2

Overview of Applicable World Trade Organization Rules

Under the World Trade Organization (WTO), countries have great flexibility in adopting environmental regulations within their territories, but the same discretion does not apply to environment-related trade or domestic measures with transborder economic effects. Accordingly, trade and domestic measures—whether adopted to meet multilateral environmental agreement commitments or to carry out domestic policies—have the potential to conflict with WTO rules. Moreover, when greenhouse gas trade measures are mixed with mechanisms designed to alleviate the burden of emission controls on domestic firms, the possibility arises of multiple collisions with WTO law. This chapter reviews the WTO and General Agreement on Tariffs and Trade (GATT) articles that might be cited in potential disputes over the greenhouse gas trade measures now favored in congressional bills. The legal texts of key GATT articles and short summaries on environmental aspects of other WTO agreements are found in tables 2.1 and 2.2, respectively. Appendix C provides summaries of several environmental dispute cases that have arisen within the multilateral trading system.

Several GATT provisions might have a bearing on environmental trade measures. However, since they were drafted long before climate change was on the horizon, their ultimate application will depend either on negotiated clarifications (e.g., a new Code of Good WTO Practice on Greenhouse Gas Emissions Controls) or on WTO Appellate Body decisions when one member's environmental controls are contested by other members. The case law does not create a landscape of "anything goes," provided only that the measure purports to address climate change. Hence, US emission controls, based either on carbon taxes or on cap-and-trade systems, may

Table 2.1 Articles applicable to environmental issues in the General Agreements on Tariffs and Trade (GATT) and on Trade in Services (GATS)

Article	Text language
GATT Article I:1 General Most Favored Nation Treatment	"1. With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties...."
GATT Article II:1 (a), (b), and 2(a) Schedules of Concessions	"1. (a) Each contracting party shall accord to the commerce of the other contracting parties treatment no less favourable than that provided for in the appropriate Part of the appropriate Schedule annexed to this Agreement. (b) The products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties, shall, on their importation into the territory to which the Schedule relates, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those set forth and provided therein. Such products shall also be exempt from all other duties or charges of any kind imposed on or in connection with the importation in excess of those imposed on the date of this Agreement or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date. 2. Nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product: (a) a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part...."
GATT Article III:1, 2, and 4 National Treatment on Internal Taxation and Regulation	"1. The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production. 2. The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1. (See also the Ad Note.)

Table 2.1 Articles applicable to environmental issues in the General Agreements on Tariffs and Trade (GATT) and on Trade in Services (GATS) *(continued)*

	4. The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product...."
GATT Article XI:1 and 2(a), (b), and (c) General Elimination of Quantitative Restrictions	"1. No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party. 2. The provisions of paragraph 1 of this Article shall not extend to the following: (a) Export prohibitions or restrictions temporarily applied to prevent or relieve critical shortages of foodstuffs or other products essential to the exporting contracting party; (b) Import and export prohibitions or restrictions necessary to the application of standards or regulations for the classification, grading or marketing of commodities in international trade; (c) Import restrictions on any agricultural or fisheries product, imported in any form, necessary to the enforcement of governmental measures which operate...."
GATT Article XX:(b) and (g) General Exceptions	"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;...."
GATS Article XIV: General Exceptions	"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 like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures; "...(b) necessary to protect human, animal or plant life or health;...."

Source: World Trade Organization, www.wto.org (accessed on January 12, 2009).

Table 2.2 Environmental aspects of other WTO agreements

Agreement	Contents
Agreement on Technical Barriers to Trade (TBT)	The TBT agreement supervises the application of governmental regulations and voluntary standards to imported products. Such measures are not to be more trade restrictive than necessary to fulfill a legitimate objective. The agreement lists the protection of the environment as a legitimate objective. In addition, the agreement requires that regulations be based on international standards except when such standards would be an ineffective or inappropriate means for the fulfillment of the legitimate objective pursued. Another part of the TBT agreement supervises conformity assessment practices. (The TBT agreement does not apply to SPS measures.)
Agreement on the Application of Sanitary and Phytosanitary Measures (SPS)	The SPS agreement supervises measures aimed at protecting humans, animals, or plants (inside the importing country) from listed risks, mainly food safety and shielding animals and plants from diseases and insect pests. A WTO member government is permitted to set its own appropriate level of health protection subject to a requirement on internal consistency unless different levels of protection are arbitrary and lead to a disguised restriction on trade. The measure that a government proposes to use to achieve its level of protection is subject to several disciplines, including that the measure not be more trade restrictive than necessary to achieve the chosen level of health protection and that the measure be based on scientific principles. Another discipline provides that an SPS measure applying to imports has to be based on a risk assessment that may include ecological and environmental conditions.
Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)	The TRIPS agreement requires that nationals of WTO member countries be accorded the intellectual property rights listed in the agreement. The TRIPS agreement has implications for the environment in several respects, including technology transfer and patenting of biodiversity. The agreement provides that WTO members may exclude inventions from patentability when necessary to avoid serious prejudice to the environment.
Agreement on Subsidies and Countervailing Measures (ASCM)	The SCM agreement supervises the use of subsidies. Export subsidies are prohibited per se, and other subsidies are prohibited if they cause serious prejudice to other countries. The agreement also contains disciplines on the use of countervailing measures. As originally negotiated, the agreement provided that certain subsidies to promote the adaptation of existing facilities to new environmental requirements would be nonactionable. These public policy carve-outs for nonactionable subsidies expired at the end of 1999.
General Agreement on Trade in Services (GATS)	The GATS supervises domestic measures that affect international trade in services. The GATS contains a general exception for measures necessary to protect human, animal, or plant life or health but does not contain an exception for the conservation of natural resources. Although the GATS recognizes that subsidies may have a distortive effect on services, the GATS does not contain disciplines on subsidies.
Agreement on Agriculture (AoA)	The AoA agreement seeks to reform trade in agricultural products and provide a basis for market-oriented policies by disciplining subsidies and quantitative restrictions. In its preamble, the agreement takes note of food security objectives and the need to protect the environment. The agreement recognizes the right of members to adopt domestic support measures with minimal impact on trade (known as "green box" policies and listed in Annex 2). Many environmental measures might qualify as "green box" supports.

Source: World Trade Organization, www.wto.org (accessed on January 12, 2009).

well spark conflicts in the WTO system with respect to how the measures affect international trade.

National Treatment

The principle of national treatment in GATT Article III holds that an imported product is to be treated no less favorably than a like domestic product. This purpose is carried out in two principal provisions: the first sentence of Article III:2 with respect to internal taxes or charges on products, and Article III:4 with respect to taxes and regulations not covered by Article III:2. The Appellate Body has explained that the broad and fundamental purpose of Article III is to avoid protectionism in the application of internal tax and regulatory measures. Article III covers taxes and regulations applied both within borders and at the time of importation. Although Articles III:2 and III:4 are parallel provisions and share some common jurisprudence, it should be noted that the term "like" is interpreted differently in the two provisions. Furthermore, an imported product may be treated less favorably than a like domestic product if the imported product is priced at a level that qualifies as "dumping" under GATT Article VI and the WTO Antidumping Agreement.

First Sentence of GATT Article III:2

The first sentence of GATT Article III:2[1] states: "The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products." As interpreted by the *Argentina—Hides and Leather* panel, for an infringement of this provision, there must be an affirmative conclusion as to three matters: (1) that the measure is the type of tax or charge covered, (2) that the taxed imported and domestic products are "like," and (3) that the imported product is taxed in excess of the like domestic product.[2] In the *Japan—Alcohol* case, the Appellate Body explained that when doing "like" product comparisons, the term "like" should be "construed narrowly" and that the factual information used could include the product's end use in a given market, consumers' tastes and habits in the importing country, and the product's properties, nature,

1. An additional discipline exists in the second sentence of GATT Article III:2, but it is not discussed here as it would seem to have little applicability to climate change measures.

2. Panel Report, *Argentina—Measures Affecting the Export of Bovine Hides and the Import of Finished Leather*, WT/DS155/R, adopted on February 16, 2001, paragraph 11.131. The panel also explained that a comparison has to be made of the "actual tax burdens" imposed on the import and the like domestic product (paragraph 11.184).

and quality, and tariff classification.[3] With regard to the meaning of "excess," the Appellate Body held that even the smallest amount of excess is too much and that a complainant need not show trade impact of the higher taxation nor a protective purpose. The scope of the first sentence of Article III:2 covers not only taxes but also "other internal charges of any kind," including those collected at the border. In *Argentina—Hides and Leather*, the panel explained that a "charge" involves a "pecuniary burden" and a "liability to pay money laid on a person."[4] In *China—Auto Parts*, the Appellate Body held that Article III:2 covers charges imposed on goods that have already been imported, with the obligation to pay triggered by something that takes place within the customs territory.[5]

GATT Article III:4

GATT Article III:4 states: "The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use." In the *European Communities (EC)—Asbestos* case, the Appellate Body explained that "like" in Article III:4 has a "relatively broad product scope" and is broader than "like" in the first sentence of Article III:2. Moreover, the likeness test is fundamentally a determination of the nature and extent of a competitive relationship in the marketplace between imported and domestic products.[6] The factors to be considered by a panel are the same as those in Article III:2, although this is not a closed list. Panels are to determine whether the evidence, as a whole, indicates that the products are "like." In *Asbestos*, the Appellate Body reversed the panel for having excluded the health risks associated with asbestos from its examination of the physical properties of the product. In the first compliance review in *United States—Foreign Sales Corporations,* the panel was considering an income tax exemption linked to a minimum amount of US origin for goods and services purchased by firms benefiting from the tax exemption. The panel ruled that, with a measure of general application that applies horizontally and is "solely and explicitly based on origin,"

3. Appellate Body Report, *Japan—Taxes on Alcoholic Beverages*, WT/DS8,10,11/AB/R, adopted on November 1, 1996, 20–21.

4. Panel Report, *Argentina—Hides and Leather*, paragraph 11.143.

5. Appellate Body Report, *China—Measures Affecting Imports of Automobile Parts*, WT/DS339,340,342/AB/R, adopted on January 12, 2009, paragraph 161, 171.

