

# Global Trade and Customs Journal

**Publisher**

Kluwer Law International  
P.O. Box 316  
2400 AH Alphen aan den Rijn  
The Netherlands

Kluwer Law International  
First Floor  
250, Waterloo Road  
London SE1 8RD  
United Kingdom

**Distribution**

*In North, Central and South America,  
sold and distributed by*  
Aspen Publishers Inc.  
7101 McKinney Circle  
Frederick MD 21704  
United States of America

*In all other countries, sold and distributed by*  
Turpin Distribution  
Stratton Business Park  
Pegasus Drive, Biggleswade  
Bedfordshire SG18 8TQ  
United Kingdom

**Subscriptions**

*Global Trade and Customs Journal* is published monthly. Subscription prices for 2008 [Volume 3, Issues 1 through 12] including postage and handling: EUR451/USD595/GBP331 (print).

This journal is also available online at [www.kluwerlawonline.com](http://www.kluwerlawonline.com). Sample copies and other information are available at [www.kluwerlaw.com](http://www.kluwerlaw.com). For further information please contact our sales department at +31 172 641562 or at [sales@kluwerlaw.com](mailto:sales@kluwerlaw.com).

For information or suggestions regarding the indexing and abstracting services used for this publication, please contact our rights and permissions department at [permissions@kluwerlaw.com](mailto:permissions@kluwerlaw.com).

© 2008 Kluwer Law International BV, The Netherlands

ISSN: 1569-755X

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior written permission of the publishers.

Permission to use this content must be obtained from the copyright owner. Please apply to: Permissions Department, Wolters Kluwer Legal, 76 Ninth Avenue, 7th Floor, New York, NY 1011-5201, United States of America. E-mail: [permissions@kluwerlaw.com](mailto:permissions@kluwerlaw.com).

## 'Border Tax Adjustment' in the Context of Emission Trading: Climate Protection or 'Naked' Protectionism?

Reinhard Quick\*

### I. INTRODUCTION

At the Spring Summit in March 2007, the European heads of state and government decided to reduce the European Union's overall greenhouse gas emissions by at least 20 per cent below 1990 levels by 2020, and by 30 per cent if other developed countries undertake similar level of efforts. For the time being, it is unclear which results the Kyoto follow-up negotiations will bring, or whether it will be possible to agree upon an ambitious reduction commitment internationally. Given the many divergences among the parties to the United Nations Framework Convention on Climate Change (UNFCCC) with respect to new binding reduction commitments of greenhouse gas (GHG) emissions – divergences evidenced by the difficult birth of the roadmap for the post 2012 Kyoto negotiations agreed at the Bali Conference in December 2007<sup>1</sup> – the issue arises which actions Europe should take in order to implement her ambitious goals.

Trade policy measures for climate change purposes are high on the political agenda and have the support of French President Sarkozy,<sup>2</sup> German Environment Minister Gabriel,<sup>3</sup> and Commission Vice-President Verheugen.<sup>4</sup> Also, the European Parliament invited the Commission to reflect on trade measures to combat climate.<sup>5</sup> The reasoning for such action is simple. If Europe wants to continue to lead the fight against climate change it will have to impose far-reaching measures. If other countries do not follow suit, the

environmental goals will be jeopardized and their industries might enjoy a competitive advantage that the European leaders consider unfair. The actions envisaged by Europe to protect the climate could lead to closing of installations in Europe followed by increased exports from countries with less strict rules or by a relocation of European installations in those countries. This phenomenon described as 'carbon leakage' could undermine European efforts to reduce GHGs and damage the competitiveness of the European energy intensive industries.

Nobel laureate Joseph E. Stiglitz also argues<sup>6</sup> that energy intensive exports from the United States enjoy an unfair competitive advantage because the United States has not ratified the Kyoto Protocol on GHG emissions.<sup>7</sup> He has proposed that Europe and Japan restrict or tax such imports in order to force the United States to reconsider its position.

Of all potential trade actions for climate change purposes, the following measures are under discussion: (a) a tax on imports or border tax adjustment; and (b) the inclusion of some imports from some countries into the EU emission trading system. In the following, it will be analysed whether those measures are compatible with World Trade Organization (WTO) obligations assuming them to be unilateral in nature and not integrated in any international agreement on climate change. It should be mentioned from the outset that the Kyoto Protocol and the United Nations Framework Convention on Climate Change (UNFCCC)

### Notes

\* Professor for International Economic Law at Saarland University, Dr iur., LL.M (University of Michigan), Geschäftsführer der Verbindungsstelle Brüssel des Verbands der Chemischen Industrie, e.V. Opinions are those of the author.

1 The results of the conference are available at: <[http://unfccc.int/meetings/cop\\_13/items/4049.php](http://unfccc.int/meetings/cop_13/items/4049.php)>.

2 Statement by President Sarkozy at Grenelle Environment Forum held in Paris on 25 October 2007; available at: <[www.ambafrance-uk.org/Presentation-of-Grenelle.html](http://www.ambafrance-uk.org/Presentation-of-Grenelle.html)>.

3 See Financial Times Deutschland, 18 June 2007; see, also, editorial by Reinhard Quick in Financial Times Deutschland, 20 June 2007.

4 Letter of Commission Vicepresident Verheugen to Commission President Barroso dated 21 November 2006. The High Level Group on Competitiveness, Energy and Environment also came close to recommending unilateral trade measures to combat climate change in its Second Report dated 30 October 2006, available at: <<http://ec.europa.eu/enterprise/environment/hlg/whois.htm>>.

5 Resolution of the European Parliament on Trade and Climate Change of 29 November 2007, EP Doc. P6\_TA (2007)0576, available at: <[www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2007-0576+0+DOC+XML+V0//EN](http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P6-TA-2007-0576+0+DOC+XML+V0//EN)>.

6 Joseph E. Stiglitz, *Making Globalization Work* (London: Penguin, 2006), p. 177.

7 See, generally, <[http://unfccc.int/kyoto\\_protocol/items/2830.php](http://unfccc.int/kyoto_protocol/items/2830.php)>.

do not envisage trade sanctions. The Kyoto Protocol says that parties are to implement Kyoto policies and measures in such a way as to minimize adverse effects on international trade while the UNFCCC refers to the language contained in the chapeau of Article XX GATT.<sup>8</sup> The WTO itself is quite reluctant to allow trade sanctions as a means to force other countries to follow one's own preferred policies thereby respecting the principle of state sovereignty and reflecting concerns about extraterritorial measures.

## II. A CARBON TAX ON IMPORTS OR BORDER TAX ADJUSTMENT WITHIN THE EUROPEAN EMISSIONS TRADING SCHEME

One of the suggestions made is the imposition of a carbon tax on imports from those countries that have not ratified the Kyoto Protocol or that have not undertaken any GHG reduction commitments. This suggestion has not yet been developed into a draft legislative text. If not accompanied by a domestic tax, such measure would run foul of GATT Articles I and II.1(b), first sentence.

