Climate Law and Developing Countries
Legal and Policy Challenges for the World Economy

Edited by
Benjamin J. Richardson
Osgoode Hall Law School, York University, Canada
Yves Le Bouthillier
Faculty of Law, University of Ottawa, Canada
Heather McLeod-Kilmurray
Faculty of Law, University of Ottawa, Canada
Stepan Wood
Osgoode Hall Law School, York University, Canada

NEW HORIZONS IN ENVIRONMENTAL AND ENERGY LAW

Edward Elgar
Cheltenham, UK • Northampton, MA, USA
15. Climate and trade in a divided world: can measures adopted in the North end up shaping climate change legislative frameworks in the South?

Francesco Sindico*

1. INTRODUCTION

Developing countries face a double challenge when dealing with climate change: they are asked to adopt mitigation and adaptation measures to start tackling this grave problem but, at the same time, development remains the number one priority for the vast majority of them. These two objectives may create tensions between sectors of a government wishing to prioritize environmental goals and those more concerned with economic development. Furthermore, this tension between addressing climate change and pursuing economic development may lead to disputes with other countries.¹ To foster development, many developing countries will strive to participate more actively in the global market, since one avenue to promote economic development is for producers to export freely their goods and services. It is therefore crucial that they be able to rely on international legal norms that facilitate exports to other developing countries and even more so to industrialized ones, as it is in the latter that most goods they produce are consumed.

This chapter seeks to explore to what extent climate change policies in the North may end up shaping policies in the South by obliging exporters from developing countries to comply with specific climate change requirements. Section 2 briefly highlights carbon leakage and competitiveness concerns as reasons why an industrialized country may consider targeting imports from developing countries. Section 3 focuses on current United States (US) legislative initiatives at the federal level proposing to link imports from developing countries to climate change policy. Section 4 examines whether the current international trade rules enshrined in the
World Trade Organization (WTO) Agreements allow for such domestic climate change measures and what options are open to developing countries in case of a climate and trade dispute. It seeks to determine, in particular, whether relying on the multilateral trading system would actually benefit these countries. The conclusion suggests a way forward.

2. CARBON LEAKAGE AND COMPETITIVENESS CONCERNS

Economic and environmental concerns may prompt an industrialized country to adopt trade measures against imports coming from developing countries. A company based in the North may worry that competitors in the South that are not bound by comparable climate change obligations will enjoy an unfair competitive advantage on the market. The company could lobby its government to adopt climate change related trade measures as a means to tackle the loss of competitiveness on the global market. The government adopting climate change related trade measures might also consider it necessary to deal with the problem of carbon leakage, which is the increase of greenhouse gas (GHG) emissions in one jurisdiction resulting from the adoption of climate change policies in another. Carbon leakage results, notably, from the relocation of production from countries with stronger climate change requirements, presumably in the North, to countries with less rigid ones, presumably in the South. To deal with carbon leakage, a government might decide to adopt a climate change related trade measure aimed at preventing companies from relocating production to jurisdictions with weak GHG standards.

Have companies in the North already started to complain about their position on the global market vis-à-vis companies in developing countries because of different climate change requirements? Have governments paid attention to these concerns when developing climate change policies and law? Certainly, a number of energy intensive industries in the European Union (EU) have warned that if the new European climate change legislation, and in particular the revised emissions trading scheme, does not deal comprehensively with 'cheap' imports from third parties, they may consider relocation as part of their business strategy. The same is true in the US where the decision not to ratify the Kyoto Protocol was mainly a political decision based on competitiveness concerns. Despite the fact that the debate on climate change has changed radically in that country in the last few years, most sectors of the economy are still of the view that accepting binding international climate change obligations when emerging developing countries are not is not a price worth paying (Houser, et al., 2008, pp. 1–13).
Both the EU and the US are aware of concerns raised by industrial associations. Furthermore, the current economic situation heightens fears by industries in the North of loss of competitiveness in the global market. These concerns are reflected in the current revision of the EU Emissions Trading Scheme (European Commission, 2008a, p. 11; European Commission, 2008c, recitals 19 and 20), and in a number of climate proposals tabled in Congress in the US in recent years.\(^5\)

Relocating to a country with less stringent climate change requirements may not be environmentally friendly, but ultimately companies respond to their shareholders. Profit-making – not reducing emissions – is their main goal. However, other considerations may deter a company from relocating. First, a company in the North may consider that, even if faced with tougher climate change requirements, it is good business strategy and consistent with its corporate social responsibility policy not to move (Bubna-Litic, 2007; Richardson, 2008).\(^6\) Second, the loss of competitiveness on climate change grounds is confined to specific sectors. Research has shown that only a relatively limited, albeit important, part of the economy will face problems due to less stringent environmental requirements in other countries (Ratnayake, 1998). Climate change does not seem to be an exception (Demailly and Quirion, 2006).\(^7\) 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 (Houser, et al., 2008, pp. 5–7). Petroleum refining, paper and pulp, steel, non-metallic mineral products, chemicals, cement, and ferrous and nonferrous metals sectors have been identified as energy intensive industries most at risk in the EU and the US (Houser, et al., 2008, p. 8; European Commission, 2008b, p. 11).

3. CAN THE CLIMATE CHANGE LAWS IN A DEVELOPING COUNTRY BE INFLUENCED BY MEASURES ADOPTED IN THE NORTH?

If a government adopts a measure for domestic producers and requires foreign producers of like goods destined for that domestic market to comply with comparable measures, this will inevitably have implications for the exporting country. In such a scenario foreign steelmakers, for example, would be allowed to enter the domestic market only if they have produced the steel in the same or in a comparable manner as domestic steelmakers. Should this be the case, and should it go unchallenged, the policy implication would be that the domestic steel production process would in effect be indirectly imposed on other countries. This section
focuses mainly on whether the current climate change debate in the US is leading to this kind of scenario.

