

Climate Change Reform: Challenges, Opportunities, and Realities within the WTO Framework

By:

Neil Roesler

TABLE OF CONTENTS

I.	Introduction.....	3
II.	Examining the World Trade Organization.....	4
III.	Cap-and-Trade and the WTO.....	9
IV.	Carbon Taxation and the WTO.....	16
V.	Other Conflicts with Environmental Reform and the WTO.....	24
VI.	Working Towards a Solution	24
VII.	Conclusion	27

I. Introduction

If no further middle ground can be found, the zealots for free trade and their counterparts in the climate change crusade will at least have in common the mutual frustrations of misinformation and controversy that surround their respective platforms. Proponents of free trade routinely have to shatter images of sweat shops and trade round riots to even open meaningful dialogue on the theoretical and practical nature of the concept. Similarly, advocates for climate change reform must battle arcane “tree-hugging” stereotypes in the quest for meaningful and productive discourse on the subject. Perhaps this shared appreciation for the difficulties attendant to advocating a controversial position can serve as a starting point for these two groups as a new conflict reaches the fore: The perceived incompatibility between currently proposed climate change reforms and the foundations of the World Trade Organization (“WTO”).

At the risk of painting with an overly broad brush, the intellectual pursuits of the environmental reformer and the Milton Friedman disciple rarely converge. It is with this relative position of unfamiliarity in mind that this paper is constructed. An understanding of the World Trade Organization and its principles is necessary to this topic and is, thus, presented first. This is followed by an examination of the two major climate change tools, carbon taxation and cap-and-trade, within the WTO framework, with a brief look at other challenges posed by WTO trade regulation. The paper concludes with suggestions to harmonize climate change reforms with the nearly omnipresent workings of the WTO.

II. Examining the World Trade Organization

The governments of all nations regulate foreign trade, but the ways in which they do so diverge greatly and are the subject of impassioned debate.¹ Strategies that favor domestic firms, often through devices such as subsidies and tariffs, align with the economic theory of protectionism.² Those that favor more expansive trading with foreign nations, with less emphasis on the sustenance of domestic firms, follow the doctrine of free trade.³ Debate about international trade theory has centered almost exclusively on these two philosophies for over two centuries.⁴

Protectionist policies are typically geared towards nationalistic ideals. Nearly every protectionist platform is based on strategies of strict regulation of industry and trade to support the domestic economy and protect national security.⁵ To achieve these ends, protectionist regimes typically implement some combination of these common devices: Tariffs (taxes on imports), domestic subsidies, import quotas, heightened regulation and/or labeling standards for foreign products, and voluntary restraint or blacklisting of certain or all foreign goods.⁶

¹ *The Basics of Foreign Trade and Exchange*, Federal Reserve Bank of New York, 1, (Nov. 5, 2009), <http://www.ny.frb.org/education/fx/free.html>

² Id.

³ Id.

⁴ See Henry George, *Protection or Free Trade* (Robert Schalkenbach Foundation) (1886) available at <http://mises.org/etexts/freetrade.pdf>

⁵ *The Basics of Foreign Trade and Exchange* at 1

⁶ Id.

Conversely, supporters of free trade vehemently oppose these protectionist policies and deny that they achieve the goals for which they are employed.⁷ Instead, the predominant thinking underlying free trade is that an entity (usually classified by nation) should produce the things in which it has a comparative advantage.⁸ That entity should then trade its outputs of production with others for desired products which the trading partner is producing.⁹ The father of modern economics, Adam Smith, famously stated that “[i]t is the maxim of every prudent master of a family, never to attempt to make at home what it will cost him more to make than to buy...”¹⁰ While the theories of free trade have grown to encompass more than just the notion of comparative advantage, their proponents continue to tout the centuries-old arguments regarding the benefits of free trade on the world economy.¹¹ These benefits include lower prices for goods and services worldwide, more choices for consumers, wealth maximization globally, and the constant motivation for improvement and innovation in goods and services.¹²

From roughly 1871 to the conclusion of World War II, a global trend of protectionist policymaking led to considerable international strife.¹³ A surge of protectionist rhetoric used to foster jingoism and simultaneously increase wealth for ruling regimes was a catalyst for the disputes that led to the outbreak of World War I.¹⁴ Following that conflict, protectionist policies borne out of economic despair that led to the extreme “defense” of domestic firms against

⁷ See Jagdish Bhagwati, *Protectionism*, The Concise Encyclopedia of Economics, 1, (2008), <http://www.econlib.org/library/Enc/Protectionism.html>

⁸ Paul R. Krugman, *Is Free Trade Passe?*, The Journal of Economic Perspectives, Autumn 1987, at 131, 132

⁹ Id.

¹⁰ Adam Smith, *Wealth of Nations*, Book IV, 2.11, (1776)

¹¹ Krugman at 143

¹² *The Basics of Foreign Trade and Exchange* at 1

¹³ *International trade*, Encyclopædia Britannica Online, 1, (Nov. 5, 2009), <http://www.britannica.com/EBchecked/topic/291349/international-trade>

¹⁴ Jan Palmowski, *Protectionism*, A Dictionary of Contemporary World History, 1, (2004), <http://www.encyclopedia.com/doc/1O46-protectionism.html>

perceived international threats perpetuated this state of icy international diplomacy until the outbreak of the second World War.¹⁵

As a result of the devastation of these two catastrophic conflicts and their protectionist roots, economic theory gradually became dominated by free trade theories.¹⁶ Recognizing the need for greater cooperation in the trade arena, twenty-three nations entered into the General Agreement on Tariffs and Trade (“GATT”) in 1947 at the Palais des Nations in Geneva, Switzerland.¹⁷ The initial entrants included the developed powers following World War II, such as the United Kingdom, the United States, and Canada.¹⁸ Perhaps more surprisingly, however, it also included developing nations such as Pakistan, India, and Burma.¹⁹ This foreshadowed what GATT was ultimately to become – a worldwide mechanism for the facilitation of trade between economic states of all classification.