First, the fact that the carbon tax will be imposed on imports from some countries and not from others constitutes a violation of the most-favoured-nation (MFN) obligation, which has been *both central and essential to assuring the success of the global rules-based system for trade in goods*.<sup>9</sup> The MFN treatment obligation is quite categorical in that it requires that any advantage, favour, privilege or immunity to any product originating in, or destined for, any other country with respect to custom duties and *charges of any kind imposed on or in connection with importation or exportation* (emphasis added) shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other members.

Second, with respect to the national treatment principle the question arises whether the 'tax' applied to imports is part of an internal taxation scheme. If there were a domestic carbon tax, one could at least argue<sup>10</sup> that such tax could be directly levied

upon imports. However, if the carbon tax is applied exclusively to imports while other (regulatory) measures aimed at reducing CO<sub>2</sub> emissions apply to domestic products, such as an emission trading scheme, an Article III GATT application does not seem possible. The Note *Ad Article III GATT* states that 'any internal tax ... which applies to the imported product *and to the like domestic product* [emphasis added] 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'. If, however, an internal tax does not exist the suggested carbon tax on imports from some countries is an import duty in excess of those laid down in the tariff schedule and constitutes a breach of GATT Article II.1(b), first sentence.

The proposal mostly discussed in the context of the climate change debate is the introduction of the principle of 'border tax adjustment' (BTA) with respect to the European Union's emission trading system scheme (ETS).<sup>11</sup> A border tax adjustment should mitigate the expected negative consequences of the European ETS scheme, namely (a) the decrease in competitiveness of European installations with respect to their competitors in other countries not having introduced an emission trading scheme; and (b) the delocalization of energy intensive industries from Europe to those areas where emission trading does not exist. If the financial implications of ETS were considered as a tax and consequently an adjustment at the border introduced, those negative effects could be prevented and the climate protected. This suggestion, like the one of a carbon tax on imports, has not yet been presented as a legislative proposal.

The GATT Working Party on Border Tax Adjustment used the following OECD definition of BTA:<sup>12</sup>

... any fiscal measure which put into effect, in whole or in part, the destination principle (i.e. which enable exported products to be relieved of some or all of the tax charged in the exporting country in respect of similar domestic products sold to consumers on the home market and which enable imported products sold to consumers to be charged with some or all of the tax charged in the importing country in respect of similar domestic products).

### Notes

8 Article 2:3 of the Kyoto Protocol says that parties should 'strive to implement policies and measures ... in such a way as to minimize adverse effects, including the adverse effects ... on international trade', while Article 4.2 of the UNFCCC says that 'measures taken to combat climate change ... should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade'.

9 See WTO Appellate Body Report, *Canada—Certain Measures Affecting the Automobile Industry*, WT/DS142/AB/R, adopted 19 June 2000, para. 84.

10 See discussion on border tax adjustment, below.

11 Directive 2003/87 of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61 EC, OJ L 275 of 25 October 2003, as amended by Directive 2004/101/EC, OJ L 338 of 13 November 2004.

12 BISD 18S/97, para. 4.

As mentioned above, the GATT permits that internal taxes subject to GATT Article III.2 be imposed at the border with respect to imports. As a consequence certain taxes on products or product components can be adjusted at the border. With respect to imports, GATT Article II.2(a) allows for an exception to the rule limiting border charges to the amount of a scheduled tariff binding for a *charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III*. With respect to exports the internal tax imposed on domestic goods can be rebated. According to *Ad Article XVI* such a rebate shall not be considered a subsidy.

In its examination of the consistency of border tax adjustment with Article III.2 GATT the above-mentioned Working Party<sup>13</sup> concluded that:

... there was a convergence of views to the effect that taxes directly levied on products were eligible for tax adjustment. Examples of such taxes comprised specific excise duties, sales taxes and cascade taxes and the tax on value added ... Furthermore, the Working party concluded that there was a convergence of views to the effect that certain taxes that were not directly levied on products were not eligible for tax adjustment. Examples of such taxes comprised social security charges whether on employers or employees and payroll taxes.

Thus border tax adjustment is possible with respect to taxes directly levied on products or on their components. But would it also be applicable to a domestic measure, such as the emission trading scheme, which entails a financial implication?

Article III.2 GATT deals with 'internal taxes and other charges of any kind' that are applied 'directly or indirectly' on products. Until now, the discussion on border tax adjustment for climate change purposes centred on the question whether the WTO allowed such adjustment for taxes on inputs (such as energy) that are fully consumed during the production process and are therefore unincorporated in the final product.

The conclusions arrived at by the above-mentioned GATT Working Party and existing GATT case law, in particular the Superfund case of 1987<sup>14</sup> are not conclusive since they do not specifically address the issue of inputs which are fully consumed in the production process. The WTO has not yet ruled on this issue and the literature is divided.<sup>15</sup> Yet at issue here is not a tax on an input that is fully consumed but a general regulatory measure serving an environmental purpose. The EU's emission trading scheme is not a tax directly levied on a product, the question is, however, whether it could be considered as an 'other charge indirectly levied on products'. If yes, a border tax adjustment would be possible.

The existing EU emission trading directive establishes 'a scheme for greenhouse gas emissions allowance trading in order to promote the reduction of greenhouse gas emissions in a cost-effective and efficient manner'.<sup>16</sup> The system is based on a 'cap and trade' regime and requires Member States to ensure that covered installations hold a GHG emission permit and to establish a national allocation plan containing the total quantity of allowances and a specific allocation proposal. For the two periods covered (2005–2007 and 2008–2012) by the Directive, 95 per cent or 90 per cent respectively of the allowances shall be allocated free of charge to the covered installations.

Given the fact that in the current EU system the overwhelming majority of allowances is attributed free of charge, it is difficult to argue that the ETS constitutes a 'charge on products'. But would this conclusion be different if the directive provided for an auctioning of the allowances, thus attributing a price to them, as suggested in the proposal amending the existing emission trading directive adopted on 23 January 2008 by the European Commission?<sup>17</sup> The words *applied directly or indirectly* should be understood to mean 'taxes and other internal charges imposed on or in connection with like products'; concerning the term *indirect* it has been suggested that a tax applied indirectly was a tax not on a product but on its production process.<sup>18</sup>

## Notes

13 *Ibid.*, para. 14.

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

15 See, e.g., Duncan Brack, Michael Grubb and Craig Windram, *International Trade and Climate Change Policies* (London: Genre, 2000), pp. 81 *et seq.* For a different view, see Roland Ismer and Karsten Neuhoff, *Border Tax Adjustment: A Feasible Way to Address Nonparticipation in Emission Trading*, Cambridge Working Papers in Economics, CWP 0409 available at: <[www.econ.cam.ac.uk/electricity/publications/wp/ep36.pdf](http://www.econ.cam.ac.uk/electricity/publications/wp/ep36.pdf)>. Also, supporting BTA for energy taxes, see Frank Biermann and Rainer Brohm, *Implementing the Kyoto Protocol without the USA: the strategic role of energy tax adjustments at the border*, available at: <<http://glogov.org/images/doc/BiermannReplaceWP5.pdf>>.

