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# AN UNEASY RELATIONSHIP: COMBATING A GLOBAL THREAT THROUGH INTERNATIONAL TRADE

FREEDOM-KAI PHILLIPS<sup>†</sup>

*Climate change has traversed from the realm of environmental speculation to political policy. No longer is it an issue of lacking scientific evidence; rather it is now an issue of lacking political will. Courageously, the European Union, after gauging the international landscape for a multilateral accord and finding it wanting, has forged forward unilaterally to combat this pressing and substantial threat. In enacting the 20/20 by 2020 the EU has not only set a profound precedent for other developed nations, but has also placed a great burden on its domestic industries. This article examines the EU's regulatory response, in light of its WTO obligations. On the whole, it argues that the EU is well within its sovereign right to apply this measure domestically. Furthermore, it demonstrates that the EU also has strong legal arguments to justify influencing other developed nations to abide by a similar regime through an interpretation of past WTO jurisprudence. Finally, it makes recommendations to empower nations to be more effective at combating threats of this magnitude. On the whole, nations must be supported in progressive environmental actions, rather than hindered.*

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<sup>†</sup> Freedom-Kai Phillip graduated in May 2009 with an LL.B. from Dalhousie University. He holds a Master of Arts in diplomacy and international relations from the John C. Whitehead School at Seton Hall University and a Bachelor of Science (*magna cum laude*) from Eastern Michigan University. His research has focused principally on public international law, international trade law and international environmental law.

## I. INTRODUCTION

The global climate crisis has recently moved to the forefront of political discourse. However, it has proven difficult to find a consensus on how to proceed at the international level, and few nations have made concrete attempts domestically to mitigate the continued damage caused to the environment by human activity. In light of such disagreement and apathy on the international stage, the European Union (EU) has forged forward with a domestic legislative initiative which amounts to a quantum leap in environmentally based climate change reforms. They have singlehandedly taken it upon themselves to act as the vanguard of the global climate revolution, although this progressive step forward comes at an immense cost to both domestic industries and the average citizen. This increased burden has invigorated a heated debate on why EU citizens should pay the price for environmental preservation while others continue to be lethargic on the subject. More prudently, Mr. Jose Manuel Barroso, the current President of the European Commission, has threatened to impose a carbon tariff on all imports into the EU to offset the lack of an international agreement on the subject, and to level the playing field for EC industries.<sup>1</sup>

This paper will examine if such a measure would be legally permissible under the EU's treaty obligations pursuant to the World Trade Organization (WTO) covered agreements. To set a solid groundwork, it will first briefly outline both the threat posed by climate change, and the EU's comprehensive response. Second, it will offer a detailed analysis of the EU's measures in relation to their legal obligations under the WTO and the subsequent limitations placed on the EU to respond to the threat of climate change. Finally, it will propose some reforms to the WTO system which will empower nations with the requisite flexibility to address the climate crisis, while allowing them to continue to be WTO compliant. Ultimately, climate change is a threat to all humankind. In lieu of an internationally negotiated response, nations should be emboldened rather than restricted

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1 Roger Harrabin, "Barroso trade threat on climate," *BBC News* (22 January 2008), online: <<http://news.bbc.co.uk/2/hi/europe/7201835.stm>>

in their reaction to such a pressing and substantial threat. For it is only through the daring actions of the valiant that others may become motivated to act as well.

## II. THE THREAT OF CLIMATE CHANGE AND THE EUROPEAN RESPONSE

It is imperative to be able to make an informed assessment of the validity of a legislative response to the threat of climate change as well as to have an understanding of both the threat itself and the possible outcomes of non-action. Thus, this section will begin by outlining what the current scientific consensus is on our world's climate, and its implications to the global citizenry. Secondly, it will offer an explanation of the particular climate regime recently agreed to by the European Commission. On the whole, the threat posed by our ever deteriorating environment is quite pressing, and the response put in place by the EU is not only a progressive change in approach, but a welcomed acceptance of responsibility by Western industrialized nations.

### A. The Current State of the Earth's Climate

To have a proper term of reference, climate change is referred to by the Intergovernmental Panel on Climate Change (IPCC), which is a representative body made up of the world's foremost experts, as "a change in the state of the climate that can be identified... whether due to natural variability or as a result of human activity."<sup>2</sup> This usage has a subtle difference from the operating definition used by the United Nations

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<sup>2</sup> IPCC, "Synthesis Report" *Climate Change 2007 Forth Assessment Report of the Intergovernmental Panel on Climate Change*, Allali, A. et al. eds. (Cambridge UK: Cambridge University Press, 2007) at 30, online: IPCC <[http://www.ipcc.ch/pdf/assessment-report/ar4/syr/ar4\\_syr.pdf](http://www.ipcc.ch/pdf/assessment-report/ar4/syr/ar4_syr.pdf)>

Framework Convention on Climate Change (UNFCCC), which focuses on “a change that is attributed directly or indirectly to human activity that alters the composition of the global atmosphere.”<sup>3</sup> It is important at the onset to focus on this nuance for a moment. Although both the IPCC and the UNFCCC concentrate on climate change and each uniquely craft their respective terms of reference to focus on the effect, the IPCC also notes the natural variability of the earth’s climate. This is a significant clarification because without question, there is a naturally occurring fluctuation in the climatic environment which has been measured over time. However, never in the history of mankind has this naturally occurring phenomenon occurred so rapidly or been so readily observable.