6. Appellate Body Report, *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted on April 5, 2001, paragraphs 98–100, 103.

the "like products" element was satisfied.[7] As a result of this ruling, the US attempt at compliance was found to be unsatisfactory because it discriminated against foreign origin goods.

The word "affecting" in GATT Article III:4 was interpreted by the Appellate Body in the *United States—Foreign Sales Corporations* first compliance review. The Appellate Body explained that "affecting" serves to define the scope of Article III:4 and operates as a link between the identified types of government actions covered by this rule ("laws, regulations and requirements") and the specific transactions, activities, and uses relating to products in the marketplace ("internal sale, offering for sale, purchase, transportation, distribution or use"). In view of that function, the Appellate Body held that the word "affecting" has a "broad scope of application."[8]

The meaning of "no less favorable treatment" has been explicated in several cases. In *Korea—Beef*, the Appellate Body explained that less favorable treatment is detected by considering whether the fundamental thrust of the measure is that it "modifies the conditions of competition in the relevant market to the detriment of imported products.[9] In the *Dominican Republic—Import and Sales of Cigarettes* case, the Appellate Body explained that "a detrimental effect on a given imported product resulting from a measure does not necessarily imply that the measure accords less favourable treatment to imports if the detrimental effect is explained by factors or circumstances unrelated to the foreign origin of the product...."[10] In *European Communities—Asbestos*, the Appellate Body noted that a government may draw distinctions between products that have been found to be "like" without, for this reason alone, according to the group of "like" imported products less favorable treatment than accorded to "like" domestic products.[11] In the first compliance review of the *United States—Foreign Sales Corporations* case, the Appellate Body explained that an adjudication of Article III:4 must be founded on a careful analysis of the contested measure and of its implications in the marketplace. The Appellate Body cautioned, however, that such an analysis did not need to be based on the

7. Panel Report, *United States—Tax Treatment for Foreign Sales Corporations*, Recourse to Article 21.5 of the Dispute Settlement Understanding (DSU) procedures by the European Communities, WT/DS108/RW, adopted on January 29, 2002, paragraphs 8.133–8.135.

8. Appellate Body Report, *United States—Tax Treatment for Foreign Sales Corporations,* Recourse to Article 21.5 of the DSU procedures by the European Communities, WT/DS108/AB/RW, adopted on January 29, 2002, paragraph 210.

9. Appellate Body Report, *Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef,* WT/DS161,169/AB/R, adopted on January 10, 2001, paragraphs 137, 142.

10. Appellate Body Report, *Dominican Republic—Measures Affecting the Importation and Internal Sale of Cigarettes,* WT/DS302/AB/R, adopted on May 19, 2005, paragraph 96.

11. Appellate Body Report, *European Communities—Asbestos*, paragraph 100.

actual effects in the marketplace.[12] In the *Dominican Republic—Import and Sales of Cigarettes* case, the panel agreed that the tax stamp requirement at issue provided formally identical treatment between domestic and imported cigarettes. Nevertheless, the panel found less favorable treatment for imports because importers had additional processes and costs.[13]

Domestic Subsidies and National Treatment

Under GATT Article III:8(b), the prohibitions in GATT Article III do not apply to payments of subsidies "exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions" of Article III.[14] For example, in the *European Communities—Commercial Vessels* case, the panel found that a shipbuilding subsidy given to domestic ship producers but not to foreign producers was precisely the kind of different treatment that is allowed by Article III:8(b), and thus not inconsistent with Article III.[15] In the *Canada—Periodicals* case, the Appellate Body ruled that Article III: 8(b) only covers the payment of subsidies that involve "the expenditure of revenue by a government" and suggested that a reduction in government fees or tax preferences would not be covered by this provision.[16]

Charges Equivalent to Internal Taxes Applied to Imports

GATT Article II:1(a) and (b) contain the core disciplines in the GATT on the imposition of ordinary customs duties. In addition, Article II:1(b) prohibits the imposition of newly applied charges (on items having bound tariffs) by extending the coverage to "all other duties or charges of any kind imposed "on or in connection with" importation.[17] The scope of Article II is limited, however, by Article II:2(a), which states that nothing in the

12. Appellate Body Report, *United States—Foreign Sales Corporations* (Article 21.5–EC), paragraph 215.

13. Panel Report, *Dominican Republic—Measures Affecting the Importation and Internal Sale of Cigarettes,* WT/DS302/R, adopted on May 19, 2005, paragraph 7.196. This was an instance of de facto discrimination.

14. GATT Article III:8(b). The meaning of "domestic producers" in terms of corporate ownership and control has not been clarified in GATT/WTO dispute settlement.

15. Panel Report, *European Communities—Measures Affecting Trade in Commercial Vessels*, WT/DS301/R, adopted on June 20, 2005, paragraph 7.69. Domestic in this context appears to mean corporate location rather than nationality.

16. Appellate Body Report, *Canada—Certain Measures Concerning Periodicals*, WT/DS31/AB/R, adopted on June 30, 1997, pp. 34–35.

17. See the WTO Understanding on the Interpretation of Article II:1(b) of the GATT, 1994.

article shall prevent a government from imposing at any time on the importation of any product "a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part." Little WTO case law exists on the meaning of Article II:2(a). In *Chile—Price Band System*, the Appellate Body opined that "charges equivalent to internal taxes" are not included within the "other duties or charges" disciplined by GATT Article II:1.[18]

The only WTO case applying Article II:2(a) to charges imposed at the border is the recent case filed by the United States against India. In that dispute, the Appellate Body explained that the concept of "equivalent" in Article II:2(a) includes elements of "effect" and "amount," and that a panel needs to make a comparative assessment of the charge and the internal tax that is both qualitative and quantitative.[19] The Appellate Body also held that a charge coming within the terms of Article II:2(a) could not be in excess of the corresponding internal tax.[20] With regard to India's additional duties and extra-additional duties, the Appellate Body found that these charges could not be justified under GATT Article II:2(a) insofar as they result in the imposition of charges on imports in excess of the domestic excise, sales, value-added, and local taxes imposed on the like domestic products.

Border Tax Adjustments on Products

WTO rules allow members to adjust product taxes at the border. Governments can impose product taxes on imports and rebate these taxes on exports. Symmetry is not required: a government can choose to adjust its product taxes on imports but not on exports, or vice versa.

No one questions that border tax adjustments (BTAs) on imports are permitted by trade rules on a consumption tax imposed on a product, such as a sales tax, or an environmental tax imposed directly on a product. But the potential adjustability of environmental taxes levied on the producer of a product—for example, a tax on the energy used or the pollution emitted—remains an uncertain and debated issue in trade law.

The role of BTA in the trading system was examined in a GATT Working Party on Border Tax Adjustments, whose report was adopted in 1970. The working party defined BTAs as fiscal measures that enable exported

18. Appellate Body Report, *Chile—Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/AB/R, adopted on October 23, 2002, paragraph 276.

19. Appellate Body Report, *India—Additional and Extra-Additional Duties on Imports from the United States*, WT/DS360/AB/R, adopted on November 17, 2008, paragraphs 172, 175.

20. Appellate Body Report, *India—Additional Import Duties*, paragraph 180.

products to be relieved of some or all of the tax charged in the exporting country with respect to similar domestic products and that enable imported products sold to consumers to be charged with some or all of the tax charged in the importing country with respect to similar domestic products.[21]

The working party report is an unusual GATT-era report in that it expresses positions on matters of consensus and on matters on which there were differences of opinion. For example, the report states that most delegations agreed that the philosophy behind BTAs is to ensure "trade neutrality."[22] The report also states: "It was agreed that GATT provisions on tax adjustment applied the principle of destination identically to imports and exports" and that the GATT rules "set maxima limits for adjustment (compensation) which were not to be exceeded," but below which governments were "free to differentiate in the degree of compensation applied."[23] In addition, the report states that some delegations believed that "GATT provisions on tax adjustment did not provide for any form of protection but rather for the possibility for governments to create equality in treatment between imported and domestically-produced goods."[24]

With regard to eligibility for BTAs, the report states that there was a "convergence of views to the effect that taxes directly levied on products were eligible for tax adjustment," and it was "agreed in principle that for composite goods, it was administratively sensible and sufficiently accurate to give export rebates by average rates for a given class of goods."[25] There was also a "convergence of views to the effect that certain taxes that were not directly levied on products were not eligible for tax adjustment," with examples given of social security charges.[26] For taxes in between, the working party reported that there was a "divergence of views." One example of such taxes were so-called taxes occultes, and several such taxes

21. Working Party Report, *Border Tax Adjustments*, BISD 18S/97, adopted on December 2, 1970, paragraph 4. The definition came from the Organization for Economic Cooperation and Development (OECD). The GATT report is available at www.worldtradelaw.net (accessed on January 12, 2009).

