ROUND TABLE
ON SUSTAINABLE DEVELOPMENT

Connecting Climate Ambition and Trade: How to align policies and build international consensus?

Summary of the 41st Round Table on Sustainable Development[1]
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The 41st Round Table on Sustainable Development followed two previous discussions on border carbon adjustments (BCAs) held in February and October 2020. Thirty-seven high level participants[2], including six current and former ministers, four deputy ministers and two state secretaries, along with experts and other stakeholders from the public and private sector, academia and the international arena, discussed ways to build international consensus on how to align climate goals and trade policy, including potential measures to prevent carbon leakage. Due to the COVID-19 pandemic, the meeting was conducted as an online videoconference, which allowed for both verbal debate and parallel exchanges in the chat window.

BCAs are currently in the spotlight, as the EU continues to move towards implementing such an arrangement. The European Commission is expected to publish its proposal for a carbon border adjustment mechanism (CBAM) in the second quarter of 2021. The CBAM will be put forward as a cornerstone of the European Green Deal and a means of complementing a revised EU emissions trading system (EU ETS). It is built on the basis of avoiding carbon leakage and providing a level playing field for industries to increase investments in low-carbon technologies. But it also raises important concerns, including the potential triggering of disputes with major trading partners and unintended consequences for other nations, particularly developing countries.

There is broad and growing consensus on the urgency of tackling climate change and achieving climate neutrality, and that increasing climate ambition via carbon pricing in some parts of the world can lead to carbon leakage. While an economic case can be made for BCAs, especially in countries that are moving towards an adequate level and scope of carbon pricing, questions remain on how much impact trade-related climate policies can have in decarbonising the economy. Other policy measures aimed at mitigating emissions, such as removing tariffs on environmental goods, phasing out fossil fuel subsidies or focusing on innovation for decarbonising energy-intensive sectors are regarded by some as effective options that should be pursued in priority.

Carbon pricing is recognised for the important role that it can play in driving the decarbonisation of the economy. Currently, more than 40 countries have put a price on carbon, but prices are often not high enough, or the base to which they apply too narrow, to provide a meaningful CO_2 mitigation incentive. A strong price signal can be the most efficient tool to reduce emissions, but governments may shy away from this if it leads to production shifting to countries with lower (or no) carbon pricing. The higher the price of carbon compared to trading partners, the greater the risk of carbon leakage. The lack of

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1 This summary does not reflect the views of the OECD Secretariat nor OECD member countries. It is prepared under the authority of the Chair of the Round Table on Sustainable Development. The European Climate Foundation's support of the 41st Round Table on Sustainable Development is gratefully acknowledged.

2 Twenty-seven percent of the meeting participants were women.

comparability across different carbon pricing systems is a challenge for creating effective and fair mechanisms to prevent carbon leakage.

In the absence of international co-ordination on carbon pricing, some countries are considering unilateral policy action, or – in the case of the European Union – group action by *de facto* forming a 'carbon club' with a common BCA mechanism. However, there is a risk that trade partners may challenge such policies at the WTO or impose retaliatory tariffs on countries introducing a BCA if they perceive it as a protectionist measure. Another concern is the impact of BCAs on developing countries that have lower levels of technological capacity and financial resources to implement a net-zero transition. In this context, reconciling the UNFCCC principle of Common but Differentiated Responsibilities with the WTO principle of non-discrimination and Paris Agreement objectives emerged as a priority for many. Leaders' capacity to gather consensus over these concerns will define the framework in which BCAs operate within the international trade regime, possibly in the context of multilateral, plurilateral or bilateral agreements.

There are some promising examples of countries ramping up their efforts to overcome these challenges. Some have already begun to work on aligning their carbon measurements to international standards such as those of the International Organization for Standardization (ISO). Others have started work on plurilateral agreements among countries with like-minded climate ambitions to address fossil fuel subsidies. The Agreement on Climate Change, Trade and Sustainability (New Zealand with Costa Rica, Fiji, Iceland, Norway and Switzerland) is one such example of how a trade agreement can drive domestic energy reform by requiring strict work on fossil fuel removal.

The Round Table discussion centred on three questions, which led to vivid exchange of views:

- How to align increasingly ambitious climate policies with different countries' trade-related policies?
- How can BCAs best be supported and complemented to ensure global acceptability and minimise possible tensions among trading partners?
- How can the international trade regime and multilateral, plurilateral and bilateral trade agreements best support accelerated climate action?

A background note that supported the discussion is available here.

Main messages

- **Carbon measurement is a complex exercise that needs further work**. For many, carbon measurement should apply at industry level as well as national level to ensure that all industries are treated fairly. The potential challenges of measuring the indirect carbon cost of electricity illustrate such complexity and highlight the importance of a co-ordinated set of measures.
- **Climate policy could benefit from a broader approach and deeper understanding of how domestic policies affect trade**. In this context, the impact of trade on land use, the long-standing issue of tariffs on environmental goods, and imported deforestation also need to be considered. Other mechanisms, such as resource mobilisation tools, the development of sectoral, national and regional cap-and-trade schemes, and green taxation can also serve as alternative measures to achieve climate goals. Finally, the structure of existing subsides and their impact on trade and emissions should be re-examined.
- **BCAs could provide an opportunity to test the ability of international rules, including the current international trading system, to respond to global challenges**. Also under scrutiny is the interplay of trade policy with international climate negotiations. BCAs should be non-discriminatory, and any policy packages involving BCAs should account for the principle of common but differentiated responsibilities. Ensuring compliance with WTO agreements would avoid unjustified trade barriers.
- **A detailed design of BCAs is likely to gain more support, though would be more difficult to achieve.** There are significant demands for a comprehensive legal and regulatory framework that would

address each sector separately. Participants also highlighted other issues that require special attention:

  - **Enforcement is key for BCAs to succeed.** With a monetary incentive for proving low-carbon content and a weak system of comparability, fraud is likely. Standardised certification and traceability are important to avoid loopholes.
  - **BCAs entail administrative challenges that need careful consideration.** While a methodology for counting carbon content might be agreed, many less developed countries lack the necessary capacity for monitoring, reporting and gathering information on carbon content.
  - **How and to what extent to account for foreign climate policies** when considering the price level of a BCA were raised as a key considerations in designing and implementing such a measure.
  - **BCAs could first be tested on a few sectors, before a broader roll-out.** For instance, the EU plans to cover only a few energy-intensive sectors to start with under its CBAM, including steel, cement, fertiliser, aluminium and electricity.