It is now unequivocal that we are experiencing a rapid shift in the global climate due principally to increased concentrations of Green House Gases (GHG) such as carbon dioxide, methane and nitrous oxide.<sup>4</sup> The rapid rise in abundance of these gases individually is also remarkably telling. Global levels of carbon dioxide (CO<sub>2</sub>), measured from ice core tests, have risen from the pre-industrial level of 280 parts per million (PPM) to 379 ppm in 2005.<sup>5</sup> Secondly, the atmospheric concentration of methane (CH<sub>4</sub>) has increased from a pre-industrial level of 715 parts per billion (ppb) to 1774 ppb in 2005.<sup>6</sup> Finally, nitrous oxide (N<sub>2</sub>O) concentrations have increased from a pre-industrial level of 270 ppb to 319 ppb in 2005.<sup>7</sup> Furthermore, this rise in CO<sub>2</sub> and CH<sub>4</sub> levels is directly attributable to the increased use of fossil fuels, while over a third of N<sub>2</sub>O is attributable to massive agricultural growth.<sup>8</sup> Although each of these statistics is focusing on relatively small increments (parts per million/parts per billion), taken cumulatively, they illustrate that GHG emissions that stem from human activity, increased by 70% in the time frame between 1970 and 2004.<sup>9</sup>

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3 *Ibid.*

4 IPCC, “Summary for Policymakers” *Climate Change 2007: The Physical Science Basis. Contribution of Working Group I to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change*, S. Solomon et al. eds. (Cambridge UK: Cambridge University Press, 2007) at 2, online: IPCC <<http://www.ipcc.ch/pdf/assessment-report/ar4/wg1/ar4-wg1-spm.pdf>>

5 *Ibid.*

6 *Ibid.* at 3.

7 *Ibid.*

8 *Ibid.*

9 Allali, *supra* note 2 at 36.

More worrisome, these affects have become readily observable not only by scientists but by citizens around the globe. Firstly, between the years 1995 to 2006 all but one year ranks among the warmest years in recorded history – a record that dates back to 1850.<sup>10</sup> Secondly, because this temperature increase is intensified at more northern latitudes, there has been a profound increase in glacial lakes, instability in permafrost regions, and alteration of Arctic and Antarctic ecosystems.<sup>11</sup> Finally, environmental strain has become acute in many regions globally, with an observable reduction in the length of growth seasons, a rise in sea level,<sup>12</sup> and an increase in both the frequency and activity of tropical storm behaviour.<sup>13</sup>

On the whole, the current state of the global climate is very tragic and demands a rapid response. What is at stake is no longer simply an economic, social or political issue; but as noted by the renowned economist and Nobel laureate Joseph Stiglitz, it has traversed into an issue of moral importance and more glaringly social justice.<sup>14</sup> However, considering the immense difficulty multilateral negotiators had at the United Nations Climate Convention 2007 in Bali to simply set a timetable for upcoming negotiations – though in the 11<sup>th</sup> hour the United States eventually gave ground allowing for an agreement – it is no wonder concerned states simply accept the responsibility to set the timetable for themselves. Clearly, climate change is not a threat to be neglected. As Dr. D. K. Pachauri, Chairman of the IPCC said in Oslo, as he was awarded the Nobel Peace Prize on behalf of the IPCC, “neglect in protecting our heritage of natural resources could prove extremely harmful for the human race and for all species that share common space on planet earth.”<sup>15</sup>

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10 Allali, *supra* note 2 at 30.

11 IPCC, “Summary for Policymakers” *Climate Change 2007: Impacts, Adaptation and Vulnerability. Contribution of Working Group II to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change*, Parry, M.L. et al. eds. (Cambridge UK: Cambridge University Press, 2007) at 8, online: IPCC <<http://www.ipcc.ch/pdf/assessment-report/ar4/wg2/ar4-wg2-spm.pdf>>

12 *Ibid.* at 9.

13 Allali, *supra* note 2 at 30.

14 Joseph Stiglitz, “The Changing Climate on Climate Change” *Project Syndicate* online: <<http://www.project-syndicate.org/commentary/stiglitz80>>

15 R.K. Pachauri, “Acceptance Speech for the Nobel Peace Prize Awarded to the Intergovernmental Panel on Climate Change” Address 10 December 2007 [unpublished],

## B. The European Union 20/20 By 2020

Following the 2007 report of the IPCC which concluded that the global average temperature could be expected to increase by an additional 1.8° to 4°C this century, the EU made a firm commitment to not allow this to occur.<sup>16</sup> Europe was already a world leader in combating climate change in many respects. Beginning in 2002 with the voluntary UK Emissions Trading Scheme (UK ETS) and later expanding into the EU Emissions Trading Scheme (EU ETS) in January 2005, the EU created a market based approach to addressing climate change. Under the EU cap-and-trade scheme, companies were granted carbon emission allowances; subsequently industries worked to reduce their emissions below the capped amount. Those industries that were able to achieve this reduction were then able to sell their extra allowance to industries that were unable – for whatever reason – to meet their targets.<sup>17</sup> There were also penalties for not being able to achieve the allotted target, which currently sits at €40 per tonne, but this rate increased to €100 per tonne in 2008.

This market based approach was both an innovative response, and a cost effective approach, to achieving the EU's Kyoto targets. The European Commission has noted the EU ETS had a total annual cost of between €2.9 to €3.7 billion (bn), compared to an estimated €6.8 billion total cost to achieve the same targets without the EU ETS.<sup>18</sup> However, there were two fundamental shortcomings to the EU ETS. First, it was sector specific, in that it focused only on energy intensive industries.<sup>19</sup> Second, the market was voluntary in nature.<sup>20</sup> However, the EU ETS did prove that a voluntary

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online: <<http://www.ipcc.ch/graphics/speeches/nobel-peace-prize-oslo-10-december-2007.pdf>>

16 EC, *EU Action against Climate Change: Leading Global Action to 2020 and Beyond* (Luxembourg: Office for Official Publications of the European Communities, 2007) at 4, online: EC <[http://ec.europa.eu/environment/climat/pdf/bali/post\\_2012.pdf](http://ec.europa.eu/environment/climat/pdf/bali/post_2012.pdf)>

17 Ron Dembo & Clive Davidson, *Everything You Wanted to Know About Offsetting But Were Afraid to Ask* (Canada: Zerofootprint Publications, 2007) at 67.

18 *Ibid.* at 68.