22. Working Party Report, *Border Tax Adjustments*, paragraph 9.

23. Working Party Report, *Border Tax Adjustments*, paragraphs 10–11. The supposed symmetry between tax adjustments on imports and exports, stated in the report, is no longer required by the GATT, even if it was accepted practice in 1970. Under the destination principle, indirect taxes on goods that move in international trade are levied by the country of destination and are remitted by the country of exportation.

24. Working Party Report, *Border Tax Adjustments*, paragraph 13.

25. Working Party Report, *Border Tax Adjustments*, paragraphs 14, 16. The report also noted that some taxes, such as cascade taxes, which were generally considered eligible for adjustment, presented a problem because of the difficulty in tracing exactly the amount embodied in the final products.

26. Working Party Report, *Border Tax Adjustments*, paragraph 14.

were listed, among them taxes on "energy" and "transportation."[27] This means that in 1970 GATT law was unclear as to whether an adjustment at the border for energy taxes was permitted.

The rules for BTAs on imports are found in GATT Articles II and III, which were discussed above. With respect to BTAs on imports, the most important trade law case on BTAs was the GATT case of 1987, *United States—Taxes on Petroleum and Certain Imported Substances* (*Superfund*).[28] In that dispute, the United States was imposing a tax on imported substances made from specific chemicals that were subject to US tax. In principle, the amount of tax on imported substances was set equal to the amount of US tax that would have been imposed on incorporated chemicals if those chemicals had been sold in the United States. The United States defended this tax before the GATT panel as a BTA fully consistent with GATT Articles II:2(a) and III:2. The panel agreed with the United States but expressed concern about a provision in the US Superfund Act that would permit an additional tax on imports when the importer fails to furnish necessary information. The panel suggested that this penalty provision would violate Article III:2 if it were actually imposed.

The European Economic Community had challenged the tax on imported substances as a violation of GATT because, according to them, the environmental tax conflicted with the OECD's "polluter-pays principle" when applied to imports, since the pollution created in the production of the imported substances did not occur in the United States. The panel ruled that the purpose of the tax was not relevant in determining whether the tax complied with GATT rules. The panel also noted that the GATT rules did not oblige the United States to impose a border adjustment on the imported product, but that the United States was free to do so.

With respect to BTAs on exports, the WTO rules are found in GATT Article XVI and the Agreement on Subsidies and Countervailing Measures (ASCM). The ASCM may have widened the scope for export rebates on energy taxes from what was available under the plurilateral Tokyo Round Subsidies Code (Hufbauer 1996, 49–50). The matter is not clear, however, as there is ambiguity in the ASCM.

The pertinent provisions in the ASCM are detailed in box 2.1. To un-

27. Working Party Report, *Border Tax Adjustments*, paragraph 15. Taxes on pollution are not specifically mentioned. No general definition of "taxes occultes" was provided by the working party; however, an OECD definition of "taxes occultes" includes taxes on capital equipment, auxiliary supplies (such as energy), and services used in the transportation and production of other taxable goods.

28. GATT Panel Report, *United States—Taxes on Petroleum and Certain Imported Substances*, BISD 34S/136, adopted on June 17, 1987. This dispute, known as the Superfund case, involved a complaint by Canada and the European Economic Community (and Mexico, in part) against the United States regarding US taxes on petroleum and certain imported substances levied under the Superfund Amendments and Reauthorization Act of 1986. The panel report is available at www.wto.org (accessed on January 12, 2009).

Box 2.1 Selected text from the Agreement on Subsidies and Countervailing Measures (ASCM)[1]

ASCM

ANNEX I

ILLUSTRATIVE LIST OF EXPORT SUBSIDIES

(e) The full or partial exemption, remission or deferral specifically related to exports, of direct taxes[58] or social welfare charges paid or payable by industrial or commercial enterprises.

(g) The exemption or remission, in respect of the production and distribution of exported products, of indirect taxes[58] in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption.

(h) The exemption, remission or deferral of prior-stage cumulative indirect taxes[58] on goods or services used in the production of exported products in excess of the exemption, remission or deferral of like prior-stage cumulative indirect taxes on goods or services used in the production of like products when sold for domestic consumption; provided, however, that prior-stage cumulative indirect taxes may be exempted, remitted or deferred on exported products even when not exempted, remitted or deferred on like products when sold for domestic consumption, if the prior-stage cumulative indirect taxes are levied on inputs that are consumed in the production of the exported product (making normal allowance for waste). This item shall be interpreted in accordance with the guidelines on consumption of inputs in the production process contained in Annex II.

ANNEX II

GUIDELINES ON CONSUMPTION OF INPUTS IN THE PRODUCTION PROCESS

1. Indirect tax rebate schemes can allow for exemption, remission or deferral of prior-stage cumulative indirect taxes levied on inputs that are consumed in the production of the exported product (making normal allowance for waste)....
2. The Illustrative List of Export Subsidies in Annex I of this Agreement makes reference to the term "inputs that are consumed in the production of the exported product" in paragraphs (h) and (i). Pursuant to paragraph (h), indirect tax rebate schemes can constitute an export subsidy to the extent that they result in exemption, remission or deferral of prior-stage cumulative indirect taxes in excess of the amount of such taxes actually levied on inputs that are consumed in the production of the exported product.

Box 2.1 Selected text from the Agreement on Subsidies and Countervailing Measures (ASCM) *(continued)*

Pertinent ASCM Footnotes

1. In accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.

5. Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

58. For the purpose of this Agreement:

    The term "direct taxes" shall mean taxes on wages, profits, interests, rents, royalties, and all other forms of income, and taxes on the ownership of real property;

    The term "import charges" shall mean tariffs, duties, and other fiscal charges not elsewhere enumerated in this note that are levied on imports;

    The term "indirect taxes" shall mean sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, border taxes and all taxes other than direct taxes and import charges;

    "Prior-stage" indirect taxes are those levied on goods or services used directly or indirectly in making the product;

    "Cumulative" indirect taxes are multi-staged taxes levied where there is no mechanism for subsequent crediting of the tax if the goods or services subject to tax at one stage of production are used in a succeeding stage of production;

    "Remission" of taxes includes the refund or rebate of taxes.

61. Inputs consumed in the production process are inputs physically incorporated, energy, fuels and oil used in the production process and catalysts which are consumed in the course of their use to obtain the exported product.

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1. The footnotes in the text of this box are from the ASCM itself and are explained in the subsection entitled "Pertinent ASCM Footnotes."

pack these provisions, start with ASCM footnote 1, which states that "In accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this agreement, the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such taxes in amounts not in excess of those which have accrued, shall not be deemed a subsidy [under the ASCM]." What is clear in this provision is that some policies to remit taxes on exports do not constitute subsidies, but which taxes qualify is not clear. The descriptor "taxes borne by the like product" takes us no further than the lack of conclusion reached in the 1970 Working Party on Border Tax Adjustments regarding which taxes are in fact borne by the product. But the new ASCM footnote 5 may help to clear up some of the ambiguity. That footnote states that: "Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." Thus, unlike the Tokyo Round Subsidies Code, which was an optional agreement, the ASCM Annex I may be able to resolve authoritatively that certain practices referred to as not constituting export subsidies are permitted by the ASCM.[29]

Annex I clarifies the scope of allowable BTAs through its definitions in footnote 58—definitions that do not exist in the GATT (although many of them were in the Tokyo Round Code). Indirect taxes are defined broadly to embrace specific types of taxes, including for purposes here both "excise" taxes and "border taxes," as well as "all other taxes other than direct taxes and import charges." The category of "tax occultes" is not mentioned, which raises the intriguing question of whether the authors of the ASCM assumed that "tax occultes" qualified as indirect taxes. An alternative explanation is that "taxes occultes" come within the term "import charges" as "other fiscal charges not elsewhere enumerated." Looking only at the definitions, energy taxes or pollution taxes could be either indirect taxes or fiscal charges. However, they are not direct taxes, akin to income taxes or social security charges.

The text and context of Annex I may help further to clarify the matter. Item (h) on "prior-stage cumulative indirect taxes on goods and services used in the production of exported products" provides a special rule for taxes levied on "inputs that are consumed in the production of the exported product" and refers to Annex II. Footnote 61 in Annex II defines such inputs as "inputs physically incorporated, energy, fuels and oil used in the production process and catalysts which are consumed in the course of their use to obtain the exported product."[30] Thus, item (h) would appear to

29. This reasoning assumes that GATT Article XVI has been superseded by the ASCM to the extent of an inconsistency.

30. ASCM, footnote 61. In that regard, it is interesting to note that the WTO Valuation Agreement recognizes "materials consumed in the production of the imported goods," and

cover taxes on energy, fuels, and oil that are used in the production process but that are *not* physically incorporated inputs. The advent of the ASCM Annex II was, of course, unknown to the 1970 Working Party on Border Tax Adjustments. Thus, the ASCM would seem to be saying that taxes on energy qualify as indirect taxes and are subject to the discipline in item (h). If so, there is an authoritative answer to the definitional uncertainty noted above as to whether energy taxes are indirect taxes or instead are fiscal charges. And the inclusion of energy taxes within indirect taxes would settle the status of energy taxes that puzzled the 1970 working party.

