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FINAL INSTANCE: WORLD TRADE ORGANIZATION –
UNILATERAL TRADE MEASURES
IN EU CLIMATE CHANGE LEGISLATION

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Unilateral Trade Measures in EU Climate Change Legislation*

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Abstract

Can the European Union (EU) introduce trade restrictive border measures under the auspices of environmental protection, whose purpose is at least inter alia to 'level the competitive playing field' for the European carbon-intensive industries? Should the World Trade Organization (WTO) dispute settlement bodies be the final instance for deciding the legality of European climate change legislation measures?

Europe is tightening its climate change policy, which inevitably increases costs for European producers. Global deviation in greenhouse gas emission reduction efforts has raised concerns about carbon leakage and deterioration in the competitiveness of European industries. To cope with these threats, the introduction of trade measures linked to the content of other countries' environmental policy has been suggested. The revised Directive 2009/29/EC on the EU Emissions Trading Scheme (ETS) accordingly lead the way forward with regard to implementing special provisions such as free allocation of allowances or a "carbon equalization system". Constituting a restriction of free trade, the announced measures are bound to clash with the multilateral trading rules of the WTO. This article checks the conformity of the anticipated trade measures in EU climate change legislation with the international obligations of the Community under the WTO, namely their compatibility with the General Agreement of Tariffs and Trade (GATT) 1994.

Keywords

Carbon leakage, trade restrictions, climate change, EU energy policy, border measures

I. Introduction

The European Climate Action and Energy Legislative Package containing measures to fight climate change and promote renewable energy was adopted on 6 April 2009 by the European Council¹. The declared aim is a 20 % reduction in greenhouse gases and a 20 % share of renewable energy in the EU's total energy consumption by 2020. The main part of this package is comprised of revisions to the European Emissions Trading Scheme (hereinafter EU ETS).² One crucial innovation is a change in emission allowance allocation: from 2013 onwards, greenhouse gas emissions permits will no longer be allocated to industry free of charge, but rather be auctioned off by the Member States. Unlike under the current scheme where national emission caps were generously set by the Member States in their National Allocation Plans (hereinafter NAPs), a harmonized EU-wide cap will be set in place. It becomes apparent that the EU is tightening its emission control legislation. This approach will cause major impacts on heavy and export-oriented European industries. The view on the international backdrop shows the EU currently ploughing a rather lonely furrow, abandoned by those countries that account for most of the greenhouse gas emissions owing to their rapid industrialization and economic growth. Therefore, it is evident that concerns on a severe competitive disadvantage in the global marketplace and the relocation of the energy-intensive industries in countries with less strict climate change legislation are growing.³ Moreover, skepticism that the European efforts will be undermined in view of the global nature of the climate change problem is not out of place. If the targeted successor treaty of the Kyoto Protocol to be negotiated at the 15th conference of the parties to the United Nations Framework Convention on Climate Change (hereinafter UNFCCC) in December 2009 in Copenhagen does not include stringent reduction commitments of all top emitters of greenhouse gases (namely the United States (hereinafter US) as non-party to the Kyoto Protocol as well as the key developing countries such as China and India with very fast rates of emissions growth and no emission commitments under the current protocol) absorption-measures will be required.⁴ Whereas for the time being the EU's strategic glance was preoccupied with refining and improving the EU ETS and establishing its role as the architectural prototype for a global system, now the issue of domestic "carbon-equalizing" measures has found its way onto the European agenda. The Commission will consider whether to establish trade measures to impose climate change related costs on imports from countries with little or no climate policy and low energy costs, provided that no global pact will be reached by December 2009. By now, the climate change community agrees that new concerns over such border measures represent the most prominent international issue.⁵ This is particularly true, in view of the unlikelihood that an agreement on a comprehensive new international climate regime will be reached already in Copenhagen. With the end of the current Kyoto limits in 2012, the implementation of trade measures at European borders does not seem unlikely. A respective provision is already included in the revised ETS Directive 2009/29/EC.⁶ Of particular interest is the provision

¹ European Council, Brussels, 6 April 2009, 8434/09 (Presse 77). Available: <http://www.consilium.europa.eu>.

² Directive 2003/87/EC 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.

³ See e.g. E. NEUMEYER, 10 'Pollution Havens: An Analysis of Policy Options for Dealing with an Elusive Phenomenon,' *Journal of Environment and Development*, (2001), p. 147 ff.

⁴ As to the future Kyoto successor treaty it cannot yet be said that there will be no commitments from developing countries, especially China and India and some other 'emergers'; they will however likely be less stringent.

⁵ The latest comprehensive report see WTO/ UNEP, 'Trade and Climate Change', A report by the United Nations Environment Programme and the World Trade Organization, June 2009. Available: www.wto.org.

⁶ Recital [25] of Directive 2009/29/EC of the European Parliament and of the Council of 23 April 2009 amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading scheme of the Community (Text with EEA relevance) OJ L 140, 5.6.2009, p. 63–87.

that importers could be required to acquire emission allowances corresponding to the embedded carbon in their goods.⁷ Such an extension of the European greenhouse gas policy has a direct bearing on the free flow of trade across borders. Accordingly, the WTO membership of all players needs to be highlighted: Does the fear of competitive disadvantages, the impact of carbon leakage or the ambition to convince reluctant states by means of trade-restrictions to join a global agreement, allow measures that are irrefutable restrictions of free trade? Such measures have the potential to infringe upon central tenets of international trade law.⁸

In this contribution, it will be asserted that carbon based trade measures as envisaged by the EU will not withstand being challenged under the multilateral trading system.⁹ The core of the analysis is a possible European trade-related regulation of greenhouse gas emissions with extraterritorial economic effects, namely the extension of the EU ETS on imports. It will be argued that the considered unilateral implementation of such a border measure will cause an infringement of basic WTO rules, such as the General Agreement of Tariffs and Trade (hereinafter GATT) 1994.¹⁰ Whether the phenomenon of increasing endorsement of trade measures within climate change regulation is cause for general concern is matter of debate. This contribution endeavors to step back and take stock of this more and more disputed field where environmental protection and trade liberalization seem to collide. Following this introduction, the context is set out in the next part providing a brief overview of the current EU climate change policy and its impacts. In the subsequent part, the key issue in question is the compatibility of the announced trade measure with the GATT, which will be examined on a case-by-case basis. The analysis of trade restrictions at European borders is not meant to be exhaustive. Instead, it is meant to be illustrative – limited to the GATT-legality of a future allowance requirement for imports it provides the reader with a sense of the key issues and themes that will emerge in the near future. The final part presents the key conclusions.

II. European Climate Change Policy and Reasons for Trade Restrictions

With the EU ETS, the EU created the world's largest multinational cap and trade scheme and put a prize on carbon. Based on Directive 2003/87/EC, the EU ETS started in January 2005. Its adoption was not just a means of ensuring that EU Member States could meet their commitments under the Kyoto Protocol. The implementation of the common emissions trading system (2005-2007) was also a

⁷ Recital [25] of Directive 2009/29/EC.

⁸ See e.g. S. CHARNOVITZ, 'Trade and Climate: Potential Conflicts and Synergies', in J. E. ALDY, J. ASHTON, R. BARON, R. BODANSKY, S. CHARNOVITZ, E. DIRINGER, T. C. HELLER, J. PERSHING, P. R. SHUKLA, L. TUBINA, F. TUDELA, X. WANG, (eds), *Beyond Kyoto. Advancing the international effort against climate change*, Pew Centre of Global Climate Change, (Arlington, VA 2003), p. 152; M. GENASCI, 'Border Tax Adjustments and Emissions Trading: The Implications of International Trade Law for Policy Design', 1 *Carbon and Climate Law Review*, (2008) p.33-42; G. GOH, "The World Trade Organization, Kyoto and Energy Tax Adjustments at the Border", 38 *Journal of World Trade* (2004), pp. 395-423; R. ISMER, K. NEUHOFF, 'Border Tax Adjustments: A Feasible Way to Address Non participation in Emission Trading', (2004), *Cambridge Working Papers*, CMI Working Paper 36; N. MEYER-OHLENDORF, C. GERSTETTER, 'Trade and Climate Change. Triggers or Barriers for Climate Friendly Technology Transfer and Development?', *Dialogue on Globalization, Occasional Papers 41*, (2009); available: <http://library.fes.de/pdf-files/iez/global/06119.pdf>; J. PAUWELYN, 'US Federal Climate Policy and competitiveness Concerns: The Limits and Options of International Trade Law', Nicholas Institute for Environmental Policy Solutions, Duke University, *Working Paper*, (2007); F. SINDICO, 17 'The EU and Carbon Leakage: How to Reconcile Border Adjustments with the WTO?', *European Energy and Environmental Law Review*, (2008), pp. 328-340; J. WERKSMANN, 8 'Greenhouse Gas Emissions Trading and the WTO', *Review of European Community and International Environmental Law*, (1999), pp. 251-264.

⁹ See e.g. for tax adjustments F. BIERMANN, R. BROHM, 4 'Implementing the Kyoto Protocol without the USA: the strategic role of energy tax adjustments at the border,' *Climate Policy*, (2005), p. 289 ff.

