

French Ideas on Climate and Trade Policies

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The French idea of imposing a “CO₂ tax” on imports from countries not respecting a post-Kyoto regime, launched in 2006, has moved to centre-stage in Europe and elsewhere. It has triggered a debate in the European discussion on the “climate package”, the legislative proposals by the Commission that will translate into concrete action the pledges made by the European Council in March 2007 to reduce European emissions by 20% by 2020. This article discusses World Trade Organisation (WTO) aspects of an import tax, and shows that WTO law needs to be looked at very carefully in the further elaboration of the import tax plan, or of any other “border adjustment mechanisms”.

I. Introduction

The idea of a “CO₂ tax” on imports from countries not respecting a post-Kyoto regime was launched by the French parliament in a report on climate change in the spring of 2006.¹ It attracted much more media attention when the then French Prime Minister Dominique de Villepin proposed to study such a tax in the fall of 2006.² President Jacques Chirac also mentioned it in early 2007.³ Since then, the new President Nicolas Sarkozy and his government have picked up the theme. France has made it increasingly clear that it wants a discussion on what it calls “border adjustment measures” to be an integral part of the European approach to climate change. In his first major speech on French environmental policy after ground-breaking consultations between government both central and local, parliament, civil society, employers and employees (“le Grenelle de l’environnement”), Sarkozy said⁴:

J’ai posé cette question à l’Union européenne. Nous avons été les premiers à soumettre nos principales entreprises à un système de quotas pour limiter leurs émissions néfastes au climat. Il n’est pas normal que les concurrents qui importent en Europe les mêmes produits ne soient soumis à aucune obligation. Je ne veux pas refermer ce dossier au prétexte qu’il serait compliqué. Il faut le traiter au niveau communautaire.

Sarkozy also raised the issue when visiting China in November 2007, albeit in a speech at a Chinese university rather than in direct talks with the Chinese authorities:⁵

...je veux sans détour vous dire que je défendrai le principe d’un mécanisme de compensation carbone aux frontières de l’Union européenne, à l’égard des pays qui ne se doteraient pas de règles contraignantes de réduction des gaz à effet de serre.

1. The French Context

The French ideas on climate and trade should be placed in context. France is a country whose popu-

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- 1 The rapporteur at the time was the present State Secretary for the environment, Nathalie Kosciusko-Morizet. The full report is available at <http://www.assemblee-nationale.fr/12/pdf/rap-info/i3021-tl.pdf>. The report refers to a working paper by Ismer/Neuhoff, Border Tax Adjustments: A Feasible Way to Support Stringent Emission Trading, Cambridge available at <http://www.econ.cam.ac.uk/eprg/pubs/wp/ep36.pdf>.
- 2 Prime Minister’s speech before the interministerial committee for sustainable development 13 November 2006, found at the time at www.premier-ministre.gouv.fr/acteurs/interventions: “Je souhaite donc que nous étudions dès maintenant avec nos partenaires européens le principe d’une taxe carbone sur les importations de produits industriels en provenance des pays qui refuseraient de s’engager en faveur du protocole de Kyoto après 2012.”
- 3 Interview with the French media, at www.diplomatie.gouv.fr/fr/article-imprim.php3?id_article=45790.
- 4 Speech available at <http://www.elysee.fr/documents/index.php>.
- 5 Speech available at <http://www.elysee.fr/documents/index.php>.

lation and leaders seem to consistently have more problems in coming to terms with globalisation than other countries. Time and again, polls show the French population's general unease about globalisation and their gloominess about the economic future that is in store for themselves and their children.⁶ Market forces are mistrusted and much faith is put in the government rather than the market to provide for purchasing power and job opportunities. France's political discourse has through the years largely responded to that unease. Despite the fact that France has a large and highly advanced economy with several world-leading companies, there has never been a strong political current of economic liberalism. The former President Jacques Chirac famously said that liberalism was as dangerous as communism.⁷

Europe, according to Sarkozy, must not just boost its own competitiveness through e.g. its handling of the Euro or its industrial policy, it should also be very firm towards third countries. The European Union (EU) has lost touch with its citizens, and the only way to win their confidence back is by showing Europe is there to protect its citizens, by countering and alleviating instead of aggravating the effects of globalisation. This being the main message of Sarkozy and his government, "l'Europe qui protège" will be an important theme of the French EU Presidency during the second half of 2008.⁸ Time and again, Sarkozy has applied the following

vocabulary when discussing how France and Europe should deal with globalisation: "fin de naïveté", "réciprocité", "préférence communautaire", and measures against "dumping environnemental, sociale, fiscale et monétaire".⁹

Another important element of the political context is Sarkozy's recent green policy drive for France, symbolised by le Grenelle de l'environnement. Named after the street in Paris where an historic labour agreement was reached in 1968, this round of discussions with relevant societal actors (various layers of government, parliament, unions, employers, environmental organisations and other non-governmental organisations (NGOs)) led to recommendations for policy measures in the field of climate and energy, biodiversity and natural resources, health and risks, ecological democracy, environmental developments, employment and competitiveness, genetically modified organisms (GMOs) and waste.¹⁰ After public and political consultations, the discussions culminated in late October 2007 in negotiations at the Elysée to reach concrete conclusions on the topic areas mentioned. Sarkozy presented them in a speech with special guests Al Gore, Jose Manuel Barroso and Wangari Maathai. Although the conclusions still need to be transposed into concrete legislative proposals, the president nonetheless drew attention nationally and internationally by inter alia promising massive investment in energy saving construction and greener transport. He also stated that a domestic carbon tax would be considered, as long as it was compensated by other tax breaks.¹¹

Thus, the Grenelle will lead to a mixture of national policy measures and EU-wide initiatives. Some national propositions necessitate European dialogue, e.g. road taxes and more generally green taxation (there has been a French-British plea for a lower Value Added Tax (VAT) rate on green products, and the French ideas for a carbon tax that are the main subject of this contribution).

There are particular concerns on competitiveness of French (and European) industry when confronted with stringent European climate measures. The external aspect of European competitiveness must, in the French view, inevitably be part of the European approach to the climate problem: what contribution is asked from third countries and, if need be, what is asked from imports from third countries who do not contribute?

6 See, for example, the polls by the German Marshall Fund on inter alia globalisation in major European countries, http://www.transatlantictrends.org/trends/index_archive.cfm?year=2006.

7 Chirac is quoted in Péan, *L'inconnu de l'Elysée*, Paris 2007: "Le libéralisme est lui aussi dangereux et conduira aux mêmes excès [que le communisme]... Je suis convaincu que le libéralisme est voué au même échec que le communisme, et qu'il conduira aux mêmes excès. L'un comme l'autre sont des perversions de la pensée humaine."

8 During the final negotiations that led to the blueprint for a new treaty at the June 2006 European Council, Sarkozy managed to persuade the then German EU Presidency and other partners that "free and unfettered competition" should no longer be a Union objective; free competition, he argued, should be a means towards economic growth and full employment, but not an objective in itself. And to the list of the Union's objectives was added upon French instigation the protection of the Union's citizens.