The inclusion of taxes on energy in ASCM Annexes I and II would therefore seem to mean that a border adjustment on energy exports is a legal possibility. We know from Annex II, paragraph 2 that an indirect tax rebate on exports would constitute an export subsidy if it were to result in a remission of "prior-stage cumulative indirect taxes in excess of the amount of such taxes actually levied on inputs that are consumed in the production process." Logically, therefore, an export rebate that exactly matches the taxes levied on inputs, such as energy consumed in the production process, would not be an export subsidy. Of course, by its own terms, item (h) applies only to "prior-stage cumulative indirect taxes."[31] The carbon taxes being proposed are not designed to be cumulative (de Cendra 2006, 140), although it may be possible to make them so. But providing energy tax rebates on exports does not depend solely on item (h). If energy taxes are indirect taxes under Annex I, then item (g) would permit the use of export BTAs on energy taxes, provided the exemption or remission does not exceed taxes levied on production and distribution for domestic use.

A counterargument against the foregoing analysis might run as follows: although energy taxes are indirect taxes, the ASCM deals with such taxes under item (h) and footnote 61 rather than item (g). Seen in that way, export rebates are only allowed under item (h) and then only for prior-stage cumulative indirect taxes and for inputs consumed in production. During the implementation of the Uruguay Round, the US government went on record suggesting that item (h) and footnote 61 were *not* meant to allow export BTAs on energy inputs (WTO 1997, paragraph 76). If the interpretation offered by the United States is correct, then one might assume that such energy BTAs were not meant to be authorized by item (g) either. The meaning of footnote 61 has been analyzed by the WTO Secre-

requires that the value of those materials be included in the customs value when such goods are supplied by the buyer at a reduced cost. Agreement on the Implementation of Article VII of the 1994 GATT, Article 8.1(b)(iii).

31. Note also that item (h) permits a tax exemption for exported products even when the same tax continues to be imposed on domestic products when the objects being taxed are inputs consumed in the production of the exported product. Such a tax exemption would not be a prohibited export subsidy under the ASCM, as per Article 3.1(a) and footnote 5.

tariat and the Committee on Subsidies and Countervailing Measures, but no clarity has emerged. If this question were to come before a WTO panel, little weight would probably be accorded to the unilateral US interpretation (Biermann and Brohm 2005, 297).

In summary, one could argue that the ASCM has clarified that status of energy taxes—as compared with the GATT era, when they were mysterious "taxes occultes"—and that energy taxes can now be rebated upon export. Conversely, one could also argue that the possibility for such an export rebate remains uncertain in the ASCM or that the ASCM actually prohibits energy BTAs on exports. Future WTO dispute settlement or negotiations may clarify these matters.

Most Favored Nation Treatment

The principle of most favored nation treatment in GATT Article I holds that any advantage accorded to an imported product has to be accorded to a "like" product from any WTO member country. Article I:1 states:

> With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

Thus Article I applies to customs duties and charges, import and export formalities, and measures covered by Article III:2 and III:4. Note, however, that if a measure is covered by GATT Article III but is not a violation of Article III because of the domestic subsidy exclusion in GATT Article III:8(b), such a measure would not come within the discipline of GATT Article I:1.[32]

GATT Article I:1 has been explicated in several WTO disputes. In *Canada—Autos*, the Appellate Body explained that Article I:1 covers not only de jure discrimination but also de facto discrimination involving ostensibly origin-neutral measures.[33] In *European Communities—Bananas*, the Appellate Body noted approvingly the broad interpretation of "advantage" followed in pre-WTO adjudication and upheld the panel's decision that the differing rules on imports did constitute an advantage, even though competition policy considerations may have been the basis for the EC

32. Panel Report, *European Communities—Commercial Vessels*, paragraph 7.90.

33. Appellate Body Report, *Canada—Certain Measures Affecting the Automotive Industry*, WT/DS139,142/AB/R, adopted on June 19, 2000, paragraph 78.

Box 2.2 How GATT rules apply to border measures for climate change

■ Other duties and charges on imported products	Article II:1(b)
■ Charge equivalent to an internal tax	Article II:2(a)
■ Internal taxes or charges on products	Article III:2
■ Regulations affecting internal sale	Article III:4
■ Import bans and quotas	Article XI:1

rules. In addition, the Appellate Body agreed with the panel that the initial allocation of export certificates to some countries gave those countries an advantage in violation of Article I:1.[34] In the *European Communities—Tariff Preferences* case, the panel held that the term "unconditionally" meant that the treatment is "not limited by or subject to any conditions."[35]

Quantitative Restrictions on Goods

The GATT prohibits complete import bans as well as quantitative restrictions. GATT Article XI:1 states: "No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party...." This provision interrelates with the provisions discussed above that supervise the use of duties, taxes, or other charges, as shown in box 2.2.

WTO panels have interpreted Article XI:1 broadly to include any form of import restriction. For example, in the *Korea—Beef* case, the panel found that action by the state trading agency to purchase grain-fed beef, while excluding the purchase of grass-fed beef, constituted a de facto import restriction on such purchase in violation of GATT Article XI:1.[36] In *Brazil—Tyres*, the panel held that a prohibition on the issuance of an import license violated Article XI:1.[37]

34. Appellate Body Report, *European Communities—Regime for the Importation, Sale, and Distribution of Bananas,* WT/DS27/AB/R, adopted on September 25, 1997, paragraphs 206–207.

35. Panel Report, *European Communities—Conditions for the Granting of Tariff Preferences to Developing Countries*, WT/DS246/R, adopted on April 20, 2004, paragraph 7.59.

36. Panel Report, *Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef,* WT/DS161,169/R, adopted on January 10, 2001, paragraphs 774, 777.

37. Panel Report, *Brazil—Measures Affecting Imports of Retreaded Tyres*, WT/DS332/R, adopted

Domestic Regulations and the Agreement on Technical Barriers to Trade

In addition to the GATT, another WTO agreement supervising governmental regulation is the Agreement on Technical Barriers to Trade (TBT). The scope of the TBT agreement includes both mandatory and voluntary measures. Mandatory measures are termed "technical regulations" and are defined as any measure that "lays down product characteristics or their related processes and production methods."[38] In *European Communities—Asbestos*, the Appellate Body explained that product characteristics are "any objectively definable 'features,' 'qualities,' 'attributes,' or other 'distinguishing mark' of a product" and noted that they might relate, *inter alia*, to a product's "composition, size, shape, colour, texture, hardness, tensile strength, flammability, conductivity, density, or viscosity."[39] The Appellate Body also stated that product characteristics include "not only features and qualities intrinsic to the product itself, but also related 'characteristics.'"[40] But the Appellate Body did not discuss the language in the definition on "related processes and production methods." Whether the term "related" can be stretched to include the energy used in making a product is unclear.

If a regulation about the energy footprint of a product is not covered by the TBT agreement, it would be covered by GATT Articles III:4 or XI. At the time that the TBT agreement was drafted, the conventional wisdom was that it covers regulations about the physical product and does not cover regulations about the way a product is made. Whether that understanding would survive the text-oriented approach to interpretation now used in the WTO dispute settlement (which gives little consideration to negotiating history) remains to be seen.

For regulations within the scope of the TBT agreement there are a host of TBT rules. For example, TBT Article 2.3 states that "Technical regulations shall not be maintained if the circumstances or objectives giving rise to their adoption no longer exist or if the changed circumstances or objectives can be addressed in a less trade-restrictive manner." Article 2.4 requires the use of international standards in certain circumstances.[41] Article

on December 17, 2007, paragraph 7.15.

38. Agreement on Technical Barriers to Trade, Article 1.2 and Annex 1, paragraph 1. The TBT agreement does not apply to sanitary or phytosanitary measures (see Article 1.5).

39. Appellate Body Report, *European Communities—Asbestos*, paragraph 67.

40. Appellate Body Report, *European Communities—Asbestos*, paragraph 67.

41. It is interesting to note that there are International Organization for Standardization (ISO) standards on climate related to the quantification and reporting of greenhouse gas emissions and reductions (e.g., ISO 14064 and 14065). At present, no ISO climate standards exist for particular products or emission levels.

2.5 states that when a technical regulation is applied for one of the legitimate objectives listed in the TBT agreement, which includes the environment, and is in accord with an international standard, the measure shall be rebuttably presumed not to create an unnecessary obstacle to international trade (Howse 2006, 393–94).