Such an ambitious goal was not inconceivable to the handful of countries that initially entered into GATT. In fact, these nations attempted to establish a formal worldwide trade organization known as the International Trade Organization (“ITO”) to complement the International Monetary Fund and the World Bank.²⁰ In fact, the GATT nations successfully created the charter for the ITO in Havana, Cuba on March 24, 1948.²¹ However, the failure of

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Fiftieth Anniversary GATT*, World Trade Organization, 1, (Nov. 5, 2009), http://www.wto.org/english/thewto_e/minist_e/min96_e/chrono.htm

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Understanding the WTO*, World Trade Organization, 4, (Nov. 5, 2009), http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact4_e.htm

the United States Congress to ratify the ITO charter prevented it from entering into force as an entity.²²

This failure did not, however, prevent these nations from pressing forward with the goal of trade cooperation. Rather than function under the umbrella of the unrealized ITO, the nations worked within the framework of the GATT agreement to handle issues relating to trade disputes and general policy.²³ While never formally constructed as a distinct organization, GATT began acting in a de facto manner as the international body responsible for regulating trade.²⁴ Many productive developments occurred under GATT, including seven rounds of trade negotiations, an enrollment increase to 102 official members, and the massive reduction in worldwide tariffs.²⁵

Despite GATT's numerous successes in regulating worldwide trade policies, it was becoming increasingly outdated and cumbersome as the decades progressed. Following the Tokyo Round of trading in 1979, the flaws with the existing GATT arrangement came into clearer focus. The explosive growth of service industries worldwide at the time was a welcome development - except that it was completely unregulated by GATT.²⁶ Loopholes in agriculture and textiles were being routinely exploited by member nations.²⁷ In short, the 1940's world that GATT was created to regulate was beginning to bear only a faint resemblance to a modern world fast approaching the 21st century.²⁸

²² Peter B. Kenen, *The International Economy*, 376, (2000)

²³ Peter Van den Bossche, *The Law and Policy of the World Trade Organization*, 80, (2005)

²⁴ *Id.*

²⁵ *Understanding the WTO* at 4

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

Seeking to reconcile not only these issues, but other perceived incongruities between GATT and the modern trade climate, the Uruguay Round of trading was launched in 1986.²⁹ In the “round to end all rounds”, the GATT members set out to engage in a massive appraisal and overhaul of the system. All of the original GATT articles were up for review, along with the establishment of dispute resolution and trade review mechanisms.³⁰ Despite unforeseen delays and much conflict between the member countries, the Uruguay Round accomplished the mission it was tasked with. Trade mechanisms were updated and overhauled under the umbrella of the now-realized international trade body, the World Trade Organization. The Uruguay Round was officially completed and the formation of the WTO set into motion with the signing of the Marrakesh Agreement on April 15, 1994.³¹

Today, the WTO consists of 153 members and observers.³² Resting on a foundation of free trade principles, the WTO has three distinct functions. The first of these functions is to be a negotiating forum.³³ While member nations often enter into bilateral or other multilateral trade agreements without direct WTO facilitation, the organization does provide the most commonly used forum for effective trade negotiation.³⁴ The second function is to provide a framework of rules for international trade, covering numerous devices like tariffs and quotas, and numerous tradable commodities such as corn and trademarks.³⁵ Trade agreements like NAFTA, while not

²⁹ Peter Gallagher, *The First Ten Years of the WTO 1995-2005*, World Trade Organization, 4, (2005)

³⁰ *Understanding the WTO* at 5

³¹ *Id.*

³² *Understanding the WTO* at 35

³³ *Understanding the WTO* at 1

³⁴ *Id.*

³⁵ *Id.*

under the auspices of the WTO directly, generally must conform to WTO rules.³⁶ Finally, the WTO offers common law dispute resolution between member nations.³⁷ Dispute resolution is critical to the WTO mission, as it allows the organization to rectify trade violations on its own and avoids the retaliatory tactics by individual nations that plagued the world economy at the turn of the twentieth century and battered notions of free trade.

Despite the gridlock that has become the Doha Round of trading, the World Trade Organization has quickly asserted itself as a massive player on the international scene. A budding library of case law has worked to create a clearer picture of what is and is not permissible in the global trade market.³⁸ Regional trade agreements, based on the WTO model, are regularly being created to employ the WTO's global aims in concentrated locations.³⁹ Finally, the WTO maintains formal relations with (and in most cases, governing influence over) almost every nation and economic community on the planet.⁴⁰ To be sure, the WTO is a major player in world affairs whose power is likely only to swell in the conceivable future.

