

PECC SIGNATURE PROJECT: FTAAP 'PATHWAYS TO PROSPERITY'

POLICY BRIEF, TRADE AND CLIMATE CHANGE - INITIAL DESCRIPTION OF TOPIC

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The issue

It is clear that FTAAP will need to address the links between the development of the rules-based trading system and efforts to combat climate change. Up to the present, most APEC members have focused on making trade rules more supportive of such efforts, eg by seeking to liberalise trade in environmental goods and services and to discipline fossil fuel subsidies.

More recently, however, the view has developed that there may be a tension between these objectives. This view is held by certain governments, by consumers and particularly by domestic producers. They argue that to the extent that climate change has been a result of market failures (eg emissions not being priced at their full costs), domestic measures are needed to correct for such failures. These include emissions trading schemes, taxes, the reduction of harmful subsidies and incentives to use cleaner technologies. The argument continues that open borders can undermine the impact of such measures on emissions by incentivising increased imports from or the movement of production to economies with "lower" emissions standards. This is known as the danger of "carbon leakage".

Recent developments

A number of WTO members (eg the EU, UK and Canada) are implementing or considering carbon border adjustment mechanisms (CBAMs) which would tackle carbon leakage by charging a levy to correct for differences in the carbon intensity of domestic production and imports. Of these, the EU is by far the most advanced, with it having taken decisions to put a regime in place (for a limited range of products) to gather information from importers from October 2023 and to collect levies based on this information from 2026. The EU CBAM will be based on the EU's ETS and firms from other economies with their own ETS will be significantly advantaged in terms of compliance.

However, other members of the Paris Agreement, including many from the Asia-Pacific region, have protested that the Agreement leaves it open for each member to decide how it will fulfill its commitments, including through taxes, subsidies and incentives as well as an ETS. They point to the fact that the WTO legality of the EU CBAM is far from clear. In addition, they say the operation of the CBAM will entail trade, supply chain, investment and innovation costs, including in the Asia-Pacific region.

Relevance to Long Term Goals of FTAAP

A key drawback of the EU CBAM is that it will impact on other economies but has been developed without their participation and input. This particularly applies to developing economies which are in some cases the most seriously impacted. Given the importance of international cooperation to combat climate change, it is important that internationally agreed alternatives to CBAMs be developed to tackle the current tensions between efforts to reduce emissions and to liberalise trade.

The development of FTAAP could be used as a vehicle for mutually supportive strategies to be put in place to relieve these tensions. One option would be agreement to a common set of rules of emissions reductions in order to allow trade to continue to flow. However, given the diversity of approaches permitted under the Paris Agreement, an approach based on "mutual recognition" is likely to be more productive. Under this, negotiators would agree that a set of policies for each party, which if faithfully implemented and enforced, would be deemed "equivalent".

Relevance to the Current Work Programme of APEC

APEC is committed to undertaking much of the work that would be required in order to develop FTAAP in a manner where efforts on trade and climate change could become mutually supportive. The Aotearoa Plan of Action requires APEC members to:

“Cooperate in relevant APEC fora to develop, encourage and exchange best practice policies, and promote capacity building programmes, that address all environmental challenges - including climate change - and support sustainable growth, such as through:

- i. structural reform;
- ii. trade, including APEC’s work on facilitation of trade in environmental goods and services;
- iii. public finance, including tax policy and rationalising and phasing out inefficient fossil fuel subsidies that encourage wasteful consumption, while recognising the importance of providing those in need with essential energy services;
- iv. sustainable infrastructure and transport;
- v. promoting sustainable growth across sectors and the development of cost effective low and zero emissions technologies, sustainable finance and, if appropriate, carbon pricing mechanisms; and
- vi. ensuring energy security, access, reliability and resilience through energy transition.

This commitment provides the platform to allow relevant work to proceed. Existing work on liberalizing trade in environmental goods and services and disciplining fossil fuel subsidies would continue to be important as would work through finance ministers on appropriate taxation policies. This could be supplemented by structural reform work in such areas as establishing market signals which support climate change objectives, appropriate broader regulatory incentives, the role that standards and conformance can play in providing for mutual recognition of approaches and the development of mutually recognised standards for carbon accounting.

How Would this Work Advance the FTAAP Concept

Our view is that this work has the potential to put FTAAP in the vanguard of developing a nexus between trade and sustainability outcomes, particularly in the area of climate change.