9 The various speeches by Sarkozy can be found at www.elysee.fr, among others the economic policy speech from July 2007.

10 The recommendations can be found at www.legrenelle-environnement.fr.

11 Full speech available, also in English, at www.elysee.fr.

2. European Emissions Trading and International Competitiveness

International competitiveness is a real issue, at least for a number of energy-intensive sectors that are exposed to international competition.¹² The issue has been addressed by various organisations, among them the European Commission.¹³ The French authorities invoke the competitiveness argument when pleading for a CO₂-tax or similar “border adjustment measures”. They admit that international competitiveness problems are limited under the current emissions trading scheme (ETS) with its (too) generous free distribution of emission rights. But they fear that once the ETS is renewed and permits are allocated less generously or auctioned, a number of energy-intensive industries may relocate their production from the EU to countries without any emission constraints and related costs, or with less stringent constraints and costs. One can think of emerging markets such as China or India, but also of countries closer to the EU. Considering the transportation costs for some sectors, some of them are more likely to locate production in the immediate periphery of the Union, such as in Northern Africa, Turkey, Ukraine, or Russia.

In the French view, the competitiveness of certain French and European industries and the risk of relocating of production are not issues that concern only economic and employment policies. If “carbon leakage” were to become a large-scale phenomenon, there are obvious concerns over the effectiveness of unilateral EU action to tackle climate change if other big emitters do not take part. In fact, according to France, there is a risk that carbon leakage causes the net effect of unilateral EU climate change measures to be very limited or even negative. Finally, and this was said by the then Prime Minister De Villepin when he first announced the French desire to discuss at European level a “CO₂ tax” on imports, the possibility of such a tax on imports is also a means to exert pressure on third countries to take on post-Kyoto commitments. In fact, the French government appears to think that European border adjustment measures may provide a positive incentive for third countries to engage in international commitments. This view stands in marked contrast with that of EU Trade Commissioner Peter Mandelson, who said not long after the French plea for a CO₂-tax said that “a Kyoto tariff gets the international politics of climate change

wrong”, and that “it’s ultimately more productive to encourage clean trade than to try and punish dirty trade”.¹⁴ Incidentally, France does not wish to rely solely on negative incentives: it also wishes to provide incentives of a more positive character to support developing countries willing to join international action to fight climate change in meeting adaptation costs.¹⁵

II. Analysis of Concrete French Ideas

The idea put forward at the time by De Villepin was a “carbon tax on the imports of industrial products from countries refusing to engage in the Kyoto Protocol after 2012” (author’s own translation).¹⁶ The French authorities thus focused on the possibilities of a border tax adjustment, apparently inspired by the aforementioned paper published by Cambridge and the MIT.¹⁷ That paper, as well as the French parliament’s study on the subject, not only addressed border tax adjustment on imports, but also a rebate on exports. This contribution focuses on the import side. Before assessing the French proposal from the perspective of WTO law, some preliminary remarks are made. First of all,

12 As indicated by the discussions in the media on the iron and steel industry being “chased away” from Europe in the weeks before the European Commission issued its proposals for climate measures in January 2008 (see Financial Times, “Steel Industry Launches Attack on ‘Vindictive’ Brussels Plans”, 14 January 2008).

13 EU ETS Review-Report on International Competitiveness, December 2006, at http://ec.europa.eu/environment/climat/emission/review_en.htm. The Commission’s Directorate General for Environment commissioned a report on international competitiveness from McKinsey and Ecofys as part of a general review of the European Union’s emission trading system (ETS). The report assumes a 20€/ton CO₂ price and assumes 95% of required allowances being granted for free. It identifies a limited number of sectors which will in these circumstances be under pressure from emissions trading: primary aluminium and certain pulp and paper production processes. It further states that the primary steel production and cement sectors, highly exposed to international competition, are likely to face pressure to shift production elsewhere when facing high marginal cost increases caused by emissions trading.

14 Speech by Peter Mandelson in Oslo, Norway, 9 February 2007, at http://ec.europa.eu/commission_barroso/mandelson/speeches_articles/sppm140_en.htm.

15 As announced in a speech by President Sarkozy in New York, N.Y., at the United Nations (UN) General Assembly climate summit, 24 September 2007, http://www.elysee.fr/documents/index.php?mode=cvview&press_id=453&cat_id=7&lang=fr.

16 *Supra*, note 2.

17 *Supra*, note 1.

close reading of the statement by De Villepin in late 2006 invites the following observations:

“Imports of industrial products”: it would seem that France envisaged a tax on all industrial products, regardless of the amount of CO₂ emitted during their production.

“From countries refusing to engage...”: apparently, France would wish to make countries’ willingness to engage in international agreement on commitments to abate climate change in the post-Kyoto era the criterion for applying the border tax. In other words, it intends to take a country-based approach.

“The Kyoto Protocol after 2012”: it is assumed that France was referring to an international agreement on climate change commitments for the period from 2012 onwards. Judging from the phrasing of the proposal, autonomous action to abate climate change would not make a country’s exports eligible for escaping the border tax.

One may wonder why agricultural products are excluded from the outset, even if agricultural production is a serious source of greenhouse gas emissions through fertilizer and energy use, and even if many processed agricultural products are manufactured using processes as energy-intensive as for some industrial products. Further, it may be questioned whether addressing emissions is best tackled by focusing on production rather than consumption. Taxing the (domestic French and European) consumer according to the carbon-intensity of the products he uses may be more effective.

Apart from these general remarks, the proposal raises serious questions as regards its compatibility with WTO rules. First of all, any carbon tax applied to imports should meet the Most-Favoured Nation requirement (MFN) in Article I.1 of the General Agreement on Tariffs and Trade (GATT).¹⁸ If it is indeed considered a tax, which depends on whether it also applies to domestic products, the tax also needs to comply with the National Treatment requirement (NT) in Article III:2 GATT. If it is not

considered a tax, it would be an import duty, which according to Article II GATT could not be raised without negotiations with trade partners.

If any of these requirements is not met, the carbon tax should be justified under the justification of Article XX GATT (or Article XXI, in the unlikely event the measure could be qualified as necessary to safeguard vital security or defence interests).

1. Most-Favoured Nation and National Treatment

As regards MFN, any advantage granted by a Member to any product originating in any other country must be given immediately and unconditionally to the like product originating in all other Members. This requirement is violated if a carbon tax is imposed on the importation of industrial products from a WTO Member that does not engage in the post-Kyoto regime, while such a tax is not imposed on the “like product” from another state (WTO Member or not). The issue of “like products” is addressed below under National Treatment.¹⁹

As regards National Treatment (NT), the first question to be answered is whether the tax applied to imports is part of an internal taxation scheme. If there also is a carbon tax on domestic products, the carbon tax on imports will be covered by the NT requirement, even if the tax is directly levied upon importation. The tax then is a Border Tax Adjustment and will be assessed under Article III:2 GATT.²⁰

If the carbon tax is applied only to imports, while quite different measures (fiscal or other) aimed at reducing CO₂ emissions apply to domestic industry, such as a cap-and-trade system, the question arises whether Article III GATT applies to the import tax at all. The Note Ad Article III states that “any internal tax ... which applies to the imported product and to the like domestic product and is collected in the case of the imported product at the time or point of importation, is nevertheless to be regarded as an internal tax”. The 1970 Working Party on BTA concluded in its report that

“there was convergence of views that taxes directly levied on products were eligible for tax adjustment. [...] Furthermore, the Working Party concluded that there was convergence of views

18 General Agreement on Tariffs and Trade 1994, contained in the Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 33 I.L.M. 1994, p. 1153 ff.

