

Reviving the Environmental Goods Agreement: Why it Matters, Why It Is Stalled, and How to Move Forward¹

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Environmental goods and services have become an important part of the international trade dialogue. Countries increasingly recognize that the removal of tariffs and non-tariff barriers on such goods could make a significant contribution to the global environmental agenda, including climate change.

In the wake of a decade-long stalemate at the World Trade Organization (WTO) on the subject, a group of 14 countries committed in 2014 to pursue global free trade in environmental goods. They agreed that this plurilateral agreement would take effect “once a critical mass of WTO members participates.”² The initial group, now extended to 17 countries, included several Asia-Pacific Economic Cooperation members as well as Costa Rica, the European Union, Norway, and Switzerland.

In spite of a promising beginning, the negotiations on an Environmental Goods Agreement failed in 2016. Participants could not agree on, among other things, how to extend the Asia-Pacific Economic Cooperation list.³ This paper discusses the underlying factors that led to the failure to reach an agreement. We begin by discussing why the removal of tariffs and non-tariff barriers is desirable from an environmental standpoint and how the Environmental Goods Agreement was supposed to deliver environmental and climate change benefits. We then describe the challenges participating countries faced and the key issues that led to the eventual breakdown. Finally, we conclude the paper by suggesting ways forward to revive the negotiations.

Reducing Tariffs on Green Goods

Global trade in environmental goods is estimated at \$1 trillion.⁴ But tariffs on some of these products, including wind turbines and solar panels, can be as high as 35 percent.⁵ Lowering or eliminating tariffs will accelerate the low-carbon energy transition that is needed to achieve the goals of the Paris Agreement.

Eliminating tariffs on environmental goods and services has benefits with respect to both trade (i.e., lowering costs and thereby increasing trade) and the environment (e.g., facilitating access to the technologies necessary to respond to key environmental challenges).

Environmental Goods Agreement: An Ambitious Plan

The 14 original participants in the negotiation of the Environmental Goods Agreement accounted for almost 90 percent of global trade in environmental goods.⁶ They intended to go beyond the earlier commitment of Asia-Pacific Economic Cooperation leaders in two ways: expanding the list of covered environmental goods beyond the 54 included in the Asia-Pacific Economic Cooperation list; and eliminating tariffs rather than simply reducing them.

Hurdles during the Negotiations

Even after negotiators excluded non-tariff barriers and environmental services to simplify their task, they faced many challenges. These included the content of the list, “free-riding,” and participation.

The major negotiating challenge was which goods to include on the expanded list. For example, negotiators generally supported the inclusion of goods that favored their own situations (i.e., their substantial exports) and vice versa. They also frequently sought to exclude goods with high tariffs, thereby defeating a key objective of the Environmental Goods Agreement.

One contentious issue related to bicycles (tariffed at 9.7 percent in the United States and 14.6 percent in the European Union). China proposed their inclusion, but the European Union, worried that China's overcapacity in bicycle production would flood its market, opposed it.⁷ By any environmental measure, bicycles should be non-controversial; they emit no greenhouse gases; unlike some products (e.g., incandescent versus LED light bulbs), they are not subject to technological change that might justify their addition or removal from the list; and they provide health-related co-benefits.

The disagreement over bicycles highlights the difficulty in reaching consensus on the extension of the list, which was in essence a political exercise. Countries selected goods in which they have particular interests, and others agreed, where possible, to include those goods as trade-offs for their own suggested goods. In the case of bicycles, even trade-offs did allow their inclusion.

Disagreement over how to address "free-riding" was another key reason why negotiations broke down. China indicated its concern about free-riding, given that countries not party to the Environmental Goods Agreement would benefit without having to cut their own tariffs. (They would benefit because, by virtue of the so-called "most favored nation" principles, the parties to the Environmental Goods Agreement would need to accord its tariff-free treatment to all countries not just other parties.)

To avoid free-riding, China suggested that the agreement not enter into force until the countries accounting for 90 percent of world trade had become parties. It also proposed various mechanisms to address a situation where the covered countries dropped below that threshold (e.g., because one or more countries withdrew from the agreement). One of these proposals was a "snap-back" clause, which would have allowed parties to the Environmental Goods Agreement to restore tariffs to those countries unfairly benefiting from most favored

nation treatment.⁸ China's proposal, however, was not accepted, largely due to pushback from the United States.

