PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

2

Border Tax Equalization

Steve Charnovitz

The topic of "border tax equalization"[1] does not match any treaty terms in the World Trade Organization (WTO) Agreement (Goode 2007, 61). Rather, the phrase "border tax equalization" is used synonymously with a border tax adjustment, which is a public policy that seeks to use fiscal measures for trade purposes. As Professor Shinya Murase explains, "The whole idea of border-tax-adjustment is, ostensibly, to ensure an equality of competitiveness in each country's market" (Murase 2011, 102). A border tax adjustment is a process by which imports are subjected to and exports exempted from internal taxation (Rosendahl 1970, 88n11) in order to match (for imports) or counteract (for exports) the effects of a domestic fiscal policy on trade. The economic rationale for a border tax adjustment was recognized by economists at least as far back as the early nineteenth century when David Ricardo argued that when a domestic tax raised the price of corn, "a duty should be imposed on its importation" (Ricardo 1822, 15).[2]

This chapter explores several facets of border tax equalization as one of the challenges facing the world trading system. In particular, the chapter will address the following two questions: First, in section 2.1, under what circumstances does the law of the World Trade Organization (WTO) permit border tax equalization?[3] Second, in section 2.2, what are the implications of those disciplines for current multilateral challenges such as climate change? Relatedly, should the WTO law on border tax equalization, including the General Agreement on Tariffs and Trade (GATT), be revised in order to better achieve the goals of the trading system and other multilateral goals?

2.1 Overview of the WTO Law on Border Tax Equalization

Governments are known to apply a variety of policy measures at the border and to imported products within the domestic market. Such

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

measures include, inter alia, tariffs, duties, taxes, charges, regulations, and subsidies. Although perhaps of diminishing significance, the most important border measure is the common tariff. In WTO law, such a tariff is known as an "ordinary customs duty" (OCD). Besides OCDs, governments utilize many other border measures that go by names such as a transitional surcharge, foreign exchange fee, and exceptional duties. Such fees, charges, and duties fall within the GATT nomenclature of "other duties and charges" (ODC). Another type of border measure is the antidumping duty or countervailing duty applied to imported products. When taxes or charges apply (equally or unequally) to both domestic and imported products, such measures are often referred to as "internal taxes" or "internal charges." Such taxes or charges can be imposed on imports or exempted from exports. The economic instrument of an internal regulation is often substitutable with a tax. Such *internal regulations* can be applied solely to imports (for example, a sanitary regulation) or to both imports and domestic production in a symmetric fashion. Although this is not typically done, a *subsidy* applied to domestic production could also be applied to a like imported product. Much more common is the subsidy applied to the exportation of a good, known in the WTO as an (prohibited) export subsidy. The rebating of taxes upon exportation can also be an export subsidy depending on the type and amount of tax rebated. Of course, some tax rebates at time of exportation are not considered export subsidies if they are WTO-allowable border adjustments.

The rationale for the use of such governmental instruments can reflect either domestic or foreign policy interests, or both. The instruments of ODC, OCD, antidumping and countervailing duties, internal taxes and charges, internal regulations, subsidies, and tax rebates are employed by governments principally to achieve a domestic policy purpose (but could also have secondary foreign policy purposes). By contrast, other instruments, including quantitative restrictions, import bans, and export bans, are commonly used not only for domestic policy purposes, but also for international policy purposes. Such quantitative restrictions and import/export bans lie outside of the scope of this chapter.

ODCs, OCDs, trade remedies, taxes, charges, regulations, and subsidies have a variety of motivations including raising revenues, shielding domestic producers from competition, protecting consumers, leveling the playing field, and avoiding double taxation. All of these purposes can be legitimate under WTO law in certain circumstances as noted in the following examples: Purely protective OCDs are permitted in GATT

10755_002.indd 26 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

provided that they exact at levels below or equal to any tariff binding and are imposed on a most-favored-nation basis (or consistently with a preferential trade agreement).[4] Consumer regulations applying to domestic products can generally be applied to imported products provided that the like imported product is not being treated less favorably and the regulation is not more trade restrictive than necessary to fulfill a legitimate objective.[5] A tax on imports intended to raise revenues is permitted provided that the imported product is not being treated less favorably than the like domestic product. The remission at the border of accrued indirect taxes on exported products is permitted.[6] Certain direct taxes related to exports can be remitted in order to avoid the double taxation of foreign source income.[7]

Although the WTO Agreement does not detail legitimate objectives of measures that are legally allowed, within WTO policy discourse several of the preceding measures are justified for the purpose of leveling the playing field with a competing economy. For example, antidumping duties imposed on imports are calibrated to equilibrate to the "full margin of dumping or less" of the foreign production.[8] The highest permitted countervailing duty is equalized to the amount of the foreign subsidy found to exist, "calculated in terms of subsidization per unit of the subsidized and exported product."[9] Although the WTO Agreement on Subsidies and Countervailing Measures (SCM) prohibits employing a subsidy as a "specific action against a subsidy of another Member," governments do regularly take into account the domestic subsidies offered by their trading partners in determining whether to provide parallel domestic subsidies.

Like the other measures, taxes and charges can be imposed or remitted for all of the same reasons noted earlier. An excise tax on a domestically made product is imposed on the like imported product to level the playing field and perhaps to raise revenue. A value-added tax imposed on domestic products is remitted on export to level the playing field and avoid double taxation despite the reduction in revenue for the government.

As noted, the policy rationale in favor of the border tax adjustment can be traced back to the British political economist David Ricardo. After pointing out that a tax on income does not subject the domestic economy to any disadvantage in foreign commerce, Ricardo explained:

> A tax, however, which falls exclusively on the producers of a particular commodity tends to raise the price of that commodity. ... If no protecting duty is imposed on the importation of a similar commodity from other countries,

10755_002.indd 27 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

> injustice is done to the producer at home. ... It is for the interest of the public that he should not be driven from a trade which, under a system of free competition, he would have chosen, and to which he would adhere if every other commodity were taxed equally with that which he produces. ... The growers of corn are subject to some of these peculiar taxes, such as tithes, a portion of the poors' rate, and perhaps one or two other taxes, all of which tend to raise the price of corn, and other raw produce, equal to these peculiar burdens. In the degree then in which these taxes raise the price of corn, a duty should be imposed on its importation. ... By means of this duty and this drawback, the trade would be placed on the same footing as if it had never been taxed, and we should be quite sure that capital would neither be injuriously for the interests of the country, attracted towards, nor repelled from it. (Ricardo 1822, 13–15)

In other words, in order to avoid injustice to home producers and to promote the interest of the public, when a domestic commodity is taxed, an equivalent duty should be imposed on the importation of a similar commodity from other countries. Ricardo promoted such an adjustment for domestic taxes that burden producers of a commodity and that raise the price of the commodity. He illustrated his principle by pointing to "peculiar taxes, such as tithes, a portion of the poors' rate, and perhaps one or two other taxes."

The GATT has always provided policy space for such Ricardian duties. Although GATT Article II:1(b) second sentence prohibits the imposition of ODCs,[10] GATT Article II:2(a) carves out from that discipline "a charge equivalent to an internal tax" in respect of the like domestic product. Specifically, Article II:2(a)[11] provides the following: "Nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product: (*a*) a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III* in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part." In other words, as Frieder Roessler explains, this provision clarifies that governments have a right to burden imports with the collection of the charges specified in Article II:2(a) (Roessler 2010, 267).[12] Furthermore, Roessler observes that the purpose of the border adjustment is "To equalize conditions of competition" (268).

