

Trade and Climate Change

R.V. Anuradha

CLARUS LAW
ASSOCIATES

The Balance under the UNFCCC

- Emphasis on Common But Differentiated Responsibilities, and Respective Capabilities
 - **CBDR-RC: Countries divided into Annex 1 and non-Annex1**
- Recognition that share of global emissions originating in developing countries will grow to meet their social and development needs- that they have “legitimate priority needs”
- Mandatory binding obligations only on Developed countries
- Developing country obligations- made contingent on financial resources and transfer of technology from Developed countries
- Recognition that within developing countries, several are especially more vulnerable- LDCs, small island countries, & those prone to environmental disadvantages.

CC Overview: Sequence of Events

- 1992: UNFCCC
 - Significant promises on Financial Mech., Transfer of Technology
 - But insignificant achievements
- 1997: Kyoto Protocol (Entry into Force: 2005)
 - Clean Development Mech.- envisaged as a vehicle for investment and financial flows- but very limited impact.
 - Main beneficiaries: India, China, Brazil.
 - In reality- very little role in funding projects.
- Carbon prices have been crashing with supply exceeding demand
 - Economic recession
 - Markets drying up

Recent Developments: CHAOS

Durban, Doha, Warsaw:

- Dilution of reference to Common But Differentiated Responsibility
- Lack of Consensus on role of 'Equity'
- Demand that developing countries commit to emission reductions
- Change of language- "Commitments" changed to "Contributions"- a legal 'downgrade'
- Uncertainties with Japan, Canada, Australia- scaling down on obligations
- New Agreement expected in 2015-
 - Vagueness about the outcome
 - Activists shouting at Warsaw: *"WTF – Where is the finance?"*

2015 Climate Deal- Trends

- Emphasis on *Contributions* by all countries
- For Developing countries- Nationally Appropriate Mitigation Actions (NAMA), coupled with:
 - Measurement, Reporting, Verification (MRV) of all NAMA
 - International Consultation and Analysis (ICA) of internationally funded NAMA
- Legal implications- uncertain

What does all this have to do with
Trade?

Post 2012: Rising Unilateralism

- Increasing threat of use of Unilateral Measures
- Examples:
 - **EU-ETS on Aviation: Requiring all aircraft carriers to buy allowances equal to the CO₂ emissions of each flight (including those emissions attributable to the non-EU leg of a journey)**
 - Though currently modified to cover only EU-leg of journey- owing to pressure from US, China, India, etc.
 - Possible Maritime related unilateral measures
 - EU-ETS: Carbon Equalization
 - US: Possible Legislation- 3 versions of the Bill since 2008- provide for cost on imported products
 - Carbon Labeling and Standards

The Problem with Unilateralism

- Financial implications for ALL countries, irrespective of CBDR
- In effect, *forces* countries to adopt ER obligations, or pay for non-adoption
- Choice of such obligations- not ‘economy-wide’ as currently allowed under UNFCCC.
- This will amount to transfer of the mitigation burden to developing countries even when the UNFCCC does NOT require any ER obligations by such countries
- **Renders CBDR redundant**

The Problem with Unilateralism

- UTMs do not follow the ‘economy-wide’ emission reduction approach as currently allowed under UNFCCC.
- *In fact, irrespective of ‘economy-wide’ emissions being low, UTMs will force sector-specific measures*
- Sector-specific measures under Kyoto Protocol- currently envisaged only for Aviation and Maritime- *AND* only for Annex I countries
- For everything else- ‘economy-wide’ emissions
- UTMs- will force sector-specific action: Examples-
 - *Reference in US bills to steel, aluminium, or cement sectors;*
 - *EU-ETS: reference to certain energy-intensive sectors which compete internationally (not defined as yet)*

UNFCCC on Trade Measures

- **Article 3.5 of UNFCCC:** The Parties should cooperate to promote a supportive and open international economic system that would lead to sustainable economic growth and development in all Parties, particularly developing country Parties, thus enabling them better to address the problems of climate change. *Measures taken to combat climate change, including unilateral ones, should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade.*
- Apart from the above, there is no formal linkage between Trade and CC policy.

Legal Uncertainties in Art. 3.5

- Very broad policy guidance; No formal trade policy instruments are sanctioned under the UNFCCC
- No concrete criteria on how or when Unilateral Measures can be made applicable
- Key Questions for which UNFCCC silent:
 - Whether a UTM is *necessary*
 - Whether '*less trade restrictive*' alternatives are available
 - Should not such measures be applied in a differentiated manner based on the different circumstances and obligations of each party?

