3

Status of Climate Measures Under the Law of the World Trade Organization

In its first decision, the World Trade Organization (WTO) Appellate Body addressed the relationship between WTO rules and environmental measures, explaining that "WTO Members have a large measure of autonomy to determine their own policies on the environment (including its relationship with trade), their environmental objectives and the environmental legislation they enact and implement. So far as concerns the WTO, that autonomy is circumscribed only by the need to respect the requirements of the General Agreement [on Tariffs and Trade, GATT] and the other covered agreements."[1] Besides the GATT, some other relevant covered agreements are the Agreement on Subsidies and Countervailing Measures (ASCM), the Agreement on Technical Barriers to Trade (TBT), the General Agreement on Trade in Services (GATS), and the Agreement on Agriculture (AoA).

The requirements of WTO rules could potentially interact with climate change policies insofar as these policies apply to goods imported into or exported from a WTO member. The literature of trade and environment points out several reasons why the US and other governments would likely want to include trade-related measures in climate programs.

First, there is a concern that emissions reductions accomplished domestically would go for naught if production and emissions migrated to other countries that had lower regulation. This concern has been termed the "polluter haven" problem in environmental policy. In the context of climate change, the problem is called "leakage" or "carbon laundering." The concern is that a national climate program is undermined, and the

1. Appellate Body Report, *United States—Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted on May 20 1996, 30.

international agenda loses coherence, if emissions are relocated from a country with higher standards to a country with lower standards.

Second, there is a possible adverse competitiveness impact on a country if it reduces emissions while its trade and investment partners do not. This concern, often given the moniker of a "level playing field," reflects a mixed motive of economics (the cost of strict greenhouse gas regulations) and politics (coalition-building). Concern about "fairness" in international commercial relations leads to various proposals to adjust for policy differences at the border.

Third, governments may seek to use trade measures to encourage other countries to cooperate in adopting equivalent environmental policies, encourage them to join multilateral environmental agreements (MEAs), or punish them for being free riders. The motive for using such leverage would be either coherence or competitiveness or both.

Figure 3.1 provides a quick view as to whether US climate policy options with respect to imports of goods can be justified under particular GATT articles, and this chapter examines in depth the status of various climate change proposals under the GATT and other WTO rules. The chapter s tarts with a discussion of key components of climate policy generically and then moves to a review of two specific proposals under consideration in the United States and Australia.

Border Adjustments on Imports

A border tax adjustment (BTA) on an import is the application of a charge or tax on the import aimed to match the domestic indirect taxes imposed on the like product and/or its inputs. Historically, of course, BTAs had nothing to do with environmental concerns; they were applied to level the playing field between domestically produced and imported goods. In the climate debate, analysts have sometimes used the BTA term imprecisely to refer to a tax imposed at the border designed to match the economic effects of a regulation on imports (Cosbey 2008a, 1, n. 2). But when there is no domestic tax, then the application of the supposedly corresponding tax or charge on imports is not a BTA.[2]

Only taxes on products can be border-adjusted. Thus taxes not applied to products are not susceptible to being border-adjusted. Whether taxes on energy consumed in making a product (sometimes called "embedded energy" or "carbon footprint" taxes) are border-adjustable on an import has not been considered in WTO dispute settlement. As noted

2. For example, one proposal being floated is to take the average cost of compliance for US companies and then impose that same charge on imported products. Such a measure would violate GATT Article III:2 because there would be no identified tax or charge on domestic production. The national treatment problem would not be cured by allowing the foreign exporter to prove that its own production is less carbon-intensive than the US average.

Figure 3.1 US climate policy options with respect to energy intensive imports

Restriction on imports of goods		Justified under General Agreement on Tariffs and Trade (GATT) articles? Article I (Most favored nation)	Article II (Tariff schedules)	Article III (National treatment)	Article XI (Quotas)	Article XX (Exceptions)
Import restriction applied to penalize "foreign-emitted carbon" (measures applied only against imports)	Import ban (quantitative restriction)	Status unclear		Covered under Article XI	No	Yes. If any provision or restriction on imports can be justified under Article XX, it is permitted even though it violates other GATT rules. Recourse to an Article XX exception is scrutinized carefully, and the burden of proof is on the country seeking to invoke the exception. The measure has to qualify under a specific exception in Article XX, such as Article XX(g) as a measure relating
	Additional or punitive tariff	No, because punitive tariffs will differ between foreign countries	No, because it violates bound tariffs.			
	Antidumping or countervailing duties	No. Under present GATT rules, even if the exporting country does not restrict its carbon emissions, the social cost of carbon cannot be labeled as dumping or a subsidy. The failure to impose a carbon tax, or otherwise internalize the full price of carbon, does not currently give other World Trade Organization members the right to impose penalty duties on imports. Such measures would violate the [illegible]				

emissions are relocated from a
try with lower standards.
ompetitiveness impact on a coun-
and investment partners do not.
a "level playing field," reflects a
trict greenhouse gas regulations)
about "fairness" in international
posals to adjust for policy differ-

rade measures to encourage oth-
uivalent environmental policies,
ironmental agreements (MEAs),
motive for using such leverage
ness or both.
o whether US climate policy op-
an be justified under particular
in depth the status of various cli-
nd other WTO rules. The chapter
nts of climate policy generically
c proposals under consideration

ort is the application of a charge
lomestic indirect taxes imposed
istorically, of course, BTAs had
s; they were applied to level the
ced and imported goods. In the
used the BTA term imprecisely
gned to match the economic ef-
008a, 1, n. 2). But when there is
supposedly corresponding tax

r-adjusted. Thus taxes not ap-
eing border-adjusted. Whether
oduct (sometimes called "em-
es) are border-adjustable on an
dispute settlement. As noted

the average cost of compliance for US
orted products. Such a measure would
identified tax or charge on domestic
not be cured by allowing the foreign
n-intensive than the US average.

Figure 3.1 US climate policy options with respect to energy intensive imports

Restriction on imports of goods		Justified under General Agreement on Tariffs and Trade (GATT) articles?				
		Article I (Most favored nation)	**Article II** (Tariff schedules)	**Article III** (National treatment)	**Article XI** (Quotas)	**Article XX** (Exceptions)
Import restriction applied to penalize "foreign-emitted carbon" (measures applied only against imports)	Import ban (quantitative restriction)	Status unclear		Covered under Article XI	No	Yes. If any provision or restriction on imports can be justified under Article XX, it is permitted even though it violates other GATT rules. Recourse to an Article XX exception is scrutinized carefully, and the burden of proof is on the country seeking to invoke the exception. The measure has to qualify under a specific exception in Article XX, such as Article XX(g) as a measure relating to the conservation of exhaustible natural resources. In addition, the measure must meet the test in the Article XX chapeau, namely, that the measure is not applied in a manner that constitutes arbitrary or unjustifiable discrimination or as a disguised restriction on international trade.
	Additional or punitive tariff	No, because punitive tariffs will differ between foreign countries	No, because it violates bound tariffs.			
	Antidumping or countervailing duties	No. Under present GATT rules, even if the exporting country does not restrict its carbon emissions, the social cost of carbon cannot be labeled as dumping or a subsidy. The failure to impose a carbon tax, or otherwise internalize the full price of carbon, does not currently give other World Trade Organization members the right to impose penalty duties on imports. Such measures would violate the Agreement on Subsidies and Countervailing Measures and the Antidumping Agreement for which no Article XX exception would be available.				
Competitiveness provision applied as an extension of domestic US climate policy (measures applied both to domestic production and imports)	Carbon tax on products	Yes, if the tax is imposed on the product and is not based on the country of origin		Not violated. Carbon taxes on products can be justified as an "internal tax" under GATT Articles III:2 and II:2(a) and thus can be adjusted at the border.		
	Cap-and-trade system with applicability to imports	No, if foreign countries are treated differently		A violation would occur if imported products are treated less favorably than like domestic products.		
	Carbon performance regulation applied to products and the production process	No, if foreign countries are treated differently		A violation would occur if imported products are treated less favorably than domestic products. (The Agreement on Technical Barriers to Trade may also be implicated.)		

Note: Cells are in grey when the referenced GATT articles are not likely to be relevant to the restriction in question. Pauwelyn (2007) contains an early summary of GATT provisions and climate policy options.

above, Annexes I and II of the ASCM can be read so as to permit the rebate of energy taxes on exports. Whether that would correspondingly allow the imposition of domestic energy taxes on imports remains unclear. Robert Howse and Antonia Eliason (2008, 24–25) have argued that ASCM Annex II would provide context for a panel's interpretation of GATT Article II as to permit the application of process-related energy taxes to imports.

It might seem straightforward to characterize carbon taxes as product taxes and impose them at the border when goods are imported. But things are not so simple. The core problem is that a product of a given physical description—say a ton of hot-rolled steel plate—will be responsible for different amounts of CO_2 emission depending on the manufacturing process. Emissions will differ from firm to firm and even within a firm. Moreover, if the border-adjustment scheme reflects carbon emissions of ancillary materials (e.g., scrap steel), the tracing challenge becomes an additional source of difficulty.

Consider this hypothetical policy as an illustration of a way to apply climate policies to imports that would probably comply with GATT rules. Suppose the United States required that any good sold be accompanied by a certificate stating its carbon footprint, meaning the quantity of greenhouse gas–producing substances used in its upstream production process (such certificates have been called a "carbon passport").[3] Suppose further that there is an internal carbon tax imposed on the product proportionate to the amount of greenhouse gas listed on the certificate. Although there is no precise trade law jurisprudence on this point, the language of GATT Article II:2(a) would seem to suggest that a BTA equivalent to the domestic tax could be imposed on imports. The language of Article II:2(a) allows the tax adjustment to be based on an "article from which the imported product has been manufactured or produced in whole or in part."[4] Thus, a certificate that adds up all of the carbon-based energy used in the

3. Whether two otherwise identical products differing only on the objective information about greenhouse gas emissions listed on a certificate are "like" products is an issue not yet determined in WTO dispute settlement. In 2003 the WTO granted a waiver for trade restrictions imposed on diamonds based on whether the diamond was accompanied by a certification that it was not a so-called conflict diamond used by rebel movements to finance conflict. The waiver applied to trade restrictions against WTO members that did not participate in the Kimberley Certification Scheme. The use of a waiver did not necessarily imply that the trade restrictions would otherwise have been WTO-illegal (Pauwelyn 2003). But that episode did show the possibility of regulating trade based on certificates that provide information about characteristics not discernible in the good (i.e., the diamond) itself.

