Implications of the United States' withdrawal from the Paris Agreement under WTO law

1. During the Obama presidency, there was much policy discussion on whether the United States (***US***) needed a carbon tariff to ensure a level playing field with countries without mandatory carbon restrictions. However, as a result of President Donald Trump announcement, on 1 June 2017, of the US' withdrawal from the Paris Agreement, policymakers from other countries now consider imposing a carbon tariff on US goods.

2. Including the US, there are 197 parties to the Paris Agreement which establishes a set of binding procedural commitments. Nationally Determined Contributions (***NDCs***) represent each party's self-defined goals for the mitigation of greenhouse gas emissions for a period beginning in 2020. The parties have committed to "prepare, communicate and maintain" successive NDCs; to "pursue domestic mitigation measures" aimed at achieving their NDCs; and to regularly report on their emissions and on progress in implementing their NDCs. The agreement also sets the expectation that each party's successive NDCs will "represent a progression" beyond its previous one and "reflect its highest possible ambition." The achievement by a party of its NDCs is not a legally binding obligation.

3. Each party is free to determine how to reach its NDC, resulting in a variety of measures being taken to reduce carbon emissions. About 100 countries, accounting for 58% of global greenhouse gas emissions, either have created carbon markets – most notably the European Union (***EU***), South Korea, Japan and Mexico – or are planning or considering proposals to adopt carbon pricing initiatives – most notably China – in order to meet their obligations under the Paris Agreement. At the sub-national level, many regional entities such as California, Ontario and Quebec, as well as cities already participate in carbon pricing initiatives, and more intend to do so.[1]

[1] World Bank, Ecofys & Vivid Economics, *State and Trends of Carbon Pricing 10*, 25 October 2016, available at: http://documents.worldbank.org/curated/en/598811476464765822/pdf/109157-REVISED-PUBLIC-wb-report-2016-complete-161214-cc2015-screen.pdf.

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4. Apart from their efforts to reduce greenhouse gas emissions, policymakers from around the world now also contemplate how to respond to the Trump administration's decision. They have a triple aim in mind: (i) to prevent further withdrawals from the Paris Agreement; (ii) to protect their domestic industry's economic competitiveness against US companies which would be, after the US' withdrawal from the agreement, under less strict environmental regulations; and (iii) to avoid carbon leakage – that is, a shift in carbon emissions to places with fewer or no greenhouse gas mitigation policies. To reach these goals, several countries such as Canada and Mexico have already indicated that they consider imposing a carbon tariff on US goods.[2]

5. This Memorandum looks into the legality under World Trade Organisation (***WTO***) law of several of the trade policy instruments that could be employed by parties to the Paris Agreement (that are also WTO Members) in order to respond to the US' decision. Section 1 discusses the application of an additional carbon tariff targeted explicitly at US goods. Section 2 considers the application of a border carbon adjustment tax from which goods originating in parties to the Paris Agreement would be exempted. Section 3 explains that, in order to guarantee compliance with WTO law, policymakers are advised to impose a border carbon adjustment tax by simply extending their domestic climate policies. Section 4 concludes.

1. ADDITIONAL CARBON TARIFF ON IMPORTS FROM THE UNITED STATES

6. The most obvious way to target imports from the US would be to make them subject to an additional carbon tariff. This could take the form of levying an additional tariff on imports of US goods. Whilst such a tariff would meet all three goals pursued by policymakers, it would likely be in violation of WTO rules.

7. Such an additional tariff would target specifically goods originating in the US. That feature renders that tariff contrary to the most-favoured-nation (***MFN***) obligation found in Article I:1 of the General Agreement on Tariffs and Trade 1994 (***GATT 1994***), requiring WTO Members to extend favourable treatment to all other Members indiscriminately, immediately and unconditionally. It would also risk violating the maximum tariff levels to which WTO Members have committed under Article II of the GATT 1994. In accordance with that provision, each WTO Member has bound itself, per product, to a maximum ceiling of the tariff which it may apply. Hence, unless such violations would be justified under the 'general exceptions' laid down in Article XX of the GATT 1994, any additional carbon tariff specifically levied on US goods could well be in violation of WTO rules.

[2] *Business leaders tell Trump carbon tariffs could result from Paris deal withdrawal,* WorldTradeOnline, 30 May 2017, available at: https://insidetrade.com/trade/business-leaders-tell-trump-carbon-tariffs-could-result-paris-deal-withdrawal.