The logic of the GATT-permitted border adjustment is trade neutrality (Leontiades 1966, 173–174). The motivating idea is that while indirect taxes are shifted into the price of the product, direct taxes are shifted back to producers taxes (174). Thus, in allowing adjustments for indirect taxes on products, the GATT was thought to be trade neutral for exports

10755_002.indd 28 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

by stripping out the taxes imposed at the origin. Similarly, by enabling tax adjustments to imported products, the GATT was thought to be trade neutral for imports by allowing the imposition of a charge to reflect whatever internal product tax exists. Of course, whether this framework for border adjustments achieves neutrality depends on the accuracy of the assumption that indirect taxes are fully shifted forward and direct taxes are fully shifted back. Yet as trade experts recognized by the 1950s,[13] this economic assumption was unwarranted, and therefore the allowable and disallowable border adjustments would not necessarily achieve trade equality. Moreover, as Jagdish Bhagwati and Petros Mavroidis observe, "it is far from easy to distinguish between direct and indirect taxes" (Bhagwati and Mavroidis 2007, 305).

Another legal issue is whether a regulation can be border adjusted via a fiscal charge on the import. For example, can a domestic regulatory cap and trade system be decomposed into a cap-and-trade equivalent charge to be applied to imported products? Traditionally, commentators have denied that such cross-adjustment was a possibility pursuant to GATT Article II:2(a). For example, Professor Rick Kirgis explained in his seminal article on trade and environment that "if legal regulation is used in place of the production tax, it almost certainly could not be supplemented by cost-equilibrating import charges on bound items without running afoul of [GATT] article II" (Kirgis 1972, 900). Paola Conconi and Jan Wouters wrote in 2010 that "the exception under Article II:2(a) seems to require that there exist a domestic *charge* (e.g. not product standard) that is counterbalanced by a border charge" (Conconi and Wouters 2010, 258; emphasis in original). Most WTO law commentators (including me) would continue to deny the possibility of cross-regulation/tax adjustment, but a comprehensive analysis would have to take into account public policy defenses under GATT Article XX. Moreover, as Don Regan has noted, whether a measure for border adjustment purposes is a tax or a regulation may not be clear (Regan 2009, 122), an ambiguity reflected in the U.S. Obamacare debate.

GATT and WTO caselaw is sparse regarding the interpretation of border adjustment rules. The GATT Article II provision came into play in the GATT *Superfund* case, where Canada and the European Economic Community (EEC) challenged a U.S. tax on certain imported substances.[14] Under this U.S. tax, "the amount of tax on any of the imported substances equals in principle the amount of the tax which would have been imposed under the Superfund Act on the chemicals used as materials in the manufacture or production of the imported substance if the taxable

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

chemicals had been sold in the United States for use in the manufacture or production of the imported substance."[15] In defending itself against a claim of a GATT violation, the United States pointed to GATT Article II:2(a) and argued that the Superfund Act "imposed the same fiscal burden on imported and like domestic substances."[16] The panel agreed with the United States that its excise tax adjustment was consistent with GATT Articles II:2(a) and III.[17]

Superfund was a highly precedential case in explicating the contours of the GATT Article II:2(a) exemption to border tax adjustments for environmental purposes. The EEC argued that the U.S. tax was not "eligible for border tax adjustment" because "It was a tax on pollution …," not a sales or excise tax imposed for general revenue purposes.[18] In addition, the EEC and Canada argued that the pollution created in the production of the imported substances did not occur in the United States, and "it was therefore inappropriate to tax these substances upon entry in the United States."[19] In addition, the EEC argued that "it was incorrect to assume that the border tax adjustments were necessary to avoid giving foreign producers an unfair advantage."[20] Rather, the EEC suggested that the foreign competitors of the United States "could be assumed to have paid for the pollution caused by the production of the chemicals and substances either directly—by paying a tax for the removal of pollution—or indirectly—by meeting regulatory requirements designed to prevent pollution."[21] Based on that theoretical construct, the EEC then argued that the U.S. border tax adjustments gave U.S. producers an unfair advantage because a chemical exported from the EEC to the United States "would have to bear the costs of environmental protection twice: once in the exporting country in accordance with the Polluter-Pays Principle and upon importation into the United States under the Superfund Act."[22] The EEC further argued that it was inappropriate for the United States to exempt export sales of the involved chemical from the excise tax "because the pollution caused by the production of those chemicals occurred in the United States whether the chemicals were sold in the domestic market or abroad."[23]

The panel rejected the entire line of reasoning put forward by Canada and the EEC. Notably, the panel did not view the contested measure as a tax on pollution, but rather a tax on a product. According to the panel, the purpose of a tax is irrelevant: "Whether a sales tax is levied on a product for general revenue purposes or to encourage the rational use of environmental resources, is therefore not relevant for the determination of the eligibility of a tax for border tax adjustment."[24] The panel went on

10755_002.indd 30 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

to explain that although the GATT's rule on tax adjustment set maxima limits for adjustment, governments were free to impose a lower tax or no tax at all on like imported products.[25] In addition, the panel did not buy the EEC's argument that the putative double taxation occurring from the burden of the environmental tax being imposed both in the exporting country and in the importing country needed to be taken into account in making a border adjustment. In other words, the panel affirmed the view of the United States that GATT's border adjustment rules were inward looking and formalistic.

The *Superfund* case played an important role in 1987 in teeing up several difficult issues that were discussed extensively in the trade and environment debate of the 1990s and that continue to complicate the trading system today. These issues include (1) what kind of taxes or charges are eligible for border adjustment; (2) when rebates on environmental or energy taxes are a prohibited export subsidy; (3) how a defendant government shows that a border tax equalization qualifies for the carveout in GATT Article II:2(a); (4) whether environmental purposes are still irrelevant under GATT Articles II:2(a) and III:2; and (5) how recourse to Article XX (General Exceptions) by the defendant would make a difference in cases challenging policy-motivated border tax adjustments.

Only one dispute has occurred during the WTO era under GATT Article II:2(a), the case of *India—Additional Import Duties and Extra-Additional Duties on Imports from the United States*. In this dispute, the complainant United States challenged certain additional and extra-additional duties levied on imports into India that were designed to "counterbalance" domestic sales taxes, value-added taxes, and various other local taxes. Ultimately, neither the panel nor the Appellate Body found any violations. But the Appellate Body in dicta suggested that many of the Indian border charges challenged did not meet the conditions of GATT Article II:2(a).

In doing so, the Appellate Body offered some important interpretations of the relevant GATT rules, and in particular of the availability of GATT Article II:2(a) to justify an ODC with respect to its alleged "corresponding" domestic "counterparts":[26]

- ODCs cover only duties and charges (on imports) that are not OCDs.[27]
- Article II:2(a) "exempts" a charge from the coverage of Article II:1(b) only when the Article II:2(a) conditions are met.[28]

10755_002.indd 31 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

- Whether a measures is a "charge" under Article II:2(a) or an "internal tax or other internal charge" under the Ad Note to GATT Article III "has to be decided in the light of the characteristics of the measure and the circumstances of the case."[29]
- An ODC is not necessarily of a nature that it discriminates against imports.[30]
- The term "equivalent" in Article II:2(a) needs to be interpreted "harmoniously" with the requirement of consistency with Article III:2.[31]
- The requirement for consistency with Article III:2 applies both to an internal tax as well as a charge.[32]
- The requirement for equivalence between a charge and an internal tax requires a comparative assessment that is both qualitative and quantitative in nature; such an assessment needs to include elements of effect, amount, and value, and a look at the "relative function" of the charge and the tax.[33]
- Consistency with Article III:2 is a necessary condition to qualification under Article II:2(a).[34]
- A plaintiff in making a prima facie claim under Article II:1(b) may be required not only to present arguments regarding that provision, but also to present arguments that the challenged measure is *not* justified under Article II:2(a).[35]

Although these holdings suggest many avenues for finding charges and taxes to be equivalent, no follow-on jurisprudence has discussed the many implications of this decision. So this case and the GATT-era *Superfund* case continue to remain the only significant jurisprudence on border adjustments under Article II:2(a).