4. It has been suggested that the equally authentic French text of GATT Article II:2(a) reads more restrictively to require that the input be incorporated into the imported product (Demaret and Stewardson 1994, 19). In that more restrictive reading, a BTA on coke consumed in steel production would be allowed by Article II:2(a), while a BTA on natural gas used to power steel furnaces would not be allowed.

production process—for examp
as a basis for the application of
To be sure, there are administra
certificates attached to imports,
to domestic products. But this il
tion of a product-specific carbo
does not inevitably lead to a cor

Border Adjustments on Ex

As noted above, whether the AS
exportation has not yet been res
on exports would seem to be en
tion does not undo the environm
sions. Of course, as was seen in t
BTA does not hinge on an enviro

The only sensible rationale
would be to avoid double carb
economy where nearly all gove
to match domestic carbon taxes,
destination principle for energy
(To be more precise, all domestic
a product is exported the tax wo
government.) As noted above, the
taxes are susceptible to being rem

Although GATT Article XX is
for outward shipments is an exp
for exports could undermine the A
applying the BTA to imports. For
have appraised the US shrimp im
caught without turtle excluder dev
In those circumstances, the import
or unjustifiable discrimination.

Another border adjustment co
greenhouse gas emissions allowan
payment was then rebated. The re
not be a rebate of a tax because the
allowance is a regulation, not a
allowance on exportation is tech
Rebating an emissions allowance w
if an emissions allowance is view

5. GATT Panel Report, *United States—Taxes o*
34S/136, adopted on June 17, 1987. See chap

production process—for example, coal, natural gas, and oil—could serve as a basis for the application of the domestic tax to the imported product. To be sure, there are administrative problems of verifying the accuracy of certificates attached to imports, or, for that matter, on certificates attached to domestic products. But this illustration shows that the parallel application of a product-specific carbon tax to domestic and imported products does not inevitably lead to a conflict with GATT rules.

Border Adjustments on Exports

As noted above, whether the ASCM permits the rebate of energy taxes on exportation has not yet been resolved. Rebating an energy or carbon tax on exports would seem to be environmentally perverse because exportation does not undo the environmental impact of the greenhouse gas emissions. Of course, as was seen in the *Superfund* case,[5] the WTO legality of a BTA does not hinge on an environmental justification.

The only sensible rationale for a rebate of climate taxes on exports would be to avoid double carbon taxation. In other words, in a world economy where nearly all governments are imposing BTAs on imports to match domestic carbon taxes, there could be an agreement to use the destination principle for energy taxes by taxing imports but not exports. (To be more precise, all domestic production would be taxed, but when a product is exported the tax would be rebated by the exporting country government.) As noted above, the ASCM is unclear as to whether energy taxes are susceptible to being remitted or rebated upon export.

Although GATT Article XX is not directly relevant to whether a BTA for outward shipments is an export subsidy, the rebate on an energy tax for exports could undermine the Article XX environmental justification for applying the BTA to imports. For example, consider how a panel might have appraised the US shrimp import ban if US law had allowed shrimp caught without turtle excluder devices to be exported by the United States. In those circumstances, the import ban would have appeared as arbitrary or unjustifiable discrimination.

Another border adjustment could occur if a domestic firm purchased a greenhouse gas emissions allowance to produce an exported good, and the payment was then rebated. The rebate of this emissions allowance would not be a rebate of a tax because the requirement to purchase an emissions allowance is a regulation, not a tax. Thus, the rebate of an emissions allowance on exportation is technically not a border tax adjustment. Rebating an emissions allowance would have WTO implications, however, if an emissions allowance is viewed by the WTO as the equivalent of

5. GATT Panel Report, *United States—Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, adopted on June 17, 1987. See chapter 2.

money. As noted in the previous chapter, if a government pays money to a firm in connection with an export, that payment constitutes a prohibited export subsidy.

Unilateral Countervailing Duties or Sanctions

A countervailing duty (CVD) is a trade penalty applied to an imported product to offset the competitive effect of a foreign subsidy. The prerequisite to a CVD is a subsidy that is specific to a firm or industry and causes material injury to the competing domestic industry producing the "like" product. Commentators have sometimes proposed applying CVDs on carbon-intensive imports as a "stick" against "carbon free riding."[6] The problem with this formulation is that free riding on carbon restrictions is not a subsidy, as currently defined by the ASCM, because the absence of a government regulation is not the legal equivalent to the presence of a financial contribution from that government.

If the intent of a proposed trade penalty is to sanction countries that are going slow on adopting climate measures, then it would violate GATT Articles I or XI or both and would not be justified by Article XX. The justification for the import ban in the *United States—Shrimp* case was that the imported products from certain producers were caught in a way that led to the killing of endangered sea turtles. The Appellate Body ultimately permitted that ban, even though it was unilateral, because conditioning market access on a foreign government's adoption of a program comparable in effectiveness to the US program gave sufficient latitude to that foreign government.[7] In our view, one cannot infer from this one case that the Appellate Body would approve a trade sanction levied against a target country proceeding at a different environmental speed than the sender country. The most prominent slowpoke on the climate issue over the past 10 years has been the United States, and there was never a serious suggestion that other countries could have legally imposed trade sanctions against the United States for that reason.

In commenting on the legal status of trade sanctions, it should first be repeated that border adjustment measures are not trade sanctions. The central purpose of a border adjustment measure is to equilibrate conditions between an imported product and a domestic product. As explained earlier, border adjustments can be legal or illegal under WTO rules, depending on the underlying economic circumstances. One motivation for a border

6. See Ralph Nader and Toby Heaps, "We Need a Global Carbon Tax," *Wall Street Journal*, December 3, 2008, A17.

7. Appellate Body Report, *United States—Import Prohibitions of Certain Shrimp and Shrimp Products*, Recourse to Article 21.5 of the DSU by Malaysia, WT/DS58/AB/RW, adopted on November 21, 2001, paragraph 144.

adjustment may be to influen
the case for a countervailing
foreign governments from s
influence another governmen
amounts to a "sanction." Ho
bright lines as to when a restr

Finally, the WTO implic
sanctions on climate scofflaws
proved trade sanctions are vir
Council and the WTO dispute
been taken through multilate
tions, per se, are not authorize

Greenhouse Gas Perforr

In contrast to a carbon tax, carl
standards) could be devised f
equally on both imports and d
es emitted in production were t
then the product could not be
sioner for Trade Peter Mandels
for biofuels should be the sam
should cover changes in land u
recently put forward in a staff
sentatives Energy and Comme

Although there is no WTO
standards would be reviewed
under Article XX. If foreign p
ample, by imputing to them ar
violate national treatment.

Whether a carbon perform
TBT "technical regulation" and
an open question. That issue w
European Communities—Asbesto
such performance measures a

8. As used here, the term "standard"
words, we follow common usage rathe
standards as nonmandatory provision

9. See Peter Mandelson, "Keeping the
Standards, We Can Make a Global Mar
guardian.co.uk (accessed on January 1

10. Appellate Body Report, *European C*
Containing Products, WT/DS135/AB/R

adjustment may be to influence the policy of another country. That is also the case for a countervailing duty, which is, in part, designed to dissuade foreign governments from subsidizing. But having the motivation to influence another government does not necessarily mean that a measure amounts to a "sanction." However, there are no officially agreed upon bright lines as to when a restrictive trade measure constitutes a sanction.

Finally, the WTO implications of multilaterally agreed upon trade sanctions on climate scofflaws have yet to be addressed. Multilaterally approved trade sanctions are virtually unknown outside of the UN Security Council and the WTO dispute system. Although enforcement actions have been taken through multilateral environmental agreements, trade sanctions, per se, are not authorized.

Greenhouse Gas Performance Standards

In contrast to a carbon tax, carbon intensity standards (or carbon footprint standards) could be devised for particular sectors that could be imposed equally on both imports and domestic production.[8] If the greenhouse gases emitted in production were to exceed the relevant performance standard, then the product could not be sold. For example, then European Commissioner for Trade Peter Mandelson suggested that environmental standards for biofuels should be the same for European and imported biofuels and should cover changes in land use.[9] The idea of performance standards was recently put forward in a staff paper published by the US House of Representatives Energy and Commerce Committee (2008, 11).

Although there is no WTO case law on this point, we assume that such standards would be reviewed under GATT Article III and, if necessary, under Article XX. If foreign products are treated less favorably—for example, by imputing to them artificial carbon footprint values—that would violate national treatment.

Whether a carbon performance standard would also be considered a TBT "technical regulation" and therefore subject to TBT disciplines remains an open question. That issue was not addressed by the Appellate Body in *European Communities—Asbestos*.[10] In our view, panels could decide that such performance measures are covered by the TBT agreement because

8. As used here, the term "standard" means a mandatory government regulation. In other words, we follow common usage rather than the TBT agreement nomenclature that defines standards as nonmandatory provisions.

9. See Peter Mandelson, "Keeping the Crop in Hand: By Imposing Rigorous Sustainability Standards, We Can Make a Global Market in Biofuels Work," *Guardian*, April 29, 2008, www.guardian.co.uk (accessed on January 12, 2009).

10. Appellate Body Report, *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted on April 5, 2001.

noncoverage would mean that the disciplines of that agreement would not apply. In other words, the definition of covered regulations in the TBT agreement—namely, regulations about "product characteristics or their related processes and production methods"[11]—could be interpreted broadly (Verrill 2008). It is true that the negotiating history of the TBT agreement would suggest an intent for narrower coverage, but in WTO jurisprudence, negotiating history takes a second place to textual and contextual analysis.

In 2007 a US law was passed to forbid federal government procurement of an alternative or synthetic fuel for a mobility-related use unless the contract specifies that the "lifecycle greenhouse gas emissions associated with the production and combustion of the fuel" is less than or equal to such emissions from equivalent conventional fuel produced from conventional petroleum sources.[12] This measure has not been challenged in the WTO. Although GATT Article III is not applicable to government procurement, the WTO Agreement on Government Procurement does embody most favored nation and national treatment principles.[13]

If a carbon performance standard were analyzed under the TBT agreement, one key question would be whether it was based on an international standard. If so, then the use of that standard would be "rebuttably presumed not to create an unnecessary obstacle to trade."[14] Whether such a standard could be imposed by the United States on developing countries is not clear under TBT rules, however, because the TBT agreement states that developing country WTO members should not be expected to use international standards that "are not appropriate to their development, financial and trade needs."[15] If a domestic carbon performance standard is not based on an international standard, then the domestic standard would be subject to the requirement in the TBT agreement that any application to imports "shall not be more trade-restrictive than necessary to fulfil a legitimate objective," such as protection of the environment.[16]

If a panel decides that a carbon performance standard is not a TBT measure, then it would be analyzed under Article III:4 of the GATT. The standard would violate Article III:4 if it treats the imported product less favorably than the like domestic product. Most commentators would say that a regulation based on the method of production would violate Article III,

11. TBT agreement, Article 1.2 and Annex 1, paragraph 1.

12. 42 USC § 17142.