Another challenge was that China and Costa Rica were the only developing countries participating in the negotiations, and these two countries had significantly different objectives. Obtaining market access for its exports primarily drove China's participation. In contrast, Costa Rica sought to put its economy on a green industrialization track. Costa Rica has a strong track record of environmental leadership, including the goal of becoming carbon neutral by 2021.

At the point when the Environmental Goods Agreement negotiations broke down, the participants had not yet reached certain modalities necessary for the functioning of the agreement, including procedures for revising the list and membership access for newcomers. Parties would need to address such issues in any renewed negotiations.

Next Steps to Revive the Negotiations

We offer three possible avenues to revive the negotiations. First, the agreement should eliminate relevant "nuisance tariffs." Second, negotiating members could take advantage of the new Harmonized System to distinguish goods based on their environmental impact. Third, negotiators should task an independent body to help with future modifications of the Environmental Goods Agreement list. We explore these three options below.

- **Eliminating nuisance tariffs:** A "*nuisance tariff*" is one that is so low it costs the government more to collect it than the amount of revenue it generates. Agreeing on a list of nuisance tariffs for elimination would be "low-hanging fruit" for negotiators. While the covered goods would have a minimal effect in terms of climate change mitigation, the gesture would create good will, particularly towards developing countries. Negotiators could agree to

eliminate tariffs in two steps: they could start by removing nuisance tariffs and remove other tariffs shortly thereafter.

- **Taking advantage of the new Harmonized System:** The Harmonized System is an international product nomenclature of the World Customs Organization.⁹ The 2017 update of the Harmonized System nomenclature could promote the Environmental Goods Agreement agenda because it makes distinctions that are environmentally relevant. As such, it could facilitate the addition and removal of products on the Environmental Goods Agreement list. For example, the new Harmonized System code now distinguishes LED light bulbs from incandescent light bulbs. Using this new system, tariffs on LED bulbs could be set to zero. Likewise, the new Harmonized System has three categories of automobiles: hybrid, plug-in hybrid, and electric vehicles. Tariffs could be set to zero for all-electric automobiles.
- **An institutional suggestion:** To overcome the somewhat self-serving behavior that prevailed during the now-stalled Environmental Goods Agreement negotiations, negotiators could task a commission of independent experts to create a set of criteria for the establishment and subsequent modification of the Environmental Goods Agreement list.

Adding Ambition: Non-Tariff Barriers and Environmental Services

As noted above, the Environmental Goods Agreement negotiators decided early on to simplify their work by limiting the agreement to environmental goods and elimination of tariffs. However, a more ambitious approach, were it achievable, would have a far greater impact on addressing climate change.

Removing Non-Tariff Barriers

Non-tariff barriers are restrictions to trade that do not correct for a market failure. They include, for instance, local-content requirements, growing anti-dumping duties in the renewable energy sector, and weak intellectual property regimes. To illustrate, minimum energy performance standards and mandatory or voluntary labeling schemes can help inform buyers about a product's environmental impacts and thereby reduce environmental damage. However, such standards vary greatly across countries, thus imposing costs associated with conformity assessments—acting, in essence, as trade-restricting measures.

Two patterns stand out in the context of non-tariff measures, often resulting in non-tariff barriers. First, the prevalence of non-tariff measures is generally greater for high-income countries than for lower-income countries. This trend reflects the positive correlation between non-tariff measures on products and measures of product quality—both of which increase with rising per capita income. Second, China's average number of non-tariff measures is relatively high. These high numbers of non-tariff measures suggest that regulatory recognition and harmonization could be a promising avenue to move the Environmental Goods Agreement negotiations forward.

Regulatory Recognition

A key non-tariff barrier is a conformity assessment: a technical procedure that includes verification, inspection, and certification to confirm that products meet certain standards and requirements.¹⁰ Given that these procedures are often lengthy and more costly for importers than for domestic firms, they can essentially act as protectionist measures.¹¹ One way to reduce the time and costs associated with conformity assessments is to establish a mutual recognition agreement. Such agreements, which are designed to eliminate duplicative testing

and certification or inspection to “facilitate mutual market access,”¹² can go as far as permitting countries to accept each other’s approval of a particular product.

Harmonization

Agreement on common labeling could also be a first step objective for an Environmental Goods Agreement. Given the complicated nature of this endeavor under the current WTO framework, there is an advantage to obtaining such cooperation in a small group setting.

