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Climate Law in Developing Countries post-2012: North and South Perspectives
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FRANCESCO SINDICO

(Lecturer in Law, School of Law, University of Surrey, Guildford, GU27XH – UK, e-mail: f.sindico@surrey.ac.uk, http://www.surrey.ac.uk/law/staff-profiles/FS.htm)

Climate and Trade in a Divided World: Can Measures Adopted in the North End Up Shaping Climate Legislative Frameworks in the South?

1. Introduction

Developing countries face a double challenge when dealing with climate change. On the one hand, they are asked to adopt mitigation and adaptation measures in order to start tackling climate change but, at the same time, for many of them, their priority still is to promote development for their country. This twofold approach may lead to tensions within the developing country with different sectors of the government wishing to prioritise environmental goals over economic development, or viceversa. Furthermore, this tension between achieving climate goals and pursuing development objectives may lead to tensions also with other countries. In fact, in order to foster its development, the developing country will strive to participate more actively in the global market. One avenue to promote economic development within a developing country is for its producers to export their goods and services to other countries. It is crucial, therefore, for the developing country to be able to rely on international legal norms that facilitate their exports to other developing countries but, in particular, to industrialised States, which is where consumption of the goods produced in developing countries mostly takes place.

Against this framework, this paper wishes to explore to what extent climate policies in the North may end up shaping climate policies in the South by obliging exporters from developing countries to comply with specific climate requirements imposed to them by the North if they wish to export their goods therein. Section 2 of this paper will briefly highlight the reasons why an industrialised country would consider targeting imports from developing countries. This will be followed by section 3 in which the paper will focus on the current proposals in the US on how a future federal climate legislation package should deal with imports from developing countries. Section 4 will then move on to see whether the current international trade rules enshrined in the World Trade Organisation (WTO) Agreements would allow such domestic climate measures. Within this section we will see which the options for developing countries before a climate are and trade dispute and we will try to determine whether relying on the multilateral trading system is actually beneficial for a developing country. Finally, section 5 will provide some conclusions and suggest a positive way forward.

2. Carbon Leakage and Competitiveness Concerns

An industrialised country may adopt trade measures against imports coming from developing countries on economic and environmental grounds. On the one hand, a company based in the North may be concerned that, if a competitor in the South is not bound by comparable climate obligations, the latter will have an unfair comparative advantage on the market. The company will lobby its government to adopt climate trade measures as a means to tackle the loss of competitiveness on the global market that the trade measure leads to. On the other hand, the government adopting a climate trade measures may also consider it as a policy necessary to deal with carbon leakage. This is the phenomenon according to which global greenhouse gas emissions increase because of less stringent climate requirements in some countries, which leads to the relocation of companies from the country with stronger climate requirements, presumably in the North, to countries with less rigid climate requirements, presumably in the South. A government adopting a climate trade measure on carbon leakage grounds will emphasize the environmental nature of the measure, while a government that takes the same measure to deal with competitiveness concerns from its companies, is inevitably focusing on the economic nature of the measure.

Have companies in the North actually started to complain about their position on the global market vis a vis companies in developing countries because of different climate requirements in different countries? And have governments started taking these concerns into account?

In the EU a number of energy intensive industries have argued that, if the new European climate regulation, and in particular the reformed emissions trading scheme, does not deal comprehensively with 'cheap' imports from third parties, they will be taking into account relocation as part of their future business strategy.[1] The same applies for the US, where the decision to not sign onto the Kyoto Protocol was mainly a political decision based on competitiveness concerns grounds.[2] Despite the fact that the debate on climate change has radically changed in the US in the last decades, most sectors of the economy in the country still fear that abiding to binding international climate obligations, when emerging developing countries are not, is a price that they are not ready to pay.[3]

Both the EU and the US are aware of the voices of concern arising from industrial unions, and both are in the midst of designing future domestic climate legislations that take into account the competiveness concerns raised by energy intensive industries. The EU is doing so in its current work on the reform of the EU Emissions Trading Scheme,[4] while the US has seen a drift of climate proposals within the Senate.[5] Both link competiveness concerns with the problem of carbon leakage in their work.[6]

[1] For example, in June 2008 the spokesman for Voestalpine, an Austrian steel firm, maintained that if the company does not get a clear signal from the Commission on how it plans to deal with the competitiveness concerns arising from energy intensive sectors, such as the steel industry, it will consider investing on a new plant outside of the EU. INCLUDE FOOTNOTE.

[2] *Byrd-Hagel Resolution* (S Res98), July 1997: "The Senate strongly believes that the proposals under negotiation, because of the disparity of treatment between Annex I Parties and Developing Countries and the level of required emissions reductions, could result in serious harm to the United States economy, including significant job loss, trade disadvantages, increased energy and consumer costs…"

[3] A thorough study of how the US currently envisages the competitiveness concerns arising from action in the field of climate change can be found in T. Houser et al, *Leveling The Carbon Playing Field: International Competition and U.S. Climate Policy Design*, Peterson Institute for International Economics (ed.), (2008), pp. 1-13.

[4] See COM(2008) 16 final, *Proposal for a Directive amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading system of the Community*, 23.1.2008, in particular recital 20.

[5] See *infra* note 14.

[6] See Doc. COM/2008/0030 final, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - *20 20 by 2020 - Europe's climate change opportunity* (2008), p. 11 and COM(2008) 16 final, supra note 4, recital 19.

In sum, relocating to a country with less stringent climate requirements may not seem environmentally friendly, but finally companies respond to their shareholders. Profit, and not emissions reductions, is their final goal. However, two observations must be made. First, companies in the North may consider good business strategy to not relocate and face tougher climate requirements as part of their corporate social responsibility policy.[7] Second, there tends to be an exaggeration on the loss of competitiveness on climate grounds. Research has shown that a relatively limited, albeit important, sector of the economy will face problems vis a vis countries with less stringent climate requirements.[8] If a country still relies primarily on fossil fuels, the amount of energy needed in the production process will determine whether a sector is at risk or not.[9] Both in the EU and in the US the petroleum refining, paper and pulp, steel, non-metallic mineral products, chemicals, and ferrous and nonferrous metals have been identifies as the energy intensive industries most at risk.[10]

3. Can the climate legislative framework in a developing country be influenced by measures adopted in the North?

In this section of the paper our goal is to determine whether climate measures adopted in the North may end up shaping how the South will regulate the production of energy intensive industries at home. In doing so, we will focus mainly on the current US proposals.