16 For an explanation of the European scheme, see brochure issued by the Commission 'EU Action against Climate Change – EU Emission Trading, An Open Scheme Promoting Global Innovation' (Brussels: 2005), available at: <[http://ec.europa.eu/environment/climat/pdf/emission\\_trading3\\_en.pdf](http://ec.europa.eu/environment/climat/pdf/emission_trading3_en.pdf)>.

17 The Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC so as to improve and extend the EU greenhouse gas emission allowance trading system, COM (2008) 16 final, of 23 January 2008, foresees in Article 10(a) that allowances are to be auctioned in the future.

18 GATT Analytical Index (6th edn: 1994), p. 132.

A 'charge' is defined in the *Oxford English Dictionary* as 'a price asked' or as 'a financial liability or commitment'.<sup>19</sup> The broad scope of this term could cover the price asked or charged for a certificate. Still, the issue remains whether the auctioning of the allowances could be considered as an 'internal charge indirectly imposed in connection with products'. Emission trading allowances are issued 'in connection with' the reduction of greenhouse gases; their primary concern is CO<sub>2</sub> reduction. The installations covered have a choice: (a) if they keep their emissions below the level of the allowances, they can sell their extra certificates; in this situation the so-called 'charge' can turn into a profit; (b) if the installations have emissions above the level of the allowances, they can invest in new technologies, use a less carbon-intensive energy source or they can buy certificates at a market price.<sup>20</sup> The choices and variations provided for by the system make it difficult, however, to consider the auctioning of the allowances as an 'indirect charge on products'. The 'charge' could have quite a different result on like products emanating from the installations covered by ETS.

In conclusion neither the existing European ETS Directive nor an amended directive introducing the auctioning of ETS allowances can be considered a fiscal measure covered by GATT Article III.2. Therefore the principle of border tax adjustment on imports from countries not having introduced an emission trading scheme cannot be applied. If the EU were to impose an ETS charge on imports, such charge would have to be considered as an 'other duty or charge' in excess of those laid down in the tariff schedule and would constitute a breach of Article II.1(b), second sentence GATT.

If one were to come to a different result and to consider the ETS Directive as a fiscal instrument in the broader sense allowing for BTA, one would be faced with the problem that, given the different possibilities and variations allowed for by the ETS Directive, the adjustment could be seen as a tax applied in excess of those applied domestically.

### III. INCLUSION OF IMPORTS INTO THE EUROPEAN EMISSION TRADING SYSTEM

The Commission's proposal mentioned above does not contain specific language on how to include imports

into its scheme. Article 10(b) of the proposal only foresees a possible future inclusion. It reads:<sup>21</sup>

Not later than June 2011, the Commission shall, in the light of the outcome of the internal negotiations and the extent to which these lead to global greenhouse gas emission reductions, and after consulting with all relevant social partners, submit to the European Parliament and to the Council an analytical report assessing the situation with regard to energy intensive sectors or sub-sectors that have been determined to be exposed to significant risks of carbon leakage. This shall be accompanied by any appropriate proposals, which may include:

- adjusting the proportion of allowances received free of charge by those sectors or sub-sectors under Article 10(a);
- inclusion in the Community scheme of importers of products produced by the sectors or sub-sectors determined in accordance with Article 10(a).

Any binding sectoral agreements which lead to global emissions reductions of the magnitude required to effectively address climate change, and which are monitorable, verifiable and subject to mandatory enforcement arrangements shall also be taken into account when considering what measures are appropriate.

In recitals 19 and 20 of the proposal, the Commission explains how it will address the situation of carbon leakage:<sup>22</sup>

(19) The Community will continue to take the lead in the negotiations of an ambitious international agreement that will achieve the objective of limiting global temperature increase to 2° C and is encouraged by the progress made in Bali (footnote omitted) towards this objective. In the event that other developed countries and other major emitters of greenhouse gases do not participate in this international agreement, this could lead to an increase in greenhouse gas emissions in third countries where industry would not be subject to comparable carbon constraints ('carbon leakage'), and at the same time could put certain energy-intensive sectors and sub-sectors in the Community which are subject to international competition at an

#### Notes

19 See <[www.askoxford.com/concise\\_oed/charge?view=uk](http://www.askoxford.com/concise_oed/charge?view=uk)>.

20 See the ETS explanation offered by the Commission, as note 16 above.

21 See note 17 above.

22 Ibid.

economic disadvantage. This could undermine the environmental integrity and benefit of actions by the Community. To address the risk of carbon leakage, the Community will allocate allowances free of charge up to 100% to sectors or sub-sectors meeting the relevant criteria. The definition of these sectors and sub-sectors and the measures required will be subject to a re-assessment to ensure that action is taken where necessary and to avoid overcompensation. For those specific sectors and sub-sectors where it can be duly substantiated that the risk of carbon leakage cannot be prevented otherwise, where electricity constitutes a high proportion of production costs and is produced efficiently, the action taken may take into account the electricity consumption in the production process, without changing the total quantities of allowances.

The Commission should therefore review the situation by June 2011 at the latest, consult with all relevant social partners, and, in the light of the outcome of the international negotiations, submit a report accompanied by appropriate proposals. In this context, the Commission will identify which energy intensive industry sectors or sub-sectors are likely to be subject to carbon leakage no later than 30 June 2010. It will base its analysis on the assessment of the inability to pass on the cost of required allowances in product prices without significant loss of market share to installations outside the Community not taking comparable action to reduce emissions. *Energy-intensive industries which are determined to be exposed to significant risk of carbon leakage could receive a higher amount of free allocation or an effective carbon equalization system could be introduced with a view to putting installations from the Community which are at significant risk of carbon leakage and those from third countries on a comparable footing. Such a system could apply requirements to importers that would be no less favourable than those applicable to installations to installations within the EU, for example by requiring the surrender of allowances* [emphasis added]. Any action taken would need to be in conformity with the principles of the UNFCCC, in particular the principle of common but differentiated responsibilities and respective capabilities, taking into account the particular situation of Least Developed Countries. It would also need to be in conformity with the international obligations of the Community including the WTO agreement.

The two alternatives mentioned in Article 10(b) are a higher amount of free allocation or the extension of the emission trading scheme to imports.

Arguably, from a WTO point of view the first alternative could be viewed as a subsidy. Given the fact that these certificates have a commercial value even a free allocation of emission trading allowances could be considered as a financial contribution; the free allocation confers a benefit (Article 1 SCM Agreement) and, given the fact that the allowances are only given to energy intensive industries, specificity would also be demonstrated (Article 2 SCM Agreement). However, one could object that free allowances are nothing but a consequence of a regulatory regime, which, like in the case of coexisting strict and less strict environmental standards in different countries, cannot be considered a 'financial contribution'. This argument is not discussed further; instead the article will concentrate on the second alternative, namely the extension of the ETS system on energy intensive imports.