In a more environmentally-friendly world, and taking industrial electric motors as an example, adopting the same minimum efficiency performance standard through labeling would demonstrate regulatory convergence.¹³ New codes describing efficiency would be created at the World Customs Organization, which could open the way for negotiating zero tariffs for the most efficient category of electric motors. As motors became more efficient, only the most energy efficient would face zero tariffs, and countries could impose tariffs on the least efficient category. Currently, the WTO is not environmentally-friendly because existing international trade law precludes raising bound tariffs once they have been lowered or eliminated, precluding punishment for free-riders.¹⁴

Inclusion of Environmental Services

Historically, the term “environmental services” in the trade context referred to infrastructure for water and waste treatment. Over time, it has evolved to encompass other non-infrastructure services, such as air pollution control.¹⁵ The role of environmental services is especially important in developing countries where environmental products and technologies are often parts of environmental services-based projects. Although there is a great potential for environmental services to contribute to climate change mitigation, as noted, they have been excluded from the Environmental Goods Agreement agenda.

Even if the participating countries decided to put them back on the Environmental Goods Agreement negotiating table, efforts to liberalize trade in environmental services would still be difficult.

- One significant challenge is that many environmental services do not cross customs, which makes it difficult to collect relevant data.
- Second, building indicators of restrictiveness for services is even harder than it is for non-tariff barriers in relation to goods. Although there is evidence that trade costs in environmental services are high and are probably falling, there are significant disparities in estimates across countries.¹⁶
- Third, negotiators will likely find it challenging to agree on which—from the comprehensive United Nations Central Product Classification services list—should be on a list of “environmental” services.
- Finally, it is challenging to monitor the extent to which a country has fulfilled a commitment to liberalize trade in services as opposed to goods.

Given such complex underlying issues, some scholars suggest that it might be easier to achieve mutual equivalence in select services sectors, rather than aiming for harmonization.¹⁷ While *harmonization* refers to international agreement on the same standards that products are supposed to meet, *mutual equivalence* is an alternative tool whereby trading partners “accept that technical regulations different from their own fulfil the same policy objectives even if through different means.”¹⁸

Equivalence could be a preferable approach to harmonization as it does not involve lengthy and costly negotiations on technical details of international standards.¹⁹ The approach would also be preferable for third parties not participating in the negotiations as they would not have to follow a single prescribed standard, but rather could choose among equivalent

options. One example where parties followed the path of mutual equivalence was the European Union Services Directive.

Conclusions

The successful negotiation of an agreement on environmental goods—and, if possible, services—would be a significant contribution to addressing climate change. It would also serve to strengthen the relationship between the international trade and climate change regimes, including better integrating environmental considerations into the trading system.

An Environmental Goods Agreement would also demonstrate that an issue-specific “club approach” to climate change and environmental negotiations could be a promising way to building a sustainable future. Indeed, there is a growing recognition that the WTO has to move towards “issue-based” plurilateral agreements to deliver on the United Nations’ Sustainable Development Goals. The Environmental Goods Agreement could, therefore, serve as a benchmark for other issue-based agreements among a subset of WTO members.

At the same time, even with a more ambitious Environmental Goods Agreement agenda (e.g., one that included environmental services and/or non-tariff barriers), the trade and climate change regimes would still require further alignment. In particular, the international community needs to agree on creating a WTO framework that would allow countries to better account for the environmental damages associated with international trade. In order to encourage participation, the General Agreement on Tariffs and Trade left the selection of domestic policies, including environmental policies, to the discretion of members—so long as they were applied in non-discriminatory terms. The original approach has yet to evolve. A total recall—call it “WTO 2.0”—is thus needed to address the growing transnational externalities in world trade.

Under this new approach, members would trade assuming a mandate to play a more active role in protecting public goods. Entrusting decisions—or at least ascribing greater weight—to independent scientific advisory bodies could become an integral part of this new WTO and perhaps mark the first step in a shift towards a more comprehensive regime to mitigate climate change.

Notes

¹ A closely related version “ The EGA Negotiations: why they are important, why they are stalled, and challenges ahead “ is forthcoming in the June issue of the *Journal of World Trade*.

² “Joint Statement regarding trade in environmental Goods,” *European Commission*, accessed April 24, 2019, <https://ustr.gov/sites/default/files/EGs-Announcement-joint-statement-012414-FINAL.pdf>

³ Paragraph 31(iii) of the Doha ministerial decisions of November 2001 states that negotiations would cover the “reduction or, as appropriate, elimination of tariff barriers to environmental goods and services.”

⁴ James Bacchus, “Ending tariffs on green goods will show free trade can fight climate change,” *The Guardian*, August 12, 2014, <https://www.theguardian.com/sustainable-business/eliminate-tariffs-green-goods-free-trade-climate-change>.