¹⁰ The General Agreement on Tariffs and Trade 1994, contained in the Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 33 I.L.M. 1994, p. 1153 ff. This is the updated version of the GATT 1947 which includes a few amendments and additions.

preparatory effort initiating the international process from 2008 onwards, and served as a particularly useful tool in gaining procedural experience. The subsequent five-year trading period then coincided with the first commitment period of the Kyoto Protocol (2008-2012). The system covers approximately 11,500 installations in the power and industrial sectors, which are collectively responsible for almost half of the EU's emissions of CO₂.¹¹ It is in the very nature of the subject matter itself that efforts to reduce the emission of greenhouse gases in Europe increases costs for the affected industries. In January 2008 the European Commission proposed the Climate Action and Energy Package which was approved by the European Parliament in December 2008. In this package, EU climate change policy is tightened. At the core of this new climate change legislation are stricter emission trading rules: it not only provides for a more stringent overall emission target of at least 20 percent below 1990 levels by 2020 with an option of 30 percent reduction target if a Kyoto successor Treaty is agreed upon. It also contains a broader coverage of energy-intensive industries including new sectors, new gases and aviation as of 2012. Moreover, the revised ETS will eliminate the hitherto 27 heterogeneous NAPs and establishes one EU-wide cap.¹² The autonomy of the Member States led to huge differences in allocation rules within Europe, and above all showed a tendency to over-allocate permits because of concerns over loss of competitiveness.¹³ Besides this, allowances have been largely allocated free of charge.¹⁴ Furthermore, as from 2013 more than 50 percent of the total cap shall be auctioned. Auctioning will be the default method in particular for the electricity sector. Companies will be required to bid for the number of allowances they need to purchase in order to cover their emissions, as opposed to receiving an initial amount free of charge.¹⁵ Augmentation of cost for European manufacturing is obvious. The European industry might be less profitable than production outside Europe with less stringent climate change regulation. Related to the potential impact on competitiveness, the issue of "carbon leakage", i.e. the risk that energy-intensive industries will relocate to countries without climate regulations has received a great deal of attention.¹⁶ By the same token, considering this effect, European industries would bear the cost but there would be no benefit to the environment if carbon-intensive industries relocate in developing countries such as China or India or even increase of greenhouse gas emissions. To address these concerns, the EU included specific provisions in the revised 2009 ETS Directive (such as the additional free allocation of allowances for

¹¹ J. DELBEKE, 'The Emissions Trading Scheme (ETS): The Cornerstone of the EU's Implementation of the Kyoto Protocol', in J. DELBEKE (eds), *EU Energy Law, Volume IV: EU Environmental Law. The EU Greenhouse Gas Emissions Trading Scheme*, (Leuven Claey's & Casteels, 2006), p. 8.

¹² In detail see D. MEADOWS, 'The Emissions Allowance Trading Directive 2003/87/EC explained', in J. DELBEKE (eds), *EU Energy Law, Volume IV: EU Environmental Law. The EU Greenhouse Gas Emissions Trading Scheme*, (Leuven Claey's & Casteels, 2006), p. 79.

¹³ Commission report to the European Parliament and the Council considering the functioning of the EU Emissions Trading Scheme in November 2006, COM 2006, 767 final, Rapid - Press Release - Europe, 15.05.2006, "EU emissions trading scheme delivers first verified emissions data for installations". Available: <http://europa.eu>; M. PEETERS, "Legislative choices and legal values: considerations on the further design of the European greenhouse gas emissions trading scheme from a viewpoint of democratic accountability", in M. FAURE, M. PEETERS, (eds), *Climate Change and European Emissions Trading: Lessons for Theory and Practice*, (Cheltenham Edward Elgar Publishing, 2009), p. 24, A. D. ELLERMANN, C. CARRARO, B. BUCHNER, 'The EU ETS allocation process: an overview,' in A. D. ELLERMANN, C. CARRARO, B. BUCHNER (eds.) *Allocation in the European Emissions Trading Scheme: rights, rents and fairness*, (Cambridge, Cambridge University Press, 2007), p; J. R. NASH, 24 "Too much market? Conflict between tradable pollution allowances and the Polluter pays principle," *Harvard Environmental Law Review*, (2000), p. 467, see as well ECCP EU ETS review process: written comments CAN-Europe, Friends of the Earth Europe, Greenpeace and WWF (2007), p. 8, available: www.climnet.org.

¹⁴ The current level of auctioning, averages about 4% of the total quantity of allowances, see Rapid Press Release, 4 June 2009, "Emissions trading: public consultation on future EU ETS auctioning rules launched". Available: <http://europa.eu>.

¹⁵ European Commission, Press Release, Questions and Answers on the revised EU Emissions Trading System, MEMO/08/796, 17/12/2008. Available: <http://europa.eu>.

¹⁶ WTO/ UNEP, 'Trade and Climate Change', A report by the United Nations Environment Programme and the World Trade Organization, June 2009, Sec.1 xviii. Available: www.wto.org, E. NEUMEYER, *note 3 above*.

European industries¹⁷) and provides for a so-called “carbon equalization system”. Recital 25 of the revised 2009 ETS Directive reads:

“The Commission should therefore review the situation by 30 June 2010, consult with all relevant social partners, and, in the light of the outcome of the international negotiations, submit a report accompanied by any appropriate proposals. In this context, the Commission should identify which energy-intensive industry sectors or subsectors are likely to be subject to carbon leakage by 31 December 2009. It should base its analysis on the assessment of the inability of industries to pass on the cost of required allowances in product prices without significant loss of market share to installations outside the Community which do not take comparable action to reduce their 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 equalisation 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 within the Community, for example by requiring the surrender of allowances. 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 (LDCs). It would also need to be in conformity with the international obligations of the Community, including the obligations under the WTO agreement.”¹⁸

Hence, the EU is considering to impose the requirement that European importers of carbon-intensive products participate in the EU ETS, i.e. have to buy CO₂ allowances when crossing the European borders. The import provisions would apply to those goods which have been determined to be subject to a significant risk of carbon leakage, i.e. to energy-intensive industries from those countries which have not taken comparable actions to reduce the greenhouse gas emissions.¹⁹ The question what makes an action an actually “comparable” one, is not easy to answer. The draft proposal for the revised ETS Directive equals “comparable action” with the status of a country being ratifiers of the international agreement succeeding the Kyoto Protocol or being linked with the EU ETS.²⁰ Against this backdrop the fact that the US did not join the Kyoto Protocol springs to mind. Additionally, the provision demands for considering the principle of common but differentiated responsibilities. It dictates a difference in treatment between emerging, developing and least developed countries. The developing countries, being party to the Kyoto Protocol would therefore not be target of the allowance requirement as long as they are under no obligation to reduce greenhouse gas emissions.²¹ The actual contents of a future allowance requirement and its implementation is not foreseeable yet. The wording of the provision indicates its aim – to achieve the standard for trade measures for environmental purposes set by the adjudicating bodies of the WTO. The langue chosen seems to be aligned with those criteria developed in the relevant case law of the GATT/WTO dealing with the conflict between the two regimes: environment and trade. However, the following investigation under WTO law will allow the conclusion that this is not sufficient to withstand a challenge before the WTO adjudicating bodies.

¹⁷ It should be noted, that free allowances could constitute actionable subsidies covered by the SCM Agreement, see e.g. G. C. HUFBAUER, S. CHARNOVITZ, J. KIM (2009), ‘Global Warming and World Trading System,’ (Washington, Peterson Institute for International Economics, 2009), p. 61; M. LODEFALK, M. STOREY, 39 ‘Climate Measures and WTO Rules on Subsidies,’ *Journal of World Trade*, (2005), pp. 41-44.

¹⁸ Directive 2009/29/EC, *note 5 above*, Recital [25].

¹⁹ R. QUICK, ‘Border Tax Adjustments in the Context of Emissions Trading: Climate Protection or ‘Naked’ Protectionism?’, 3 *Global Trade and Customs Journal*, (2008), p. 168.

²⁰ R. QUICK, *note 14 above*, p. 167.

²¹ R. QUICK, *note 14 above*, p. 168.

III. The Multilateral Trading Rules of the WTO

The European measure, as far as foreseeable, will collide with the rules of the WTO, namely with the GATT 1994. Unilateral regulations of imports linked to the content of another country's environmental policy are not necessarily precluded²². Affording a different treatment on products based on the adoption of "comparable" climate change mitigation measures outside the EU intervenes in the process of production extraterritorially. This raises the longstanding question of process and production methods and what the WTO requires concerning them. Under the GATT 1994 countries basically cannot use import barriers in efforts to affect how goods are produced in foreign countries, since this raises concerns of systemic protectionism and of arbitrary imposition of one country's national policies on other country's sphere of domestic jurisdiction. This basic rule may change in favour of environmental protection. At the time of the birth of the international trade regime in the 1940s, questions on environmental protection did not get as significant attention as they do today, or as in the early 70ies when the first international environmental issues became prominent.²³ The text of the GATT agreement, adopted in 1947 did not contain a specific reference to the protection of the environment. With the adoption in 1994 of the agreement establishing the WTO, although the text of GATT 1947 was left unchanged in its lack of a specific linkage with the environment, an explicit note in the Preamble makes reference to the principle of sustainable development and to the need to consider that principle in the making of trade²⁴. The relevant GATT/WTO practice has been inconsistent concerning this question. Since 1982, the GATT/WTO dealt in nine cases with the application of the environmentally relevant exceptions of the GATT 1994, which led to a formation of criteria to evaluate the interpretation and application of the respective vague legal terms in the GATT 1994. Even that the WTO panels and Appellate Bodies, established to resolve disputes among WTO members, are not bound by precedent, previous rulings on similar issues are nevertheless likely to be indicators available for predicting how the WTO might deal with disputes involving climate change mitigation issues.²⁵ In the following section the status of case law as it stands now on this score will be clarified in order to evaluate the GATT-compatibility of a future allowance requirement for imports.