As to the second alternative, the concrete actions Commission will propose in 2011 are still unknown. However, an earlier draft of the proposal<sup>23</sup> contained the following provisions on how to include imports into the emission trading scheme, the so-called FAIR system:

(1) From 31 December 2014, a *future allowance import requirement ('FAIR')* shall apply in respect of goods which have been determined, in accordance with Article 10(b)(8), to be subject to significant risk of carbon leakage. In order to encourage the successful conclusion of an international agreement by as many countries as possible, this requirement shall not apply to countries and administrative entities which are taking binding and verifiable action to reduce greenhouse gas emissions *comparable to the action taken by the Community* [emphasis added], subject to the principle of common and differentiated responsibilities as indicated in paragraph 2. Where countries have ratified the international agreement referred to in Article 28 or countries or administrative entities are linked with the EU emission trading system pursuant to Article 26, such countries or administrative entities may be determined in accordance with Article 23(2) to be taking comparable action, and therefore exempted from this requirement.

(2) The Commission shall calculate the average level of greenhouse gas emissions resulting from the production of individual goods or categories of goods across the Community which are the subject of a determination of under paragraph 1. This calculation shall take into account information from independently verified reports under Article 14 and all relevant emissions covered by the EU emission

## Notes

<sup>23</sup> Article 10(c) (Option 1:FAIR) of draft Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC, dated 10 December 2007, version 14; the draft is available with the author.

trading system. *Importers or exporters of goods shall be respectively required and entitled to surrender or receive allowances equivalent to the average level of green house gas emissions resulting from the production of those goods across the Community, reduced by the average transitional free allocation given in respect of the production of such goods, and multiplied by the tonnage of goods imported.* The principle of common but differentiated responsibilities will be reflected by reducing the proportion of allowances to be surrendered in respect of imports from developing countries in accordance with principles and modalities to be developed pursuant to Article 23(2).

(3) To facilitate the establishment of methodologies in accordance with paragraph 2, the Commission may specify requirements for operators to report on the production of goods, and for the reporting of this information to be independently verified, in its Regulation adopted under Articles 14 and 15. These requirements may include reporting on the level of emissions covered by the EU emission trading system that are associated with the production of each good or category of goods.

(4) Importers of goods which are subject of a determination in accordance with Article 10(b)(8) (i.e., carbon leakage) shall be required to make a written declaration in respect of these imports. The written declaration shall confirm that a sufficient number of allowances, as determined in accordance with paragraph 2, have been surrendered in the Community registry, in respect of the goods subject to entry, in accordance with specific administrative procedures to be established by Commission Regulation.

(5) The Commission shall adopt, in accordance with the procedure referred to in Article 23(2), provisions to enable exporters of goods in respect of which a methodology has been established under paragraph 2, to receive allowances from the Community registry, in respect of exports from the Community from 31 December 2014 onwards. Two percent of the EU-wide quantity of allowance shall be set aside for this purpose.

(6) The FAIR may be met by allowances, or by ERUs or CERs usable in the Community emission trading system up to the percentage used by operators in the preceding year, or by allowances from an emission trading system in a third country or administrative entity which is recognized as equivalent in stringency to the Community system. All FAIR relevant provisions and implementing measures shall be adopted and implemented no later than 1 January 2013. All

necessary measures shall be taken to ensure full WTO compatibility of FAIR.

The FAIR system would extend the EU emission trading system to some imports from some specific countries. This system would apply only to those goods which have been determined to be subject to significant risk of carbon leakage, in other words to energy intensive productions from some countries which have not introduced an emission trading system comparable to the Community system or which have not taken other measures comparable to those of the Community to reduce GHG emissions. Furthermore the system would take into account the principle of common but differentiated responsibilities such as a difference in treatment between emerging, developing and least developed countries. The system would treat covered imports from different sources in a different manner, a treatment that is incompatible with the MFN principle contained in GATT Article I.

According to the requirements of the existing Kyoto Protocol only countries not having ratified it could be considered as targets under the FAIR approach. Developing countries, party to the protocol, are under no obligation to reduce GHG emissions. For the time being, it seems that the United States would therefore be the only FAIR target. But even the United States or the US states – which are probably covered as administrative entities – could argue that they have taken binding and verifiable actions to reduce greenhouse gas emissions comparable to those taken by the Community. It goes beyond the scope of this paper to analyse whether the actions taken by the United States as a whole or by US states individually could be regarded as actions comparable to those of the EU, yet the scope of FAIR seems to be quite limited. This situation could be different if the parties to the UNFCCC fail to agree on new binding reduction commitments in the negotiations of a successor to the Kyoto Protocol and if the European Union goes ahead with an ambitious emission trading scheme including a decision on how to treat imports.

#### IV. JUSTIFICATION

From the two preceding sections, the conclusion can be drawn that the trade measures suggested constitute violations of GATT obligations. Such violations could however be justified under GATT Article XX. In the context of climate change the justification could be found under Article XX(b) or (g). Article XX requires a two-step analysis. The measure found to be in violation of a GATT obligation has to fall under one of the paragraphs of Article XX and, if so, it must also respond to the requirements of the chapeau of Article XX.<sup>24</sup>

#### Notes

24 The two-tier test has been developed by the Appellate Body in *US—Gasoline*. Appellate Body Report, *United States—Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, p. 22.

## A. Preliminary Remarks: Limited Exceptions, International Agreement, Territorial Nexus

### 1. Limited Exceptions

Article XX GATT contains a 'limited and conditional'<sup>25</sup> list of exceptions. Although the protection of the environment is not explicitly mentioned as an exception, it is nevertheless covered by Article XX since the exceptions mentioned under paragraphs (b) and (g) can be interpreted<sup>26</sup> as relating directly or indirectly to the protection of the environment.

The protection of the competitiveness of the European industry is the predominant element of the trade policy measures discussed. The unilateral introduction of strict domestic measures to combat climate change will increase the cost of production in Europe and therefore decrease the European industry's competitiveness. The protection of the industry's competitiveness is, however, not foreseen among the exception provided for by Article XX GATT as it would undermine the economic rationale of the WTO, namely the international division of labour and the principle of comparative advantage of cost of production. The WTO aims at the 'substantial reduction of tariffs and other barriers to trade' and at 'the elimination of discriminatory treatment in international trade relations'.<sup>27</sup>

### 2. International Agreement

The Kyoto Protocol<sup>28</sup> commits developed countries to stabilize GHG emissions but does not impose a similar obligation on developing countries. Given the 2012 expiry date of the first commitment period, discussions are under way to negotiate a Kyoto II Protocol with stringent emission reductions. This new protocol might well contain reduction commitments both for developed and emerging countries as well as trade policy provisions for climate change purposes.

If a WTO dispute settlement case were to arise between parties who have ratified both agreements the WTO provisions would be interpreted in light of Kyoto II.<sup>29</sup> But could a new Kyoto II agreement

also be used as a means of interpretation against a non-member? The WTO Panel in *EC—Approval and Marketing of Biotech Products* rejected such broad interpretation when analyzing the question whether the rules of the WTO should be interpreted in light of the *Convention on Biological Diversity*.<sup>30</sup>

We note that like most other WTO Members, Argentina, Canada and the European Communities have ratified the *Convention on Biological Diversity* and are thus party to it. The United States has signed it in 1993, but has not ratified it since. Thus the United States is not a party to the *Convention on Biological Diversity*, and so for the United States the *Convention* is not in force. In other words, the *Convention on Biological Diversity* is not 'applicable' in the relations between the United States and all other WTO Members. The mere fact that the United States has signed the *Convention on Biological Diversity* does not mean that the *Convention* is applicable to it. Nor does it mean that the United States will ratify it, or that it is under an obligation to do so. We have said that if a rule of international law is not applicable to one of the Parties to this dispute, it is not applicable in relations between all WTO-Members. Therefore, in view of the fact that the United States is not a party to the *Convention on Biological Diversity*, we do not agree with the European Communities that we are required to take into account the *Convention on Biological Diversity* in interpreting the WTO agreements at issue in this dispute.

