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Rohinton Medhora and Maria Panezi,  
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WILL THE PRICE EVER BE RIGHT? CARBON PRICING AND  
THE WTO

ROHINTON MEDHORA\* AND MARIA PANEZI†

*Since the creation of the GATT and later WTO, the global trade governance system has served multiple related purposes – the reduction of tariffs and other trade barriers, the creation of norms around international trade, and dispute resolution. Climate change provides an opportunity to extend the role of norms in global trade governance, because of the central role that carbon pricing plays in reducing emissions. For carbon pricing to be effective and not lead to a “race to the bottom”, it has to be applied across all trading countries at a similar level. We show that a system of carbon taxes and border carbon adjustments (BCAs) that equalizes the price of carbon across all traded goods and services is compatible with the letter and practice of the WTO. In fact, given the inherently global nature of climate change, such a system will only function if it is centered within the multilateral trading system. Thus a global institution is used for the purpose global institutions are created for – enabling the production of a global public good, a cleaner environment.*

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**I. FROM TARIFF REDUCTION TO NORMS AND BEHIND-THE-BORDER  
ISSUES IN GLOBAL TRADE GOVERNANCE**

When delegates from 44 Allied nations met in Bretton Woods, New Hampshire in July 1944, their aim was nothing less than to create the foundations of a global trade and finance system that might lead to (first) reconstruction and stability, and (later) growth and prosperity that would create enduring peace. Thus were born the International Monetary Fund and the International Bank for Reconstruction and Development (better known as The World Bank). The third pillar in the system, the putative International Trade Organization (ITO), was only half-born. Although negotiations for an ITO were successfully completed in the Havana Charter of March 1948, the Charter was not ratified by the United States (US) Congress, on the grounds that it intruded into domestic economic issues. Instead, the General Agreement on Tariffs and Trade (GATT) became operational on January 1, 1948 with 23 members including the US.<sup>1</sup>

The purpose of the GATT was to reduce tariffs, lower quantitative restrictions and other non-tariff barriers to trade, and eliminate trade discrimination. Starting with the Annecy Round in 1949 and through to the end of the Tokyo Round in 1979, the main thrust of the GATT negotiations was tariff reduction, mainly on manufactured goods. Since tariffs on goods averaged 22% at the end of World War II,<sup>2</sup> the focus on lowering tariffs on manufactured goods is understandable.

The Kennedy Round (1962-67) did start the process of going beyond the narrow tariff reduction for manufactured goods agenda, by including in its deliberations agricultural goods and other primary products, and incorporating developmental considerations in trade policy. But these were a symbolic nod to the demands by some countries for a wider approach to international trade governance rather than a substantive shift in its application. An assessment of the GATT process written in 1981 under the heading 'The March of Events' concluded that:

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<sup>1</sup> See CHAD P. BOWN, *The WTO and GATT: A Principled History*, in SELF-ENFORCING TRADE 10 (2009).

<sup>2</sup> Chad P. Bown & Douglas A. Irwin, *The GATT's Starting Point: Tariff Levels circa 1947* (NBER Working Paper No. 21782, 2015), <http://www.nber.org/papers/w21782>.

“The environment of world commerce has changed in many ways since the inception of GATT. The growth in importance of the developing countries is one significant change that we have already noted. Another, with profound implications, is the growth of the multinational corporations and the increase in the mobility of capital and technology between nations.

Increased mobility of factors serves the overall GATT objective of more efficient use of world resources, but the multinationals bring with them many complications for the economy and polity of nations. It is an anomaly that GATT has no provisions for dealing with the problems which they raise in the commerce of nations: concentration of economic power, risks of cartelisation or other restrictions on trade, intra-firm trade and transfer pricing, government controls on foreign investment, to name but a few.”<sup>3</sup>

In short, the GATT still had little appetite to deal with issues that had derailed the creation of the ITO over three decades earlier, because recognisance of the development or multinational agendas rapidly bled into behind-the-border matters. The environment, much less climate change, was so far off that not even the authors of the assessment saw fit to mention it as missing from the GATT discourse.

