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Using Trade to Tackle Climate Challenges

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by *Penelope Naas**

Annual temperatures are at the warmest levels since record keeping began,¹ bringing urgency to government, business, and individual efforts to stem the climate crisis. At the same time, the transition away from fossil fuels and towards more sustainable and renewable sources of energy is upending economies, requiring transformations of manufacturing industries and investments in new industries such as batteries and other “green” technologies. Against these trends, policymakers are juggling their climate mitigation efforts while still encouraging current and future economic growth.

As the U.S. government advances its goals at home using a range of domestic economic tools, trade policy provides an avenue to expand decarbonization efforts globally. John Podesta, President Biden’s climate envoy, spoke at Columbia University earlier this year and acknowledged the fundamental nexus between trade and the environment, calling for the creation of a task force to look at how trade policies can contribute to solving urgent climate challenges. “The stakes couldn’t be higher,” Podesta said. “But I believe if we make the right choices, we can create and maintain millions of good-paying jobs in the clean energy economy of the future. We can mobilize billions in private investment in countries around the world. We can accelerate technological innovation and position nations to overcome the challenges of today and tomorrow. And we can do it while protecting our planet for ourselves and our children.”²

Since 2020, the World Trade Organization (WTO) has also taken a more expansive view on the range of topics where trade could help address climate and environmental challenges. On July 4th, WTO Deputy Director General Paugam stated, “... (W)e are at a crossroads in the multilateral system, with an opportunity to shape a global win-win approach for trade and the environment. We can combine green transition, green industrialization and trade cooperation. This is what “reglobalization” is about. And the time to act is now.”³

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¹ U.S. Department of Commerce, National Oceanic and Atmospheric Administration, [see: 2023 was the world’s warmest year on record, by far | National Oceanic and Atmospheric Administration \(noaa.gov\)](#)

² [Remarks as Prepared for John Podesta Columbia Global Energy Summit | The White House](#)

³ [WTO | 2024 News items - DDG Paugam – WTO at a “crossroads” in addressing trade and climate nexus](#)

The U.S.'s most ambitious environmental trade commitments are in the U.S.-Mexico-Canada Agreement (USMCA), which allows countries to continue with domestic climate initiatives while encouraging cooperation on environmental goals and calling for a level playing field in these efforts. The work is ongoing, but separate and siloed from the other aspects of USMCA. Moving forward, there is an opportunity to incorporate climate as a core consideration in all aspects of future agreements, adding an additional priority to the existing goals of reducing barriers to U.S. exports, protecting U.S. interests competing abroad, and enhancing the rule of law.⁴

Imagine if U.S. trade negotiators asked “Will this help (or hurt) climate change” for each issue in their negotiation and then used all aspects of trade, supply chain or economic security agreements to create positive (or negative) incentives to accelerate climate-mitigation efforts. Topics such as subsidy rules, market access (tariffs), and non-tariff barriers could be recast to tackle climate concerns in new and more aggressive – and possibly more effective - ways. New mechanisms like carbon border taxes and other “domestic” policies with international implications could also be used to accelerate efforts to both reduce carbon and ensure a level playing field for countries with stringent rules. But such a focus may need to be balanced with other politically important priorities, such as development, economic growth, and employment.

Listed below are four ways that the U.S. could use trade and other economic agreements to accelerate efforts to thwart detrimental climate impacts.

TARIFFS AND OTHER BORDER TAX MEASURES

Lowering tariffs on specific climate-related goods and services would then lower the costs to businesses or consumers, while raising tariffs on goods and services that negatively impact the environment would (usually) increase product costs and reduce demand. As an example, a country could place a higher tariff on imported vehicles that are less fuel efficient and/or a lower tariff on more efficient vehicles, which in turn would reduce the price difference between the two vehicles and making the technology more attractive to consumers. Tariffs can also be used to ensure that domestic industries, which may have to comply with higher domestic carbon-related regulations,

⁴ International Trade Administration, U.S. Department of Commerce, Free Trade Agreement Overview (<https://www.trade.gov/free-trade-agreement-overview>)

are not disadvantaged by imports coming from countries with lower carbon regulations or costs (known as “carbon leakage”).

Realigning the U.S. tariff code to reflect carbon embedded in imported products would be complicated and challenging for many reasons, particularly as the U.S. does not have a national carbon price. Applying a set tariff on imports from all countries, regardless of the carbon levels embedded in the products, would not achieve the intended effect of encouraging less carbon emissions. Such a change would also need to consider the impact on U.S. consumers, the impact on less developed countries, as well as the impact on U.S. competitiveness if unilaterally applied.

The European Union is currently implementing a border tax that tries to tackle both the pricing and the leakage concerns outlined above. The Carbon Border Adjustment Mechanism (CBAM) establishes a fee (tax) at importation based on the carbon embedded in the product. The fee is calculated based on real figures reported on a factory-specific basis in foreign countries. Currently applied to six products (cement, fertilizer, iron and steel, aluminum, electricity, and hydrogen), the program is in a transitional period with full implementation expected in 2026. The U.K. is developing a similar program. Imports from countries with existing carbon-pricing systems will be able to deduct this from their embedded carbon calculations. The system is administratively complex but drives global market adjustments for these 6 products and is worth watching. This could be a potential system for the U.S. to emulate.

Another proposal would look at a small, more specific set of products that promote environmental benefits, known as environmental goods and services. The market for environmental goods is estimated to be \$1 trillion annually⁵ and growing rapidly, and includes technologies such as water treatment equipment, solar panels, and windmills. The U.S. participated in previous talks (the Environmental Goods Agreement, known as EGA) that were abandoned in 2014, due to disagreements with China.⁶ Concerns with China’s state-driven industrial policy in green goods have only increased with recent trade cases around solar panels, wind turbines and electric vehicles from China.