III. Cap-and-Trade and the WTO

³⁶ Frederick M. Abbott, *The NAFTA in the WTO System*, The Jean Monnet Center for International and Regional Economic Law & Justice, sec. II, C, 2 (1999) <http://centers.law.nyu.edu/jeanmonnet/papers/99/990204.html#Heading8>

³⁷ *Understanding the WTO* at 1

³⁸ See *WTO Analytical Index – Guide to WTO Law and Practice*, World Trade Organization, (Nov. 7, 2009), http://www.wto.org/english/res_e/booksp_e/analytic_index_e/analytic_index_e.htm

³⁹ Jo-Ann Crawford & Sam Laird, *Regional Trade Agreements and the WTO Practice*, Centre for Research in Economic Development and International Trade, University of Nottingham, 18, (May 2000), <http://www.nottingham.ac.uk/economics/credit/research/papers/cp.00.3.pdf>

⁴⁰ *Understanding the WTO* at 1

Article 17 of the Kyoto Protocol envisions the recognition of emission permits for carbon dioxide and other greenhouse gases as a future commodity.⁴¹ This Article further goes on to endorse the concept of trading these emissions permits to satisfy domestic obligations to reduce emissions under the Protocol.⁴² Undoubtedly this should raise eyebrows, as it is generally the province of the WTO to regulate international trade – especially international trade of commodities.

In analyzing potential conflicts between international emissions trading (also known as “cap-and-trade”), it is important to determine exactly who will be trading future permits. While the Kyoto Protocol specifically concerns the obligations of nation states to reduce greenhouse gas emissions, Article 17 clearly leaves open the possibility of private entities engaging in the trading of emissions permits.⁴³ In the WTO context, the distinction between a nation state trading permits and a private entity doing the same is crucial.

In terms of emissions trading within states by and between private and state actors, the issue is quite problematic. The first troubling situation arises with the initial allocation of emissions permits themselves. At least one group of scholars feels that this initial allocation falls primarily within the jurisdiction of the WTO.⁴⁴ The crux of this argument is that when a state undertakes to allocate what is unquestionably going to be a valuable commodity to the entities doing business within its borders, the limits of permissible favoritism are sure to be stretched.

⁴¹ Kyoto Protocol to the United Nations Framework Convention on Climate Change art. 17, Dec. 11, 1997, http://UNFCCC.int/essential_background/kyoto_protocol/items/1678.php

⁴² *Id.*

⁴³ Matthias Buck & Roda Verheyen, *International Trade Law and Climate Change – A Positive Way Forward*, Friedrich-Ebert-Stiftung, 24, (July 2001), <http://library.fes.de/pdf-files/stabsabteilung/01052.pdf>

⁴⁴ “it is ... probable that the initial allocation of permits [will] fall under the disciplines of the WTO Agreement on Subsidies and Countervailing Measures” Duncan Brack with Michael Grubb & Craig Windram, *International Trade and Climate Change Policies*, xxii, (2000)

For example, a disproportionate allocation of permits to domestic firms versus foreign firms or disproportionate allocations to certain sectors of the economy may constitute an export subsidy – a clear violation of WTO rules.⁴⁵ WTO members are already legally bound to reduce trade barriers to foreign firms and subsidies to domestic firms on everything from bathtubs to algorithms.⁴⁶ With emissions targets likely to have significant bottom-line implications for a large swath of firms in any nation, demand for these permits promises to be fierce. Any perceived iniquities in the allocation of permits will almost surely give rise to litigation within the WTO. These disputes and any ensuing litigation may seriously hamper cap-and-trade implementation in terms of both time and potential adverse rulings.

Those wishing to avoid WTO issues altogether with the allocation of micro-level emissions permits undoubtedly will find solace in the opinions proffered by Buck and Verheyen. These scholars feel that the greatest potential areas for conflict with the WTO lay in the GATT 1994 agreement (the result of the Uruguay Round that formed the WTO) and with the General Agreement on Trade and Services (“GATS”).⁴⁷ They conclude succinctly that GATT 1994 is irrelevant to the issue, because emissions targets cannot be regarded as “goods” or “products,” a view shared by most economists.⁴⁸ Buck and Verheyen instead liken emissions permits to currency, which is not covered by GATT.⁴⁹ This makes sense logically, as it is hard to conceive of a situation where an emissions permit could be construed as a productive creation. However, if emissions permits do eventually wind up in one of these classifications, then GATT 1994 clearly applies and WTO governance will be triggered.

⁴⁵ Zhong Xiang Zhang, *Should the Rules of Allocating Emissions Permits be Harmonised?*, Ecological Economics, at 11 (October 1999)

⁴⁶ *Understanding the WTO* at 6

⁴⁷ Buck & Verheyen at 25

⁴⁸ *Id.*

⁴⁹ *Id.*

In the context of GATS, Buck and Verheyen conclude that, “at best,” the allocation of permits by states constitutes a mere government service.⁵⁰ Such a label is important, because Article I of GATS specifically exempts from WTO regulation services “supplied in the exercise of government authority.”⁵¹ If allocation of emissions permits is simply a service provided by the government analogous to waste removal or highway repair, then the WTO ramifications are irrelevant.

Buck and Verheyen’s quick conclusion that permit allocation is simply a service should be taken with caution, though, as other designations bring WTO interaction squarely back into the equation. For example, the notion that permit allocation constitutes a financial contribution or subsidy to the recipients directly raises WTO questions and is one that also has support among scholars.⁵² One study has determined that when industries or sectors within an economy are “grandfathered” into an emissions trading program, inimitable cost advantages are obtained by that firm that result in “windfall profit” thanks to the clear “capital gift” to the firm.⁵³ Certainly this is an issue that is not solved and has the potential to produce momentous litigation.

Looking beyond the initial allocation of permits, another important private entity topic to consider is the trading of permits between those entities. If one uses the “currency” view of permits put forth by Buck and Verheyen, then the WTO is effectively out of the picture as it has

⁵⁰ Id.