WTO & Climate Change

- Preamble: Recognition of differential responsibilities of countries to Environment
- But substantively, not concerned with CBDR principle
 - S&DT Provisions in WTO Agreements provide for certain concessions with regard to trade liberalization, not CBDR with regard to environmental obligations
- Environmental action in breach of trade commitments can be justified as *exceptions* to GATT and GATS

WTO & Climate Change

- Fundamental principle of Non-Discrimination with regard to domestic and imported *Like Products*
- *Assessment of Likeness* – traditionally based on physical characteristics
- Increasing focus however on Processes and Production Methods (PPMs)
 - With regard to carbon, the key issue is treatment of *embodied carbon* under WTO law
 - WTO evolving jurisprudence- possibility that non-discriminatory *process-based* measures are WTO consistent

GHG Policy Framework: Interface with Trade

Overview of GHG Policy across countries

- EU- One of the early regimes for cap and trade- under the EU-ETS system
- Other countries with evolving regulatory measures in form of taxes, cap & trade obligations, other fiscal measures- Australia, South Korea, China, New Zealand
 - **Predominant focus- obligations on domestic players;**
 - **In Australia, competitiveness concerns for domestic industry led to suspension of their domestic regime.**
- Currently- EU's system is the only one that could have likely direct implications for imported products
- US- Evolving legislation. Each version has provisions mandating importers to purchase allowances

EU-ETS: *Carbon Equalization*

Principles laid out in the EU-ETS Directive:

- If other developed countries or major emitters of greenhouse gases fail to participate in an international agreement to curb emissions,
- **Then such failure could result in increased GHG emissions in third countries where industry is not subject to *comparable carbon restraints*** This would put certain energy-intensive sectors of the EU which compete internationally, at an economic disadvantage
- EU will then work out methods for ‘carbon equalization’

EU- Carbon Equalization

- Obligation on “economically advanced countries” to undertake action and contribute *adequately*
- *Comparability of action*: When failure of an international agreement could result in industry in third countries not being subject to *comparable* carbon restraints
- Main concern: Economic disadvantage to EU based industry

EU Unilateralism & ‘Equalization’- Measures on Aviation and Maritime

- Aviation was included as part of EU-ETS;
 - Mandatory compliance requirement on foreign airlines in respect of their air travel outside EU space- suspended after resistance
 - Multilateral discussions at ICAO- Ongoing.
- EU is considering including Maritime sector as well
 - Would depend on outcome of multilateral IMO discussions
 - If maritime sector is built into the EU-ETS, this would have implications for trade in goods being imported through sea-route.

US- Proposed Legislation

- Mandate that there should be “Equitable reductions” by “Major GHG Emitting countries”
- Exemption for countries that:
 - have GHG reduction obligations “*as stringent as*” that established under US law
 - GHG intensity for a sector that is equal to or less than US
- Domestic producers have access to free allowances/rebates/borrowing from future allowances; not so for importers

Carbon Labelling/Standards

- Projected as only voluntary standards, informational tools for consumers
- BUT, in reality, are they providing any inaccurate information?
 - *E.g. of Food Miles: Penalization of non-locally produced food*
- No consensus on elements of a ‘Life-cycle’ approach used in Carbon Footprint standards
 - *How a product is used often determines its GHG potential; not just how it was produced!*
 - *A UK House of Commons report: LCA very complex; based on “highly hypothetical average use”- can be misleading*
- Examples: UK Carbon Trust; France- Grenelle 2, Japan Carbon Footprint

International Standards

- ISO standards relevant basis for determining “international standards” under WTO TBT Agreement
- 2/3 majority sufficient
- ISO Membership- National Standardising bodies; significant representation of industry from Dd countries
- ISO 14000 series:
 - Environmental management
 - Environmental assessments
 - Product labeling
 - Environmental communication
- ISO- uses Life-Cycle Analysis approach
- ISO- dominated by Developed country industry

Risks

- **Any Unilateralism would pose a threat to both:**
 - **UNFCCC system**
 - **Trade system under the WTO**
- **Question therefore: Should there be a more formal, structured linkage between Trade and Climate Change?**

WTO- No Real Answers

- Broadly 2 Types of Measures:
 - Carbon taxes/charges as a Border Tax Measure
 - Carbon Labelling
- Design of measures would determine WTO evaluation
- Not all unilateral measures are strictly ‘trade measures’
- WTO ill-equipped to handle issues relating to ‘CBDR’

Carbon Charges/Taxes

What type of measures are being contemplated?

- Measures that seek to impose costs on a foreign producer through the obligation to purchase emission allowances (as in the case of the U.S.) or some sort of ‘carbon equalization’ in the case of the EU.
- At the heart of these allowances/ equalization program, is a charge/ tax being imposed on imports based on the process of production, in this case, in respect of the energy used in the production process.

