

# WTO Compatibility of « Carbon Leakage Measures »

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# Two Responses To « Carbon Leakage » :

## 1. Allowance requirement extended to imports

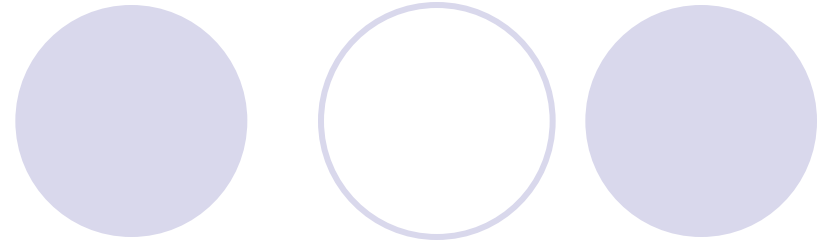
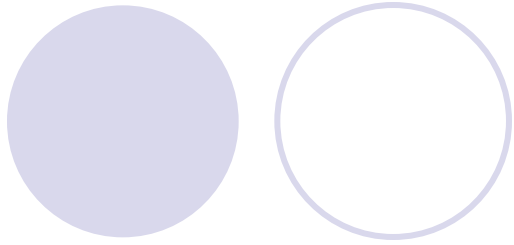
- US, Waxman-Markey: « International Reserve Allowance Program » (determination in 2018, application in 2020)
- EU, Directive 2009/29/EC: « Carbon Equalisation System » (June 2010, Commission Report)

## 2. Free allowances or rebates

- US: 100% rebate until 2025; phased out by 2035 (list: June 2011)
- EU: 100% free allowances (no explicit phase out) (list: Dec. 2009)
- Australia: « Emissions-Intensive Trade-Exposed Assistance Program »

# Allowance requirement for imports

- Questions of Legal Classification:
  - « charge » or « regulation »?
  - « product » or « producer »?
  - « internal » or « border »?
- Substantive Tests:
  - National treatment
  - Most-favored nation
  - Environmental exception



**I.**

# **Questions of legal classification**

1. Is allowance requirement a « charge » or a « regulation »?

- WTO prefers « charges » (import tariffs, border tax adjustment)
- Cap-and trade is novelty in between « tax » and « regulation »
- Is allowance requirement a « payment » to « government » or a « licence » available on the private market?
- If pool is unlimited: « charge » on imports?

## 2. Is allowance requirement applied to « products » or « producers »

- WTO prefers « product » measures
- Only « product » or « consumption » measures can be imposed also on imports (VAT v. income tax)
- Cap-and-trade is novelty: imposed on « installations » during « production » but for « consumption » of energy/carbon and aimed at price effect on « products »

### 3. Is allowance requirement triggered by « internal » factor or « border » measure on « importation »

- WTO prefers application of « internal » measures to imports (e.g. VAT or asbestos ban) **over** purely « border » measures
- Allowance requirement for imports is based on « foreign » emissions and « importation » not internal sale or internal factor (China – Autoparts)
- Only border charge, not border regulation is subject to « border tax adjustment »

| DOMESTIC MARKET →<br><br>IMPORTS ↓        |                            | Domestic Measure is a <u>CHARGE</u>                            |  | Domestic Measure is a <u>REGULATION</u>            |   |
|---|----------------------------|--|--|--|---|
|   |                            | <u>Product charge</u>  | <u>Producer charge</u>   | <u>Product regulation</u>                          | <u>Producer regulation</u>  |
| Measure on Imports is a <u>CHARGE</u>     | <u>Border charge</u>       | “Equivalent” Border Tax Adjustment Is permissible Art. II:2(a) | No Border Tax Adjustment (BTA) Is Permissible<br>Border charge is subject to “tariff ceiling”<br>Art. II:1 |  |   |
|   | <u>Internal charge</u>     | Non-discrimination Art. III:2                                  | No BTA permissible Art. III:2  | Non-discrimination Art. III:4                      | No BTA permissible Art. III:2   |
| Measure on Imports is a <u>REGULATION</u> | <u>Border regulation</u>   | N/A  |  | Prohibited Quantitative Import Restriction Art. XI | No Border Adjustment Permissible;<br>Prohibited Quantitative Import Restriction Art. XI |
|   | <u>Internal regulation</u> |  |  | Non-discrimination Art. III:4                      |   |



# US Waxman-Markey “International Reserve Allowance”

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# French Carbon Tax on Imports

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|---|----------------------------|--|--|--|--|
|   |                            | <u>Product charge</u>  | <u>Producer charge</u>   | <u>Product regulation</u>                          | <u>Producer regulation</u>   |
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|   | <u>Internal regulation</u> |  |  | Non-discrimination Art. III:4                      |  |



## **II.**

# **Substantive tests**

# 1. National treatment

- Are imports treated less favorably than like domestic products?
- Is, for example, steel with different carbon footprints “like product”?
- Is differential treatment related to “national origin”?
- Actual footprint v. sector average v. best-available technology
- How to account for domestic rebates?

## 2. Most-Favoured Nation

- US full exemption for:
  - Post-Kyoto parties with cuts “as stringent”
  - Sectoral agreement
  - GHG intensity equal or below US
  - Least-developed countries
  - Less than 0.5% world emissions & 5% of US imports
- Fewer allowances based on climate efforts in country of origin

### 3. Environmental Exception

- SUBSTANCE

“related to the conservation of exhaustible natural resources”

“necessary to protect ... life or health”

- APPLICATION

no “arbitrary or unjustifiable discrimination”

no “disguised restriction on international trade”

# Substance of border measure: Environment or health link?

- Earth's atmosphere (global commons)
- All life and health on earth (global commons)
- Related to / Necessary?
  - Not if multilateral deal by 2018
  - Carbon leakage v. competition (e.g. trigger of 85%?)
  - Less trade restrictive alternatives?
  - Individual carbon footprint v. sector average?

# Application of border measure: Non-discriminatory?

- Prior negotiations with other countries & due process?
- Takes account of local conditions v. imposing own standards?
  - cuts “as stringent” as US (not all post-Kyoto parties!)
  - same or lower GHG intensity as US
- Country distinctions based on environmental grounds?
  - exclusion of least-developed countries
  - less than 0.5% of world emissions and 5% of US imports



# Conclusion

- With cap-and-trade, core questions of legal classification remain unanswered
- Recent case law: US proposal likely inconsistent with GATT principles on border measures (tariffs – QR) and MFN
- **But** the environmental exception may justify these inconsistencies
- Carbon leakage, not competitiveness/trade
- Carefully distinguish between countries