13. WTO Agreement on Government Procurement, Article III. It should be noted that the agreement lacks a general exception for the environment or for measures relating to the conservation of exhaustible natural resources.

14. TBT agreement, Articles 2.4, 2.5.

15. TBT agreement, Article 12.4.

16. TBT agreement, Article 2.2.

but there is no WTO jurisprud
Article III would not be fatal,
invoke Article XX(g). Assumi
standard is applied to all count
same way, we believe that the A

"Food Miles" and Transp

A new idea that has emerged in
ties from international transport
and Murphy 2008, 5). For agricu
"food miles." In a climate conte
border for the greenhouse gas e
that product to the importing co
country, it could be treated the sa
internal transport-related emissi

Certainly, any food mile cha
because it is origin-specific. More
the scope of Article II:2(a), which
transportation is a service, not a
the General Agreement on Trad
services. Food mile charges woul
imports as a group would be trea

Using a Multilateral Clima against Import Restriction

Some commentators (e.g., Cosbey
that are not listed in Annex I of t
tion on Climate Change (UNFCC
ance with their (minimal) obliga
Protocol, then potential defendan

17. The possibility that such a measure co
the reason why we believe that a parallel
mile" charges also violate the TBT agreeme
er, this claim would put complaining devel
the TBT agreement covers process-based m
countries argued that the TBT agreement d
would legalize PPMs under the TBT agree
prohibited by the GATT. After the *United Sta*
could allow PPMs but that the TBT agreem

18. Note that the second sentence of Article
be based on "the economic operation of the
on the nationality of the product. The impl
charges based on the nationality of the pro

isciplines of that agreement would
ɔn of covered regulations in the TBT
t "product characteristics or their re-
ds"[11]—could be interpreted broadly
ating history of the TBT agreement
overage, but in WTO jurisprudence,
e to textual and contextual analysis.
orbid federal government procure-
el for a mobility-related use unless
le greenhouse gas emissions asso-
ustion of the fuel" is less than or
it conventional fuel produced from
s measure has not been challenged
II is not applicable to government
n Government Procurement does
nal treatment principles.[13]
ere analyzed under the TBT agree-
er it was based on an international
andard would be "rebuttably pre-
stacle to trade."[14] Whether such a
ed States on developing countries
because the TBT agreement states
rs should not be expected to use
ppropriate to their development,
ic carbon performance standard is
then the domestic standard would
T agreement that any application
strictive than necessary to fulfil a
of the environment.[16]
rformance standard is not a TBT
der Article III:4 of the GATT. The
treats the imported product less
t. Most commentators would say
roduction would violate Article III,

aph 1.

t, Article III. It should be noted that the
onment or for measures relating to the

but there is no WTO jurisprudence squarely on that point. A violation of Article III would not be fatal, however, as the regulating country could invoke Article XX(g). Assuming that the greenhouse gas performance standard is applied to all countries (including the domestic market) in the same way, we believe that the Article XX defense would succeed.[17]

"Food Miles" and Transport Emissions

A new idea that has emerged in recent years is to internalize the externalities from international transport into the cost of a product (Kejun, Cosbey, and Murphy 2008, 5). For agricultural products, this idea is referred to as "food miles." In a climate context, this might mean adding a charge at the border for the greenhouse gas emissions entailed in the transportation of that product to the importing country. Once such an import comes into a country, it could be treated the same as a domestic product with respect to internal transport-related emissions.

Certainly, any food mile charge would be a violation of GATT Article I because it is origin-specific. Moreover, food mile charges would be outside the scope of Article II:2(a), which permits border tax adjustments, because transportation is a service, not an "article." Nowhere does the GATT or the General Agreement on Trade in Services (GATS) authorize BTAs on services. Food mile charges would also be a violation of Article III because imports as a group would be treated less favorably.[18]

Using a Multilateral Climate Agreement as a Sword against Import Restrictions

Some commentators (e.g., Cosbey 2007, 16) have suggested that countries that are not listed in Annex I of the United Nations Framework Convention on Climate Change (UNFCCC) could argue that if they are in compliance with their (minimal) obligations under the UNFCCC or the Kyoto Protocol, then potential defendant importing countries would not be able

17. The possibility that such a measure could be defended under Article XX of the GATT is the reason why we believe that a parallel claim would be mounted to the effect that "food mile" charges also violate the TBT agreement, as discussed in the subsequent section. However, this claim would put complaining developing countries in an ironic posture of arguing that the TBT agreement covers process-based measures (so-called PPMs). A decade ago, developing countries argued that the TBT agreement did not cover PPMs because they thought coverage would legalize PPMs under the TBT agreement, even though the PPMs would otherwise be prohibited by the GATT. After the *United States—Shrimp* decision, it became clear that the GATT could allow PPMs but that the TBT agreement might instill discipline that the GATT lacks.

18. Note that the second sentence of Article III:4 permits "internal transportation charges" to be based on "the economic operation of the means of transport" so long as they are not based on the nationality of the product. The implication is that differential external transportation charges based on the nationality of the product would amount to less favorable treatment.

to justify trade restrictive measures under WTO rules. This is not a facetious argument, but since the WTO Appellate Body has not given weight to obligations under other international agreements (e.g., *Brazil—Tyres*),[19] it is difficult to imagine a panel would imbue greater legal significance to the lack of obligations under other international agreements. Moreover, the two existing climate MEAs do not contain provisions obliging developed countries to refrain from using trade or border measures against developing countries.

In upcoming negotiations in Copenhagen for the next climate protocol, it would be possible for developing countries to seek treaty language to forestall the use of border measures that would hamper their exports. In other words, there may be proposals that if developing countries accept some emissions reduction commitments, developed countries have to agree not to impose additional commitments through unilateral measures. A specific provision of that sort, if written into the next climate protocol, could perhaps be given legal effect in WTO dispute settlement.

Another proposition being offered in "trade and climate" debates is that, because it is a nonparty to the Kyoto Protocol, the United States could be disqualified from invoking an Article XX defense (Frankel 2008, 10) for a trade-related climate measure. Although the Appellate Body in *United States—Shrimp* never said that prior negotiations was a prerequisite for invoking Article XX, there is nevertheless a widespread perception that the Appellate Body did so, and one could imagine a panel finding fault with the United States for not being a Kyoto Protocol party.[20] Support for that outcome could be found in the Appellate Body's statement that "good faith" is required under the Article XX chapeau. Furthermore, in *United States—Shrimp*, the Appellate Body took note that the United States had not ratified three environmental MEAs that loosely relate to turtle conservation.[21]

Using a Multilateral Climate Agreement to Establish Rules for Trade

It would also be possible for a new climate protocol to establish a rule that all goods in international commerce have to carry an emissions permit ("carbon passport") obtained from an international facility. The permit could be issued free for production that meets an internationally determined performance standard or could be purchased at an internationally

19. Appellate Body Report, *Brazil—Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R, adopted on December 17, 2007, paragraphs 228, 234.

20. Of course, the United States was a major player in the negotiation of the Kyoto Protocol. Many countries objected to the United States not ratifying Kyoto, but the United States did not have any international law obligation to do so.

21. Appellate Body Report, *United States—Shrimp*, paragraph 171, n. 174.

set price. If all WTO membe
conflicts regarding the treatm
members were a party to th
the nonparties could compla
without such a permit. How
not certain. Box 3.1 discusses
The most likely outcome is th
does not override WTO rules
seek to internalize the climat
nonparties because the rule i
the *United States—Shrimp* case
multilateral.

This hypothetical is put f
tive synergism between trade
the climate regime moving i
would only address the clima
production for domestic consu
tion is by far the bigger prob
cement production is traded i
proposals for border adjustme
foreign country, not just its ex

Allocating Emissions Al

One idea being floated in clir
the United States to give som
countries that are taking early
1.1(a)(1) of the ASCM is ambig
by government A can be char
money to economic actors in go
however, that free subsidies g
cient adverse effects to be actio
("Actionable Subsidies") is on
ample), not the recipient coun
the ASCM does not have a mos
need not give the same subsidy

Output-Based Rebates

Alan H. Price (2008) from Wiley
government payments to certa

der WTO rules. This is not a face-
pellate Body has not given weight
agreements (e.g., *Brazil—Tyres*),[19]
mbue greater legal significance to
ernational agreements. Moreover,
contain provisions obliging devel-
de or border measures against de-

hagen for the next climate proto-
countries to seek treaty language
that would hamper their exports.
s that if developing countries ac-
ments, developed countries have
nitments through unilateral mea-
written into the next climate pro-
t in WTO dispute settlement.
in "trade and climate" debates is
Protocol, the United States could
XX defense (Frankel 2008, 10) for
gh the Appellate Body in *United*
gotiations was a prerequisite for
a widespread perception that the
gine a panel finding fault with the
ocol party.[20] Support for that out-
ody's statement that "good faith"
. Furthermore, in *United States—*
the United States had not ratified
elate to turtle conservation.[21]

eement to Establish

te protocol to establish a rule that
ve to carry an emissions permit
nternational facility. The permit
meets an internationally deter-
purchased at an internationally

g *Imports of Retreaded Tyres*, WT/DS332/
228, 234

in the negotiation of the Kyoto Protocol.
tifying Kyoto, but the United States did

aragraph 171, n. 174.

set price. If all WTO member countries subscribe to this rule, then trade conflicts regarding the treatment of imports should not arise. If some WTO members were a party to this agreement and some refused to join, then the nonparties could complain if a party refused to allow an importation without such a permit. How a WTO panel would deal with such a case is not certain. Box 3.1 discusses the relation between WTO rules and MEAs. The most likely outcome is that the panel would find that the MEA norm does not override WTO rules. Yet the possibility exists that a panel could seek to internalize the climate norm into WTO rules and apply it against nonparties because the rule is multilateral. This situation did not arise in the *United States—Shrimp* case because the US measure was unilateral, not multilateral.

This hypothetical is put forward to show the possibility of constructive synergism between trade and climate law. We do not, however, see the climate regime moving in this direction, because carbon passports would only address the climate effects of production for exportation, not production for domestic consumption. Production for domestic consumption is by far the bigger problem. For example, only about 6 percent of cement production is traded internationally. This explains why almost all proposals for border adjustment hinge on the entire emissions profile of a foreign country, not just its exports.