19 *Ibid.* at 67; focus was on oil refineries, iron and steel plants, and manufacturers of cement, glass and paper amounting to approximately 13,000 installations and accounting for about one half of the EU's total CO<sub>2</sub> emissions.

20 Ricardo Bayon, Amanda Hawn & Katherine Hamilton, *Voluntary Carbon Markets: an International Business Guide to What They Are and How They Work* (London: Earthscan,

compliance system was viable, laying the groundwork for an efficient trading scheme, and encouraged a relative level of forward thinking regarding carbon management which was non-existent prior.<sup>21</sup>

Building on the success of the EU ETS, in the early days of 2008, the EU passed a Directive amending the original ETS system (created under Directive 2003/87/EC) and implemented a mandatory community-wide commitment to achieve two broad-based goals. First, the EU committed to reducing all GHG emissions by at least 20% below 1990 levels, with that percentage increasing to 30% contingent upon comparable emission commitments by other developed nations.<sup>22</sup> Second, and simultaneously, the EU also committed to using 20% renewable energies by 2020.<sup>23</sup> Thus, the proposal received the endearing name of the 20/20 by 2020. However, a proposal such as this is both extremely complex to initiate and has immense costs to implement and maintain. It is suggested that the program could have a direct cost of, on the low end (with oil costing between \$55-62 USD per barrel) €91bn by 2020 accounting for 0.58% of EU GDP, or on the high end (with oil costing \$100 USD per barrel) €275bn.<sup>24</sup> Principally, the EU is going to focus on enhancing the EU ETS to capitalize on its past accomplishment while looking to harmonize the system across the community to broaden its application to get maximum results. Further, EU companies will also have the option to use Clean Development Mechanisms (CDM), a system which allows for foreign investment in emission-saving projects, particularly in developing countries, to earn carbon credits which can then be used domestically.<sup>25</sup>

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2007) at 80.

21 *Ibid.*

22 EC, *Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading system of the Community*, [2008] O.J. 2008/0013 (COD), at 13. This proposed Directive was recently adopted by the EC and is available in its updated form online at: <<http://register.consilium.europa.eu/pdf/en/08/st03/st03737.en08.pdf>>.

23 *Ibid.* at 15.

24 EC, "Impact Assessment" *Document accompanying the Package of Implementation Measures for the EU's Objectives on Climate Change and Renewable Energy for 2020*, [2008] O.J. 85/3 at 7, online: EC <[http://ec.europa.eu/energy/climate\\_actions/doc/2008\\_res\\_ia\\_en.pdf](http://ec.europa.eu/energy/climate_actions/doc/2008_res_ia_en.pdf)>

25 EC, "Communication from the Commission to the European Parliament, the Council,

It is important to note that the EU makes explicit references to achieving these progressive goals in accordance with WTO obligations.<sup>26</sup> Paradoxically, it seems almost impossible to demand a high level of environmental protection – at an immense cost – and to protect industries from a competitive disadvantage, all the while staying WTO compliant. However, the EU has put forward three curious strategies of particular interest to this quandary. First, they propose Global Sectoral Agreements (GSA) which would allow for industry leaders to come to an accord to reduce GHG emissions across sectors and without requiring recourse to the multilateral arena.<sup>27</sup> Second, the EU could allot ETS allowances free of charge to energy intensive industries to offset or compensate for the direct and indirect costs of adaptation to the new program.<sup>28</sup> Finally, the EU put forward the notion of including importers of energy intensive products into the EU ETS system, thus forcing them to purchase the same ETS credits as EU industries.<sup>29</sup> All three have promise and could be utilized to assist in the difficult transition ahead. However, each carries with them particular elements of concerns in the context of the WTO.

On the whole, although quite lofty the 20/20 by 2020 actually seems rather plausible. It sets out various options for implementation dependent upon the level of development of the member state, has flexibility in approach incorporated into the overall framework and is aimed at minimizing market detriment by embracing the most cost effective strategy available. Furthermore, it now has the broad support of the European Communities as a whole, and is expected to be formally enacted by the spring of 2009.<sup>30</sup> The question, however, remains: are the measures proposed formally compatible with the WTO covered agreements?

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the European Economic and Social Committee and the Committee of the Regions,” *20 20 by 2020: Europe’s Climate Change Opportunity* [2008] O.J. 30 (COM) at 6, online: <[http://ec.europa.eu/commission\\_barroso/president/pdf/COM2008\\_030\\_en.pdf](http://ec.europa.eu/commission_barroso/president/pdf/COM2008_030_en.pdf)>

26 *Ibid.* at 17.

27 “Impact Assessment” *supra* note 24 at 18.

28 *Ibid.*

29 *Ibid.*

30 Nick Childs, “EU agrees climate plan deadline,” *BBC News* (14 March 2008), online: BBC <<http://news.bbc.co.uk/2/hi/europe/7296564.stm>>

### III. WTO OBLIGATIONS AND LIMITATIONS OF STATE ACTION

Climate change is a real and viable threat, and the EU has stepped forward with an innovative plan to combat arguably the single greatest peril facing humankind. They have proposed a comprehensive strategy which is aimed at achieving their articulated goals, while maintaining commercial competitiveness. However, an inherent concern at the onset is, would the proposed framework be in violation of the EU's treaty obligations under WTO law? This section will first put forward the three EU measures aimed at harmonizing both market efficacy and the overall climate change initiative while defining how they fit into the EU initiative on the whole. Second, it will scrutinize if these measures in fact are acceptable under the WTO through an analysis of the appropriate jurisprudence. Holistically, the EU must be tremendously tactful in how it implements its 20/20 by 2020 measures. For if they are not drafted carefully, the EU may be in violation of the covered agreements, and even if they are acceptable under the WTO legal regime, the measures may not be politically sound considering the international effects.