General Exceptions

A measure violating any provision of the GATT can be excused if it qualifies for an exception under GATT Article XX.[42] Under the heading "General Exceptions," Article XX states in part:

> 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 Appellate Body has explained that the exceptions are "limited and conditional" and that the analysis is two-tiered.[43] A panel will look first to see whether the measure comes within the scope of one of the paragraphs in Article XX and then, if so, will consider whether the measure meets the terms of the specific exception. When a measure is provisionally justified under one of the specific exceptions, the next step for a panel will be to see if the measure meets the legal standard set forth in the chapeau of Article XX. The list of public policy purposes under Article XX is a closed list. Clearly, the list does not include measures necessary to avoid adverse competitive impact from environmental laws imposed on the domestic economy.

Fifteen years ago, there was uncertainty as to whether the GATT outlawed import bans linked to the content of another country's environmental policy (Esty 1994). Since then, the case law of the WTO has clarified that GATT rules do not necessarily preclude such environmental measures. In a central ruling in the *United States—Shrimp* case, the Appellate Body explained that "conditioning access to a Member's domestic market on whether exporting Members comply with, or adopt, a policy or policies unilaterally prescribed by the importing Member may, to some degree, be

42. Importantly, however, Article XX does not excuse violations of the TBT agreement.

43. Appellate Body Report, *United States—Import Prohibitions of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted on November 6, 1998, paragraph 157 (emphasis deleted).

a common aspect of measures falling within the scope of one or another of the exceptions (a) to (j) of Article XX."[44] In the follow-up compliance litigation, the panel stated that the WTO agreement "does not provide for any recourse" to an exporting country in a situation where another WTO member requires "as a condition of access of certain products to its market, the exporting countries commit themselves to a regulatory program deemed comparable to its own."[45] The Appellate Body seemed comfortable with that conclusion. On the other hand, it should be noted that in the final *United States—Shrimp* ruling, the complaining country (Malaysia) had not even applied for US certification of its shrimping regulations.[46] The Appellate Body might have reached a different conclusion if Malaysia had applied to export shrimp to the United States but been turned down by the US authorities.

Article XX contains several exceptions that could be relevant to climate change, but the one most discussed is paragraph (g), which provides an exception for measures "relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption." Whether the (g) exception fits the climate change problem is not free from doubt. Climate is being affected by many factors, but the primary one is the emission of greenhouse gases into the upper atmosphere. The policy response of reducing greenhouse gas emissions is a classic pollution control policy, not a conservation policy.[47] Speaking very narrowly, climate change policies do not seek to conserve the atmosphere itself; instead they seek to preserve a certain balance of gases within the atmosphere.

If WTO adjudicators were to hold that greenhouse gas mitigation programs do not fit the (g) exception (a surprising determination), then there could be recourse to the Article XX(b) exception for measures "necessary to protect human, animal or plant life or health" (Bhagwati and Mavroidis 2007, 308).[48] Our study, however, does not address the (b) exception because we assume that WTO adjudicators will agree that climate change can be treated as an "exhaustible natural resource" within the (g) exception. After all, in the first WTO case, *United States—Gasoline*, a case about

44. Appellate Body Report, *United States—Shrimp*, paragraph 121.

45. Panel Report, *United States—Import Prohibitions of Certain Shrimp and Shrimp Products,* Recourse to Article 21.5 by Malaysia, WT/DS58/RW, adopted on November 21, 2001, paragraph 5.103.

46. Panel Report, *United States—Import Prohibitions of Certain Shrimp and Shrimp Products,* paragraph 148.

47. As a stretch, climate policies might be characterized as efforts to conserve terrestrial carbon and keep it from going into the atmosphere.

48. If it were in litigation, the United States would likely invoke both the (b) and (g) exceptions.

air pollution, the panel ruled that clean air was a resource, had value, was natural, and could be depleted.[49] In *Gasoline*, the US law sought to prevent further deterioration of the level of air pollution prevailing in 1990. For a future panel to refuse to apply this precedent to climate change seems highly unlikely. In the *United States—Shrimp* case, the Appellate Body stated that the term "exhaustible natural resources" had to be "read by a treaty interpreter in the light of contemporary concerns of the community of nations about the protection and conservation of the environment."[50] Furthermore, the Appellate Body said that "natural resources" is not "static" but rather "by definition, evolutionary."[51]

That said, it is interesting to note that in the *Brazil—Tyres* case (a dispute about the health effects of waste tires), the Appellate Body interjected a discussion of climate change into its analysis of Article XX(b). Was the Appellate Body signaling something? The point made by the Appellate Body was that a measure being proposed for justification under Article XX(b) had to bring about "a material contribution to the achievement of its objective."[52] Yet for measures adopted to attenuate global warming and climate change, the Appellate Body explained that results "can only be evaluated with the benefit of time."[53] In our view, the Appellate Body did not intend to suggest that climate change had to be justified under the (b) exception in Article XX rather than the (g) exception.

Article XX(g)

Once a panel concludes that a climate measure falls within the scope of Article XX(g), the panel will consider the two prongs of the (g) exception: first, whether the measure challenged is one "relating" to conservation of exhaustible natural resources, and second, whether the measure is "made effective in conjunction with restrictions on domestic production or consumption." Important case law exists on both of these points.

Regarding the first prong, in *United States—Gasoline*, the Appellate Body held that there was a "substantial relationship" between the US measures and the goal of "conservation of clean air."[54] In *United States—*

49. Panel Report, *United States—Standards for Reformulated and Conventional Gasoline,* WT/DS2/R, adopted on May 20, 1996, paragraph 6.37. The Appellate Body did not review this holding but did analyze the US measure under Article XX(g) and not Article (b).

50. Appellate Body Report, *United States—Shrimp*, paragraph 129.

51. Appellate Body Report, *United States—Shrimp*, paragraph 130.

52. Appellate Body Report, *Brazil—Measures Affecting Imports of Retreaded Tyres*, WT/DS332/R, adopted on December 17, 2007, paragraph 151.

53. Appellate Body Report, *Brazil—Tyres*, paragraph 151.

54. Appellate Body Report, United States—Standards for Reformulated and Conventional

Shrimp, the Appellate Body found that the sea turtles being protected by US law were "exhaustible" and that they had "sufficient nexus" to the United States.[55] The Appellate Body then considered the relationship between the "general structure and design" of the measure and the legitimate policy of conserving natural resources.[56] The measure at issue was an import ban, and the Appellate Body saw it as being designed to influence other countries to adopt national regulatory programs requiring the use of turtle excluder devices and requiring that such programs be comparable to US programs. In examining the US measure, the Appellate Body concluded that the means used "are, in principle, reasonably related to the ends," and, therefore, the measure qualified under the first prong.[57]

The second prong is whether the measure is "made effective in conjunction with restrictions on domestic production or consumption." In *United States—Gasoline*, the Appellate Body interpreted this clause as requiring "even-handedness in the imposition of restrictions."[58] The Appellate Body further noted that the clause speaks disjunctively of "domestic production *or* consumption."[59]

Article XX Chapeau

A measure that is provisionally justified by one of the GATT Article XX exceptions is then further appraised to see whether it is consistent with the chapeau of Article XX. The chapeau states that recourse to a GATT exception for challenged measures is "[s]ubject 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." The standards in the chapeau may vary as between different paragraphs in Article XX.[60] Whatever paragraph is invoked, the burden of proof is on the defendant government.

Before discussing the chapeau, it should be noted that its norms have been internalized into the United Nations Framework Convention on Climate Change (UNFCCC). Article 3.5 of the UNFCCC states, in part, that "Measures taken to combat climate change, including unilateral ones,

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Gasoline, WT/DS2/AB/R, adopted on May 20, 1996, p. 19.

55. Appellate Body Report, *United States—Shrimp*, paragraphs 133–134.

56. Appellate Body Report, *United States—Shrimp*, paragraph 138.

57. Appellate Body Report, *United States—Shrimp*, paragraphs 141–142.

58. Appellate Body Report, *United States—Gasoline*, p. 21 (emphasis omitted). The Appellate Body also explained that "made effective" is not a reference to an "effects test."

59. Appellate Body Report, *United States—Gasoline*, p. 21.

60. Appellate Body Report, *United States—Shrimp*, paragraph 120.

should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade." GATT Article XX thus exemplifies the way that some fundamental norms of environmental regulation have been incorporated into the GATT through interpretation and some fundamental norms of the GATT have been incorporated into the climate regime (Runnalls 2007).

According to the Appellate Body, the function of the chapeau is to prevent abuse of the Article XX exceptions and to ensure that governments use the Article XX exceptions "in good faith."[61] Thus a measure being reviewed under the chapeau "must be applied reasonably."[62] Explaining further, the Appellate Body has stated that the task of interpreting and applying the chapeau (by panels and the Appellate Body) is a "delicate one of locating and marking out a line of equilibrium" between the rights of the WTO member invoking the exception and the rights of the member lodging the case.[63] The Appellate Body has further noted that the preamble to the WTO agreement "gives colour, texture, and shading" to the chapeau and that the preamble demonstrates a recognition by the negotiators drafting the WTO agreement that "optimal use of the world's resources should be made in accordance with the objective of sustainable development."[64] This jurisprudence suggests, and the Article XX cases confirm, that adjudicators exercise a great deal of discretion in using the chapeau to discipline national measures.