Allocating Emissions Allowances to Other Countries

One idea being floated in climate talks is for an industrial country like the United States to give some free emissions allowances to developing countries that are taking early action to reduce greenhouse gases. Article 1.1(a)(1) of the ASCM is ambiguous as to whether a financial contribution by government A can be characterized as its subsidy when it gives the money to economic actors in government B. In any event, we are doubtful, however, that free subsidies given to other countries would cause sufficient adverse effects to be actionable, because the ASCM Part III discipline ("Actionable Subsidies") is on the donor country (country A in our example), not the recipient country (country B). One should also note that the ASCM does not have a most favored nation clause, so a donor country need not give the same subsidy to every WTO member.

Output-Based Rebates

Alan H. Price (2008) from Wiley Rein LLP has proposed temporary federal government payments to certain firms equal to their cost of purchasing

Box 3.1 WTO rules and multilateral environmental agreements

At the Doha Ministerial Conference in 2001, World Trade Organization (WTO) members agreed for the first time to launch negotiations that would address the trade-environment nexus. The Doha Declaration thus includes a negotiating mandate on clarifying the relationship between multilateral environmental agreements (MEAs) and WTO rules.[1] Like much else in the Doha Declaration, nothing has come from this mandate so far. However, existing WTO rules, past initiatives, and decisions by the Appellate Body are already shaping the WTO response to environmental issues.

In 1995 the WTO Ministerial Decision on Trade and Environment created the Committee on Trade and Environment. Among its works, the committee has examined the relationship between WTO provisions and trade measures for environmental purposes. At present, there are more than 250 MEAs in force, and over 20 of these incorporate trade measures.[2]

As the number of MEAs has increased, the committee has debated whether the WTO should change its rules to accommodate them. While the committee has never agreed on recommendations that would modify WTO rules, Sampson (2005) contends that its work has been useful in understanding the complexity of MEA issues, which may explain why no dispute related to an MEA has yet been brought to the WTO.

1. Paragraph 31 of the Doha Declaration states: "With a view to enhancing the mutual supportiveness of trade and environment, we agree to negotiations, without prejudging their outcome, on: (i) the relationship between existing WTO rules and specific trade obligations set out in multilateral environment agreements. The negotiations shall be limited in scope to the applicability of such existing WTO rules as among parties to the MEA in question. The negotiations shall not prejudice the WTO rights of any Member that is not a party to the MEA in question; (ii) procedures for regular information exchange between MEA Secretariats and the relevant WTO committees, and the criteria for the granting of observer status; (iii) the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services."

2. Among MEAs with trade provisions are the Convention on International Trade in Endangered Species of Wild Fauna and Flora; Montreal Protocol on Substances that Deplete the Ozone Layer; Basel Convention; Convention on Biodiversity; and the Stockholm Convention and Rotterdam Convention. For more details, see the WTO website at www.wto.org (accessed on January 12, 2009). Trade measures in MEAs usually refer to one of the following actions: (1) reporting requirements; (2) labeling or other identification requirements; (3) requirements for transportation documents involving notification and consent by exporters and importers; (4) export and/or import bans (targeted or general); and (5) market measures such as taxes, charges, and subsidies.

climate emission permits. steel, aluminum, pulp/pa Eligibility would require t globally traded commodit domestic energy prices. P subsidies under WTO rul incurred under a domesti have any demonstrable im

Our view is different. A ducers is designed to prot effects of higher domestic be expected to distort trac members. If so, the paymen granting subsidies that cau

Climate Safeguards

In a study group organize esting idea. Rather than co tion of emissions allowanc government assistance to c peting imports or reduced be distinguishable from saf Safeguards. Under the Saf ernments may respond to d the suspension of GATT ol concessions.[23] Although the Safeguard Agreement does obligations under the ASCM a safeguard be a trade restri than a subsidy. This interpr taken by the Appellate Body countervailing subsidies to c subsidies. Instead, the Appe ties could be used.[24] Perhaps ex post relief suggested abo

22. The paper is available on the (accessed on January 12, 2009).

23. Agreement on Safeguards, Artic

24. Appellate Body Report, *United S* WT/DS217/WT/AB/R, adopted o

nvironmental agreements

, World Trade Organization (WTO)
ı negotiations that would address
:laration thus includes a negotiat-
etween multilateral environmental
uch else in the Doha Declaration,
However, existing WTO rules, past
dy are already shaping the WTO re-

rade and Environment created the
ıg its works, the committee has ex-
sions and trade measures for envi-
re than 250 MEAs in force, and over

: committee has debated whether
odate them. While the committee
vould modify WTO rules, Sampson
l in understanding the complexity
ute related to an MEA has yet been

h a view to enhancing the mutual sup-
negotiations, without prejudging their
/TO rules and specific trade obliga-
s. The negotiations shall be limited
les as among parties to the MEA in
'TO rights of any Member that is not
gular information exchange between
and the criteria for the granting of
elimination of tariff and non-tariff

ntion on International Trade in Endan-
tocol on Substances that Deplete the
iversity; and the Stockholm Conven-
e the WTO website at www.wto.
in MEAs usually refer to one of the
eling or other identification require-
its involving notification and consent
t bans (targeted or general); and (5)
es.

climate emission permits.[22] The eligible industries would include iron, steel, aluminum, pulp/paper, bulk glass, cement, and certain chemicals. Eligibility would require that an industry be energy-intensive, produce a globally traded commodity, and face rising imports in response to higher domestic energy prices. Price recognizes that such payments would be subsidies under WTO rules but argues that "a rebate for added costs incurred under a domestic environmental policy would be unlikely to have any demonstrable impact on international competitors."

Our view is different. As we see it, if a direct payment to domestic producers is designed to protect domestic companies from the competitive effects of higher domestic regulation, then the payment may reasonably be expected to distort trade and cause serious prejudice to other WTO members. If so, the payments would violate the ASCM prohibition against granting subsidies that cause adverse effects on other countries.

Climate Safeguards

In a study group organized for this book, one analyst floated an interesting idea. Rather than compensate US firms ex ante with free distribution of emissions allowances, an ex post system should instead provide government assistance to companies upon a showing of injury from competing imports or reduced opportunities to export. This program would be distinguishable from safeguards permitted in the WTO Agreement on Safeguards. Under the Safeguards Agreement, importing country governments may respond to domestic injury by trade restrictions that entail the suspension of GATT obligations or the modification of GATT tariff concessions.[23] Although the point has not been litigated in the WTO, the Safeguard Agreement does not appear to relieve WTO members of their obligations under the ASCM. In other words, WTO law seems to insist that a safeguard be a trade restrictive measure (on an imported product) rather than a subsidy. This interpretation would be consistent with the position taken by the Appellate Body in ASCM jurisprudence, which ruled against countervailing subsidies to domestic companies that are hurt from foreign subsidies. Instead, the Appellate Body held that only countervailing duties could be used.[24] Perhaps WTO rules should be modified to permit the ex post relief suggested above.

22. The paper is available on the Environmental Law Institute website at www.eli.org (accessed on January 12, 2009).

23. Agreement on Safeguards, Article 1 and GATT Article XIX:1.

24. Appellate Body Report, *United States—Continued Dumping and Subsidy Offset Act of 2000*, WT/DS217/WT/AB/R, adopted on January 27, 2003, paragraphs 269–273.

Hybrid Systems

"Hybrid" measures are found not only within each approach to the competitiveness question—carbon taxes and cap-and-trade systems—but also within each country's overall policy framework to cope with climate change. Governments are legislating a mixture of subsidies (e.g., biofuels, solar, and wind power), performance standards for vehicles, and other greenhouse gas controls. Major nations find it congenial to design legislation in a way that fosters domestic producers, especially "national champions." The United States is well along this path with respect to biofuels, having enacted measures that generously support ethanol production by firms like Archer-Daniels-Midland. The US domestic auto industry is likewise on the threshold of more government assistance, which almost certainly will encourage CO_2 efficient engines. President Nicolas Sarkozy of France and other European leaders favor the same approach, especially in the current financial crisis.

Because of their complexity and variations from country to country, hybrid systems would need to be examined under several WTO agreements. A violation of WTO rules may arise when the measure to be applied to an imported product is not the same as the measure to be applied to a domestic product. For example, this could happen when the domestic measure to be matched is not a tax on products but rather is a regulation. In that case, the measure on imports cannot be immunized by GATT Article II:2(a), dealing with border tax adjustments. The measure would instead be reviewed under GATT Article III, and if a violation is found, a panel would inquire whether an exception is permitted by GATT Article XX. Another WTO violation could arise when a measure treats foreign countries differently depending on their climate policies. Although there are valid environmental reasons for discriminating between countries, such discrimination could run afoul of GATT Article I. If so, recourse to Article XX is possible, but measures will need to be carefully designed and applied to meet the various prerequisites of Article XX.

Boxer Amendment to Lieberman-Warner Climate Security Act of 2008

The amendment proposed by Senator Barbara Boxer (D-CA) on May 20, 2008 to the Climate Security Act (S. 3036) sponsored by Senators Joseph Lieberman (I-CT) and John Warner (R-VA) establishes a cap-and-trade program for greenhouse gas emissions in the United States.[25] Its stated purpose is to "reduce United States greenhouse gas emissions substantially enough to avert the catastrophic impacts of global climate change." For

25. This paragraph is based on Sections 3, 202, and 203 as well as various other sections of the bill. Boxer Amendment, S. Amdt. 4825, available at http://thomas.loc.gov.

domestic producers, the pro
business entities in the Un
allowances to cover its own
would create emissions all
auction them. For example,
percent of the allowances w
intensive manufacturers, fos
petroleum-based fuel, natu
renewable energy projects,
made available to commerci
allowances to local energy d
allowances would be distrib
for clean fleets or buildings.
to firms requiring emissions
allowances could be used fo

Imports are instead cov
titled "Promoting Fairness
poses include "to promote a
greenhouse emissions"; "to
that greenhouse gas emissior
undermine the objectives of tl
change"; and "to encourage
of the bill circulated by its pr
candidly; for example, one d
the shifting of US jobs to fore
facturing costs merely becaus
house gas emissions" (McBro

The Boxer bill also lays ou
central idea is to prod other c
ing greenhouse gas emissions
bon tax comparability." The
would fill a significant gap un

As written up in the sprin
Boxer bill would be largely ad
tion Agency (EPA). Some adm
be made by an independent c
president. Of course, all of the
in the 111th Congress in 2009.

The import provisions of
covered countries (Section 13
products, such as steel and ch
when the production process
house gas emissions. Covered
US good whose cost of product
requirements. Some examples

ithin each approach to the com-
ap-and-trade systems—but also
ork to cope with climate change.
ıbsidies (e.g., biofuels, solar, and
hicles, and other greenhouse gas
design legislation in a way that
tional champions." The United
o biofuels, having enacted mea-
uction by firms like Archer-Dan-
try is likewise on the threshold
ost certainly will encourage CO_2
y of France and other European
in the current financial crisis.
ıtions from country to country,
ıed under several WTO agree-
se when the measure to be ap-
ıe as the measure to be applied
uld happen when the domestic
roducts but rather is a regula-
annot be immunized by GATT
ustments. The measure would
II, and if a violation is found, a
ı is permitted by GATT Article
vhen a measure treats foreign
imate policies. Although there
iminating between countries,
ATT Article I. If so, recourse to
ed to be carefully designed and
f Article XX.