**US Climate Change Laws**

The US does not have a federal climate change law package that deals comprehensively with emission reductions across the entire country (Driesen, 2007; Szymanski and Stone, 2008). While this is not surprising, given the position of the Bush administration on climate change (especially during its first mandate), the situation may change under President Obama. In addition, a recent decision of the US Supreme Court seems to have pushed climate change on the government agenda.

It is in this context that an overarching federal climate change bill, America’s Climate Security Act (CSA), proposing a cap-and-trade scheme, was introduced in Congress in 2007. However it did not pass the two houses’ scrutiny. Amendments were proposed in 2008 by Senator Boxer but the proposed Act was defeated in a June cloture vote, and will have to be reintroduced in 2009. Despite the fact that CSA is not yet a US federal law, I refer to it throughout this chapter since it proposes to deal with carbon leakage and competitiveness concerns through, among other things, the adoption of border adjustment measures.

The US, especially at the state level, appears to be rising to the challenges posed by the threat of climate change. Considering the importance of overall US emissions at the global level, state and regional mitigation efforts are a very positive first step. The next one needs to cover the entire US territory through a federal climate change law package. The presence of a new president in the White House is likely to trigger action in this direction. A fragmented US policy on climate change is unsustainable over the long term as Americans are asking for federal action to enhance legal certainty across the country in order for them to conduct their business accordingly (Driesen, 2007, p. 43). Therefore, time will come, probably sooner rather than later, when an overall federal climate change legislative package will be adopted.

**The US Approach to Carbon Leakage and Competitiveness Concerns**

In the same way that that some players in the industry are concerned with having to comply with a diversity of US states’ regulations, they are also lobbying the government to adopt measures meant to target imports from developing countries whose climate change policy is not as stringent as the one envisioned in the US. A White Paper on Competitiveness suggested three approaches (Subcommittee on Energy and Air Quality of the
Border Adjustment Measures (BAMs), mandatory energy-intensity performance standards and specific carbon market design aimed at encouraging cleaner production in developing countries.

In this chapter, I will focus only on BAMs, since developing countries may also face these types of measures in their trade relations with the EU (European Commission, 2008a, p. 11). These measures 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’ (Subcommittee on Energy and Air Quality of the US House of Representatives, 2008, p. 8). An approach of this kind would mean, for example, that a developing country like China or India would have to buy allowances on a future US emissions trading scheme to gain market access to the US. According to the proposals on the table, the US government would determine whether a developing country has taken measures comparable to those in the US. This approach would apply to a limited number of energy intensive sectors. As a result, if an Indian producer wishes to export an energy intensive product such as paper or steel, and if the US government determines that the Indian government has not enacted climate change legislation comparable to that of the US, the Indian goods would be allowed into the US only if the Indian producer purchased allowances on the US emissions trading scheme.

In addition to border adjustment measures requiring foreign exporters to participate in a cap and trade scheme through the mandatory purchase of emission allowances, other BAMs have been considered to deal with loss of competitiveness and carbon leakage. Some countries, France in particular, have argued that border tax adjustments could also be a feasible option to level the playing field (Wiers, 2008, pp. 18–19). According to this option, imports from countries with lower climate change standards would be taxed at the border at the same level as domestic products, therefore eliminating any competitive advantage arising from lower standards in the producing country. Border tax adjustments would also apply to products originating from countries with higher standards. Climate change taxes on these products would be rebated at the border if the products were exported to countries with lower climate change standards (Faucauld, 1998, pp. 164–93). Despite the ongoing debate on border tax adjustments, there does not seem to be currently much political interest in this option. This is why I will focus on BAMs linked to cap and trade schemes.

A developing country faced with US trade measures of this kind would have three policy options. First, it could decide to modify its legislation in order to harmonize it somewhat with the US legislation. Countries like China and India would probably not do so, and should not do so just to
Climate law and developing countries

please the US economy. However, this would be a very difficult choice to make in cases where the US export market is particularly important for the developing country affected by the trade measures. Second, it could choose to redirect trade. Trade flows in energy intensive industries from China to the US, for example, are not as dominant as one may think. Except for cement, imports from China amount to less than 10 per cent of carbon intensive imports, Canada being the main importer (Houser, et al., 2008, pp. xviii and 45). China could, therefore, decide to export steel elsewhere and strengthen other commercial ties, including South–South trade. The last option, discussed in the next section, would be to lodge a complaint against the US measures before the Dispute Settlement Body (DSB) of the multilateral trading system.

4. COMPATIBILITY OF POTENTIAL US BORDER ADJUSTMENT MEASURES WITH WTO LAW

Before proceeding further it is worth remembering that this part of the chapter is obviously speculative in nature since no US climate change law has been adopted yet and, therefore, no dispute of this kind between the US and a developing country can arise at this stage.

The following section first explains the design of the climate change related trade measures included in the America’s Climate Security Act 2008 and then it examines how an affected developing country may seek redress through the WTO dispute settlement system.