It will therefore be difficult, if not impossible, to use the Kyoto II Protocol as a means of interpretation in a future WTO case against a non-member of Kyoto II. Given its wide acceptance UNFCCC remains the only agreement on climate change that panels or the Appellate Body could refer to. It is less stringent than the Kyoto Protocol though, since it only encourages developed countries to stabilize green house gas emissions without obliging them to do so. It is interesting to note that the negotiating mandate adopted at the Doha WTO Ministerial Conference in 2001 limits, in its paragraph 31(i), the negotiations on the 'relationship between existing WTO rules and specific trade obligations set out in multilateral environmental

## Notes

25 GATT Panel Report, *US—Section 337*, para. 5.9. BISD 36S/345. See, also, Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R adopted 6 November 1998, para. 157.

26 See also the Preamble of the WTO Agreement, which explicitly mentions the protection of the environment.

27 Ibid.

28 The major distinction between the UNFCCC and the Kyoto Protocol is that 'while the Convention encourages developed countries to stabilize GHG emission, the Protocol commits them to do so'.

29 For a more detailed discussion of the question of whether an international agreement not specifically referred to by the WTO texts can be a source of WTO law, see Peter van den Bossche, *The Law and Policy of the World Trade Organization* (Cambridge: Cambridge University Press, 2005), p. 58, note 1.4.2.5 with further references.

30 WTO Panel Report, *European Communities—Measures Affecting the Approval and Marketing of Biotech Products*, WT/DS291/292/293/R, adopted 29 September 2006, para. 7.74.

agreements (MEAs) to the specific situation of applicability of existing WTO-rules as among parties to the MEA in question.

### 3. Territorial Nexus

Principle 12 of the Rio Declaration on Environment and Development reads:<sup>31</sup>

States should cooperate to promote a supportive and open international economic system that would lead to economic growth and sustainable development in all countries, to better address the problem of environmental degradation. Trade policy measures for environmental purposes should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade. Unilateral actions to deal with environmental challenges outside the jurisdiction of the importing country should be avoided. Environmental measures addressing transboundary or global environmental problems, should, as far as possible, be based on an international consensus. (emphasis added)

The WTO Appellate Body has not been presented yet with a case on whether unilateral trade measures imposed by a WTO member to protect the global commons can be justified under GATT Article XX (provided that all the other requirements exist) or whether there is a jurisdictional limitation on the application of Article XX. In the cases decided so far a jurisdictional nexus has always been established.

In the (heavily criticized) GATT *Tuna* case, the panel excluded from the scope of Article XX(b) and (g) all measures *outside* the jurisdiction of the jurisprudence of the country imposing the measure. It argued that:<sup>32</sup>

... if the broad interpretation of Article XX (b) suggested by the United States were accepted, each contracting party could unilaterally determine the life or health protection policies from which other contracting parties could not deviate without jeopardizing their rights under the General Agreement. The General Agreement would then no longer constitute a multilateral framework for trade among all contracting parties but would provide legal security only in respect of trade between a limited number of contracting parties with identical internal regulations.

In the *Shrimp/Turtle* case the Appellate Body did not have to rule on whether Article XX GATT contained jurisdictional limitations since it noted that sea turtles migrate to or traverse waters subject to the jurisdiction of the United States and therefore concluded:<sup>33</sup>

We do not pass upon the question of whether there is an implied jurisdictional limitation in Article XX(g), and if so, the nature or extent of that limitation. We note only that in the specific circumstances of the case before us, there is a sufficient nexus between the migratory and endangered marine populations involved and the United States for the purposes of Article XX(g).

The Appellate Body's reference to a 'sufficient nexus' must be taken into account in the present analysis. One could argue that such a nexus always exists when the measure concerned affects a global situation – such as climate protection.<sup>34</sup> This is questionable, however, because the Appellate Body speaks of a 'sufficient' nexus and not just any nexus and this seems to indicate a specific qualification.

The following two examples should help understand the issue of jurisdictional limitation. Let us assume that the European Union prohibits the domestic production and importation of car seats foamed with the ozone depleting substance CFC (chlorofluorocarbons) and let us further assume that these car seats no longer contain CFCs after production, in other words that CFCs are present only during the production process. If the ban were attacked and found in violation of GATT Article III.4, the EU could almost certainly establish a sufficient nexus for its extra-territorial measure since it could demonstrate that the ozone depletion provoked by the use of CFCs in the exporting country had an effect on its territory. In the second example, let us assume that the EU imposes a ban on black socks from a developing country because the production of the colour used to dye the socks polluted a river in that country. Let us further assume that the river's ecosystem was able to provide for a clean up of the environmental damage. In this case it could be argued that Article XX contained a jurisdictional limitation and that the EU could not have recourse to it.

Border measures for climate change purposes are aimed at protecting the global commons, namely the global climate. Yet contrary to the CFC example a direct effect on the territory taking the action is difficult to establish because the EU itself continues to emit

## Notes

31 See *The Global Partnership for Environment and Development, A Guide to Agenda 21* (Post Rio edn, New York: United Nations, 1993).

32 GATT Panel Report, *United States—Restrictions of Imports of Tuna*, BISD 39S, para. 5.27.

33 See *US—Shrimp*, as note 25 above, para. 133.

34 See Peter van den Bossche, Nico Schrijver and Gerrit Faber, *Unilateral Measures Addressing Non-Trade Concerns* (The Hague: Netherlands Ministry of Foreign Affairs, 2007), p. 290.

CO<sub>2</sub> notwithstanding its reduction efforts. The border measures are directed against those countries, which, according to the EU, do not sufficiently commit to CO<sub>2</sub> reductions. These countries, however, might emit (in absolute or in relative terms) less CO<sub>2</sub> than EU. They could therefore argue that the EU's overall domestic CO<sub>2</sub> emissions are greater than their own and that therefore the EU cannot establish a sufficient nexus?

In order to solve the 'sufficient nexus' issue the Appellate Body would probably require the EU to come forward with figures demonstrating a territorial effect or other arguments in favour of such a nexus. In the absence of statistical elements available, for the purpose of this article we will assume that a sufficient nexus can be established.

## B. The Requirements of Article XX(b)

Paragraph (b) reads: 'necessary to protect human, animal or plant life or health'. A GATT inconsistent measure can therefore be provisionally justified under paragraph (b) if the policy objective pursued by the measure is the protection of life or health of humans, animals or plants. This first criterion does not create too many difficulties since the above trade measures are aimed at reducing CO<sub>2</sub> emissions. Reducing CO<sub>2</sub> emissions and stabilizing the climate protects, according to the Intergovernmental Panel on Climate Change (IPCC),<sup>35</sup> the life or health of humans, animals and plants.