19 Although it should be noted that the interpretation of “like” products is not necessarily the same in Articles I and III GATT.

20 See the Note Ad Article III GATT and Article II.2(a) GATT.

to the effect that certain taxes that were not directly levied on products were not eligible for tax adjustment.”²¹

The Working Party’s references to “taxes directly levied on products” and to “taxes that were not directly levied on products” should be read as references to indirect and direct taxes, respectively. Only “indirect” domestic taxes (levied on products) may be compensated upon import and export, while “direct taxes” (levied on persons) may not.²² When the tax is not directly levied on the product, it is difficult or impossible to ascertain what “adjustment” requires.²³ Thus, taxing imported products in order to adjust a domestic producer tax contravenes Article III:2, because the like domestic products would not be subject to such a tax, even if the domestic producers would. Alternatively, Article II:1(b) GATT is violated when the tax is collected at the border and is considered a charge that violates a tariff binding.²⁴

If only taxes levied on products as such can be adjusted, that does not mean that taxes based on production methods can never be applied to imported products. It is recalled that Article III:2 itself contains the words “subject, directly or indirectly”. The major focus of the term “indirectly” in that Article seems to be in enabling the adjustment of taxation of inputs in products. In discussions in the Preparatory Committee that prepared the relevant GATT Articles back in 1947-48, it was stated that the word “indirectly” would even cover a tax not levied on a product as such but on the processing of the product.²⁵ The text of Article II.2(a) GATT speaks of “an article from which the imported product has been manufactured or produced in whole or in part”. The question on inputs has as yet not been settled in the GATT/WTO. The famous 1970 GATT Working Party on Border Tax Adjustment did not reach a conclusion on it.²⁶ Thus, it is as yet unclear whether taxes on inputs that are consumed domestically in producing a final product may be adjusted upon the import or export of the final product.²⁷

Considering the above, how should an import tax on products from certain countries not willing to play their part in an international agreement to combat climate change be classified? A first question that arises is whether a domestic cap-and-trade system can be classified as a tax, as it does not meet the basic requirement of a tax that it be a contribu-

tion to government without a specific service being rendered.²⁸ It has been argued that a cap-and-trade system in which emission rights are auctioned is sufficiently comparable to a domestic tax that it can be considered one. Some authors even argue that this is the case where, in the domestic cap-and-trade system, only part of the emission rights are auctioned and another part is granted for free (e.g. by grandfathering or on the basis of benchmarking). They argue that the costs of the emission rights acquired can simply be divided by the total amount of emission rights needed by the domestic producer in order to calculate the amount of the internal “tax”.²⁹ The current author entertains some doubts as to whether such a wide interpretation of the word “tax” in Article III:2 GATT and the Note thereto would be upheld in a WTO dispute settlement procedure.

If Article III and the Note thereto do not apply to the border tax, the border tax will be considered an import duty, which should not be higher than those laid down in the importing Member’s tariff schedule according to Article II.1(b) GATT. To avoid a breach of this requirement, the EU’s tariff schedule

21 Report of the GATT Working Party on Border Tax Adjustments, Doc. BISD 185/97, para. 14.

22 On border tax adjustment in the GATT/WTO context, see Dam, *The GATT – Law and International Economic Organization*, Chicago 1970, p. 124; Demaret/Stewardson, “Border Tax Adjustments under GATT and EC Law and General Implications for Environmental Taxes”, *Journal of World Trade* 1994, p. 5 ff.; Thaggart “A Closer Look at the Tuna-Dolphin Case: ‘Like Products’ and ‘Extrajurisdictionality’ in the Trade and Environment Context”, in Cameron/Demaret/Geradin (eds.), *Trade and the Environment: The Search for Balance*, London 1994; GATT Working Party Report, Doc. BISD 185/97; and a useful overview is contained in WTO Doc. WT/CTE/W/47.

23 Howse/Regan, “The Product-Process Distinction: An Illusory Basis for Disciplining Unilateralism in Trade Policy”, *European Journal of International Law* 2000, p. 249 ff., footnote 19.

24 As suggested by Hudec, “The Product-Process Doctrine in GATT/WTO Jurisprudence”, in Bronckers/Quick (eds.), *New Directions in International Economic Law – Essays in Honour of John Jackson*, London 2000, in the text accompanying footnote 10.

25 Docs. EPCT/A/PV/9, p. 19, and EPCT/W/181, p. 3.

26 See OECD, *The Political Economy of Environmentally Related Taxes*, Paris 2006, p. 98.

27 Demaret/Stewardson, *supra*, note 22, at 18.

28 On the definition of what constitutes a tax, see Fauchald, *Environmental Taxes and Trade Discrimination*, London 1998; De Cendra, “Can Emissions Trading Schemes be Coupled with Border Tax Adjustments? An Analysis vis-à-vis WTO Law”, *RECIEL* 2006, p. 131 ff.

29 Ismer/Neuhoff, *supra* note 1, at 9.

would need to be adapted so as to introduce specific tariff lines for “non climate change friendly” products. This would cause enormous practical problems for hundreds of tariff lines and would raise the problem of differentiating between “non climate change friendly” products and physically identical products whose production generates less CO₂ and which should therefore benefit from lower tariffs. In any event, such an approach, even if these difficulties were overcome, would not be possible on the basis of a country-based approach, since that would run counter to the MFN requirement. The possibility of differentiating tariff lines on the basis of climate-friendliness, however, should not altogether be discarded: a list of such products with lower or zero tariffs might be agreed upon between WTO-members. The thorny negotiations during the Doha Round on additional tariff reductions for green products show, however, that it is by no means easy to agree on a list of products among 150 states.³⁰

2. Article III GATT

Assuming that Article III:2 and the Note Ad Article III do apply, then the carbon tax should meet either of the following National Treatment requirements³¹:

- No taxation of imports in excess of taxes on “like” domestic products
- In case products are not “like”, but directly competitive or substitutable, no tax may be applied so as to afford protection to domestic production.

“Likeness” is usually assessed on the basis of physical characteristics, tariff classification, end-use, and consumer tastes, habits, and preferences³². If the products are found to be “like”, the imported products may not be taxed at a higher rate than the domestic ones, because such taxation would be considered protectionist. Therefore, if Article III:2 first sentence were to apply to the border tax (this being dependent, as discussed above, on the question whether there is also an internal tax on domestic products; in the absence of which the border tax will be judged an import duty and assessed under Article II.1(b) and the applicable tariff schemes), the analysis will focus on the question of “likeness” and of excessive taxation of imported products.³³

Could industrial products from a country refusing to engage in post-Kyoto be considered “unlike” physically identical products from a country engaging in post-Kyoto? This raises the important and as yet unanswered question whether different production processes that do not in any way affect the product traded may be so important as to fundamentally alter the comparison of their (fiscal or regulatory) treatment under Article III GATT. This question is addressed below when discussing the other possibly relevant paragraph of Article III, on regulatory measures.