Climate Change Related Trade Measures in the 2008 Climate Security Act

The overarching goal of Title XIII of the Act was ‘to promote a strong global effort to significantly reduce greenhouse gas emissions’.19 The first and best route to achieve this is through international negotiations. Therefore, the Act took an explicit stand in favor of multilateralism.20 In doing so, however, it also raised concerns about carbon leakage and the overall ineffectiveness of 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’.21 This second goal was to be achieved through ‘measures carried out by the United States that comply with applicable international agreements’.22 Therefore, while multilateralism was stated as the best way forward, CSA also considered unilateralism explicitly as the second best means to deal with global climate change.
Section 1306 of the Act imposed the following requirement on US importers of goods from developing countries:

Effective beginning January 1, 2014, a United States importer of any covered good shall, as a condition of entry of the covered good into the United States, submit to the Administrator and the Bureau of Immigration and Customs Enforcement a written declaration . . . [that will] include a statement certifying that the applicable covered good is (A) subject to the international reserve allowance requirements of this section . . . or (B) exempted from the international reserve allowance requirements of this section . . . [T]he written declaration for the covered good shall include . . . an estimate of the number of international reserve allowances that are required for entry of the covered good into the United States . . . and the deposit of . . . international reserve allowances in a quantity equal to the estimated number required for entry.23

This climate related trade measure had several elements. Which goods were covered? Did the measure affect developing countries? In other words, where did developing countries fit in the list mentioned in the Act, and what were the criteria on which this list was based? And, finally, if imports from developing countries were covered, what did a climate change trade related measure like this actually require from the affected foreign country to allow its goods to enter the US market? In other words, what was the Act referring to when it mentioned ‘international reserve allowances’?

Coverage

A developing country would be affected if it traded with the US in ‘primary products or manufactured items for consumption’. Primary products are a limited number of carbon intensive goods. CSA 2008 explicitly mentioned ‘iron, steel mill products, aluminium, cement, glass, pulp, paper, chemicals, or industrial ceramics’.24 However, since the relevant section in CSA 2008 provided for cumulative conditions, not all carbon intensive goods were covered but only those that:

generate[s], in the course of the manufacture of the good, a substantial quantity of, direct greenhouse gas emissions or indirect greenhouse gas emissions; and [are] closely related to a good the cost of production of which in the United States is affected by a requirement of this Act.25

The second category of covered goods was ‘manufactured items for consumption’. These are not primary products and, according to CSA 2008, was a product that: ‘generates, in the course of the manufacture, a substantial quantity of direct greenhouse gas emissions or indirect greenhouse gas emissions, including emissions attributable to the inclusion of a primary product in the manufactured item for consumption;’.26 Therefore, CSA 2008

expanded the coverage to goods produced through a process resulting in significant GHG emissions. In other words, not only could steel imports (primary product) be targeted, but also cars the production of which depends on carbon intensive steel (manufactured item for consumption). However, this was the case only when the application of the measure was ‘administratively feasible and necessary’.27

The criteria according to which a developing country would be targeted
How could developing countries be targeted? The climate change related trade measure provided for in CSA would only be imposed on foreign countries that would not take comparable action to the US in tackling climate change. The procedure called for an international climate change commission to evaluate whether a foreign country had taken comparable measures.28 If it had, that country would be put on an ‘excluded list’, while others would fall into the ‘covered list’.29 Only those exporting into the US from countries on the ‘covered list’ would face the climate change related trade measure.30 The key issue here is to understand what was meant by comparable measures. CSA 2008 amended the guidelines found in CSA 2007,31 and provided for the following:

[A] foreign country shall be considered to have taken comparable action if the Commission determines that the percentage change in greenhouse gas emissions in the foreign country during the relevant period is equal to or greater than the percentage change in greenhouse gas emissions of the United States during that period.32

CSA allowed some flexibility to a foreign country in designing a climate change policy, since it did not require the same cap and trade scheme.33 Comparable measures were assessed against baseline emission levels,34 defined as ‘the total annual greenhouse gas emissions attributed to the category of the covered good of the foreign country’.35 Best available technology was one of the criteria used in order to determine the above-mentioned amount.36 A strict application of this requirement meant that most emerging developing countries were included in the ‘covered list’ and, therefore, that their imports would be subject to the climate change related trade measure provided for in CSA. This brings us to discuss the design of the measure itself.

The implementation of the trade measure
What did the US require from a developing country in order to allow it to export its goods into the US territory? Countries found not to have taken comparable action on climate change would be obliged to purchase allowances from an international reserve allowance programme set up for this
Climate and trade in a divided world

purpose. The measure would have begun in January 2014. A company exporting its products into the US would be required to submit a written document indicating if a product was manufactured or processed in a country included in the ‘covered list’. If that was the case, the company would estimate in the document the number of international reserve allowances that it would have to surrender to be granted access to the US market. A final decision on the correct number of international reserve allowances would be made by the Administrator 180 days after the submission of the written document. How many international reserve allowances would the developing country have to buy? CSA 2007 provided that methodology rules and formulas for this purpose had to be established and, therefore, there was no clear-cut answer to this question. The amendments presented in 2008 dealt very thoroughly with this question. According to section 1306(d), entitled ‘Quantity of Allowances Required’, a company exporting its products into the US had to purchase a number of allowances equal to:

the product obtained by multiplying . . . the national greenhouse gas intensity rate for each category of covered goods of each covered foreign country for the compliance year . . . ; the allowance adjustment factor for the industry sector of the covered foreign country that manufactured the covered goods . . . ; and the economic adjustment ratio for the covered foreign country,. . .

Drafters allowed alternative options to the purchase of international reserve allowances. In fact it was clearly stated that a foreign country could rely on allowances issued under non-US cap and trade schemes (for instance, allowances from the European emissions trading scheme) to gain access to the US market.

In sum, an analysis of goods covered, of the criteria according to which a foreign country could be targeted, and of the implementation of the measure provided for in CSA demonstrate that developing countries could be negatively affected by such a measure.