The Uruguay Round (1986-94) lasted as long as it did and yet did not deliver on all of its ambition precisely because – to their credit – member countries added subjects hitherto considered out of bounds for trade negotiators. These included services, financial flows, textiles, agriculture and intellectual property. Most importantly, the Round resulted in the creation of the World Trade Organization (WTO) in 1995. The change from a negotiating forum to a full-fledged treaty-based international institution modernised, codified and systematised international trade governance. Trade in services and intellectual property lay within its remit; the dispute resolution system became authoritative; and the institutional edifice meant that consideration of new issues, perhaps even mission creep, were built into the structure.

The Doha Round that started in 2001, while mostly a failure (and technically still ongoing), was termed the Doha Development Round, but also included issues raised earlier at the 1996 Ministerial Conference in Singapore - competition,

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<sup>3</sup> A. I. MACBEAN. & P. N. SNOWDEN, INTERNATIONAL INSTITUTIONS IN TRADE AND FINANCE, 80-81 (George Allen & Unwin eds., 1981).

investment, government procurement and trade facilitation. Developing countries successfully lobbied against the inclusion of the first three topics arguing that they did not belong in a development agenda.<sup>4</sup> But the notion of the WTO process dealing with norms rather than tariff reduction is now embedded in international trade governance. And the tenure of the Doha Round coincides with a worsening of the quality of the bio-physical environment, as documented by successive reports of the Intergovernmental Panel on Climate Change and the scientific literature on which it draws.<sup>5</sup>

Moreover, by raising questions around health, labour, culture and the environment, Article XX of the GATT provides an entry point for considerations around coordination of governance in such matters. Specifically, Article XX(b) allows for exceptions “necessary to protect human, animal or plant life or health” and Article XX (g) for ones “relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.” There is thus an opening for the WTO process to be used to address environmental concerns, specifically the use of carbon in manufacturing and trade whose emissions lead to climate change.

The exceptions listed in Article XX relate to national treatment of these matters. But differential national treatment of the carbon content of traded goods in the face of overwhelming evidence of the global spillover effects of carbon-induced climate change inevitably raises the question of “smoothing” implicitly different national prices of carbon towards a consensus-based world price. This is where a border tax adjustment regime for carbon (otherwise referred to as a “Border Carbon Adjustment” or BCA) centered at the WTO enters the discourse on global governance.

Currently, there is effectively no global carbon pricing regime; it is a patchwork of national and regional carbon price and exchange systems (as in the countries of the European Union), sub-national systems (as in some Canadian provinces and States in the US) and, in most countries of the world, no carbon pricing system. But climate change knows no country borders and requires a harmonized global effort

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<sup>4</sup> Pradeep S. Mehta & Bipul Chatterjee, *India in the International Trading System*, in THE OXFORD HANDBOOK OF INDIAN FOREIGN POLICY, 641-642 (David M. Malone et al. eds., 2015).

<sup>5</sup> See INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE, CLIMATE CHANGE 2014: SYNTHESIS REPORT (R.K. Pachauri & L.A. Meyer eds., 2015), <http://www.ipcc.ch/report/ar5/syr/>; HM Government (2017); UK *Climate Change Risk Assessment* 2017, [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/584281/uk-climate-change-risk-assess-2017.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/584281/uk-climate-change-risk-assess-2017.pdf).

to reduce emissions into the atmosphere. Countries that do not price carbon adequately are in effect subsidizing the production of goods that increase climate change at the expense of countries that do price carbon adequately. To avoid a “race to the bottom” which is what the current non-system incentivizes, a carbon price equalization regime at the global level is required. This is what a WTO-centered BCA system would achieve.

This article will discuss in Part II the various parameters of a BCA regime, offering first a brief account of how it works and what its main objective is. Then, it will discuss how one can ensure that the regime does not violate current WTO rules. In Part III, we will briefly comment on the carbon pricing efforts of subnational entities and offer ideas on how the WTO can clarify its rules to assist with environmentally conscious sub-federal entities around the world. Part IV will offer some concluding thoughts on the global governance parameters of carbon pricing and BCAs.