#### A. MEASURES AIMED AT HARMONIZING THE MARKET AND THE ENVIRONMENT

There are three primary measures referenced by the EU to help strike a balance between market competitiveness and the obvious restrictiveness of the proposed climate change initiative. Each measure has both merits and demerits, but each on the whole is a worthwhile attempt to combat such a complex and inherently global problem. First, a GSA would aim to curb GHG discharge through a deal by pollution heavy segments of the international economy to collectively reduce emissions. If a GSA were struck between major industrialized sectors and realistic efforts were put forth equally, this approach could amount to a large scale reduction of

GHG in the atmosphere in a very short period of time.<sup>31</sup> Another positive aspect of a GSA approach is that the cost of implementation and adaption would be dispersed over several large economies rather than simply concentrated in one. Lastly, by virtue of it being a mutually beneficial agreement between the parties and with the costs being delineated outward, the competitiveness of the industries on the whole would be maintained. Albeit a minor increase in product value to offset some of the initial costs of adaptation, when compared to a government mandated program, this cost would be relatively low because of its voluntary nature. However, the largest and most damaging drawback of a GSA approach is that it is too idealistic. Industries may, out of self interest, consider signing on to an agreement of this sort but most likely they will not unless they must. A multilateral agreement would need to be constructed, in turn challenging industries to evolve.

Second, if the EU were to allocate ETS allowances to energy intensive sectors free of charge, at first glance, it would seemingly undermine the ETS system as a whole because of the number of industries that would claim the “energy intensive” classification. However, if clear benchmarks were established for the type of industry, energy efficiency levels, requisite emission reduction, and percentage of investment in new technologies and research and development (R&D), theoretically, free allocations could maximize the effective use of economic resources from the corporate perspective, while insuring only a marginal increase in product costs to the public. Moreover, free allocations could also be valuable in that they could act as a means of compensation to offset the increased cost of energy,<sup>32</sup> thus preserving a moderate level of competitiveness and reducing the subsequent costs to consumers.

Lastly, if importers were included into the ETS market and forced – just like domestic produces – to purchase allowances to offset their products, such an approach could have some very interesting results. First, by having ETS credits as a precursor to being granted access to the EU market,

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31 *Supra* note 24 at 18.

32 *Ibid.*

it would require importing industries to reconsider their approach to the topic of GHG emissions. Second, such a strategy could also work to decrease global emissions by putting a price-tag on a failure to comply. Finally, if importers were to purchase ETS credits it would have favourable impacts on domestic producers as it would be a levelling mechanism to concerns of competitiveness. However, there are two major worries. Initially, having wide spread demand for ETS credits would not only increase the value of them on the market, but would also put an increased pressure on the domestic ETS system as a whole.<sup>33</sup> Secondly, demanding that all importers have the requisite ETS allowance could have some very negative political consequences. On the whole, each measure individually has validity, but no one strategy on its own would seem overly persuasive.

## **B. CLIMATE CHANGE MEASURES AND WTO JURISPRUDENCE**

Each of the aforementioned mechanisms looks to be beneficial in terms of balancing competitiveness and effectiveness. However, a preliminary question of key importance is whether each measure individually, or in concert with another, is compatible with the EU's obligations under the covered agreements. The EU has repeatedly stressed the importance of maintaining its WTO obligations. Thus, this section will first consider the permissibility of each strategy individually under WTO law. Second, it will consider the legal ramifications of unifying two of the measures – free ETS allocations and importer inclusion – to see if a hybrid measure is still permissible.

### **1. Global Sectoral Agreement (GSA)**

Although there are three measures enumerated, focus will be spent on the two most contentious. The rationale for this stems from the initial assessment of the Global Sectoral Agreement (GSA). Logically, unless there is some detrimental effect or ulterior purpose behind the agreement which would draw particular attention to it, obviously sectors are not

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33 *Ibid.*

forbidden under either domestic or international legal regimes to conclude an emission reduction accord. However, although it would be acceptable, a multilaterally negotiated agreement would still surely be preferred as it is concluded on intergovernmental rather than intersectoral grounds, and would be multisectoral in nature rather than unisectoral.

## 2. ETS Allowances to Energy Intensive Industries

More debatable, if the EU were to offer free ETS allowances to energy intensive industries, it *prima facie* raises concerns as to whether that measure would amount to a subsidy. A subsidy has been loosely defined for working purposes as “a form of benefit provided by government to a private party, such as an industry group, a particular company or an individual.”<sup>34</sup> Although a more specific definition is found in the *Agreement on Subsidies and Countervailing Measures* (SCM),<sup>35</sup> if we utilize the previous definition as a term of reference, it seems plausible that the allotment of free ETS credits would be deemed a subsidy. More concisely, the measure seems to be an actionable subsidy because it is limited to particular sectors or industries, in this case, classified as energy intensive.<sup>36</sup> However, two interesting questions must be addressed. First, considering that the allocation is occurring within the confines of a rigid environmental program, and while keeping in mind that some subsidies could be correctional in nature, the question of benefit arises. If no real benefit is being conferred, in that the allowance is in place to alleviate a gross market distortion from relaxed environmental standards, a panel may – when considering if it causes injury, nullification or impairment, or serious prejudice – find that the allowance was not a subsidy. Second,

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34 Andrew Green, “Trade Rules and Climate Change Subsidies” (2006) 5:3 World Trade Review 377 at 380.

35 WTO’s Agreement on Subsidies and Countervailing Measures defines “subsidy” as: (a)(1) financial contribution by a government or any public body within the territory of a Member or (a)(2) any form of income or price support and (b) a benefit is thereby conferred; WTO, *Agreement on Subsidies and Countervailing Measures*, 15 Apr. 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex IA Legal Instruments – Results of the Uruguay Round, at Article 1.1, online: WTO <[http://www.wto.org/english/docs\\_e/legal\\_e/24-scm.pdf](http://www.wto.org/english/docs_e/legal_e/24-scm.pdf)>

36 Michael Trebilcock & Michael Fishbein, “International Trade: Barriers to Trade” in Andrew Guzman & Alan Sykes, eds., *Research Handbook in International Economic Law* (Cheltenham, UK: Edward Elgar, 2007) at 22.

the Appellate Body suggested in *US – Foreign Sales Corporations*, that in the absence of a uniform world tax system states were free to exercise their discretion in taxation.<sup>37</sup> In an analogous situation, would it not be permissible, in the absence of a uniform ETS system, to exercise similar discretion? Realistically, although there are arguments to the contrary which may be persuasive, it seems plausible that a panel would err on the side of sovereignty and allow the EU to allocate ETS allowances to particular industries barring there is no benefit.