WTO Compatibility of Potential US Border Adjustment Measures Concerning Developing Countries

Could a developing country targeted by such a measure have successfully questioned its legality before the WTO DSB? It seems that the drafters of the Act were well aware of this possibility since a sub-section of the provision that established the climate change related trade measures in CSA 2007 was entitled ‘Consistency with international agreements’ and provided: ‘[t]he 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'. While this subsection was not replicated in CSA 2008, the latter did provide that any other action deemed necessary ‘to address GHG emissions attributable to the production of covered goods in covered foreign countries’ had to be adopted ‘in compliance with all applicable international agreements’. It was reasonable to expect that the application of the climate related trade measure upon companies wishing to gain access to the US market must also follow this requirement. Interestingly, under the definition of ‘international agreements’ CSA 2008 specifically included the Marrakesh agreement establishing the WTO.

The US House of Representatives Subcommittee on Energy and Air Quality White Paper was also concerned that unilateral climate change measures be compatible with WTO obligations. It expressed the following view:

\[
\text{[s]ince the US cannot unilaterally bind other countries, our goal will be to craft legislation that also induces developing countries to limit their emissions growth \ldots in a manner that is reasonably certain to withstand challenge before the World Trade Organization (Subcommittee on Energy and Air Quality of the US House of Representatives, 2008, p. 2).}
\]

It is not my goal here to provide a detailed account of the technicalities of the climate change and trade debate (see, e.g., Pauwelyn and Sindico, 2008; Green, 2005; Zhang and Assunção, 2004; Pauwelyn, 2007), but instead to draw attention to those points in the CSA that a developing country could have focused on, had a US measure been brought before the WTO DS5. I will also assess whether bringing the multilateral trading system into the carbon leakage debate is in the interests of a developing country. If a climate policy from the North can end up shaping the climate and non-climate policies in the South, can a referral to the WTO prevent this, or does it make the situation worse for the developing country?

A developing country’s position in a possible WTO dispute

Imagine a scenario in which imports from a developing country steelmaker, for instance India, were caught by a US climate change related trade measure because the latter considered that India had not taken comparable climate change measures. Could India argue that the US requirements either to purchase a specific number of international reserve allowances or to rely on allowances from other cap and trade schemes constitute a breach of WTO law? This is not a far fetched scenario. The Confederation of Indian Industry has already stated, in relation to the EU proposal for the reform of the directive on the European trading scheme
that, ‘[p]rincipally, 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.’

Despite the fact that the EU proposal does not include a specific climate change related trade measure such as the one found in CSA, it does put forward a ‘carbon equalization system’ (European Commission, 2008c, recital 20; Sindico, 2008), which may be, in the end, similar to the climate change related trade measure found in CSA. Therefore, speculating on how a developing country could challenge the latter is not a mere academic exercise.

A developing country could focus its attention on three different sets of issues before the WTO DSB: it could look at the nature of the goods covered by the import requirement scheme; it could consider the criteria under which the developing country was targeted; and, finally, it could focus on the design and implementation of the climate change related trade measure.

**Coverage**

CSA 2008 stated that the import requirement scheme could also apply to manufactured items for consumption on the basis of the amount of emissions released by the primary products during the manufacturing process. This meant that the US could treat domestic low carbon steel differently from carbon intensive products imported from a developing country. India could then argue that the US treated two products differently solely on the basis of production and process methods (PPMs). WTO law does not allow a Party to impose requirements that result in imported like products being given ‘less favorable treatment’ than domestic ones. A developing country could raise two questions on this issue.

First, it could argue that low carbon and carbon intensive goods are like products and, therefore, that they should be treated similarly. If, from an environmental point of view, the differentiation of two products based on their climate friendliness makes sense, it can be argued that 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, the case law under the WTO DSB has taken other elements into account to determine whether two products are ‘like’: end uses, consumer habits and tariff classification. This could open up some space for the adoption of measures based on the process and production methods of a product. Indeed, the WTO Appellate Body has stated that two products may not be ‘like’ based on their PPMs if the way a product has been manufactured is recognized by a consumer in a specific marketplace as a criterion to differentiate it from another otherwise ‘like’ product. However, consumer differentiation can be assessed only on a
case by case basis. Furthermore, it is arguably not very likely that consumers will distinguish between energy intensive imports based on their carbon intensity, despite the fact that this could change if more information is conveyed to consumers. In sum, despite the fact that WTO case law on trade and environment has widened the scope of ‘like’ products, a developing country can make a strong case that two products are ‘like’, despite their different carbon intensity.

Second, a developing country could dispute the nature of the cap and trade scheme linked to the measure. If it was interpreted as domestic regulation, then GATT Article III: 4 would apply and, if the two products are ‘like’, no less favorable treatment could have been accorded to the developing country import by the US administration. On the other hand, if the cap and trade scheme was understood as a tax under WTO law, then GATT Article III: 2 would come into play. In that case there would be even 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 constitute a breach of WTO law. From a developing country point of view it is preferable to consider the cap and trade scheme to which the climate related trade measure is attached as a tax, and not as a domestic regulation, because in the former case ‘any’ difference in treatment between the US domestic product and the like product being imported from a developing country will make the trade restrictive measure WTO incompatible.

Therefore, from a developing country perspective the best option would be to maintain that the two products, the domestic low carbon product and its high carbon imported product, are ‘like’ products, and that the cap and trade scheme to which the trade measure was linked amounted to a tax under WTO law. If either of these arguments were accepted by the WTO DSB, any discriminatory measure would constitute a breach of WTO law. 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.