In its first case, the *United States—Gasoline* decision, the Appellate Body suggested that the chapeau addresses the manner in which the challenged measure "is applied" and not so much the measure itself or its contents.[65] The Appellate Body has repeated this principle in several cases. In *United States—Shrimp*, the Appellate Body stated that a violation of the chapeau could occur "where a measure, otherwise fair and just on its face, is actually applied in an arbitrary and unjustifiable manner."[66] The Appellate Body has suggested that "the general design and structure" of a measure are examined under an Article XX paragraph rather than the chapeau.[67]

Yet in the same case, the Appellate Body stated that there could be a violation of the chapeau "when the detailed operating provisions of

61. Appellate Body Report, *Brazil—Tyres*, paragraphs 215, 224.

62. Appellate Body Report, *United States—Gasoline*, p. 22.

63. Appellate Body Report, *Brazil—Tyres*, paragraph 224.

64. Appellate Body Report, *United States—Shrimp*, paragraphs 153, 155.

65. Appellate Body Report, *United States—Gasoline*, p. 22.

66. Appellate Body Report, *United States—Shrimp*, paragraph 160.

67. Appellate Body Report, *United States—Shrimp*, paragraph 149.

the measure prescribe the arbitrary or unjustifiable activity."[68] Thus one should not read too strictly the suggestion that only the application of the measure is examined under the chapeau and not a measure's design.[69] Indeed, in *United States—Gambling*, the Appellate Body reversed part of the panel's analysis of the chapeau for having focused on isolated instances of nonenforcement rather than on the statutory wording of the measure at issue.[70] The Appellate Body also upheld one panel finding of a chapeau violation based solely on an ambiguity of a law (not being challenged) that affected the measure being challenged.[71] Based on this jurisprudence, one can expect WTO adjudicators to look not only at how a measure has actually been implemented but sometimes also its design in order to determine whether the chapeau is violated.

The Appellate Body has held that the standards of the chapeau "project both substantive and procedural requirements."[72] For example, a procedural requirement could be whether the challenged measure gives the affected party a right of appeal to the government imposing a regulation. A substantive requirement could be discrimination that arises in the implementation of the measure being challenged.

The Appellate Body has expounded the "arbitrary or unjustifiable discrimination" clause in several cases and has recently refined its jurisprudence in the *Brazil—Tyres* case. In that case, the Appellate Body stated that "analyzing whether discrimination is arbitrary or unjustifiable usually involves an analysis that relates primarily to the cause or rationale of the discrimination."[73] Elaborating further, the Appellate Body suggested that the key questions are whether the discrimination has a legitimate cause and whether the rationale put forward can justify the discrimination.

The first step in the analysis is to consider whether the application of the measure results in discrimination. The Appellate Body has said that this language "cannot logically refer to the same standard(s) by which a violation of a substantive rule has been determined to have occurred."[74]

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68. Appellate Body Report, *United States—Shrimp*, paragraph 160.

69. Furthermore, in its review of the appeal in the compliance proceeding in *United States—Shrimp*, the Appellate Body endorsed the panel's chapeau analysis of the "design and application" of the revised US measure. Appellate Body Report, *United States—Import Prohibitions of Certain Shrimp and Shrimp Products,* Recourse to Article 21.5 of the DSU by Malaysia, WT/DS58/AB/RW, adopted on November 21, 2001, paragraph 140.

70. Appellate Body Report, *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/AB/R, adopted on April 20, 2005, paragraph 357. This case involves the chapeau of the General Exceptions in the GATS rather than the GATT.

71. Appellate Body Report, *United States—Gambling*, paragraphs 369, 371.

72. Appellate Body Report, *United States—Shrimp*, paragraph 160.

73. Appellate Body Report, *Brazil—Tyres*, paragraph 225.

74. Appellate Body Report, *United States—Gasoline*, p. 23.

This seems to mean that the discrimination entailed in a violation of national treatment or most favored nation treatment would not in itself be sufficient to be "discrimination" under the Article XX chapeau. But how much more is needed remains unclear. In *United States—Shrimp*, the Appellate Body explained that the "nature and quality" of chapeau discrimination "is different from the discrimination in the treatment of products" to be found under other GATT provisions.[75] The Appellate Body also stated that discrimination results "not only when countries in which the same conditions prevail are differently treated, but also when the application of the measure at issue does not allow for any inquiry into the appropriateness of the regulatory program for the conditions prevailing in those exporting countries."[76]

The second step is to judge whether the discrimination is "unjustifiable" or "arbitrary." There is important case law on both provisions. Little case law exists on when the same conditions prevail between countries, but the Appellate Body has accepted the assumption of litigants that such discrimination could occur between foreign countries and between a foreign country and the domestic market.[77]

With regard to "unjustifiable" discrimination, the Appellate Body has considered how the measure treats other countries with different regulatory programs. In *United States—Shrimp*, the Appellate Body held that it is not acceptable in trade relations, and hence a violation of the chapeau, to "use an economic embargo to require other Members to adopt essentially the same comprehensive regulatory program...without taking into consideration different conditions which may occur in the territories" of other countries.[78] In *United States—Shrimp*, the Appellate Body also sharply criticized the US measure for excluding shrimp from fishing vessels from uncertified countries even when those shrimp were caught using methods identical to those employed in the United States.[79] In the follow-up compliance review in *United States—Shrimp*, however, the Appellate Body explicitly stated that the chapeau permits a government to condition market access by requiring the governments of exporting countries to put in place regulatory programs "comparable in effectiveness" to that

75. Appellate Body Report, *United States—Shrimp*, paragraph 150.

76. Appellate Body Report, *United States—Shrimp*, paragraph 164.

77. Appellate Body Report, *United States—Shrimp*, paragraph 150. In one case, the panel rejected the defendant Argentina's claim that the same conditions did not prevail between it and the complainant, the European Communities. Panel Report, *Argentina—Hides and Leather*, paragraph 11.315, n. 570.

78. Appellate Body Report, *United States—Shrimp*, paragraph 164. The jurisprudence is silent as to whether the same standard would apply to a measure that is not a trade embargo—for example, an import charge.

79. Appellate Body Report, *United States—Shrimp*, paragraph 165.

of the importing country.[80] Even so, the Appellate Body cautioned that "a measure should be designed in such a manner that there is sufficient flexibility to take into account the specific conditions prevailing in *any* exporting Member....Yet this is not the same as saying that there must be specific provisions in the measure aimed at addressing specifically the particular conditions prevailing in *every individual* exporting Member."[81]

The issue of whether the defendant government pursued a cooperative approach has also come up in the analysis of unjustifiable discrimination. In the *United States—Shrimp* case, the Appellate Body found that it was unjustifiable discrimination for the United States to have neglected to negotiate with the complaining countries while having negotiated with other countries on turtle conservation issues.[82] In the *United States—Shrimp* compliance review, the Appellate Body explained that exporting countries should be given similar opportunities to negotiate an international agreement and that such agreements should be "comparable from one forum of negotiation to the other."[83]

Because of the inexact phraseology used by the Appellate Body, many commentators have perceived it to be saying that a quest for an international agreement was a prerequisite for invoking an Article XX exception.[84] This view receives further support from *United States—Gasoline*, where the Appellate Body seemed to suggest that one of the flaws in the US measure, in terms of the chapeau, was that the United States had not pursued cooperative agreements with foreign industry and government to collect

80. Appellate Body Report, *United States—Shrimp* (Article 21.5—Malaysia), paragraph 144.

81. Appellate Body Report, *United States—Shrimp* (Article 21.5—Malaysia), paragraph 149 (emphasis in original). The Appellate Body also noted approvingly that the revised US regulation took into account other measures being taken by the exporting country beyond those indicated by the United States (see paragraph 147).

82. Appellate Body Report, *United States—Shrimp*, paragraph 172. The Appellate Body also noted that the United States had failed to raise the issue of turtle conservation in one multilateral environmental agreement forum and had failed to ratify two environmental treaties relevant to the sea turtle problem. Appellate Body Report, *United States—Shrimp*, paragraph 171, n. 174. This was an interesting observation by the Appellate Body because the United States had no obligation in international law to ratify either of those treaties.

83. Appellate Body Report, *United States—Shrimp* (Article 21.5—Malaysia), paragraph 122. The Appellate Body seemed to endorse the panel's proviso that the defendant country be engaging in "serious good faith efforts to negotiate a multilateral agreement" (see paragraph 152, n.117).