If a government adopts a measure that obliges importers from third parties to comply with similar or comparable measures to those that domestic producers must comply with, this will inevitably have implications on the importing country. In such a scenario foreign steel producers will be allowed to enter the US market only if they have produced the steel in the same or in a comparable than the US steelmaker. Should this be the case, and should it go unchallenged, the policy implication would

[7] INCLUDE FOOTNOTE ON CSR and climate change.

[8] INCLUDE FOOTNOTE ON Competitveness on climate grounds.

[9] T. Houser et al, *supra* note 3, pp. 5-7.

[10] See T. Houser et al, *supra* note 3, p. 8 and, for the EU, Commission staff working document accompanying document to the Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC so as to improve and extend the EU greenhouse gas emission allowance trading system (2008), p. 11.

be that the US steel production process would be indirectly imposed upon India steel producers.

A survey of the current climate debate in the US on how to deal with competitiveness concerns and carbon leakage will allow us to see whether this is actually the case.

3.1. The US climate change law

The US does not have a federal climate change law package that deals comprehensively with emission reductions across the entire country.[11] While this is not surprising given the stance of the Bush administration on climate change (especially during its first mandate), things might change when a new president takes position. There are two reasons for optimism: the two presidential candidates have climate change on their agenda,[12] and a recent decision of the US Supreme Court seems to have pushed climate change on to the government agenda.[13]

Against this background, in the last year or so a number of climate bills have been presented at Congress and all of them relied to a greater or lesser extent on cap and trade schemes.[14] The McCain Lieberman Act was very ambitious asking for an 80% reduction in greenhouse gas level emissions below levels of 1990 by 2050.[15] Not surprisingly none of these bills passed through Senate. While the US has been considered a climate laggard for many years, efforts arising from States and regional initiatives have been received with enthusiasm by the climate community. Three initiatives merit particular attention: vehicle emission standards in California,[16] the

[11] For an overview of climate change related law in the US see D. M. Driesen, "The Changing Climate for United States Law" (2007) 1 *Carbon and Climate Law Review* 35-44 & t. Szymanski and S. Stone, "U.S. Efforts on Climate Change: New Beginnings and Enduring Realities", (2008) 2 *Carbon and Climate Law Review* 134-139.

[12] INCLUDE FOOTNOTE ON Obama and McCain and climate.

[13] See *Massachusets vs EPA*, 127 S.Ct. 1438 (2007).

[14] 110th Congress, *American Climate Security Act*, S. 2191 (2007), hereinafter *ACSA*;

[15] CHECK AND INCLUDE FOOTNOTE.

[16] The State of California has implemented legislation about vehicle emissions standards according to which by 2030 new passenger vehicles will have to achieve a 33% reduction of carbon dioxide emissions; see *California Air Resources Board*. Furthermore, in 2005 the government of California adopted a political decision stating that the State must reduce its overall greenhouse gas emissions to 1990 levels by 2020 and reduce them by 80% (!!!) by 2050; *see California Government Code*, paragraph 12812.6 (west 2007). A Global Warming Solutions Act was passed in 2006 and it is going to be implemented through a cap and trade scheme; see *California Health and Safety Code*, paragraphs 38500-38597 (2007).

cap and trade scheme established by the Northeast States Regional Greenhouse Gas Initiative (RGGI)[17] and the Renewable Portfolio Standards.[18]

In sum, we can say that the US, especially at a state level, is finally rising to the challenges that the threat of climate change is facing us with. Considering the importance of the overall US emissions on a global level,[19] state and regional mitigation efforts are a very positive first step, the next one being obviously a federal climate law package that covers the entire territory of the US. The presence of a new president in the White House will probably trigger action in this direction, but nevertheless time will come, probably sooner than later, when an overall federal climate legislative package will be passed due to the unsustainability over a long term of a fragmented US climate system, as it is starting to look like now. The very same US companies that must face state and regional climate initiatives are asking for federal action in order to promote legal certainty in this field in order for them to conduct their business accordingly.[20]

3.2. The US approach to carbon leakage and competitiveness concerns

The same concern that US companies have domestically; i.e. of different systems applying for different areas of the country, is what is pushing them to lobby at a government level to adopt measures that would target imports coming from developing countries that do not have comparable climate measures than the ones that

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[17] See Regional Greenhouse Gas Initiative, *Memorandum of Understanding* (2005). This is a cap and trade scheme has a rather limited coverage; in fact, it only covers electric utility emissions. However, it has two very interesting features that must be highlighted. First, RGGI allows companies to buy credits from extra north eastern sources and then place them on the carbon market in order to comply with their emission reductions obligations. While this approach is similar to the current international and European design of emissions trading, RGGI takes a much stricter stand on the complementarity use of credits within the overall compliance of the scheme.[17] In fact, companies are allowed to use credits only for 3.3% of reported emissions (*Ibid*, paragraph 2(F)(2)) and specific rules are provided for in order to ensure the environmental integrity of the projects from which credits accrue (*Ibid*, paragraph 2(F)(1)). For more information on RGGI INCLUDE FOOTNOTE.

[18] Renewable portfolio standards have been enacted in 2007 by twenty three states and by the District of Columbia. According to these standards, States must ensure that a certain percentage of the electricity on the grid comes from renewable energy sources. Two of the most important States, New York and California, have obliged themselves to very ambitious targets: New York aiming at 24% renewable energy on the grid by 2013 and California at 20% by 2010. For more information on renewable portfolio standards see B. Rabe, "Race to the Top: The Expanding Role of State Renewable Energy Standards", 7.3. *Sustainable Development Law and Policy* (2007), pp. 10-16.