A. Violation of Article I of GATT 1994

The main principle upon which the GATT 1994 is based is the principle of non-discrimination, enshrined in two clauses: the Most-Favoured-Nation clause of Article I, which contains the obligation of non-discrimination among trading partners, and the National Treatment Provision of Article III, codifying the obligation of equal treatment between domestic and foreign products. With regard to the expected design of the EU measure a violation of Article I will be inherent.²⁶ The Most-Favoured-Nation obligation shall guarantee that any advantage accorded to an imported product has to be

²² See J. FRANKEL, 'Addressing the Leakage/Competitiveness Issue in Climate Change Policy Proposals', Written for panel on "Proposals to Deal with Leakages," conference on Climate Change, Trade and Investment: Is a Collision Inevitable? June 9, 2008, Brookings Institution, Washington D.C. Available: <http://ksghome.harvard.edu>. It was a breaking ruling that environmental measures can target, not only exported products (Article XX), but also Processes & Production Methods - subject, as always, to non-discrimination (Articles I & III), see *US-Shrimp*, Appellate Body Report, *United States-Import Prohibition of certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted 6 November 1998.

²³ D. BODANSKY, J. C. LAWRENCE, 'Trade and Environment', in D. BETHLEHEM, D. MCRAE, R. NEUFELD, I. VAN DAMME (eds), *Oxford Handbook of International Trade Law*, (Oxford 2008), p. 506.

²⁴ F. FRANCONI, 'Environment, Human Rights and the Limits of Free Trade', in F. FRANCONI (eds) *Environment, Human Rights and International Trade*, (Oxford 2001), p. 15.

²⁵ See Appellate Body Report, *Japan-Taxes on Alcohol Beverages II*, WT/DS8/AB/R, of 4 Oct 1996.

²⁶ With respect of the purpose of this investigation to illustrate the key issues concerning the GATT-legality of a future allowance requirement for imports, a violation of Article III²⁶ is excluded from the scope of the investigation.

extended to the like product from any WTO member country.²⁷ Products that are not ‘like’ may be treated differently.

The question to start with is whether e.g. steel “remains” steel no matter how it is produced, in other words, whether two otherwise like products, one of which has been produced in conformity with the requirement of “comparable climate change action”, and one not, continue to be like products as per Article I: do products have to be considered “unlike” because of differences in the way in which they have been produced even though the production method used is not visible in the final product, i.e. the physical characteristics remain identical?²⁸ Basically two constellations have to be distinguished: first, the case of an incorporation or visibility of the process of production in the final product, e.g. asbestos-containing and asbestos-free construction material and secondly, that the production process does not live a trace, e.g. shrimp that were fished in a prohibited manner. Whereas once in 1991 the GATT panel in the *Tuna/Dolphin I*²⁹ case came to the conclusion that this criterion is irrelevant, the Appellate Body later in the 2001 *EC-Asbestos* case defined ‘likeness’ rather differently.³⁰ Based on the assumption that the manner in which products are made may have an impact on the preferences and tastes of consumers, and thus on the nature and the extent of the competitive relationship between these products,³¹ the analysis of the likeness-criterion shall include four criteria: (a) the physical properties of the product; (b) the extent to which the products are capable of serving the same or similar end-uses; (c) the extent to which consumers perceive and treat the products and (d) the international classification of the products for tariff purposes.³² Asbestos containing products in which the production process was incorporated, the adjudicating body decided that a reasonable and as such, informed consumer who is aware of the environmental or health hazard, will treat the two goods as unlike goods. Conversely, if the production process is not visible as e.g. in the case of shrimp the respective products have to be seen as like products. If steel that is produced in a country that did not adopt “comparable” climate change mitigation measures would be shunned by consumers, a situation may arise in which there is in fact no (or only a weak) competitive relationship between this steel and steel made e.g. in the EU. In the light of the nature and the extent of the competitive relationship between them, a product produced in a climate-friendly way and the same product produced in the conventional way could in such a situation be found not to be ‘like’. However, it seems very unlikely that this type of situation will arise as consumers in most markets are in their choice between products primarily guided by the price and other aspects that are not related to the conditions (e.g. environmental, labour or animal welfare conditions) under which the products were produced.³³ Therefore it can be assumed that the affected products will be considered as like products.

²⁷ P. C. MAVROIDIS, *The General Agreement on Tariffs and Trade. A Commentary*, (Oxford University Press 2005), p. 110.

²⁸ J. BHAGWATI, P. C. MAVROIDIS, ‘Is Action Against US Exports for Failure to Sign Kyoto Protocol WTO-Legal?’, 6 *World Trade Review*, (2007), p. 304, M. DOELLE, 13 ‘Climate Change and the WTO: Opportunities to Motivate State Action on Climate Change Through the World Trade Organization,’ *Review of European Community and International Environmental Law* (2004), p. 93.

²⁹ Panel Report, *US-Tuna/Dolphin I, United States-Restrictions on Imports of Tuna*, 30 ILM (1991), p. 1594 f.

³⁰ The 1970 Working Party on Border Tax Adjustments suggested some criteria for determining whether products are “like”: “the product’s end-uses in a given market; consumers’ tastes and habits, which change from country to country; the product’s properties, nature and quality”. GATT Working Party (1970), para. 18.

³¹ The concept of ‘like products’ has different meanings in the different contexts in which it is used. Concerning Article III of GATT 1994, see Panel Report *EC-Asbestos, European Communities – Measures Affecting Asbestos and Asbestos containing Products*, WT/DS135/R, paras 98-100,103; *Japan-Taxes on Alcoholic Beverages II*, note 20 above, p. 112-113.

³² Appellate Body Report, *EC-Asbestos*, European Communities-Measures Affecting Asbestos and Asbestos Containing Products, WT/DS135/AB/R, para 101.

³³ P. VAN DEN BOSSCHE, N. SCHRIJVER, G. FABER, ‘Unilateral Measures Addressing Non-Trade Concerns’, A study on WTO Consistency, Relevance of other International Agreements, Economic Effectiveness and Impact on Developing

Considered being like products, they must be treated equally, irrespective of their origin. Since the prospective EU measure would be based on the origin of the good, i.e. depending on the countries climate change policy a violation of Article I is inherent. The requirement of surrendering allowances should only apply for imports from countries and administrative entities, which are not taking comparable action to reduce greenhouse gas emissions. To determine which countries actually take sufficient action in that sense, the proposal for a revised ETS Directive referred to their status being signatories to a Kyoto successor treaty or not: an exclusion of this allowance requirement is therefore foreseen *inter alia* for those countries that will ratify the international agreement succeeding the Kyoto protocol.³⁴ If the respective European measure is applied on products based on their country of origin, favouring products from countries with stringent or comparable climate policies like in Europe proves the existence of a discriminatory effect to be fairly obvious. Since these countries are at least not in the “same situation”, i.e., different “conditions prevail”, differentiating between their imports would be only acceptable as long as the differential treatment would be based on objective factors related to these countries’ “situation”, and not to the national origin of the products concerned.³⁵

Another generally contested point is the required unequal treatment of developing countries in the light of the prohibition of unequal treatment under Article I. The principle of common but differentiated responsibilities which finds its roots in the 1992 Rio Earth Summit³⁶ and is incorporated in Article 3 of the UNFCCC, the Kyoto Protocol and now in the European provision at issue, ascribes the main responsibility for solving the climate problems of industrialized countries. It does not entirely exonerate the developing and emerging countries from their share of responsibility, yet also acknowledges their right to develop. Taking into account this principle when implementing the trade measure, i.e. treating imports from developing countries differently such as exempting these countries from the requirement to surrender emission allowances in order to import their like products, will unavoidably lead to prohibited unequal treatment under the Most-Favoured-Nation provision.³⁷

B. The Application of Article XX (g) GATT 1994

The panel would now see whether the import measure being challenged can be justified under Article XX GATT 1994. Though embodying the principle of free trade, the GATT considers the necessary pursuit of non-trade policy goals by providing a set of exceptions. Under these limited conditions, WTO members are permitted to act outside of their GATT obligations in order to pursue the designated policy. This exception clause in Article XX consists of an introductory clause and a list of specific exceptions, it states:

(Contd.) _____

Countries of Measures concerning Non-Product-Related Processes and Production Methods. (The Hague The Ministry of Foreign Affairs of The Netherlands, 2007), p. 25.