The second criterion is that the measure must be necessary to fulfil the policy objective. Necessity has originally been demonstrated with the so-called *least trade restrictive* test developed in the *Thai—Cigarettes* case: a measure is considered 'necessary' if there is no alternative measure consistent with the GATT, or less inconsistent with it, which the country could reasonably be expected to employ to achieve its health policy objective.<sup>36</sup> The necessity requirement is not a test of the necessity of the policy goal but a test of the necessity of the disputed measure to achieve the objective at issue. It results into a proportionality argument that the Appellate Body has elaborated upon in the *Asbestos* case:<sup>37</sup>

It is undisputed that the WTO Members have the right to determine the level of protection of health that they consider appropriate in a given situation.

We indicated in *Korea—Beef* that one aspect of the 'weighing and balancing process ... comprehended in the determination of whether a WTO inconsistent measure' is *reasonably available* is the extent to which the alternative measure 'contributes to the realization of the end pursued'. In addition, we observed in that case, that 'the more vital or important the common interests or values' pursued, the easier it would be to accept as 'necessary' measures designed to achieve those ends. In this case the objective pursued by the measure is the preservation of human life and health through the elimination, or reduction, of the well-known and life-threatening, health risks posed by asbestos fibres. The value pursued is both vital and important to the highest degree.

The ... question ... is whether there is an alternative measure that would achieve the same end and is less restrictive of trade than a prohibition ... In our view *France could not reasonably be expected to employ any alternative measure if that measure would involve the continuation of the very risk the (French) Decree seeks to halt.*

In justifying a measure under Article XX(b), a Member may also rely, in good faith, on *scientific sources* which, at that time, may represent a *divergent, but qualified and respected opinion*. A Member is not obliged in setting health policy, automatically to follow what, at a given time, may constitute a majority scientific opinion (emphasis added).

One could put forward arguments that the above-mentioned trade measures are not proportionate since other measures exist that would probably achieve the same aim, such as technical solutions relating to the production processes. Yet the Appellate Body's clarification of Article XX(b) puts the country taking the action in a very strong position so that a detailed scientific analysis would be required to demonstrate that the measures are not proportionate. And even if this were the case the further question would have to be answered whether the EU could reasonably be expected to employ the suggested alternative.

In *Brazil—Tyres*, the Appellate Body elaborated on the meaning of the term 'necessary' contained in GATT Article XX(b). It said:<sup>38</sup>

At this stage it might be useful to recapitulate our views on the issue of whether the Import Ban is

## Notes

35 See <[www.ipcc.ch/about/index.htm](http://www.ipcc.ch/about/index.htm)>.

36 GATT Panel Report, *Thailand—Restrictions on Importation of and Internal Taxes on Cigarettes*, BISD 35S/215, para. 73.

37 Appellate Body Report, *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, paras 168, 172, 174, 178.

38 Appellate Body Report, *Brazil—Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R, adopted 17 December 2007, para. 201.

necessary within the meaning of Article XX(b) GATT. This issue illustrates the tension that might exist between, on the one hand, international trade, and on the other hand, public health and environmental concerns arising from the handling of waste generated by a product at the end of its useful life. In this respect, the fundamental principle is the right that WTO Members have to determine the level of protection that they consider appropriate in a given context. Another key 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. To be characterized as necessary, a measure does not have to be indispensable. However, its contribution to the achievement of the objective must be material, not merely marginal or insignificant, especially if the measure at issue is as trade restrictive as an import ban. Thus, the 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.

If one applies this statement to the case of border measures for climate change purposes, one could doubt whether there is indeed a genuine relationship of ends and means between the objective of the protection of human health and the border measures at issue. The 'tax', the 'border tax adjustment' or the extension of imports to the ETS could only be seen as relating to the protection of human health if they were to incite the exporting countries affected by the measure to produce these products in a more environmentally friendly way. Lacking an international agreement, they might continue to produce without taking CO<sub>2</sub> arguments into account, thus reducing the border measures to being 'marginal or insignificant' with respect to CO<sub>2</sub> emissions. The following hypothetical explains this situation: suppose a country produces steel in a highly environmental installation thereby limiting CO<sub>2</sub> emissions to a very low level. Suppose also that the same country produces the same steel in another installation with an old production process thereby emitting a considerable amount of CO<sub>2</sub>. The FAIR system could incite the steel importer only to import the steel from the highly environmental installation whereas the steel from the other installation would not be imported into the European Union but would probably be produced and exported to other countries. Would the required genuine relation of ends and means really be established?

On the other hand, one could argue that the measure was not insignificant in so far as it could be seen as an incentive to lower CO<sub>2</sub> emissions and to help to avoid 'carbon leakage' thereby genuinely contributing to the objective of mitigating the effects of climate change thereby protecting human health. On top of that these measures are less trade restrictive than import bans.

Given this uncertainty it is difficult to conclude whether there is a 'genuine relationship of ends and means between the objective pursued and the measures at issue'. Nevertheless we continue the analysis presuming that the requirements of Article XX(b) are fulfilled.

### C. The Requirements of Article XX(g)

Together with paragraph (b) also paragraph (g) can be applied to measures protecting the environment, that is, 'measures relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption'. The first requirement of paragraph (g) is the conservation of exhaustible natural resources. The EU measures under analysis protect the planet's climate and therefore contribute to the covered objective. The second requirement is that the measure at issue has to 'relate to' the conservation of an exhaustible natural resource. In its rulings, the Appellate Body<sup>39</sup> clarified the meaning of 'relate to' as requiring a substantial or a close and real relationship between the measure and the policy objective. Here again, as in the analysis under Article XX (b), one could probably argue that the EU measures under analysis are disproportionately wide in their scope with respect to the policy objective of mitigating the effects of climate change and that the means are not necessarily related to the ends. There remains, therefore, some doubt as to whether the second criterion is fulfilled.

The third requirement is that the measure has to be made effective in conjunction with restrictions on domestic production and consumption. The Appellate Body interpreted this criterion to mean that the measures concerned impose restrictions not just in respect of imported goods but also with respect to domestic production and concluded that this criterion 'required even-handedness in the imposition of restrictions in the name of conservation upon the production and consumption of exhaustible natural resources'.<sup>40</sup>

With respect to the first two suggestions for trade measures discussed above one could doubt whether

#### Notes

39 See *US—Gasoline*, as note 24 above, p. 19; and *US—Shrimp*, as note 25 above, para. 141.

40 See *US—Gasoline*, as note 24 above, pp. 20–21.

such even-handedness exists. The EU imposes measures at the border (taxes or border tax adjustment) for which no domestic parallels exist. One could of course argue that the current EU emission trading scheme constituted a 'restrictions on domestic production and consumption' yet, given the fact that the ETS allocates 95 per cent of the certificates free of charge and, more importantly, leaves the installations covered a wide range of possibilities on how to comply with its rules, one can doubt whether it can be considered as a restriction. In *US—Gasoline*, the Appellate Body observed:<sup>41</sup>

... if no restrictions on domestically produced like products are imposed at all, and all limitations are placed upon imported products alone, the measure cannot be accepted as primarily or even substantially designed for implementing conservationist goals. The measure would simply be naked discrimination for protecting locally produced goods.