The WTO law on border adjustments is also informed by the talismanic 1970 *Report of the Working Party on Border Tax Adjustments* (GATT 1970), which has been cited by five Appellate Body reports. The Working Party begins its report by defining "border tax adjustments"—based on a definition elaborated upon in the Organization for Economic Co-operation and Development (OECD)—as measures that "enable exported products to be relieved of some or all of the tax charged in the exporting country in respect of similar domestic products sold to consumers on the home market and which enable imported products sold to consumers to be charged with some or all of the tax charged in the importing country in respect of similar domestic products" (GATT 1970,

10755_002.indd 32 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

para. 4). In addition, the Working Party made several points that undergird the current doctrine on border adjustments. First, the GATT provisions on border tax adjustment "set maxima limits for adjustment (compensation)" (para. 11).[36] Second, taxes "directly levied on products were eligible for tax adjustment," such as excise duties, sales taxes, and value-added taxes (para. 14). Third, "certain taxes[37] that were not directly levied on products were not eligible for tax adjustment," such as payroll taxes (14).[38] Fourth, no GATT consensus existed as to the eligibility for adjustment of "taxes occultes" (hidden taxes), which are certain consumption taxes on capital equipment, and taxes on advertising, energy, machinery, and transport (para. 15(a)). Fifth, no consensus existed on other taxes, such as property taxes, which "are not generally considered eligible for tax adjustment" (para. 15(b)). Sixth, the Working Party made the useful suggestion that the term "border tax adjustments" be replaced with "tax adjustments applied to goods entering into international trade" (para. 5). Seventh, the Working Party provided excursus on the term "like product" (para. 18) and this is the part of the report that has been regularly alluded to in the WTO jurisprudence. Of course, the WTO caselaw on "like product" has continued to evolve and is more nuanced today than suggested by a rereading of the 1970 Working Party report. In addition, the Working Party made a statement that continues to be cited but that clearly is no longer good law, even if it was good law at the time.[39] That is, the Working Party asserted that "GATT provisions on tax adjustment applied the principle of destination[40] identically to imports and exports" (para. 10).

With regard to exports, the rules are in the original GATT and the SCM Agreement. The GATT clarified that the exemption of an exported product from duties or taxes "borne by the like product when destined for domestic consumption" shall not be deemed to be a subsidy."[41] In 1960, the GATT Working Party on Subsidies enacted an interpretation of "subsidy" that included the remission on exported goods of "direct taxes or social welfare charges on industrial or commercial enterprises" (GATT 1960). This interpretation was brought forward into the SCM Agreement which prohibits adjustments for direct taxes and social welfare charges and permits adjustments for indirect taxes so long as the adjustment is not in excess of the domestic tax.[42] Direct taxes are defined to be taxes on wages, profits, interest, rent, and all other forms of income including the ownership of real property. Indirect taxes, however, are defined more inclusively to include sales and excise taxes, but also "border taxes and all taxes other than direct taxes and import charges."[43] Since direct taxes

10755_002.indd 33 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

are defined by example, and the examples do not include taxes occultes, one could argue that taxes occultes are treated by the SCM Agreement as indirect taxes rather than formalistically as direct taxes. The inclusion of "border taxes" as an indirect tax is puzzling, but one probably should not assume that any tax applied at the border is an indirect tax.

This ambiguity about the meaning of "indirect taxes" leaves open the possibility that export rebates are possible for energy or environmental taxes. For example, a carbon or energy tax could be an indirect tax "levied in respect of the production" of a product.[44] Indeed, on the one hand, one scholar has recently opined that rebates of energy and carbon taxes are justified under the SCM Agreement (Coppens 2014, 518). On the other hand, a carbon tax could be a "social welfare" charge for which an export rebate has been prohibited since 1960.

Although the *Report of the Working Party on Border Tax Adjustments* applies just as much (or more) to exports as it does to imports, the report is less relevant today for exports because export law has been clarified by the SCM Agreement, which seems to permit adjustments beyond those validated in the report. For example, the SCM Agreement allows the rebate of prior-stage cumulative indirect taxes levied on "inputs" that are consumed in the production of the exported product.[45] "Inputs consumed in the production process are defined as "inputs physically incorporated, energy, fuels and oil used in the production process."[46] After this 1994 provision had been finalized by negotiators and publicly released, praise for the new text in some quarters provoked negotiators to reexamine the treaty and to assert that it was not intended to apply the destination principle to energy-intensive exports (Hufbauer 1996, 49–50). So far, this provision has not been interpreted in WTO dispute settlement but based on WTO jurisprudence, a textual interpretation would be favored over one premised on tenth-inning negotiating history.

By defining inputs to include energy and oil used in the production process, the SCM Agreement would seem to allow export rebates of taxes on inputs such as energy. Thus, the SCM Agreement does not follow a physical incorporation principle in distinguishing between a permissible export rebate and an export subsidy. By contrast, the 1979 GATT Subsidies Code had limited export remission to indirect taxes on goods that were "physically incorporated" into the exported product" (GATT 1979, Annex item (h)). That rule reflected U.S. countervailing duty policy at the time, which distinguished between tax rebates that were not subsidies and those that were subsidies, such as rebates of tax occultes, which were

10755_002.indd 34 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

subject to U.S. countervailing duties (Hufbauer and Shelton-Erb 1984, 56–57).

Putting all this together, one can restate the WTO law on border tax equalization. Three basic principles can be noted. First, imports and exports are not treated symmetrically. Second, with regard to imports, a government may impose a border charge on an imported product when such charge is equivalent to (and not in excess of) an internal tax on a like domestic product. Under GATT Article II:2(a), a government may also impose a border charge on an imported product when such charge is equivalent to an internal tax in respect of an article "from which"[47] the imported product has been manufactured or produced in whole or in part.[48] Moreover, because Article II:2(a) incorporates Article III:2, a charge imposed on an import cannot be in excess of a tax or charge applied directly or indirectly to a like domestic product. Third, with regard to exports, a government may remit (or relieve) from an exported product an indirect tax, but may not remit in excess of those taxes levied in respect of the production or distribution of like products when sold for domestic consumption. In addition, internal payroll or social security tax cannot be rebated on exports.

This restatement of WTO law on border equalization is summarized in table 1.1.

Having restated the positive law, this chapter should also underline the lacunae in the law. In my view, three fundamental issues remain unresolved: First, would a tax occultes be border adjustable on imports or exports, particularly when such a tax—for example, a pollution tax or an energy tax (Charnovitz 2003, 148)—is crafted as a tax on a product? The *Superfund* case teaches that certain environmental taxes can be border adjustable on imports, but its holding does not extend to taxes on producers rather than taxes on products.

Second, are property taxes adjustable? Footnote 58 of the SCM Agreement precludes adjustment on exports of property taxes.[49] But how about imports? In introducing the concept of a border adjustment and explaining why it was sound economic policy, Ricardo gave examples of tithes and the poors' rate, which in English law were fiscal, or in-kind measures imposed on property production and income. (The poors' rate was a tax used to assist the poor.) Ricardo viewed such taxes as burdening producers and raising commodity prices. Of course, GATT law need not match Ricardo's categories, but a rereading of his works raises the question of whether the "peculiar taxes" that Ricardo discussed are necessarily taxes

10755_002.indd 35 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

Table 1.1
When do WTO rules prohibit border equalization of social and environmental taxes?

