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GENERAL WTO ASPECTS OF A CLIMATE BORDER MEASURE

1. National measures to address climate change which have an impact on trade can be compatible with WTO law.

WTO law must be interpreted '*in the light of contemporary concerns of the community of nations about the protection and conservation of the environment*'.

WTO Appellate Body (AB) in *US-Shrimp*, October 1998

'the results obtained from certain actions, for instance, measures adopted in order to attenuate global warming and climate change ….. can only be evaluated with the benefit of time'.

AB in *Brazil-Retreaded Tyres*, December 2007

2. These national measures can include border measures.

A border measure does not have to be identical to the domestic measure.

GATT Article XX

There is a *requirement of even-handedness* but without the requirement of *identical treatment of domestic and imported goods*.

AB in U*S-Gasoline*, May 1996

If there is '*a genuine relationship of ends and means'* and the border measure makes a *'material contribution*' to the achievement of the environmental objective then a border measure can be considered '*necessary*'.

AB in Brazil-Retreaded Tyres

3. The EU can legitimately have higher climate ambitions than other countries.

WTO law recognises the EU's sovereign right to set as high a level of protection of the environment as it determines to be appropriate. This right is not unfettered. If the high ambition includes a border measure then it must not be *a disguised restriction on international trade* or *discriminate between countries where the same conditions prevail* or discriminate *between imported and domestic goods*.

GATT Articles III and XX

High EU standards can have the *de facto* effect of exporting those standards to companies wishing to sell into the EU market. This is most clearly seen, for example, in the health and safety of imported foods or chemicals complying with REACH. This *de facto* effect is not incompatible with trade law.

4. The Climate Border Measure should not be a tariff or import charge

To avoid a GATT II inconsistency, the triggering of the imposition of the charge must not be *importation* itself but an *internal factor* such as consumption.

AB *in China-Auto Parts*, January 2009

GATT Article II prohibits the imposition of *duties or charges of any kind* in excess of the tariffs set out in a Member's Country Schedule.

5. 'As Such' and 'As Applied': the Architecture of the EU's border measure

WTO Panels and the Appellate Body judge if a measure is compatible with WTO law 'as such' or 'as applied'. An 'as such' review examines whether the national law itself is compatible with WTO law. An 'as applied' review examines whether the WTO member has acted in breach of WTO law when applying the national law.

The shape or architecture of the EU's carbon border measure must aim at 'as such' compliance.

6. The Architecture of a border measure must address the EU's climate objective

[W]e consider that a measure's purposes, objectively manifested in the design, architecture and structure of the measure, are intensely pertinent to the task of evaluating whether or not that measure is applied so as to afford protection to domestic production.

AB *Chile-Taxes on Alcoholic Beverages*, December 1999

The EU has chosen to achieve carbon neutrality by restricting the right to emit carbon. This policy addresses the carbon footprint of goods manufactured in the EU. This is a market-based approach (as opposed to a tax or standards approach).

As the EU has an internal a market-based mechanism imposing a market-based mechanism at the border is not likely to be considered WTO incompatible 'as such'. A tax based approach at the border might be.

7. Carbon leakage

Recital 24 of Directive 2009/29 addresses two types of carbon leakage: emissions imbedded in imported goods, and emissions from industries that could leave the EU. The substantive provisions of the Directive only address carbon leakage from moving manufacturing abroad. Rules in relation to the carbon footprint of imported goods have not been elaborated.

WTO law does not require that the means to avoid carbon leakage in imports are identical or even exactly mirror the avoidance of carbon leakage through moving manufacturing abroad. If they are considered different aspects of carbon leakage they can be addressed differently.

8. Technical or Product Standards

WTO members retain the sovereign right to set whatever standard they consider appropriate to achieve a legitimate public policy objective. The EU defends this right even to the point of setting standards for hormones in beef or on genetically modified organisms (GMOs) which some consider are in breach of WTO law.

The standard would apply equally to domestic and imported goods. Products not meeting EU standards cannot be present in the European Union (whether produced domestically or abroad). These standards could be tightened over time.

9. Conclusion

If EU policy is that all goods consumed in the EU must comply with the EU's carbon emissions reduction policy then a properly constructed border measure can comply with WTO law.

SPECIFIC ELEMENTS OF A CLIMATE BORDER MEASURE

Any cost to be imposed on imports to be consumed in the EU should be at a level appropriate to the high level of the EU's climate objective.

The EU's policy of limiting and reducing emissions over time must also be applied to goods imported for consumption in the Union.

The EU's climate objective cannot be achieved if production is shifted to countries with less ambitious objectives and thus less production cost. Therefore, the risk of carbon leakage can be addressed by a Climate Border Measure. Carbon leakage will not be prevented if the overall burden on imports is less than the overall burden on EU manufacturing. This in turn requires measures to prevent the absorption of any costs by exporting producers or the sending of low carbon footprint goods to the EU and diverting high carbon footprint goods to markets with standards lower than the EU.