The Act took a list approach by providing that foreign countries were to be divided into countries with and without comparable climate change action. The adoption of a climate change related trade measure depended on the foreign exporter being based in a country listed among the climate change ‘unfriendly’. Measures taken according to this approach were country based measures. Since the import requirement
scheme applied on all exporters coming from a country included in the list of climate ‘unfriendly’ states, a developing country could have easily attacked the US measure as a violation of the most favored nation principle (MFN). The MFN principle is one of the cornerstones of the multilateral trading regime. It provides that if a WTO party confers special treatment to another WTO party, it will have immediately and unconditionally to do the same for all other WTO parties.53

Furthermore, the criteria by which a country was deemed to have a comparable climate policy could be questioned, and this despite the fact that the wording of the Act provided for some flexibility. This could be raised in the second phase of a possible dispute. If a developing country’s claim of the non-legality of the US climate change related trade measure with WTO law per se was to be accepted by the DSB, the US could argue that the measure was, nevertheless, valid by virtue of one of the exceptions under GATT Article XX. This Article allows for otherwise unlawful WTO measure if they are necessary, among other things, to protect human health,54 or they relate to the conservation of exhaustible natural resources. 55 It would be difficult for a developing country to argue that these exceptions are not applicable, given that climate change science supports climate measures.56 Instead, in our hypothetical scenario, India should focus on the chapeau of Article XX, which provides that a country can adopt an otherwise unlawful WTO measure ‘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’.

One of the criteria 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’.57 According to the DSB, flexibility entails the possibility of taking into account policies from other countries which, without being exactly identical with the domestic measures, achieve similar goals. CSA provided that ‘any’ foreign climate measure would be considered comparable if it achieved similar reductions.58 Therefore, if a developing country adopts a tax or a command and control scheme to improve the energy efficiency of domestic steel makers, this could be considered ‘comparable’ by the US. The application of the measure in this way would favor the US in a dispute against a developing country. However, how would the US decide whether the developing country has achieved results ‘comparable in effect to actions carried out by the United States’?59 According to the CSA, comparable effect would be assessed by reference to the baseline emissions level. The latter, as mentioned earlier, amounts to ‘the total
annual greenhouse gas emissions attributed to the category of the covered good of the foreign country’. In a specific time frame. The climate record of a developing country would be based on best available information, described as follow:

all relevant data available that are available for a particular period; and to the extent necessary economic and engineering models; best available information on technology performance levels; and any other useful measure or technique for estimating the emissions from emission activities.

Criteria such as ‘best available technology’ are still not clear-cut and, more importantly, are not harmonized internationally. India could, therefore, argue that the implementation of a climate change related measure based on this criterion lacks international recognition and, therefore, that it would lead to an arbitrary application of the baseline emissions level criterion. Furthermore, the CSA’s wording did not allow the possibility for a foreign country to provide the relevant and necessary information to assess the average GHG emissions arising from its production of goods under a covered sector. As a result India could also argue that the imposition of US methodologies to determine the climate ‘friendliness’ of Indian industries, without taking into account Indian data, demonstrate a considerable lack of flexibility in the application of the measure and, therefore, amount to a disguised restriction on international trade.

The implementation of the measure A developing country could also raise at least two arguments on the implementation of the climate change trade related measure. First, despite the fact that the wording secured equal treatment for the price of the allowances, the actual implementation could be scrutinized. If an importer from a developing country purchased international reserve allowances at a higher price than domestic producers, the foreign importer could argue that he had been treated ‘less favourably’. Furthermore, this line of argument could also be invoked by a developing country within GATT Article XX, since one of the decisive criteria to determine whether the implementation of a measure constitutes a disguised restriction on international trade is the measure’s design and architecture.

Second, CSA 2008 dealt with the competitiveness concerns of domestic industries by allocating to them, at no cost, a specific number of allowances under the domestic cap and trade scheme. In other words, the US would grandfather allowances to carbon intensive domestic manufactures until 2030 to facilitate their transition to a low carbon economy. Despite the fact that the import allowances requirement to companies wishing to
export their products to the US did take this factor into account, a developing country could still claim that its goods were, contrary to WTO law, treated differently from domestic ‘like’ products.

Third, a developing country exporter could claim that the final decision on the amount of international reserve allowances that it has to surrender to gain market access was ultimately arbitrary. I have mentioned that the CSA 2008 provided for a fairly complex formula according to which the total amount of allowances that a US importer had to purchase is equal:

the product obtained by multiplying . . . the national greenhouse gas intensity rate for each category of covered goods of each covered foreign country for the compliance year . . .; the allowance adjustment factor for the industry sector of the covered foreign country that manufactured the covered goods . . .; and the economic adjustment ratio for the covered foreign country. . . .

While the first two elements of this formula, national GHG intensity rate and allowance adjustment factor, related to the goods manufactured in a specific country, the last element, the economic adjustment ratio, referred directly to the country itself. In other words, despite the methodological problems at the time of applying the climate change related trade measures, the number of international reserve allowances could be tracked down to objective criteria under the first two elements of the formula. The third element, on the contrary, was per se subjective and reveals the country based nature of the climate related trade measure since it refers to the appreciation of the domestic climate efforts occurring in the country wishing to export its products to the US. The developing country could, therefore, focus on this third element of the formula to establish that the measure was in violation of the MFN rule and/or that the measure constituted a disguised restriction on international trade under GATT Article XX.