	Measure	WTO law status
On imports		
	Application of charge equivalent to a domestic tax on like products	Permitted by GATT Art. II:2(a)
	Application of a charge equivalent to a domestic tax on inputs physically incorporated in the imported product	Permitted by GATT Art. II:2(a)
	Application of a charge equivalent to a domestic tax on inputs used in making the imported product	Arguably prohibited by GATT Art. III:2 and II:2(a), but status unclear
	Application of a charge equivalent to the economic effect of a domestic regulation on like products	Prohibited by Article II:2(a)
On exports		
	Exemption of a tax or charge borne by the domestic product	Permitted by SCM Agreement and GATT, ad art. XVI
	Exemption of a tax on inputs physically incorporated in the exported product	Permitted by SCM Annex I item (h)
	Exemption of a tax on inputs used in making the exported product	Arguably permitted by SCM Annex II, but status unclear

of the type for which border adjustments are precluded on imports. Recall again that the GATT Working Party left the question of property taxes unsettled.[50]

Third, how narrowly does the accordion of product likeness contract in comparing an imported and a domestic product, each of which has different environmental or social externalities? In other words, is a widget made with clean energy a *like* product to a widget made with carbon energy? A recent development in WTO caselaw, discussion of which follows, makes the answer appear to be no.

10755_002.indd 36 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

A border tax adjustment on imports that violates GATT Articles I, II, or III could be defended by the General Exceptions in GATT Article XX that can exculpate measures that would otherwise violate the GATT. Even though Article XX could save a border tax equalization, most of the legal debate revolves around justifying such adjustments under baseline GATT rules. After all, if the Article XX exception ultimately is needed, then there would be no particular benefit in using a border adjustment over some other instrument.

Although a restatement of Article XX doctrine and caselaw is beyond the scope of this chapter, four key points can be noted: First, traditionally border tax adjustments were used to achieve trade and competitiveness purposes. That motivation is clearly insufficient for an Article XX justification. As noted in the World Economic Forum, "measures taken to ensure continued competitiveness in the marketplace are not environmental measures eligible for the GATT defence" (World Economic Forum 2010, 11).[51] Second, a climate border adjustment may reflect mixed motives of both trade and environment. Although a tax measure instituted to make a domestic regime politically feasible would be viewed by a WTO panel as falling outside of allowable environmental purposes, using a border measure on imports to incentivize foreign behavior could be a valid Article XX defense.[52] Back in 1972, Frederic L. Kirgis expressed skepticism that Article XX(b) could be used to justify a border charge for health purposes, stating that the "bond between the charge and the health measure is too tenuous" (Kirgis 1972, 901). Over forty years later, there is GATT caselaw wherein the Article XX(b) justification has been accepted, but none of those cases involved something as tenuous as applying a tax to address a production externality in another country. Third, a border adjustment on exports that violates the SCM rules by being a prohibited subsidy cannot be saved by GATT Article XX (Shadikhodjaev 2015, 499–500). Moreover, even aside from the problem of SCM as higher law than the GATT, the terms of Article XX could not shield a remission of a tax on export because there would not be any environmental reason to do so. Fourth, to qualify under Article XX, a measure must pass scrutiny under the chapeau of Article XX which requires "that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade." This provision has been interpreted to require transparency, due process, and flexibilities for individual exporting countries (Voigt 2009, 228–231). In my view, these requirements

10755_002.indd 37 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

preclude imposing on imports a charge calculated on the basis of the carbon content in domestic production (as opposed to the production in the country of export).[53]

2.2 Using Border Adjustments for Climate Challenges

The interface of climate and international trade was recognized from the beginning of the climate regime. The UN Framework Convention on Climate Change (UNFCCC) states the general principle that "Measures taken to combat climate change, including unilateral ones, should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade" (Art. 3.5). Neither the UNFCCC nor any subsidiary acts discuss border tax equalization.

Over the past fifteen years, considerable attention has been devoted to the idea of imposing and adjusting carbon taxes at the border. For example, one recent study defines a "carbon-motivated border tax adjustment" (CBTA) as "a tax on the emissions of products imported by any region or country to compensate for different carbon policies (and especially carbon taxes) on products from different origins that compete in the same market."[54]

Can a domestic carbon tax be imposed at the border to imports? This simple question should be easy for a WTO lawyer to answer, but unfortunately, the answer is not clear. To elaborate the question, suppose a government imposed a domestic tax on carbon emissions entailed in the upstream production of a widget. Or suppose that a government imposed a domestic tax based on the sources of energy used in making the widget. Would it be legal for the government to impose a border charge on imported like widgets?

If such a carbon charge is to be GATT-legal, it would have to have an extraterritorial character. In other words, the importing country government would have to calculate the charge to be equal to the tax that would have been imposed on the widget had its law applied to the production.[55] The *U.S.–Gasoline* case, the WTO's first environmental case, certainly teaches us that an effort to use a shortcut, such as imposing on the import the average domestic tax, would be viewed as a violation of national treatment. Note that the calculation of the border carbon charge based on facts occurring in a foreign country is no different than what occurs in antidumping law.

Whether such a carbon charge on imports would meet GATT's border adjustment rules depends on the status of the taxes involved. As noted

10755_002.indd 38 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

earlier, the legal status of so-called taxes occultes is not settled in GATT law and therefore a tax on either energy consumed or pollution emitted might or might not qualify for a border adjustment. One of the leading WTO law experts, Frieder Roessler, has written that GATT Articles II and III "do not permit Members to offset the competitive impact of internal taxes borne by producers (such as energy taxes raising the costs of transportation) and regulations affecting exclusively production (such as emission regulations increasing the cost of production)" (Roessler 2010, 271). In support of that position, one could note the failure of Germany's efforts at the GATT in 1954–1955 to clarify that under Article III, the border adjustment could reflect internal taxers at various stages of production including "the power consumed for the production" of the finished products" (GATT 1995, 144–145).

Roessler's position may be a majority view, but other analysts disagree. For example, I believe that a true carbon tax matched to the carbon footprint of a product could be adjusted at the border (Hufbauer, Charnovitz, and Kim 2009, 67–69). Roessler seems to want to distinguish between taxes on products and taxes on producers, but products veritably do not pay taxes. The payer of taxes is the taxpayer. So, for example, a so-called indirect sales tax on the sale of a product is paid by the seller or the buyer. Thus, while GATT doctrine holds that sales taxes are border adjustable, there is no obvious way to distinguish the adjustability of different kinds of indirect taxes. For example, if an excise tax on a vendor for the "privilege" of selling[56] is adjustable, why not an excise tax on a manufacturer for the privilege of polluting?

When the GATT Working Party discussed taxes occultes in 1970, the Working Party indicated that the scarcity of complaints indicated a relative lack of importance justifying its decision to conduct no further examination (GATT 1970, para. 15). Today the issue has grown in importance and should such taxes be border adjusted, there would be a lot of trade complaints. At the same time, the ranks of carbon border adjustment defenders have been growing. For example, a study from 2011 suggests that applying domestic energy and pollution taxes to imports would be "indirect" product taxes with a nexus between the tax and the product based on the goal of "creating a level playing field between like products in the country of destination" (Kaufmann and Weber 2011, 520). A more recent study finds that "BTA [border tax adjustment] can serve as a device to ensure a level playing field between countries with high and such with lax or no environmental policies" (Weber forthcoming, 4).

10755_002.indd 39 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

Being able to impose a border charge on an import based on its production process raises the issue of PPMs, an acronym for processes and production methods. The legal question is whether a WTO court would ever treat two otherwise "like" products as *not* like based on the PPMs used in producing the product. That matters because if the imported high-carbon-footprint widget is a like product to the domestic low-carbon-footprint widget, then imposing the border charge on the imported widget would be a violation of national treatment (GATT Article III:2).