³⁴ “Where countries have ratified the international agreement referred to in Article 28 or countries or administrative entities are linked with the EU emissions 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.” See R. QUICK, *note 20 above*, p. 167. referring to Article 10 (c) of the Draft Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC, dated 10 Dec 2007, version 14.

³⁵ J. PAUWELYN, Working Paper 07/02, Nicholas Institute for Environmental Policy Solutions, Duke University, April 2007, available at <http://www.nicholas.duke.edu/institute/internationaltradelaw.pdf>.

³⁶ Principle 7 of the Rio Declaration provides the first formulation of the CBDR, and it states:

"In view of the different contributions to global environmental degradation, States have common but differentiated responsibilities. The developed countries acknowledge the responsibility that they bear in the international pursuit of sustainable development in view of the pressures their societies place on the global environment and of the technologies and financial resources they command."

³⁷ It should be noted however, that the different treatment of developing countries would be considered pardonable. WTO member already distinguish between developing countries in general and least developed who get better tariff and quota treatment. Article I has to be read with the Enabling Clause alongside, much as it has to be read alongside Article XXIV which also allows discriminatory treatment

“Subject to the requirement 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: [...] (b) necessary to protect human, animal or plant life or health; [...] (g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption,”

The analysis of Article XX is executed in two steps:³⁸ Firstly, it must be demonstrated that the European measure falls under one of the exemptions in Article XX, either (b) or (g). Secondly, the measure must be assessed in light of the introductory clause of Article XX - the so-called chapeau.³⁹ Since it is sufficient justification that the measure at hand falls under one of the exceptions, it is assumed that the EU in claiming justification will primarily invoke Article XX (g). The necessity requirement in exception (b) is not easily met, since only the reasonably available least-restrictive measure will pass the test, whereas the exception in (g) simply demands the measure to be “related to” the stated objective. Thus, the adjudicating body will only look at Article XX (b) if the EU measure would not fall within the ambit of Article XX (g).

1. The Relevant Case Law

The panels and the Appellate Body have progressively developed jurisprudence that seeks to address the compatibility of unilateral measures pursuing allegedly environmental objectives with the WTO rules. The following case summaries concentrate on those aspects that are instructive for the evaluation of the envisaged European trade measure.⁴⁰

(a) The US-Tuna and Tuna Products and the Canada – Unprocessed Herring and Salmon Case

In the GATT *US-Tuna and Tuna Products*⁴¹ case the US imposed an import prohibition on tuna and tuna products against Canada in response to Canada’s seizure of US fishing vessels in waters regarded by Canada being under its jurisdiction. The prohibition was lifted after the US and Canada agreed on access to the respective nautical-mile zone. Measures concerning the protection of tuna were not the subject of these negotiations. The panel declared the US measure as inconsistent with Article XI. Examining thereupon Article XX (g), it found that the import prohibition was not justified because the US did not impose equivalent restrictions on the domestic production and the measure was applicable to all kinds of tuna. The reasoning did not include an analysis of the motivation for the measure. This would have been desirable regarding the original cause of the prohibition, which seems to be more protectionist than environmental.

³⁸ Appellate Body Report, *US-Shrimp*, note 17 above, para 157.

³⁹ S. CHARNOVITZ, ‘Exploring the Environmental Exceptions in GATT Article XX’, 25 *Journal of Environmental Law*, (1991), p. 5.

⁴⁰ Pointing out the importance of the case law see e.g. J. DE CENDRA, 15 ‘Can Emissions Trading Schemes be Coupled with Border Tax Adjustments? An Analysis vis-à-vis WTO Law’, *Review of European Community & International Environmental Law* (2006), pp. 143; J. PAUWELYN, ‘US Federal Climate Policy and competitiveness Concerns: The Limits and Options of International Trade Law’, Nicholas Institute for Environmental Policy Solutions, Duke University, *Working Paper*, (2007), p. 33-41; C. VOIGT, 1 ‘WTO Law and International Emissions Trading: Is there Potential for Conflict?’, *Carbon and Climate Law Review* (2008), pp. 61; J. WERKSMANN, 8 ‘Greenhouse Gas Emissions Trading and the WTO’, *Review of European Community and International Environmental Law* (1999), p. 260.

⁴¹ Panel Report, *US-Tuna and Tuna Products, United States – Prohibition of Imports of Tuna and Tuna Products from Canada*, BISD. 29S/91, adopted on 22 February 1982.

In the GATT *Canada – Unprocessed Herring and Salmon*⁴² case, Canadian law prohibited the exportation of unprocessed salmon and herring. According to Canada, the export restrictions were part of a long-standing management program pursuing the conservation of fishery resources. The US claimed that the true purpose of the measure was the protection of the domestic fish processing industry and the preservation of jobs. The Panel held that the Canadian measure was not ‘primarily aimed at’ conserving salmon and herring and thus was not justified under Article XX (g). Decisive circumstances were e.g. that for other types of fish no export prohibition existed and only foreigners were prohibited to buy unprocessed herring and salmon, whereas domestic consumers were allowed to buy unlimited amounts, also of those underlying the export prohibition.⁴³

(b) The two Tuna/Dolphin Cases

The two *Tuna/Dolphin* disputes were the first to test the legitimacy of using environmentally-unfavourable foreign process and production methods as justification for trade restrictions. In the GATT *US-Tuna/Dolphin I*⁴⁴ case, the US banned imports of tuna from countries that allowed the fishermen to use nets that also caught dolphins.⁴⁵ The declared purpose, according to the US, was to protect dolphins in the Eastern Tropical Pacific Ocean from incidental mortality, and was therefore declared an environmental purpose. Mexico brought the case before the GATT. The core issue was whether a state is allowed to protect environmental goods outside its territory, e.g. to impose production requirements to be complied with from foreign manufacturers. The panel held that the measures were neither justified under Article XX (b) since they did not pass the necessity test, nor under the exemption in (g) since they were not “primarily aimed at” conservation of dolphins but at attempting to enforce domestic laws in another country. The panel ruled that the effective control of an exhaustible resource requires that both, production and consumption are subject to the country’s sovereignty; thus, Article XX (g) shall be meant as allowing trade measures that are primarily aimed at restrictions within the territory of the imposing country.⁴⁶ This case was heavily criticized because the panel dealt with the requirement of a “territorial nexus”, stating that all measures “outside the jurisdiction of the jurisprudence of the country imposing the measure” are excluded from the scope of Article XX (b) and (g).⁴⁷ The GATT *US-Tuna/Dolphin II* case was centred on a secondary US embargo against countries who re-exported tuna from nations under the US primary embargo. The case was brought by the European Economic Community and the Netherlands. Despite of the fact that the panel also in this case denied a justification under Article XX (g), it stated that the application of Article XX (g) is not restricted to resources located within the respective territories⁴⁸ as long as it does not coerce the policy of other states. Furthermore, it agreed with the reasoning of the panel in the *Canada-Unprocessed Herring/Salmon case*, on the understanding that the words “primarily aimed at” refer not only to the purpose of the measure but also to its effect on the conservation of the respective natural resource.⁴⁹ The panel then denied that the measure aimed primarily at the protection of dolphins because it first would have needed a change in policy in other countries concerning fishery methods. The measure at issue therefore was only effective if such changes are made: neither the

⁴² Panel Report, *Canada-Herring and Salmon, Canada -Measures affecting Exports of unprocessed Herring and Salmon*, adopted 22 March 1988, BISD. 35S/98.

⁴³ *Canada-Herring and Salmon*, note 35 above, para 4.7.

⁴⁴ Panel Report, *US – Tuna/Dolphin I*, note 24 above (unadopted) and Panel Report *US-Tuna/Dolphin II, United States – Restrictions on Imports of Tuna*, (unadopted), 33 ILM (1994).

⁴⁵ F. ORTINO, ‘GATT’, in D. BETHLEHEM, D. MC RAE, R. NEUFELD, I. VAN DAMME (eds), *Oxford Handbook of International Trade Law*, (Oxford 2008), p. 133.

⁴⁶ Panel Report, *US – Tuna/Dolphin I*, note 24 above, para 5.32.

⁴⁷ R. QUICK, note 14 above, p. 170.

⁴⁸ Panel Report, *Tuna/Dolphin II*, note 37 above, para 5.20.