[19] CHECK AND INCLUDE FOOTNOTE.

[20] See D. M. Driesen, *supra* note 11, p. 43.

allegedly the US will put in place.[21] According to the US Committee on Energy and Commerce three approaches are currently on the table:[22] Border Adjustment Measures (BAM), performance standards,[23] and carbon market design.[24]

In this paper we will focus only on BAM, since developing countries might face them also vis a vis their trade relations with the EU.[25] BAM against developing countries are one of the approaches that are being currently debated in the US and they would be: "… trade related policies that use tariffs, taxes, or other mechanisms such as requiring foreign goods imported into the US to be accompanied by emission allowances;"[26] An approach of this kind would imply, for example, that a developing country like China or India would have to buy allowances on a future US emissions trading scheme in order to gain market access to the US. According to the proposals on the table it would be the US government itself to determine whether a developing country has, or does not have, comparable measures to the ones present in the US. Furthermore, the measure would apply to a limited number of energy intensive sectors, and measures would be not immediate but would start targeting developing countries seven years after the beginning of the cap and trade scheme. In sum, according to this first approach, if an Indian producer wishes to export an energy intensive good (i.e. paper or steel), and if the US government has assessed that the

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[21] See the proposal put forward by The International Brotherhood of Electrical Workers-American Electric Power IBEW/AEP, which then inspired the American Climate Security Act.

[22] Subcommittee on Energy and Air Quality of the U.S. House of Representatives, *Climate Change Legislation Design White Paper* (2008), p. 8.

[23] A second approach relies on the adoption of performance standards: "… a 'non-market-based' type of regulation, such as emission standards or carbon intensity-based regulations;" *Climate Change Legislation Design White Paper*, *supra* note 22, p. 8, emphasis present in the original . If the US were to follow this path, imports from developing countries would be allowed provided that they complied with the emission standards that foreseeable climate legislation would adopt. There is some talk on adopting standards that would be based upon the carbon content of goods in their production process, independently from where they are produced. (XX) If an Indian, a Chinese or, in this case, even an American steel producer does not adopt a climate friendly production process, its products would not be allowed onto the market. On the trade law implications of such a measure see C. O. Verrill, "Maximum Carbon Intensity Limitations and the Agreement on Technical Barriers to Trade" (2008) 1 *Carbon and Climate Law Review* 43-53.

[24] This approach would rely on designing the future cap and trade scheme in a way that it would encourage developing countries participation therein. The Committee on Energy and Commerce talks about "imposing conditions for other countries' access to and participation in the US carbon market..."; *Climate Change Legislation Design White Paper*, *supra* note 22, p. 8. The range of options that have been proposed here all have in common rewarding countries that have decided to take a stronger stance on climate change by giving them preferential treatment in the participation of a future cap and trade scheme. Furthermore, interestingly offsets arising from uncapped countries would be *not like* credits arising from projects in capped countries; see *ibid*, p. 12.

[25] See supra note 4 and *infra* note 53.

[26] *Climate Change Legislation Design White Paper*, *supra* note 22, p. 8.

Indian government has not enacted comparable climate legislation to the one present in the US, the Indian goods can enter the US provided that the Indian producer purchases allowances on the US emissions trading scheme.[27]

A developing country faced by US trade measures of this kind has three policy options. First, it can decide to modify its national legislation in order to make it more US friendly. Obviously, a country like China and India will not do so, and should not do so, just to please the US economy… Second, it can do nothing, and just decide to trade elsewhere. Since there is no legal obligation to trade with another country, this option has not been discussed a lot in the legal literature on climate and trade. However, considering trade flows in energy intensive industries from China to the US,[28] for example, China could decide to just export steel elsewhere and strengthen other commercial ties, including South-South international trade. The last option is the one we will look at in the following section and it is the one in which a country like India or China considers that the US trade measures is a violation of WTO law and, therefore, decides to bring a dispute before the Dispute Settlement Body (DSB) of the multilateral trading system.

4. Compatibility of US measures vs developing countries with World Trade Organization (WO) law?

Before moving on one must be warned that this part of the paper is a speculative exercise since no US climate law has been adopted yet and, therefore, no dispute between the US and a developing country may arise at this stage at the WTO on the basis of a climate related trade measure. Nevertheless, there are two reasons why it is important to determine the compatibility with the multilateral trading system of those measures that have been suggested within the ongoing climate and trade debate in the US vis a vis developing countries. On the one hand, future US climate policies may include similar measures and, on the other hand, if we were to conclude that the climate related trade measure is actually WTO compatible, it would mean that climate policies in the North may effectively end up shaping climate policies in the South.

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[27] This kind of BAM was provided for in the American Climate Security Act (not enacted in law), which will be analysed in depth in *infra* section 4.1.

[28] T. Houser et al, *supra* note 3, p.

We will first explain the design of the climate related trade measure present in the 2007 America Climate Security Act and then we will see how an affected developing country may seek redress through the WTO dispute settlement system.

4.1. Climate related trade measure in the 2007 America Climate Security Act

The overarching goal of Title VI of the Act was "to promote a strong global effort to significantly reduce greenhouse gas emissions".[29] The first and best way to achieve this goal is through international negotiations. There was therefore an explicit stand in favour of multilateralism.[30] However, the Act clearly stated its concerns for carbon leakage and for the overall ineffectiveness of a global action against climate change if other countries did not take comparable measures. Therefore, another overarching goal of this title was:

> "to ensure, to the maximum extent practicable, that greenhouse gas emissions occurring outside the United States do not undermine the objectives of the United States in addressing global climate change; …"[31]

This second goal would have been achieved through "measures carried out by the United States that comply with applicable international agreements."[32] Therefore, while multilateralism was stated as the best way forward, ACSA considered explicitly unilateralism as the second best way to deal with global climate change.