... In the first place the problem of determining causation, well known on both domestic and international law, is always a difficult one. In the second place in the field of conservation of exhaustible natural resources, a substantial period of time, perhaps years, may have to elapse before the effects attributable to implementation of a given measure may be observable. The legal characterization of such a measure is not reasonably made contingent upon occurrence of subsequent events ... In a particular case, should it become clear that realistically, a specific measure cannot in any possible situation have any positive effect on the conservation on conservation goals, it would very probably be because that measure was not designed as a conservation regulation to begin with.

The two measures have an element of 'naked discrimination' insofar as they require a tax or a charge on imports whilst such a charge is not required domestically. On the other hand the emission trading system has the effect of restricting domestic production, at least indirectly by making it more costly, an effect which is supposed to be beneficial to the climate. The question therefore remains open whether the first two proposals can be provisionally justified under Article XX(g) GATT.

With respect to the third proposal, namely the extension of the emission trading scheme to imports the third criterion is fulfilled since the ETS also applies domestically.

## D. The Requirements of the Chapeau of Article XX

In the previous two sections some doubts have been cast as to whether the measures could be provisionally justified. We will nevertheless continue the Article XX analysis and consider whether the measures meet the requirements of the chapeau. The chapeau of Article XX GATT reads:

Subject to the requirements that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures: ...

In *US—Gasoline*, the Appellate Body clarified the object and the purpose of the chapeau of Article XX as the search for a balance between the right of a Member to invoke the exception and the rights of other Members under the GATT:<sup>42</sup>

The chapeau by its express terms addresses, not so much the questioned measure or its specific contents as such, but rather the manner in which that measure is applied. It is, accordingly, important to underscore that the purpose and object of the introductory clauses of Article XX is generally the prevention of 'abuse of the exceptions of (what was later to become) Article XX'. This insight drawn from the drafting history of Article XX is a valuable one. The chapeau is animated by the principle that while the exceptions of Article XX may be invoked as a matter of legal right, they should not be so applied as to frustrate or defeat the legal obligations of the holder of the right under the substantive rule of the *General Agreement*. If those exceptions are not to be abused or misused, in other words, the measures falling within the particular exceptions must be applied reasonably, with due regard both to the legal duties of the party claiming the exception and the legal rights of the other parties concerned.

With respect to the three suggested measures the search for balance or 'line of equilibrium'<sup>43</sup> in the Appellate Body's words lies between the EU's right to invoke Article XX for climate change reasons and the right to unrestricted trade of other WTO members. The requirements to be taken into account in this

### Notes

41 Ibid., pp. 21–22.

42 Ibid., p. 22.

43 See *US—Shrimp*, as note 25 above, para. 159.

analysis are that the measures may not constitute 'arbitrary or unjustifiable discrimination where the same conditions prevail' or 'a disguised restriction on international trade'. The Appellate Body also stressed that in the application of Article XX one cannot apply the same standard as the one used in the finding that the measure was inconsistent with a respective GATT obligation.<sup>44</sup>

### 1. Border Tax on Imports or Border Tax Adjustment

Although the lack of a legislative proposal with respect to the first two suggestions complicates the search for a 'line of equilibrium', the following can already be said: the EU would impose a tax or a border tax adjustment on imports that it does not apply to domestic products. In the words of the Appellate Body such measures could simply be considered as 'naked' discrimination for the protection of locally produced goods'.<sup>45</sup> The measures could constitute an abuse insofar as they are in fact only a disguise to conceal the real intention, which is to protect the competitiveness of the domestic industry. Although it might be difficult to find out the real aim of such a measure, the Appellate Body suggests that such aim can often 'be discerned from its design, architecture and revealing structure'. Again, without a legislative proposal neither the 'design, nor the architecture or the revealing structure' can be analysed. However, Principle 12 of the Rio Declaration and the provisions of the UNFCCC and the Kyoto Protocol with respect to trade measures could be used in this balancing exercise resulting in a judgement of arbitrary and unjustifiable discrimination.

Furthermore, if the European Union were to impose such measures in the wake of the negotiations for a follow-up agreement to the Kyoto-Protocol, this could be seen as coercing countries to accept ambitious CO<sub>2</sub> reduction commitments. Moreover the argument could be made that these proposals were primarily oriented towards protecting the competitiveness of the domestic industry and only incidentally towards protecting the climate. Therefore the 'line of equilibrium' would probably be drawn against the EU and the measures be considered a disguised restriction on international trade with the consequence that

the measures could not be justified under Article XX GATT.

### 2. Extension of the ETS to Imports

The text of the Commission's proposal and the above-mentioned FAIR system are more responsive to the requirements established by the Appellate Body with respect to the analysis under the chapeau. They avoid the character of rigidity – found to be inconsistent with GATT in *US—Shrimp*, take the situation of other countries into account and therefore could provide for some flexibility. The climate change measures of other countries do not have to be identical with those of the European Union, they have to be comparable. In *US—Shrimp* the Appellate Body made clear that measures which imposed a single, rigid and unbending requirement on other countries could not be justified under Article XX.<sup>46</sup>

However, it is not acceptable, in international trade relations, for one WTO Member to use an economic embargo to *require* other Members to adopt essentially the same comprehensive regulatory program, to achieve a certain policy goal, as that in force within the Member's territory, *without* taking into consideration different conditions which may occur in the territories of those Members.

The Appellate Body accepted however that a programme that was 'comparable in effectiveness' with a domestic measure could be justified under Article XX.<sup>47</sup> It is therefore correct for the EU not to require from other countries identical climate change measures but only 'measures comparable to those of the EU'. The EU text adds another proviso, namely 'subject to the principle of common and differentiated responsibilities', thereby reflecting the requirement that the EU would take the situation of other countries, in particular developing countries into account.

Nevertheless, the Commission's proposal and the FAIR system contain some elements that could turn the line of equilibrium against the EU. First, the announcement contained in Article 10 (b) that the EU would eventually include imports in the emission trading scheme has a coercive effect in so far as it puts pressure on the countries negotiating the

## Notes

44 The provisions of the chapeau cannot logically refer to the same standard(s) by which a violation of a substantive rule has been determined to have occurred. To proceed down that path would be both to empty the chapeau of its contents and to deprive the exceptions in paras (a)–(j) of meaning. See *US—Gasoline*, as note 24 above, p. 23.

45 See note 41 above.

46 See *US—Shrimp*, as note 24 above, para. 164.

47 See Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products, Recourse to Article 21.5 of the DSU by Malaysia*, WT/DS257/AB/R, adopted 21 November 2001.

Kyoto II Protocol. The measures envisaged might influence the negotiating positions of those countries since the decisive factor could be their export dependency towards the EU's internal market of 500 million consumers and not their willingness to agree CO<sub>2</sub> reduction commitments. The EU behaviour contradicts Principle 12 of the Rio Declaration according to which 'transboundary or global environmental problems (should), as far as possible, be based on an international consensus'. The EU tries to impose her views on other countries and twists their position in her direction.

