

Center for Strategic and International Studies (CSIS)

Report Part Title: Green Industrial Policy Dialogue

Report Title: U.S. Climate Leadership at the G20

Report Subtitle: A Strategy for Investment, Debt Relief, and Industrial Policy

Report Author(s): Lachlan Carey, Sarah Ladislaw and Nikos Tsafos

Published by: Center for Strategic and International Studies (CSIS) (2021)

Stable URL: <https://www.jstor.org/stable/resrep30170.7>

JSTOR is a not-for-profit service that helps scholars, researchers, and students discover, use, and build upon a wide range of content in a trusted digital archive. We use information technology and tools to increase productivity and facilitate new forms of scholarship. For more information about JSTOR, please contact support@jstor.org.

Your use of the JSTOR archive indicates your acceptance of the Terms & Conditions of Use, available at <https://about.jstor.org/terms>



JSTOR

Center for Strategic and International Studies (CSIS) is collaborating with JSTOR to digitize, preserve and extend access to this content.

Green Industrial Policy Dialogue

Climate change policy and the global free trade regime are on a possible collision course. A growing number of the world's major economies are pledging to reduce emissions to net-zero by 2050 and proposing more stringent regulations, direct government investment, and larger incentives to meet that goal. Many of these domestic climate policies are increasingly being justified not only on the basis of solving the global climate crisis, but also for securing domestic manufacturing, job creation, and economic opportunity.

The theory behind this green industrial policy approach is that if governments provide more direct domestic economic benefits from clean energy development, citizens are more likely to support aggressive climate policy.⁷⁴ In the past, green industrial policy has led to technology- or sector-specific trade disputes. Previous disputes have had limited impact on the growth of clean energy, but the potential for harmful trade conflicts could be much greater in a world where countries are taking stronger climate action. And yet, from a climate perspective, if green industrial policy spurs more ambitious clean energy development and deployment, it should be encouraged regardless of its adherence to trade rules.

The G20 should establish a green industrial policy and trade dialogue in order to begin the negotiations on how to avoid and resolve trade disputes over clean energy-oriented climate policy.⁷⁵ This dialogue could also agree to the terms of a WTO climate waiver, allowing countries to support local clean energy industries without fear of new trade disputes. The group should also discuss creating supply chain alliances for clean energy, so as to expedite the deployment of emerging clean energy technologies. In general, the dialogue should seek to advance a common understanding of how to craft effective and productive industrial strategy, facilitating competition between countries that support their local industries rather than sparking trade wars that pull down the industries of others.

The Biden administration can use this dialogue as an opportunity to fulfil its promise to center climate change in the recovery and rebuilding of the G20. The dialogue also provides a venue to consult other major economies and trading partners about elements of the Biden agenda that are already raising concerns, such as its supply chain review, Buy America executive order, and focus on reshoring domestic manufacturing. It would also advance key international climate goals, such as global collaboration to accelerate the deployment of clean energy technologies and the phasing out of support for fossil fuel subsidies.

The G20 should establish a green industrial policy and trade dialogue in order to begin the negotiations on how to avoid and resolve trade disputes over clean energy-oriented climate policy.

Context

If the world is going to meet its global climate change goals, governments will have to create policies, regulations, and investments that not only deploy clean energy technologies at the margin but replace or retrofit almost the entirety of their energy systems. Mobilizing this type of effort on an expedited timescale will require a combination of policies and investments that capture more benefit for domestic workers and constituencies but also save on costs via collaboration and investment across borders. There is also a perceived need to deliver such benefits in a bid to politically justify stronger climate measures. While this approach appears to be having greater success politically, it has led to rising trade conflict and protectionism.

For many years, climate policymakers were able to work around the potential conflicts between trade and climate policy by trying to create climate policies and systems that were trade compliant, such as globally linked cap and trade programs. Environment and trade disputes that did arise were predominantly issues of market access based on environmental regulation.⁷⁶ To settle these disputes, the WTO used a “balancing test” to judge whether a country’s right to enforce an environmental regulation outweighed the need to avoid protectionist action that could hinder trade. These disputes mostly reinforced the principle outlined in the WTO’s General Agreement on Tariffs and Trade Article XX that countries could establish trade measures to protect the environment so long as they were found not to be overly or unnecessarily protectionist.