⁵ Bacchus, “Ending tariffs on green goods will show free trade can fight climate change.”

⁶ “FACT SHEET: WTO Environmental Goods Agreement: Promoting Made-in-America Clean Technology Exports, Green Growth and Jobs,” SICE, accessed April 24, 2019, http://www.sice.oas.org/TPD/EGA/Negotiations/Negotiations0814_e.pdf.

⁷ “Environmental Good Agreement negotiations stall,” *Bicycle Retailer*, accessed November 13, 2018, <https://www.bicycleretailer.com/international/2016/12/07/environmental-goods-agreement-negotiations-stall#.W-s1NrpFxaR>; Tom Miles, “Chinese bikes just one obstacle for WTO environmental trade talks,” *Reuters*, December 2, 2016, <https://www.reuters.com/article/us-trade-environment-idUSKBN13R1UE>.

⁸ ICTSD, “Environmental goods agreement participants prepare final push,” *ICTSD*, September 28, 2016, <https://www.ictsd.org/bridges-news/biores/news/environmental-goods-agreement-participants-prepare-final-push>.

⁹ World Customs Organization, “What is the Harmonized System (HS)?” accessed April 24, 2019, <http://www.wcoomd.org/en/topics/nomenclature/overview/what-is-the-harmonized-system.aspx>.

¹⁰ WTO, “Technical Information on Technical barriers to trade,” *WTO*, accessed April 24, 2019, https://www.wto.org/english/tratop_e/tbt_e/tbt_info_e.htm.

¹¹ Mahesh Sugathan, *Mutual Recognition Agreement on Conformity Assessment: A Deliverable on Non-Tariff Measures in the EGA*, (Geneva, Switzerland: International Centre for Trade and Sustainable Development, 2016); WTO, “Technical Information on Technical barriers to trade.”

¹² Anabela Correia de Brito, Céline Kauffmann, and Jacques Pelkmans, “The contribution of mutual recognition to international regulatory co-operation,” *OECD Regulatory Policy Working Papers 2* (2016): 10, https://www.oecd.org/gov/regulatory-policy/WP2_Contribution-of-mutual-recognition-to-IRC.pdf.

¹³ The International Electrotechnical Commission has published a standard of efficiency for electric motors with three levels of efficiency that has been adopted by many countries. See Sugathan, *Mutual Recognition Agreement on Conformity Assessment*.

¹⁴ William Nordhaus “Climate Clubs: Overcoming Free-Riding in International Climate Policy,” *American Economic Review* 105, 4 (2015): 1339-1370 shows that raising tariffs on members of a climate club—essentially high-income countries—is a credible punishment strategy that would prevent free-riding since it would be in the interest of the punishers to deny market access by raising tariffs and to the free-riders to lower their tariffs to keep market access.; Furthermore, under current WTO law, labeling falls under the Technical Barriers to Trade (TBT) agreement where “likeness” is not adjudicated by reference to the Harmonized Standards but by consumers. In case of a complaint by a WTO member that is not part of the Environmental Goods Agreement that the labeling is unnecessary and discriminatory, so far WTO case law has ruled that it is up to the consumer to decide if the labelling, which has to be non-discriminatory, is necessary. A move towards a WTO 2.0 (see below) under which countries agree that environmental policies are part of WTO obligations is then necessary for labeling to contribute to avert climate change. Petros C. Mavroidis and Jaime de Melo, “Climate Change Policies and the WTO: Greening the GATT Revisited”, in *Towards a Workable and Effective Climate Regime*, eds. Scott Barrett, Carlo Carraro, and Jaime de Melo (VoxEu.org, 2015), 225-236.

¹⁵ Massimo Geloso Grosso, “Managing Request-Offer Negotiations under the GATS: The Case of Environmental Services,” *OECD Trade Policy Papers* 11 (2015), <https://doi.org/10.1787/276102368237>.

¹⁶ James E. Anderson, Ingo Borchert, Asditya Mattoo, and Yoto V. Yotov, “Dark Costs, Missing Data; Shedding some Light on Services Trade,” Policy Research Working Paper #7465, World Bank, 2015.

¹⁷ Patrick Messerlin, “The Quest for an Efficient Instrument in Services Negotiations” in *Building on Bali: A Workprogram for the WTO*, Simon Evenett, Alejandro Jara eds. (VoxEU, 2013).

¹⁸ WTO, “Technical Information on Technical barriers to trade.”

¹⁹ WTO, “Technical Information on Technical barriers to trade.”