If “likeness” were not to be affirmed and the measure applied to directly competitive or substitutable domestic products (still assuming the measure were to be identified as a tax so that Article III applied through the Note Ad Article III to the border tax), the question arises whether or not the taxation of imported products is intended to afford protection, rather than to reduce global greenhouse gas emissions. A complainant would have to make a *prima facie* case that there was a protectionist application of the measure, which, if granted, would lead to the defendant being asked to explain why the measure was not protectionist, but rather aimed at reducing global CO₂-emissions. The whole group of directly competitive or substitutable products will be taken into account in the analysis, and the design, architecture and structure of the fiscal regime in the importing country will be assessed so as to determine whether there is protective application.³⁴

Also with regard to Article III, there is a possibility that border taxes might be considered part of a domestic regulatory scheme (such as the European directive on the emissions trading system ETS), and

30 See the overview of submissions on environmental goods, WTO Doc. TN/TE/W/63, at www.wto.org.

31 Fauchald, *supra* note 28.

32 See below for further discussion on ‘likeness’.

33 As addressed by the Appellate Body report in Japan – Taxes on Alcoholic Beverages, Report of the Appellate Body, WTO Docs. WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, and by the panel in Mexico – Tax Measures on Soft Drinks and Other Beverages, Report of the Panel, WTO Doc. WT/DS308/R, paras. 8.26 ff.

34 See Appellate Body reports in Japan-Alcohol, *supra*, note 33; Chile – Taxes on Alcoholic Beverages, Report of the Appellate Body, WTO Doc. WT/DS87/AB/R, paras. 43 ff., Korea – Taxes on Alcoholic Beverages, Report of the Appellate Body, WTO Docs. WT/DS75/AB/R, WT/DS84/AB/R, paras. 103 ff., and the panel report in Mexico – Beverages, *supra*, note 33, paras. 8.66 ff.

that they thus have to be assessed under the National Treatment obligation for regulatory measures in Article III:4 GATT. If that is the case, the regulatory scheme should not offer “less favourable treatment” to imported products than to “like” domestic products. Traditionally, the analysis has mostly focused on the question of the likeness of products, less favourable treatment being readily assumed in the event of like imported and domestic products and a difference in treatment. Some authors have argued that physically identical products can be considered “unlike” due to different production processes.³⁵ Others have argued that, for production methods, the criterion “consumer tastes and habits” cannot be stretched so far as to render identical products “unlike”.³⁶

The WTO Appellate Body in the Asbestos dispute seems to have suggested a more sophisticated approach to the question of whether the regulatory National Treatment obligation is breached. This approach does not so much focus on “likeness”, but rather looks at the overall treatment of a group of imported products vis à vis a group of like domestic products.³⁷ Such an analysis would seem to be informed by the introductory sentence to Article III that stipulates that Members should not apply internal tax and regulatory schemes so as to afford protection to domestic production. The Appellate Body itself did not go as far as to state that physically like products may be considered “unlike” because of their production methods. But it did suggest that for less favourable treatment to be found, it is not always sufficient to show that one imported product is treated less favourably than a like domestic product.

As stated above, similar questions arise in the assessments under Article III:2, first sentence for tax measures and under Article III:4 for regulatory measures: is there “excessive taxation” or “less favourable treatment” of the imported products that are physically like domestic products, but have been produced in a different way, e.g. emitting more CO₂, or (as in the French proposal) in a different place where no emission constraints are imposed on production?

It should be noted that the more sophisticated approach to “likeness” was discussed in the context of de jure neutral regulatory measures. It is highly unlikely to be upheld in the context of a tax that is applied differently to imports and domestic products, that is: a country-based carbon tax, seeing how

the decisive criterion for applying the border tax would be the country from which a product was imported, rather than e.g. its carbon content.

In sum: the tax as proposed would appear to be in breach of Article I.1 GATT, and in addition – if it were considered an import duty – would likely be in breach of Article II.1(b). If the tax were to be considered the application to imports of a domestic tax scheme (which, it is recalled, depends on whether the restraints on domestic products qualify as a “tax”), compatibility with Article III:2 GATT appears unlikely (the first sentence applying if the products are like, otherwise the second sentence).

3. Justification Possibilities: Article XX (g)

If Article I and/or Article II and/or Article III were breached, could Article XX GATT offer justification? It should be noted at the outset that Article XX cannot be invoked to justify a measure to offset competitive disadvantages for domestic industry: Article XX does not cater for economic arguments. However, as noted, the French argument (and that of European energy-intensive industry) combines

35 See Howse/Regan, *supra* note 23; Howse/Tuerk, “The WTO Impact on Internal Regulations – A Case Study of the Canada – EC Asbestos Dispute”, in De Burca/Scott (eds.), *The EU and the WTO: Legal and Constitutional Aspects*, London 2001. At first sight, the Financial Times appears to share this view, considering its editorial comment on 4 January 2008: “Assuming these [border taxes] merely equalised the carbon taxes paid by domestic and foreign producers, they need not necessarily be against World Trade Organisation rules, which allow countries to use trade policy to stipulate production methods and protect natural resources as long as they do not discriminate between companies from different countries”. However, the Financial Times seems to be referring rather to the interpretation of Article XX GATT than to Article III, as it refers to the protection of natural resources and brings to mind the Appellate Body that said, in *United States-Import Prohibition of Certain Shrimp and Shrimp Products*, Report of the Appellate Body, WTO-Docs. WT/DS58/AB/R and WT/DS58/AB/RWV, that prescribing production methods elsewhere is a general characteristic of the justifications in Article XX and the discrimination referred to in the Chapeau to Article XX.

36 Quick/Lau, “Environmentally Motivated Tax Distinctions and WTO Law: The European Commission’s Green Paper on Integrated Product Policy in Light of the ‘Like Product-’ and ‘PPM-’ Debates”, *Journal of International Economic Law* 2003, p. 419 ff.

37 See in particular *European Communities – Measures Affecting Asbestos And Asbestos-Containing Products*, Report of the Appellate Body, WTO Doc. WT/DS135/AB/R, para. 100. On National Treatment and like products, see Ehring, “De Facto Discrimination in WTO Law: National Treatment and Most-Favoured-Nation Treatment-or Equal Treatment?”, *Journal of World Trade* 2002, p. 921 ff.; Ortino, *From ‘Non-discrimination’ to ‘Reasonableness’: A Paradigm Shift in International Economic Law?*, Jean Monnet Working Paper 01/05, available at <http://www.jeanmonnetprogram.org/papers/05/050101.pdf>.

competitiveness with environmental reasons: because of the competitiveness loss if carbon curbing measures are applied only in the EU, business will move out of the EU into countries not curbing emissions, thus causing “carbon leakage” and more overall greenhouse gas emissions worldwide. In order to justify a measure under Article XX, the environmental argument needs to be made. Carbon leakage may be part of that argument, but it will make the causal link between measures applied to imports and their environmental objectives less direct.

The most likely provision to resort to would be paragraph (g): “relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption”. As to the first part, if air that is not “depleted” by pollutants emitted through the consumption of gasoline qualifies as an exhaustible natural resource, as has been recognised by the WTO Appellate Body in *US – Gasoline*,³⁸ it would seem that air not “depleted” by excessive greenhouse gas concentrations caused by human-induced CO₂-emissions may also qualify as an exhaustible natural resource.³⁹ Discussions on the degree of certainty as to whether climate change is human-induced would resurface here, and the reports of the Intergovernmental Panel on Climate Change (IPCC) would play a major role in helping a WTO panel or the Appellate Body to interpret paragraph (g).