Second, the FAIR system for imports shall be calculated on the basis of the Community average CO<sub>2</sub> emission in the production process of an energy intensive product: the importers will have to surrender allowances equivalent to the average level of greenhouse gas emissions resulting from the production of energy intensive products in the Community. Such a calculation could be seen as an arbitrary discrimination in so far as it does not take into account the actual CO<sub>2</sub> emission in the exporting country. Suppose that an importer demonstrates that the production process in the installation in the country of exportation resulted in less CO<sub>2</sub> emissions than in installations in the Community he would nevertheless have to surrender certificates based on the average CO<sub>2</sub> emissions in the Community. This could lead to arbitrary results. For the FAIR system to be a genuine climate change measure it must base its calculation on the actual CO<sub>2</sub> emission in the production process and not on a Community average.

Third, the most stunning aspect of FAIR is that it applies to exports as well. Exporters, also on the basis of a Community average, are entitled to receive allowances when exporting. Notwithstanding her CO<sub>2</sub> reduction ambitions the European Union exempts exports from the onuses of the emission trading system so that these exports can compete 'fairly' at the global market. Even assuming that FAIR will only cover exports to those nations which are considered as not having adopted climate change measures comparable to those of the EU, the measure is not taken for environmental but purely for competitiveness reasons.

Given these critical aspects of FAIR one could plausibly argue that this system amounts to unjustifiable discrimination and that the European Union would abuse its right to invoke Article XX GATT.

## V. CONCLUSIONS

The previous analysis comes to the conclusion that the suggested trade policy measures to combat climate change can be considered WTO incompatible. Before adopting such measures any country will have to analyse its WTO obligations and the Appellate Body's rulings and draft them carefully already preparing the arguments to defend their WTO compatibility.

The decision of the European Commission not to include imports into the emission trading scheme for the time being and to foresee a reporting obligation by 2011 has been wise. In fact, it is questionable whether the FAIR system is WTO-compatible. The Commission can now use the time to convince the other parties to the UNFCCC to agree on an ambitious CO<sub>2</sub> reduction target in the negotiations of a Kyoto II Protocol without the immediate threat of trade action. Once the negotiations are concluded it can decide whether and how to include imports into the ETS system.

It should be of concern to politicians that the quest to combat climate change is surrounded by protectionism and that the inhibition threshold to come forward with protectionist proposals has been considerably reduced. This is a dangerous development in times when the multilateral trading system is already doing quite badly.

Popular solutions to accommodate competitiveness' concerns and the show of 'political muscle' should be resisted. Whilst the protection of the climate is a serious concern that needs to be addressed multilaterally the export oriented European Union cannot ignore the lessons of trade policy, namely that the spiral of protectionism will be difficult to stop once it has been started. The suggestion of border tax adjustment in the context of a domestic environmental regulation provides for such a start. In principle, legislation always entails a cost on business. If one were to calculate that cost on every product and adjust such cost at the border, international trade would come to a halt. The much-feared 'slippery slope' would materialize.

If Europe pushes the possible WTO legal arguments to the limits because of climate change it might be faced with the situation that her trading partners might do the same thereby potentially inflicting heavy economic damages on Europe. The old saying 'do unto others as you would have them to do unto you' is particularly true for trade relations and should be a Leitmotiv for our politicians.



**Kluwer Law International** is a renowned publisher of books, journals, and looseleafs in areas of international legal practice.

We publish important and interesting titles in the following areas:

- Air & Space Law
- Arbitration
- Banking and Finance Law
- Business Law
- Commercial law
- Company/Corporate law
- Competition Law
- Environmental Law
- European Community Law
- Intellectual Property
- International Trade Law
- Labour Law
- Maritime Law
- Taxation

Please browse our website for information on all our books, journals, looseleafs and electronic products: [www.kluwerlaw.com](http://www.kluwerlaw.com)

## **KluwerLawOnline: One of the most complete libraries on the web**

**Kluwer Law Online** is your online gateway to Kluwer Law International publications. Completely revamped, the Kluwer Law Online is packed with new functionality.

Improved functionality includes:

- inclusion of product types other than journals
- regularly updated homepage texts to keep you informed about us and our products
- a homepage for every publication
- improved Browse Topics
- suggestions for related titles
- informative and regularly updated site texts (About Us, Contact Us)

At [www.kluwerlawonline.com](http://www.kluwerlawonline.com), you will find all our journals online. Feel free to browse the site and view a sample copy of the journal of your interest.

## **Global Trade and Customs Journal**

*Global Trade and Customs Journal* provides you with new ideas, fresh insights, and expert views on critical practical issues affecting international trade and customs compliance. Written for practitioners by practitioners, the journal offers you reliable guidance on critical areas affecting international business. It also provides you with actionable advice to ensure that you are able to protect your clients or organization from developments that could adversely affect their interests. With a subscription to *Global Trade and Customs Journal* you will be able to:

- Stay up-to-date with today's rules and regulations and one step ahead of tomorrow's trends
- Develop successful compliance programs and cost-effective business processes
- Heighten your awareness of trade issues with serious potential financial implications for your organization or your client's business
- Identify compliance opportunities and the do's and don'ts of taking advantage of these benefits
- Avoid trade and customs problems through industry-specific guidance
- Feel confident in your decision making knowing you've been briefed by highly regarded trade and customs experts

**Editor-in-Chief:** Edwin Vermulst, *Vermulst Verhaeghe & Graafsma, Brussels*

**Editorial Board:** Ana Caetano, *Partner Veirano Advogados São Paulo, Brazil*; Lourdes Catrain, *Partner Hogan & Hartson L.L.P., Brussels, Belgium*; Joris Cornelis, *Vermulst, Verhaeghe & Graafsma, Brussels, Belgium*; Lyn Fischer Cox, *WilmerHale, Washington DC, USA*; Gary Horlick, *Partner WilmerHale, Washington DC, USA*; Jesse G. Kreier, *Counsellor and Chief Legal Officer, Rules Division, World Trade Organization*; Lakshmi Kumaran, *Lakshmi Kumaran & Sridharan, New Delhi, India*; Keon-Ho Lee, *Head of International Trade Team and Anti-Dumping Practice Group, Bae, Kim & Lee, Seoul, South Korea*; Michael Lux, *Head of Unit Customs Procedures, Directorate-General TAXUD, European Commission*; Kunio Mikuriya, *Deputy Secretary General, World Customs Organization*; Fernando Piérola, *ACWL, Geneva, Switzerland*; Prof. Dr. Reinhard Quick, *Verband der Chemischen Industrie, e.V., Frankfurt, Germany*; Davide Rovetta, *Directorate -General TAXUD, European Commission*; Evelyn Suarez, *Williams Mullen, Washington DC, USA*; Apisith John Sutham, *Apisith & Alliance Ltd, Bangkok, Thailand*

**If you would like to receive your issues the day they are published become an online subscriber.**

**Visit [kluwerlawonline.com](http://kluwerlawonline.com) for more details.**