The measure that the Act referred to in order to prevent carbon leakage would have imposed a condition that importers from developing countries would have had to comply with in order for their goods to gain market access in the US. Section 6006 maintained that:

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[29] *ACSA*, sec. 60002 (1)

[30] *Ibid*, sec. 6003 (a): "Congress finds that the purpose described in section 60002 can be most effectively addressed through agreements negotiated between the United States and foreign countries."

[31] *Ibid*, sec. 6002 (2).

[32] *Ibid*, sec. 6002 (3) (B).

> "Effective beginning January 1, 2020, a United States importer of any covered good shall, as a condition of importation… submit to the Administrator and the appropriate office of the US Customs and Border Protection a written declaration with respect to each such importation… A written declaration under paragraph (1) shall contain a statement that (A) the applicable covered good is accompanied by a sufficient number of international reserve allowances…. (B) the covered good is from a foreign country on the excluded list under subsection (b)(2)… *an imported covered good that is not accompanied by a written declaration under this subsection shall not be permitted to enter the customs of the United States*."[33]

There are several elements of this climate related trade measure that must be underlined: which goods would have been targeted? Would have the measure actually target developing countries? In other words, where did developing countries fit in the list that the Act mentioned, and which were the criterions on which this list was based? And, finally, should have imports from developing countries been targeted, what would a climate trade related measures like this one actually have required from the affected foreign country in order to allow its goods to enter the US market? In other words, what was the Act referring to when it mentioned "international reserve allowances"?

A) Coverage

A developing country would have been affected by such a measure just if it traded with the US in a specific and limited number of energy intensive goods. ACSA explicitly mentioned "iron, steel, aluminium, cement, bulk glass, or paper;…"[34] We have already underlined that, especially for China, trade flows with the US in these kind of goods are much less significant than what one would expect, considering the level of current political talks on the risks of loss of competitiveness vis a vis developing countries in energy intensive industries.[35] However, other developing

33 *Ibid*, section 6006 (c)(1) and (c)(2)(A).
34 *Ibid*, section 6001 (10).
35 *Vid. supra* 28.

countries imports could have been also targeted since ACSA maintained that covered goods included also those

> "that… generate[s], in the course of the[ir] manufacture…, a substantial quantity of direct greenhouse gas emissions and indirect greenhouse gas emissions; and is closely related to a good the cost of production of which in the United States is affected by a requirement of this Act."[36]

In other words, the climate trade related measure could have been adopted also against a developing country good, if its production process was not climate friendly and if it competed with a domestic US product that had to comply with domestic climate requirements that would have ended up affecting the costs of production.

B) The criterions according to which a developing country could have been targeted

The second element that we must highlight is whether developing countries could have actually been targeted. The climate related trade measure that was provided for in ACSA would have been imposed only on those foreign countries that did not take *comparable action* to the US in tackling climate change. The procedure set in place called for an ad-hoc interagency group to evaluate whether a foreign country had taken comparable measures.[37] However, it would have been the President to take the final decision whether to include that country or not on the list of countries whose imports would have been banned from the US.[38] The key issue here would have been what was meant by comparable measures. ACSA stated that it had to be understood as:

> "… any greenhouse gas regulatory programs, requirements, and other measures adopted by a foreign country that, in combination, are comparable in effect to actions carried out by the United States to limit greenhouse gas emissions

[36] *ACSA*, section 6001 (5)(B)(C).
[37] *Ibid*, section 6004 (b)(1)
[38] *Ibid*, section 6005 (a)

> pursuant to this Act, as determined by the President, taking into consideration the level of economic development of the foreign country."[39]

ACSA would have left some flexibility to the foreign country, since it did not require the same cap and trade scheme, and it did give some further flexibility to countries depending on their economic development. Comparable measures would have been assessed against baseline emission levels,[40] which had to be intended as "the total average annual greenhouse gas emissions attributed to a category of goods of a foreign country…".[41] Best available technology would have been one of the criterions used in order to determine the above-mentioned average.[42] Interestingly, a strict application of a measure of this kind could have led the US to find that some developing countries that policy documents have identified as targets would actually be exempted. In fact, if one looks closely at the environmental record of some of these countries, one finds out that in several cases the climate laggard is actually the US…[43]

C) The implementation of the trade measure

The third element refers to the requirements provided for in the climate trade related measure. What would have the US required from a developing country in order to allow it to import its goods into the US territory? Countries like India or China, if found not to have comparable action on climate change, would have been obliged to purchase allowances from an international reserve allowance programme set ad-hoc for this purpose by the US.[44] Two features of this programme are worth mentioning. First, the regulator was asked to put in place a system that would have guaranteed that the price of these allowances would have not been higher than the price of allowances bought by domestic companies.[45] Second, the revenue accruing from these allowances would have financed a mitigation fund for the developing countries

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39 *Ibid*, section 6001 (2)

40 *Ibid*, section 6005 (a)(1).

41 *Ibid*, section 6001 (1)

42 *Ibid*, section 6001 (1)(B).

43 T. Houser et al, *supra* note 3, p. xviii.

44 *ACSA*, section 6006 (a)(1). Every international reserve allowance would have had a different serial number (Ibid, section 6006 (4)) and the developing country importer could have imported his goods into the US provided he released the required number of international reserve allowances.

45 *Ibid*, section 6006 (a)(3)(A) and (a)(3)(B).

themselves.[46] But how many international reserve allowances would have the developing country exactly had to buy? ACSA maintained that methodology rules and formulas for this purpose had to be established.[47] While we do not have any clear-cut answer on this question, we do know that the drafters had considered alternative options to the purchase of international reserve allowances. In fact it was clearly stated that:

> "A United States importer may submit, in lieu of an international reserve allowance issued under this section, a foreign allowance or similar compliance instrument distributed by a foreign country pursuant to a cap and trade program that represents a comparable action."[48] And "A United States importer may submit, in lieu of an international reserve allowance issued under this section, a foreign credit or a credit for an international offset project that the Administrator has authorized for use under subtitle E of title II."[49]

This means that a foreign country could have relied on allowances arising from non-US cap and trade schemes (i.e. emission reduction units within the European emissions trading scheme) or on credits from international offset projects (i.e. certified emission reduction units arising from clean development mechanisms projects).