⁵¹ General Agreement on Trade in Services art. I, Apr. 15, 1994, http://www.wto.org/english/docs_e/legal_e/26-gats_01_e.htm

⁵² Richard W. Parker, *Designs for Domestic Carbon Emissions Trading: Comments on WTO Aspects*, Washington, DC: The H. John Heinz III Center for Science, Economics and the Environment, 15 (1998)

⁵³ Edwin Woerdman, *Competitive Distortions In An International Emissions Trading Market, Mitigation and Adaptation Strategies for Global Change*, (Dec. 2000), 337

minimal involvement with currency regulation.⁵⁴ However, it can be envisioned that brokers will emerge to facilitate the trade of these permits.⁵⁵ If this indeed does occur (which seems likely), such brokerage services almost certainly fall within the GATS and the WTO rules.

As with all aspects of cap-and-trade, classification is again vital. The necessary classification in this instance is what specifically are emissions trading programs primarily trying to accomplish? While brokers of emissions credits would almost certainly be providing a service, that service may still be exempt from regulation under GATS. Article XIV, section b states that “nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures necessary to protect human, animal or plant life or health.”⁵⁶ Certainly it can be argued that emissions trading is a measure taken to preserve all life as we know it on the planet. Accordingly, it would be exempt from WTO regulation under GATS.⁵⁷ Perhaps not surprisingly, this is the view advocated by Buck and Verheyen.⁵⁸

For nation states engaging in emissions trading with other nation states, the issue is relatively less complex than when private actors are involved. A leading theory is that the trading of emissions permits simply represents the reallocation of an overall assigned amount of permits, which therefore would not be the creation of a new trading market.⁵⁹ This thought generally seems sound, but ignores a fairly obvious question: How will the initial allocation of permits to nation states be conducted?

⁵⁴ See Jonathan E. Sanford, *Currency Manipulation: The IMF and WTO*, Congressional Research Service, 1, (May 8, 2008), http://assets.opencrs.com/rpts/RS22658_20080508.pdf

⁵⁵ Buck & Verheyen at 27

⁵⁶ General Agreement on Trade in Services art. XIV, sec. b

⁵⁷ *Id.*

⁵⁸ Buck & Verheyen at 27

⁵⁹ Brack, *supra* at xxii

Important questions beg to be answered regarding macro-level emissions permit trading by nation states. The first question returns to the seemingly endless problems that arise in the initial allocation of permits. Who will “hand” these permits out? At the micro level, this question rarely need even be asked as it is certain to be the government of the state. The answer at the international level is not as easy. Almost certainly the permits will come in some form from the United Nations (“UN”), but the UN lacks the sweeping powers of the governing bodies of nation states.⁶⁰ As such, adoption and enforcement of an international emissions trading program would require independent ratification of this UN program.

One fears to speculate on the legal grey areas that may surface in this situation. Imagine this scenario: A developing nation is reluctant to ratify a new cap-and-trade program to be implemented by the UN as a result of the successfully negotiated Copenhagen Protocol. Its reasons for its leering are legitimate – the costs of implementing change threaten the financial viability of its main industry and thus, its economy as a whole. However, the developed nations with which it regularly trades are putting intense political pressure on the developing nation to ratify the agreement, which will be especially favorable to those nations. If the developing nation, fearing debilitating trade sanctions, ratifies the cap-and-trade program and submits to the UN program, could not the political pressure imposed by its developed trading partners constitute the type of impermissible use of trade policy as a sword that is abhorrent to the WTO underpinnings? A plausible argument could be made that the developed nations, to whom the fictional cap-and-trade program is more favorable, would unilaterally be using trade as a weapon to induce the partner in the inferior position to ratify the agreement. Such a scenario is pure

⁶⁰ See *The United Nations at a Glance*, United Nations, 1, (Nov. 11, 2009), <http://www.un.org/en/aboutun/index.shtml>

fantasy at this point, but represents one of a number of possible infringements that could be attendant to a UN-implemented cap-and-trade program.

Problems with the allocation of permits are exacerbated by the fact that the WTO is a distinct entity separate from the UN.⁶¹ It is true that the two bodies maintain close relations, including the UN holding a position on the WTO general council.⁶² Nevertheless, the fact still remains that is the WTO, not the UN, which holds the most direct and concrete authority over international trade. Any cap-and-trade program implemented by the UN that does not involve the significant involvement of the WTO runs the risk of being an illegal international subsidy. A unilateral disbursement of emissions permits to nations by the UN would constitute a handout of incredibly valuable assets. Such action would almost certainly have to be considered a subsidy by a quasi-governmental body. The ramifications of such a bold move in the WTO context are without peer. Suffice it to say that considerable litigation would spring forth from those nations which felt shortchanged by the permit allocations and conflict of laws experts on international agencies would be in high demand.

While private-to-private and state-to-private trading at the micro level⁶³ and macro-level state-to-state trading⁶⁴ have already been considered, there remains one final pairing of buyer and seller. This transaction is between state actors and foreign private entities. Assuming that the problem of initial allocation of permits to nation states is solved, this is where the next great question emerges.

⁶¹ *The WTO and the United Nations*, World Trade Organization, 1, (Nov. 11, 2009), http://www.wto.org/english/thewto_e/coher_e/wto_un_e.htm

⁶² *International intergovernmental organizations granted observer status to WTO bodies*, World Trade Organization, 1, (Nov. 11, 2009), http://www.wto.org/english/thewto_e/igo_obs_e.htm

⁶³ See pg. 8

⁶⁴ See pg. 11

The Agreement on Government Procurement, which was entered into concurrently with GATT 1994, mandates non-discrimination by nation states in purchasing goods and services.⁶⁵ This buyer-seller relationship could materialize in many different situations, with arguably the most important being the scenario where a nation state is scrambling to purchase credits from foreign firms to comply with its targets under the relevant United Nations Framework Convention on Climate Change (“UNFCCC”) protocol.⁶⁶ In these situations, the Agreement on Government Procurement arguably could be violated in a number of ways by states purchasing emissions credits from foreign firms, depending on the transparency of the purchase and the mechanism employed by the state for purchasing these credits. Again, the classification of the permits will be crucial. If they are goods⁶⁷ or their trade classified as the marketing of services,⁶⁸ the WTO certainly has the power to regulate the transaction. If neither of these classifications is accurate, then arguably the transaction is outside the province of the WTO.