WTO Provisions

- WTO Provisions likely to be attracted:
 - **Article II.2(a)**, which deals with the nature of charges that may be imposed at the border, in order to create parity between like domestic products and imported products.
 - **Article III.2** and **Article III.4**, which deal with the principle of National Treatment in respect of internal taxes and regulations as applicable to imported products.
 - **Article XX**, which deals with General Exceptions to GATT obligations, especially the exceptions in respect of environmental grounds under Article XX(b) and Article XX(g).

WTO's Approach

- Assessment will be purely on whether:
 - Impact of energy consumed in production process, or of emissions released in production process- on *Likeness* of product- the issue of 'embodied carbon'
 - Whether there is *differential* treatment of like products;
 - Whether there is *protectionism* for domestic industry;
 - Whether there is *unjustifiable discrimination*
 - Have *less trade restrictive* alternatives been considered
- WTO Jurisprudence so far- not entirely clear on how these issues will be adjudicated.

WTO on Border Tax Adjustments

- Working Party on BTA: Such measures can be imposed in respect of *indirect taxes* on domestic products
- Did not consider:
 - Impact on energy consumed in manufacturing process
 - Whether the tax has to be on inputs *embodied* into the final product
- *US-Superfund Case* (1987 GATT Panel)
 - US levy of taxes on certain chemical inputs and end-products, based on whether or not domestic taxes applicable
 - Panel silent on whether the chemical input has to be present in final product

Article III Tests

- Whether the measures contemplated- i.e., emission allowances or carbon tax, etc.- are:
 - *Internal Taxes for purposes of Article III:2; or*
 - *Laws, regulations, requirements for Article III:4*
 - *And whether design of is measure such that it:*
 - *Is it treating domestic products differentially to afford protection?*
 - *Is it treating imports “less favourably”?*
 - *Is it modifying conditions in the market for imported products?*
- Traditional GATT jurisprudence- that distinguishing products based on PPMs- violates principles of non-discrimination
- “Like products” are those that are distinguishable by their characteristics as products

Article XX - The ‘Exceptions’ Jurisprudence

- Even if a measure is found violating Articles II or III, Article XX General Exceptions available
- XX(b) and (g)- most relevant
- **Shrimp-Turtle Case:** Appellate Body found:
 - That the requirements under U.S. law which required the exporting country to have the *same* legal requirements as that of the U.S. are “*arbitrary and discriminatory*”
 - But it would be acceptable to require exporting countries to have regulations that are “*comparable in effectiveness*” to that of the U.S.

WTO on Extra-Territoriality

- In the implementation of Shrimp-Turtle ruling, AB held: Article XX did not require the *conclusion* of an international agreement; but that this test would be satisfied if the U.S. could demonstrate that it had made ‘serious efforts’ to negotiate.
- Both US and EU measures- seem to be reflecting the *US-Shrimp Turtle principle* on when environmental measures having *extra-territorial* impact can be considered
 - This principle is that Parties should have *tried to* conclude an international agreement;
 - Not that they should *actually conclude*.
 - Trying is enough.

Other MEAs with Trade Measures

- **Montreal Protocol on Substances that Deplete the Ozone Layer :**
 - Trade measures against Non-Parties: To deter non-participation
 - Against Parties for non-compliance
- **CITES:** Import prohibition for non-complying countries
- **International Convention for Conservation of Atlantic Tuna:** Punishment for parties and non-parties for Illegal, Unreported and Unregulated Fishing

UNFCCC- Any possibility for clarity?

- Inconclusive discussions on How to Interpret and Apply Article 3.5 on Unilateral Measures
- Given current uncertainties, no possibility of any resolution under the Paris Agreement

Climate Agenda at the WTO

Issues on WTO's Plate with Climate Interface

- Increasing focus by Developed Countries on liberalization of *Environmental Goods*
 - *Davos Joint Declaration on Plurilateral EGS Agreement*
- WTO Implications on Carbon labeling and Standards- Exclusion so far of *Private Standards* - which constitute bulk of existing standards
- WTO Treatment of Subsidies for Climate-Friendly Measures
- IPRs and Technology Transfer

WTO- Tech Transfer

- Submission by India-China in relation to the EGS Discussions on Obligations of Developed countries to:
 - Commitments for Effective Transfer of EST
 - IPRs to not become a barrier; Commitment to ensure reasonable terms of access
 - Linkage with UNFCCC Discussions on Climate Tech Centre
 - Sound financial mechanism to enable transfer of EST
 - S&DT: Less than Full Reciprocity in Commitments of Developing countries and LDCs

State of things

- In an ideal world- climate issues and measures should be part of the Climate negotiations; not WTO
- Reality- increasing focus on Trade linkages
 - Threat of unilateral trade measures
 - Rapid proliferation of carbon labels and standards
 - Climate as pretext for EGS access
- Need for a proactive agenda