CATCHING CARBON AT THE BORDER:

A Legal Analysis of the Prospects for WTO-Compliance of an EU Border Carbon Adjustment Measure, and the Relevance of Such a Measure for New Zealand

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TABLE OF CONTENTS

"You cannot escape the responsibility of tomorrow by evading it today"

Abraham Lincoln

INTRODUCTION

Climate change is the defining crisis of our time – the devastation it has and will continue to wreak on the environment should need no introduction at this point. What we are still coming to grips with, however, is the threat that this poses to the global economy, with climate-related issues now occupying the top five spots in the World Economic Forum's Global Risks Report.[1]

Unfortunately, most countries have taken a myopic approach to the economics of climate change, too concerned about the potential trade impacts of imposing higher costs on domestic producers by forcing them to reduce their greenhouse gas (GHG) emissions, to focus on the long-term collective benefits of doing so. For those nonetheless willing to undertake ambitious climate action, this means shouldering a significant economic burden, especially in the trade space. This dissertation therefore examines a trade-based approach to help address that imbalance and encourage greater emissions-reduction efforts internationally, this being border carbon adjustments (BCAs).

Much has been written about BCAs in the abstract, with some articles dating from the early 2000s, but significantly, none have ever been implemented. However, interest in the topic is seeing a resurgence in light of a recent European Commission (EC) proposal to introduce a BCA – most likely in the form of a border carbon tax on imports – as part of its Green Deal for Europe. Such a measure will have wide-ranging implications for international trade, and is likely to trigger a World Trade Organisation (WTO) dispute. Thus, it is crucial to consider the measure's prospects for compliance with WTO rules. This has been reported on at length, but for the most part commentators have merely identified the legal provisions likely to be relevant, and acknowledged that the EU will have its work cut out trying to prove compliance with these. The substantive focus of this dissertation is to therefore provide a more exhaustive legal analysis than has been seen elsewhere to date, with the view that this is a measure that *should* be allowed under the WTO rules.

[1] Charlotte Edmond "These are the top risks facing the world in 2020 (15 January 2020) World Economic Forum <https://www.weforum.org/agenda/2020/01/top-global-risks-report-climate-change-cyberattacks-economic-political/>.

This dissertation also seeks to bring a new perspective to bear on the issue of BCAs, by examining how this move by the European Union (EU) is relevant for New Zealand (NZ), and thus, how NZ should respond. The relevance is two-fold. Firstly, NZ has a strong interest in ensuring that the EU measure does not distort global trade in a manner that would negatively impact our export economy. This requires that the EU design and implement a border carbon tax that complies with WTO rules, as highlighted above. Secondly, even if the EU proposal is likely to be found compliant with WTO rules, it is bound to attract challenge nonetheless. NZ should therefore consider how it might support such a proposal from a trade law and policy perspective, given the gravity of the climate crisis and NZ's desire to be seen as a world leader in the climate action space.

The focus of Chapter I will be a discussion of the economics of climate change in greater depth. It characterises climate change as a market failure, and explains the challenges facing both collective and unilateral action to tackle the issue. It then introduces BCAs as a possible trade-based solution to make unilateral action more attractive, addressing both the benefits and risks associated with such measures. Finally, it outlines in more detail the relevance of BCAs for NZ, in the context of the proposed EU border carbon tax.

Chapter II then provides a detailed legal analysis of the prospects for WTO-compliance of the proposed EU border carbon tax, in accordance with the relevant provisions contained in the General Agreement on Tariffs and Trade (the GATT).[2] It demonstrates why proving compliance will not be straightforward, but argues that even if the measure is held to be discriminatory, the EU has decent prospects for relying on environmental exceptions in the GATT to justify its imposition, so it should be regarded as justifiable by a WTO panel.

Finally, Chapter III will provide suggestions for an NZ response to an EU border carbon tax. The first option is third party involvement in a WTO dispute, with some examples of arguments NZ could submit in favour of an EU border carbon tax being regarded as WTO-compliant. The second option is seeking an international agreement

[2] General Agreement on Tariffs and Trade (Signed 30 October 1947, provisionally entered into force 1 January 1948) 55 UNTS 187.

on the climate-compatible regulation of international trade, in order to facilitate the implementation of BCAs moving forward. This will also involve a discussion as to whether such an agreement can – or rather, should – be conducted in a multilateral or plurilateral setting, with the view that the latter approach is more viable.

CHAPTER I: THE ECONOMICS OF CLIMATE CHANGE, BORDER CARBON ADJUSTMENTS, AND THE RELEVANCE FOR NEW ZEALAND

A The Problem

1 Climate change as a market failure

With forecasted global economic losses of at least US$2 billion per day should countries fail to reduce their GHG emissions by 2030,[3] it is small wonder that climate change has been described as the "greatest and widest-ranging market failure ever seen".[4] A market failure is an inefficient distribution of goods and services in the free market. It occurs when the decisions of individuals – made in the pursuit of their rational self-interests – do not lead to rational outcomes for the market, such that it fails to maximise society's welfare.[5]

Technically speaking, climate change is made up of several distinct market failures, but by far the most significant is the 'GHG externality'.[6] An externality is a cost or benefit arising from the production or consumption of a good that is not financially incurred or received by that particular producer or consumer; in essence, the externality is a 'spill-over' effect associated with a good that is borne by third (i.e. 'external') parties.[7]

As outlined in the previous paragraph, an externality can involve either costs or benefits. That is, it can be either *positive* or *negative*. The GHG externality is an example

[3] Stephen Leahy "Most countries aren't hitting 2030 climate goals, and everyone will pay the price" (5 November 2019) National Geographic <https://www.nationalgeographic.com/science/2019/11/nations-miss-paris-targets-climate-driven-weather-events-cost-billions/>.