In recent years, however, trade disputes over subsidies, local content rules, and export restrictions have become more prevalent.⁷⁷ Trade officials have tried to remove barriers to climate-positive commerce where possible, seeking to negotiate an Environmental Goods and Services Agreement to reduce or eliminate trade barriers to energy-efficient or clean energy technologies and services. However, low-level trade conflicts persisted, with several countries erecting trade barriers to protect nascent markets or seeking recourse through the WTO for the use of perceived unfair subsidies. Many, but not all, of these cases have been against China and its heavy support for solar PV manufacturing, or were launched by China in retaliation for these disputes.

By and large, these trade conflicts have not hampered the development of climate-friendly energy technologies overall, but they have damaged certain companies—and perhaps stymied efforts by some countries to accelerate the development of nascent clean energy industries, particularly solar PV manufacturing.⁷⁸ More often than not, supply chains simply shifted to avoid trade barriers, and the overall market for these technologies continued to grow. However, tariffs and other trade remedies have effectively increased the cost of certain clean energy technologies and decreased the likelihood of their adoption.

The situation is likely to get worse given changes in global trade architecture, country preferences for protectionism, and the need to ramp up climate ambition. China, the target of many of the punitive trade measures, is now a dominant manufacturer and exporter of clean energy technologies such as solar PV, wind, and battery technologies. It has included clean energy as one of its 10 “emerging strategic industries” in its upcoming Five-Year Plan, suggesting it is not going to relinquish its dominance in clean energy supply chains without a fight.⁷⁹

Meanwhile, major economies such as Europe, Japan, India, and the United States have pledged much more aggressive emissions reduction pathways that will also deliver concrete domestic economic co-benefits. For example, several countries, including the United States and India, are considering (or have already implemented) domestic purchasing requirements for clean energy technology—an area where the two countries have already gone to the WTO’s trade dispute mechanism.⁸⁰ Another potential area of trade conflict is on border adjustments that account for carbon content. The European Union has proposed a border carbon adjustment mechanism to protect its domestic industry from trade exposure to countries without stringent climate policies. It is now increasingly likely that countries with stringent climate policies will seek to protect their economies using such trade measures.

The global trading system represented by the WTO is also under significant pressure due to fundamental disagreements among some of its largest members, the exacerbation of those conflicts over the course of the Trump administration, and a general re-evaluation of the trade-offs between free trade and resilience in the wake of Covid-19. Successful broad-based reform to modernize the WTO and address these more existential concerns seems unlikely under the incoming Biden administration. This means that alleviating trade tensions with potentially negative consequences may have to happen through incremental reform efforts or alternative forums. The UNFCCC, the most obvious place to deal with climate policy, has also not proven a fruitful venue thus far for clarifying the relationship between trade and climate-related measures.

Existing Initiatives

Many existing climate-related trade initiatives within the WTO have failed to make sufficient progress over the years. Most are oriented around removing barriers to trade, facilitating exchanges between the WTO and the entities responsible for multilateral environmental agreement such as the UNFCCC, and addressing technical barriers to trade.

The most notable example is the Environmental Goods Agreement, proposed in 2007 by the European Union and the United States to remove trade barriers to goods and services that were deemed to have environmental benefits. The negotiations collapsed due to a ballooning list of goods that countries wanted to include on the list. Some progress was made in 2011, when Asia-Pacific Economic

Cooperation (APEC) countries agreed to negotiate a list of environmental goods and services for which they would remove tariffs. The agreed-upon list was finalized in 2016.⁸¹ There could be some value in extending those negotiations based on the agreement achieved by APEC.

Another proposal within the WTO is the Agreement on Climate Change Trade and Sustainability. Led by New Zealand, Norway, Fiji, Iceland, and Costa Rica, the agreement seeks to remove tariffs on clean energy goods and services, eliminate all fossil fuel subsidies, and promote environmental labelling of products.⁸² Negotiations were set to get underway in 2020, but no major economies have joined the effort so far.