84. For example, in a recent speech, WTO Director-General Pascal Lamy asserted that the Appellate Body in the *United States—Shrimp* case had established that, as a condition for unilateral measures to be greenlighted, "all efforts first be made to achieve a consensual multilateral accord." See Pascal Lamy, "A Consensual International Accord on Climate Change Is Needed," Temporary Committee on Climate Change, European Parliament, May 29, 2008.

information needed for US regulatory purposes.[85] Importantly, however, the Appellate Body also made clear that recourse to the chapeau was not contingent upon a successful result to the negotiation.[86]

The case law suggests some other possible causes for a finding of unjustifiable discrimination. In *United States—Gasoline*, the Appellate Body criticized the United States for taking account of costs to domestic industry in devising US regulations but having "disregard[ed] that kind of consideration when it came to foreign refiners."[87] In *United States—Shrimp*, the Appellate Body criticized the United States for having given some countries longer phase-in periods to meet US regulations and for having given some countries greater transfer of technology than others. It was unclear in *United States—Shrimp* whether each of those elements alone could trigger a violation. In *Brazil—Tyres*, the Appellate Body suggested that the effects of the discrimination can be a relevant factor in showing unjustifiable discrimination.[88] In *Argentina—Hides and Leather,* the panel found that even after refunding the higher prepayment of taxes required for imports, Argentina was engaging in discrimination because importers had to forego more interest on prepaid taxes than domestic competitors did. The panel concluded that Argentina had not justified this extra burden on importers because an alternative course of action—namely, refunding the interest—was available to Argentina.[89]

In some cases, unjustifiable and arbitrary discrimination have been considered of a piece. In *European Communities—Tariff Preferences*, the panel found that the EC did not satisfy its burden of proof by providing evidence to demonstrate that its country selection criteria for a program dealing with illicit drugs (known as "Drug Arrangements") did not entail arbitrary and unjustifiable discrimination.[90] The panel could see no justification for the EC's decision to name only 12 countries as beneficiaries, to the exclusion of other countries with the same prevailing conditions. For example, the EC had not included Iran within the list of beneficiary

85. Appellate Body Report, *United States—Gasoline*, pp. 27–28. The context was that the United States had rejected giving foreign industry individual baselines because of a lack of reliable information.

86. Appellate Body Report, *United States—Shrimp* (Article 21.5—Malaysia), paragraphs 123–124.

87. Appellate Body Report, *United States—Gasoline*, pp. 28–29.

88. Appellate Body Report, *Brazil—Tyres*, paragraph 230.

89. Panel Report, *Argentina—Hides and Leather*, paragraphs 11.315–11.331. The panel agreed that its suggested approach would entail some administrative costs for Argentina, but the panel was not convinced that the costs would be excessive.

90. Panel Report, *European Communities—Conditions for the Granting of Tariff Preference in Developing Countries*, WT/DS246/R, adopted on April 20, 2004, paragraphs 7.225–7.235. The panel's holding and reasoning on this point was not appealed.

countries even though Iran was a more seriously drug-affected country than the beneficiary Pakistan. In addition, according to the panel, the EC's explanations were unconvincing for why Pakistan had been excluded from the program before 2002 but included later even though there was no objective change in Pakistan's situation. The panel's solicitude for Iran is remarkable because Iran is not a WTO member.

The Article XX chapeau jurisprudence was further developed in the *Brazil—Tyres* case, where the EC challenged Brazil's import ban. There the Appellate Body considered arbitrary and unjustifiable discrimination together and suggested that both would exist if a measure is applied in a discriminatory manner between countries where the same conditions prevail, "and when the reasons given for this discrimination bear no rational connection to the objective falling within the purview of a paragraph of Article XX, or would go against that objective."[91] Explaining further, the Appellate Body stated that "we have difficulty understanding how discrimination might be viewed as complying with the chapeau of Article XX when the alleged rationale for discriminating does not relate to the pursuit of or would go against the objective that was provisionally found to justify a measure under a paragraph of Article XX."[92] Two findings by the Appellate Body illustrate this principle. In *Tyres*, Brazil was banning retreaded tires from most countries while permitting them from countries in the Southern Common Market (Mercosur). The Appellate Body found that such discrimination was arbitrary or unjustifiable because its justification (regional treaty compliance) "does not relate to the pursuit or would go against the objective" in Article XX(b) being claimed by Brazil.[93] Also in *Tyres*, Brazil was permitting the importation of used tires that would then be retreaded by domestic companies; at the same time, Brazil was prohibiting the importation of tires that had been retreaded in the European Union. The Appellate Body explained that this was discrimination, and that it was arbitrary or unjustifiable because the only rationale put forward by Brazil was that such importation, although ostensibly prohibited by law, was being permitted under various court injunctions. Such a rationale was unacceptable, according to the Appellate Body, because it "bears no relationship" to the objective of reducing exposure to the risks from the accumulation of waste tires.[94]

Brazil—Tyres provided an important test case for a classic conflict of law problem where a defendant country in a WTO dispute points to a non-WTO treaty obligation as a defense within the WTO. In *Tyres*, an in-

91. Appellate Body Report, *Brazil—Tyres*, paragraph 227.

92. Appellate Body Report, *Brazil—Tyres*, paragraph 227.

93. Appellate Body Report, *Brazil—Tyres*, paragraph 228. The Appellate Body reversed the panel that had found that the quantity of imports from Mercosur was not significant.

94. Appellate Body Report, *Brazil—Tyres*, paragraph 246.

ternational Mercosur tribunal had ruled that Brazil was obliged to allow imports from Uruguay. Nevertheless, the EC argued that taking such a treaty obligation into account would seriously undermine the effectiveness of the Article XX chapeau. The Appellate Body agreed and held that allowing imports from Uruguay while prohibiting them from the EC violated the chapeau. In winning this point, the EC solidified WTO jurisprudence that so far has refrained from giving legal weight to nontrade treaty obligations as an Article XX defense. It should be noted that in *Tyres*, the international obligation being offered as a defense by Brazil arose from a trade liberalization treaty. Whether the Appellate Body would be more deferential to an environmental treaty remains to be seen.

As noted above, the Appellate Body has held that there is a procedural dimension in the adjudication of "unjustifiable." In *United States—Shrimp*, the Appellate Body stated that the unjustifiability of the US measure was underscored by the unilateral way in which US regulators had acted. Specifically, the jurists criticized the fact that the operating details of the US policies were shaped without the participation of other WTO members.[95] Furthermore, the "system and processes of certification are established and administered by the United States agencies alone," and the decision making for the grant, denial, or certification of countries is also unilateral.[96]

With specific regard to "arbitrary" discrimination, the Appellate Body has held that "rigidity and inflexibility" in administration can be arbitrary discrimination when there is no inquiry in regulating countries as to the appropriateness of the regulatory program for conditions prevailing in exporting countries.[97] In addition, procedural inflexibilities can constitute arbitrary discrimination. For example, in *United States—Shrimp*, the Appellate Body stated that, in a country certification process, the lack of a formal opportunity for other countries to be heard and to respond to arguments against the process and the lack of a procedure for appeal would constitute arbitrary discrimination for a country denied certification.[98] The Appellate Body also criticized the nontransparent nature of the internal US government procedures being applied.

WTO adjudicators have expounded the "disguised restriction on international trade" condition in a few cases. In *United States—Gasoline*, the Appellate Body made clear that a concealed or unannounced restriction does not exhaust the meaning of a disguised restriction and that "disguised discrimination" would amount to a disguised restriction.[99] In line with the

95. Appellate Body Report, *United States—Shrimp*, paragraph 172.

96. Appellate Body Report, *United States—Shrimp*, paragraph 172.

97. Appellate Body Report, *United States—Shrimp*, paragraph 177.

98. Appellate Body Report, *United States—Shrimp*, paragraphs 180–181.

99. Appellate Body Report, *United States—Gasoline*, p. 25.

reasons that it found "unjustifiable discrimination," the Appellate Body in *United States—Gasoline* also found a "disguised restriction on international trade." In *European Communities—Asbestos*, the panel suggested that "intention" is an element of "disguised," and that discriminatory measures could violate this prong if they are "in fact only a disguise to conceal the pursuit of trade-restrictive objectives."[100] The panel also suggested that "protectionist objectives" of a measure can be ascertained from its "design, architecture, and revealing structure"[101] and called attention to the lack of evidence showing that the French import ban had benefited domestic industry to the detriment of foreign producers. In the *United States—Shrimp* compliance adjudication, the panel echoed this formulation in *European Communities—Asbestos* and examined the design, architecture, and revealing structure of the measure being contested to see if it was a "disguised restriction." The panel concluded that even though the US competing industry was probably in favor of the import ban, US domestic industry was "likely to incur little commercial gain from a ban" and thus there was no chapeau violation."[102] The panel also noted approvingly that the US government was offering technical assistance to exporting countries to develop the utilization of environmental-friendly technology. By contrast, in *Brazil—Tyres*, the panel found that the allowance of imported used tires made the tire import ban a "disguised restriction on international trade" because such importation benefited domestic retreaders while undermining the health purpose of the import ban.[103]

In summary, although the applicability of the Article XX exception to measures linked to the life cycle of a product was not clear from the Uruguay Round negotiation, the jurisprudence of the Appellate Body leaves no doubt that measures linked to the production processes used in foreign countries are not, per se, outside the scope of Article XX. If such a measure is challenged in the WTO and is found to be discriminatory or an import ban, the defending country may seek to justify the measure under Article XX. In such litigation, the defending country will have to show that its measure is provisionally justified by an Article XX exception such as XX(g) and then that the measure is applied consistently with the Article XX chapeau.

100. Panel Report, *European Communities—Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/R, adopted on April 5, 2001, paragraph 8.236.

101. Panel Report, *European Communities—Asbestos*, paragraphs 8.236, 8.238.

102. Panel Report, *United States—Shrimp* (Article 21.5—Malaysia), paragraph 5.143.

103. Panel Report, *Brazil—Tyres*, paragraph 7.348. The Appellate Body upheld this finding but reversed the panel in part because the panel had conditioned its analysis on the quantity of used tire imports.