[4] Nicholas Stern *The Economics of Climate Change: The Stern Review* (Cambridge University Press, Cambridge, UK 2007) Executive Summary at i.

[5] Jim Chappelow "Market Failure" (7 April 2020) Investopedia <https://www.investopedia.com/terms/m/marketfailure.asp>.

[6] Grantham Research Institute and Duncan Clark "Why do economists describe climate change as a 'market failure'?" *The Guardian* (online ed, London, 21 May 2012).

[7] Will Kenton "Externality" <https://www.investopedia.com/terms/e/externality.asp>.

of a *negative* externality of production. When carbon-intensive goods are produced, GHGs are emitted. The impacts of these emissions – such as environmental degradation, reduced air quality and rising sea levels – do not fall on the producers of the goods. Neither are the impacts constrained to the immediate environment of the manufacturing facility. Instead, they fall on future generations, in particular, those in developing countries.[8] In other words, because producers are not currently paying for these 'costs' to society (by factoring them into the market price of their carbon-intensive goods), the adverse effects of emissions are external to them. Consequently, there is usually only an ethical – rather than an economic, or 'rational' – incentive for businesses to reduce their emissions. The market therefore 'fails' by producing more GHGs than is optimal for society.[9] To complicate things further, since every country produces emissions, these emissions are not ordinary, localised externalities, but externalities occurring on a global scale.[10]

To *internalise* this social cost of carbon therefore requires policy intervention in the market, which is usually undertaken by governments. But, as science has shown, emissions have the same effects no matter where they arise, so one government alone cannot resolve the issue. Climate change is therefore a collective action problem.[11]

[8] Fulco Ludwig and others *Climate change impacts on developing countries – EU Accountability* (Policy Department Economic and Scientific Policy) IP/A/ENVI/ST/2007-04, March 2007) at 5: This is an example of just one report detailing how climate change disproportionately impacts developing countries. It explains how climate change aggravates the effects of population growth, poverty, and rapid urbanisation (problems that already plague developing countries), and that it is likely to reduce economic growth in developing countries.

[9] Grantham Research Institute and Duncan Clark, above n 6. In direct contrast is a *positive* externality of production, for example, a beekeeper who produces honey. The beekeeper makes a profit when selling that honey, but there is also a spill-over benefit associated with the production of this honey, namely, that the bees will pollinate nearby fields and farms, potentially increasing those farmers' yields.

[10] Nicholas Stern "The Economics of Climate Change" (2005) 98(2) Am Econ Rev 1 at 1. To give a fairly crude example, a more localised negative externality of production might be the aesthetic detriment to a landscape when a new motorway is built, which in turn lowers the house average house price in the area.

[11] Joost Pauwelyn "US Federal Climate Policy and Competitiveness Concerns: the Limits and Options of International Trade Law" (April 2007) Nicholas Institute for Environmental Policy Solutions <https://nicholasinstitute.duke.edu/climate/policydesign/u.s.-federal-climate-policy-and-competitiveness-concerns-the-limits-and-options-of-international-trade-law> at 4.

2 *Climate change as a collective action problem*

When 175 Parties signed on to the Paris Agreement in 2016, it was heralded as a landmark effort for collective climate cooperation.[12] But for the most part, this is where it stops. The Paris Agreement sets the ambitious goal of limiting the increase in the global average temperature to under 1.5 degrees Celsius above pre-industrial levels, which requires a 50 percent reduction in global GHG emissions by 2030.[13] Yet analysis of current reduction commitments between 2020 and 2030 shows that almost 75 percent of Parties' climate pledges are partially or totally insufficient to meet this target, and many pledges are unlikely to be achieved as it is.[14] This dismal outlook has been attributed to the voluntary nature of the Paris Agreement – which has allowed Parties to make pledges that differ considerably in their timing, content and scope[15] – and its provisions on compliance and enforcement being modest at best.[16] Moreover, the United States' intended withdrawal from the Paris Agreement – despite being the world's largest economy and historical emitter – demonstrates that participation in the international climate regime cannot be taken for granted.[17] Critics therefore argue that uncertainty, inefficiency and asymmetry are what will define collective climate action for the foreseeable future.[18]

What, then, is to be done? It would appear that governments can either resign themselves to this fate or undertake greater emissions-reduction efforts unilaterally.

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[12] "What is the Paris Agreement?" United Nations Framework Convention on Climate Change <https://unfccc.int/process-and-meetings/the-paris-agreement/what-is-the-paris-agreement>.

[13] "What is the Paris Agreement?", above n 12.