For many decades, trade law doctrine has denied that PPMs could lead to product unlikeness, but the caselaw has evolved on how to consider the factor of "consumers tastes and habits" identified in the *Report of the Working Party on Border Tax Adjustments* (GATT 1970) as one of the relevant factors in determining product likeness. Indeed, two leading WTO law commentators, Jagdish Bhagwati and Petros Mavroidis, contend that "a consumer (in the eyes of the Appellate Body) who is aware of the environmental (and eventually health) hazard that global warming might represent, will treat the two goods (*Kyoto Protocol*-compatible, *Kyoto Protocol*-incompatible) as unlike goods" (Bhagwati and Mavroidis 2007, 308; original footnotes omitted).

Although it did not consider product likeness, the recent decision of the Appellate Body in *Canada—Renewable Energy/FITs* shows an important evolution of the caselaw. In that dispute, the central issue was whether the Ontario renewable energy subvention was a subsidy as defined in the SCM Agreement (Cosbey and Mavroidis 2014, 23). A contested question was whether the feed-in-tariff provided a "benefit" to the recipient and for that, the Appellate Body held that the relevant market for analysis was not the wholesale electricity market, but rather electricity produced from certain renewable energy.[57] The Appellate Body did not specifically state that electricity made from renewable energy was not a like product to electricity made from carbon energy, but based on past jurisprudence, if two products do not compete in the same market, then not only are they not "like" under GATT Article III:2 first sentence, but they are also not "directly competitive" under GATT Article III:2 second sentence. The legal significance is that when two products are not like, then treating the imported product less favorably cannot be a violation of national treatment. This holding has important implications for the PPM question.

10755_002.indd 40 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

The MFN Problem for Carbon Adjustments

The application of border adjustments to imports also raises issues under the most-favored nation disciplines in GATT Article I.[58] Consider an easier and then a harder question. The easier question is whether the border adjustment on a widget from Country A can be higher than on a widget from Country B if the production process in A is more carbon intensive than in B. In my view, the answer has to be yes, assuming that a border adjustment linked to carbon intensity is permissible in the first place. In *Superfund*, the amount of the tax on the imported substance could have differed from country to country depending on the product composition. But if two countries had an identical production process, then the tax for those two countries ought to be the same.

The harder question is whether the border tax adjustment can treat exporting countries differently not based on the production process used for a shipment of products, but rather on the laws of the exporting country. To put this more concretely, if Country A already imposes a carbon tax on a good and does not remit the tax on export, can importing Country E refrain from taxing the imported product so as to avoid double taxation or double burdening? Such double burdening would arguably make the imported product uncompetitive. Or in other words, if Country E refrains from border taxing the import from green Country A but Country E does impose the border tax on environmentally indifferent Country B, would Country B be able to complain to the WTO that there is illegal discrimination?

This problématique arose early in the GATT in the *Belgian Family Allowances* case in 1952.[59] To complement the domestic tax revenue it was using to pay for family allowances, Belgium had imposed a parallel domestic tax on imported goods purchased by public bodies.[60] Yet in an exercise of comity, Belgian had exempted from taxation imports from countries whose system of family allowances met requirements similar to Belgium's system. (Belgium was not using its provision to encourage other countries to adopt a similar social policy, but rather was presumably seeking to avoid double taxation.) Norway and Denmark had been denied the exemption and brought a case to the GATT seeking to show that they were as qualified for the exemption as France and other countries, and alleging discrimination. The complainants won the case but on much broader grounds because the panel ruled that the entire system of policy-linked exemptions violated GATT Article I:1.

Belgian Family Allowances established an important precedent in the trading system that remains good law today although one should note

10755_002.indd 41 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

that Article XX would be available as a defense for a policy motivated system of exemptions if that policy is covered within Article XX. In addition, one should note that WTO jurisprudence has left open the issue of whether certain origin-neutral distinctions (e.g., based on corporate characteristics) could be consistent with GATT Article I. The most recent Appellate Body holding came in the 2014 EC—*Seal Products* case where the appellators stated that "Article I:1 permits regulatory distinctions to be drawn between like imported products, provided that such distinctions do not result in a detrimental impact on the competitive opportunities for like imported products from any Member."[61]

The issue of whether to exempt the imported product from a border adjustment for policy reasons was at the forefront of the 1970 *Superfund* case and has reappeared in discussions of trade and the environment since then. As noted earlier, the EEC argued that the United States should have assumed that foreign producers had already paid a tax on pollution and therefore its exports should have been exempt from the border adjustment so that its producers would not have to bear the costs of environmental protection twice.[62] The panel rejected this line of reasoning, holding that the United States was entitled to a tax adjustment to match its tax on like domestic products.

The two GATT panel holdings—*Superfund* and *Belgian Family Allowances*—combine to create a policy conflict. On the one hand, the adjustment on imports is allowed to equilibrate competition. Yet on the other hand, applying the adjustment to imports from certain countries could disequilibrate competition because the exported product would already be bearing the burden of the tax at home. But GATT Article I and *Belgian Family Allowances* rule out distinguishing imports based on their origin.

One traditional answer to this conundrum going back to early OECD studies is that if all countries remitted such a domestic tax on exports, then in principle there would be no double taxation. But the problem is that relevant government instruments are broader than just taxes on products. Taxes on processes and producers may not be rebatable on exports under the SCM Agreement and the cost of regulations cannot be remitted to exporters. Furthermore, a government for environmental (or even budget) reasons may not want to remit taxes on exports. Thus, GATT Article I will constrain the ability of a government to tailor its border adjustments to conditions in other countries.

10755_002.indd 42 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

Legality of Proposed U.S. Border Carbon Equalization

Several governments considering climate legislation have floated proposals to utilize border adjustments to address so-called carbon leakage or to avoid competitiveness impact. Such proposals have been a particularly salient feature in the U.S. legislative process (Durán Medina and Polanco Lazo 2011, 31). For example, consider the Healthy Climate and Family Security Act of 2014 (H.R. 5271), introduced by Congressman Chris Van Hollen and colleagues in July 2014. This bill caps carbon emissions, auctions carbon pollution permits, and returns these auction receipts to American residents. In addition, the Van Hollen bill includes a chapter on "Border Adjustments" that would impose a "carbon equivalency fee" on imports of carbon-intensive goods. The amount of the carbon equivalency fee would be set equal to the cost that domestic producers of a comparable carbon-intensive good incur as a result of (1) prices paid in the acquisition of carbon permits by covered entities; and (2) carbon equivalency fees paid by importers of carbon-intensive goods used in the production of the comparable carbon-intensive good. The bill also provides for a payment to exporters of carbon-intensive goods produced in the United States. The amount of the payment would be equal to the cost that domestic producers of the carbon-intensive good incur as a result of (1) prices paid in the acquisition of carbon permits by covered entities; and (2) carbon equivalency fees paid by importers of carbon-intensive goods used in the production of the comparable carbon-intensive good. The bill also contains a sunset provision for the import and export provisions that states that these programs shall cease to have effect at such time as and to the extent that (1) an international agreement requiring countries that emit greenhouse gases and produce carbon-intensive goods for export markets to adopt equivalent measures comes into effect; or (2) the country of export has implemented equivalent measures. The bill defines an "equivalent measure" as a tax, or other regulatory requirement that imposes a cost, on manufacturers of carbon-intensive goods located outside the United States, by reason of greenhouse gas emissions in the production of such goods by such manufacturers, approximately equal to the cost imposed by this legislation on manufacturers of comparable carbon-intensive goods located in the United States. The bill does not discuss its relationship to WTO law, and no statement by Van Hollen has come to my attention analyzing the WTO implications of this bill. Moreover, unlike some other U.S. legislation over the years,[63] the bill does not contain a provision for suspending a challenged measure should it be found to be a trade law violation.