Varner Climate Security

ıara Boxer (D-CA) on May 20,
sponsored by Senators Joseph
.) establishes a cap-and-trade
the United States.[25] Its stated
ıse gas emissions substantially
of global climate change." For

ıs well as various other sections of the
p://thomas.loc.gov.

domestic producers, the program works as follows: An operator of covered business entities in the United States would need to submit emissions allowances to cover its own greenhouse gas emissions. The US government would create emissions allowances and either distribute them freely or auction them. For example, in the first five years of the program, about 48 percent of the allowances would be given away free to domestic carbon-intensive manufacturers, fossil fuel–fired electricity generators, refiners of petroleum-based fuel, natural gas processors, carbon sequestration and renewable energy projects, and biofuels. Additional allowances could be made available to commercial recipients via the allocation of 13 percent of allowances to local energy distribution companies. Another 13 percent of allowances would be distributed freely to states and Indian tribes or used for clean fleets or buildings. These allowances could be transferred or sold to firms requiring emissions allowances. However, none of the emissions allowances could be used for imports.

Imports are instead covered in Title XIII Part A of the bill, which is titled "Promoting Fairness While Reducing Emissions." Its stated purposes include "to promote a strong global effort to significantly reduce greenhouse emissions"; "to ensure, to the maximum extent practicable, that greenhouse gas emissions occurring outside the United States do not undermine the objectives of the United States in addressing global climate change"; and "to encourage effective international action." Descriptions of the bill circulated by its private-sector authors state the purpose more candidly; for example, one description says that the bill "helps prevent the shifting of US jobs to foreign countries that would have lower manufacturing costs merely because they refuse to do their part to limit greenhouse gas emissions" (McBroom 2008, 2).

The Boxer bill also lays out US objectives for climate negotiations. One central idea is to prod other countries to take comparable action in reducing greenhouse gas emissions. The bill points toward a standard of "carbon tax comparability." The inclusion of explicit negotiating objectives would fill a significant gap under current US law.

As written up in the spring of 2008, the international program in the Boxer bill would be largely administered by the US Environmental Protection Agency (EPA). Some administrative determinations, however, would be made by an independent commission of US citizens appointed by the president. Of course, all of the details of the Boxer bill are subject to change in the 111th Congress in 2009.

The import provisions of the program apply to covered goods from covered countries (Section 1301). Covered goods are so-called primary products, such as steel and chemicals, and possibly manufactured goods when the production process generates a substantial quantity of greenhouse gas emissions. Covered imports also have to be closely related to a US good whose cost of production is affected by the new domestic climate requirements. Some examples of primary products listed in the bill are

iron, steel, aluminum, cement, glass, pulp, paper, chemicals, and industrial ceramics. Covered countries are those that are not on the excluded list. To qualify for the excluded list, a country has to be either (1) taking action comparable to the United States to limit domestic greenhouse gas emissions from the 2005 base year, (2) a least-developed country, or (3) a country that is a de minimis emitter of greenhouse gases.

The determination as to whether a foreign country is taking comparable action is to be made by the independent commission (Sections 1306 and 322). Comparable action will be found if the foreign country reduces its greenhouse gas emissions from 2005 levels in terms of percentage at least as much as the United States did in the preceding year.[26] The commission can also find comparable action if a foreign government implements, verifies, and enforces state-of-the-art technologies that lead to actual emissions reductions and has greenhouse gas–limiting regulatory programs in place. A tie vote in the commission goes against the foreign country. The bill gives the commission considerable latitude, so it is impossible to know in advance what would qualify as comparable action and whether the commission would apply the same standard to every trading partner. However, according to the bill, "Any determination on comparable action made by the Commission...shall comply with applicable international agreements."[27]

Title XIII would require, two years after the US domestic program goes into effect, that an importer of a covered good purchase sufficient international reserve allowances to cover the corresponding greenhouse gas emissions (unless the good arrives from a country on the excluded list).[28] The price of the international reserve allowance would be set daily equal to the market price for a domestic emissions allowance. The quantity of international reserve allowances needed for an importation would be set according to a formula that takes into account (1) the national greenhouse gas intensity rate for each category of covered goods for covered countries,

26. There are many ways to define comparability. In a discussion draft, circulated as a prelude to a House bill that would be sponsored by Representatives John Dingell (D-MI) and Richard Boucher (D-VA), a foreign-issued emissions allowance would qualify in the United States only if the foreign law requires a mandatory absolute greenhouse gas tonnage limit that is at least as stringent as the US program, including comparable monitoring and compliance (p. 201–02).

27. Boxer Amendment, S. Amdt. 4825, p. S5091 §1301. The bill makes clear that international agreements include the WTO agreement. It should be noted, however, that the WTO does not have rules defining comparable action on climate change, so the statutory reference can only have meaning by reference to general WTO rules.

28. See Sections 202(a)(2) and 1306(d). As an alternative to purchasing an international reserve allowance from the United States, an importer could substitute an allowance from a foreign government cap-and-trade system that is deemed comparable to the US system or an offset allowance from an approved program. We do not see how this option ameliorates the WTO law problems, but we do not venture a separate analysis.

and both direct and indirect e
tor), (2) an allowance adjustm
for the free distribution of allo
States (as determined by the a
ment ratio for foreign countri
to limit greenhouse gas emiss
(as determined by the commis
determination of international
and potentially contentious—
A few other trade-related
provides for an exclusion for p
a North American Free Trad
greenhouse gas reduction requ
United States (see Section 202
clusions) that when a product
ance was used in domestic pro
a compensatory allowance upo
provides for financial assistanc
proceeds of the sale of interna
to carry out a program "to mi
on disadvantaged communitie
Fourth, the bill authorizes the
ments for imported goods so as
mines necessary to address gre
"in compliance with all applica
1307). Fifth, the bill would allo
allowances issued by other gov
house gas limits when such pro
the US program, including adm
compliance, and enforcement.
Analyzing the WTO legalit
cause a defense under Article X
been enacted, and implementati
involving Article XX have deal
applied. Thus applying the Art
tentative exercise.
Before getting to Article XX,
GATT discipline. Such violations
reasons. The requirement that im
allowance seems to fit within "o
that are regulated by GATT Artic
to an automatic violation (Quick

29. The economic adjustment ratio is dete
would not be able to take into account di

·, pulp, paper, chemicals, and indus-
e those that are not on the excluded
a country has to be either (1) taking
tes to limit domestic greenhouse gas
2) a least-developed country, or (3) a
of greenhouse gases.
r a foreign country is taking compa-
ependent commission (Sections 1306
found if the foreign country reduces
005 levels in terms of percentage at
in the preceding year.[26] The commis-
if a foreign government implements,
technologies that lead to actual emis-
e gas-limiting regulatory programs
on goes against the foreign country.
erable latitude, so it is impossible to
/ as comparable action and whether
e standard to every trading partner.
y determination on comparable ac-
omply with applicable international

ars after the US domestic program
covered good purchase sufficient in-
r the corresponding greenhouse gas
m a country on the excluded list).[28]
allowance would be set daily equal
nissions allowance. The quantity of
ed for an importation would be set
account (1) the national greenhouse
overed goods for covered countries,

In a discussion draft, circulated as a prelude
esentatives John Dingell (D-MI) and Richard
owance would qualify in the United States
solute greenhouse gas tonnage limit that is
ng comparable monitoring and compliance

1301. The bill makes clear that international
d be noted, however, that the WTO does not
change, so the statutory reference can only
s.

alternative to purchasing an international
orter could substitute an allowance from a
deemed comparable to the US system or an
do not see how this option ameliorates the
arate analysis.

and both direct and indirect emissions (as determined by the administrator), (2) an allowance adjustment factor designed to adjust in each sector for the free distribution of allowances to the same industry in the United States (as determined by the administrator), and (3) an economic adjustment ratio for foreign countries that takes into account foreign programs to limit greenhouse gas emissions and use of state-of-the-art technology (as determined by the commission).[29] This brief exposition reveals that the determination of international reserve allowances entails considerable—and potentially contentious—discretion and complexity.

A few other trade-related provisions should be noted. First, the bill provides for an exclusion for petroleum-based liquid fuel imported from a North American Free Trade Agreement (NAFTA) country that has greenhouse gas reduction requirements no less stringent than those in the United States (see Section 202). Second, the bill provides (with some exclusions) that when a product is exported for which an emissions allowance was used in domestic production, the exporting entity will receive a compensatory allowance upon export (see Section 202). Third, the bill provides for financial assistance to certain countries and specifies that the proceeds of the sale of international reserve allowances would be used to carry out a program "to mitigate negative impacts of climate change on disadvantaged communities in foreign countries" (see Section 1306). Fourth, the bill authorizes the EPA administrator to adjust the requirements for imported goods so as to take action that the commission determines necessary to address greenhouse gas emissions in covered imports "in compliance with all applicable international agreements" (see Section 1307). Fifth, the bill would allow domestic producers to use emissions allowances issued by other governments that impose mandatory greenhouse gas limits when such programs are of "comparable stringency" to the US program, including administrative action that ensures monitoring, compliance, and enforcement.

Analyzing the WTO legality of the import provisions is difficult because a defense under Article XX would be required, the program has not been enacted, and implementation is some way off. So far, all of the cases involving Article XX have dealt with measures that have actually been applied. Thus applying the Article XX case law ex ante is necessarily a tentative exercise.

Before getting to Article XX, however, there has to be a violation of a GATT discipline. Such violations may exist under the Boxer bill for several reasons. The requirement that importers purchase an international reserve allowance seems to fit within "other duties and charges" on importation that are regulated by GATT Article II:1(b). If so, the requirement amounts to an automatic violation (Quick 2008, 166). It may be possible, howev-

29. The economic adjustment ratio is determined on an economywide basis. The commission would not be able to take into account differing facts at the company level.

er, for the authors of the bill to rewrite the requirement to be an internal charge rather than a charge on importation. If so, such a charge would be reviewed under GATT Article III:2. The panel might then ask whether the burden on imports exceeds the burden on domestic production. The answer to that would depend on a comparison of relative burdens.[30] Then, if the burdens are found to be the same, the panel might conclude that the requirement to purchase an international reserve allowance passes muster under the GATT national treatment rule.