Alternatively or additionally, biodiversity that is threatened by climate change may be invoked as an exhaustible natural resource. Another question and one yet to be answered is whether a territorial nexus should exist between the natural resources to be protected and the Member imposing the tax. To date, there has been no clear-cut case in which the WTO Appellate Body has been asked to rule on this issue; in *US – Shrimp Products*, it avoided the question. In the author’s view, however, for climate

change, a global problem par excellence, such a nexus could be argued to exist.

Further, the measure needs to be “relating to” the conservation goal. This causal link requirement has been interpreted by the WTO Appellate Body as a “close and genuine relationship of means and ends”.⁴⁰ Looking at the analysis of whether that was the case by the Appellate Body in *US – Shrimp Products*, the following of its findings are of possible relevance: the US in that case required countries wishing to export shrimp to the US to require shrimp fishers to limit the accidental catch of turtles. The Appellate Body found that requirement directly connected to the policy objective of sea turtle conservation. Looking further at the design of the US measure, the Appellate Body found in that case that the measure was “not disproportionately wide” in its scope and reach in relation to its policy objective, and that the means were “reasonably related to the ends”.⁴¹

In other words, the measure should really contribute to attaining its environmental goal and should not be disproportionately wide in its scope and reach. Judging from *US – Shrimp Products*, this also implies that there be a direct connection between measure and objective. Would that be the case for import restrictions on products from countries not curbing CO₂ emissions? The point about the role to be played by competitiveness issues and carbon leakage was made above. The defending WTO Member (in our case the EU) would need to show that the measures applied to importations contributes to the objective. That is, it would need to convincingly argue that the import measures directly incite foreign producers to lower emissions, and/or that it indirectly helps achieving the goal by keeping industry in the EU where its emissions are curbed and preventing it from moving abroad where its emissions are not curbed.

Finally, the measure must be taken in conjunction with restrictions on domestic production or consumption. This is an important and not yet extensively elaborated issue in those cases where domestic measures are taken at production level, while for reasons of jurisdiction the exact same measures cannot be applied to foreign producers. Together with Article III GATT and the Note Ad Article III, this part of Article XX (g) is therefore highly relevant to trade restrictions focusing on production or processing methods, so-called PPMs. For example, the US in *US – Shrimp Products* pre-

38 *United States – Standards for Reformulated and Conventional Gasoline*, Report of the Appellate Body, WTO Doc. WT/DS2/AB/R.

39 As argued by this author before, see *Wiers*, *Trade and Environment in the EC and the WTO*, Groningen 2002, p. 239.

40 Appellate Body in *US – Shrimp Products*, *supra*, note 35, para. 136.

41 *Ibid.*, paras. 140 and 141.

scribed how US fishermen or other fishermen in US waters should fish shrimp. As it could not directly regulate foreign fishermen fishing in foreign waters, it resorted to making imports dependant on whether countries were certified as doing comparable efforts to regulate the fishing methods under their jurisdiction. The Appellate Body showed considerable leniency in accepting such an approach in US – Shrimp Products. It recalled its earlier interpretation of the “taken in conjunction with”-requirement in US – Gasoline as one of “even-handedness” between the measures concerning imported and domestic gasoline. In that case, the Appellate Body had suggested that it would be quite demanding as to the fulfilment of the requirement, observing that restrictions on the domestic production of “dirty” gasoline had been established jointly with corresponding restrictions with respect to imported gasoline.⁴² However, in US – Shrimp Products, the Appellate Body referred to “even-handedness”, but not to “joint establishment” of “corresponding” domestic and import restrictions. Arguably, the difference is explained by the fact that more “even-handedness” between domestic and import restrictions can be demanded for products standards than for production standards.

What about import-restrictive measures for climate reasons? Arguably, a conjunction with domestic production restrictions could convincingly be demonstrated by pointing at the new European emissions trading system, its sectoral EU-wide caps, and the legal obligation for large emitters to have enough emission rights each year to balance their real emissions. However, it would be a problem if part of the emission rights were given away for free domestically in a sector while no similar arrangement were made for imports in that sector.

4. Article XX (b)

Another possibility to resort to is Article XX (b), “necessary to protect human, animal or plant life of health”. The challenge here is to show that the measure is “necessary”. Thus, purely looking at the text, the causal link requirement is tougher than the “relating to” requirement in paragraph (g).⁴³ However, the difference should not be overstated, considering the fact that the Appellate Body seems to be putting a “genuine relationship of ends and means” centre stage in both paragraphs, as will be discussed

below. After a long GATT-history centred on “least-trade-restrictiveness”, the Appellate Body has started developing a more elaborate formula to interpret “necessary”, albeit first in another paragraph of Article XX:

whether a measure is “necessary” ... involves in every case a process of weighing and balancing a series of factors which prominently include the contribution made by the ... measure, the importance of the common interests or values protected ... and the accompanying impact ... on imports or exports.⁴⁴

The Appellate Body has also addressed the “necessity” test in the context of Article XIV of the GATS. There, it stated that the weighing and balancing process inherent in the necessity analysis begins with an assessment of the relative importance of the interests or values furthered by the challenged measure, and also involves an assessment of other factors which will usually include the contribution of the measure to the realization of the ends pursued by it and the restrictive impact of the measure on international commerce.⁴⁵ The Appellate Body had already applied the “necessary” formula in the context of Article XX (b) in EC – Asbestos, but in that particular case it did not strictly speaking need to rule on Article XX (b), as it had not found a violation of a substantive GATT provision, so in a way its interpretation of “necessary” in paragraph (b) was a sort of obiter dictum there.⁴⁶

42 Appellate Body in US – Gasoline, *supra*, note 38, p. 22.

43 As noted by this author, it does not seem logical that it is harder to justify a measure aimed at protecting human, animal, or plant life or health than to justify a measure aimed at conserving natural resources, and the result of this will be that at least in animal protection cases Members may prefer to resort to paragraph (g) (Wiers, *supra*, note 37, p. 240). Paragraph (g) was originally intended to address export restrictions (see Fauchald, *supra*, note 28, p. 330; Charnovitz, “Exploring the Environmental Exceptions in GATT Article XX”, *Journal of World Trade* 1991, p. 37. Back in the 1940s when these provisions were negotiated, Article XX (g) was mostly if not entirely relevant for export restrictions on natural resources, aimed at helping post-war economic reconstruction.

44 The “necessary” formula was first laid down by the Appellate Body in Korea-Beef, an Article XX(d) dispute, see Korea – Measures Affecting Imports Of Fresh, Chilled And Frozen Beef, Report of the Appellate Body, WTO-Docs. WT/DS161/AB/R, WT/DS169/AB/R, para. 164.

45 United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services, Report of the Appellate Body, WTO Doc. WT/DS285/AB/R, para. 306.