## II. THE OPTION OF BORDER CARBON ADJUSTMENTS: WHY PUTTING A PRICE ON CARBON ISN'T ENOUGH AND BCAs ARE NEEDED

After being tested for almost a decade, the ongoing efforts of American States and Canadian provinces to tax carbon emissions have demonstrated that carbon taxes are not detrimental to the local economies where these taxes are imposed.<sup>6</sup> While holding industries and consumers accountable for the monetary cost of burning fossil fuels is a sensible first step to address climate change — if carbon taxing is adopted on a larger scale, there are significant political and economic risks.<sup>7</sup> Eventually, there is the risk that domestic manufacturers will flee to countries with lower environmental standards – carbon emission havens – where companies can produce commodities uninterrupted and without accounting for their carbon footprint. This industry “leakage”<sup>8</sup>, the relocation of companies, will result in subsequent carbon leakage,<sup>9</sup> the transfer of carbon emission hot-spots to jurisdiction without strict environmental regulation. There, companies will be able

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<sup>6</sup> *Proof that Putting a Price on Carbon Works*, N.Y. TIMES (Jan. 19, 2016) <https://www.nytimes.com/2016/01/19/opinion/proof-that-a-price-on-carbon-works.html>.

<sup>7</sup> For a general discussion on market mechanisms and climate change mitigation, among many, see Nico Bauer et al., *Global Fossil Energy Markets and Climate Change Mitigation—An Analysis with REMIND*, 136(1) CLIMATE CHANGE 69-82 (2016).

<sup>8</sup> Christian Gollier & Jean Tirole, *10 Effective Institutions Against Climate Change*, in GLOBAL CARBON PRICING: THE PATH TO CLIMATE COOPERATION 165, ¶15-12 (Peter C. Crampton, et al. eds., 2017).

<sup>9</sup> Kateryna Holzer, CARBON-RELATED BORDER ADJUSTMENT AND WTO LAW 42-54 (2014).

to pollute without being accountable for their emissions, which will result in cheaper products and the continuation of a price advantage.<sup>10</sup>

There is a way however to remove the incentive to relocate, by reducing or removing the price advantage manufacturers hope to achieve from relocation. The tool, called Border Carbon Adjustments, raises the price of the less accountable or non-accountable product manufactured abroad, to match the monetary impact of domestic environmental accountability mechanisms. In other words, BCAs allow national governments to move beyond ensuring national manufacturers pay for their carbon emissions and towards holding imported foreign products to the same standard. From a business perspective, BCAs would ensure that it is not just domestic producers who need to be accountable for their carbon emissions, but everyone else who wishes to trade within their jurisdiction too. By raising the price of carbon intensive products, companies and consumers are incentivised to gravitate away from such commodities. For governments working to reduce carbon emissions, carbon taxes are the best existing option as they are part of their immediate tool kit for addressing climate change and easier to implement than cap-and-trade systems.

For the 164 members of the WTO, trade governance carries an additional layer of obligations outlined in the GATT and other WTO Agreements. Since BCAs are taxes that are applied to foreign products, a BCA regime will inevitably need to comply with the WTO rules. The cardinal rule of international trade under the WTO is the principle of non-discrimination. It has two sides: one “international” and one “domestic”.

The international side is called the most-favoured-nation principle. This obligation is outlined in article I, paragraph 1, of the GATT. It applies to products originating outside the importing country and obliges the importing country to treat all identical products originating from any other WTO member in the exact same way. For example, if a country agrees with one of its major trading partners to lower a tariff on a certain product, then this treatment is automatically extended to every WTO member state. For carbon pricing and BCAs this would translate as follows: If the same two foreign products with the identical carbondioxide (CO<sub>2</sub>) footprints were taxed differently at the border of the importer country, this could constitute a violation of the most-favoured-nation treatment. The best way to avoid a violation of GATT article I is to ensure that the same amount of BCA is applied to identical

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<sup>10</sup> *Id.*, at 45-62.



products and the measure is origin-neutral. Any references to major CO<sub>2</sub> emitters or other nation-specific properties must be avoided entirely in BCA legislation.<sup>11</sup>