⁵ USTR, see [Environmental Goods Agreement | United States Trade Representative \(ustr.gov\)](#)⁶

⁶ For more information, see “[Environmental Goods Agreement: A New Frontier or an Old Stalemate?](#)” by William Alan Reinsch, Emily Benson, and Catherine Puga, Center for Strategic and International Studies, October 28, 2021

However, the U.S. could look at negotiating with a smaller set of like-minded allies on a smaller range of products creating a new agreement that would support U.S. goals for resilient supply chains and economic security. This would promote U.S. environmental goods exports as well as ensure U.S. companies compete on a level playing field.

SUBSIDIES

Existing subsidy rules look at financial contributions granted by governments to determine if they create an unfair advantage and cause injury to other firms. The intent of the subsidies can determine if they are outright prohibited but the impact on the environment is not currently a consideration. With the implementation of the U.S. Inflation Reduction Act (IRA) and other specific environmental policies meant to spur “green” innovation, re-examining subsidies policy to create permissible climate-related subsidies - like some provisions allowed for agriculture - could be one potential change for the U.S. to propose.⁷ The U.S. would need to work with allies to ensure that the permissible subsidies are narrowly defined, as China has been subsidizing its green industries at three to nine times the levels of the U.S. and E.U., often using non-specific subsidies that could be allowed under current rules.⁸

Another area where the U.S. could advance its climate goals would be the reduction of fossil fuel subsidies. In 2022, \$7 trillion in fossil fuel subsidies were granted globally, reflecting 7% of global GDP, and leading to retail prices that do not reflect the costs and externalities created by fossil fuels.⁹ Tackling this issue is challenging, as consumers are sensitive to any price increases, demonstrated by recent farmer and other civil society protests over feelings of unfair and disproportionate impact on rural communities of various national “Green Deals”. The WTO’s Trade Ministers for Climate, a group of 61 trade ministers, have proposed work in this area, and the U.S. could lead efforts by proposing the phase out of certain fossil fuel subsidies, such as for exploration and drilling, as these do not impact the cost of gasoline to U.S. consumers and run counter to the goals to decarbonize the U.S. economy.

⁷ Jennifer Hillman and Inu Manek, Council of Foreign Relations, [Rethinking International Rules on Subsidies \(cfr.org\)](https://www.cfr.org/entry/article/rethinking-international-rules-on-subsidies)

⁸ F. Bickenbak, D. Dohse, RJ Longhammer, and W-H Liu, [Foul Play? On the Scale and Scope of Industrial Subsidies in China](https://www.kielinstitute.org/publications/foul-play-on-the-scale-and-scope-of-industrial-subsidies-in-china), Kiel Institute for World Economy April 2024

⁹ www.imf.org/en/Topics/climate-change/energy-subsidies

Although it seems unlikely that there would be agreement on green subsidies or fossil fuel subsidies at the WTO soon, the U.S. could move forward to negotiate bilateral and regional agreements that include these provisions with a group of like-minded countries.

TRANSPARENCY AND REVIEWS

Domestic regulations can impact climate and the environment and distort global efforts. Agreements could be used to identify problematic regulations, which can then be tackled via reviews or negotiations. Some of the specific policies to discourage waste and encourage recycling and reuse, for example, are limited by countries' domestic rules that may differ from international norms. A specific example is the use of recycled plastic materials such as PET in food containers, which is allowed in many countries but not in China. Instead, recycled plastic such as rPET is mainly used in Chinese clothing production and for other purposes¹⁰, creating challenges for food companies in China who can only source and use virgin plastics. Including transparency rules in economic and climate agreements will help identify regulatory problems that can then be addressed to help advance global climate and environmental goals.

A NEW MODEL

On July 2, Costa Rica, Iceland, New Zealand and Switzerland, announced the conclusion of negotiations for a trade agreement on climate change- the first of its kind.¹¹ The Agreement on Climate Change, Trade and Sustainability (ACCTS) has some of the elements discussed in this paper. It includes a commitment to eliminate tariffs on 300 environmental goods and eliminate non-tariff barriers for 100 environmental services. The agreement incorporates a new framework to discipline and eliminate fossil fuel subsidies. The agreement also provides for a voluntary ecolabelling system to help consumers and businesses understand the environmental impact of products. This agreement is potentially a model for other countries to join or emulate.

¹⁰ https://www.westwoodsourcing.com/en_GB/blog/services-14/recycling-plastic-bottles-china-101#:~:text=The%20process%20of%20plastic%20bottles,high%2Dquality%2OrPET%2Oraw%20materials.

¹¹ See [Agreement on Climate Change, Trade and Sustainability \(ACCTS\) | New Zealand Ministry of Foreign Affairs and Trade \(mfat.govt.nz\)](#)

CONCLUSION

Under the Biden Administration, the U.S. has focused on accelerating the low-carbon economy through incentives under the Inflation Reduction Act (IRA) and spurring private sector investment in U.S. manufacturing and innovation. The U.S. can advance and accelerate global efforts on climate and environmental using trade policy to spur the uptake of new, innovative U.S. goods and services while ensuring a global level-playing field in new, green technologies. Decarbonization is driving re-industrialization, and the U.S. should proactively lead in ensuring that international trade rules play a constructive role in this re-industrialization and dissemination of new technologies.

As John Podesta said in his speech at Columbia University, “We need a smart, 21st century-approach to climate and trade policy that launches a ‘race to the top’ for climate action...a global trading system that slashes pollution, creates a fair and level playing field, protects against carbon dumping, supports good manufacturing jobs and economic opportunity...” Podesta said that the U.S. “doesn’t claim to have all the answers but we’re ready to accelerate progress in turning conversations about climate-smart trade tools and policies into practice.” The time is now right to start those conversations.