10755_002.indd 43 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

In August 2014, the *Washington Post* praised the Van Hollen bill in its editorial "An Answer to Global Warming" (Washington Post 2014, A16.) The editorial opines that the border charge "will be hard to pull off efficiently. Officials will have to calculate the carbon footprint of various goods from various points of origin, and other countries will accuse the United States of protectionism. Yet any carbon pricing plan will have to include some trade adjustment. Otherwise U.S. industry will be disadvantaged." The *Post* editorial omits any discussion of the WTO law problems with the scheme they praise.

The question of whether the Van Hollen bill would be consistent with WTO border adjustment rules is straightforward. It would not. The carbon equivalency fee would not qualify under GATT Article II:2(a) because there would be no equivalent internal tax or charge to mirror. Rather, there would be a domestic regulation that would require producers to purchase carbon permits. The payment to exporters would be a prohibited export subsidy because there is no domestic indirect tax to be rebated at the border. The exemption for imports of particular goods from countries with taxes or regulations that impose a cost on local manufacturers approximately equal to the cost imposed by U.S. law would violate GATT Article I and would not fit within Article XX, which contains no exception to assure that foreign regulatory costs are as high as U.S. regulatory costs. Furthermore, the Article XX chapeau would rule out a program that shifts cost to foreign countries based solely on costs to domestic producers. Even if it were true that for domestic U.S. political reasons any carbon plan will have to include some trade adjustment, as the *Post* avers, that domestic political constraint would not buttress the case for WTO legality before a WTO panel.

Besides the vulnerability to WTO litigation, a government that put in place a unilateral border adjustment for climate policy would also be subject to tit-for-tat retaliation (Houser et al. 2008, 42; Bhagwati 2009, 176). That is because any country could enact an idiosyncratic Van Hollen type measure to protect local competitors from the real or imagined harms imposed by domestic environmental laws. I say imagined harms because as OECD Secretary-General José Àngel Gurría has noted, "fears about the potential impact of leakage and loss of competiveness are exaggerated" (Gurría 2009). Moreover, as Robyn Eckersley has noted, "border measures could potentially poison the international climate negotiations by angering major developing countries, such as India and China, against which such measures are primarily directed" (Eckersley 2010, 379). So the simplistic, jingoistic answer to global warming

10755_002.indd 44 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

trumpeted by the *Washington Post* is hardly an answer to complex environmental and trade questions.

What Can Be Done?

The last section of this chapter reflects on whether WTO law needs to be changed to accommodate climate measures. Is there anything wrong with current law? One answer could be that current WTO law is adequate because governments should not attempt to shift the costs of their domestic policies onto their trading partners. But that is not a satisfactory answer given the justification for at least some adjustments in Ricardian economics and the longtime accommodation in trade rules for border equivalency measures. The fact that climate change is a global challenge also makes it hard to rule out in principle all unilateral measures seeking to induce multilateral solutions. While it may be true that if all governments agreed to identical climate measures there might not be need for border measures, that condition of consensual climate policymaking does not exist.

Another problem with current WTO law is that it is ambiguous. Although a stupidly designed legislative proposal such as the Van Hollen bill is clearly WTO-legal, whether a well-designed border carbon adjustment would be legal or not is debatable. In my view, WTO law should not be inscrutable. Governments contemplating climate policy should know in advance whether the tool of a border adjustment is available. To that end, one could imagine legislative refinements to GATT Article II:2(a) and to SCM Annex I. Over four decades ago, a leading scholar of border tax adjustments called for clarification of their application particularly to the tax occultes (Rosendahl 1970, 140).

Two types of reforms can be considered: One is to rationalize border tax adjustments overall. The other is to seek a special law for climate-related adjustments.

On border equalization generally the most radical proposal came thirty years ago in a landmark study by Gary Clyde Hufbauer and Joanna Shelton Erb. They recommended that in order to “restore fiscal sovereignty” to GATT parties, “the international community should embrace the full destination principle as a *permissible* (not *mandatory*) method of border tax adjustment, for both direct and indirect taxes” (Hufbauer and Erb 1984, 55).[64] In other words, a country that wants to shelter its industries from the consequences of high taxation could provide destination-principle border adjustments, and a country that did not wish to shelter its production could refrain from them. How such a flexible tax

10755_002.indd 45 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

adjustment scheme might have worked out in practice would be an interesting gaming exercise.

With regard to climate, the Peterson Institute study (Hufbauer, Charnovitz, and Kim 2009, 105–106) called for the negotiation of an international Trade and Climate Code that would include permission for the imposition of carbon equivalent taxes at the border based on domestic climate-related taxes. This proposal also called for a credit for imports from countries that imposed equivalent carbon taxes on their production and exports. Not much progress toward such a code has occurred since 2009, but a group of academics has prepared a very helpful guidance document for border adjustments.[65]

Looking ahead, one step forward might be for multilateral stakeholders in the trade and climate regimes to devise a template carbon-adjustment scheme that could be copied by governments into their domestic climate legislation and considered by climate negotiators for inclusion within climate law norms. International trade norms would be important to consider in this exercise but equally important are international environmental norms. As I have pointed out in a previous study, the unilateral application of carbon charges to imports may be inconsistent with environmental law (Charnovitz 2010, 411). Furthermore, as one leading climate analyst has concluded, “a border adjustment on carbon-intensive manufactured goods from countries that have not taken comparably effective action to address climate change, as commonly proposed today, would do little to reduce overall leakage and have little environmental benefit” (Bordoff 2009, 52). Thus, the best path ahead may be to avoid trade conflicts through the imposition of unilateral carbon border adjustments and instead strive to improve multilateral cooperation on climate policy including free trade in environmental goods and services.

Notes

Thanks to Jagdish Bhagwati and Michael Levi for their helpful comments.

1. Note that the terms “border equalization tax” (on exports) and “import equalization taxes” (on imports) were used in Feller’s landmark article on border adjustments in international trade Feller 1969, 51–52). The terms “equalization charge” and “equalization tax” were also used in Dam’s classic treatise on GATT in his chapter on border tax adjustments (Dam 1970, 212).

2. At the time that Ricardo wrote his treatise, border tax adjustments on exports were already in existence (e.g., the U.S. Whiskey Act of 1791 §14, 15, 51, 1 Stat. 199).

10755_002.indd 46 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

3. This article addresses only general WTO law, not the individual laws of accession applying to WTO members, such as China, that joined the WTO pursuant to sui generis rules. In addition, this article only addresses trade in goods, not trade in services.

4. The WTO Appellate Body has quoted approvingly the statement of the Turkey–Textiles panel that "A basic principle in the GATT system is that tariffs are the preferred and acceptable form of protection." Appellate Body Report, *India: Additional Import Duties*, adopted November 17, 2008, para. 159 footnote 316 (citing Panel Report, *Turkey–Textiles*, para. 9.63).

5. GATT Art. III:4, Agreement on Technical Barriers to Trade (TBT Agreement), Arts. 2.1, 2.2.

6. Agreement on Subsidies and Countervailing Measures (SCM Agreement), Art. 1.1(a)(1)(ii) and footnote 1, and Annex I, items (g), (h).

7. SCM Agreement, Annex I, para. (e), footnote 59, para. 2.

8. Antidumping Agreement, Art. 9.1.

9. SCM Agreement, Art. 19.4.

10. GATT Article II:1(b) states: "Such products shall also be exempt from all other duties or charges of any kind imposed on or in connection with the importation in excess of those imposed on the date of this Agreement or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date." This means that no new ODCs can be imposed (on at least bound items) following a government's entry into the GATT or the WTO. See WTO Understanding on the Interpretation of Article II:1(b) of the General Agreement on Tariffs and Trade 1994. Former GATT legal adviser Frieder Roessler goes further in saying, "The second sentence obliges Members to reduce the number and diversity of import duties or charges by prohibiting, in principle, all duties and charges on bound items other than ordinary customs charges" (Roessler 2010, 266, 269 table 1.1). Yet as Roessler also notes, there is suggestion in the caselaw that an ODC validly recorded in the GATT Schedule of Concessions would be permitted (ibid., 267).