The domestic side of non-discrimination is called national treatment. It applies after foreign products have been imported into a country. This rule, outlined in article III of the GATT, prescribes that beyond treating all WTO member states without discrimination with respect to tariffs, member states cannot favour domestic products over imported ones. According to most-favoured-nation treatment, upon entry into the importing country, all products, foreign and domestic have to be treated equally in the internal market.<sup>12</sup>

Beyond product and process identity, the foreign product must also not be taxed for its carbon emissions in its jurisdiction of origin. Special consideration must be made for products with high CO<sub>2</sub> emissions that have already been taxed elsewhere. A WTO-compatible BCA cannot explicitly exempt an already taxed product by referencing its country of origin. At the same time it would be clearly unfair, against the purpose of the legislation and overly burdensome for some products to be taxed twice for the same CO<sub>2</sub> emission. To overcome double taxation for certain exported products, there can be agreements with exporting countries, rebuttable border mechanisms, processes and certificates that offer rebates to offset the otherwise twice imposed foreign tax.<sup>13</sup>

WTO judges, panelists and Appellate Body members examine claims and arguments of countries on either side of a dispute and determine whether discriminatory treatment of products has occurred. To date, no jurisdiction has implemented border carbon adjustment measures and thus carbon taxes have not been examined before the WTO judicial organs. The WTO panel and Appellate Body members, however, are not strangers to disputes with strong environmental and health-related aspects. Products containing asbestos, cigarettes, gasoline, and endangered species such as dolphins and sea turtles, have all been examined in a series of cases dating from the early days of the organisation. The concept of

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<sup>11</sup> Jennifer Hillman, *Changing Climate for Carbon taxes: Who's Afraid of the WTO?* 5 German Marshall Fund of the United States Climate and Energy Paper Series, (2013) [hereinafter Jennifer Hillman].

<sup>12</sup> Maria Panezi, *When CO<sub>2</sub> Goes to Geneva: Taxing Carbon Across Borders- Without Violating WTO Obligations*, C.I.G.I., [https://www.cigionline.org/sites/default/files/cigi\\_paper\\_no.83\\_web.pdf](https://www.cigionline.org/sites/default/files/cigi_paper_no.83_web.pdf) (last visited May 30, 2018).

<sup>13</sup> Joost Pauwelyn, *Carbon Leakage Measures and Border Tax Adjustments Under WTO Law*, in RESEARCH HANDBOOK ON ENVIRONMENT, HEALTH AND THE WTO 448 (Geert VanCalster & Denise Prévost eds., Edward Elgar Publishing, 2013) [hereinafter Joost Pauwelyn].

Border Tax Adjustments, the more general category of adjustments at the border to match a domestic tax, was interestingly discussed in the very first case during the GATT years.<sup>14</sup>

A prerequisite for determining whether one country discriminates is “likeness” of goods. The question of likeness is central to the investigation of compliance with both the rules of national and most-favoured-nation treatment. The question of which two products are similar or the same has preoccupied the WTO panels and Appellate Body several times. Are Japanese shochu and vodka “like” products?<sup>15</sup> How about tuna fished with “dolphin-safe” nets versus that fished without such environmentally friendly nets?<sup>16</sup> Or products containing asbestos and their substitutes?<sup>17</sup> Such determinations are part and parcel of the work of WTO judges.

It has been accepted, after many years of legal disputes between numerous WTO members, that the determination of likeness is based on the following criteria: physical properties and characteristics of products; substitutability; end-use; tariff classification; and consumers’ tastes and habits.<sup>18</sup> For the case of a carbon tax, it can be argued that likeness should be determined by comparing two similar products with the same CO<sub>2</sub> footprint, and not similar products with different CO<sub>2</sub> footprints. This should happen because the national carbon-BCA legislation is already distinguishing in the domestic market between domestic high and low carbonpolluters and their products, and is treating them differently.<sup>19</sup> In order to avoid discriminatory treatment, the same method of measuring CO<sub>2</sub> must be used for all products, imported and domestic. That may be practically difficult, although prevalent scientific methods and standards seem to be better accepted during the scrutiny process for the compatibility between domestic laws and WTO law. Additionally, all taxes have to be applied in a manner that does not “afford protection” to domestic products. The wording, goals and application methods of the legislation should be entirely origin-neutral, and any differences in treatment would have to be explained by reasons other than geographic origin.<sup>20</sup> Generally, the notion of competitiveness as an explanatory reason behind domestic regulation

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<sup>14</sup> Report of the Panel, *Belgian Family Allowances*, G/32 - 1S/59 (Nov. 7, 1952), GATT BISD (1<sup>st</sup> Supp.), at 59.