There is one implementation related argument on which a developing country could probably not rely. A trade related measure will not fall within the chapeau of GATT Article XX if the country adopting the measure fails to meet the prior negotiation effort criterion. Indeed, a trade restrictive measure must be a last resort after serious negotiations have been initiated with the country that may be affected by the measure. The CSA 2008 clearly stated that international negotiations are to be preferred, and it reaffirmed its commitment to the United Nations Framework Convention on Climate Change. Furthermore, it strategically maintained that, should the multilateral or bilateral agreements negotiated with foreign countries ‘involve measures that will affect international trade in any goods or service’, the objective of the negotiations would be environmental (i.e., ‘the reduction of greenhouse
Climate law and developing countries

gas emissions’).\textsuperscript{74} If the future US policy on climate change follows these requirements it will be difficult for a developing country to claim that a trade related measure has been adopted only to deal with US domestic competitiveness concerns.\textsuperscript{75}

Finally, the CSA allowed foreign countries to rely on alternative compliance options: foreign allowances and credits, but these were not available to all US trade partners. If a developing country had not established a cap and trade scheme as a measure to tackle climate change within its domestic climate policy, how could it purchase a ‘commensurate’ foreign allowance? Furthermore, developing countries were 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? Given the above, a developing country could argue that industrialized countries that could rely on foreign allowances or on credits were given special treatment compared to a country like India. There would have been, therefore, scope to explore the possibility, once again, of a breach of the MFN rule.

As mentioned earlier, the goal of this chapter is not to provide a definitive answer to the WTO compatibility of a climate change trade related measure like the one that was included in CSA. This would be a counterproductive exercise since the Act has not been enacted into law and because WTO jurisprudence on trade and environment is still evolving. Yet, authors tend to agree that a climate change related measure of the kind provided for in the CSA 2007, which is roughly similar to the one provided for a year later, would be lawful only if careful attention were given to its implementation (Janzen, 2008, p. 24; Morgenstern, 2007, p. 116).\textsuperscript{76} Only if procedural requirements such as previous notification of the measure to affected trading partners were followed and, in particular, only if a real degree of flexibility were granted to the developing country’s climate change policies would it be possible to maintain that such a measure could withstand a WTO dispute as an environmental exception under Article XX of the GATT. The CSA 2008 has improved some of the pitfalls in the previous bill, but a developing country could probably still raise worthwhile arguments against the nature and, in particular, the implementation of the measure.

**Developing country strategies to deal with the climate and trade tension**

The second question to address with regard to a climate change related trade measure and the WTO is whether a developing country ‘should’ bring a dispute before the WTO. In this context it is worth exploring whether a developing country has any other strategic options, in particular within multilateral forums.
Countermeasures at the WTO: should a developing country consider them? Would it be beneficial for a developing country to raise the tension with the US to such a point that a trade dispute is inevitable and a dispute arises at the WTO? The same question is also asked by policymakers in the US. For instance, the White Paper posits 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 (Subcommittee on Energy and Air Quality of the US House of Representatives, 2008, p. 2).

This passage seems to suggest 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 considers the retaliatory effect of final decisions by the WTO DSB. The DSB does not have competence to award any damages. It can only recommend to the party in non-compliance with WTO law that it modify its laws accordingly. At this point the WTO party that has adopted the unlawful measure has two choices: it can either comply by modifying its domestic legislation or it can do nothing and suffer countermeasures 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 to the dispute modifies its domestic legislation according to the recommendations of the DSB.77

We must assess the impact on developing countries of the possibility that a party may willingly decide not to take into account a final decision by the DSB. Would the US be concerned about suffering retaliatory trade measures from a developing country whose carbon intensive imports had been subjected to a restrictive trade measure for climate change related reasons, if its measure were not upheld by the WTO DSB? The answer to this question belongs to the realm of politics and current international trade power relations rather than law. While I do not wish to move too far into this field, the obvious however can be stated. If a developing country plays an important role on the global market, then it will be able to impose countervailing measures that may harm the US economy.78 Whether these are more or less harmful to the US than entry of the banned imports would be is a question that can be answered only on a case-by-case basis. However, if the developing country has a small economy, the US exports would easily find other replacement markets in response to validly imposed countermeasures.79 In any event, this scenario is not likely, since the goods covered by a climate change related trade measure will mostly be carbon-intensive
goods produced in big developing countries. Therefore, it is likely that trade disputes will be between the US and economically important developing countries.

Should a developing country decide to use countermeasures in the context of a climate change trade dispute against the US, it will have to decide which US imports would be the object of countermeasures and how these would be implemented.

Given that the WTO dispute settlement system allows countermeasures as a pressure mechanism and that there is an urgency to deal with climate change by shifting toward alternative energy sources, it seems undesirable to resolve a future climate and trade dispute between the US and a developing country through the DSB. What may begin as climate change dispute may end up involving a wide range of sensitive economic areas, increasing the political tension between industrialized and developing countries.80 Furthermore, given that countermeasures under the WTO DSB can slow down mitigation action necessary to deal with the urgent need to address climate change, it appears self-defeating to rely on the multilateral trading system to deal with a climate and trade dispute.

**Alternative multilateral options to disentangle the climate and trade deadlock** The WTO Director General argued recently that this deadlock could be solved through international negotiations within the current Doha Development Agenda.81 There are however serious reasons to doubt such optimism. Paragraph 31 of the Doha Mandate sets out the terms for a negotiation the goal of which is to promote the liberalization of environmental products and services, ‘[w]ith a view to enhancing the mutual supportiveness of trade and environment, we agree to negotiations, without prejudging their outcome, on: the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services’.82

While a first reading of this part of the mandate may seem to lead to a win-win solution in both the fight against climate change and the promotion of economic development, the outcome of the negotiations until now is not promising. These negotiations are driven by industrialized countries. Most developing countries have other priorities within the Doha mandate, focusing in particular on removing barriers to agricultural trade.83 In addition, developing countries should not rely too much on the trade and environment mandate within Doha because trade and environment negotiations are linked to the overall trade negotiations. Countries cannot just settle specific trade issues; they need to reach a global compromise on the entire Doha talks. Unfortunately, the round is currently in an impasse, and no positive result is foreseeable in the near future (Drache and Froese, 2007).
CONCLUSION: FROM UNILATERAL CLIMATE CHANGE RELATED TRADE MEASURES TO A MULTILATERAL PRODUCTION AND CONSUMPTION DIALOGUE