In sum, the analysis of the coverage of goods, of the criterions according to which a foreign country could have been targeted, and of the implementation of the measure provided for in ACSA shows that developing countries could have been negatively affected by such a measure.

4.2. WTO compatibility of the US climate related trade measure vis a vis developing countries

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[46] *Ibid*, section 6006 (a)(7): "All proceeds from the sale of international reserve allowances under this subsection shall be allocated to a program that the Administration, in coordination with the Secretary of State, shall establish to mitigate the negative impacts of global climate change on disadvantaged communities in other countries."

[47] *Ibid*, section 6006 (d)(1).

[48] *Ibid*, section 6006 (e)(1)(A).

[49] *Ibid*, section 6006 (e)(2)(A).

The key question at this point is to determine whether a developing country targeted by such a measure could have questioned the legality of a climate related trade measures of this nature under the WTO dispute settlement body. The drafters of the Act were well aware of this possibility when they were working on this piece of legislation. In fact, a specific sub-section of the provision that established the climate related trade measures was titled "Consistency with international agreements":

> "The Administrator… shall adjust the international reserve allowance requirements established under this section… as the Administrator determines to be necessary to ensure that the United States complies with all applicable international agreements."[50]

The US obligations under WTO law were one of the things the drafters were thinking of when they worked on this provision. The Subcommittee on Energy and Air Quality White Paper shows also concern for the WTO compatibility of future unilateral climate measures. It states as follows:

> "[S]ince the US cannot unilaterally bind other countries, our goal will be to craft legislation that also induces developing countries to limit their emissions growth… in a manner that is reasonably certain to withstand challenge before the World Trade Organization."[51]

It is not my goal here to go into a detailed account of the technicalities of the climate and trade debate,[52] but mainly to draw the attention to those points in ACSA that a developing country could have focused on, should have the US measure been brought before the WTO DSB. I will also assess whether bringing the multilateral trading system in the carbon leakage debate plays actually in favour, or against, the interests of a developing country. If a climate policy from the North can end up shaping the

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50 *ACSA*, section 6006 (g).

51 *Climate Change Legislation Design White Paper*, *supra* note 22, p. 2.

52 For detailed accounts of the WTO compatibility of trade related measures see, amongst others, J. Pauwelyn and F. Sindico (Eds.), "Climate Change in a Global Economy", 2.1. *Carbon and Climate Law Review* (2008); A. Green, "Climate Change, Regulatory Policy and the WTO" (2005) 8.1 *Journal of International Economic Law* 143 – 189; and Z. Zhang and L. Assunção, "Domestic Climate Policies and the WTO" (2004) 27 *The World Economy* 359-386.

climate, and non-climate, policies in the South, would a referral to the WTO prevent this, or would it make the situation worse off for the developing country?

4.2.1. Elements of interest for a developing country before a possible WTO dispute

The scenario we are looking at would be a situation in which imports from a developing country steelmaker are banned from the US because the latter considers that India, for example, does not have comparable climate measures. Can a developing country argue that the ban constitutes a violation of WTO law by the US? Furthermore, can it maintain that the requirements that the US would have established through the Act; that is, to purchase a specific number of international reserve allowances, or to rely on allowances from other cap and trade schemes or on credits, constitute also a breach of WTO law?

This is not an abstract theoretical question. The Confederation of Indian Industry has already maintained in relation to the EU proposal for the reform of the directive on the European trading scheme that:

> "Principally, we do not agree with the proposal. It seems a new tariff barrier is being set up and we are preparing inputs for the government to fight it at the WTO."[53]

Despite the fact that the EU proposal has not included a specific climate related trade measure such as the one that was included in ACSA, it does consider establishing a

> "[A]n effective carbon equalisation system could be introduced with a view to putting installations from the Community which are at a significant risk of carbon leakage and those from third countries on a comparable footing."[54]

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[53] Seema Arora, head of the Centre of Excellence for Sustainable Development, Confederation of Indian Industry, quoted in "Europe threatens carbon tax on Third World " (Tuesday May 6, 2008) 16 *Down to Earth: Science and Environment online*, available at http://www.downtoearth.org.in/full6.asp?foldername=20080515&filename=news&sec_id=4&sid=11

[54] *Proposal for a Directive amending Directive 2003/87/EC, supra* note 4, recital 20.

The implementation of a "carbon equalisation system" may be similar to the climate related trade measure present in ACSA. Therefore, speculating on how a developing country could challenge the latter is not a mere academic exercise.

A developing country could have focused its attention on three different set of things before the WTO DSB: it could have looked at the possible nature of the goods covered by the import ban, it could have considered the criterions according to which the developing country was targeted; and, finally, it could have focused on the design and implementation of the climate related trade measure.

A) Coverage

Firstly, ACSA clearly stated that the import ban could have applied to products on the basis of the amount of emissions released in the manufacture of a product. This would have meant that the US would have treated domestic low carbon steel differently than high carbon style imported from a developing country. India, for example, could have argued that the US was treating two products differently solely on the basis of their production and process methods (PPMs). In principle WTO law does not allow a Party to impose requirements that give "less favourable treatment" to domestic products compared to imported like products [55] A developing country could have raised two questions linked to this point.

On the one hand, it could have argued that low carbon and high carbon steel were like products and, therefore, that they should have been treated similarly.[56] In fact, while from an environmental point of view the differentiation of two products based on their climate friendliness makes sense, this is not the case (yet) from an international trade law perspective. However, while the GATT case law on trade and environment focused on the final product, notwithstanding how it was produced,[57] the case law under the WTO dispute settlement body on the environmental exception provided for

[55] *General Agreement on Tariffs and Trade (GATT),* art. III: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."