IV. Carbon Taxation and the WTO

The other major climate change reform that has received considerable attention is the taxation on carbon and other greenhouse gas outputs.⁶⁹ There are two potential carbon taxation plans that could be implemented individually or separately. The first is a global tax by some governing body, such as the United Nations. The problems with UN (or similar body) action in

⁶⁵ *The plurilateral Agreement on Government Procurement (GPA)*, World Trade Organization, 1, (Nov. 15, 2009), http://www.wto.org/english/tratop_e/gproc_e/gp_gpa_e.htm

⁶⁶ Buck & Verheyen at 24

⁶⁷ See pg. 9

⁶⁸ See pg. 10

⁶⁹ See David Duff, *Carbon Taxation in Theory and Practice*, The Law and Society Association, 1 (May 25, 2009)

matters like this have been touched upon in this paper.⁷⁰ A global carbon tax has certainly generated literature,⁷¹ but has received insignificant attention relative to the other carbon taxation option. As a result, the remainder of this section will consider the carbon tax in the form of the second option, namely, taxation by the individual states at the micro level.

Taxation at the state level potentially could give rise to WTO conflicts in at least two ways. The first of these is that carbon taxes on domestic firms may inadvertently affect the flow of international commerce. If carbon taxation is the only realistic option towards adherence to Kyoto or a potential Copenhagen Protocol, then the state is forced to choose between violating the Protocol or its WTO obligations. The other potential violation arises when a country uses carbon taxes on imports to combat the problem of “freerider” countries producing without assuming the environmental obligations.⁷² While such penalizing measures may be desirable from the environmental standpoint, they appear to be precisely the sort of retaliatory action that has been shunned by the WTO in favor of settled dispute resolution standards.⁷³ These two scenarios are taken in turn.

The first situation where internal carbon taxation could create friction with the WTO is when domestic firms and foreign firms producing in the country are taxed at different levels. One of the bedrock principles of the WTO is the “nondiscrimination provision” of Article III.⁷⁴ The nondiscrimination provision was included to prevent nations from employing taxes and

⁷⁰ See generally pg. 11

⁷¹ Joseph Stiglitz, *A New Agenda for Global Warming*, 1, (2006), <http://www2.gsb.columbia.edu/faculty/jstiglitz/download/GlobalWarming.pdf>

⁷² Terence Corcoran, *WTO Would Blow Away Carbon Trade War*, The Financial Post, 1, (Apr. 1, 2008), <http://www.financialpost.com/story.html?id=413057>

⁷³ See Chad P. Brown & Michele Ruta, *The Economics of Permissible WTO Retaliation*, World Trade Organization, 1, (Sept. 2008), http://www.wto.int/english/res_e/reser_e/ersd200804_e.pdf

⁷⁴ General Agreement on Tariffs and Trade, art. III, sec. 2, (1947), http://www.wto.org/english/docs_e/legal_e/gatt47_e.pdf

tariffs on foreign goods under the guise of regulation or other false pretenses. If the carbon tax is levied at differing levels among sectors within a state, and a foreign firm dominates one of these sectors, it is conceivable that a claim may be made that the carbon taxation scheme is simply a mask for more nefarious protectionist motives.

There is an even more likely scenario that presents problems with a state's WTO obligations. States that currently impose carbon taxes do so to meet their respective emissions targets under the Kyoto protocol.⁷⁵ As all states have various options available to them to reach their emissions targets that are not restricted to only the carbon tax, carbon tax levels across the various states are not likely to be equal. Suppose that a state has other options such as a domestic cap-and-trade program and a relatively sophisticated system of alternative energy to help it reach its emissions targets. This state's carbon tax levels would be relatively low compared to a state forced to rely solely on the carbon tax to reach its targets. It is entirely plausible, however, that the state with the higher tax levels would accuse the other of falsely inflating its other offsetting options in the name of lowering its carbon tax to create a competitive advantage for its industries against international competitors. This potential manipulation of carbon taxation levels is illegal in the WTO framework and the mere existence of numerous state-specific carbon taxation schemes will foster suspicions of this impermissible activity.⁷⁶

The other potential conflict that could arise from domestic carbon taxation schemes is the use of the so-called "border tax." At present, the border tax is typically aimed at the United States, but is also applicable to any state that has not adopted prevailing environmental reforms.⁷⁷

⁷⁵ Zhong Xiang Zhang & Lucas Assuncao, *Domestic Climate Policies and the WTO*, 17 (Jan. 16, 2002)

⁷⁶ General Agreement on Tariffs and Trade, art. III, sec. 4, (1994), http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gatt1994_02_e.htm#article3A4

⁷⁷ See Stiglitz at 1

The border tax is a duty placed on goods and services coming from these nations as a way of correcting an unfair competitive advantage.⁷⁸ Traditional theory relates that firms in states that have voluntarily undertaken carbon-reducing measures are fully bearing the real costs of production, whereas firms in non-conforming states are able to produce without having to account for an additional real cost – damage to the environment.⁷⁹ Products imported from these non-conforming nations are taxed “at the border” to reflect this as-yet unaccounted for cost and pull the producing firms back into the competitive market with the firms in conforming nations.⁸⁰

The inevitable clash with the WTO is apparent simply by reading the name “border tax.” The WTO operates under the umbrella of an agreement designed first and foremost to cripple one specific institution: The tariff.⁸¹ Tariffs, quite simply, are taxes “at the border” of imported goods.⁸² On its face, it seems incredible to think that these border taxes could possibly comport with the WTO and the GATT agreements.