If a panel were to consider the reserve allowance requirement to be a tax or charge on an entity rather than on the product itself, then the measure would be reviewed under Article III:4.[31] The key question would be whether the program modifies the conditions of competition between imported and domestic products in a way that is less favorable to imports. The answer would probably be affirmative because the formula for calculating the requisite quantity of international reserve allowances facially discriminates based solely on the origin of the products. The formula for imports is based on the national (i.e., foreign) greenhouse gas intensity rate, while the emissions allowances for domestic products are based on the emissions of the individual producer. Such discrimination would be to the detriment of at least some imported products. Of course, a panel would also want to find some quantitative evidence of probable discriminatory effect, and a conclusion on that would depend on the decisions made regarding the other two factors in the formula.

The program would clearly be a violation of GATT Article I:1 because of the inherent origin-based discrimination. Some WTO members would be covered countries and some would not. Article I:1 generally does not permit an importing government to condition trade treatment on the policies being followed by an exporting country government, and yet the program classifies countries into covered and uncovered categories based on the comparability of the foreign government's climate change policies with US policies. Of course, finding an Article I violation would depend on a conclusion that two otherwise identical products are "like" if the only difference between them is the country of origin. In our view, this conclusion is inescapable under contemporary tariff classifications that do not take carbon content during production into account. In the future, if WTO members renegotiate tariff classifications to create separate headings based on greenhouse gas emissions, that would be a different story (Wiers

30. If a panel determined that foreign steel produced without a government emissions program is not a like product to domestic steel produced under such a program, then there would not be a violation of GATT Article III:2. Such a panel determination is highly unlikely in our view and would conflict with existing precedents. Nonetheless, we note the evolving role of regulatory purpose and consumer preference in Article III:4 jurisprudence as to what constitutes a "like" product and less favorable treatment.

31. The points made in footnote 30 with respect to Article III:2 also apply to Article III:4.

2008, 22–23).[32] In such a scen
on their carbon footprints w
purposes of GATT rules.

Whatever the outcome ir
national allowance requirem
justification under Article X
the *United States—Shrimp* ca
the import measures being c
The panel would have to st
particularly its international
eral purposes, as noted abov
of conservation, it might no
is to promote "fairness."[33] O
ten to make clear that the go
tries to enact greenhouse ga
shared by all countries, that
goal could also be stated as
tion by imposing emissions
parallel consumption polici
view of the *United States—S*
US consumption of imports
friendly methods is a reaso

32. Harmonized tariff categories
characteristics. Sometimes goods a
how a good will be used. For exam

33. The text of the bill does not ex
person close to the drafting has su
playing field" common in the trac
differentiated responsibilities" use

34. Encouraging other countries
environmental logic behind the me
by the Appellate Body as fitting w
defend its import ban as promotin

35. In the *United States—Shrimp* d
import ban to keep out all shrim
Boxer program, imports would be
paid for an allowance. The allow
ban, but ironically, by allowing tr
undermined. After all, in *Shrimp*, t
unsafe shrimp to buy their way i
that the requirement of an impor
countries to enact greenhouse gas
that foreign polluters pay and tha
of greenhouse gas effects when
greenhouse gas control policies.

2008, 22–23).[32] In such a scenario, two otherwise like products that differed on their carbon footprints would be considered as not "like" products for purposes of GATT rules.

Whatever the outcome in the GATT Article II and III analysis, the international allowance requirement is a violation of Article I and would need justification under Article XX(g). Based on the *United States—Gasoline* and the *United States—Shrimp* cases, a panel would first look to see whether the import measures being challenged are reasonably related to the ends. The panel would have to start by ascertaining the ends of the program, particularly its international dimension. The text of the bill suggests several purposes, as noted above. Since Article (g) only covers the policy goal of conservation, it might not be available to justify a program whose goal is to promote "fairness."[33] On the other hand, if the legislation was rewritten to make clear that the goal of the program is to encourage other countries to enact greenhouse gas emission controls because the atmosphere is shared by all countries, that could fit within the text of Article (g).[34] The US goal could also be stated as promoting the sustainability of US consumption by imposing emissions controls on domestic producers and applying parallel consumption policies to imported products (Carmody 2008). In view of the *United States—Shrimp* precedent, a trade measure that reduces US consumption of imports that are produced with environmentally unfriendly methods is a reasonable instrument[35] to achieve the conservation

32. Harmonized tariff categories typically differentiate goods by observable product characteristics. Sometimes goods are differentiated by nonobservable characteristics, such as how a good will be used. For example, see 4411.92.30 in the US Tariff Schedule.

33. The text of the bill does not explain precisely what kind of fairness is being sought. One person close to the drafting has suggested that the fairness being pursued is not the "level playing field" common in the trade policy context but rather the concept of "common but differentiated responsibilities" used in multilateral environmental agreements.

34. Encouraging other countries to adopt comparable conservation policies was the environmental logic behind the measures at issue in *United States—Shrimp* that were accepted by the Appellate Body as fitting within the (g) exception. The United States did not seek to defend its import ban as promoting fairness for US shrimp harvesters.

35. In the *United States—Shrimp* dispute, the instrument used by the United States was an import ban to keep out all shrimp imports from uncertified countries. In Title XIII of the Boxer program, imports would be allowed from uncertified countries so long as the importer paid for an allowance. The allowance requirement is less trade restrictive than an import ban, but ironically, by allowing trade, the environmental rationale for the import charge is undermined. After all, in *Shrimp*, the United States did not allow foreign producers of turtle-unsafe shrimp to buy their way into the US market. The best answer to this quandary is that the requirement of an import charge may boost political pressure in foreign supplier countries to enact greenhouse gas control measures and, as a second best consequence, assure that foreign polluters pay and that US consumers are faced with some cost-internalization of greenhouse gas effects when imports are bought from countries without comparable greenhouse gas control policies.

ends being sought.[36] One might question whether charging importers for an international reserve allowance promotes conservation; perhaps, instead, the charge simply transfers resources from foreign producers to the US government. However, the program provides a built-in answer: The funds collected from the sale of international reserve allowances will be expended by the US government in foreign countries for climate change prevention. Thus, the first prong of (g) could be satisfied.[37]

The second prong of (g) could be satisfied, as the program is even-handed in requiring greenhouse gas reductions for imported goods only when domestic production is also subject to greenhouse gas reductions. Nevertheless, an objection could be raised that, by rebating emissions allowances on exports, the United States would not be fully even-handed, since some domestic production would effectively escape climate regulation. One answer to this might be that the program is even-handed with respect to goods destined for domestic consumption, even if it is not even-handed with respect to all domestic production. That answer is not wholly satisfactory.

The most serious barrier to legality under GATT Article XX would be the Article XX chapeau. The first step in the legal analysis would investigate whether there was discrimination within the meaning of Article XX. The Appellate Body has expostulated that Article XX discrimination has to be of a different quality than what has already been found in the preceding analysis under Articles I and III. Recalling the Appellate Body's statement in *United States—Shrimp* that Article XX discrimination exists when the application of the measure at issue does not allow for any inquiry into the appropriateness of the regulatory program for the conditions prevailing in exporting countries, a panel could find that there is "discrimination" because the Boxer bill does not insist on an inquiry into

36. The "ends" to be defended by the United States need not be to prevent carbon leakage. Thus, although some analysts have suggested that a border charge might do little to actually reduce leakage (Bordoff 2008, 20), reducing leakage need not be the sole objective that the United States might seek.

37. Trevor Houser from the Peterson Institute for International Economics has raised the question of whether border measures would qualify for Article XX(g) if they carry insufficient leverage to convince foreign governments to adopt comparable greenhouse gas regulatory programs. The question of the standard of scrutiny by the international judge of environmental programs has been discussed in trade law literature, but there is little jurisprudence on that point. In our view, the Appellate Body in *United States—Shrimp* did not carefully scrutinize the actual utility of the challenged measure. The test applied by the Appellate Body was whether the means used were "reasonably related" to the ends. In parallel cases involving the exception in Article XX(b), the Appellate Body in *European Communities—Asbestos* and *Brazil—Tyres* did not carefully scrutinize the effectiveness of those measures either. Calling for a stricter attitude by the Appellate Body would put the WTO in the paradoxical position of insisting that climate demandeur nations impose tough surveillance on developing countries in order to justify their own measures under Article XX. We doubt that the Appellate Body would follow this course.

whether a greenhouse gas r
fected foreign country. Furt
use their 2005 emission leve
against rapidly growing cou
emitted cumulatively much
the United States.

Next, the panel would
tion identified is arbitrary o
examining the rationale put
ing in the *United States—Shr*
considering justifiable a pro
whether the foreign govern
in effectiveness" to that of tl
the Boxer bill seem designed
late Body of providing suffi
conditions in foreign countri
determined after implement
rable action and, for covere
and the economic adjustme
discrimination in negotiatio
tiations with all countries, b
tion rather than congression

The bill also tries to add
Tyres that the discriminatior
of the program, but in our
chapeau for several reasons
against like products based
produced in a company in I
purchase an international al
able discrimination because
gram.[39] As explained by Trev

38. On the other hand, one shoulc
countries had not offered a dueling
some uncertainty as to what a par
metric—namely, reduction in emis
to argue for other metrics, such as
cumulative baseline. Imagine a thir
United States and a different metri
inconsistent metrics faced by its exp
States—Shrimp dispute, the domesti
By contrast, the effectiveness of a US
emissions remains to be seen.

39. See Appellate Body Report, *Unit*
of shrimp solely from a particular fi
and Appellate Body Report, *Brazil*-

whether a greenhouse gas regulatory program is appropriate for each affected foreign country. Furthermore, a requirement that other countries use their 2005 emission level as a baseline could be found to discriminate against rapidly growing countries, particularly when those countries have emitted cumulatively much less greenhouse gas over past decades than the United States.

Next, the panel would consider whether the Article XX discrimination identified is arbitrary or unjustifiable, and the panel would do so by examining the rationale put forward by the United States. Given the ruling in the *United States—Shrimp* compliance review, a precedent exists for considering justifiable a program that makes import access contingent on whether the foreign government has a regulatory program "comparable in effectiveness" to that of the United States.[38] The flexibilities existing in the Boxer bill seem designed to achieve the standard set out by the Appellate Body of providing sufficient latitude to take into account the specific conditions in foreign countries. Whether they do so, in fact, could only be determined after implementation, especially the determination of comparable action and, for covered countries, the allowance adjustment factor and the economic adjustment ratio. The Appellate Body's concern with discrimination in negotiations is dealt with in the bill by calling for negotiations with all countries, but again a panel would look at implementation rather than congressionally written goals.