[56] Similarly here stands as "no less favourable treatment".

[57] CHECK AND INCLUDE FOOTNOTE ON GATT, Tuna.

in GATT article XX seems to be opening some policy space to the adoption of measures based on the process and production methods of a product.[58] In particular, if the way a product has been manufactured is recognised by a consumer on a specific marketplace as a criterion to differentiate to products, then the WTO Appellate Body has maintained that two products may not be *like* based on their PPMs.[59]

On the other hand, a developing country facing a climate related trade measures such as the one planned in ACSA could have disputed the nature of the US measure. If the latter is a domestic regulation, then article III:4 would have applied and, if the two products are like, no less favourable treatment must be accorded to the developing country import by the US administration. However, if India, for example, would have considered that the cap and trade scheme, to which the trade measure is linked, was a tax under WTO law,[60] and not a domestic regulation, then a slightly different discipline would have applied. Article III:2 would have come into play and there would have been less policy space for the US administrator since any measure adopted against imports "in excess of those applied, directly or indirectly, to like domestic products" would have constituted a breach of WTO law.[61]

Therefore, from a developing country perspective the best option would have been to maintain that the two products, the domestic low carbon good and its high carbon imported good, were like products, and that the cap and trade scheme to which the trade measure was linked was actually a tax under WTO law. Would have this been accepted by the WTO DSB, then any discriminatory measure would have immediately constituted a breach of WTO law. However, a developing country has to be aware that the nuances of the like products concept may lead to different conclusions in the future, and that a cap and trade scheme may also be considered a domestic regulation, in which case the US would have wider policy space to treat imported products differently.

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58 CHECK AND INCLUDE FOOTNOTE ON WTO, Shrimp.

59 CHECK AND INCLUDE FOOTNOTE ON WTO, Asbestos.

60 Authors are divided on whether a cap and trade scheme would be considered a tax or a domestic regulation. The first option is defended by XXX, while XXX argues in favour of the second one.

61 *GATT*, article III: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." (Emphasis added).

B) The criterions according to which a developing country could have been targeted

Secondly, the Act took a list approach by saying that foreign countries would have been divided into countries with and without comparable climate action. The adoption of a climate related trade measure would have depended on the importer being based in a country present in the climate 'unfriendly' list. Measures taken according to this approach would have been country based measures. If the US would have favoured a narrow application of the climate related trade measures by automatically applying the import ban on all importers coming from a country included in the list of climate 'unfriendly' States, without taking into account the specific circumstances of each case, a developing country could have easily attacked the US measure as a violation of the most favoured nation principle (MFN). The MFN principle is one of the cornerstones of the multilateral trading regime and it maintains that if a WTO party gives a special treatment to another WTO party, it will have to immediately and unconditionally give the same treatment to all other WTO parties.[62]

Furthermore, the criterions according to which a country was to be deemed to have a comparable climate policy or not with the one in the US could have also been questioned. Despite the fact that the wording of the Act gave scope for some flexibility,[63] the implementation of the Act would have been scrutinised. This would have come up in a second phase of a possible dispute. If a developing countries' claim of the non-legality of the US climate related trade measure with WTO law per-se would have been agreed upon by the dispute settlement body, the US could have argued that the measure, nevertheless, was WTO lawful because it constituted an exception under GATT article XX. The latter allows for otherwise non legal WTO measure if they are necessary to protect human health,[64] or if they related to the

62 *GATT*, art. I: "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."

63 See *supra* note 39.

64 *GATT*, art. XX (b).

conservation of exhaustible natural resources.[65] A developing country should not loose time disputing these first two requirements, since the current status of climate change science stands in favour of the adoption of a climate measure.[66] What India could have done, and should have done from a strategic point of view, was to focus on the chapeau, according to which the US can adopt an otherwise unlawful WTO measure

> "[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,…"

One of the criterions that the WTO trade and environment case law has established to determine whether the application of a measure is actually an unlawful disguised restriction on international trade is its 'flexibility'.[67] ACSA maintained that 'any' foreign climate measure would be considered comparable if it achieved similar reductions.[68] Therefore, if a developing country decided to adopt a tax, or a command and control scheme to improve the energy efficiency of domestic steel makers, this should have not been considered negatively by the US administrator. The application of the measure in this way would have played in favour of the US in a dispute against a developing country. However, how would have the US decided whether the developing country had achieved results "comparable in effect to the actions carried out by the United States"?[69] According to ACSA comparable effect would have been assessed on the basis of the baseline emissions level, the latter being "the total average annual greenhouse gas emissions attributed to a category of covered goods of a foreign country"[70] in a specific lapse of time. The climate record of a developing country would have been based on:

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65 *Ibid*, art. XX (g).

66 The current case law on trade and environment also makes it easier for the country adopting the trade measure on environmental grounds to prove that the measure is actually *necessary* to protect human health, or that it really *relates to* the conservation of exhaustible natural resources. On the necessity test see XXX, and on the related to test see XXX.

67 CHECK AND INCLUDE FOOTNOTE ON WTO, Shrimp

68 See *supra* note 39.

69 *ACSA*, section 6001 (2).

70 *Ibid*, section 6001 (1)

> "relevant data available for that period; and to the extent necessary with respect to a specific category of covered goods, economic and engineering models and best available information on technology performance levels for the manufacture of that category of covered goods."[71]

Criterions such as 'best available technology' are still not clear-cut and, more importantly, they are not harmonised internationally.[72] India could, therefore, have argued that the implementation of the climate related measure based on this criterion lacked international recognition and, therefore, that it would lead to an arbitrary application of the baseline emissions level criterion. Furthermore, ACSA's wording did not highlight the possibility for the foreign country to provided the relevant and necessary information to assess the average greenhouse gas emissions arising from its production of goods under a covered sector. Should have that been the case, India could have argued that the imposition of US methodologies in order to determine the climate 'friendliness' of Indian industries, without taking into account Indian data, would have demonstrated a considerable lack of flexibility in the application of the measure and, therefore, its nature as a disguised restriction on international trade.