⁴⁹ *US-Tuna/Dolphin II*, note 37 above, para 5.22.

indirect import prohibition nor the direct one contributed by itself to achieving the aim of dolphin-conservation. The very change in intermediate trade was not sufficient.⁵⁰

(c) The US-Reformulated Gasoline Case

Since the advent of the WTO, the most significant effort to reconcile the trade and environmental regimes has come from the newly created Appellate Body: in both, the *US-Gasoline* and the *US-Shrimp* case (see below) the Appellate Body interpreted Article XX (g) less restrictively, demonstrating increased sensitivity to environmental values.⁵¹ In the *US-Reformulated Gasoline*⁵² case, the first case decided after the establishment of the WTO, the US imposed a gasoline rule on foreign refiners wishing to export their products into the US territory which required stricter environmental standards than those applicable for US national refiners, namely to reformulate the gasoline. After the panel found the measure unjustifiable with Article XX (b), the case was appealed before the Appellate Body who decided the case on the basis of Article XX (g). It turned away from the more stringent panel decisions equating “related to” with “primarily aimed at” and stated that a “substantial relationship” between the measure at stake and the goal of conservation [of clean air] is sufficient.⁵³ Therefore, it found that the measure was ‘related to’ the conservation of exhaustible natural resources because the rules were aiming at scrutiny and monitoring of the level of compliance of refiners, importers and blenders. Without some baselines of that kind, scrutiny would not have been possible and the Gasoline rule’s objective of stabilizing and preserving further deterioration of the level of air pollution prevailing in 1990 would have been substantially frustrated. Given such a relationship between aim and measure, the baseline rules could not be seen as incidental or inadvertent.⁵⁴ It answered the question as to whether the measure was also successfully “made effective” in conjunction with restrictions on domestic production and consumption in the affirmative, because it was applicable for imported and domestic products. At the end, it however denied the justification under the introductory clause of Article XX (g): domestic producers had the choice of establishing their own 1990 baseline or relay on a statutory baseline, whereas foreign producers had to no option of establishing a facility-specific baseline. Therefore, the Appellate Body qualifies the measure of the US as unjustified discrimination and a disguised restriction of trade.⁵⁵

(d) The US-Shrimp Case

The Appellate Body’s *US-Shrimp*⁵⁶ decision overturned the jurisprudence on *US-Tuna/Dolphin* lending legitimacy to action against other nations because of their refusal to conform to the production processes unilaterally specified by a member of the WTO. It made clear that unilateral measures in the field of environment are not *per se* WTO inconsistent.⁵⁷ The US imposed a sales ban on all shrimp fished in a manner that results in the incidental deaths of sea turtles. Since turtles often swim together with shrimp, the US legislation requested from domestic and foreign fishermen alike wanting to export shrimp to the US market, to guarantee that they had caught them using so-called TEDs (Turtle excluding devices). Challenged before the WTO by India, Malaysia, Pakistan and Thailand, the US

⁵⁰ *US-Tuna/Dolphin II*, note 37 above, para 5.24.

⁵¹ D. BODANSKY, J. C. LAWRENCE, ‘Trade and Environment’, in D. BETHLEHEM, D. MC RAE, R. NEUFELD, I. VAN DAMME (eds), *Oxford Handbook of International Trade Law*, (Oxford: 2008), p. 516.

⁵² Appellate Body Report, *US-Gasoline, United States-Standards for Reformulated and Conventional Gasoline*, WT/DS2 and 4/AB/R, of 29 April 1996.

⁵³ Appellate Body Report, *US-Gasoline*, note 45 above, p. 19.

⁵⁴ Appellate Body Report, *US-Gasoline*, note 45 above, p. 19.

⁵⁵ Appellate Body Report, *US-Gasoline*, note 45 above, p 25-27.

⁵⁶ Appellate Body Report, *US-Shrimp*, note 17 above.

⁵⁷ M. MAVROIDIS, 34 ‘Trade and Environment after the Shrimp-Turtles Litigation’, *Journal of World Trade* (2000), p. 87.

authorities sought justification *inter alia* under Article XX (g). The Appellate Body found that sea turtles are an “exhaustible natural resource”, clarifying that the meaning of the term is not fixed, but must be interpreted in the light of the evolving rules of international law, including the principle of sustainable development, which the Preamble of the WTO Agreement explicitly recognizes.⁵⁸ Furthermore, it prescribed a series of requirements necessary for measures to fulfil the chapeau’s obligations. It basically clarified that “conditioning access to a members’s domestic market on whether exporting members comply with, or adopt, a policy or policies unilaterally prescribed by the importing member may, to some degree, be a common aspect of measures falling within the scope of one or another of the exceptions (a) to (j) of Article XX.”⁵⁹ With this, the existing uncertainty of whether such import restrictions are generally outlawed by the GATT was eventually resolved. By stating that the measure at hand was justifiable under Article XX (g), at least insofar as it was “*not disproportionately wide in its scope and reach in relation to the policy objective of the protection and conservation of sea turtles species*” and the “*means [we]re in principle reasonably related to the ends*”, the Appellate Body introduced a new interpretative test according to which the possibility of justifying a national measure under Article XX (g) ought to depend. It stated that it should not depend so much on the assessment that the measure is “primarily aimed” at the conservation of exhaustible natural resources, but rather on the evaluation that the measure is reasonably related to the ends. It however came to the conclusion that the measure was not justified by Article XX because it had a coercive effect on foreign countries’ policy without taking into account the different conditions prevailing there. Secondly, the US failed to negotiate a co-operative solution before implementing such unilateral measure. The US later on revised the measure and conditioned market access on the adoption of a programme comparable in effectiveness (and not essentially the same as required before) to that of the US. On compliance review, the Appellate Body found the revised US measure as justified under Article XX (g), since the US fulfilled the flexibility requirement.

(e) The EC – Asbestos and Brazil-Tyres Cases

In the WTO *EC-Asbestos*⁶⁰ case, France prohibited the import and sale of certain types of asbestos and asbestos products in France. It distinguished between asbestos-containing and asbestos-free construction material, allowing the sale of the latter and banning the sale of the former. Canada argued that the two products were like and therefore different treatment was not justified. This case was important in defining the requirement for a measure being “necessary” under Article XX (b) and the term “like product”. The Appellate Body held that the two products were unlike. According to the reasoning the process of production shall be part of the physical characteristics of a product. Physical characteristics, thus construed, become the dominant criterion when deciding whether products are like. A reasonable consumer knowing that one construction material contains asbestos and its negative health externalities will not treat the two materials as like products.⁶¹

In the most recent WTO *Brazil-Tyres*⁶² case, Brazil imposed an import prohibition on retreaded tyres and fines on importation, marketing, transportation, storage, keeping or warehousing of retreaded tyres. This was followed by a complaint raised by the European Communities. The Appellate Body found that the measure failed to fulfil the requirements of Article XX (b). It particularly determined in accordance with the precedent *US-Shrimp* case that the assessment of whether discrimination is arbitrary or unjustifiable should be made in the light of the objective of the measure. The effects of the discrimination are irrelevant.

⁵⁸ Appellate Body Report, *US-Shrimp*, note 17 above, p. 130-131.

⁵⁹ Appellate Body Report, *US-Shrimp*, note 17 above, para 121.

⁶⁰ Appellate Body Report, *EC – Asbestos*, note 26 above.

⁶¹ J. BHAGWATI, P. C. MAVROIDIS, ‘Is Action Against US Exports for Failure to Sign Kyoto Protocol WTO-Legal?’, 6 *World Trade Review*, (2007), p. 304.

⁶² Appellate Body Report, *Brazil-Tyres*, *Brazil-Measures affecting Imports of Retreaded Tyres*, WT/DS.3322007, para 225.

2. An Implied Jurisdictional Limitation of Application of Article XX GATT 1994?

There is no explicit and it seems, also no implicit jurisdictional limitation, in that Article XX of GATT cannot be invoked to protect societal values outside the territorial jurisdiction of the EU. Whereas the GATT Panels in *US – Tuna/Dolphin I (Mexico)* and *US – Tuna/Dolphin II (EEC)* stated that Article XX (b) and (g) cannot justify measures that pursue the protection of public health and environmental policy objectives outside the jurisdiction of the member enacting it⁶³, the Appellate Body in *US – Shrimp* held that in the specific circumstances of the case, there was at least a sufficient nexus between the migratory and endangered sea turtles and the US for the purposes of Article XX(g).⁶⁴ The Appellate Body therefore did not have to rule on whether Article XX contains jurisdictional limitations since the turtles migrate to and traverse waters subject to the jurisdiction of the US. Since the European measure at stake affects climate protection, i.e. the emission of greenhouse gases causes harms globally wherever it is emitted, it can be assumed that the “sufficient nexus” argumentation would be applicable. In order to establish a sufficient nexus, the EU would however be required to provide figures demonstrating a territorial effect or similar arguments in favour of such a nexus.⁶⁵

(a) An Exhaustible Natural Resource

It can be assumed that the European measure is concerned with the conservation of "exhaustible natural resources" within the meaning of Article XX(g). The drafting history of the GATT suggests that the term “exhaustible natural resource” should be primarily confined to non-living organisms such as petrol and minerals. Conversely, the Appellate Body in its report on *US-Shrimp* stated that Article XX(g) is *not* limited to the conservation of "mineral" or "non-living" natural resources. Referring to modern biological sciences it holds that living species, though in principle, capable of reproduction and, in that sense, "renewable", are in certain circumstances indeed susceptible of depletion, exhaustion and extinction, frequently because of human activities. Thus, living resources are just as "finite" as petroleum, iron or and other non-living resources.⁶⁶ It came to this conclusion on the basis of a dynamic-evolutionary⁶⁷ interpretation. The term has to be “*read by the treaty interpreter in the light of contemporary concerns of the community of nations about the protection and conservation of the environment and from the perspective embodied in the preamble of the WTO Agreement,*”⁶⁸ i.e. the term must be given a meaning in accordance with today’s perceptions. Regarding what has been qualified as “exhaustible natural resources” within the frame of a GATT/WTO dispute, the list ranges from dolphins⁶⁹ and turtles⁷⁰ to crude oil⁷¹. In the *US-Gasoline* case, the panel ruled that clean air is

⁶³ Panel Report, *US-Tuna/Dolphin I*, note 24 above, para 133.