### 3. Importers Incorporated into the ETS System

The most politically contentious and difficult to administer of the proposed measures, is if importers were to be required to purchase ETS credits as a prerequisite to gaining access to the European common market, such a measure would carry with it initially an air of insolence. Fundamentally, the principles of Most Favoured Nation (MFN)<sup>38</sup> and national treatment<sup>39</sup> are the pillars of the international trading system. MFN is focused on preferential treatment being afforded by one Member to another, and obliges the party to afford that same privilege to all Members, while national treatment is concerned with favouring domestic production over the foreign production, and requires treatment of international products to be “no less favourable” than its domestic counterpart.<sup>40</sup> Furthermore, these articles turn on whether the foreign and domestic products are considered to be sufficiently “like.” For argument’s sake, likeness will be conceded at this stage – although it will be revisited more thoroughly during the consideration of the hybrid measure. However, if as suggested domestic industries must not only purchase an annual ETS allowance, but must also invest in greener technology, and pay an increased cost for energy – by virtue of it being more environmentally sustainable – it is difficult

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37 *United States—Tax Treatment for “Foreign Sales Corporations” (Complaint by European Communities)* (2000) WTO Doc. WT/DS108/AB/R (Appellate Body Report), online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds108\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds108_e.htm)>; Jagdish Bhagwati and Petros Mavroidis, “Is Action Against US Exports for Failure to Sign the Kyoto Protocol WTO-Legal?” (2007) 6:2 *World Trade Review* 299 at 302.

38 *General Agreement on Tariffs and Trade*, 30 October 1947, 58 U.N.T.S. 187, Can. T.S. 1947 No. 27 (entered into force 1 January 1948) [*GATT 1947*]; see Article I.

39 *Ibid*, Article III.

40 Trebilcock & Fishbein, *supra* note 36 at 30.

to see how in application such a requirement would be problematic. In regards to imports, Article III: 4 of the GATT focuses on “treatment no less favourable” than that afforded to domestic products, in terms of non-tax regulations. Realistically, requiring importers to purchase the exact same ETS credits for the same purpose – to offset carbon – as domestic producers may not, therefore, be considered unacceptable by the panel.

### **C. HYBRID MEASURE – A DIFFICULT QUESTION**

One of the difficulties with each of the aforementioned measures proposed by the EU is that they are quite docile in application. They seem to only superficially address the overall costs of the 20/20 by 2020 placed on domestic producers, essentially leaving uncompetitive industries to sink or swim. This was the exact concern French President Nicolas Sarkozy had in mind when he called for importing nations to be “penalized” for not capping their GHG emissions.<sup>41</sup> A hybrid measure which requires importers to purchase ETS credits if they have not achieved adequate emission benchmarks, and which allocates a free allowance to domestic producers who have, is seemingly more robust. Such a measure would proactively encourage pollution intensive industries to evolve, if for no other reason than to save on the annual cost under ETS mechanism. However, the question remains, would such a measure be either permissible or a justifiable exception under WTO law? The analysis will first proceed through the MFN and national treatment stage, with particular focus placed on likeness. Second, it will move to the exception stage under Article XX of GATT. Finally it will consider the particularities of the chapeau. In the end, if the hybrid measure has the requisite flexibility it would stand a good chance of a panel finding it justified.

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41 Jenny Barchfield, “France’s Sarkozy Calls for Carbon Tax” *International Business Times* (15 January 2008) online: IBT <<http://www.ibtimes.com/articles/20080115/frances-sarkozy-calls-for-carbon-tax.htm>>

## 1. MFN and National Treatment – focusing on Likeness

As noted, the crux of the MFN and national treatment provisions of the GATT turn on if the imported and the domestic products are considered to be “like.” Although Article I of the GATT has been given historically a broader interpretation than Article III for practical reasons, both sections have been interpreted by panels using the findings of the Working Party on Border Tax Adjustments. Using a case-by-case analysis, panels have applied the Working Party’s criteria of: i) the properties, nature and quality of the products, ii) the end-uses, iii) consumers’ tastes and habits, and iv) the tariff classification in their assessment of likeness.<sup>42</sup> In *EC – Asbestos* the panel stressed the need to focus on each criterion individually, although they are interrelated, and only once all relevant information has been examined should a determination be found.<sup>43</sup>

Climate change has received an immense amount of interest in recent years by politicians and consumers alike. People everywhere – particularly in Europe – have become aware of the detrimental effects they are having on the environment, and subsequently are beginning to change their consumption habits. Although on the surface two products – one being GHG friendly and one not – may seem to be “like” or “directly competitive or substitutive,” because of identical properties, end-use, and tariff classification the marketplace may still treat them as fundamentally different for two important reasons. First, although chemically identical, steel, for example, made under the EU ETS system will have an important differentiating property; in its production its carbon emissions were offset. Many products like “free-range” eggs, organic vegetables or dolphin friendly tuna are differentiated because of some unique characteristic of the product, arguably analogous to climate change initiatives. Second, consumer tastes may demand to know how the product was produced. With the increased attention on climate change and formal EU awareness

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42 Susanne Dröge, et. al., “National Climate Change Policies and WTO Law: A Case Study of Germany’s New Policies” (2004) 3:2 *World Trade Review* 161 at 165.