The bill also tries to address the Appellate Body's concern in *Brazil—Tyres* that the discrimination not go against the environmental objective of the program, but in our view that effort fails to meet the tests of the chapeau for several reasons. First, recall that the program discriminates against like products based on national origin. Thus an importer of steel produced in a company in India using clean energy would still have to purchase an international allowance. This could be viewed as unjustifiable discrimination because it would go against the objective of the program.[39] As explained by Trevor Houser et al. (2008, 36), there would be an

38. On the other hand, one should recall that in *United States—Shrimp*, the complaining countries had not offered a dueling metric for measuring turtle conservation. So there is some uncertainty as to what a panel would do if the United States were to present one metric—namely, reduction in emissions from a 2005 baseline—and other countries were to argue for other metrics, such as reduction in emissions per capita, or reduction from a cumulative baseline. Imagine a third country T facing one metric of comparability from the United States and a different metric from India. Country T could perhaps argue that the inconsistent metrics faced by its exports are arbitrary. Another difference is that, in the *United States—Shrimp* dispute, the domestic regulatory program was effective in saving sea turtles. By contrast, the effectiveness of a US cap-and-trade program in reducing US or global carbon emissions remains to be seen.

39. See Appellate Body Report, *United States—Shrimp*, paragraph 165 (discussing exclusion of shrimp solely from a particular firm solely because of its origin in uncertified countries) and Appellate Body Report, *Brazil—Tyres*, paragraph 246 (criticizing discrimination that

environmental benefit in using measures that require foreign producers to track their own emissions and take responsibility for them. Second, aside from the allowances distributed freely to covered US industries (which are reflected in the allowance adjustment factor), an additional one-quarter of the total allowances would be distributed without charge in the early years and would be sloshing around the US economy. Such allowances could only be used to enable domestic production and could not be used for imports. The handout of such allowances by the government could cause market distortions against imports that would not be justified by any environmental purpose. If all such allowances were traded in an arm's-length transaction, that might not cause a distortion because the price for the domestic emissions allowances would go down, which would correspondingly lower the price for the international reserve allowance. But if some of the domestic allowances reach covered producers through off-market arbitrage, it would, in effect, be a way for government to lower the regulatory burden on domestic industry to the detriment of foreign firms that would have to pay the official, higher price for an international reserve allowance.

The chapeau could also be violated because of procedural deficiencies in the bill. The Appellate Body in *United States—Shrimp* criticized the US program because its operating details were shaped without the participation of other WTO members and because the system of certification was established and administered by US agencies alone. The same flaw exists in the Lieberman-Warner-Boxer bill. This flaw could be remedied if there was an internationally agreed-upon approach being followed by the United States for how countries that adopt emissions control policies should treat imports. Another corrective would be to provide for foreign government participation on the commission that is set up in Title XIII. The Appellate Body in *United States—Shrimp* also criticized the lack of opportunities for foreign governments or companies to participate in administrative proceedings and to appeal the decisions. Such flaws appear to exist with respect to the key determinations by the commission; for example, there is no appeal mechanism indicated in the program. Indeed, the Boxer bill is so complex that its very complexity could be arbitrary discrimination against foreign producers.

With regard to the disguised restriction clause in the Article XX chapeau, a panel could look at the "intention" of US policymakers as well as the design of the program. If there was evidence that the intention of the program is to restrict foreign imports in order to level the playing field between US and foreign producers, that could be viewed as a protectionist motive that could run afoul of the chapeau, even if there would be some environmental benefit to the United States of discouraging production

bears no relationship to the environmental objective). On the other hand, it could be argued that allowing firm-specific imports would undermine the defense under Article XX.

and exports in countries wit
tory design feature that a pa
goods that are covered are th
cost of production in the Unit
lective concern about imports
purpose of the program.

As noted above, the com
dispute explained that the u
the US measure was a facto
guised restriction under the A
US measure does lead to a d
petitors, it would seem more
restriction and hence disquali

Another consideration w
"Promoting Fairness While Re
the differences from the *Unite*
was not being justified as a w
vesters. Rather, the country c
was designed to change turtle
anticipate that this and some
may be cleaned up in the vers

In addition to failing to q
XX, the program could run int
main concerns are the free allo
sions allowances on exports.

A threshold question wou
allowance is a subsidy. From
ance would arguably fall outs
it is not a financial contributio
imagine a panel saying that an
bill has provisions for sale an
government of emissions allo
allowance can exchange it for
ment, the panel will deem it t
allocation were pure grandfath
out some level of carbon emis
another, then such a permissiv

If an emissions allowance

40. Panel Report, *United States—Shrim*

41. The Boucher-Dingell draft bill, tab
purpose in its International Reserve A

42. Boxer Amendment, S. Amdt. 4825,

s that require foreign producers to
onsibility for them. Second, aside
to covered US industries (which
t factor), an additional one-quar-
istributed without charge in the
nd the US economy. Such allow-
nestic production and could not
h allowances by the government
mports that would not be justi-
ll such allowances were traded
t not cause a distortion because
wances would go down, which
for the international reserve al-
wances reach covered producers
effect, be a way for government
stic industry to the detriment of
fficial, higher price for an inter-

because of procedural deficien-
ted States—Shrimp criticized the
were shaped without the par-
ause the system of certification
agencies alone. The same flaw
. This flaw could be remedied
n approach being followed by
dopt emissions control policies
ould be to provide for foreign
ion that is set up in Title XIII.
imp also criticized the lack of
ompanies to participate in ad-
decisions. Such flaws appear
ns by the commission; for ex-
cated in the program. Indeed,
complexity could be arbitrary

clause in the Article XX cha-
of US policymakers as well as
lence that the intention of the
der to level the playing field
d be viewed as a protectionist
even if there would be some
of discouraging production

n the other hand, it could be argued
e defense under Article XX.

and exports in countries with less extensive climate policies. One statutory design feature that a panel might consider is that the only imported goods that are covered are those that are closely related to a good whose cost of production in the United States is affected by the program. This selective concern about imports seems to operate against the environmental purpose of the program.

As noted above, the compliance panel in the *United States—Shrimp* dispute explained that the unlikelihood of any "commercial gain" from the US measure was a factor in favor of finding that there was no disguised restriction under the Article XX chapeau.[40] In a situation where the US measure does lead to a domestic commercial gain over foreign competitors, it would seem more likely that a panel would detect a disguised restriction and hence disqualify the measure under Article XX.

Another consideration would be the legislative title of the program, "Promoting Fairness While Reducing Emissions." The panel could point to the differences from the *United States—Shrimp* case, where the US measure was not being justified as a way to promote fairness for US shrimp harvesters. Rather, the country certification process in *United States—Shrimp* was designed to change turtle conservation policies of other countries. We anticipate that this and some other incriminating features of the Boxer bill may be cleaned up in the version to be introduced in 2009.[41]

In addition to failing to qualify for an exception under GATT Article XX, the program could run into WTO problems under the ASCM. The two main concerns are the free allocation of allowances and the rebate of emissions allowances on exports.

A threshold question would be whether the free grant of an emissions allowance is a subsidy. From a formal perspective, the emissions allowance would arguably fall outside the scope of an ASCM subsidy because it is not a financial contribution. But from a functional perspective, one can imagine a panel saying that an allowance is equivalent to cash because the bill has provisions for sale and for "auction on consignment" by the US government of emissions allowances.[42] In other words, if anyone with an allowance can exchange it for cash in an auction facilitated by the government, the panel will deem it to be a subsidy. By contrast, if the method of allocation were pure grandfathering, to allow an entity to continue to spew out some level of carbon emissions, and that right was not transferable to another, then such a permissive regulation would not be a "subsidy."

If an emissions allowance is considered as the equivalent of a govern-

40. Panel Report, *United States—Shrimp* (Article 21.5—Malaysia), paragraph 5.143.

41. The Boucher-Dingell draft bill, tabled on October 7, 2008, does not include a "fairness" purpose in its International Reserve Allowance Program (Part G).

42. Boxer Amendment, S. Amdt. 4825, p. S5062 §401, S5065 §441.

ment payment,[43] then there are two implications for WTO subsidy law: first, whether there are actionable subsidies, and second, whether there are export subsidies. Because over half of the emissions allowances in the Boxer program are distributed freely, there will be a question as to whether this causes an actionable subsidy. This question cannot be judged a priori because the ASCM disciplines are linked to the effects of the subsidy on competition.[44]

The other question is whether the export rebate of an emissions allowance is a prohibited subsidy under ASCM Article 3. A key test in determining whether an export rebate is a prohibited subsidy is ASCM footnote 1, which excludes from ASCM subsidies a BTA on exports that is consistent with WTO law. As discussed in chapter 2, WTO law is not clear on whether a requirement to purchase an emissions allowance is a domestic tax or charge on a product that could serve as a basis for a rebate on exports.[45]

Another issue that could arise is a hypothetical decision by foreign governments to purchase international reserve allowances and give them freely to companies that want to export to the United States. If the free allocation of an emissions allowance within the United States is a subsidy, then a free allocation of a US-created international reserve allowance outside the United States would also be a subsidy. Indeed, even if all emissions allowances within the United States were auctioned, and therefore not subsidies, a foreign government program to buy an international reserve allowance may be considered a "financial contribution" under ASCM Article 1. Therefore, if domestic injury to a US industry could be shown, the US government would be able to countervail imports from countries that bought international reserve allowances for the benefit of their exporters.

In summary, the Lieberman-Warner-Boxer provisions on imports seem to have been written with a roadmap of WTO law in mind, and some of the potential legal conflicts were nicely dealt with in the design of the legislation. Nevertheless, there remain GATT violations that would require defense under Article XX, and an adjudication would probably find that the program fails to comply with the chapeau of Article XX. We have doubts about the assumption made by the proponents of the bill that a WTO panel would apply the *United States—Shrimp* precedent approvingly to a climate program that, after all, involves astronomically more trade

43. Jason E. Bordoff (2008, 23) has observed that under US budget scorekeeping, free allocation of permits will be scored as a budget outlay.

44. Article 5, footnote 13 of the ASCM permits a cause of action for a threat of serious prejudice, but WTO panels have not yet clarified how such a threat could be demonstrated in litigation.

45. In other words, the only way that ASCM footnote 1 could help is if the requirement to deposit an emissions allowance is viewed as a tax on a product, not a tax on the producer.

than was involved in the *Sh*
also come into play, and th
allowances are treated unde

Australia's Carbon Pol

In July 2008 the Australian g
a cap-and-trade scheme. To
firms that do not at this sta
paper proposes special assi
industries" (Australian Gov
in the form of freely alloca
tries. The amount allocated
carbon pollution permits is
not provided these industri
ternational competitors."

