Alliance for Market Solutions
A carbon tax policy can be consistent with trade rules
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Background

As policymakers examine solutions to address climate change, the Alliance for Market Solutions (AMS) sponsored research on issues around international trade and a carbon tax policy. More specifically, it examines whether a carbon tax can be designed to apply to imports and exports and also comply with U.S. international trade commitments. The research, conducted by Ambassador Susan Schwab and the law firm Mayer Brown LLP, concluded that it would be possible to adopt a properly designed carbon tax that is consistent with those commitments.

A carbon tax is a consumption tax. Consumption taxes are common features of global tax systems that are widely understood to be consistent with existing trade law, even when applied to imports and/or refunded on exports. In this regard, there are a number of important design features and trade-offs that will need to be considered.

Analysis

In considering a U.S. carbon tax policy, in order to maintain a level-playing field for U.S. producers, one approach would be to collect the tax on imports and refund it on exports. In that case, World Trade Organization (WTO) rules require that the tax is an indirect tax (e.g., excise tax) rather than a direct tax (e.g., income tax). To comply with this requirement, the carbon tax should apply to products, rather than producers' income. Most proposals for a U.S. carbon tax have suggested doing this by implementing the tax on carbon-intensive products at their point of production. This approach is reasonably simple to administer since the tax will need to be collected from fewer entities than if the tax were imposed further downstream.

Treatment of Imports

When assessing the tax on imports, several factors must be considered to ensure that the addition of a carbon tax on imports complies with WTO rules. These include:

- The carbon tax must treat all WTO members equally.
- The tax on products should support the fact that the tax has been enacted for environmental protection.
- Domestic products that are "like" imported products must also be subject to the tax.
- To avoid discriminating against imports, they cannot be taxed more than their "like" domestic counterparts.

Treatment of Exports

- The refund cannot create a "prohibited export subsidy."
- WTO rules are less clear about refunding a tax when downstream products are exported.

Potential Approaches to a Carbon Tax

One general way to categorize the international features of a carbon tax are the following five potential approaches. These approaches produce different results with respect to the environmental impact of the tax, the impact on competitiveness, and the administrability of a carbon tax program.

1. A Trade Agreement-Based Approach
2. Carbon Tax Imposed on Imports, no Refund on Exports
3. Carbon Tax Imposed on Imports and Refunded on Exports Based on Producer-Supplied Data
4. Carbon Tax Imposed on Imports and Refunded on Exports Based on Energy Intensity
5. Carbon Tax Imposed on Imports and Refunded on Exports Using a Uniform Rate

Conclusion

It would be possible to adopt a properly designed carbon tax that is consistent with U.S. trade obligations. Policymakers will need to weigh and balance the issues described above and detailed in the full brief when determining how to structure the tax to achieve this goal.