43 *European Communities—Measures Affecting Asbestos and Products Containing Asbestos (Complaint by Canada)* (2001), WTO Doc. WT/DS135/AB/R at para. 101-103 (Appellate Body Report), online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds135\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds135_e.htm)> [*EC—Asbestos*].

initiatives, the marketplace is beginning to slowly adapt to more environmentally conscientious choices. Fundamentally, consumers may, as was the case in *EC—Asbestos*, see the health risks associated with particular products as unacceptable and thus treat them as two distinctly different products. On the whole, as one commentator noted, “depending on the level of consumer interest in addressing climate change on the one hand, and the link between the PPM and environmental and human health impacts of climate change on the other hand, it would seem reasonable to conclude that a similar argument [to *EC—Asbestos*] could be made for products that differ in their GHG emissions from production.”<sup>44</sup>

Finally, it is conceivable that a panel may look at a measure that has essentially required importers to incur an increased cost unless they demonstrated an adherence to particular benchmark scheme similarly applied domestically as discriminatory. However, such an assessment would focus entirely on the equality of the measure as it pertained to domestic versus international products. In *US—Reformulated Gas* the United States had a variable standard for domestic producers and an inflexible standard for importers.<sup>45</sup> This lack of consistency in application was found to be a discriminatory trade measure. Similarly, if importers were held to an equivalent set of emission benchmarks, or even a set which was more flexible (as it would be practically difficult for the EU to require technological or R&D investment) surely a panel would find such a measure not to be in violation of national treatment.

## 2. Environmental Exceptions

Assuming however, that the products were considered sufficiently “like” and that the measure was discriminatory in nature – even to a small degree – the panel would next move to a consideration of the general

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44 Meinhard Doelle, “Climate Change and the WTO: Opportunities to Motivate State Action on Climate Change through the World Trade Organization,” (2004) 13:1 R.E.C.I.E.L. 85 at 94.

45 *United States—Standards for Reformulated and Conventional Gasoline (Complaint by Venezuela)* (1996) WTO Doc. WT/DB2/AB/R (Appellate Body Report), online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds2\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds2_e.htm)> [*US—Reformulated Gas*].

exception clause found in Article XX of the GATT. Two sections would be of most applicability, Article XX(b) and (g). Article XX(b) is a difficult option, for although it allows for exemptions aimed at the protection of “human, animal or plant life,”<sup>46</sup> it also carries with it a strict necessity requirement.<sup>47</sup> A more feasible line of argument would be through Article XX (g) that affords for the protection of an “exhaustible natural resource.”<sup>48</sup> Furthermore, Article XX (g) is functionally broader in two ways. First, the phrase “[measures] relating to” has been granted a liberal interpretation,<sup>49</sup> thus encompassing a wide array of environmental projects. Second, the term “exhaustible natural resources” has been similarly interpreted, encompassing biological resources such as fish stocks,<sup>50</sup> or turtles,<sup>51</sup> and non-living resources, such as clean air.<sup>52</sup> Measures relating to the protection of the global climate should have little difficulty finding a home in Article XX (g).

A measure which requires both domestic and international producers to achieve a *green* benchmark or purchase an ETS allowance surely is a measure aimed at preserving an exhaustible natural resource. However, the analysis does not simply come to a standstill on that point alone. A measure which essentially amounts to an import ban, with the caveat of permissible admission into the common market barring either adherence to the exact emission regime as domestic producers who receive free ETS credits, or the purchasing of an ETS allowance like all other domestic producers is quite burdensome and will draw tight scrutiny from a panel.

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46 See *GATT 1947*, *supra* note 38 Article XX (b).

47 *Thailand—Restrictions on Importation of Internal Taxes on Cigarettes (Complaint by United States)* (1990), GATT Doc. BISD 37S/200 (Panel Report), online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/gt47ds\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/gt47ds_e.htm)>

48 *Ibid*; see *GATT 1947*, *supra* note 38 Article XX (g).

49 *EC—Asbestos*, *supra* note 43 at para. 174.

50 *United States—Prohibition of Imports of Tuna and Tuna from Canada (Complaint by Canada)* (1982), GATT Doc. BISD 29S/91 (Panel Report), online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/gt47ds\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/gt47ds_e.htm)>

51 *United States—Importation Prohibition of Certain Shrimp and Shrimp Products (Complaint by India, Malaysia, Pakistan and Thailand)* (1998) WTO Doc. WT/DS58/AB/R (Appellate Body Report), online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds58\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds58_e.htm)> [*US—Shrimp/Turtle I*].

52 *Supra* note 45.

A similar scenario arose in *Shrimp/Turtle I* where the US put in place an import ban on all shrimp not harvested using a Turtle Excluder Device (TED).<sup>53</sup> Upon examination, the tribunal found the measure to be aimed at the preservation of an exhaustible natural resource,<sup>54</sup> done so in a precise fashion,<sup>55</sup> and neutral in its applications to domestic and international products. Subsequently, the measure was found to be provisionally justified. Likewise, if the EU measure was found to be aimed at the preservation of an exhaustible natural resource – in this case the global climate – and was considered both specific and impartial in its application, it too would be provisionally justified barring the application of the provisions under the *chapeau*.

### 3. Application of the *Chapeau*

After a measure is found to be provisionally justified under Article XX, the panel then applies the three part requirement established by the *chapeau*; namely is the measure a means of “arbitrary” or “unjustifiable discrimination” or a “disguised restriction on international trade[?]”<sup>56</sup> Functionally the requirements of the *chapeau* are focused on the implementation of the measure in question. As such, it reinforces the need for both substantive and procedural fairness in application.<sup>57</sup> In *Shrimp/Turtle I*, the panel found that although the measure was indeed aimed at the protection of an exhaustible natural resource (turtles), it also had an ulterior motivation of attempting to require Members to adopt essentially the same regulatory regime through coercion rather than discourse.<sup>58</sup> It was further noted by the panel that the certification process for importers was unclear, and thus the overall measure was unjustifiable.<sup>59</sup> In response, the US did not remove its ban. Rather, it refined its certification process to have clear and flexible guidelines, and entered into “good faith” multilateral negotiations with concerned states over conservation measures. These steps

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53 *Supra* note 51.