<sup>15</sup> Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WTO Doc. WT/DS8/AB/R(adopted Oct. 4, 1996) [hereinafter *Japan Alcoholic Beverages*].

<sup>16</sup> Report of the Panel, *United States — Restrictions on Imports of Tuna*(Sep. 3, 1991), GATT BISD (39<sup>th</sup> Supp.), at 155.

<sup>17</sup> Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WTO Doc. WT/DS135/AB/R (adopted 5 April 2001).

<sup>18</sup> *Japan Alcoholic Beverages*, *supra* note 15.

<sup>19</sup> Joost Pauwelyn, *supra* note 13.

<sup>20</sup> Jennifer Hillman, *supra* note 11.

should be avoided as it is directly linked to protectionism. Finally, the offset domestic carbon tax must be “indirect” since the WTO does not allow its member states to counter personal taxes, property taxes or income taxes with BCAs. This requirement should not be difficult to meet, since generally genuine carbon taxes, determined entirely based on emissions, are considered indirect taxes.<sup>21</sup>

Even when a WTO panel finds that BCAs discriminate between two products of foreign origin, or between a domestic and a foreign product, the WTO allows for exceptions from non-discrimination rules for the protection of human, animal and plant health and life, public morals, or exhaustible natural resources. These exceptions appear in article XX of the GATT and become applicable once a country has failed to pass the economic test of non-discriminatory treatment of articles I and III. In other words, article XX is applicable as a justification platform when some form of unequal treatment has been found. CO<sub>2</sub> emissions could be justified under paragraph (g) of article XX, which discusses exceptions to WTO rules for the conservation of exhaustible natural resources. When article XX becomes relevant, the panels and Appellate Body would focus on the domestic environmental policy and whether it is appropriate for the problem it attempts to solve.

Article XX (g) requires that similar restrictions, such as taxation, be imposed not only on imports but also on domestic products. This means that a country cannot impose a BCA on imports only: a CO<sub>2</sub> tax or other equivalent and explicit carbon pricing system must be imposed simultaneously for domestic products. Under existing WTO law, no country can move forward with a BCA without a nationally harmonised carbon pricing system in place. In the next section we will try to discuss this proposition and subnational initiatives, but currently, no subnational can propose a BCA simply because there is a sub-federal carbon tax or other carbon price adopted by them.

Generally speaking, the article XX (g) threshold is easy to reach if domestic legislation serves a legitimate environmental purpose, avoids observable protectionism and is consistently applied.<sup>22</sup> At the same time, Article XX exceptions are qualified by the article’s chapeau which sets a much higher barrier for national regulation. It focuses on the application of the carbon tax and BCA, which must be done in a way that is not “a means of arbitrary and unjustifiable discrimination.” Countries imposing such legislation should, under the chapeau of article XX, take into account varying conditions in different countries. For

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<sup>21</sup> *Id.*; Horn, Henrik & Petros C. Mavroidis, *To B (TA) or not to B (TA)? On the legality and desirability of border tax adjustments from a trade perspective*, 34 THE WORLD ECON. 1911-1937 (2011).