46 See the Appellate Body report in EC – Asbestos, *supra*, note 37, paras. 172-174.

Brazil – Tyres has made it definitely clear that the Appellate Body considers the “necessary” formula applicable to Article XX (b).⁴⁷ It recapitulated in its report as follows:

[K]ey element of the analysis of the necessity of a measure under Article XX (b) is the contribution it brings to the achievement of its objective. A contribution exists when there is a genuine relationship of ends and means between the objective pursued and the measure at issue. [T]he contribution of the measure has to be weighed against its trade restrictiveness, taking into account the importance of the interests or the values underlying the objective pursued by it.⁴⁸

In other words, in order to invoke Article XX (b) to justify a carbon tax on imports, the defendant should make the case that the measure contributes to the achievement of the objective of protecting humans, animals and plants against the consequences of global warming caused by CO₂ emissions. What was discussed above in the context of paragraph (g) applies here too; the import measure may be argued to directly incite foreign producers to lower emissions, and indirectly by preventing carbon leakage. If this causal link were to be satisfactorily established, a weighing exercise would follow of the measure’s contribution against its trade restrictiveness, taking into account the importance of taking action against climate change.

5. The Chapeau to Article XX

Finally, the “Chapeau” to Article XX requires that an import-restrictive measure such as the proposed carbon tax not be applied as a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a

disguised restriction on international trade. The Appellate Body in Brazil – Tyres, referring to US – Gasoline, US – Shrimp Products and US – Shrimp Implementation, stated that “the analysis of whether the application of a measure results in arbitrary or unjustifiable discrimination should focus on the cause of the discrimination, or the rationale put forward to explain its existence.”⁴⁹ There is arbitrary or unjustifiable discrimination when a measure provisionally justified under a paragraph of Article XX is applied in a discriminatory manner between countries where the same conditions prevail, and when the reasons given for this discrimination bear no rational connection to the objective falling within the purview of a paragraph of Article XX, or would go against that objective. Thus, the assessment of whether discrimination is arbitrary or unjustifiable should be made in the light of the objective of the measure.⁵⁰

The above guidelines from the Appellate Body from Brazil – Tyres, as well as US – Shrimp Products and US – Shrimp Implementation,⁵¹ should be carefully studied when further discussing possible EU import measures. It is certain that not taking into account different conditions prevailing in different countries in the application of the border tax will amount to discrimination, rendering a carbon tax unjustifiable under Article XX. Another requirement is to have engaged in serious, good faith and across the board negotiations to seek international agreement on climate change abatement before enacting the carbon tax. It is recalled that the French government proposed only to apply a border tax once there is an international agreement and some countries do not take part in it, so this requirement would seem to be met in that scenario. However, one may wonder whether a problem of “arbitrary discrimination” will not arise if and when a new agreement for the post-Kyoto period sets emission reduction targets for a future year, e.g. 2020, and trade-restrictive measures are imposed upon countries not joining the agreement although it will only be clear by 2020 whether its signatories will have met their targets.⁵²

Finally, the Chapeau imposes due process requirements. If, for instance, the law instituting the carbon tax does not provide for exemptions for products from individual companies that have ensured their production process is CO₂-free or low (e.g. in California) but are nevertheless hit by the carbon tax because they happen to be situated in a

47 See Brazil – Measures Affecting Imports of Retreaded Tyres, Report of the Appellate Body, WTO Doc. WT/DS332/AB/R, in particular paras. 145-155 and 178-183.

48 *Ibid.*, at para. 210.

49 *Ibid.*, at para. 226.

50 *Ibid.*, at para. 227.

51 United States – Import Prohibition of Certain Shrimp and Shrimp Products, Recourse to Article 21.5 by Malaysia, Report of the Appellate Body, WTO Doc. WT/DS58/AB/RW.

52 As observed by Reinhard Quick in his correspondence with the author.

country targeted, this will render justification under Article XX highly unlikely.

III. Other Relevant Considerations

1. Role of a Post-Kyoto Agreement in the Analysis

In the above, it has been assumed that there will be no international agreement on a CO₂-tax as such, but that border taxes would be applied to countries not willing to adhere to a post-Kyoto agreement. Of course, it is difficult to talk about an agreement that still needs to be written. But let us suppose a new agreement would have roughly the same structure as Kyoto, i.e. precise CO₂-reduction targets, but no precise prescriptions as to how to reach these targets. In such a case, the existence of such a post-Kyoto agreement will inform the above analysis in various ways. For example, it may be used to inform the Article III analysis, demonstrating that higher taxation of unlike but directly competitive products is not applied for protectionist reasons. And to inform the various parts described above of both the analysis of Article XX (g) and/or (b) and its Chapeau.⁵³

In addition, some scholars assert that, as a matter of international law, a WTO Member applying a trade-restrictive measure permitted or imposed by a multilateral treaty such as the one envisaged for post-Kyoto, when its measure is challenged in the WTO, does not necessarily need to resort to the WTO provisions such as GATT Article XX, but can rather defend itself by referring to its obligations and rights under the multilateral treaty.⁵⁴ However, such a defence would not seem to be possible in the event the WTO Member challenging the measure is not a party to the other multilateral treaty invoked in defence. And it is precisely that situation which will arise in the event of a multilateral post-Kyoto agreement being reached while one or two major players (and WTO members) decide to remain outside it. Another question that will need to be addressed is whether trade-restrictive measures can be foreseen against parties to a post-Kyoto treaty that have less stringent or no compulsory commitments. If the EU agrees to a treaty where, say China or India also takes part, but with less stringent or no compulsory commitments, two scenarios are conceivable: first, trade-restrictive measures to be

taken by parties taking on stringent commitments as against imports from parties taking on no or less stringent commitments are agreed on and conditioned in the post-Kyoto treaty, or second, no such measures are foreseen in the treaty. In the latter case, it will be difficult for the EU to invoke the post-Kyoto treaty in order to justify trade-restrictive measures.

2. Country-based and Non-country-based Approaches

In the above, it has been argued a number of times that a carbon border tax is likely to run into difficulties with the substantive obligations in the GATT (Articles I, II, III in particular) because of its being based on the country of origin of the products. This being so, the question arises whether other approaches than the country-based one proposed by France can be envisaged.

First of all, the country-based approach itself should not necessarily be based on the question of whether the exporting country adheres to a post-Kyoto agreement. It could alternatively be based on the exporting country's efforts to abate climate change in general or in certain CO₂-intensive production processes. The example in US – Shrimp Products comes to mind, where the US certified countries depending on whether their authorities did enough to ensure that turtles were saved in shrimp fishing. However, such an approach raises a lot of questions. How should efforts of exporting countries be assessed, and by whom? Is it for example the importing country that certifies exporting countries as “climate-change-friendly”? What differentiation should be made between countries according to their development levels? What products would be covered by the import adjustment

53 Article 31 (3) (c) of the Vienna Convention on the Law of Treaties, 8 I.L.M. 1969, p. 679 ff., provides that in the interpretation of a treaty, there shall be taken into account, together with the context: “any relevant rules of international law applicable in the relations between the parties.”