Not surprisingly, this view has attracted a number of supporters. The World Bank has stated that, absent Article XX exemptions⁸³ or Process and Production Method exemptions,⁸⁴ the use of border taxes to combat the freerider problem is illegal within the WTO framework.⁸⁵ Of

⁷⁸ *Border Adjustments*, Carbon Tax Center, 1, (Nov. 20, 2009), <http://www.carbontax.org/issues/border-adjustments/>

⁷⁹ J. Andrew Hoerner, *The Role of Border Tax Adjustments in Environmental Taxation: Theory and U.S. Experience*, Center for a Sustainable Economy, 5, (Mar. 19, 1998), http://www.rprogress.org/publications/1998/BTA_1998.pdf

⁸⁰ *Id.*

⁸¹ The General Agreement on Tariffs and Trade, art. I, sec. I, (1947), http://www.wto.org/english/docs_e/legal_e/gatt47_e.pdf

⁸² “What is a Tariff?”, WiseGeek.com, 1, (Nov. 20, 2009), <http://www.wisegeek.com/what-is-a-tariff.htm>

⁸³ See pg. 20

⁸⁴ See pg. 20

⁸⁵ *International Trade and Climate Change*, The World Bank, 98-99, (2008), <http://books.google.com/books?id=IMgTPxrrGCwC&pg=PT111&lpg=PT111&dq=Carbon+Taxation+and+the+WTO&source=bl&ots=Ax-m3-9OAR&sig=VUuhNgko2eOwiB->

further note to environmentalists, it also noted that carbon taxes serve as an impediment to the diffusion of clean technologies to developing nations.⁸⁶ Zhang analyzed the mechanics behind carbon taxation and its effect on world trade, concluding that such schemes could potentially affect the “like-product” provisions⁸⁷ of GATT 1994.⁸⁸ Other legitimate arguments mainly center on the “slippery slope” of using purportedly neutral trade regulations to further social agendas.

At first glance, border taxes appear to be prima facie incompatible with the WTO. Surprisingly, there is considerable disagreement with this assertion. Those that find hope for a dual existence for the WTO and carbon taxation base their optimism in various places. One of these is to question the applicability of the “like-product” provision of Article III. In the unique view of the International Centre for Trade and Sustainable Development, the WTO provisions are read not to classify products only by their end form, but also by evaluating their means of production.⁸⁹ By distinguishing products by the carbon footprints incumbent in their production, such outputs are not like-products at all.⁹⁰ Such a distinction would render the Article III issue moot and potentially open the door for permissible carbon taxation schemes.⁹¹

9szbTjOQ_OMY&hl=en&ei=NIoTS7jCAoiLnQfAi-3YAw&sa=X&oi=book_result&ct=result&resnum=4&ved=0CBAQ6AEwAw#v=onepage&q=Carbon%20Taxation%20and%20the%20WTO&f=false

⁸⁶ Id. at 101

⁸⁷ See footnote 76

⁸⁸ Zhong Xiang Zhang, *Greenhouse Gas Emissions Trading and the World Trade System*, vol. 3, 2, at 228 (1998)

⁸⁹ *Border Adjustments* at 1

⁹⁰ Id.

⁹¹ Support for this theory can be found in WTO case law, specifically in the 1994 *US Auto* case which determined that automobiles with different fuel economies were not like-products. *WTO| dispute settlement – the disputes – DS340*, World Trade Organization, 1, (Nov. 27, 2009), http://www.wto.org/english/tratop_E/dispu_e/cases_e/ds340_e.htm

Another view takes a rather obvious, yet noteworthy, stance. Professor Joost Pauwelyn states that regardless of whether it is a domestic cap-and-trade program or carbon tax that is being employed, the use of a border tax can exist under WTO rules.⁹² The way that this coexistence can be achieved is simply by treating domestic products and foreign products identically.⁹³ This theory is couched in persuasive support. GATT Article II, section 2(a) states that tariff ceilings do not prevent states from “from imposing at any time on the importation of any product . . . a charge equivalent to an internal tax . . . in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part”.⁹⁴

Pauwelyn is cautious to point out that Article II does not necessarily guarantee that border taxes that treat domestic and foreign products alike are permissible, however. The ultimate fate of his theory hinges on a somewhat arcane distinction between a product tax and a producer tax. In short, such a tax may be targeted at foreign products to achieve harmony in regulation with identical products produced domestically.⁹⁵ It cannot be used to primarily target foreign firms instead of their products.⁹⁶ Whether these border taxes would be classified as product-aimed or producer-aimed by the WTO is unclear and is still a matter of much conjecture.⁹⁷

⁹² Joost Pauwelyn, *U.S. Federal Climate Policy and Competitiveness Concerns: The Limits and Options of International Trade Law*, Nicholas Institute for Environmental Policy Solutions, Duke University, 16, (Apr. 2007), http://www.carbontax.org/wp-content/uploads/2007/09/pauwelyn_-_duke-univ_-_working-paper-on-climate-and-competitiveness_-_2007.pdf

⁹³ *Id.*

⁹⁴ The General Agreement on Tariffs and Trade, art. II, sec. 2(a), (1947), http://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm

⁹⁵ *Id.*

⁹⁶ Pauwelyn at 18

⁹⁷ *Id.* at 19

The majority of people who believe that border taxes can survive the tests of WTO regulation rely on two fascinating theories that show that the WTO's stance on these duties may not be so rigid after all. The first of these theories is found in the text of GATT 1947 itself and is very similar to Article XIV section b of GATS.⁹⁸ GATT Article XX states:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures
(b) necessary to protect human, animal or plant life or health⁹⁹

Situations that may constitute “arbitrary or unjustifiable discrimination” are certain to be legitimate concerns, yet, are overcome in the minds of many scholars. Pauwelyn asserts that even if the Article II argument in favor of the border tax fails, the legality of the tax must still be upheld under Article XX.¹⁰⁰ Pauwelyn's basis for this claim is that the carbon tax would be a measure undertaken to preserve the world climate, which would be a necessary step in protecting life on the planet.¹⁰¹ It is unclear if this argument would or will ultimately succeed, but it is one that has been contemplated by numerous scholars.¹⁰²

The other theory that may justify the use of border taxes lies in the common law developed by the dispute resolution mechanism built into the WTO. A major dispute was brought to the dispute resolution panel in 1991 after Mexico claimed that the United States'

⁹⁸ See pg. 10, footnote 56

⁹⁹ The General Agreement on Tariffs and Trade, art. XX, (1947), http://www.wto.org/english/docs_e/legal_e/gatt47_02_e.htm

¹⁰⁰ Pauwelyn at 3

¹⁰¹ Id.

¹⁰² Thomas L. Brewer, *The WTO and the Kyoto Protocol: Interaction Issues*, Climate Policy, vol.4, 5, (2004), <http://www.usclimatechange.com/downloads.php/WTO-KP%2520in%2520CP.pdf>

refusal to import tuna collected by practices unsafe to dolphins was a violation of trade policy.¹⁰³ The position taken by the United States was that this was a permissible intermediary nation embargo based upon the previously discussed Article XX.¹⁰⁴ The dispute panel disagreed.¹⁰⁵ It ruled that the United States could not ban imports based on the process used by the producer, as this would be an impermissible use of trade policy to impose its own standards on foreign countries.¹⁰⁶ While the tuna/dolphin case appears to be a blow to the viability of the Product vs. Production Process exemption, it is important to note that the tuna/dolphin report was never formally adopted and, thus, is not a legal interpretation of GATT law.¹⁰⁷

Instead, more persuasive authority may come from the so-called “shrimp/turtle” case. In that dispute, a group of Southeast Asian companies brought a dispute to the WTO over the United States’ refusal to import shrimp that was harvested with methods unsafe to sea turtles.¹⁰⁸ The United States ultimately lost the case on separate discrimination issues, but the appellate panel stressed that the environmental motives of the plan were permissible under GATT.¹⁰⁹ Here, the panel specifically stated that the Article XX argument that was unsuccessfully raised by the United States in the tuna/dolphin dispute was sound.¹¹⁰ The panel declared in dicta that countries had the right to take such action under Article XX, although it conceded that the WTO did not have to allow them this right if it so chose.¹¹¹

¹⁰³ *WTO| Environment – disputes 4*, World Trade Organization, 1, (Nov. 27, 2009), http://www.wto.org/english/tratop_e/envir_e/edis04_e.htm

¹⁰⁴ See footnote 99

¹⁰⁵ *WTO| Environment – disputes 4* at 1

¹⁰⁶ See footnote 96

¹⁰⁷ *WTO| Environment – disputes 4* at 1

¹⁰⁸ *WTO| Environment – disputes 8*, World Trade Organization, 1, (Nov. 27, 2009), http://www.wto.org/english/tratop_e/envir_e/edis08_e.htm

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ *Id.*

The implication on carbon taxation is clear. If a state can discriminate on imports based on environmentally unsafe production processes as they relate to specific animals, could it not also do so based on production process harmful to the entire planet? Commentators have been quick to make this short leap from shrimp/turtle to border taxes¹¹² – while noting the irony of the United States advocating the Article XX position that ultimately underpins this piece of case law precedent.¹¹³

V. Other Conflicts with Environmental Reform and the WTO

While beyond the scope of this paper, it is important to note that the friction between WTO regulation and environmental reform is not limited to cap-and-trade and carbon taxation. Buck and Verheyen conducted an analysis of many of these other conflicts, including energy efficiency standards,¹¹⁴ eco-labeling,¹¹⁵ and subsidy reduction in the name of environmental reform.¹¹⁶ Insightful literature has also been generated on the subsidizing of clean development mechanisms as a means to meet emissions targets.^{117 118} While these topics are not addressed in this paper, they are mentioned here to provide a starting point for the reader if or she would like to explore these topics further.

VI. Working Towards a Solution

¹¹² J. Andrew Hoerner & Frank Muller, *Carbon Taxes for Climate Protection in a Competitive World*, Swiss Federal Offices for Foreign Economic Affairs, 26, (Jun. 1996), http://www.rprogress.org/publications/1996/swiss_1996.pdf

¹¹³ Stiglitz at 2

¹¹⁴ Buck and Verheyen at 7

¹¹⁵ Id. at 15

¹¹⁶ Id. at 20

¹¹⁷ Id. at 27

¹¹⁸ Brewer at 7

Any potential solution to ultimately harmonize the aims of free trade and environmental protection will require cooperation between the major players, namely the WTO and the UN through the UNFCCC. Plans that are implemented that disregard international trade or only address it on the periphery are doomed to fail. For example, as previously discussed, many commentators are in favor of a uniform, global tax on carbon emissions.¹¹⁹ However, the EU already attempted a similar multilateral plan in 1992 and it failed largely on concerns that such a tax violated national sovereignty.¹²⁰ These fears could perhaps be mitigated if a tax was couched in a familiar mechanism of rules and regulation like that offered by WTO. The tax could be positioned as a necessary inhibition on trade in accordance with Article XX. In that situation, national sovereignty would be no more infringed by the uniform carbon tax than it is by any other assumption of trade obligations under the WTO rules.