<sup>22</sup> Jennifer Hillman, *supra* note 11.

example, consideration for the needs of least-developed countries would indicate that the legislation is applied in a non-arbitrary manner.<sup>23</sup>

Another condition imposed by the article XX chapeau is that the legislation cannot be a “disguised restriction on international trade.” Consideration for local circumstances, environmental negotiations conducted in good faith and respect for basic fairness and due process have all been used by WTO judges in order to determine whether the application of article XX exceptions are disguised restrictions to trade.<sup>24</sup>

Finally, to support the compatibility of national regulation with WTO law, a country can take steps to demonstrate a firm commitment to the environment instead of discriminatory and trade-distorting tendencies.<sup>25</sup> For example, the carbon tax-BCA imposing country could give all or part of the tax revenues collected in the context of carbon-environmental legislation to research and development related to the conservation of the environment. Another idea for the use of the tax revenues would be toward developing country assistance. Developed countries could support the establishment of environmental studies at universities in developing countries. They could finance new CO<sub>2</sub>-friendly infrastructure and technologies for small industries with a high CO<sub>2</sub> footprint. Such initiatives would not only help with long-term international convergence on environmental protection, they would also help the taxing country meet the high threshold of the article XX chapeau.

### III. RAISING WTO SUPPORT FOR THE EFFORTS OF SUB-NATIONAL ENTITIES

If we are to save the environment in a market-friendly way, a carbon tax must be federally coordinated and complemented by a border carbon adjustment in order to produce benefits for domestic manufacturers, businesses, governments, consumers and the environment itself. This section explains in more detail the legal reasons behind the need for federal coordination in carbon pricing, if a country will also adopt a BCA for imports. Under WTO law, GATT article XXIV: 12 prescribes, consistently with general international law and the Vienna Convention on the Law of Treaties<sup>26</sup> that: “Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this

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<sup>23</sup> Joost Pauwelyn, *supra* note 13.

<sup>24</sup> Report of the Appellate Body, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, ¶160, WTO Doc.WT/DS58/AB/R (adopted Nov. 6, 1998).

<sup>25</sup> Jennifer Hillman, *supra* note 11.

<sup>26</sup> Vienna Convention on the Law of Treaties, Jan. 27, 1980, 1155 U.N.T.S. 331.

Agreement by the regional and local governments and authorities within its territories.”

Many worth-examining carbon pricing initiatives currently are not adopted at the national level. Instead, these are being introduced in sub-federal jurisdictions, especially in the US and Canada. There exists a long-standing domestic debate in the United States regarding the extent to which states can and will regulate carbon pricing and other environmental governance areas. One of the stand-out examples is the Californian Environmental Quality Act.<sup>27</sup> In Canada, Ontario and British Columbia have both regulated carbon emissions and other environmental standards.<sup>28</sup> Additionally, California, Quebec and Ontario are part of the so-called Western Climate Initiative (WCI). The WCI links the three subnational carbon markets.<sup>29</sup>

When domestic legislation, whether it originates at the federal or the sub-federal level, affects imports or otherwise touches upon the WTO Agreements, if such legislation is found to be violating WTO rules, then the federal government remains responsible for its subnational entities. Frequently, it is not entirely clear whether subnational rules affect international trade in the first place. WTO rules certainly appear to limit attempts by provinces, states or even cities to adopt and implement climate change regulation, if that affects any tradable commodities. At the same time, whenever national consensus is difficult to achieve, or takes longer, subnationals who want to be part of the green economy move forward alone before any national harmonisation. GATT article XXIV:12 does not always help with such environmental regulatory innovation, and federal governments have been found liable for sub-national initiatives before the DSB in several cases.<sup>30</sup>

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<sup>27</sup> CALIFORNIA ENVIRONMENTAL QUALITY ACT of 1970 CAL. PUB. RES. CODE §§ 21000-21189.3 (2018)(Cal).

<sup>28</sup> See REDUCTION OF CARBON DIOXIDE EMISSIONS FROM COAL-FIRED GENERATION OF ELECTRICITY REGULATIONS of 2014 SOR/2012-167 (Can.), ENVIRONMENTAL PROTECTION ACT of 1990 R.S.O. c. E.19\_(Ont.), THE GREENHOUSE GAS INDUSTRIAL REPORTING AND CONTROL ACT OF 2014, ch. 29 (B.C.).

<sup>29</sup> WESTERN CLIMATE INITIATIVE, INC., <http://www.wci-inc.org/>. [https://perma.cc/8PERVJUV] (last visited Jun. 13, 2018).