GATT Article III

In relation to the cost burden, GATT Article III provides that there should be no discrimination between imported and domestically produced goods. In other words, the carbon cost burden on imported goods should not be *in excess of* the carbon cost burden on *like* or *substitutable/competitive* EU products.

The exact carbon cost burden on an EU manufacturer for a particular good at any one time will always be a matter of fact. This implies that some sort of mechanism will be required to set the exact cost burden on the imported good. The import cost burden mechanism cannot operate so as to allow carbon leakage and therefore must also address the wider carbon reduction objectives.

GATT Article XX

If a border measure which reflects a high level of climate ambition is in breach of GATT Article III, recourse to the exceptions in GATT Article XX will be required.

The key to a successful recourse to GATT Article XX is that any discrimination or trade restriction is done for authentic environment/health related considerations.

To come within GATT XX, the border measure must be shown:

- to be *necessary* to protect human, animal, plant health (GATT XX(b))
- to *relate to* the conservation of exhaustible natural resources (GATT XX(g))

And, if it passes either one of these first two tests, the chapeau of GATT XX provides:

- It must not be a disguised restriction on international trade, or
- Constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail.

An import cost burden mechanism is in line with the general legal requirement (reflected in the EU *Outokumpu Oy* case from April 1998 – Case C-213/96) that there must always be a mechanism that allows importers to show the actual conditions of the imported good.

A mechanism of this nature would have to allow, for example, adjustments for countries participating in the EU's ETS or its equivalent or for products that have already incurred specific costs.

Burden of Proof

It need not be problematic from a WTO law perspective if the burden of proof both in relation to actual emissions and actual costs already incurred is on the importer.

Flexibility for EU importers at company and/or country level

GATT Article I prohibits discrimination between imports based on origin. Thus exempting, *per se*, imports from certain origins on the basis of carbon policies could breach this provision. However, *Canada-Autos* (February 2000) indicates that origin neutral measures which evaluate production processes in particular countries could be WTO compatible. This reasoning might well apply to a country that participated in the EU's ETS or had an equivalent ETS system in place.

EU policy seeks to reduce emissions by placing limitations and costs on emissions. This results in a cost burden per tonne of steel. The border measure must materially

contribute to this objective of limiting and costing emissions while seeking, as far as possible, not discriminating between imported and domestically produced goods.

If, in the production of the imported good, emission limitations or costs have already been incurred, whether those limitations or costs are due to third country public policy or individual company policy, then those limitations and costs must be taken into consideration in ensuring no discrimination on the goods themselves within GATT Article III and on the origin within GATT Article I, so long as to do so would not undermine the EU's overall climate policy.

It is reasonable to think of border cost burden mechanism that, when evaluating the emissions of a particular good, would provide that if the good came from a particular origin (whether country or company) a pre-evaluated amount of emissions (or cost) might be provisionally recognised (so as to facilitate trade and ease of border evaluation). This evaluation would have to be based on verified evidence rather than political assumptions and a mechanism to contest the provisional evaluation should be available to importers.

Risk of Absorption and Source Shifting

A third country producer could export its low carbon footprint steel to the EU and sell its high carbon footprint steel on the domestic market or in markets with lower climate ambitions than the EU (source shifting).

Or a third country producer could absorb the EU carbon costs imposed at the border if the percentage of exports to the EU as against its total sales was low and there were no carbon emission costs on the other volumes not exported to the EU (absorption).

A border measure that addresses absorption and source shifting need not, *per se,* be incompatible with WTO rules. At the same time, it can be complex. GATT Article III applies to the good traded rather than total production of all the goods from the country of origin or the manufacturer. This indicates that a provision in the border measure addressing total company or country emissions so as to avoid source shifting and absorption would have to be designed to come within GATT XX.

It can be expected that addressing absorption and source shifting will require the development of a sophisticated monitoring and enforcement mechanisms. These types of mechanisms are common in trade and can be seen in trade defence instruments or in ensuring the health and safety of foods and agricultural products.

Abatement costs

Abatement investment costs are incurred today with the object of a future benefit. Given the view of the WTO Appellate Body in *Brazil-Retreaded Tyres* (cited above) the legality of one part of a border measure addressing the issue of abatement and which made a material contribution to the EU's carbon reduction policy does not appear to be *per se* incompatible with WTO law. Compatibility will depend on the issues of *material contribution* and *necessity*.

To the extent that EU law requires abatement or sets specific carbon reduction targets for specific products these policies could be reflected in the border measure.

Transition and complexity

There is nothing inherently incompatible with WTO law if the EU's carbon border measure is phased-in over time and is made up of a variety of elements.

The transition to carbon neutrality can also be complex and the fact of complexity does not make it WTO incompatible. This could see the possibility of evolution of the two types of carbon leakage policies (addressing emissions in imports and avoiding the flight of manufacturing) independently of each other if there is an environmental justification for such difference within the EU's high level of ambition.