[14] Robert Watson and others "The Truth Behind the Climate Pledges" (November 2019) FEU-US <https://drive.google.com/file/d/1nFx8UKTyjEteYO87-x06mVEkTs6RSPBi/view> at i.

[15] Willem Pauw and others "Beyond Headline Mitigation Numbers: We Need More Transparent and Comparable NDCs to Achieve the Paris Agreement on Climate Change" (2018) 147 Clim Change 23 at 24.

[16] The Agreement establishes a committee to facilitate implementation and promote compliance "that shall be expert-based and *facilitative in nature* and function in a manner that is transparent, *non-adversarial* and *non-punitive*." (emphasis added): Paris Agreement (opened for signature 22 April 2016, entered into force 4 November 2016), art 15.2.

[17] Michael A Mehling and others "Designing Border Carbon Adjustments for Enhanced Climate Action" (2019) 113 AJIL 433 at 434.

[18] Korkut A Ertürk and Jason Whittle "Climate Change, Procrastination and Asymmetric Power" (2015) 5 WEA 40 at 40-41.

3 *The challenges facing unilateral action*

Unilateral climate action is by no means a new concept. Several countries have implemented strong domestic climate policies to date, such as carbon regulations, carbon taxes, and emissions trading schemes (ETSs). The problem with taking unilateral action – and the corresponding disincentive for other countries to follow suit – is the economic and environmental consequences involved, in particular, free-riding and carbon leakage.

From an economic standpoint, the earth's climate represents a global commons,[19] in that it is non-excludable and rivalrous. This means that it is costly or impossible to exclude people from 'using' it (in this case, polluting it), and that its use reduces the ability of other people to use it (i.e. its degradation hinders the global population's access to a 'healthy', or even 'liveable', climate).[20] The inverse of this is that unilateral emissions-reduction efforts are open to free-riding from other countries, because the benefits cannot be confined to the territory where the policies are implemented. When it is evident that not all countries are pulling their weight, this can create an 'all-or-nothing' mentality to tackling climate change, further disincentivising climate laggards from getting involved.[21]

Furthermore, in a world of heterogeneous climate efforts, 'carbon leakage' can result.[22] This is a phenomenon where, as a result of stringent domestic climate policies, companies shift their production abroad to countries with lax or no emissions

[19] Office of the United Nations High Commissioner for Human Rights and others "Global governance and governance of the global commons in the global partnership for development beyond 2015" (January 2013) UN System Task Team On The Post-2015 UN Development Agenda <https://www.un.org/en/development/desa/policy/untaskteam_undf/thinkpieces/24_thinkpiece_global_governance.pdf> at 5.

[20] OpenStax College "Public Goods"(5 June 2015) OpenStax CNX <https://cnx.org/contents/S4JG5L0k@5/Public-Goods>.

[21] The Stern Review, above n 4, at i.

[22] It should be noted that while empirical research provides little evidence of carbon leakage, economics analysis shows that the risk of carbon leakage nonetheless exists, especially in the long run: Baris Karapinar and Kateryna Holzer "Legal Implications of the Use of Export Taxes in Addressing Carbon Leakage: Competing Border Adjustment Measures" (2012) 10 NZJPIL 15 at 18.

constraints.[23] After all, requiring companies to reduce emissions increases their costs of production, putting them at a competitive disadvantage in the international market when compared to producers in countries without such restrictions. By outsourcing production in retaliation, this not only undermines the effectiveness of domestic climate policies, but it can lead to a rise in net global emissions.[24]

B A Possible Solution in the Form of BCAs

With collective action proving largely ineffective and unilateral action proving rather unappealing, addressing the climate crisis becomes all the more challenging. There is, however, a proposed trade-based solution that seeks to prevent free-riding and carbon leakage, which may make unilateral action more attractive. This solution is BCAs, which include imports in, or exempt exports from, the scope of domestic climate policy.[25] While BCAs can take many forms, the most commonly discussed measure – and the focus of Chapter II – is to impose a tax on carbon-intensive imports equivalent to the carbon tax(es) levied on domestic producers.

1 Arguments for and against BCAs

(a) The benefits

Firstly, it should be noted that while BCAs have strong environmental justifications, the immediate demand for their consideration is usually economic in nature. In particular, emissions-intensive, trade-exposed (EITE) industries in countries with strict climate policies want to level the playing field by subjecting imports from countries that have not taken comparable climate action to the same costs domestic producers face.[26] However, as will become evident in Chapter II, if it turns out that BCAs distort or restrict trade in a manner that breaches the GATT provisions and

[23] "Carbon Leakage" (29 August 2014) Carbon Market Watch <https://carbonmarketwatch.org/2014/08/29/carbon-leakage/>.

[24] It also is likely to result in lost jobs and tax revenue: Karapinar and Holzer, above n 22, at 19.

[25] Akin to the adoption of a 'polluter-pays' principle.

[26] Every source I have come across in my research that covers BCAs on imports cites this particular reason in some capacity, including: Pauwelyn, above n 11, at 2; and Mehling, above n 17, at 438.

requires resort to the General Exceptions, this economic justification will carry little weight. Rather, their environmental justification will take on heightened importance. The key environmental reasons for introducing BCAs are:[27]

(i) *Avoiding carbon leakage* – a carbon tax on imports would avoid carbon leakage to the extent that even relocated firms would have to pay the cost of carbon when they re-export their products back to the home market.