8. Under Article XX of the GATT 1994, such violations would be justified if, for example, the additional carbon tariff is found to relate to the conservation of exhaustible natural resources and to have been made effective in conjunction with restrictions on domestic production or consumption. It is possible that the WTO dispute settlement bodies would accept, taking into account previous case-law, that the planet's atmosphere is an exhaustible natural resource.[3] However, whether the additional carbon tariff relates to the conservation of the planet's atmosphere and is made effective in conjunction with restrictions on domestic production and consumption would depend on the specific facts at issue. In order to meet these requirements, first, there would need to be a substantial relationship between the additional carbon tariff and the conservation of the planet's atmosphere and, second, the domestic legislation would have to impose even-handed, but not necessarily identical, restrictions on domestic consumption.[4]

9. Furthermore, under WTO law, the additional carbon tariff should not be applied in a manner that constitutes a means of 'arbitrary or unjustifiable discrimination between countries where the same conditions prevail', or as a 'disguised restriction on international trade'. That condition means that WTO Members must take into consideration measures, taken by other WTO Members that are comparable in effectiveness to reach the desired goal.[5] Thus, justification of an additional carbon tariff is likely to fail under Article XX of the GATT 1994 if that tariff is levied without taking into account measures taken by different US states or (possibly) initiatives adopted by US companies that might be found to have a comparable effectiveness in conserving the exhaustible natural resource that is the planet's atmosphere.

2. BORDER ADJUSTMENT CARBON TAX EXEMPTING PRODUCTS ORIGINATING IN PARTIES TO THE PARIS AGREEMENT

10. A second (and softer) option available to parties to the Paris Agreement is to enact a border adjustment carbon tax on imports (***BACT***) with an exemption for products from signatory countries to the Paris Agreement. This would take the form of a tax on imports which would simply be the equivalent of the domestic carbon tax. In order to meet the objective of discouraging future withdrawal from the Paris Agreement, it has been suggested that imports from parties to the Paris Agreement could be exempted from such a tax. In addition, imports from sub-national entities or foreign companies participating in carbon pricing initiatives could also obtain an exemption from the BACT. [6]

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3 See for example: Panel Report, *US – Gasoline,* para. 6.37.

4 Appellate Body Report, *US – Gasoline.*

5 Appellate Body Reports, *US – Shrimp,* para. 161 and *US – Shrimp (Article 21.5 – Malaysia)*, para. 144.

6 See for example: Brian Chang, *A proposal for a multilateral border carbon adjustment scheme that is consistent with international trade law,* ICTSD, 1 June 2017, available at:

11. As a matter of WTO law, it is highly likely that such a BACT would still violate the MFN obligation enshrined in Article I:1 of the GATT 1994 because imports from WTO Members which are party to the Paris Agreement would be treated more favourably than imports from WTO Members which are not (which would include also the United States). Hence, this discriminatory measure would also need to be justified under Article XX of the GATT 1994.

12. For the BACT not to be dismissed as an 'arbitrary or unjustifiable discrimination' under Article XX, it would need to be sufficiently flexible and take into consideration different conditions which may occur in different foreign countries.[7] At first sight, the BACT seems more likely (as compared to the additional carbon tariff) to satisfy the conditions for invoking the exception under Article XX because that measure would enable sub-national entities and foreign companies to apply for an exemption from the BACT. Nonetheless, the general exclusion of goods originating in parties to the Paris Agreement would still lead to arbitrary and unjustifiable discrimination. As explained earlier, the parties to the Paris Agreement have committed to reducing their greenhouse gas emissions in various ways and are free to decide how to reach these commitments. Hence, the non-application of the BACT to all other parties regardless of these differences would lead to arbitrary and unjustifiable discrimination because the measure would not take into consideration the different conditions prevailing in different parties to the Paris Agreement. In addition, it would lead to the undesirable result – also called carbon leakage – of businesses relocating their polluting activities to the territory of parties to the Paris Agreement which have the lowest carbon regulations governing the particular activities of those businesses.

3. BORDER ADJUSTMENT CARBON TAX COUPLED WITH LABELLING SCHEME

13. A third trade policy instrument available to parties to the Paris Agreement is to impose a BACT and to extend domestic climate policy to all imports without any exemption for imports from parties to the Paris Agreement.[8]

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http://www.ictsd.org/opinion/a-proposal-for-a-multilateral-border-carbon-adjustment-scheme-that-is-consistent

7 Appellate Body Report, *US – Shrimp,* para. 177.

8 On this question, see also: Jennifer Hillman, *Changing Climate for Carbon Taxes: Who's Afraid of the WTO*, July 2013, available at: http://www.gmfus.org/file/3102/download; Joost Pauwelyn, *Carbon Leakage Measures and Border Tax Adjustments under WTO Law,* in D. Prevost and G. Van Calster (eds.), *Research Handbook on Environment, Health and the WTO* (Edward Elgar, 2012).

