SUMMARY
TESTIMONY OF GARY N. HORLICK
BEFORE THE UNITED STATES SENATE COMMITTEE
ON FINANCE, JULY 8, 2009

Thank you, Mr. Chairman, and Senator Grassley, for the opportunity to appear before this Committee. I wish to state at the outset that I am not appearing on behalf of any client or any other organization or person.

The issues presented by climate change are extremely complex, and seem to evoke extremely complex solutions. I wish to start, however, with two basic rules to apply to these very complicated questions.

1. Before we adopt any measures in our legislation, would we like it if other countries adopted the same measures? There are good practical reasons for this old-fashioned rule. The U.S. exports about 20% of its manufactured goods. And 30% of U.S. manufactured exports are by small and medium companies. We export about 30% of our agricultural production, which is the difference between a profit and a loss for many of America's farmers.

2. Is the measure consistent with the obligations we have undertaken, most obviously through the WTO Agreements, but also our other agreements? There are also very practical reasons for following this rule. It is tempting to say that we can re-interpret existing WTO rules to permit whatever measures are necessary to protect our environment. But do we really want to change those existing rules? The key to the U.S. economy is constant innovation. One of the important fields where we lead the world of innovation is biotechnology, which is revolutionizing medicine, agriculture, and even many of the environmental concerns dealt with in proposed legislation (such as environmental remediation and renewable fuels). So far the United States has resisted efforts in Europe and elsewhere to limit our market access for our products because of how they are produced – from biotech means. But if we re-interpret WTO

rules to allow trade barriers based on how things are made, we open up a can of worms – and might permit other countries to block our biotech exports, including major items such as corn, soybeans, and other crops.

With these two points in mind, I would like to address some of the international trade issues that have arisen in the context of the climate change debate:

1. The WTO itself, in a recent report with UNEP, has pointed out that some border measures would be permissible as part of a climate change package. But the WTO very carefully stated that WTO rules "permit, under certain conditions" (emphasis added) the use of border measures and indeed the devil is in the details. A VAT-style tax, imposed identically on domestic and imported goods, should past muster, but after that, it gets very difficult to design a border tax which would pass muster, as we have seen with prior GATT and WTO litigation. Requiring emission permits for importers – especially if there are any restrictions on those permits, or if any are given away to domestic producers – would raise serious WTO questions. But before we even get to those legal issues, it may be worth pondering the practical ones.

- As noted above, do we want similar import taxes or permit requirements imposed on our exports. Do we want each country finding a separate basis for imposing border restrictions? Do we want countries with stricter emissions standards than our factory emissions standards blocking our exports? As President Obama pointed out, India and China have lower per capita emissions than we do. Do we want developing countries, including not only China and India, but indeed most countries in the world, blocking our exports on the grounds that our per capita greenhouse gas emissions are greater than theirs?

- Border measures would raise costs for some U.S. manufacturers – just as they have to adapt to new climate change standards.

- In practice, it seems that import restrictions are much more likely to be challenged in the WTO than is financial assistance to producers, such as offsetting costs or giving away permits. Thousands of pages of non-export subsidies are reported to the WTO, but only a handful have been challenged in the WTO, while literally hundreds of border measures have been challenged in the WTO and its predecessor GATT.

2. Permit allocation is not prohibited by the WTO rules – but, again, it depends on the details of the design. Linking permits to export requirements, or requirements to use domestic goods, would be prohibited. And even without those problems, permit allocations could be challenged in the WTO as an "actionable" subsidy. WTO rules require objective criteria -- rules insisted on by the United States. The same subsidy rules would also be relevant in designing incentives for developing new sources of energy, and even renewable energy standards.

3. Obviously, no one country, even one as large as the United States, can clean up Earth's atmosphere on its own. It is essential that all major emitters co-operate in this effort. U.S. efforts will fail if other emitters do not do their part. I have great respect for the U.S. negotiator, Todd Stern, and his team. They certainly have a difficult job, and one which will require close cooperation between Congress and the executive as the U.S. pursues an international agreement. Fortunately, all the major countries realize that they have a stake in this game -- some major developing countries face rapidly increasing desertification if GHG emissions are not reduced worldwide, including by those same countries. Even though there are shared interests, the climate change negotiation will not be easy, and numerous tactical choices will have to be made, such as whether to complete the legislation before the Copenhagen talks. If we make choices which reduce the chances of a good international agreement, we harm ourselves as well.

4. Perhaps the biggest international trade challenge -- and one on which a lot more work needs to be done -- is how the mechanics of international trade will work if each of the hundred and ninety countries (or even 10-15 regional groupings) has its own individual climate change implementation. What if some of them have border taxes, some require permits for imports, and others instead offset the costs for their domestic industry. Or each country has a cap-and-trade system with different limitations on the permits? These are highly practical questions, but, in the end, they will determine the true economic impact of the climate change legislation and agreements.

According to a recent study, an Apple iPOD with a retail price of $299 arrives in the U.S. in a box labeled Made In China, but only $4 stays in China while $130 stays in the U.S. and the remainder is scattered among 18 other countries. How are the 20 countries that collectively make an Apple iPOD going to calculate all the carbon impacts and untangle all those permits, taxes, and rebates? These details need to be worked out carefully – and in advance.

Thank you very much, I would be happy to answer any questions.