54 Pauwelyn, “How to Win a World Trade Organization Dispute Based on Non-World Trade Organization Law?”, *Journal of World Trade* 2003, p. 997 ff., at p. 1023. More generally on the relationship between WTO and other international law, see Pauwelyn, *Conflict of Norms in Public International Law: How WTO Law Relates to Other Rules of International Law*, reviewed by Trachtman, *American Journal of International Law*, 2004, p. 855 ff., and an interesting discussion on the ILC Study Group on fragmentation of international law, at http://worldtradelaw.typepad.com/ielpblog/2006/09/ilc_report_on_f.html.

measure? Another question is how countries' imports are to be treated; in *US – Shrimp Products*, shrimp from non-certified countries was simply not allowed onto the US market. This was basically a one size fits all measure, but once the US adapted its legislation and required that exporting countries put in place regulatory programmes comparable in effectiveness to that of the US, the Appellate Body found this acceptable, arguing that such a requirement "gives sufficient latitude to the exporting Member with respect to the programme it may adopt to achieve the level of effectiveness required."⁵⁵

Import adjustment measures for climate reasons, such as taxes, are already less stringent. One could imagine a border adjustment tax that is differentiated according to categories of exporting countries, e.g. based on overall CO₂ emissions per capita, per unit of GDP, or a combination thereof.

It should also be noted that the US did allow individual exporters from non-certified countries to gain access to its market by showing that they used turtle-friendly fishing methods. That was arguably although admittedly rather implicitly one of the main reasons why the US measures that did not pass the Chapeau test in *US – Shrimp Products* did pass the test in *US – Shrimp Implementation*.⁵⁶ This suggests that in discussing and possibly preparing a European import adjustment measure, it would be a good idea to make arrangements in order to enable individual companies from exporting countries to demonstrate they have low emissions.

An approach based on countries' efforts to abate climate change could be applied regardless of whether a post-Kyoto agreement is reached. If such an agreement is reached, the agreement itself would most probably contain provisions on the subject of border adjustment. Even if the new agreement were to be silent or unclear on border adjustment, it is conceivable that countries' adherence to the agreement would raise a presumption of being "climate change friendly", and thus would in principle qualify them for access to the EU market without being subjected to import adjustment measures.

Alternatives to country-based approaches are also conceivable, although not easy to apply in practice. For instance, a tax could be applied only to the importation of certain goods in the production of which much CO₂ is emitted. As discussed above, the risk of "carbon leakage" is greatest for those sectors that are highly energy-intensive and can be delocated, such as steel, aluminium, pulp and paper, and cement. This of course invites the question of the basis on which the tax should be calculated. Should there be one standard for maximum CO₂ emissions per product unit, based on the European industries' emissions? Or one standard for developed and one for developing countries? Or various standards, taking into account local circumstances and/or levels of development? Again, who is to judge all this? The importing country?

In any event, if a tax on imported products is chosen in order to offset costs incurred by domestic industries because of their obligation to respect the European emissions cap (which will be set per sector Europe-wide) and to buy emission rights, the costs incurred by European industry would need to be calculated per unit of end product, in order to be able to determine what the level of the import tax should be.

From the foregoing, while it is clear that different sorts of country-based approaches are complicated, non-country-based approaches are not free of difficulties either, and may not provide sufficient guarantees that any measure taken is not in breach of Articles I and/or II and/or III GATT, so that again, recourse would need to be sought to justification under Article XX GATT (or by referring to obligations under international law resulting from a multilateral agreement on climate change, if that were to come into being). In fact, although the current author has never been a great fan of country-based trade restrictions, he must admit that the WTO case-law on Article XX GATT does provide pointers towards such an approach. Did not the Appellate Body say in *US – Shrimp Products* that "conditioning access to a Member's domestic market on whether exporting Members comply with, or adopt, a policy or policies unilaterally prescribed by the importing Member may, to some degree, be a common aspect of measures falling within the scope of one or another of the exceptions (a) to (j) of Article XX"?⁵⁷ And did not the Appellate Body in that same dispute eventually (that is, in the implementation dispute) accept an American measure that certified

⁵⁵ Appellate Body in *US – Shrimp Implementation*, supra, note 51, para. 144.

⁵⁶ See the Appellate Body in *US – Shrimp Products*, para. 165 and the panel in *US – Shrimp Implementation*, paras. 5.105 – 5.111.

⁵⁷ Appellate Body in *US – Shrimp Products*, supra, note 51, para. 121. And emphatically confirmed by the Appellate Body in *US-Shrimp Implementation*, supra note 51, para. 138.

countries on the basis of an assessment by the importing country of measures taken by the exporting countries' authorities to protect natural resources? This is indeed, in the author's opinion, the essence of the Appellate Body reports in *US – Shrimp Products* and *US – Shrimp Implementation*: as long as certain requirements are met, apparently a country-based approach can be justified.

However, even if one wishes to construct a reasoning for climate adjustment measures based on the fact that the Appellate Body in *US – Shrimp Products* endorsed the country-based approach as justifiable in principle, the remarks made above about the Chapeau still apply. Thus, in the application of any such measure, arbitrary or unjustifiable discrimination between countries where the same conditions prevail as well as disguised trade restrictions should be avoided. As discussed, this means that genuine efforts must be made to look for international solutions, that due process requirements must be met, and that any differential treatment between countries where the same conditions prevail must have a rationale linked to the measure's objective.

3. Alternatives to a Border Tax: Obligation for Importers to Buy Carbon Credits

Ideas in Europe now seem to be moving somewhat away from a tax and towards giving certain European sectors exposed to international competition carbon credits for free, or obliging importers to buy carbon credits in the revised European emissions trading system, in order to offset the loss of competitiveness of those European sectors that would have to buy their emission rights at auctions in the new European emissions trading system.⁵⁸ The question of whether giving certain European sectors carbon credits for free constitutes an illegal or actionable subsidy under WTO law is outside the ambit of this paper. However, the possibility of obliging importers to buy carbon credits in Europe is briefly discussed. Such an obligation for importers would not seem to qualify as a tax and could therefore not be covered by Article III:2 GATT. However, the regulatory national treatment obligation in Article III:4 GATT would seem to apply to such an obligation. The question is whether imported products are treated less

favourably than like domestic products. This may not be the case if European producers need to buy 100% of their emission allowances, but becomes more difficult to answer if European sectors are obliged only to buy credits for part of their emissions. And even if national treatment were to be respected, there is also the most-favoured nation treatment obligation; any difference in treatment between importers from different third countries would contravene that obligation.

Also, one may wonder whether an obligation for importers to buy carbon credits would be covered by Article XI GATT, which prohibits any restrictions other than duties, taxes or other charges upon importation. If any of these obligations were to be violated, the justification under Article XX GATT as discussed above would again come up.

Apart from the question of WTO-compatibility, an obligation for importers to buy carbon credits raises other questions: how to decide upon the width of application of such an obligation: which importers, in which sectors and on what basis? Domestic industry may not provide objective data. How to objectively and fairly determine the carbon content of imported goods; base it on national averages from a third country? On best available technology? Should there be a differentiation between developed, developing and least developed countries? Should individual cleaner producers be allowed to show they are eligible for an obligation to buy less credits?

Another set of questions that arise is related to the functioning of the European emissions trading system itself. How to account for importers having to buy credits in the management of the ETS-system? How to avoid excessive upward pressure on the carbon credit price by importers' demand? Should the European emissions cap per sector and the number of available credits in the ETS be adapted regularly in order to reflect importers' demand for credits? That would seem a difficult exercise, as adaptations would necessarily follow market developments *ex post facto* and would therefore always be outdated.