The Standing Committee on Environment under the WTO is also advancing work and technical discussion on trade and the circular economy—an issue which includes climate change considerations alongside other important environmental concerns. This work is still at the stage of mapping out the intersections of circular economy issues and trade, trying to build a common approach to pursuing circular economy-oriented policies that are compliant with the global trade architecture.

Outside the WTO, the European Union has proposed a carbon border adjustment mechanism (CBAM) to protect domestic industry from cheaper competitors originating from countries without strict emissions reduction policies. The proposal, expected to be adopted in June 2021, has raised concerns over green protectionism, despite assurances from Europe that the CBAM will be crafted with the express intention of discouraging carbon leakage, being trade compliant, and encouraging better environmental performance in other countries.⁸³ While not the first time the international community has encountered a carbon border tariff proposal, Europe's CBAM has spurred conversations about how other countries will react by either coordinating with or combatting the proposal.

Finally, there are a myriad of technology- and sector-specific policies in forums such as Mission Innovation, the Clean Energy Ministerial, and international organizations such as the International Civil Aviation Organization (ICAO) and the International Maritime Organization (IMO). These seek to increase support for the development and deployment of clean energy technologies by working throughout the innovation value chain. These forums operate from a variety of perspectives (e.g., policy, technology, finance, and standards) and bring together public and private sector interests to share insights and experiences.

Proposed Strategy

Propose a G20 agenda item to advance a dialogue on clean energy industrial policy and trade.

Its dual aims should be: (1) to provide direction on how to resolve potential trade conflicts arising from clean energy subsidies and tariffs, and (2) to propose a clean energy supply chain partnership structure to advance deployment of clean energy technologies among companies and countries that adhere to lead environmental standards. The IEA could be an official partner and lend its counsel and expertise on technology readiness and policy measures to help guide the conversation on which technologies are most in need of additional support. The dialogue would likely receive support from the United Kingdom, Korea, Japan, Canada, and perhaps China and India—all countries that have committed to some level of clean energy industrial policy and share concerns that supply chain scrutiny could lead to trade disputes. The proposals arising from this dialogue could inform the subsequent actions and agendas of organizations such as the WTO, UNFCCC, and others.

Provide guidance on how and when to apply trade remedies to climate-related policy action and how to mitigate the damage of doing so.

Possible examples include an agreement to have a sliding scale of allowable subsidy levels based on the overall level of technology readiness to be commercially deployed.⁸⁴ Clean energy technologies that have reached a cost-competitive stage of development could be afforded less latitude for direct subsidy and protection, whereas technologies at earlier stages of development could be allowed more protection. When it comes to promoting domestic industries or local content, there could be some quota levels established to ensure that green protectionism allows for some domestic capacity, both for economic opportunity and supply chain resilience—but also that these measures do not fully block market access. Finally, countries could agree that some of the revenue generated by the tariffs be recycled into clean energy incentives even when trade remedies are levied, thereby at least partially negating the potentially negative impact on clean energy promotion caused by the hiring prices resulting from the tariffs.⁸⁵

Operationalize recommendations through a temporary climate waiver within the WTO.

This would establish some general principles for how to balance the domestic economic benefits of climate change policy while still striving to foster global cooperation and cost reduction. Waivers, within the context of the WTO, are used to provide specific countries and activities exemption from normal trade preference rules. While waivers are normally applied to just one country, in extraordinary circumstances and for only a one-year timeframe, there is precedent for larger and broader applications of a waiver, such as removing intellectual property rights for the purposes of making certain medicines more broadly available.⁸⁶ In this case, a climate waiver could exempt actions taken to achieve climate-related targets from normal trade rules. This could open the door to more aggressive subsidies, domestic purchasing, and domestic industry support, all ideas that countries with ambitious plans to decarbonize their energy sectors by 2050 are likely to promote. In theory, a climate waiver could also clarify the trade rules around carbon pricing, border carbon adjustments, and punitive trade measures against actions that are contrary to international climate objectives. It may be politically infeasible for the waiver to include all these dimensions at first, but even a more limited waiver would represent an important entry-point into broader areas of clarification, and ultimately into reform of the trade rules.