(ii) *Reducing domestic opposition to climate policies* – without BCAs, policymakers may have to exclude a number of EITE industries from the purview of climate legislation, impose lower overall emissions cuts, or, in the case of an ETS, hand out emissions allowances for free. By employing BCAs to achieve symmetry in the treatment of domestic and imported products, this may help get domestic producers on-side, allowing for wider and deeper emissions reductions in the home country.

(iii) *Limiting free-riding* – if overseas producers are forced to pay the social cost of carbon when trading with the BCA-imposing country, this may incentivise them to reduce their own emissions. It may also create political leverage for more ambitious climate action from laggard countries.

(b) The challenges

Whilst BCAs make for a promising policy instrument at first glance, they are likely to come up against serious political, administrative and legal hurdles.[28] These include:

(i) *Threatening future climate cooperation* – there is no guarantee that BCAs will incentivise free-riders to undertake more ambitious climate action. Instead, some argue that BCAs will incite retaliation from trading partners, which could quickly devolve into trade wars. Not only might this take the

[27] These have been compiled with reference to: Jennifer Hillman "Changing Climate for Carbon Taxes: Who's Afraid of the WTO?" (July 25 2013) The German Marshall Fund of the United States <https://www.gmfus.org/publications/changing-climate-carbon-taxes-whos-afraid-wto> at 3; Pauwelyn, above n 11, at 4; and Mehling, above n 17, at 441.

[28] Karapinar and Holzer, above n 22, at 23-24.

spotlight away from the climate crisis, but it would undermine the trust needed for greater international cooperation.[29]

(ii) *Costly implementation* – administering BCAs is likely to be complex and costly. For example, where a carbon tax on imports is imposed, customs would have to collect information on their carbon content, for which a proper reporting, monitoring and verification system would need to be established. This is by no means a small or inexpensive task.[30]

(iii) *Allegations of 'green protectionism' and the corresponding risk of a WTO challenge* – protectionism is the practice of shielding a country's domestic industries from foreign competition,[31] with green protectionism being the use of environmental policies as a pretence in order to achieve such ends.[32] Protectionist measures, for the most part, run contrary to the international trading rules of the WTO, because they distort competition. BCAs are both environmentally-focused and trade-restrictive, meaning they will almost undoubtedly attract allegations of green protectionism and/or trigger a WTO challenge. This is arguably the biggest challenge associated with BCAs.

C The Relevance of BCAs for NZ

1 The European Green Deal and proposed border carbon tax

In December 2019 the EC announced the European Green Deal – a "roadmap" for making Europe the first climate-neutral continent by 2050.[33] In doing so, the EC

[29] At 25.

[30] At 23; and Pauwelyn, above n 11, at 5: Although it has been suggested that the revenue generated from border carbon taxes could help fund the administrative costs involved in establishing and maintaining such a system.

[31] Jim Chappelow "Protectionism" (6 September 2020) Investopedia <https://www.investopedia.com/terms/p/protectionism.asp> for example, via traditional trade barriers such as tariffs and quotas.

[32] Peter Holmes, Tom Reilly and Jim Rollo "Border carbon adjustments and the potential for protectionism" (2011) 11 Clim Policy 883 at 883.

[33] "The European Green Deal sets out how to make Europe the first climate-neutral continent by 2050, boosting the economy, improving people's health and quality of life, caring for nature, and leaving no

acknowledged that Europe's climate-related efforts are likely to be undermined by a lack of ambition from its trading partners, and consequently the risk of carbon leakage.[34] A key proposal within the Green Deal is therefore the introduction of an EU BCA, which is likely to take the form of a border carbon tax on imports.[35] Although the sectoral scope of the border carbon tax is yet to be determined, it will most likely apply to sectors where the risk of carbon leakage is the highest, such as the manufacture of steel, cement and aluminium.[36]

2 What does this mean for NZ?

The EU's proposal is one of significant relevance to NZ. Firstly, the EU represents NZ's third largest trading partner, with whom we are currently negotiating a free trade agreement.[37] Any trade-based measure it introduces – particularly a restrictive one – is therefore of interest to us, as we will not want it to hinder these negotiations. Moreover, NZ has had a prolonged trade deficit with the EU, and the government is facing pressure to address this imbalance.[38] If any NZ exports to the EU are captured by the border carbon tax then this deficit is likely to widen, so being able to point to the fact that it is a WTO-compliant measure (provided this can be proven), is valuable from a political perspective. Significantly, NZ's biggest industry and most emissions-

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one behind" (11 December 2019) European Commission | Press Corner <https://ec.europa.eu/commission/presscorner/detail/en/IP_19_6691>.

[34] "EU Green Deal (carbon border adjustment mechanism)" European Commission <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12228-Carbon-Border-Adjustment-Mechanism>.

[35] "EU Green Deal", above n 34; and Francesco Guarascio, Jonas Ekblom "Explainer: What an EU carbon border tax might look like and who would be hit" (11 December 2019) <https://www.reuters.com/article/us-climate-change-eu-carbontax-explainer-idUSKBN1YE1C4>.

