring pricing options. But divergent GHG prices across nations present a strategic challenge for the international trading system.

In light of the global commitment to halt GHG emissions, governments that fail to impose a price on emissions or otherwise regulate GHGs might well be seen to be offering their producers an inappropriate subsidy. To level the playing field, eliminate any incentive to shift production to places with laxer climate change policies, where operating costs might be lower, and to protect the efficacy of emissions reduction efforts, governments with strong climate change policies have begun to develop *border carbon adjustment* (BCA) strategies. Such mechanisms are intended to impose tariffs on imported goods based on the difference between the producer's level of GHG pricing and the carbon price in the importing jurisdiction.

Those seeking to better align the structure of the trading system with the international community's commitment to climate change action are urging the WTO to authorize appropriately structured BCA tariffs. But developing nations have expressed concerns about whether such tariffs will be implemented in a discriminatory fashion or in a manner that violates the commitment to common but differentiated responsibility, a principle of equity which undergirds the global climate change regime. Additional questions have been raised about GHG accounting and whether technical capacity limitations will disadvantage developing nations.

I have argued that the design details of any BCA mechanism will be critical, and that analytic rigour, validation, fairness, and transparency must be prioritized (Dominioni and Esty, 2022). I believe that border tariffs designed to eliminate the unfair advantage arising from GHG externalities should be based on differences in effective rather than explicit GHG prices, which would allow nations greater flexibility in carrying out their climate change policies. An even more straightforward approach would require that the tariffs be based on the level of unabated GHGs attributable to an imported product multiplied by an agreed-upon *global social cost of carbon*. Domestic goods would, of course, have to adhere to the same GHG pricing framework.

Such a BCA methodology would reward producers with lower actual GHG emissions both domestically and internationally – and make it nearly impossible to deploy BCA tariffs as a disguised barrier to trade. It would require some effort to establish emissions accounting standards, but carbon calculators and GHG content databases are increasingly available. Equity considerations could argue that any funds collected from exports by the least-developed nations should be recycled to these countries to support their investments in the transition to a sustainable energy future.

The legitimacy of the trading system would be enhanced by a clear acknowledgement of the sustainability imperative and recognition of the urgency of global success in responding to the threat of climate change, paired with a reiterated commitment to sustainable development and access to global markets for developing nations (Lubin and Esty, 2010). Fundamental to such efforts would be a WTO initiative to validate carefully structured BCA mechanisms and thus reinforce – and not undermine – GHG pricing and other national climate strategies.