This chapter aimed to demonstrate that measures that an industrialized country adopts in its struggle to cope with competitiveness and carbon leakage might end up shaping climate (and non-climate) policies in the global South. Using proposals in the US climate debate as a case study, it explained how a developing country could challenge these measures before the WTO’s DSB. Questions related to the coverage of goods, to the criteria according to which a developing country would be targeted and to the actual implementation of the climate related trade measure could be argued before a WTO Panel. Despite some obvious uncertainty as to whether the final decision would be in favor of or against a developing country affected by a climate change related measure, the important point is that a WTO dispute may by no means be the end of the story. The possibility for the winning party to adopt retaliatory countermeasures may actually exacerbate tensions and be counterproductive, from both an environmental and an economic point of view. Unfortunately, current talks at the WTO to find win-win avenues on climate and trade by liberalizing environmental goods and services are not promising.

Nevertheless, despite the current stalemate, the Doha Round points in the right direction. The climate and trade deadlock could be resolved if unilateralism were replaced by genuine multilateralism, if countries understood that climate change is not only an environmental or an economic problem, but first and foremost a global challenge to energy consumption and production patterns. The international community will be moving forward only when states decide to engage in serious efforts to promote sustainable production policies that favor low carbon energy sources and, far more challenging, to devote time and funding to adopting and implementing sustainable consumption policies (Bradbrook and Wahnschafft, 2001). Only the latter will move society towards a low carbon economy, which must be the aim of the international community when dealing with climate change.

NOTES

* Lecturer in Law, School of Law, University of Surrey, Guildford, UK and Deputy Director, Environmental Regulatory Research Group. Research for this chapter has been facilitated by funding from the School of Law of the University of Surrey
and from the URSF Conference support scheme. The author wishes to thank Rosa Fernández Egea, Harro Van Asselt and Michael Mehling for comments on earlier drafts of this article. Errors remain the author’s sole responsibility.


2. For example, in June 2008 the spokesman for Voestalpine, an Austrian steel firm, indicated that if the company did not get a clear signal from the Commission on how it plans to deal with competitiveness concerns arising from energy intensive sectors, such as the steel industry, it would consider investing in a new plant outside the EU. See Voestalpine (2008), *Annual Report 2007–08* (Voestalpine).


4. However, others are of the view that the US should be setting ambitious climate targets for itself irrespective of developing country participation. This is for instance the position taken by a coalition of NGOs and businesses. See USCAP (2008), ‘A Call for Action – Consensus Principles and Recommendations from the U.S. Climate Action Partnership: A Business and NGO Partnership’, www.us-cap.org/ (visited 29 January 2009).

5. See infra note 14.

6. This could end up being a prudent business strategy if consumers in a given market are climate conscious and reward the company by buying its products, despite the fact that they may be more expensive than ‘dirty’ products. In other words, climate friendly consumers would not consider the two products to be ‘alike’.

7. The cement sector is one of the energy intensive industries that will most likely suffer losses from the adoption of higher climate standards (OECD, 2005). It must be acknowledged that research on whether the economy can suffer negative effects from lower climate standards elsewhere has been undertaken thoroughly only in the framework of the first phase of the European emission trading scheme in which generous allocation of allowances prevented carbon leakage from happening. It will be interesting to see if the situation will change now that the trend will be to move towards further auctioning and less grandfathering of allowances (Reinaud, 2008a and 2008b).

8. President Obama has been supportive of an emission trading scheme that will help reduce emissions by 80 per cent below 1990 levels by 2050. He also vows to bring the US back into multilateral forums on climate change. See B. Obama and J. Biden (2008), ‘New Energy for America’, www.barackobama.com/pdf/factsheet_energy_speech_080308.pdf (visited 6 December 2008).

9. *Massachusetts v. EPA*, 127 SCt 1438 (2007). The Court ruled that the Environment Protection Agency (EPA) should make a so-called ‘endangerment finding’ on whether CO₂ constitutes a pollutant under the Clean Air Act and thus needs to be regulated. The EPA has only published an advance notice of regulatory intent implying that EPA regulation of GHGs would not be the best approach. Nevertheless, this case is generally understood as confirming that the federal EPA has jurisdiction to regulate GHG emissions.


12. However, while the US federal government has been considered a climate laggard for many years, state governmental and regional initiatives have been well received by the climate community. Three initiatives merit particular mention due to their scope and the current extent of implementation: vehicle emission standards in California, the cap and trade scheme established by the Northeast States’ Regional Greenhouse Gas Initiative (RGGI) and the Renewable Portfolio Standards.

14. Two initiatives from President Obama, before he assumed the presidency, suggested a change of direction. He appointed the Nobel-prize winning scientist Steven Chu, well known for his stand in favor of promoting renewable energies, as Secretary of Energy. In addition, he created a new position – Assistant to the President for Energy and Climate Change – which will be held by former EPA administrator C.M. Browner. See S. Goldenberg (2008), ‘Obama’s New Team Raises Hope for US Environment’, *The Guardian*, 11 December.

15. President Obama’s stand on climate change will not reverse this trend. In fact, one of his first announcements was to let states set their own vehicle emissions standards, which will surely lead to complaints from the auto industries. See P. Walker (2009), ‘Obama to Put Bush Car Pollution Policies into Reverse’, *The Guardian*, 26 January.

16. See the Low Carbon Economy Act, S. 1766, 11 July 2007, the proposal put forward by the International Brotherhood of Electrical Workers-American Electric Power IBEW/AEP, which then inspired the America’s Climate Security Act.