⁶⁴ Appellate Body Report, *US-Shrimp*, note 17 above, paras 130-134.

⁶⁵ See R. QUICK, note 14 above, p. 171, criticizing that a direct effect on the territory taking the respective climate change mitigation action is difficult to establish since the EU itself continues to emit CO₂. The countries, subject to the trade measure might emit less CO₂ than the EU and could therefore argue that the EU’s overall emissions are greater than their own and therefore the EU could not establish a sufficient nexus.

⁶⁶ Appellate Body Report, *US-Shrimp*, note 17 above, para 128.

⁶⁷ Appellate Body Report, *US-Shrimp*, note 17 above, para 130.

⁶⁸ Appellate Body Report, *US-Shrimp*, note 17 above, para 129. The preamble of the WTO Agreement - which informs not only the GATT 1994, but also the other covered agreements - explicitly acknowledges "the objective of sustainable development": The Parties to this Agreement, recognizing that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development” (emphasis added).

⁶⁹ Panel Report *US-Tuna/Dolphin II*, note 37 above, para 5.13.

⁷⁰ Appellate Body Report, *US-Shrimp*, note 17 above, para 191 – 132.

⁷¹ Panel Report, *US-Taxes on Automobiles*, United States- Taxes on Automobiles, 33 ILM (1994), para 5.57.

also a resource since it has a value, is natural and exhaustible since it can be depleted.⁷² The fact that fresh air is renewable was not an objection.⁷³

The European Communities would argue that the introduced carbon “equalizing” measure aims at conserving and/or protecting our climate. The climate as such is just the *state* of the earth’s atmosphere. The atmosphere itself is the layer of gases surrounding the planet. Put simply, it ensures that the rays of the sun are not reverberated back into space. The atmosphere acts in a similar way as the roof of a greenhouse, letting in the visible light and absorbing the outgoing infra-red energy, keeping it warm inside.⁷⁴ Human activities are adding greenhouse gases to the atmosphere, which are enhancing the natural greenhouse effect and making the earth warmer. The European measure therefore would seek at preserving a specific balance of gases within the atmosphere. That the atmosphere has a value and is also natural should be undisputed. Furthermore, in view of the fact that recent acknowledgements made by the international community regarding the importance of concerted bilateral or multilateral action to protect living natural resources and the principles of an evolutionary interpretation were a key factor in acknowledging that Article XX (g) includes living resources, also the atmosphere should be within this scope. The meaning and purpose of Article XX (g) is to make trade restrictions possible in order to secure the natural basis on which life and humanity depends in the future. This objective, as well as the principle of sustainability, fights for a comprehensive understanding of the term ‘exhaustible’ and to apply this exception also to the protection of global commons in the narrower sense - such as for the ozone layer and the earth’s atmosphere. The disturbance of the natural balance of the earth’s atmosphere by anthropogenic emission of greenhouse gases increases the natural greenhouse effect and leads to global warming. In alliance with the panel’s viewpoint concerning clean air, the fact that the atmosphere can be brought into imbalance makes it exhaustible. A certain level of endangerment is not a necessary requirement: the general statement of the panel in the *US-Gasoline* case⁷⁵ that clean air can be depleted leads to the assumption that a potential danger or a tendency towards exhaustibility is sufficient. A reference to scientific data will be however necessary, such as the IPCC report,⁷⁶ to show that the gases within the atmosphere are not actually in equilibrium.⁷⁷ Finally, it could be argued that the intention is to conserve also certain plant and animal species that may disappear because of global warming.⁷⁸

(b) Measure Must Be Relating to the Pursued Objective

With respect to the requirement that the measure must be related to the conservation of the exhaustible resource, the *US-Gasoline* as well as the *US-Shrimp* case provide guidance for interpretation. The Appellate Body in the *US – Gasoline* case turned away from the more stringent panel decisions equating “related to” with “primarily aimed at” and made an interpretation on the basis of the Vienna Convention of the Law of the Treaties (VCLT). On this basis, it stated that a “substantial relationship” between the measure at stake and the goal of conservation is sufficient.⁷⁹ In the *US – Shrimp* case report it held that the ‘relating to’ requirement implies that there is a national connection between a measure and the conservation of the exhaustible natural resource, and found that the protected sea

⁷² Panel Report, *US-Gasoline*, note 45 above, para 6.37.

⁷³ Panel Report, *US-Gasoline*, note 45 above, para 6.37.

⁷⁴ European Commission, “What is climate change?”. Available: <http://ec.europa.eu>.

⁷⁵ Panel Report *US-Gasoline*, note 45 above, para 3.59.

⁷⁶ Contribution of Working Groups I, II and III to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change, R. K. PACHAURI, A. REISINGER (eds), IPCC, Geneva.

⁷⁷ P. MAVROIDIS, ‘Trade and Environment after the Shrimp-Turtles Litigation’, 34 *Journal of World Trade*, (2000), p. 86.

⁷⁸ See e.g. UNEP/WTO Report, note 4 above, p. 108.

⁷⁹ Appellate Body Report, *US-Gasoline*, note 45 above, p. 19.

turtles had “sufficient nexus” to the US.⁸⁰ This means that even measures that do not primarily aim at the conservation of the resource can be justified through recourse of Article XX (g), to the extent that they have a rational connection with this objective.⁸¹ Therefore, the aim of resource conservation does not have to be the main aim but also must not be subordinated to the other goals. Thus, it is acceptable that several aims, even protectionist aims are of equal importance.⁸² These circumstances will be of relevance not before examining the requirements of the introductory clause of Article XX. Therefore, it has to be assessed whether the implementation of border measures, namely the allowance requirement for imports in the EU, have a rational and concrete connection to the conservation of the balance of greenhouse gases in our atmosphere. Objectively, the measure has to be suited to achieve the aim; subjectively it has to be aimed at achieving the aim. The imposition of an allowance requirement is objectively suited to serve the aim and subjectively aimed at achieving it: The political debate (but also the proposal for the revised ETS Directive) suggests three main purposes: to level the playing field for European industries, to avoid carbon leakage and thereby avoiding also that the European efforts are diminished and eventually, to provide economic incentive for other countries to take comparable climate change action. It cannot be ignored that the announced measures at least *inter alia* aims at promoting “fairness” and therefore obviously pursues protectionist purposes. Particularly with view at the requirements a trade measure has to fulfill under the GATT, the name of the announced measure, the “Future Allowance Import Requirement” (‘FAIR’⁸³) has to be seen as somewhat bizarre. The question therefore is whether a justification can be denied in a case where environmental protection is only one of several goals or even a secondary objective. In the *US-Tuna/Dolphin II* case the panel found that a measure by itself alone must be able to achieve the pursued aim rather than requiring firstly a policy change in the concerned country.⁸⁴ Thus, it implicitly criticized that the embargos were not suited to achieve their aim – the protection of dolphins. By stating that not only the purpose but also the effects of the measure have to be considered the panel clarified, that a measure is “not related to” the conservation objective if it is *a priori* not able to achieve the aim.⁸⁵ Since the problem of determining causation is always difficult the Appellate Body in the *US-Gasoline* case held that an “*empirical effects test*” is not required for the availability of the Article XX (g) exception.⁸⁶ Only if the measure has no positive effect on conservation goals a justification under Article XX (g) would be excluded. Therefore, the abstract possibility of resource conservation seems to be sufficient. The application of similar cost on international competitors from outside the EU fulfils these criteria. Doubts⁸⁷, that border measures actually might only carry insufficient leverage to influence foreign governments to adopt comparable greenhouse gas regulatory programs are therefore irrelevant. Requiring further that the measure must not only incidentally or inadvertently aim at the conservation⁸⁸, the Appellate Body asks for a subjective component. At this point of the investigation it could be argued that the extension of the EU ETS *inter alia* serves as a means of convincing foreign supplier countries to adopt national regulatory programs comparable to the EU climate change regulation. According to the reasoning in the *US-Shrimp* case this would be

⁸⁰ Appellate Body Report, *US-Shrimp*, note 17 above, paras 130-134.

⁸¹ P. S. MAVROIDIS, *The General Agreement on Tariffs and Trade. A Commentary*, (Oxford: University Press 2005), p. 195.

⁸² A. THIEDEMANN, *WTO und Umwelt*, (Münster: LIT Verlag, 2005), p. 194.

⁸³ See R. QUICK, note 14 above, p. 166, referring to Article 10 (c) of the Draft Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC, dated 10 Dec 2007, version 14.

⁸⁴ Panel Report, *US-Tuna/Dolphin II*, note 37 above, para 5.23.

⁸⁵ Panel Report, *US-Tuna-Dolphin II*, note 37 above, para 5.22, 526.

⁸⁶ Appellate Body Report, *US-Gasoline*, note 45 above, p. 21.