⁵⁸ Earlier drafts of the Commission's proposal for a new Emissions Trading System (ETS) directive contained a so-called Future Allowance Import Requirement ("FAIR"), cited by Quick, "Border Tax Adjustment' in the Context of Emissions Trading: Climate Protection or 'Naked' Protectionism?", manuscript on file with the author.

4. Further Alternatives: Sectoral Agreements, Lower Tariffs, Production Standards

Some feel that the way forward may be to agree emission standards per sector, in particular in the energy-intensive sectors mentioned.⁵⁹ The European Commission in its proposed directive on the European Emissions Trading System takes account of possible sectoral agreements, on the condition that they are binding.⁶⁰ The US feel that sectoral agreements may be a more fruitful way to engage emerging economies and to succeed in bringing down emissions than adoption of a cap, but they are less explicit about the binding nature of such schemes.⁶¹ Sectoral approaches, where voluntary standards for CO₂ emissions in production processes are agreed upon by major players in e.g. the cement or aluminium industries, seem promising ideas, but they require all major players to join in order to be effective. Again, there are questions: how to check whether participants comply with the standards; should there be product labelling and/or factory certification, and if so, by whom? In addition, it is not sure that voluntary sectoral agreements solve all competitiveness and carbon leakage worries. Suppose a cement manufacturer in China meets the voluntary standard, but it still has no need to buy emission rights in China, while its European competitor needs to buy emission rights. Thus, even if they have agreed on their allowed level of CO₂ emissions, the European cement producer is still incurring costs by the obligation to buy emission rights, costs that weaken his competitive position. Would the call in Europe for some sort of border adjustment of imports from that Chinese producer vanish?

Other interesting venues for further reflection include pursuing agreement among WTO Members on lower tariffs for climate-friendly products. If an agreement could be reached on what constitutes a climate-friendly product – and CO₂ emitted during the production process would need to become a part of this – such lower duties on climate-friendly products could be used to make climate-unfriendly products relatively more expensive on the market. The Doha Round negotiations on environmental goods (and services) may provide a precedent for such agreement, or even a forum in case these negotiations would continue for some years from now. The discussions on what constitutes an environmental good suggest that agreement on what constitutes a climate-friendly product will not be easy.⁶² But negotiations among 150 countries are never going to be easy, so that is not a reason not to try.

Another possibility is agreeing on international technical standards for CO₂-intensive production processes. These raise mostly issues relating to technical barriers to trade (TBT), such as under what conditions the presumption of compatibility with the TBT Agreement⁶³ when conforming to international standards would apply. Finally, labelling requirements of certain products on the basis of CO₂ emitted during their production are conceivable; again, this would mostly raise TBT questions. Of particular relevance here would be the interpretation of the definition of a technical regulation, which in the TBT Agreement refers to “product characteristics and their related processes and production methods”, and to “labelling requirements as they apply to a product, process or production method.”

IV. Conclusion

Is this all mostly rhetorics for domestic political consumption, or are we witnessing the beginning of a “paradigm shift” originating in France? In the debate on climate change and trade, the more general French ideas that Europe should no longer be naïve and demand reciprocity from its trading partners coincide with competitiveness worries if Europe takes unilateral steps to put a price on carbon emissions, and with environmental worries that such unilateral steps may not have much effect as a result of “carbon leakage” to countries not will-

59 See e.g. European Commission contribution to the OECD Steel Committee, Doc. DSTI/SU/SC(2007)61, www.ois.oecd.org.

60 ETS directive proposal at http://ec.europa.eu/commission_barroso/president/focus/energy-package-2008/index_en.htm.

61 See the comments by the US special envoy following the February 2008 Hawaii “Major Economies” meeting, <http://www.telegraph.co.uk/earth/main.jhtml?xml=/earth/2008/02/01/eaha-hawaii101.xml>.

62 See the overview document on the WTO Doha Round environmental goods negotiations referred to supra, note 30.

63 Agreement on Technical Barriers to Trade (TBT), 18 I.L.M. 1979, p. 1079 ff.

ing to take engagements to curb emissions. These worries are not just French.⁶⁴ The divisions within the European Commission and among European Member States illustrate that there is a real issue here. Doubts about the WTO-compatibility of a proposed CO₂-tax or other “border adjustment measures” are not the end of the discussion in the view of the French president and his advisers, but rather the beginning: the issue of climate change is so important that the WTO rules perhaps need to be reconsidered, if need be.⁶⁵

As this contribution has shown, the proposed border tax raises thorny issues with regard to the interpretation of Articles III and XX GATT, in particular: to what extent could a domestic scheme under which producers are obliged to buy emission rights be applied to imported products, through a “border tax adjustment” or perhaps otherwise? And if such a measure were to contravene basic GATT obligations, could it be justified under Article XX as necessary to protect natural resources or human, animal and plant life, even if it targeted products on the basis of whether their country of origin adhered to a post-Kyoto agreement?

In the author’s view, in view of the seriousness of the climate issue, it is perfectly legitimate to raise the question whether the current WTO rules are able to accommodate the climate change problem and measures to be taken to deal with it. Including, if need be, a reconsideration of the interpretation of central GATT disciplines like Articles III and XX.

However, the underlying danger seems to be that France would welcome such an opening to start questioning the WTO rules in a much broader way: to seek ways to accommodate its views on European (regional) preferences in a way going far beyond what is currently considered admissible under Article XXIV GATT, and on “environmental, social, fiscal and monetary dumping” in a way going far beyond the current understanding of what constitutes dumping, potentially undermining some of the basic notions the world trading system is built on, such as national treatment, in the process. France’s trading partners, both within and outside Europe, are well advised to engage serious-

ly in the climate and trade discussion. That seems to be the best way to ensure that the discussion remains focused on the real issue of “carbon leakage” and its consequences for the effectiveness of climate change abatement measures and for the competitiveness of European industry.

At the time this contribution was being finalised, the European Commission made public its legislative proposals known as the “climate package”.⁶⁶ In the proposed amendments to the Emissions Trading System directive, the Commissions suggests postponing proposals on the possible application of a border adjustment mechanism – whatever shape it might take – until mid-2011, i.e. until after the targeted deadline for the conclusion of an international post-Kyoto agreement (to be concluded in December 2009 in Copenhagen), and not entirely incidentally also until after the European Commission has been renewed in the autumn of 2009. Perhaps the Commission considers the issue of border adjustments for reasons of competitiveness and carbon leakage too controversial, both within its own ranks, between Member States, and internationally. This would mean in concrete political terms that those who plead for border adjustment measures as a lever to urge other countries to actively engage in international negotiations and sign up to an eventual agreement, the French president and government in the first place but others too, have not been heard. However, both the Council and the European Parliament still need to agree to the climate measures. The last word about carbon leakage and border adjustment subject has not been said, that much is certain.

64 See e.g. the letter by Robert Howse in the Financial Times, 7 January 2008, arguing that unilateral measures by early movers may be necessary to get other countries to move as well.

65 A possibility not discarded by DG WTO Pascal Lamy himself in a recent speech: http://www.wto.org/english/news_e/sppl_e/sppl83_e.htm.

66 The legislative proposals as well as explanations can be found at http://ec.europa.eu/commission_barroso/president/focus/energy-package-2008/index_en.htm.