[36] "DRAFT Annex to the Commission Delegated Decision determining, pursuant to Directive 2003/87/EC of the European Parliament and of the Council, a list of sectors and subsectors which are deemed to be at risk of carbon leakage, for the period of 2021 to 2030" (5 December 2018) European Commission at 2.

[37] "Key facts on EU-NZ trade" (2019) Ministry of Foreign Affairs and Trade <https://www.mfat.govt.nz/en/trade/free-trade-agreements/agreements-under-negotiation/eu-fta/key-facts-on-nz-eu-trade/> In 2019, NZ exports to the EU (including the UK) totalled NZ$9 billion, with imports totalling $14.8 billion.

[38] Hon David Parker "Trade for All and the state of international trade" (speech delivered to the Trade for All Advisory Board, Wellington, 23 July 2020) Beehive.govt.nz <https://www.beehive.govt.nz/speech/trade-all-and-state-international-trade>.

intensive sector, agriculture, is not covered by NZ's ETS[39] (nor is agriculture in the EU covered by the EU Emissions Trading System), so NZ's agricultural exports are unlikely to be subject to an EU border carbon tax. However, it cannot be guaranteed that this will always be the case. The EU will be setting a precedent by implementing a BCA, and in future they will be able to look at whether and how to expand its scope, which could well include agriculture. NZ cannot afford to ignore that possibility. Thus, NZ has a strong interest in ensuring that an EU border carbon tax is capable of being designed and implemented consistently with WTO rules.

Secondly, in international trade law, every country has a stake in how the WTO Agreements' obligations are interpreted.[40] Given the importance and wide-ranging implications of the EU's BCA proposal, some aspect(s) of it – if not the entire measure – will almost inevitably be challenged at the WTO. The WTO dispute settlement system allows Member countries to bring complaints against each other if they consider that a Member is in violation of the rules. The system also allows for third party participation, where a country that is neither a complainant nor a respondent is entitled to attend hearings and make submissions. Sometimes WTO Members participate in disputes as third parties because they have a commercial interest, but more often it is because they have a systemic interest in how the rules in question are interpreted and applied.[41]

If an EU border carbon tax is challenged in the WTO, NZ would therefore have to consider whether or not to involve itself as a third party. The foregoing discussion provides a compelling case for involvement, so the question really is what position to take on the measure's compliance. Provided NZ is confident that the EU's proposal is not just green protectionism in action, there is a strong justification for supporting

[39] "Emissions Trading Scheme" (12 September 2020) Ministry for Primary Industries <https://www.mpi.govt.nz/protection-and-response/environment-and-natural-resources/emissions-trading-scheme/>.

[40] WTO "The WTO can… give the weak a stronger voice" <https://www.wto.org/english/thewto_e/whatis_e/10thi_e/10thi07_e.htm>.

[41] David Evans and Penelope Ridings "A Decade of WTO Dispute Settlement: New Zealand's Experience" (2006) 2 NZYbkIntLaw 1 at II.D.

such a proposal, given the urgency of the climate crisis and NZ's desire to be seen as a world leader in the climate action space.[42]

More generally, it is also important to realise that where Europe leads, other countries tend to follow. Known as the 'Brussels Effect', this describes the EU's ability to promulgate regulations that become entrenched in the legal frameworks of other countries, leading to the 'Europeanisation' of key aspects of global commerce.[43] Indeed, the EU set the global standards for privacy and data governance in recent years,[44] so it is entirely possible that its trading partners may fall into line once again with the introduction of a border carbon tax, if it means continued access to the world's largest trading bloc. As a small, trade-dependent economy, the widespread use of BCAs would undoubtedly affect NZ, so it is essential that we begin grappling with the idea now and figure out how we can make BCAs align with our own interests.

To summarise, how NZ responds to an EU border carbon tax is a very real question. This starts with an in-depth legal analysis – namely, assessing its compliance with WTO rules, which is the focus of Chapter II – but must also take into account and be balanced against broader environmental and political considerations.

[42] "The transition to a low-emissions and climate-resilient Aotearoa New Zealand" (15 September 2020) Ministry for the Environment <https://www.mfe.govt.nz/climate-change/climate-change-and-government/climate-change-programme>.

[43] Anu Bradford "The Brussels Effect" (2012) 107 Nw U L Rev 1 at 1.

[44] Alan Beattie "The Brussels Effect, by Anu Bradford" Financial Times (online ed, London, 27 January 2020).

CHAPTER II: THE PROSPECTS FOR WTO-COMPLIANCE OF AN EU BORDER CARBON TAX

A Overview

The EU's proposed border carbon tax would essentially be a climate-related variant of an import-side border tax adjustment (BTA).[45] Import-side BTAs are measures that "enable… imported products… to be charged with some or all of the *tax* charged in the importing country in respect of similar domestic products" (emphasis added).[46]

In the present case, the EU does not impose a domestic carbon 'tax' *per se*, because it has an Emissions Trading System (the EU ETS) instead (under which EU producers are required to hold emissions allowances).[47] This factor is relevant to an analysis of the proposed measure's prospects for WTO-compliance, as it is necessary to determine whether the EU ETS can nonetheless be considered a tax.

