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As discussed in other posts on this blog, last month was particularly challenging for those working toward national and international climate agreements. At a summit in Italy, G8 members failed to resolve key sticking points and developing nations refused to sign onto new greenhouse gas reduction targets. In Washington, prospects for passage of a Senate climate bill dimmed as a preparatory hearing of White House officials and Senate leadership revealed a troublesome — and perhaps surprising — road block: our international trade obligations.

The hearing was aimed at finding a path forward for climate legislation, building on work by the House in passing its American Clean Energy Security Act. However, talks ran up against questions about how to craft a comprehensive climate bill that steers clear of collisions with the World Trade Organization.

Reportedly, Sen. John Kerry, D-Mass., expressed his belief that border measures included in the House version must be weakened to fit within the limits of WTO law. Sen. Chuck Grassley, R-Iowa, a ranking Republican and central figure in Senate climate talks, openly doubted the potential for any climate legislation to avoid conflict with the WTO. At the same time, a significant block of Senators, mostly from manufacturing states, appear to be conditioning their support of a bill on the inclusion of the strong border measures that Kerry hopes to weaken. The stage appears set for a fight.

Why would the WTO pose an obstacle to domestic climate change law? Greenhouse emissions are embedded in every product and every service in virtually every economic sector, thanks to the energy, raw materials and transportation used to get them on the market. In large part, those embedded emissions reflect the climate policies and energy sources embraced by their country of manufacture.

The job of a good climate regulation is to distinguish greenhouse-gas intensive products from cleaner alternatives, and to favor the latter. The WTO, by contrast, aims to prevent discrimination among products in international trade based on manufacturing methods or country of origin.

A clash between the WTO, an institution enforcing deregulated export-oriented economic policy for the last 50 years, and innovative climate initiatives may be inevitable.

Any U.S. climate bill will attempt to account for costs of greenhouse gas emissions that the market has failed to internalize during the last half century. The cap and trade system, designed for this purpose, places a price on each ton of greenhouse gas emissions and requires industry to hold one “allowance” per ton of emissions. Some increase in costs to suppliers and manufacturers, especially in energy-intensive industries like steel and iron, may result.

Serious problems arise when these industries compete in an international market with firms from countries that refuse to address the impact of greenhouse gases on our environment.

For example, foreign steel is generally produced at lower costs than in the United States, in large part due to lower labor and environmental standards. Reports suggest that foreign steel manufacturing also results in nearly 300 percent more greenhouse gas emissions, ton for ton, than U.S. steel. U.S. manufacturers, steel workers and communities — and the senators who represent them — are concerned that climate legislation, if not done right, will cause job losses, plant relocations to countries with lax environmental standards, and a resulting net increase in global emissions. This is an obvious losing scenario for U.S. businesses, workers and the environment, not to mention for foreign communities organizing for better social, economic and environmental conditions in their countries.

In response, Congress has embraced policy tools designed to minimize the burden on U.S. businesses and workers, level the playing field for domestic and international firms, and prevent “carbon leakage,” caused when domestic firms pack up and leave for less regulated markets. One such tool is the giveaway of some allowances to energy-intensive and trade-exposed industries in the U.S.

The House border tax provision, from which Kerry suggested the Senate must back away, is another. Starting in 2020, if no international agreement is reached by then meeting certain trade objectives, it would increase border charges on imports from countries with climate plans deemed to be inadequate by Congress and the president, with the aim of re-establishing a fair basis for trade.

However, the WTO enforces rigid tariff limits and a broad definition of illegal subsidies that will almost certainly be used to challenge these mechanisms. The National Treatment principle of GATT Article III requires that imported goods be treated no less favorably than “like” domestic products — and caselaw suggests that greenhouse-gas-intensive products must be considered “like” their cleaner competitors, preventing any discrimination between the two. Likewise, WTO subsidy rules are designed to prevent governments from giving their domestic firms any financial or regulatory benefit that might interfere with market forces, including, potentially, free CO_2 allowances.

Some suggest that countries can defend their climate policies using exceptions to WTO rules for certain environmental regulations. Article XX, for example, provides for an exception to WTO restrictions for regulations “relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.”

But the existence of these exceptions doesn’t solve the climate-trade conflict, for several reasons.

First, they have historically been construed narrowly by trade lawyers and WTO judges, who have little environmental or legislative expertise. Second, such exceptions are entirely absent from several climate-relevant trade agreements likely to be invoked, such as the Agreement on Subsidies and Countervailing Measures.

Third, and importantly, any *ex ante* uncertainty about the legitimacy of these domestic climate policies will likely delay legislation in countries around the world — an especially devastating result, given what scientists tell us will happen if we fail to act quickly to reduce global emissions. Grassley is right to be pessimistic about any climate bill’s chances of successfully navigating these waters.

Unfortunately, the specific WTO conflicts being addressed in Congress are only the tip of a melting iceberg. Unlike competitiveness and “carbon leakage” provisions, many important climate tools have nothing to do with trade, but are equally likely to face a WTO challenge.

Trade rules signed onto by California expose to challenge numerous “green” procurement programs, by which governments flex their own buying power to reduce greenhouse gas emissions, perhaps including the state’s support of renewable energy. Subsidy rules limit the ability of governments to fund infrastructure upgrades necessary to transition to a green economy.

Even seemingly benign measures like eco-labeling, designed to inform consumers about the emissions embedded in the goods they buy (such as by revealing how far food traveled to get to their local store), may be off limits. Remarkably broad language defining illegal barriers to trade, especially in “technical barriers” and “trade in services” agreements, takes special aim at non-tariff (i.e., non-border) regulations. In a recent report on the relationship of trade law and the environment, the WTO specifically cites eco-labeling programs as potentially inconsistent with trade rules. Consumers may thus be prevented from learning about some of the simplest ways to reduce their carbon footprint.

What to do about this conflict? In the short term, the Senate should carefully assess how much to permit current WTO rules to constrain the policy space needed to pass a climate bill this year. This is especially important because international negotiators anticipate that U.S. legislative progress is paramount to the success of landmark talks in Copenhagen this December on a successor to the Kyoto Protocol.

Part of the Senate's calculation, of course, should be an assessment of trade relationship risks, WTO litigation risks, and whether those risks are outweighed by the imperative to act now. It should also consider whether trade rules are likely to evolve on this issue and should push for needed changes.

In the longer run, WTO members should consider several modifications to clarify trade rules and confront the unique climate challenge. First, environmental exceptions must be expanded to apply to all agreements and to include measures that are part of a comprehensive climate strategy, so long as those measures apply evenly to products from all countries. Second, countries should be permitted to treat "like" products differently if their production and processing result in different levels of emissions. Finally, government support for infrastructure upgrades that reduce greenhouse gas emissions must be permitted and even encouraged, especially in developing nations.