11. The original proposal for what became Article II:2(a) came from a U.S. proposal that was based on U.S. bilateral trade agreements with Canada, The Netherlands, and Switzerland Rosendahl 1970, 144–145).

12. The remainder of Article II:2 clarifies that governments have a right to burden imports with antidumping and countervailing duties and with import fees commensurate with the costs of services rendered.

13. Stewart, Salonen, and McDonough 2007, 37.

14. GATT Panel Report, *United States—Taxes on Petroleum and Certain Imported Substances*, adopted June 17, 1987. Another issue in the case was a U.S. tax on petroleum. This dispute is known as the *Superfund* case.

15. Ibid., para. 2.5.

16. Ibid., para. 3.2.5.

17. Ibid., paras. 5.2.7, 5.2.8, 5.2.10.

10755_002.indd 47 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

18. Ibid., para. 3.2.7.
19. Ibid.
20. Ibid., para. 3.2.8.
21. Ibid.
22. Ibid.
23. Ibid., para. 3.2.7.
24. Ibid., para. 5.2.4.
25. Ibid., para. 5.2.5.
26. Appellate Body Report, *India—Additional Import Duties*, paras. 208, 211.
27. Ibid., para. 151.
28. Ibid., para. 153.
29. Ibid., para. 153, footnote 304.
30. Ibid., para. 158.
31. Ibid., para. 170.
32. Ibid.
33. Ibid., paras. 170–175.
34. Ibid., para. 181.
35. Ibid., para. 190.

36. This point was picked up in the *Superfund* case and remains a good interpretation today.
37. Note that the Report does not say that all taxes not levied on products are not eligible for border adjustment.
38. This remains good law and was broadened and enacted with respect to exports in the SCM Agreement (SCM Agreement, Annex I, para. E).
39. Gary Hufbauer argues that it was never good law (Hufbauer 1996, 56). However, even if it was good law until 1994, such symmetry was overturned by the adoption of the SCM Agreement, which trumps the GATT in the event of an inconsistency. The SCM Agreement provides distinctive rules for border adjustments for exports that do not apply to imports. Thus, the SCM Agreement may permit or prohibit adjustments for exports that would not be permitted or prohibited by the GATT.
40. The destination principle means taxing a good should be taxed where it is consumed as contrasted with the origin principle of taxing a good where it is produced.
41. GATT Ad Note GATT Art. XVI (added in 1957).
42. See SCM Agreement, Annex I, items (e), (g).
43. SCM Agreement, Annex I, footnote 58.
44. See SCM Agreement, Annex I, item (g). World Trade Organization and UN Environment Programme 2009, 105.

10755_002.indd 48 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

45. SCM Agreement, Annex I, item (h) and Annex II.

46. Ibid., Annex II, footnote 61.

47. There has been considerable scholarly debate on whether the term "from which" necessitates physical incorporation of inputs or whether one might say more broadly, for example, that coal produces energy from which a widget is manufactured. According to one commentator, "The words 'from which' suggest that any input from which the imported product is manufactured should be eligible for adjustment regardless of physical incorporation, including energy and catalysts, which are consumed in the production process and are not found in the final product" (Maruyama 2011, 691). Other scholars have pointed to the French version of Article II:2(a), which seems to imply that only taxes on items incorporated in the imported product can be collected at the border (Holzer 2014, 100, footnote 337). Another stream of scholarship points out that charges on byproducts of the production process, such as carbon emissions, may not be eligible for a border adjustment. See Veel 2009, 774; Low, Marceau, and Reinaud 2012, 492, 497.

48. To wit, "Offsetting domestic taxation by imposing similar taxes on imports at the border is considered lawful under Article II" (Cottier, Nartova, and Shingal 2014, 1019).

49. SCM Agreement, Annex I, para. (e), footnote 58.

50. See GATT 1970, para. 15(b). Four years before the GATT Working Party report, one border adjustment scholar pondered whether property taxes could be indirect taxes (Leontiades 1966, 174).

51. See also O'Brien 2009, 1095, 1109.

52. Whether Article XX could be used to prevent so-called carbon leakage presents a slightly different question. To wit, Country A has an export sector in widgets that may relocate abroad to polluter haven B if A imposes higher environmental regulation. Here the problem A faces is that B is a polluter haven. Certainly, A may need to take some action to green B's policies, but incentivizing A's widget sector to remain addresses only a minuscule part of the B problem. Perhaps the best solution for A short term would be to subsidize its widget sector for adaptation costs to higher environmental regulation. Such a subsidy was specifically permitted in SCM Article 8 but the WTO allowed that right of subsidy to expire in 2000 (Luengo 2007, 158).

53. It is interesting to note that recently, two distinguished trade policy scholars endorsed a border adjustment based on the carbon content in domestic production (Mattoo and Subramanian 2013).

54. Rocchi et al. 2015, 7.

55. In other words, the charge would be outwardly looking in the sense that it would be based on facts occurring in a foreign country. But the charge would be inwardly looking in applying the internal rules for the charge to the foreign facts available.

56. See D.C. Code Ann. §§ 47–2002 to 47–2004.

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

57. Canada—Certain Measures Affecting the Renewable Energy Generation Sector/ Canada—Measures Relating to the Feed-In Tariff Program, WT/DS412, WT/DS426, adopted May 24, 2013, paras. 5.177–5.178.

58. GATT Article I:1 states:

With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

59. *Belgian Family Allowances*, BISD 1S/59, adopted Nov. 7, 1952.

60. Belgium's tax was an internal tax reviewed solely under Article III; Belgium did not raise a defense under Article II:2(a).

61. *EC—Seal Products*, WT/DS400,401/AB/R, adopted June 18, 2014, paras. 5.88, 5.95.

62. GATT Panel Report, *United States—Taxes on Petroleum and Certain Imported Substances*, para. 3.2.8.

63. For example 22 USCA §1978(a).

64. Compare Leontiades 1966, 180, suggesting that direct and indirect taxes "should be abandoned as useful concepts for applying border price adjustments."

65. Cosbey et al. 2012.

References

Bhagwati, Jagdish, and Petros C. Mavroidis. 2007. "Is Action against US Exports for Failure to Sign Kyoto Protocol WTO-Legal?" *World Trade Review* 6:299–310.

Bhagwati, Jadish. 2009. "Reflections on Climate Change and Trade." In *Climate Change, Trade and Competitiveness: Is a Collision Inevitable?*, ed. Lael Brainard and Isaac Sorkin, 171–176. Washington, DC: Brookings Institution Press.

Bordoff, Jason E. 2009. "International Trade Law and the Economics of Climate Policy: Evaluating the Legality and Effectiveness of Proposals to Address Competitiveness and Leakage Concerns." In *Climate Change, Trade and Competitiveness: Is a Collision Inevitable?*, ed. Lael Brainard and Isaac Sorkin, 35–59. Washington, DC: Brookings Institution Press.

Brainard, Lael, and Isaac Sorkin, eds. 2009. *Climate Change, Trade and Competitiveness: Is a Collision Inevitable?* Washington, DC: Brookings Institution Press.

10755_002.indd 50 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

Charnovitz, Steve 2003. "Trade and Climate: Potential Conflicts and Synergies." In *Beyond Kyoto. Advancing the International Effort Against Climate Change*, ed. J. Aldy et al., 141–170. Washington, DC: Pew Center on Global Climate Change.

Charnovitz, Steve. 2010. "Reviewing Carbon Charges and Free Allowances Under Environmental Law and Principles." *ILSA Journal of International and Comparative Law* 16 (2): 398–412.