Disciplines on Subsidies

The Agreement on Subsidies and Countervailing Measures governs the use of subsidies. Because many climate change proposals rely on subsidies, the ASCM will need to be examined to assure that any subsidies comply with the agreement. Certainly, a grant or tax exemption by a government is a "subsidy" under the ASCM, but the status of emissions allowances is not clear.

ASCM Article 1 defines a "subsidy" under the agreement, and if a measure does not fit within that definition, it is not covered by the agreement. A subsidy requires a "financial contribution" and a "benefit" to the recipient. The question of whether the free allocation of an emissions allowance is a subsidy does not have an obvious answer, and there has been no WTO jurisprudence on this point (Lodefalk and Storey 2005, 41–43). The same puzzle exists for the rebate of an emissions allowance upon export. Under the ASCM, a subsidy exists when there is a financial contribution by a government and a benefit conferred to the recipient. The granting of an emissions allowance is intended as a benefit and surely is one.[104] So the key question is whether such a grant is a financial contribution. The ASCM definition of financial contribution is broad and includes, among other points, "a direct transfer of funds" and a situation where "a government provides goods or services other than general infrastructure."[105] A "fiscal incentive" where revenue that is "otherwise due is foregone or not collected" is also a financial contribution.[106] None of these examples of financial contribution clearly match an emissions allowance given to a private economic actor by a government because such an allowance may not be a good or a service but rather an intangible property right.

The closest WTO case regarding property rights was *United States—Softwood Lumber IV,* where Canada challenged a US countervailing duty on lumber.[107] In that case, the Appellate Body was asked to decide whether

104. Under ASCM, Article 14(d), the provision of goods or services by the government confers a benefit if the provision is made for less than adequate remuneration under prevailing market conditions. Whether or not an emissions allowance is a good, the same principle should apply; since emissions allowances could be traded on the market, they would have a market price, and so providing them free to the recipient is a benefit. It does not matter whether the recipient of the subsidy uses it in a manner that promotes public policy objectives on climate. In other words, one might presume that a government subsidy generates a benefit to the government, but the ASCM does not take such private-sector performance into account in deciding whether the recipient has benefited from the subsidy.

105. ASCM, Article 1.1(a)(1)(i), (iii). Note that government grants for general infrastructure, such as a new electrical grid, are not treated as financial contributions under the ASCM.

106. ASCM, Article 1.1(a)(1)(ii).

107. Appellate Body Report, *United States—Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, adopted on February 17,

an intangible right to harvest timber was a good, and the Appellate Body decided that it was, stating that "we believe that, by granting a right to harvest standing timber, governments provide that standing timber to timber harvesters."[108] The principle in that case—that a right to a good translates for ASCM purposes into a good—might also carry forward to services such that a right to use a service is itself a service.

A greenhouse gas emissions allowance, however, would not appear to be a good or a service as those terms are generally understood.[109] Rather, such permits are government licenses to pollute within a regulatory scheme. Since the definition of subsidy in the ASCM was drawn narrowly to prevent the existence or nonexistence of government regulation from being considered a subsidy,[110] it might seem anomalous to pigeonhole government licenses into the definition of a subsidy. Moreover, unlike a right to timber where timber itself is a good, a right to generate greenhouse gas emissions is not a right to a good because greenhouse gas emissions are not a good as the term is commonly used.[111]

Nevertheless, there would be strong trade policy grounds for treating emissions allowances as subsidies covered by the ASCM because, if not, governments in the future carbon-conscious world would be able to avoid all subsidy disciplines by using the form of tradable emissions allowances to confer aid on favored industries or agricultural producers.[112] Thus, a panel faced with deciding whether carbon permits are subsidies would probably find that they are through an expansive interpretation of the definition of an ASCM subsidy. One possibility would be to call an emis-

2004 [known as *Softwood Lumber IV*].

108. Appellate Body Report, *United States—Softwood Lumber IV*, paragraph 75.

109. de Cendra (2006, 137) suggests that emissions allowances could be considered financial services under the GATS Annex on Financial Services because Article 5(a) of the annex includes trade in negotiable instruments. We do not agree with that argument. Although trading in negotiable instruments is a service, nothing in the annex suggests that the negotiable instrument itself is a service.

110. The negotiating history is discussed in the WTO Panel Report, *United States—Measures Treating Export Restraints as Subsidies*, WT/DS194/R, adopted on August 23, 2001, paragraphs 8.64-8.74.

111. Some international law experts (e.g., Murase 2008, 408) suggest that certified emissions credits are either a good or a service.

112. Treating the government grant of an emissions allowance as a financial contribution can be distinguished from other government acts that are not subsidies. For example, the ASCM would seem to permit a government to relax its regulations on exporters. The limited purview of the ASCM was noted in one WTO case when the panel explained that not every "government intervention that might in economic theory be deemed a subsidy with the potential to distort trade is a subsidy within the meaning of the SCM Agreement." Panel Report, *United States—Export Restraints*, paragraph 8.62.

sion allowance either a good or a service.[113] Another would be to use the "direct transfer of funds" definition of a financial contribution to include government permits that are convertible into cash through a government-approved auction. A third possibility would be to hold that the allocation of some subsidies freely while others are being auctioned by the government is tantamount to the foregoing of revenue by a WTO member.

If a free distribution of an emissions allowance is a subsidy, then it is subject to the disciplines of the ASCM. Under ASCM Article 3, the granting of a subsidy contingent upon export performance is prohibited. The other ASCM disciplines require that the subsidy be specific. When subsidies are limited to certain enterprises, such subsidies are specific (Green 2006, 400–401). Otherwise, specificity is judged based on several factors listed in ASCM Article 2. Under Article 5, the granting of a specific subsidy causing adverse effects to the interests of other WTO members is prohibited. The meaning of "adverse effects" is spelled out in Articles 5 and 6. Under Part V of the ASCM, when a specific subsidy causes injury to the import-competing domestic industry producing a like product to that being subsidized, the importing country may impose a countervailing duty on the imported product.

The adverse effect most applicable to climate subsidies is "serious prejudice" as defined in ASCM Article 6.3. Under that provision, one form of serious prejudice occurs when "the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member."[114] For example, if the United States subsidizes its domestic widget industry, and that subsidy causes a displacement of imports of widgets into the United States from China, then China could lodge a WTO case against the United States alleging an actionable subsidy. In the context of climate subsidies, an interesting question arises as to whether there is any legal significance when the domestic subsidy is part of a larger program imposing onerous domestic regulation. In other words, what is the baseline against which displacement should be measured? Is it the status quo ante before the subsidy or before both the subsidy and the domestic regulation? As far as we are aware, this exact question has not come up in WTO dispute settlement.

If the purpose of the ASCM provisions outlawing actionable subsidies is to prevent them, then it would be illogical to allow governments to defend such a subsidy on the grounds that it is linked to another domestic policy that has put the industry receiving the subsidy at a disadvantage. Generally, the motive for a subsidy is something that the ASCM does not

113. Whether electricity is a good or a service in WTO law is not specified. (Electricity is specifically excluded from the Convention on Contracts for the International Sale of Goods.) Traditionally, many trade experts have considered electricity a good (Voigt 2008, 58). So the right to use electricity could likewise be a good.

114. ASCM Article 6.3(a).

take into account; the agreement treats subsidies to prevent market failure with the same rules as it treats subsidies to redistribute income. The fact that the original ASCM specifically declared as nonactionable certain environmental subsidies connected to burdensome environmental regulations further suggests that without such an exception, environmental subsidies would be treated the same way as other subsidies in assessing the prejudice to other countries of a government's domestic subsidy.[115] Unfortunately, the WTO exception permitting environmental adaptation and general research subsidies has expired.[116] Thus, the proper baseline for determining the effects of a subsidy would seem to be the economic situation that would have existed but for the subsidy.

The WTO Agreement on Agriculture also contains disciplines on domestic subsidies linked to commitments made in trade negotiations. Article 6 forbids WTO members from providing greater subsidies than the commitments made in particular categories.[117] This provision also provides a policy exemption for developing countries for subsidies to producers to encourage diversification from growing illicit narcotic crops.[118] In addition, the agreement exempts qualifying subsidies that have at most minimal trade-distorting effects or effects on production.[119] Certain environmental subsidies are specifically noted as qualifying.[120]

115. The one exception in ASCM law shows the rule: Article 27.13 provides that ASCM Part III (Actionable Subsidies) does not apply to "subsidies to cover social costs" when such subsidies are granted as part of a privatization program of a developing country. This carve-out would not have been added by negotiators if the adverse effects of a subsidy to cover such social costs would have been automatically immunized, because the subsidies were in response to the economic effects of the government's privatization policy.

116. See ASCM, Articles 8.2. Among the nonactionable subsidies were grants to promote adaptation of existing facilities to new environmental requirements imposed by laws "which result in greater constraints and financial burdens on firms...."

117. Note that bioethanol is covered by the Agreement on Agriculture, but whether biodiesel is covered is a matter of debate.

118. Agreement on Agriculture, Article 6.2.

119. Agreement on Agriculture, Article 7 and Annex II (so-called green box subsidies).

120. Agreement on Agriculture, Annex II, paragraph 2(g), 8(a), 12.