⁸⁷ See T. HOUSER, R. BRADLEY, B. CHILDS, J. WERKSMANN, R. HEILMAYR, ‘Leveling the Carbon Playing Field: International Competition and US Climate Policy Design’, (2008), p. 76. Available: <http://www.piie.com>.

⁸⁸ Appellate Body Report, *US-Gasoline*, note 45 above, para 19.

qualified as an environmental motivation.⁸⁹ The aim to protect the European industry could stand equally beside. The actual effectiveness would be irrelevant. Applying this logic, it has to be assumed that the European Communities will be successful in circumventing this requirement.

(c) Even-Handedness

The measure must also be made effective in conjunction with restrictions on domestic production or consumption, i.e. the intervening State when imposing trade restrictions must also adopt domestic measures aimed at the same objective. An indicator on how to assess this requirement is again found in the *US-Gasoline* case where the Appellate Body stated, that “*even-handedness in the imposition of restrictions*” is required.⁹⁰ The Appellate Body qualified this interpretation, adding that this standard does not require ‘identical’ treatment for imported and domestic products.⁹¹ This interpretation remained in the *US-Shrimps* case.⁹² Another question was whether the domestic restrictions must take place at the same time. It seems to be decisive that comparable domestic restrictions already exist when the restriction on imports is objected to.⁹³ The extension of the EU ETS on imported goods under the same conditions as for the European industry that is subject to the scheme would be basically an even-handed approach. If an extra amount of free allowances would be issued to the European exporters, the EU would not be even-handed at least with respect to domestic production. Since even-handedness on production or consumption is sufficient, it could be argued that at least those goods destined for domestic consumption are treated equally. The EU ETS is also already operating. Since the Appellate Body in the *US-Gasoline* case also clarified that the term “made effective” is not tantamount with an “effects test” any consideration on the actual effects of such an approach became obsolete.

3. The Introductory Provisions of Article XX of GATT 1994

Recalling the wording of the introductory clause, the measure, now that it is entitled to “provisional justification” must meet also the three standards regarding the factual application of the measure at issue established in the introductory clause⁹⁴: first, it must be no ‘arbitrary’ discrimination between countries where the same conditions prevail; second, there must be no ‘unjustifiable’ discrimination; and third, there must be no ‘disguised restriction on international trade’. Purpose and object of the introductory clause is generally the prevention of abuse of the exceptions. The legal analysis under the chapeau will be the most crucial one for the European measure. It relates to the general nature and extent of the duty of WTO members to pursue international cooperation to resolve a common concern in the mutual interest; furthermore, the necessary flexibility of trade restricting measures.⁹⁵ The analysis will address all concerns mentioned by the parties in the *US-Shrimp* case in detail since it seems that this case will play a decisive role in a possible future dispute before the WTO. The close scrutiny of the EU measure will eventually disclose that it fails to comply with the chapeau of Article XX.

⁸⁹ Similarly, see Appellate Body Report, *US-Shrimp*, note 17 above, para 138.

⁹⁰ Appellate Body Report, *US-Gasoline*, note 45 above, p. 21.

⁹¹ Appellate Body Report, *US-Gasoline*, note 45 above, p. 19 - 21.

⁹² Appellate Body Report, *US-Shrimps*, note 17 above, paras 143 ff.

⁹³ Appellate Body, *US-Shrimps*, note 17 above, paras 286 ff.

⁹⁴ Appellate Body Report, *US-Gasoline*, note 45 above, p. 22; Appellate Body Report, *US-Shrimp*, note 17 above, para 160.

⁹⁵ Appellate Body Report, *Brazil-Tyres*, note 54 above, para 215.

(a) Unjustifiable or Arbitrary Discrimination

It has to be scrutinized first whether the announced EU measure would be applied in a manner constituting unjustifiable discrimination between countries where the same conditions prevail. The concept of discrimination is not synonymous with the non-discrimination clause contained in Article I of GATT: any measure that singles out a specific country as opposed to all other countries, by definition amounts to discrimination against that country, and hence constitutes a violation of the Most-Favoured-Nation principle.⁹⁶ Therefore, for the purpose of Article XX, a certain degree of discrimination is acceptable, on condition that this discrimination is not arbitrary or unjustifiable.⁹⁷ Making recourse to the *US-Shrimp* case the most conspicuous flaw in that measure's application related to its intended and actual coercive effect on the specific policy decisions made by foreign governments. The economic embargo required all other exporting members to adopt *essentially the same* policy as that applied to, and enforced on, US domestic shrimp trawlers.⁹⁸ Article XX does not allow such inflexibility. According to the Appellate Body, the chapeau of Article XX only permits a measure which requires only "*comparable effectiveness*".⁹⁹ The language in the revised ETS Directive shows that it must be written with the WTO legality in mind. According to the expected design of the ETS extension scheme, criterion for evaluating whether imports are subject to the allowance requirement or not, is whether in the country of origin a "comparable" climate change policy is in place. The language of the European provision for border measures does not mention any effectiveness criteria. This is reasonable since the effectiveness of the EU ETS to reduce greenhouse gases and/or conserve the earth's atmosphere remains to be proven.¹⁰⁰

Another complaint¹⁰¹ eventually referred to the fact that the US engaged in negotiations on these issues with certain Caribbean countries though, but not with others, including the complainants. Not instigating a "good faith effort", the US had failed to undertake the necessary "serious across-the-board negotiations" with the other members. Such a duty for international cooperation follows from the character of transnational environmental problems that requires cooperative and consensual solutions. Since the chapeau calls for the less restrictive measure; the cooperation with just a few countries has furthermore been seen by the Appellate Body as contrary to this requirement. In view of the leading role of the EU in international climate change negotiations and the imminent CoP 15 in Copenhagen, at least the effort for an international agreement is not in doubt.¹⁰² A conclusion is not required. Basically, it seems to be sufficient that the EU is working with other partner countries in the UNFCCC towards a post-2012 climate agreement, which will address adaptation as well as mitigation.

A third requirement is that the EU measure allows for an inquiry into the appropriateness of the European regulatory program for the conditions prevailing in the exporting countries. In the *US-Shrimp* case it has been criticized that the US measure prohibited imports of shrimp caught using TEDs if they are from uncertified countries, even when those shrimp were caught using methods identical to those employed by the US¹⁰³. Taking into account also the reasoning in the *Brazil-Tyres*

⁹⁶ J. KLABBERS, 'Jurisprudence in International Trade Law. Article XX of GATT', 26 *Journal of World Trade Law* (1992), p. 90.

⁹⁷ J. KLABBERS, *note 87 above*.

⁹⁸ Appellate Body Report, *US - Shrimp*, *note 17 above*, paras 150, 164.

⁹⁹ Appellate Body Report, *US-Shrimp*, *note 17 above*, para 143.

¹⁰⁰ House of Lords EU Committee, 'The Revision of the EU's Emissions Trading System,' 33rd Report of Session 2007–08, p. 114, 149, available: <http://www.publications.parliament.uk/pa/ld200708/ldselect/ldcom/197/197.pdf>.

¹⁰¹ Another point that led to the assumption of discrimination in the *US-Shrimp* case was different transitional periods: because of a court decision, the complainants only had four months in which to implement the rules, whereas Caribbean countries had three years, see Appellate Body Report, *US-Shrimp*, *note 17 above*, para 173.

¹⁰² The Commission's proposals in this context are set out in the Communication entitled "Towards a comprehensive climate change agreement in Copenhagen", see COM (2009) 39, 28.1.2009.

¹⁰³ S. LESTER, B. MERCURIO, *World Trade Law*, (Oxford Hart Publishing 2008), p. 414.

case, where the Appellate Body stated that the discrimination must not go against the environmental objective¹⁰⁴, the point of the analysis is reached where the EU measure will fail to meet the requirements to be justified: First of all, the allowance requirement is linked to the country of origin. Therefore, goods produced using clean energy will nevertheless be subject to the extension of the EU ETS solely because they have been produced in manufactories in countries that have not ratified the Kyoto successor Treaty, namely the US. The resulting situation obviously goes against the declared policy objective of protecting the environment, particularly the conservation of the earth's atmosphere. The affected producer would have no incentive to reduce their emissions. Furthermore, the provision in the revised ETS Directive allows for a higher amount of free allowances for energy-intensive industries which are determined to be exposed to significant risk of carbon leakage. Additionally, not all allowances will be auctioned within the EU from 2013 on. Allocating allowances free of charge leads to market distortions against importers that would not be justified by an environmental purpose: these allowances could only be used to enable domestic production and could not be used for imports.¹⁰⁵ The regulatory burden for the European industry would be lowered to the detriment of foreign firms that will have to pay for the respective amount of allowances in any case.

Finally, procedural shortcomings have been found to cause arbitrary discrimination: In the *US – Shrimp* case, the Appellate Body qualified procedural shortcomings such as a lack of flexibility, transparency and verifiability of the proceedings as unforeseeable and uncontrollable and therefore as “arbitrary” discriminations.¹⁰⁶ Moreover, the fact that the operating details were elaborated without foreign government participation led in the *US-Shrimp* case to the assumption that the chapeau was violated. These criteria will have to be taken into account when shaping the European trade measure.