17. Supra note 1.

18. This kind of BAM was provided for in the Climate Security Act (not enacted into law), which will be analysed in depth in section 3 infra.

19. CSA 2008, supra note 11, s. 1302(1).

20. Ibid., s. 1303(a): ‘Congress finds that the purpose described in section 1302 can be most effectively addressed through agreements negotiated between the United States and foreign countries’.

21. Ibid., s. 1302(2).

22. Ibid., s. 1302(3)(B).

23. Ibid., s. 1306(c)(1), (c)(2)(a), (c)(3)(C) and (c)(3)(D)(i).

24. Ibid., s. 1301(15)(A). We have already underlined that, especially for China, trade flows with the US in these kinds of goods are much less significant than one would expect (Houser, et al., 2008, pp. xviii and 45).

25. Ibid., s. 1301(7), emphasis added.

26. Ibid., s. 1301(13)(B), emphasis added.

27. Ibid., s. 1301(13)(C).

28. Ibid., s. 1305(a).

29. Ibid., s. 1306(b)(2) and (b)(3).

30. Ibid., s. 1306(d)(1)(A). This was much clearer in CSA 2007, s. 6006 (b)(3)(A): ‘the President shall identify and publish in a list, to be known as the “covered list”, each foreign country the covered goods of which are subject to the requirements of this section’.

31. CSA 2008, s. 6001(2).

32. Ibid., s. 1301(4)(b)(i).

33. Ibid., s. 1301(4)(A). The CSA 2007 did consider also the level of economic development: see CSA 2007, supra note 10, s. 6001(2).

34. CSA 2008, s. 1301(14).

35. Ibid., s. 1301(1)(A).

36. Ibid., s. 1301(2).

37. Ibid., s. 1306(c)(2).

38. Ibid., s. 1306(c)(3)(A).

39. Ibid., s. 1306(c)(4).

40. Ibid., s. 1306(d)(1).

41. Ibid., s. 1306(d)(2). The implications of the definitions of national greenhouse gas intensity rate, of allowance adjustment factor and of economic adjustment ratio will be discussed later in this chapter.

42. Ibid., s. 1306(e).

43. CSA 2007, s. 6006(g).

44. CSA 2008, s. 1307(b)(3).

45. Ibid., s. 1301(11).

46. Supra note 1.
382  

Climate law and developing countries

47. General Agreement on Tariffs and Trade (GATT), 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 UNTS 187, (1994) ILM 33, 31, Art. III:4: ‘[t]he 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’.


50. Ibid., ss. 113, 114.

51. Several authors argue that an emissions trading scheme can be considered a tax for WTO purposes (De Cendra, 2006, pp. 135–36; Ismer and Neuhoff, 2004, p. 11), but others do not share the same view (Wiers, 2008, p. 22).

52. GATT, Art. III:2.

53. Ibid., Art. I.

54. Ibid., Art. XX(b).

55. Ibid., Art. XX(g).


58. CSA, supra note 11, s. 1301 (4)(A).

59. Ibid.

60. Ibid., s. 1301(1).

61. Ibid., s. 1301(2).

62. Ibid., s. 1306(a)(3).

63. See reference to GATT, supra note 47, Art. III:4. Once again, the question would have been whether the national treatment principle had been violated.


65. CSA 2008, supra note 11, Title V, sub-titles E, F, G and H.

66. Ibid., s. 1306(d)(4)(A)(i) and (4)(B).

67. Ibid., s. 1306(d)(2).

68. Ibid., s. 1306(d)(3).

69. Ibid., s. 1306(d)(4).

70. Ibid., s. 1306(d)(5).

71. The main problem will be to calculate correctly the average greenhouse direct and indirect emissions accruing from covered goods in a specific country where data may not be available or the foreign country may not be willing to provide them. Furthermore, should the number of international reserve allowances be decided on a per-unit basis (this would be preferable from an international trade law perspective), on a covered goods basis or on an industry sector basis. CSA 2008 does not clarify this in any detail since it uses the three expressions within the same formula (per-unit base for the greenhouse gas intensity sector and industry sector and covered goods for the allowance adjustment factor).
Climate and trade in a divided world

72. Supra note 56, s. 172.
73. CSA 2008, supra note 11, s. 1303(a) and (b).
74. Ibid., s. 1303 (b)(2)(A).
75. Furthermore, the Act requires speedy notification to foreign countries of the negotiating objective: see ibid., s. 1303(c).
76. Supra note 45, p. 41.
80. It should be recalled that we are currently in the midst of key global negotiations that will shape the future of the international climate and international trade regimes. The Bali Road Map and the Doha Round already stand on very unstable feet. Increased tension between key countries – such as the US and China – over the adoption of a climate related trade measure may undermine ongoing negotiations further. These observations suggest that, at least until global climate and trade negotiations have been addressed properly, the WTO DSb, despite how attractive it may seem, should not be considered as the correct forum to deal with a difficult climate and trade relationship.
83. Since the early 2000s, divisions have persisted between a list-based approach promoted by industrialized countries and a project-based approach favored by some developing countries. According to the former approach, countries should agree on specific goods and services which are per se environmentally friendly, and then promote trade therein amongst them. According to the project-based approach, goods and services to be further liberalised should be those that aid in the development of environmentally friendly projects. See TN/TE/W/6 2007 and TN/TE/W/67 2006. It is frustrating that after so many years there is no agreement yet on the definition of environmental goods and services (Vikhlyaev, 2004).

REFERENCES

Climate law and developing countries


Richardson, B.J. (2008), Socially Responsible Investment Law: Regulating the Unseen Polluters (Oxford University Press).