<sup>30</sup> See Shelley M. Kierstead, *An International Bind: Article XXIV: 12 of GATT and Canada*, 25 OTTAWA L. R. 315, 324-334 (1993); See also *US Shrimp*, *supra* note 24; *US Tuna*, *supra* note 16; Appellate Body Report, *Canada – Certain Measures Affecting the Renewable Energy Generation Sector / Canada – Measures Relating to the Feed-in Tariff Program*, WTO Doc. WT/DS412/AB/R (adopted 24 May 2013).

Canada adopted the Vancouver Declaration in March 2016<sup>31</sup> and the federal government has proposed new legislation aiming at federal coordination.<sup>32</sup> The Declaration seems to allow for interprovincial differentiation when it discusses the adoption of ‘a broad range of domestic measures, including carbon pricing mechanisms, adapted to each province’s and territory’s specific circumstances’.<sup>33</sup> Similarly, the new regulation is aiming at a “common floor” system, a minimum mandatory carbon pricing mechanism for all provinces without a specified carbon pricing ceiling, an agreed maximum national price. Full coordination is deferred for a future time. In this sense a BCA that brings import prices up to the national floor price for identical products is very likely to be legal under WTO rules. If the BCA brings products at a price point higher than the minimum national price, this could end up being problematic from a WTO compliance perspective.

If all governments were to fully harmonise a carbon price on specific energy intensive products and agree on it at regional or global level, this would mitigate WTO law concerns. Alternately, the WTO could take a more active stance. In the context of the Committee on Trade and Environment, or CTE, it could explicitly acknowledge that climate change is not a problem with a single solution. The 2018 report on WTO and Sustainable Development Goals acknowledges the important relationship between trade and climate change mitigation efforts when it notes that the CTE:

“is a focal point for information exchange, coordination and cooperation between the WTO and multilateral environmental agreements (MEAs), including the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES), the hazardous chemicals and wastes conventions (Basel, Rotterdam and Stockholm Conventions) and the United Nations Framework Convention on Climate Change (UNFCCC). This role of the CTE as a forum for information exchange and policy dialogue has fostered a harmonious co-existence between the WTO and MEAs while assisting countries in their collective

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<sup>31</sup> See Vancouver Declaration on Clean Growth and Climate Change, CAN. INTERGOVERNMENTAL CONF. SECRETARIAT (Mar. 3, 2016), <http://www.scics.ca/en/product-produit/vancouver-declaration-on-clean-growth-and-climate-change> [hereinafter Vancouver Declaration].

<sup>32</sup> See Legislative and Regulatory Proposals Relating to the Greenhouse Gas Pollution Pricing Act and Explanatory Notes, GOV’T CAN. (Jan. 2018), <https://www.fin.gc.ca/drlég-apl/2018/ggpp-tpcges-eng.asp> [hereinafter Legislative and Regulatory Proposals].

<sup>33</sup> Vancouver Declaration, *supra* note 31.

efforts to manage the complex interaction between trade and environment in a coherent and effective manner.”<sup>34</sup>

Using this as a guiding platform, the WTO could initiate a discussion among its member states on the aforementioned GATT article XXIV:12. Members could negotiate an interpretative note that does not change the GATT text per se but instead allows for the easier adoption of innovative legislation that only affects part of the domestic market and imports if such legislation clearly contributes to the protection of the environment and the promotion of a green economy. Provinces or states should be given the opportunity to become carbon sinks, otherwise industries will simply relocate internally with no improvement in overall emissions at the country level. If an interpretative note proves difficult to negotiate, then a set of guidelines, outlining permissible subnational environmental measures could be useful for outlier sub-nationals and their leaders, governors, mayors and subnational ministers and officials who want to take environmental action immediately, before achieving complete federal coordination.

A recent example of how a government which signed the Paris Agreement has been working on a comprehensive national carbon pricing policy is that of Canada. In Canada, the Federal Government has in 2018 put forward draft legislation under the title “Greenhouse Gas Pollution Pricing Act” as an effort to achieve such federal coordination that may perhaps in the future allow for the adoption of BCAs.<sup>35</sup> The legislation applies only to provinces without a carbon pricing system. At the time of the publication of this article, such legislation will not affect the provinces of Ontario, Quebec, Alberta or British Columbia as they all have provincial carbon pricing systems in place. The legislation proposes the adoption of a charge on fossil fuels, either in the form of direct pricing as a tax or, instead, through an Output Based Pricing System for industrial facilities. A price on carbon affects “registered distributors”, “registered importers” and “registered emitters.”