C) The implementation of the measure

Thirdly, a developing country could have focused on the implementation of the climate trade related measure. Two points could have been raised here. On the one hand, despite the fact that the wording secured equal treatment as far as price of the allowances was concerned,[73] the actual implementation would have been scrutinized. If an importer from a developing country were to purchase international reserve allowances at a higher price than domestic producers, the foreign importer could argue that he had been treated "less favourably".[74] Furthermore, this line of defence could also be invoked by a developing country within GATT article XX, since one of the decisive criterions to see whether the implementation of the measure constitutes a

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[71] *Ibid*, section 6001 (1) (A) and (1)(B).

[72] Actually, the definition of best available technology that most authors in the climate and trade debate use comes from the work of the European Communities…

[73] *ACSA*, section 6006 (a)(3).

[74] See reference to *GATT*, article III:4 supra XX. Once again, the question would have been whether the national treatment principle had been violated.

disguised restriction on international trade is precisely the measure's design and architecture.[75]

On the other hand, ACSA allowed foreign countries to rely on alternative compliance options, foreign allowances and credits, which are not available to all US trade partners. If a developing country did not establish a cap and trade scheme as a measure to tackle climate change within its domestic climate policy, where would it have been able to purchase a 'commensurate' foreign allowance? Furthermore, developing countries are not allowed to accrue credits from clean development projects since they are the beneficiaries of these projects. Where would they have been able to accrue credits from international offset projects? Before such a scenario, a developing country could have maintained that industrialised countries that can rely on foreign allowances or on credits were given special treatment if compared to the situation that a country like India was facing vis a vis the US. There would have been, therefore, scope to explore the possibility, once again, of a breach of the MFN principle.[76]

The goal of this paper is not to give a definitive answer on the WTO compatibility of a climate trade related measure like the one that was included in ACSA. This would be a counterproductive exercise since the Act has not been enacted into law and because WTO jurisprudence on trade and environment is volatile and is not set in stone. Authors however tend to agree that a climate related measure of this sort would have been lawful only if extreme attention was placed on the implementation side of it.[77] Only if procedural requirements such as previous notification of the measure to

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[75] CHECK AND INCLUDE FOOTNOTE ON WTO case law.

[76] See *supra* note 62.

[77] See B. G. Janzen, "International Trade Law and the "Carbon Leakage" Problem: Are Unilateral U.S. Import Restrictions the Solution?" (2008) 8 *Sustainable Development Law and Policy*. 22-26, p. 24: "It remains unclear – and the source of considerable concern – whether U.S. laws such as ACSA [American Climate Security Act] would be vulnerable to attack from WTO Members alleging that ACSA discriminates against their exports to the United States, but that it does not meet the narrow GATT Article XX tests permitting such trade discrimination."; R. Morgenstern, "Addressing Competitiveness Concerns in the Context of a Mandatory Policy for Reducing U.S. Greenhouse Gas Emissions", in *Assessing U.S. Climate Policy Options: A Report summarizing work at RFF as part of the inter-industry U.S. Climate Policy Forum.* Resources for the Future, November 2007, p. 116, quoted in White Paper, p. 9, argues that in order to be WTO consistent "great sensitivity must be shown… including the need to put major trade partners on notice and provide sufficient time for them to develop viable domestic emissions reduction policies."; and J. Pauwelyn, *U.S. Federal Climate Policy and Competitiveness Concerns: The Limits and Options of International Trade Law*, Prepared by the Nicholas Institute for Environmental Policy Solutions, Duke University, (2007), p. 41: "Most

affected trading partners and, in particular, if a real degree of flexibility was granted to the developing countries climate policies, it would have been possible to maintain that a climate related trade measure could withstand a WTO dispute as an environmental exception under article XX of the GATT. However, a developing country would still have a lot of points that it could raise against the nature and, in particular, the implementation of a climate related trade measure.

4.2.2. Developing country strategies to deal with the climate and trade tension

The second question that we wish to address in relation to the relationship of a climate related trade measure and the WTO is whether a developing country 'should' bring a dispute before the WTO. We will also see whether a developing country has any other strategic option, in particular within the multilateral forum in which it takes part.

A) Countermeasures at the WTO: should a developing country consider them?

Will it be beneficial for a developing country to raise the tension of its relationship with the US to such a point that a trade dispute is inevitable and a dispute arises at the WTO? These questions are daunting to some extent on the very same policymakers in the US. In fact, the White Paper clearly maintains that:

> "[S]ince the US cannot unilaterally bind other countries, our goal will be to craft legislation that also induces developing countries to limit their emissions growth… on terms that pose acceptable risks to U.S. interests in the event of a negative WTO determination."[78]

This passage is very important because it shows that the US is ready to take WTO unlawful actions if the consequences thereof are acceptable for its economy. This approach is self-explanatory when one looks at the retaliatory effect of the final decisions given by the WTO DSB. The multilateral trading system is not entitled to

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controversial by far would be the imposition of trade restrictions on imports based on the carbon or other greenhouse gases that were emitted in their production *abroad* (so-called trade restrictions in respect of "foreign-emitted" or "offshore" carbon)… the broader WTO consistency of such process-based restrictions is unclear and remains to be tested." (Emphasis present in the original).