Beyond the narrow issue of a uniform carbon taxation scheme, the broad issue of importance is that the WTO needs to be at the table when major climate change reforms are being contemplated and implemented. The WTO has explicitly stated that it “endorses and supports multilateral solutions based on international cooperation and consensus as the best and most effective way for governments to tackle environmental problems of a transboundary or global nature.”¹²¹ In turn, the UNFCCC has explicitly recognized the need for cooperation between trade regimes and climate change reforms, having commissioned a report stating as much.¹²² If these two bodies have explicitly recognized the mutual need for cooperation, then why has there not been more meaningful progress towards this goal? Perhaps the answer lies in

¹¹⁹ See footnote 71

¹²⁰ Zhang & Assuncao at 22-23

¹²¹ Id. at 24

¹²² *Cooperation with Relevant International Organizations: World Trade Organization, United Nations Framework Convention on Climate Change, 2*, (May 14, 2003), <http://UNFCCC.int/resource/docs/2003/sbsta/inf07.pdf>

this paper's introduction – the supporters of international trade and environmental reform are still not familiar enough with their respective platforms to make sure that this essential cooperation is included in any new reform.

As a result, the first step has to be education for both sides. While the two bodies have expressed their desire for cooperation, they have done so in obscure reports¹²³ and memoranda that can easily be missed. These statements must be made jointly and prominently to spark meaningful progress.

Additionally, it has been continually recognized that the mistrust between environmentalists and free traders has been borne out of misunderstanding or ignorance of the true nature of the other side's platform.¹²⁴ As has been shown in this paper, while these platforms may seem to be incongruous at first, further examination reveals more similarities and potential accommodations within the potential frameworks than one might first think. Thus, both sides must be adequately educated about one another to facilitate meaningful cooperation.

When this is accomplished, both sides must be represented at the table when potential reforms are being developed and implemented. In terms of carbon taxation at the global level, it has already been shown how WTO involvement may help to ease fears about the infringement of national sovereignty.¹²⁵ In the cap-and-trade context, much of the uneasiness lies in the fact that nobody is sure how emissions permits will be categorized in terms of international trade. Their

¹²³ See footnote 122

¹²⁴ Daniel C. Esty, *Greening the GATT: Trade, Environment, and the Future*, 2, (1994), <http://books.google.com/books?hl=en&lr=&id=Rxe3d2mlAbQC&oi=fnd&pg=PR11&dq=Trade+Supporters+and+Environmental+Reform&ots=C2R8elgMmA&sig=EjR7FuWiqG1HBkP9M1LP3UUoJFM#v=onepage&q=Trade%20Supporters%20and%20Environmental%20Reform&f=false>

¹²⁵ See pg. 22

characterization has a major impact on whether or not the WTO will have jurisdiction to regulate them.¹²⁶

Rather than leave it up to the dispute panel (which will undoubtedly end up with a case of this kind) to struggle to determine how emissions permits should be classified, why not involve the WTO from the beginning in such a program? If the WTO has a stake in the creation of these permits, then it will certainly have a stake in determining whether or not they will fall within its jurisdiction. Indeed, the WTO would have the ability to accurately classify these permits at its discretion, as it would be fully versed in the precise nature of these new creations. If the GATT members have shown a willingness to overhaul their core principles in the name of modernization¹²⁷, surely they would be receptive to the comparatively minor task of assisting in the creation of a new tradable unit to respond to a changing and imperiled world.

Finally, both the UNFCCC and the WTO require that their members exert minimum cooperation efforts to accomplish the missions of the respective bodies.¹²⁸ Currently, these minimum levels of cooperation are wholly distinct from one another.¹²⁹ If the WTO and the UN enter into a partnership between climate change reform and international trade, harmonization of these minimum standards could be a critical component in bringing about reform. For instance, the UNFCCC's minimum standards could reflect a recognition that a nation must concurrently satisfy its trade obligations. Reciprocal environmental obligations within the WTO's minimum standards of cooperation could be an effective tool in preventing industrialized countries from

¹²⁶ See Buck & Verheyen at 25

¹²⁷ See pg. 6

¹²⁸ See Buck & Verheyen at 38

¹²⁹ Id.

seeking to avoid their environmental obligations, a la the United States and the Kyoto Protocol.¹³⁰

VII. Conclusion

Unfamiliarity with their respective goals has led to unnecessary friction between supporters of international trade and environmental reformers. Certainly there are areas of potential friction within the two dominant climate change reform systems (cap-and-trade and carbon taxation) and the WTO. However, much of this friction has resulted from the fact that the independent functioning of the UNFCCC and the WTO has led to confusion as to how specific programs and rules fit within the respective frameworks. These two groups must establish an open dialogue based on an educated view of each other's aims. From there, policies created by the respective bodies should include one another in all stages, from formulation to ultimate implementation. This will give environmentalists and free traders alike a stake in the outcomes of trade policy and environmental reform, thus giving clarity to the interaction between these two regimes and giving each group a stake in the successful advancement of each platform.

¹³⁰ Id.