A key resource for understanding BTAs in the context of international trade rules is the GATT Working Party Report on Border Tax Adjustments (Working Party Report). The Working Party Report clarified that the GATT provisions governing import-side BTAs are Articles II (Schedules of Concessions) and III (National Treatment on Internal Taxes and Regulations).[48] In addition, Article I (Most-Favoured-Nation) may be relevant.[49]

1 Article II (Schedules of Concessions)

Article II applies to customs duties that WTO Members impose at the border. Importantly, Article II:1(b) stipulates that imported "products shall… be exempt from all other duties or charges of any kind imposed on or in connection with the

[45] Mehling, above n 17, at 457.

[46] *Border Tax Adjustments* GATT BISD 18S/97, L/3464, 2 December 1970 (Report by the Working Party) at [4].

[47] "EU Emissions Trading System" European Commission <https://ec.europa.eu/clima/policies/etsen>.

[48] Working Party Report, above n 46, at [7].

[49] At [37].

importation" in excess of the ceilings provided in Members' Schedules of Concessions. However, Article II:2(a) explicitly permits Members to impose on the importation of any product:

> a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III* in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part.

2 Article III (National Treatment on Internal Taxes and Regulations)

Article III applies to internal taxes and regulations, and provides that they not be discriminatory towards imports (the National Treatment obligation). In particular, Article III:2 states that imported products:

> … shall not be subject, directly or indirectly, to internal taxes… in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes… to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.*

3 Key questions to address

In assessing whether the EU's proposed border carbon tax is likely to be consistent with these provisions, we therefore need to ask the following questions:

(1) Is the EU ETS a *tax*?

(2) If the EU ETS is a tax, is the proposed adjustment to it likely to fall within the scope of Article II or Article III?

(a) This involves an inquiry into whether the proposed adjustment is likely to be classified as:

(i) a customs duty or charge imposed on or in connection with *importation* (and therefore captured by Article II:2(b), and

prohibited if it is in excess of the EU's scheduled tariff bindings); or

(ii) an *internal* tax that has been extended to imports (therefore attracting the more permissive Article III:2 from the outset)?[50]

(b) Even if the proposed adjustment is imposed on or in connection with the importation of goods, could it nonetheless be considered a *charge equivalent to an internal tax* for the purposes of Article II:2(a) (and therefore permissible, provided it is also imposed consistently with Article III:2)?

(3) Is an internal carbon tax the type of tax which is permitted to be adjusted at the border under Articles II and III (namely, is it a *product* tax)?[51]

(4) If the internal carbon tax is permitted to be adjusted at the border- – in which case we can properly refer to the EU's proposed measure as an "EU carbon BTA", or "EU BTA" – is an EU BTA likely to comply with the requirements of Article III:2 (National Treatment) and Article I (Most-Favoured-Nation)?

(5) If an EU BTA is found to contravene the National Treatment and/or MFN obligations in Articles I and III, we will need to consider whether it is likely to be justifiable under Article XX (General Exceptions). This would require the EU to prove that its BTA falls under either:

(a) Article XX(b) – measures "necessary to protect human, animal or plant life or health"; or

(b) Article XX(g) – measures "relating to the conservation of exhaustible natural resources".

[50] Joost Pauwelyn "Carbon Leakage Measures and Border Tax Adjustments under WTO Law" in Denise Prévost and Geert Van Calster (eds) *Research Handbook on Environment, Health and the WTO* (Edward Elgar Publishing, Cheltenham, UK, 2012) at 24.

[51] At 25-26.

B Is the EU ETS a Tax?

Whilst carbon taxes and ETSs operate very differently in practice, their outcomes are more or less equivalent from an economic perspective. Leaving aside the case of free allocations, the requirement to 'hold' (i.e. purchase) emissions allowances, much like a carbon tax, puts a price on carbon emissions. In both instances, this increases firms' costs of production, which acts as an incentive to reduce emissions, therefore helping to correct a market failure.[52]

From a legal perspective, however, there is no consensus as to whether such a requirement can properly be called a tax, be it in the case of the EU ETS or jurisdictions with comparable schemes.[53] To complicate things, there is no definition for the term "tax" in the WTO agreements either. Commentators have instead relied on the OECD definition, which describes taxes as: "… compulsory, unrequited payments to general government. Taxes are unrequited in the sense that benefits provided by the government to taxpayers are not normally in proportion to their payments."[54]

1 Does the EU ETS involve compulsory payments to its Member States' governments?

Most EU ETS Member States allocated all emissions allowances free of charge under phases 1 and 2 of the scheme (2005-2007 and 2008-2012, respectively).[55] However, the auctioning of allowances has been the default method of allocation under phase 3 (2013-2020).[56] Allowances may still also be allocated for free or placed in the Market

[52] "Cap and Trade vs. Taxes" (March 2009) Center for Climate and Energy Solutions <https://www.c2es.org/document/cap-and-trade-vs-taxes/>.