- **A forum to ensure comparability of different carbon pricing systems would enhance transparency, and could be key for the functioning of BCAs.** In order to ensure that carbon content is measured equally across countries, that prices are fair, and that climate action can be justly quantified, a common space to discuss comparability was called for by several participants. Raising carbon prices explicitly or implicitly through sectoral measures can only be possible if comparability across various carbon pricing systems exists, which would include both a method to measure carbon content of traded goods and a method to measure the carbon price resulting from exporting countries' policies. Globally accepted standards for carbon measurement, e.g. those of the ISO, have already been tested in real case scenarios.
- **BCAs are not only an opportunity for balancing economic and environmental but also social perspectives.** Carbon cost is real and a direct component of daily operating costs for some industries who perceive BCAs as a mechanism to level the playing field. By increasing transparency and traceability of value chains, environmental and social dumping will be easier to identify and address. Such efforts would contribute to gaining support from workers and strengthen the credibility of climate policies among the public.
- **For BCAs to gain acceptance they should respond to mounting demands from citizens to increase climate ambition while also ensuring good communication and public engagement.** A broad consultation on the design of BCAs, both domestically and internationally, can help improve their legitimacy and support. Impact studies should cover not only the industrial sectors affected but also their effect on different population groups, including vulnerable communities who are often the most affected by climate change. Transparency about how revenues will be used is also important for the public.
- **Removing fossil fuel subsidies remains a key climate mitigation policy.** BCAs will indirectly offset fossil fuel subsidies, although even in the absence of fossil fuel subsidies the issue of accurate carbon pricing would still need to be addressed. Trade agreements have the potential to drive domestic reform in this direction, if removing fossil fuel subsidies were to become a prerequisite to trade, as is the case for the ACCTS agreement.
- **Co-operation between developed and developing countries is key.** For many, the acceptability of BCAs hinges on the principle of leaving no one behind. Recycling revenues to assist developing countries in their transition to low-carbon technologies should be part of this effort. Given the sectors involved, the impact of BCAs will be felt more intensely in developing countries, some of which have managed to advance the decarbonisation of their economy in recent years. Such efforts should be recognised and further supported. Specific impact assessments for such cases will be crucial.

- **There is a preference for a multilateral approach to the alignment of trade and climate policy.** However, the complexity of the issue and magnitude of the challenges leave room for plurilateral agreements to bring about positive contributions to climate goals. Agreements between like-minded countries with similar climate ambitions are key for demonstrating possible alignment of climate and trade policies. Either way, BCAs will require diplomatic effort and great transparency to be accepted and avoid protectionism. Participants called for more transparency in current discussions and showed a clear preference for co-operative multilateralism. Many agreed that there is a need for the WTO to take forward this debate and for climate issues to be part of the reform discussions in the organisation.
- **BCAs should avoid double protection for producers and double burdens on exporters.** Domestic subsidies and free allocation of carbon permits should be avoided in conjunction with BCAs. Similarly, BCAs need to account for synergies with international sectoral efforts to reduce GHG emissions (e.g. those of the International Civil Aviation Organization and International Maritime Organization) to avoid double taxation of exporters. In the case of the EU CBAM, compatibility between the current system of free allocation permits under the ETS and the CBAM needs to be examined, as it will likely face opposition and cause inefficiencies.

Suggestions for next steps

Round Table participants acknowledged that while there are legitimate reasons to support BCAs, there is a strong preference for multilateral approach to the alignment of trade and climate policy. The debate allowed participants to become acquainted with different perspectives and advance the agenda towards a broader consensus on climate action and greater consistency and coherence in approaches.

The following possible next steps are proposed:

- Transparent and internationally agreed calculation of carbon leakage is necessary to ensure acceptance of any BCAs among trading partners. Accounting for non-price policy measures in other countries is also important. The OECD, possibly under the umbrella of its existing bodies, could provide analytical support in this area, including for specific sectors.
- Establishing an international forum devoted to ensuring the necessary comparability and heterogeneity across different carbon pricing systems. A multilateral comparability forum would enhance transparency, and allow connections between experts in different carbon pricing systems and enable a common understanding on carbon measurement mechanisms.
- Further analysis and discussion is needed on the social dimension of climate and trade actions, including initiatives such as BCAs, fossil fuel reform and support to green sectors. Another important angle is the implications of climate mitigation actions on developing countries and how to support their own low-carbon transition. The OECD is well placed to advance such agenda in co-operation with other partners.

By conducting this meeting virtually, 26.4 metric tonnes of carbon emissions were saved. This is equal to:

- 5.7 passenger vehicles driven for one year
- 2,971 gallons of gasoline consumed
- 29,089 pounds of coal burned
- 3,366,851 smartphones charged

To sequester the same amount of emissions, 437 tree seedlings would need to grow for ten years.

Source: Carbon Footprint (2020), Carbon Footprint Calculator.