54 *Ibid.* at para. 134.

55 *Ibid.* at para. 142.

56 *GATT 1947, supra* note 38 Article XX.

57 *Supra* note 36 at 48.

58 *Supra* note 51 at para. 165-166.

59 *Ibid.* at para. 186.

were found to be sufficient to address the concerns raised by the tribunal, and thus the measure was subsequently upheld under an Article 21.5 review.<sup>60</sup> Furthermore, in *Brazil—Retreaded Tyres* the Appellate Body chose to focus its analysis of the *chapeau* on “the cause of the discrimination, and the rationale put forward to explain its existence.”<sup>61</sup> Moreover, they found that if the measure was to be applied in an inconsistent fashion – principally because of the MERCOSUR exception – and thus Brazil’s measure was found to be in violation of the *chapeau*.

Applying these considerations to the EU measure for it to be found as consistent with the requirements of the *chapeau*, three major elements would need to be present. First, the EU must continue to use the multilateral track in hopes of finding a mutually beneficial and, more importantly, binding accord. However, as noted in *Shrimp/Turtle 21.5* an agreement need not be reached to satisfy the “good faith” requirement. Rather the panel focused on “good faith” participation and financial support for the process.<sup>62</sup> For to have the bar requiring an agreement would essentially offer a veto to any Member who did not want to comply. This is an important point considering the difficulty states had in Bali simply trying to find consensus on a road map for future negotiations. Second, the EU measure must have environmental benchmarks for the exception from the ETS program that are clear, readily available, justifiable, realistic and flexible. Moreover, they must be as demanding or even less so when compared to domestic producers or risk falling victim to the same faults as in *US—Reformulated Gas, and Shrimp/Turtle I*. Finally, the measure must be applied in a homogenous manner both domestically and abroad.

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60 *United States—Importation Prohibition of Certain Shrimp and Shrimp Products—Recourse to Article 21.5 (Complaint by Malaysia)* (2001) WTO Doc. WT/DS58/RW at para. 152. (Panel Report), online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds58\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds58_e.htm)> [*Shrimp/Turtle 21.5*]

61 *Brazil—Measures Affecting Imports of Retreaded Tyres (Complaint by European Communities)* (2007) WTO Doc. WT/DS332/AB/R at para. 226. (Appellate Body Report), online: WTO <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds332\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds332_e.htm)>

62 *Supra* note 60 at para.132.

On the whole, and barring any technicalities in its application, even a hybrid measure which requires importers who have not achieved the accepted emissions benchmarks to purchase ETS credits, while allowing for a free allowance to domestic producers who have, seems justifiable even under the *chapeau*. The goal of such a measure is not to restrict trade, rather to encourage it in an environmentally sustainable fashion. Governments have an unequivocal right to regulate the conditions in which products are sold in their market.<sup>63</sup> As long as the terms for exemption from the ETS regime are equal for both domestic and international producers (arguably slightly lesser for foreign producers for increased flexibility), and is not simply intended to protect ailing EU industries, then the measure should be looked upon favourably by a WTO panel.

#### IV. PROVISIONAL REFORMS TO COMBAT CLIMATE CHANGE

Countries vary greatly in their particular position on the issue of climate change, and their willingness to pay for adaptation to mitigate it. Some are progressive and forward-thinking in their approach, taking the globe on their shoulders and leading the way. Others concern themselves with stifling the process at every opportunity, seemingly content to see the world deteriorate under their watch. By virtue of the problem being global in character, it demands a global response. However, because of the difficulty of achieving a binding international agreement on the topic, many fear states will be forced to resort to unilateral measures to persuade derogatory nations to comply. This section will put forward two general areas which could be reformed to empower nations with a wider array of tools to mitigate the costs of climate change. First, it will address the issue of environmental subsidies, and second, it will consider the issue of unilateral

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63 *Supra* note 37 at 306.

action. In the end, the world trade system is meant to maximize the welfare of states, not act as an oppressive yoke to addressing concerns of immense importance.

### A. ENVIRONMENTAL SUBSIDIES

Subsidies that are aimed at a valid environmental objective should, without question, be permissible under WTO law. It seems terribly illogical that if a nation wants to impose tight environmental restrictions on its industries, in turn demanding them to bear the cost of an increased domestic regulatory regime, that these industries should also have to face the world market as under-competitive – albeit progressive – but under-competitive nevertheless. Indeed, some measures are arguably justifiable (as demonstrated above) but it would be much more efficacious to simply address environmentally grounded subsidies in a comprehensive manner.

There seem to be three major areas where reform could occur. First, the rules pertaining to subsidies could be refined to differentiate between positive and negative subsidies.<sup>64</sup> If a more narrowed definition of subsidy was put forward, with a particular emphasis on injury to the foreign party, or one that allowed for an exception when measures were aimed at readjusting competitive discrepancies due to environmental practices,<sup>65</sup> it may alleviate much of the problems. Second, a clear exception could also be worked in for subsidies aimed at implementing environmental measures. Admittedly, this is a similar notion to the old Tokyo Round Subsidies Code, and could fall victim to the difficulty of differentiating between a useful and a harmful subsidy.<sup>66</sup> However, that worry could be eased with the articulation of some criteria for what constitutes a beneficial versus a harmful subsidy. Lastly, there could be an explicit clause hindering a state from subsidizing high GHG emitting industries – for instance coal. If integrated in unison, states would find themselves with a wider

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64 *Supra* note 34 at 405.

65 *Ibid.*

66 *Supra* note 34 at 407.

selection of tools to combat environmental threat, while preserving the competitiveness of domestic industries.