The Australian propos
leakage problems through
cause domestic aid is involv
provision requires consider
tains disciplines for action
the scope of Part III, it must
above, the question of whet
tion permit is a subsidy do
no WTO jurisprudence on
permit is a financial contrib
the facts of the Australian p
targeted to carbon-intensiv
the Australian measure is a

Part III of the ASCM pr
the interests of other memb
of adverse effect is "seriou
One is having the effect "to
uct of another Member into

46. We also note that, despite pro
has imposed border measures on
had not adopted a climate progra
government released a legal analy
with WTO rules. During the Geor
such a measure would violate W
proposal a few years ago for the
adopt it (see box 3.2).

47. ASCM, Article 6.3(a). Another
price undercutting because of the

than was involved in the *Shrimp* dispute.[46] In addition, the ASCM would also come into play, and the panel would need to decide how emissions allowances are treated under the relevant subsidy disciplines.

Australia's Carbon Pollution Reduction Scheme

In July 2008 the Australian government released a Green Paper presenting a cap-and-trade scheme. To deal with the problem of competition "against firms that do not at this stage have comparable carbon constraints," the paper proposes special assistance for "emissions-intensive trade-exposed industries" (Australian Government 2008, 27). The assistance would come in the form of freely allocated carbon pollution permits to those industries. The amount allocated would be large, about 30 percent of the total carbon pollution permits issued. The paper explains that "if assistance is not provided these industries may be disadvantaged relative to their international competitors."

The Australian proposal deals with competitiveness and emissions leakage problems through aid to certain carbon-intensive industries. Because domestic aid is involved, an examination of the WTO legality of this provision requires consideration of the ASCM. Part III of the ASCM contains disciplines for actionable subsidies. For a measure to come within the scope of Part III, it must be a subsidy and it must be specific. As noted above, the question of whether an emissions allowance or a carbon pollution permit is a subsidy does not have a clear answer, and there has been no WTO jurisprudence on this point. If the free allocation of a pollution permit is a financial contribution, then it is a subsidy. If it is a subsidy, then the facts of the Australian program make it a specific subsidy because it is targeted to carbon-intensive industries. The analysis below assumes that the Australian measure is a specific subsidy.

Part III of the ASCM prohibits subsidies that cause adverse effects to the interests of other members (ASCM, Article 5). The most pertinent form of adverse effect is "serious prejudice," which may arise in a few ways. One is having the effect "to displace or impede the imports of a like product of another Member into the market of the subsidizing Member."[47] Here

46. We also note that, despite proposals to do so, no government over the past eight years has imposed border measures on the United States on the grounds that the US government had not adopted a climate program comparable to its own. Nor to our knowledge has any government released a legal analysis suggesting that such a border measure would comply with WTO rules. During the George W. Bush administration, US trade officials argued that such a measure would violate WTO rules. The European Commission considered such a proposal a few years ago for the European Union Emission Trading Scheme but did not adopt it (see box 3.2).

47. ASCM, Article 6.3(a). Another relevant provision is Article 6.3(c) regarding significant price undercutting because of the subsidy.

Box 3.2 European Union Emission Trading Scheme

In January 2005 the European Union launched its Emission Trading Scheme (ETS), a cap-and-trade system.[1] The EU ETS was originally designed to help member states meet their targets under the Kyoto Protocol. However, the EU ETS is an independent scheme, since it was enacted before the Kyoto Protocol became legally binding.

After its three-year trial period (Phase I, 2005–07), the EU ETS entered its second trading period (Phase II, 2008–12), which corresponds with the compliance period of the Kyoto Protocol. The EU ETS currently covers more than 10,000 installations in the energy and industrial sectors—which account for about half of the overall EU CO_2 emissions—across all 27 EU member states plus three other members of the European Economic Area: Norway, Iceland, and Liechtenstein.[2]

While the EU ETS is considered successful because it put a price on carbon and created a multinational climate regime,[3] the two trading periods revealed fundamental problems. For both the first and second phases, member states were required to draft their national allocation plans (NAPs), which determine their total levels of emissions and the EU allowances (EUAs) that each installation in their country would receive. NAPs then needed approval by the European Commission. This approach created huge differences in each member's allocation rules, giving rise to fears about unfair competition between members. Another issue is that the ETS has provided little incentive to develop new energy technology, as it gave away large numbers of free allowances during the two trading periods.

Keeping these concerns in mind, the European Commission proposed a far-reaching climate action and energy package in January 2008, and the European Parliament approved the package with revised terms on December 17, 2008. Under a so-called 20-20-20 proposal, the European Union sets a stringent reduction target of greenhouse gas emissions at least 20 percent below 1990 levels by 2020 (or a possible 30 percent reduction if a post-Kyoto regime were to agree), and a 20 percent target share for renewable energies in energy use by 2020.

While the European Union has extended the scope and coverage of the ETS by approving the climate package, some criticized the European Union for failing to ensure the original climate package. Citing heavy costs on certain industries and the prospect of a sharp recession, some members threatened to veto the EU climate package unless the package addressed their concerns. Consequently, a series of concessions were granted to selected industries and to poorer members in the final version. The EU climate package does not include trade restrictive measures, but there are growing concerns about the possible loss of competitiveness by domestic industries to non-EU suppliers. As a result, discussions continue within

Box 3.2 European Union Emission Trading Scheme *(continued)*

the European Union on the imposition of carbon taxes or kindred fees on imports from countries that do not have comparable domestic climate programs.[4]

While the package includes provisions for auctioning permits that will start in 2013 and gradually increase as a share of the total over Phase III, a significant number of permits are still planned to be given away free. For example, the package allows the European Community to allocate 100 percent of allowances free of charge to certain industries that are exposed to a significant risk of carbon "leakage" if they meet certain criteria.[5] The auctions for manufactured goods will start at 20 percent in 2013 and then rise to 70 percent in 2020. For most EU utilities, full auctioning will start in 2013, but for existing Eastern European power plants, permit auctions will start at 30 percent in 2013 and not rise to 100 percent until 2020.[6] As mentioned earlier, free allowances would be examined under the Agreement on Subsidies and Countervailing Measures, even though it is still unclear whether an emissions allowance amounts to a subsidy.

1. The EU ETS is based on Directive 2003/87/EC, which entered into force October 25, 2003. The directive can be found at http://eur-lex.europa.eu (accessed on January 12, 2009).

2. See Memo/08/35, available at http://europa.eu (accessed on January 12, 2009).

3. See appendix E for details about the EU ETS as a carbon market.

4. For example, the European Union considered the inclusion in its Phase III plan of a requirement that European importers of carbon-intensive products buy carbon allocations. However, this proposal was dropped at the last minute due to opposition from the United States. See *Inside US Trade* 26, no. 4, January 25, 2008. Also, the day before the parliament approved the package, French President Nicolas Sarkozy urged that the United States and other countries take similar action, matching the EU commitment. See Associated Press, "Sarkozy: Others Must Match EU Climate Change Cuts," December 16, 2008, http://news.yahoo.com (accessed on January 12, 2009).

5. The full text adopted by the European Parliament on December 17, 2008 is available at www.europarl.europa.eu (accessed on January 12, 2009).

6. See Jonathan Stearns, "EU Slashes Emission Caps on Utilities, Factories," Bloomberg News, December 17, 2008, www.bloomberg.com (accessed on January 12, 2009).

Australia would be the subsidizing member, and another WTO member challenging Australia's subsidy would have a cause of action if its potential exports to Australia from emissions-intensive industries are being displaced or impeded by Australia's domestic subsidy.

One cannot say in advance whether the proposed subsidy would be actionable, because under ASCM rules, that conclusion has to be demon-

strated by evidence of a subsidy's effects. But a yellow flag must be raised regarding the Australian proposal because, by its own admission, its very purpose is to prevent trade disadvantage to emissions-intensive, trade-exposed domestic industries. Thus, if the program succeeds, it would surely be displacing imports from a country that could bring and win a WTO case.

Future Climate
World Trade O

At the climate change confere
agreed to launch a two-year pr
sor pact to the Kyoto Protocol.
finalized in Copenhagen in Dec
new ambitious targets for reduc
mit both developing and devel
leave many controversial issue
the extent and binding force of
and developing countries, and
one country can take to induce

At the ministerial session
2008, representatives from dev
treaty to tackle climate change
tainable development. In his sta
Qingtai emphasized that any f
be firmly based on the principle
bilities" as previously establishe
vention on Climate Change (U
stated that the effective particip

1. The main nonparty issue inherent in
old free-rider question, which also raise
can enjoy the environmental benefits
Under the Kyoto Protocol, a related is
emissions trading program with flexible

GLOBAL WARMING
WORLD TRADING SYSTEM

Gary Clyde Hufbauer has been the Reginald Jones Senior Fellow at the Peterson Institute for International Economics since 1992. He was formerly the Maurice Greenberg Chair and Director of Studies at the Council on Foreign Relations (1996–98), Marcus Wallenberg Professor of International Finance Diplomacy at Georgetown University (1985–92), senior fellow at the Institute (1981–85 and 1992–96), deputy director of the International Law Institute at Georgetown University (1979–81), deputy assistant secretary for international trade and investment policy of the US Treasury (1977–79), and director of the international tax staff at the Treasury (1974–76). His publications include *Maghreb Regional and Global Integration: A Dream to Be Fulfilled* (2008), *Economic Sanctions Reconsidered*, 3d ed. (2007), *US Taxation of Foreign Income* (2007), *China Trade Disputes: Rising Tide, Rising Stakes* (2006), and *NAFTA Revisited: Achievements and Challenges* (2005).

Steve Charnovitz is an associate professor of law at the George Washington University Law School. Before joining the faculty, he practiced law at WilmerHale in Washington. Earlier he was the director of the Global Environment & Trade Study at Yale University and policy director of the (US) Competitiveness Policy Council. He serves on the Board of Editors of the *American Journal of International Law* and on the editorial boards of the *Journal of International Economic Law*, *World Trade Review*, and *Journal of Environment & Development*. He contributed a chapter on labor and environmental issues to *Restarting Fast Track* (1998).

Jisun Kim is a research assistant at the Peterson Institute for International Economics. Her areas of research at the Institute include international trade, international tax, and climate change issues. She holds a US CPA certificate and previously worked as a tax consultant at PricewaterhouseCoopers in Seoul, Korea. She received her MA degree in international relations, focusing on global markets and Asia, from the Maxwell School of Syracuse University. She has coauthored several papers with Gary Clyde Hufbauer and assisted with *US Taxation of Foreign Income* (2007) and *Economic Sanctions Reconsidered*, 3d ed. (2007).

Peterson Institute for International Economics
1750 Massachusetts Avenue, NW
Washington, DC 20036-1903
(202) 328-9000 Fax (202) 659-3225
www.piie.com

ISBN 978-0-88132-428-0
52395

9 780881 324280