Conconi, Paola, and Jan Wouters. 2010. "Appellate Body Report, India—Additional and Extra-Additional Duties on Imports from the United States (WT/DS360/AB/R, adopted on 17 November 2008)." *World Trade Review* 9:239–263.

Coppens, Dominic. 2014. *WTO Disciplines on Subsidies and Countervailing Measures: Balancing Policy Space and Legal Constraints*. Cambridge, UK: Cambridge University Press.

Cosbey, Aaron, Susanne Droege, Carolyn Fischer, Julia Reinaud, John Stephenson, Lutz Weischer, and Peter Wooders. 2012. *A Guide for the Concerned: Guidance on the Elaboration and Implementation of Border Carbon Adjustment*. Entwined Policy Report 03, November.

Cosbey, Aaron, and Petros C. Mavroidis. 2014. "A Turquoise Mess: Green Subsidies, Blue Industrial Policy and Renewable Energy: The Case for Redrafting the Subsidies Agreement of the WTO." *Journal of International Economic Law* 17:11–47.

Cottier, Thomas, Olga Nartova, and Anirudh Shingal. 2014. "The Potential of Tariff Policy for Climate Change Mitigation: Legal and Economic Analysis." *Journal of World Trade* 48:1007–1038.

Dam, Kenneth W. 1970. *The GATT: Law and International Economic Organization*. Chicago: University of Chicago Press.

Durán Medina, Valentina, and Rodrigo Polanco Lazo. 2011. "A Legal View on Border Tax Adjustments and Climate Change: A Latin American Perspective." *Sustainable Development Law & Policy* 11 (3): 29–34, 43–45.

Eckersley, Robyn. 2010. "The Politics of Carbon Leakage and the Fairness of Border Measures." *Ethics & International Affairs* 24:367–393.

Feller, Peter Buck. 1969. "Mutiny Against the Bounty: An Examination of Subsidies, Border Tax Adjustments, and the Resurgence of Countervailing Duty Law." *Law and Policy in International Business* 1:17–76.

GATT. 1960. *Provisions of Article XVI:4*, report adopted Nov. 19, 1960. GATT BISD 9S/185.

GATT. 1970. *Report by the Working Party on Border Tax Adjustments*. BISD 18S/97, adopted Dec. 2, 1970.

GATT. 1979. *Agreement on the Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade*.

GATT. 1995. *Analytical Index*. http://www.wto.org/english/res_e/booksp_e/gatt_ai_e/gatt_ai_e.htm (accessed June 1, 2016).

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

Goode, Walter. 2007. *Dictionary of Trade Policy Terms*. 5th ed. Geneva: WTO.

Gurría, José Àngel. 2009. "Carbon Has No Place in Global Trade Rules." *Financial Times*, November 5.

Holzer, Kateryna. 2014. *Carbon-Related Border Adjustment and WTO Law*. Cheltenham, UK: Edward Elgar.

Houser, Trevor, Rob Bradley, Britt Childs, Jacob Werksman, and Robert Heilmayr. 2008. *Leveling the Carbon Playing Field*. Washington, DC: Peterson Institute for International Economics.

Hufbauer, Gary Clyde, assisted by Carol Gabyzon. 1996. *Fundamental Tax Reform and Border Tax Adjustments*. Washington, DC: Institute for International Economics.

Hufbauer, Gary Clyde, Steve Charnovitz, and Jisun Kim. 2010. *Global Warming and the World Trading System*. Washington, DC: Peterson Institute for International Economics.

Hufbauer, Gary Clyde, and Joanna Shelton-Erb. 1984. *Subsidies in International Trade*. Washington, DC: Institute for International Economics.

Kaufmann, Christine, and Rolf H. Weber. 2011. "Carbon-related Border Tax Adjustment: Mitigating Climate Change or Restricting International Trade?" *World Trade Review* 10:497–525.

Kirgis Frederic L., Jr. 1972. "Effective Pollution Control in Industrialized Countries: International Economic Disincentives, Policy Responses, and the GATT." *Michigan Law Review* 70:859–918.

Leontiades, Milton. 1966. "The Logic of Border Taxes." *National Tax Journal* 19 (2): 173–183.

Low, Patrick, Gabrielle Marceau, and Julia Reinaud. 2012. "The Interface between the Trade and Climate Change Regimes: Scoping the Issues." *Journal of World Trade* 46:485–544.

Luengo Hernandez de Madrid, Gustavo E. 2007. *Regulation of Subsidies and States Aids in WTO and EC Law*. AH Alphen aan den Rijn: Kluwer Law International.

Maruyama, Warren H. 2011. "Climate Change and the WTO: Cap and Trade versus Carbon Tax?" *Journal of World Trade* 45:679–726.

Mattoo, Aaditya. and Arvind Subramanian 2013. "Four Changes to Trade Rules to Facilitate Climate Change Action." CGD Policy Paper 021.

Murase, Shinya. 2011. *International Law: An Integrative Perspective on Transboundary Issues*. Tokyo: Sophia University Press.

O'Brien, Julia. 2009. "The Equity of Levelling the Playing Field in the Climate Change Context." *Journal of World Trade* 43:1093–1114.

Regan, Donald H. 2009. "How to Think about PPMs (and Climate Change)." In *International Trade Regulation and the Mitigation of Climate Change*, ed. Thomas Cottier, Olga Nartova and Sadeq Z. Bigdeli, 97–123. Cambridge, UK: Cambridge University Press.

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY

Ricardo, David. 1822. *On Protection to Agriculture*. 3rd ed. London: J. Murray.

Rocchi, Paola, Iñaki Arto, Jordi Roca, and Mónica Serrano. 2015. "Carbon-Motivated Border Tax Adjustment: A Proposal for the EU." Universitat de Barcelona Economics Working Papers E15/327, July 2015.

Roessler, Frieder. 2010. "India: Additional and Extra-Additional Duties on Imports from the United States." *World Trade Review* 9:265–272.

Rosendahl, Roger W. 1970. "Border Tax Adjustments: Problems and Proposals." *Law and Policy in International Business* 2:85–146.

Shadikhodjaev, Sherzod. 2015. "Renewable Energy and Environmental Support: Time to 'Green' the SCM Agreement?" *World Trade Review* 14 (3): 479–506.

Stewart, Terence P, Eric P. Salonen and Patrick J. McDonough 2007. "More Than 50 Years of Trade Rule Discrimination on Taxation: How Trade with China Is Affected." The Trade Lawyers Advisory Group, http://www.uscc.gov/Research/more-50-years-trade-rule-discrimination-taxation-how-trade-china-affected (accessed June 1, 2016).

Veel, Paul-Erik. 2009. "Carbon Tariffs and the WTO: An Evaluation of Feasible Policies." *Journal of International Economic Law* 12:749–800.

Voigt, Christina. 2009. *Sustainable Development as a Principle of International Law. Resolving Conflicts between Climate Measures and WTO Law*. Leiden: Martinus Nijhoff Publishers.

Washington Post. 2014. "An Answer to Global Warming: Congress Doesn't Have to Make It Complicated." *Washington Post*, Aug. 28, A16.

Weber, Rolf H. 2015. "Border Tax Adjustment—Legal Perspective." *Climactic Change* 13 (3): 407–417.

World Economic Forum. 2010. *From Collision to Vision: Climate Change and World Trade*. Ad Hoc Working Group on Trade and Climate Change, November.

World Trade Organization and UN Environment Programme 2009. *Trade and Climate Change*.

10755_002.indd 53 7/18/2016 8:47:10 PM

PROPERTY OF THE MIT PRESS
FOR PROOFREADING, INDEXING, AND PROMOTIONAL PURPOSES ONLY