14. Whether such a BACT would be consistent with GATT 1994 would not so much turn on whether that BACT is designed as a 'customs duty' or as an 'internal charge', but rather on whether that measure is imposed on products that are 'like' the domestic products that are subject to the internal tax. It would also depend on whether the amount of the BACT imposed on the imported goods exceeds the amount of the tax imposed on the domestically produced 'like' products.[9]

15. As a result, imposing a carbon tax on both domestic and imported products at the time of their sale or distribution would appear to be a straightforward measure for achieving at least some of the three objectives preoccupying policy-makers following the announcement of President Trump's decision. It also offers more guarantees of being consistent with WTO law.

16. Assuming that the tax is to be assessed based on the amount of greenhouse gases emitted in the production of a ton of steel, an importing country would then need to put in place a process for collecting the information needed to determine the carbon footprint of each ton of imported steel. This could be done, for example, by requiring imported products to be labelled according to the relevant aspects of their production process and the related carbon emissions resulting from their production. Such a labelling scheme would likely be subject to the obligations found in the Agreement on Technical Barriers to Trade (***TBT Agreement***). The TBT Agreement applies to technical regulations 'which lay down product characteristics and their related processes or production methods'.[10] Although this might be read as including only processes and production methods that affect the physical characteristics of the product, the carbon footprint of a product could still be found to be a product characteristic or its related processes or production methods. Indeed, the TBT Agreement does not expressly require that product characteristics or their related processes or production methods must be physically incorporated in the end product. Furthermore, the WTO dispute settlement bodies have acknowledged that product characteristics do not only include features and qualities intrinsic to the product itself.[11]

17. If the carbon footprint of a product is found not to be a product characteristic or its related processes or production methods, a carbon footprint label would still possibly be subject to the obligations found in the TBT Agreement. With respect to labelling requirements, the TBT Agreement does not repeat the term 'related' to qualify the process or production method but simply refers to 'product, process or production method'. Hence, this might mean that labels which concern processes and production methods which do not affect the physical characteristics of the product could still fall within the ambit of the TBT Agreement.[12] If covered by the TBT Agreement, the labels would need to be non-discriminatory and no more trade-

9 Articles II.2 and III.2 of the GATT 1994.
10 Annex I, paragraph 1 to the TBT Agreement.
11 Appellate Body Report, *EC – Asbestos,* para. 67.
12 This was indeed not questioned in both *US – Tuna II* and *US – COOL.*

restrictive than necessary in order to fulfil the objective of, for example, protecting the environment.[13] Should the labelling scheme be applied similarly to imported and domestic products, there would likely be no hurdle in meeting these requirements.

18. Based on this labelling scheme, all products could be taxed using the same methodology for determining the amount of greenhouse gases that was emitted during their production. However, in the event that the carbon content of a good cannot be established because companies, importers, or countries are unwilling or unable to provide the necessary data, the amount of the carbon tax could be based on the best information available. In order to avoid creating an incentive for not providing information, companies should be made aware that not providing information regarding the carbon footprint of their products might lead to a higher carbon tax. This mechanism would need to apply equally to both domestic and foreign products in order to respect the non-discrimination obligation.

19. Finally, policymakers could decide to grant a remission to producers who paid the domestic carbon tax but ultimately export their products. Without such a remission, exporters would be at a competitive disadvantage because their goods, if exported to a country with a similar BACT or no carbon tax at all, would be subject to additional taxation as compared to domestic products of the importing country. A carbon tax imposed on a product could be remitted as an 'indirect' tax when that product is exported without being qualified as an export subsidy, provided that the amount of the remission is not higher than the amount of the carbon tax paid.[14]

20. Hence, while this option would not meet policymakers' objective of disincentivising further withdrawals from the Paris Agreement, it is likely to be WTO compliant and would still protect their domestic industry's economic competitiveness against any advantage enjoyed by US companies as a result of the US's withdrawal from the Paris Agreement. It would also avoid a shift in carbon emissions to countries with fewer or no greenhouse gas mitigation policies.

[13] Article 2 of the TBT Agreement.
[14] Illustrative List of the Agreement on Subsidies and Countervailing Measures.

4. CONCLUSION

21. In brief, any additional carbon tariff imposed solely on US imports and a BACT that would exempt imports from parties to the Paris Agreement are likely to violate the most-favoured-nation obligation in Article I:1 of the GATT 1994 without a successful defence of such measure under Article XX of the GATT 1994 being available. However, a WTO Member could introduce a BACT coupled with a labelling requirement as long as those measures are an extension of its domestic climate policy and that policy is made applicable to also 'like' products from other WTO Members. Furthermore, the level of the tax imposed on the imported goods must not exceed that of the tax imposed on the 'like' domestic products. Finally, it would appear that no obligation in WTO law would prevent a remission of the tax for domestic products upon exportation as long as the amount of that remission is not higher than the carbon tax paid.

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