[53] Kateryna Holzer "WTO law issues of emissions trading" (April 2016) World Trade Institute <https://www.wti.org/media/filer_public/6e/88/6e884b29-f5e2-4a25-85a6-a6edb5c25ed9/working_paper_short_version.pdf> at 12.

[54] *Definition of Taxes* DAFFE/MAI/EG2(96)3, 19 April 1996 (Expert Group No.3 on Treatment of Tax Issues in the MAI) at [1].

[55] "Phases 1 and 2 (2005-2012)" European Commission <https://ec.europa.eu/clima/policies/ets/pre2013_en>; and Yvonne Hoffman *AUCTIONING OF CO2 EMISSION ALLOWANCES IN THE EU ETS Report under the project "Review of EU Emissions Trading Scheme"* (European Commission Directorate General for Environment), October 2006) at 2.

[56] "Auctioning" European Commission <https://ec.europa.eu/clima/policies/ets/auctioning_en>.

Stability Reserve under phase 3; nonetheless, the European Commission has estimated that 57% of the total amount of allowances will be auctioned during this period.[57]

Whilst auctioning constitutes a compulsory payment to the relevant Member State's government, the free allocation of allowances is less clear-cut. On the one hand, it seems to follow logically that where there is no payment imposed by the government, there is no 'tax'. However, Pauwelyn and de Cendra submit that the requirement to hold allowances operates as a tax of sorts, because allowances always have an opportunity cost: they still stimulate a holder to reduce emissions (thereby increasing their costs of production), because when emissions are cut, the surplus allowances can be sold on the carbon market.[58] Whilst this argument seems less compelling, it does have some empirical backing. de Cendra describes how electricity producers in the EU have treated the price of the allowances they have received as opportunity costs, which they have then factored into their electricity prices in an attempt to pass the majority of the burden on to consumers.[59] Of course, even if it can be shown that the resulting effect on energy consumers is similar to that generated by a tax on electricity, there is no payment to the government involved, so this aspect of the OECD definition would not be satisfied. There is, however, a possibility that this whole debate can be avoided, as carbon market observers have suggested that a BTA would need to replace free allocation entirely, if the EU is to avoid allegations of double protection.[60]

2 Are these payments unrequited?

Assuming the payment aspect of the definition *is* satisfied, there remains the question of whether it is an unrequited payment. Pauwelyn contends that it is unrequited, because a 'polluter pays' approach almost exclusively serves the interests of the wider

[57] "Auctioning", above, n 56. See Pauwelyn "US Federal Climate Policy", above n 11, at 22 for a discussion of what might happen if some of a company's allowances are allocated for free and the rest must be bought at auction.

[58] Pauwelyn "US Federal Climate Policy", above n 11, at 22; and Javier de Cendra "Can Emissions Trading Schemes be Coupled with Border Tax Adjustments? An Analysis vis-à-vis WTO Law" (2006) 15 RECIEL 131 at 134.

[59] de Cendra, above n 58, at 134.

[60] "CO2 border tax would 'replace' EU ETS free allocation" (10 October 2019) Argus Media <https://www.argusmedia.com/en/news/1993310-co2-border-tax-would-replace-eu-ets-free-allocation>.

community.[61] Meanwhile, the industries and installations subject to these requirements do not receive any identifiable 'benefits' in return (compared with, say, a toll road arrangement, whereby drivers get to use a motorway in return for paying the toll).[62] Moreover, the EU ETS Directive provides that Member States should use at least 50% of auction revenues (or the equivalent in financial value) for climate and energy-related purposes, but that they otherwise have the discretion to decide how auction revenues will be spent.[63] Thus, there is no guarantee that specific benefits will be provided to those making the payments, let alone that any such benefits would be proportionate.

At the same time, it could be argued that governments are providing something akin to a proportionate 'benefit' in exchange for payment, as the firms captured by the scheme need these allowances in order to emit carbon dioxide.[64] Bartels also takes the view that so long as surplus allowances can be sold in the carbon market to generate revenue, any payments made to the government cannot be considered unrequited.[65]

3 If not a tax, what else might the EU ETS be?

An alternative position is to classify the obligation to hold emissions allowances not as a tax, but as a special kind of regulation instead. This was the approach taken in *Air Transport Association of America.* In that case, the European Court of Justice (ECJ) found that the requirement imposed on American aircraft operators to buy EU ETS allowances constituted a market-based (i.e. non-fiscal) measure, as opposed to a tax or charge on fuel load.[66] The ECJ distinguished the ETS requirement from a tax for two key reasons. Firstly, taxes typically have a fixed rate, whereas the cost of emissions

[61] Pauwelyn "US Federal Climate Policy", above n 11, at 21.

[62] At 21.

[63] "Auctioning", above n 56.

[64] De Cendra at 136.

[65] Lorand Bartels *The Inclusion of Aviation in the EU ETS: WTO Law Considerations* (Global Platform on Climate Change, Trade and Sustainable Energy, Issue Paper 6 ICTSD, 2011) at 4.