## B. UNILATERAL ACTION

Although a multilaterally negotiated accord is the preferable avenue to combating climate change, historically it has proven extremely difficult to either come to an agreement, or if an agreement is signed, major emitters are notably absent. How then does anyone proactively address global environmental threats, if by their very nature the threat is global in character? Some scholars suggest in certain circumstances the use of trade measures as a weapon to encourage exporting states to adopt some level of environmental control.<sup>67</sup> Others propose a more coercive approach, where large green states makes foreign aid packages contingent upon accepting more stringent environmental measures.<sup>68</sup> Both approaches have their merit. However, the latter option only works when there is a power imbalance favouring the green state – generally this situation arises in relation to developing countries.

What then to do about large, powerful and generally environmentally deviant nations, who no matter how clear the threat is, still resist action? It is one of the principle shortcomings of such multilateral treaties as the Kyoto Protocol, for although it is comprehensive in nature there are many notable countries absent. More troublesome, there is no mechanism to persuade them to join.<sup>69</sup> Robust trade measures could be used as a tool to persuade dissenters to come to the negotiation table with a more realistic agenda, or be prepared to conclude a more wholesome agreement. It must

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67 The World Bank, *International Trade and Climate Change: Economic, Legal and Institutional Perspectives* (Washington DC: The World Bank, 2008) at 36.

68 Richard H. Steinberg, "Power and Cooperation in International Environmental Law" in Andrew Guzman & Alan Sykes, eds., *Research Handbook in International Economic Law*, (Cheltenham, UK: Edward Elgar, 2007) at 528

69 Jeffrey Frankel, "Kyoto and Geneva: Linkage of the Climate Change Regime and the Trade Regime" (2004) [unpublished archived at Kennedy School of Government Faculty Working Paper no. PWP04-042] online: Harvard <[http://ksgnotes1.harvard.edu/Research/wpaper.nsf/rwp/RWP04-042/\\$File/rwp\\_04\\_042\\_frankel.pdf](http://ksgnotes1.harvard.edu/Research/wpaper.nsf/rwp/RWP04-042/$File/rwp_04_042_frankel.pdf)>

be stressed that this strategy is not put forward to condone a global trade war. To the contrary, in our time of economic interdependence nations are in need of global trade more than ever in human history. However, if nations are prepared to sacrifice the health of not only their citizens, but the earth's climate as a whole, to simply take a quicker path on the road to development, the global community should be able to restrict the flow of their goods.

More prudently, the WTO should allow this. A plausible option could be in the form of an approval for differential treatment among Members in terms of MFN or national treatment based on objective criteria as was suggested in *EC—Trade Preferences*.<sup>70</sup> Understandably, differential treatment in this case was in relation to developing countries. However, the logic still holds when applied to the globally developed. If a nation uses valid objective criteria and is uniform in its application, granting preferential access to nations that are greener, while still providing a means for developing nations to achieve these benchmarks (foreign aid, or CDMs), an approach like this should be favoured not frowned upon. A second option that should be approached with caution is an acceptance that nations may unilaterally impose tight domestic regulations, and force importers to adhere to a similar standard or risk losing access to that particular market. Although under current GATT Article XX jurisprudence such a measure has an arguable level of success, the constraints placed by the *chapeau* are at times worrisome from an environmental perspective. It is understandable why they are in place, to protect Members from unjustifiable discrimination. However, holistically, these requirements also hinder the creativity of Members to react to the threat of climate change, because they must constantly be wary of the measure employed having a discriminatory effect. In the absence of a uniform global approach to taxation of energy and GHG emissions,<sup>71</sup> minor deference being paid by the panel to Members who are addressing a global threat such as climate change – even if they are unilateral in nature – would be sufficient.

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70 *European Communities – Conditions for the Granting of Tariff Preferences to Developing Countries (Complaint by India)* (2004) WTO Doc. WT/DS246/AB/R at para. 20 (Appellant Body Report) online: <[http://www.wto.org/english/tratop\\_e/dispu\\_e/cases\\_e/ds246\\_e.htm](http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds246_e.htm)>

71 *Supra* note 67 at 40.

## V. CONCLUDING REMARKS

Human activity has been proven unequivocally to be a root cause of the recent shift in the global climate, and there is no longer any disputing this. The IPCC are in agreement that action must be taken immediately to address the underlying fundamental contributors to climate change, namely GHG emissions, or risk an irreversible alteration to the global ecosystem.<sup>72</sup> In response, the EU has forged forward. Their recently signed climate initiative, the 20/20 by 2020 is a comprehensive domestic response, and sets a high standard for other progressive nations to follow. However, in the absence of a wide-ranging multilateral reaction to climate change that binds on signatories a cap on GHG emissions, European industries and consumers will be paying the price for progress while others capitalize. This reality has urged calls from some for the imposition of a carbon tax of sorts to equalize the international playing field for European products and to encourage responsible states to accept responsibility.

However, many worry that such a rash action may not only have a chilling effect on international relations, but will also be found to be discriminatory under the WTO covered agreements. The EU has stressed that its intention is not to breach WTO law and, as illustrated, each of the measures suggested by the EU has a strong chance of being found to be acceptable using the reasoning of *EC—Asbestos*, and *Shrimp/Turtle 21.5*. Furthermore, even a more robust hybrid measure has a viable chance of success under the same reasoning. Nevertheless, states should be empowered with the requisite tools to combat such a threat. Environmental subsidies should be incorporated into WTO law, to allow states to offset the negative competitive effects of progressive green initiative. Further, states should be given the support necessary to act unilaterally if necessary. In a global system dominated by interest politics, many times it may be difficult to conclude an agreement on climate change which is potent or binding. Absent such an agreement, nations who choose to adhere to a

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<sup>72</sup> *Supra* note 2 at 72.

more rigorous environmental regime should not have to pay for it twice; once in terms of the costs of adaptation and again in terms of a loss of competitiveness. The WTO must be aware of this concern and adapt to accommodate it. Although it is not a politically prudent option, large GHG emitting states may never truly consider a realistic reduction unless they feel there is a threat (be it either by having markets closed off to their goods, or by being forced to incur a great cost to comply with import standards). Regardless of how, progressive nations must be empowered to persuade others to collectively combat climate change, and at very least they should not be penalized for protecting the planet.