Building from the Vancouver Declaration, the Working Group on Carbon Pricing Mechanisms has put together a set of principles underlying the current legislation that include flexibility, application on a broad set of emission sources, predictability, transparency and the minimisation of competitiveness and carbon leakage especially for the so-called Energy Intensive Trade Exposed (EITE) sectors. The legislation roughly proposes a \$10 CAD price per tonne of emissions which will rise to \$50 CAD by 2022. Revenues are planned to return to the jurisdiction of origin.<sup>36</sup>

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<sup>34</sup> WTO and Sustainable Development Goals, 2018 Report, W.T.O., [https://www.wto.org/english/thewto\\_e/coher\\_e/sdgs\\_e/sdgs\\_e.htm](https://www.wto.org/english/thewto_e/coher_e/sdgs_e/sdgs_e.htm)

<sup>35</sup> Legislative and Regulatory Proposals, *supra* note 32.

<sup>36</sup> *Id.*

#### IV. CONCLUSION

This paper demonstrates that for the majority of countries in the world who are members of the WTO, the carbon tax and BCA combination is compatible with their trade obligations. In order to be compatible with the WTO requirements, a carbon tax and BCA combination cannot be adopted by states or provinces – the decisions must be taken at the national level.

With the revenues raised, governments can put these to a variety of uses if earmarked as such - for clean energy transitions and technology innovation, or for supporting other (i.e. developing) countries in the process. Here, though, a dilemma should be underlined. As with tobacco and other ‘sin’ taxes, the main purpose of the BCA is not to raise revenue but to alter behavior. So, in an ideal world once all countries price carbon equally, the BCA will raise zero revenues, which is exactly as it should be. But even in this scenario, presumably many countries achieve the global price of carbon via taxation, in which case the question of how revenues might be used remains as a policy choice.

The carbon tax/BCA combination also has potential benefits for the environment. If any inconsistencies are found in the application of carbon taxes and BCAs, countries can invoke their commitment to protect the environment. In order to demonstrate that the national concerns for the environment are genuine, countries can, for example, use some of the revenues from taxation towards the development of carbon sinks, such as forests; fund research and development for clean energy technologies; or even assist other countries to transition to environmentally friendly production methods.

A BCA regime is an archetype solution for the sort of problem for which multilateral institutions like the WTO were created. It is in the tradition of “internationalizing cross-border spillovers”,<sup>37</sup> and as with the global trading system more broadly, exhibits all the characteristics of a global public good. A BCA regime is available to all member countries of the WTO. It offers non-rivalrous consumption meaning that as more countries join the system it does not detract from the benefits that existing countries enjoy. In fact, as Mendoza argues in the case of the WTO itself, “having more members makes the regime’s rules more valuable, increasing their legitimacy and credibility”.<sup>38</sup> As for the other criterion for

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<sup>37</sup> Peter S. Heller, *Internationalizing Cross-Border Spillovers*, in INGE KAUL & PEDRO CONCEIÇÃO, *THE NEW PUBLIC FINANCE: RESPONDING TO GLOBAL CHALLENGES* (2006).

<sup>38</sup> Ronald U. Mendoza, *The Multilateral Trade Regime: a Global Public Good For All?*, in INGE KAUL ET AL., *PROVIDING GLOBAL PUBLIC GOODS: MANAGING GLOBALIZATION*, 455-83 (2003).



a public good, non-excludability, once implemented the BCA regime's costs and benefits are available to the global public. Indeed these benefits would be available even to residents in countries that have not signed on because the impacts of climate change including its mitigation are globally dispersed.

This solution is a future-looking approach for international trade. By promoting international accountability for climate change, the WTO can move away from trying to solve only 20<sup>th</sup> century problems. The explicit legalisation of BCAs for carbon emissions is a step the organisation can take in order to reinvent itself as a 21<sup>st</sup> century institution while making the planet better off.