[78] *Climate Change Legislation Design White Paper*, *supra* note 22, p.2.

award any damages, but it will only recommend the party in non-compliance with WTO law to modify its laws accordingly. At this point the WTO party that has adopted the unlawful measure has two choices: it can either obey and change its domestic legislation, or it can do nothing and suffer countermeasure from the other party in the dispute. These countermeasures will be of a retaliatory nature. In fact, the WTO Dispute Settlement Understanding allows the party that has won the dispute to suspend its trade obligations under any of the WTO Agreements until the other party in the dispute decides to modify its domestic legislation according to the recommendations of the DSB.[79]

The comments that have been made about the risks of not taking into account the final decision of the dispute for industrialised countries can be also seen through the lens of developing country interests. The question obviously begs on whether the developing country is, or is not, in a strong bargaining position. Will the US be concerned about suffering retaliatory trade measures from a developing country whose, for example, steel imports have been banned for climate related reasons, should this ban not have been upheld by the WTO DSB? To answer this question we obviously leave the realm of the law and move into the field of policy and the current international trade power relations. Not wanting to move too much into this field, we can just state the obvious. On the one hand, if a developing country is big enough to play an important role on the global market, then it will be able to impose countervailing measure that may harm the US economy.[80] Whether these are more or less than what the US economy would have been harmed by the imports that have been banned is not a question that can be answered here.[81] On the other hand, if the developing country has a small economy, the US exports will easily find other markets that will replace the market of the developing country that has imposed import bans to US products as a countermeasure to the allegedly WTO unlawful climate related measure.[82] However, in the climate and trade debate, this last option is not very likely since the goods

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[79] INCLUDE FOOTNOTE ON WTO DSU art. XX. CHECK AND INCLUDE FOOTNOTE ON the hormones dispute.

[80] INCLUDE FOOTNOTE on Case of Brazilian countermeasures.

[81] However, some studies consider that the most affected party will en up being the US consumers from the climate import ban and consequent countermeasures from strong developing countries; INCLUDE FOOTNOTE Leveliing the Playing field, p. X.

[82] INCLUDE FOOTNOTE ON Antigua and US

covered by a climate related trade measure will mostly be energy-intensive goods produced in big developing countries.[83]

It is very difficult to provide a clear-cut recommendation on whether a developing country should consider the possibility of using countermeasures in the framework of a climate trade dispute against the US. If the dispute arrives at such a point, then the developing country would most likely take countermeasures. But against which US imports? And how?

In sum, the very nature of the WTO dispute settlement system that allows countermeasures as a pressure mechanism, together with the delicacy of climate change as an urgent environmental problem and the need to make shifts in the energy sources we use, makes a future climate and trade dispute between the US and a developing country a very unwelcomed scenario, even for the developing country.

B) Alternative multilateral options to disentangle the climate and trade deadlock

A dispute at the WTO may, therefore, lead to just more tension with counterproductive results both from an environmental and economic point of view. Some authors still have faith that this deadlock can be solved through international negotiations within the current Doha Development Agenda. I will not go too much in depth in this and I will put forward two reasons for caution against relying on the trade and environment negotiations in the Doha agenda from a developing country perspective.

Paragraph 31 of the Doha Mandate sets out the terms for a negotiation whose goal is to promote the liberalisation on environmental products and services:

> "With a view to enhancing the mutual supportiveness of trade and environment, we agree to negotiations, without prejudging their outcome, on: the reduction or,

[83] See *supra* note 8.

> as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services."[84]

While the first reading of this part of the mandate may seem to lead to a win-win solution for both the fight against climate change and the promotion of economic development, the outcome of the negotiations until now gives quite another perspective. The first reason why developing countries should be aware of these negotiations is because they are driven by industrialised country. Most developing countries have other priorities within the Doha mandate, focusing in particular on removing barriers to agricultural trade. There has been a clash now already for several years on a list based approach promoted by industrialised countries and a project based approach favoured by some developing countries.[85] It is paradoxical that after seven years there is no agreement yet on the definition of environmental goods and services.[86]

The second reason why developing countries should not rely too much on the trade and environment mandate within the Doha mandate is because the round itself is currently facing a crisis, and no result is foreseeable in the near future.

If the agenda and the current status of the overall international trade talks are the reasons why a developing country should not devote too much attention to the Doha mandate in order to solve its climate and trade disputes with industrialised countries, the Doha Mandate does, however, point in the right direction.

5. Conclusion: from unilateral climate related trade measures to a multilateral production and consumption dialogue

In this paper I tried to demonstrate that measures that an industrialised country adopts in its struggle to cope with domestic competitiveness concerns and carbon leakage worries may end up shaping climate (and non-climate) policies in the South. Using proposals in the US climate debate as a case study I showed that a developing country

[84] Doc. WT/MIN(01)/DEC/120, *Doha Ministerial Declaration*, 20 November 2001, paragraph 31(iii).
[85] INCLUDE FOOTNOTE ON List based approach vs project based approach
[86] INCLUDE FOOTNOTE ON On this point see XXXX.

could consider challenging these measures before the WTO DSB. Questions related to the coverage of goods, to the criterions according to which a developing country would be targeted and questions related to the actual implementation of the climate related trade measure could all be brought before a WTO Panel. Despite some disagreement whether the final decision would be in favour or against the developing country that has suffered the climate related measure, the point that I want to make is that a WTO dispute may by no means the end of the story. The possibility for the winning party to adopt retaliatory countermeasures may actually exacerbate tensions in a way that will be counterproductive both from an environmental and an economic point of view. Unfortunately, current talks at the WTO on the possibility to find win-win avenues on climate and trade by liberalising environmental goods and services are facing the same fate of the entire Doha Mandate and therefore cannot be relied upon.

However, the spirit behind the Doha Mandate could be the right one. The climate and trade deadlock could be dealt with positively if unilateralism is replaced by genuine multilateralism, and if countries understand that climate change is not only an environmental or an economic problem, but it is mainly a global behavioural challenge. Climate change is mainly about energy. We will be moving in the right direction only when States will start putting their efforts into seriously promoting sustainable production policies that favour low carbon energy sources and, far more challenging, when States will devote time and funding to adopt and implement sustainable consumption policies. Just the latter will move society towards a low carbon economy, which must be the aim of the international community when dealing with climate change.

In conclusion, this paper has tried to highlight the limits of the current climate and trade debate and its negative effects on policy choices of developing countries. There must be new emphasis and further research on exploring what international law can do in order to promote a renewed dialogue on sustainable production and consumption policies.[87]

[87] INCLUDE FOOTNOTE ON Literature on production and consumption.