(b) Disguised Restriction on Trade

Finally, the measure will be considered being a disguised restriction on international trade. Its design, architecture and the structure reveal that it does not pursue the legitimate policy objective on which the provisional justification was based, but in fact, pursues protectionist objectives.¹⁰⁷ In the *tuna from Canada* case, the panel held that the measure at stake was not a disguised restriction since the US made it public.¹⁰⁸ Whereas the Appellate Body in the *US-Gasoline* case later disagreed and held that a public announcement is not a sufficient criteria to fulfill the requirements of a non-disguised restriction,¹⁰⁹ the panel in the *EC-Asbestos* case again put emphasis on the usage of the term “disguised”. It however stated that “disguise” contains an intention,¹¹⁰ i.e. a measure that is formally legitimate but contains a protectionist intention qualifies as a disguised one. In sum, there is the requirement of a public announcement, and it also must not be a protectionist motivation hidden behind environmental intentions. With regards to the design of the measure at issue clear indicators for

¹⁰⁴ Appellate Body Report, *Brazil-Tyres*, note 54 above.

¹⁰⁵ Referring to the US Boxer Amendment to Liebermann-Warner-Climate Security Act of 2008 which establishes a cap-and-trade program for greenhouse gas emissions in the US (Available: <http://thomas.loc.gov>). Aside from distributing allowances freely for specific US industries, an additional one-quarter of the total allowances would be distributed without charge in the early years. In detail see G. C. HUFBAUER, S. CHARNOVITZ, J. KIM, *Global Warming and the World Trade System*, (Washington, Peterson Institute for International Economics, 2009), p. 86.

¹⁰⁶ Appellate Body Report, *US-Shrimps*, note 17 above.

¹⁰⁷ Panel Report, *EC-Asbestos*, note 25 above, paras 8.236, 8.238; Panel Report, *US-Shrimp, United States-Import Prohibitions of Certain Shrimp and Shrimp Products*, WT/DS58/R, para 5.143.

¹⁰⁸ Panel Report, *Tuna Canada*, note 34 above, para 4.8; criticized by J. KLABBERS, note 87 above, p. 91; J. H. JACKSON, *World Trade and the Law of the GATT. A Legal Analysis of the General Agreement on Tariffs and Trade*, (Indianapolis: Bobbs-Merrill Company 1969); E. U. PETERSMANN, ‘International Trade Law and International Environmental Law – Prevention and Settlement of International Disputes in GATT’, 27 *Journal of World Trade* (1993), p. 76.

¹⁰⁹ Appellate Body, *US-Gasoline*, note 45 above, p. 24.

¹¹⁰ Panel Report, *EC-Asbestos*, note 25 above, para 8.236.

a protectionist motivation are not deniable. If the target would really be to avoid carbon leakage the environmental motivation would be superior. Conversely, it speaks for a competitive motivation if the measure targets avoiding increasing costs of European producers. First of all the possibility that carbon-intensive industries could get additional free allowances speaks against an environmental objective, since it explicitly aims at a financial relief of the European industry and even reduces the cost of carbon emissions. Moreover, the fact that only those imported goods are covered that are produced by energy-intensive industries which are exposed to significant risk of carbon leakage, i.e. whose cost of production in the EU is affected by the EU ETS operates against an environmental purpose.¹¹¹ A further indicator for a protectionist motivation would be a financial gain for the European industry.¹¹² Considering the reasoning of the Appellate Body in the *US-Shrimp* case where the import restriction has been seen as being designed in order to change policies in foreign countries, at least one argument speaks in favour of an environmentally motivated action: the application related to the country of origin could demonstrate that the measure is concerned with effectively influencing WTO members to adopt essentially the same comprehensive regulatory regime as that applied by the EU. Nevertheless, in the overall picture it becomes apparent that the measure, even promoting the adoption of climate change mitigation measures, primarily aims at levelling the competitive playing field for the European industries. Against this background the (even unavoidable) acronym 'FAIR' but also the decision to chose a name like "Future Allowance Import Requirement" is positively grotesque since the goal is first of all to prove an intention what requires to take into consideration all circumstances, and secondly, to prove the very opposite.

Finally, with respect to the current development in the US, namely the "American Clean Energy and Security Act" the House passed currently, it does not seem unlikely that the US will establish a climate change mitigation scheme "comparable" to the EU, since the Act provides *inter alia* for a cap-and-trade scheme that sets a limit on the overall emissions and furthermore assuming. Assuming further, that the developing countries will not be target of the envisaged trade measure the question arises whether the actual purpose of the measure is simply to win the support of the European industry.

IV. Conclusion

The language chosen in Directive 2009/29/EC concerning the envisaged measures demonstrates that their WTO legality, particularly the case law dealing with the requirements of the introductory clause of Article XX of GATT 1994 has been taken into consideration. A violation of basic GATT principles seems to be expected. The EU seems to prepare justification under Article XX. Although unilateral measures linked to the production process used in foreign countries are not *per se* prohibited, their legality depends on how these policies are designed. Crucial point is that the protection of domestic producers from foreign competition is not recognized as a legitimate policy objective under WTO law. For the time being, it does not seem that the EU will be able to credibly articulate that the measure is designed to achieve greenhouse gas reductions. Even though the *US-Shrimp* case will be decisive for determining the legality of the envisaged measure and the EU could revise the existing incriminating features, it has to be taken into consideration that climate change is an issue far more complex than the protection of turtles. Therefore, it is nevertheless not predictable how the adjudicating bodies will decide the case, particularly since trade in carbon-intensive goods is by far larger than trade in shrimp. It is also worth recalling that in the *US-Shrimp* case the US was trying to protect the environment and not its producers (at least as a first order objective).¹¹³

¹¹¹ Similar argumentation concerning the regulation in the Boxer Amendment to Lieberman-Warner Climate Security Act, see G. C. HUFBAUER, S. CHARNOVITZ, J. KIM, *Global Warming and the World Trade System*, (Washington, Peterson Institute for International Economics, 2009), p. 87.

¹¹² Panel Report, *US-Shrimp*, note 97 above, para 5.143.

¹¹³ A. COSBEY, 'Border Carbon Adjustment, Trade and Climate Change Seminar', Copenhagen June 2008, *IISD, German Marshall Fund of the United States*, p. 7, available: http://www.iisd.org/pdf/2008/cph_trade_climate_border_carbon.pdf.

Additionally, reasonable concerns related to the ability of the WTO adjudicating bodies but also regards the danger of a global ‘arms raise’ with trade measures come into play. First of all, it is rather questionable that the WTO as a non-democratic body could come in the position to be the last instance to decide about legality or illegality of a major country’s legislation.¹¹⁴ Moreover, the political character of its interpretations enhances legal uncertainty and unpredictability since changing political preferences of the changing membership of the panels and the Appellate Body may be reflected in their legal findings.¹¹⁵ Moreover, the task of reconciling free trade and (allegedly) environmental protection is a work in progress and therefore already not predictable.

Eventually, apprehensions are not out of place that the implementation of trade measures will not be a single action of one country, but lead to a tit-for-tat situation. The view at the current US legislation and also at draft proposals in e.g. Australia and Canada point in that direction. In June 2009 the House of Representatives passed the American Clean Energy and Security Act (ACES).¹¹⁶ The ACES Act calls *inter alia* for an economy-wide greenhouse gas cap-and-trade system and various complementary greenhouse gas reduction measures. In its Sec. 766 it provides for the implementation of an ‘international reserve allowance’ regime. Under this scheme importers might also have to purchase special allowances to cover the emissions associated with their imports under special conditions.¹¹⁷ It has to be noted that the current considerations carry the risk of sparking damaging trade wars, ultimately hurting exports of those countries that implement border measures, too.

¹¹⁴ Similar F. JEFFREY, ‘Global Environment and Trade Policy.’ *Discussion Paper 09-01, Belfer Center for Science and International Affairs, Harvard Kennedy School*, April 2009. Available: <http://belfercenter.ksg.harvard.edu>.

¹¹⁵ C. VOIGT, ‘WTO Law and International Emissions Trading: Is There Potential for Conflict?’, 1 *Carbon and Climate Law Review* (2008), p. 64.

¹¹⁶ Introduced by U.S. House Energy and Commerce Committee Chairman Henry Waxman (D-CA) and House Energy and Environment Subcommittee Chairman Edward Markey (D-MA), H.R. 2454. Full text available at: http://energycommerce.house.gov/Press_111/20090515/hr2454.pdf. (to become law, a similar bill must now however pass the US Senate.).

¹¹⁷ Products from least developed countries and countries responsible for less than a half percent of world GHG emissions would however be exempted. This provisions differ from those drafted earlier in a bill that failed on the Senate floor in 2008: The Boxer Amendment to the Lieberman-Warner Climate Security Act of 2008 bill laid out ‘comparable action’ that countries could take in order to avoid carbon import permits, whereas the ACES Act would require that countries undertake more stringent greenhouse gas reduction commitments, sign onto sectoral agreements with the U.S. or have lower greenhouse gas intensity in a sector to avoid the border measures.

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