Complement and protect countries' NDCs through the climate waiver.

That is, trade rules would be removed from national measures that are designed to preference the use of energy sources or industrial processes that lower emissions and that are not found to be arbitrarily protectionist.⁸⁷ This means that most of the activity included in a country's NDC (i.e., their climate plan submitted to the UNFCCC for the purposes of joining the Paris Climate Agreement) also subject to trade rules would be allowed, so long as it did not constitute unjustifiable discrimination or was not motivated by climate needs.

Include ongoing sector- and technology-based dialogues to explore the potential for clean energy supply chain alliances.

There are already nascent sector dialogues on clean energy partnership throughout a range of technical associations and trade organizations. These alliances could help provide specific recommendations, guidelines, and advice for how countries can take the principles established in the industrial policy dialogue and apply them within the context of the climate waiver. As noted earlier, there are

already broad multilateral groupings, such as Mission Innovation and the Clean Energy Ministerial process, that work with sectors and supply chains on pathways to reduce emissions through policies, investments, and innovation. These groupings should be brought together to discuss how to accelerate the development and deployment of clean energy technologies in order to protect members of the supply chain from the competitive pressures of less environmentally ambitious firms and countries.

Create supply chain alliances based on agreed approaches to subsidies and incentives, local content requirements, and deployment efforts.

This discussion could include a way to reconcile the carbon border adjustment mechanism idea currently being promoted by the European Union. For example, not all countries will get equal treatment through regulation or carbon pricing of their emissions-intensive industries. Many countries will, however, have firms that choose to act in environmentally stringent ways, be it to gain access to markets with more stringent policies or to partner with companies in the clean energy supply chain with high environmental or quality standards. These partnerships can also work by encouraging governments and consuming industries to establish Buy Clean policies or consumer agreements to help them scale their operations even faster. The steel sector is one possible example: to pioneer lower-carbon steel before it is cost-competitive, producers will need systematic support from governments, access to markets and purchasing agreements, and protection from less expensive but more emissions-intensive competitors. Advancing the development of these technologies will likely require a degree of coordination and cooperation throughout the supply chain for steel and steel-related products all the way to end markets.⁸⁸

Discussion

It should be noted that many countries may find this approach concerning. Proponents of a free trade agenda will see it as a slippery slope to green protectionism and may consider it damaging to the broader WTO reform agenda. Indeed, the United States, the European Union, and Japan have been working on a proposal through the WTO that aims to constrain the state-economy-led practices of China; they have put forward proposals to restrain China's approach to subsidies, state-owned-enterprises, forced technology transfer, and more. These efforts are a source of tension between those three countries and China. Promoting the above strategy may have two desired effects: (1) it may allow China to claim a small victory with its model of state support when it comes to climate action, and (2) it may allow the United States, the European Union, and Japan to focus their reform arguments on other sectors of the Chinese economy by offering a legitimate reason to make an exception for the climate sector.

As the single largest trading relationship in the world, any reform to the rules of global trade has to include the United States and China. It is clearly in both countries' interests to rewrite the rules of the WTO in such a way that further damage from trade disputes can be avoided. While the bilateral trade relationship is strained by years of such disputes, there may be scope for climate-friendly trade reform in a multilateral setting where neither side is perceived to be making direct concessions to the other. In general, China should be very open to a dialogue that seemingly validates its approach to clean energy industrial policy but also seeks to ensure that more ambitious policies do not lead to higher prices for energy technologies that would benefit developing countries. There will be considerable pressure on the Biden administration to pick up where the Trans-Pacific Partnership left off, the threat

of which may be enough to bring China to the table. The issue of climate change offers a possible fulcrum around which such discussion can take place, replacing “free trade” as the moral and narrative driver of reform.

It is also important to persuade developing countries that this type of “green protectionism” will not adversely impact their interests. It will be important to make the case that the trade environment for clean energy goods could still be relatively open despite allowing more ambitious domestic climate policy—particularly if countries are not fighting trade battles with one another—and that if markets expand quickly, the cost of clean energy technology could drop.