



The Environment / Trade Interface in the Revised ETS Directive

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Overview

- The key interface between climate change mitigation measures and trade rules
- Measures to address the problem of “carbon leakage”
- Trade law compliance under substantive rules
 - Free allocation as a subsidy
 - Border tax adjustments
 - Extraterritorial extension of measures
- Justification of measures under exceptions to trade rules

Climate change mitigation measures and international trade rules

- Domestic measures
- The problem of “carbon leakage”:
 - emissions intensive industries relocate to places with least costly carbon regulation
 - Net result is no impact on global carbon emissions while negatively impacting competitiveness of domestic industry
- Measures to address “carbon leakage”
 - Free allocation
 - Border tax adjustments
 - Extraterritorial application of emission limits

Free allocation – WTO compliance issues

- WTO subsidy rules under the *SCM Agreement*
 - Financial contribution
 - Revenue foregone?
 - Provision of goods or services for less than adequate remuneration?
 - Benefit
- Remedies
 - Prohibited subsidies
 - Actionable subsidies
 - Need for specificity
 - Adverse effects
 - Countervailing duties

Border tax adjustments (BTAs)

- Discussed in context of future direction for ETS
- BTAs would seek to equalize conditions of competition between domestic goods subject to mitigation measures & imported goods not subject to mitigation measures
- Conceptually like paying or receiving a rebate on domestic VAT at the border on import or export
- Possibility to exempt imports from territories with equivalent mitigation measures
- A key challenge: determining embodied carbon content in traded goods

BTAs - WTO compliance issues

- Discrimination issues
 - Article I GATT: MFN treatment
 - Unless *all* imports are subject to BTA, a measure would inherently discriminate between imports from different sources
 - Article III GATT: National treatment for internal fiscal measures and regulatory measures
 - Scope for BTAs to discriminate between products of domestic producers and imported products, esp. if imports pay a *tax* whereas domestic producers *trade in permits*
 - Not inconceivable that an even-handed measure could be designed

Covering extraterritorial emissions from aviation

- Application of EU ETS to aviation from Jan 2012
- International carriers using EU airports must surrender allowances for carbon emitted during final leg, irrespective of whether GHGs are emitted over EU territory or elsewhere
- For current period 85% allowances allocated freely proportionate to activity in benchmark period; remainder auctioned
- In future, free proportionate allowances will decrease and a special reserve of free permits will be held for high-growth or new operators
- Possibility for mutual recognition of other countries' efforts to deal with aviation-related emissions

Aviation coverage– WTO compliance issues

- Rules apply to **goods** transported by air
- Also apply to measures that affect “selling or marketing of air transport **services**” except “pricing” issues
- MFN or National Treatment Discrimination?
 - No obvious discrimination on the face of the measure
 - But potential for *de facto* discrimination

Aviation coverage– WTO compliance issues

- Freedom of transit and GATT Article V?
- Quantitative restrictions?
 - GATT Art XI ?
 - GATS Art XVI:2?
- Other issues – adverse impact on price sensitive distant tourism destinations as GATS MFN violation

Applicability of exceptions to trade rules

- Do exceptions apply to subsidies disciplined by *SCM Agreement*?
- GATT Article XX & GATS Article XIV
 - Measures necessary to protect human, animal or plant life or health (GATT Art. XX(g) & GATS Art XIV(b))
 - Measures relating to the conservation of exhaustible natural resources (GATT Art. XX(b))
 - Proviso that measures not be applied as means of “arbitrary or unjustifiable discrimination” or “disguised restriction on international trade”

Conclusion

- Complex issues where *domestic* carbon mitigation measures seek to deal with *international* trade exposure
- Governments generally consider it necessary to re-balance competitiveness between affected domestic operators and their foreign competitors
- EU ETS presents several examples of this problem, in particular with the extension of emissions limits to non-EU territory through coverage of international aviation