



Trade Policy Analysis

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Renewable Fuels and the WTO

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The rapid growth in production of biofuels in developed and developing countries, often encouraged by government incentives and mandates, has resulted in increased international trade of feedstocks and finished biofuels. A discussion paper by the International Food & Agricultural Trade Policy Council titled WTO Disciplines and Biofuels: Opportunities and Constraints in the Creation of a Global Marketplace "examines how the rules of the World Trade Organization (WTO) might apply to the biofuels sector."

The authors use the word "might" because the biofuels industry did not exist when the current WTO rules were written. Biofuels are not subject to a standard classification system and production from agricultural feedstocks leaves much uncertainty about how they should be regulated. The authors suggest "a debate needs to occur on how the rules apply to this technology and how or whether the rules need to be clarified or even changed." They suggest three sets of issues need to be addressed.

The first one is how to classify biofuels; are they agricultural, industrial or environmental goods? Biofuels are produced from agricultural feedstocks; they replace industrial products; and, they are often used to achieve environmental benefits. How they are classified will determine which WTO rules apply. Most WTO members belong to the World Customs Organization (WCO) and use the Harmonized Commodity Description and Coding System, or "HS". In general, biofuels would be considered agricultural or chemical products. Ethanol is classified based on its chemical composition and is in HS chapter 22 as an agricultural product, but there is no differentiation for fuel ethanol versus ethanol for other uses. Biodiesel is in Chapter 38 as an industrial product. Under these classifications, ethanol would be covered by the Agreement on Agriculture, but biodiesel would not be covered. In the currently suspended Doha Round of WTO negotiations, several countries have suggested that biofuels should be considered as environmental goods.

The second set of issues is subsidies for production of biofuel feedstocks, the biofuels themselves and by-products of biofuels production. Major producing countries use some combination of subsidies, mandates and import restrictions to encourage domestic production. If biofuels are considered agricultural products, the subsidies may need to be included in the amber box and be subject to limits. The Subsidies and Countervailing Measures Agreement for non-agricultural products prohibits subsidies for the use of domestic products rather than imported one. If biofuels were considered environmental goods, subsidies could possibly be continued in the name of protecting the environment. The U.S. may already have a problem with cross-subsidies with distillers dried grains that are a by-product of ethanol production and sold into international markets.

Domestic regulations and standards are the third set of issues. The basic approach for the WTO has been one of non-discrimination between domestic products and imported products and among the various potential importers. Imports of "like" products are to be treated "no less favorably" than domestic products for standards and internal tax purposes. The U.S. has already had disagreements with the EU over its standards for biodiesel that favor production from rapeseed widely grown in the EU over soybean oil-based biodiesel. Environmental issues with terms like "life-cycle energy use" and "sustainability" of feedstock production are taking on more importance. Efforts are being made in the E.U. to restrict palm oil imports from Indonesia because of concerns that rainforest are being replaced with palm plantations.

A consistent classification system would seem to be the place to begin sorting out the issues. The authors

suggest that amending the harmonized system would be the best approach, but the time required to do that would mean no changes before 2012. An agreement could be reached within the WTO. This may allow some balancing of whether biofuels are agricultural, industrial or environmental goods, but any agreement would be complex. Individual countries could decide to rationalize classifications and reduce tariffs on imported feedstocks and biofuels.

The subsidy issues will be more complex because of the pervasive use of subsidies and difficulties of determining if a subsidy is a production subsidy, a consumption subsidy or designed to protect the environment. Without resolving the classification issues there will be disputes over which subsidy rules apply to biofuels. Since subsidies reduce economic efficiencies, the longer subsidies are not dealt with the more misallocation of resources will occur and greater the pain when markets are allowed to function. Since subsidies are so common in developed and developing countries, producing and consuming countries may have enough self-interest to seek a joint reduction in subsidies.

Domestic regulations and standards may be a good place to begin working. The Technical Barriers to Trade Agreement focuses on tying domestic standards to internationally agreed upon standards. These do not now exist for biofuels. There are also exceptions to WTO standards based on national security, health, "conservation of exhaustible natural resources" and other reasons.

All of this uncertainty is likely to lead countries to ignore ill-defined WTO obligations. This will cause some countries to file WTO cases to define allowable subsidies and market access. Under this process it will likely take several years to begin clarifying what is and is not permissible in biofuels under the WTO. That is too slow for this rapidly changing industry and could stunt the now developing trade in feedstocks and biofuels.