[66] In this case, a tax or charge would have been prohibited under Article 11 of the Open Skies Agreement: *Air Transport Association of America and Others v Secretary of State for Energy and Climate Change* C-366/10, ECLI:EU:C:2011:864, [2012] AII ER (EC)1133, [2012] 2 CMLR 81, [2013] PTSR 209 at [147].

allowances for an aircraft operator will vary depending on the number of allowances freely allocated (if any) and the market price of allowances, should an operator require additional allowances to cover its emissions. Secondly, quite unlike a tax, the primary motivation behind the allocation of allowances is not to generate revenue for the public authorities imposing the scheme.[67]

In the event that the EU ETS is classified as a regulation, it would then become subject to GATT Article III:4.[68] While a substantive analysis of a carbon regulation's eligibility for border adjustment and prospects for GATT-compliance are outside the scope of this dissertation, for present purposes, it is enough to note that similar considerations to those outlined in the upcoming sections would be relevant (namely, whether it is an *internal* regulation affecting *products,* and whether it contravenes the GATT non-discrimination obligations).[69]

4 Conclusion

Whilst the ECJ judgment remains the most relevant source on whether or not the EU ETS is comparable to a carbon tax, the appropriate categorisation would ultimately need to be decided by a WTO panel, which could well take a different view to the ECJ. Insofar as the OECD definition on taxes is concerned, the EU can likely make a strong case that, at least where allowances are auctioned, this constitutes a compulsory, unrequited payment to the government, and therefore qualifies as a tax. On this basis, we turn next to consider whether the proposed adjustment is likely to fall within the scope of Article II or III.

[67] At [142]-[147].

[68] Note that a carbon regulation may also fall within the scope of the WTO Agreement on Technical Barriers to Trade: see Pauwelyn "Carbon Leakage Measures", above n 50, at 33.

[69] The BCA/regulation interface has been discussed at length (albeit not in the context of an EU ETS) by Pauwelyn "Carbon Leakage Measures", above n 50; and Kateryna Holzer *Carbon-related Border Adjustment and WTO Law* (Edward Elgar Publishing, Cheltenham, UK, 2014).

C If the EU ETS is a Tax, is the Proposed Adjustment to it Likely to Fall Within the Scope of Article II or Article III?

This inquiry is important because – as discussed in C.1 and C.2 – if the proposed adjustment on carbon-intensive imports into the EU is triggered by an internal factor, this will render it an internal tax extended to imports, attracting the more permissive Article III:2 from the outset. However, if the adjustment is said to accrue on importation (making it a customs duty or charge, which will be prohibited under Article II:1(b) if it is in excess of the EU's scheduled tariff bindings), then the exception in Article II:2(a), *and* Article III:2 will be relevant.

1 Is the proposed adjustment likely to be classified as a customs duty or charge imposed on or in connection with importation, or an internal tax extended to imports?

The WTO Appellate Body (AB) clarified this distinction in *China—Auto Parts.* A measure will be classified as a customs duty or charge on or in connection with importation when the obligation to pay the duty or charge accrues "at the very moment the product enters the customs territory… *by virtue of the event of importation*".[70] Meanwhile, a measure will be regarded as an internal tax when it is imposed on goods already imported and "the obligation to pay [it] is triggered by an 'internal' factor, something that takes place *within* the customs territory".[71] Examples of internal factors include the distribution, use or re-selling of a product internally.[72] In *China—Auto Parts*, the AB concluded that the Chinese duty on auto parts was an internal tax, as it was imposed after the parts entered its territory and were assembled into motor vehicles.[73]

For present purposes, there is a good case for arguing that the proposed adjustment will be deemed an internal tax, either on the basis that the EU ETS operates as an internal trigger, or alternatively because products imported into the EU are highly

[70] *China—Measures Affecting Imports of Automobile Parts* GATT BISD WT/DS339/AB/R, WT/DS340/AB/R, WT/DS342/AB/R, (Report of the Appellate Body Adopted on 12 January 2009) at [158] (emphasis added).

[71] At 161.

[72] At 163.

[73] At 179-181.

likely to be distributed, used or re-sold internally. Importantly, this internal trigger would not prevent an EU ETS Member State from actually collecting revenue at the time of importation. The AB has confirmed, with reference to the *Ad* Note to Article III, that collection or payment of revenue at the moment of importation is not determinative of whether a measure is a carbon duty or charge, or an internal tax.[74]

2 *Even if the proposed adjustment is imposed on or in connection with importation, could it nonetheless be considered a charge equivalent to an internal tax for the purposes of ArticleII:2(a)?*

(a) What is meant by "equivalent"?

The drafters of the GATT once explained the meaning of the word "equivalent" with the following example:[75]

> If a charge is imposed on perfume because it contains alcohol, the charge to be imposed must take into consideration the value of the alcohol and not the value of the perfume, that is to say the value of the content and not the value of the whole.

In the case of an EU's proposed adjustment, this would presumably involve taking into consideration the value, or perhaps cost, of the carbon content of carbon-intensive imports, when calculating an equivalent charge. While this might be administratively burdensome, it is surely possible to do.

Furthermore, the AB in *India—Additional Import Duties* stated that the requirement in Article II:2(a) that a charge be imposed consistently with Article III:2 must be read together with, and imparts meaning to, the requirement that a charge and internal tax be 'equivalent''.[76] In other words, the conclusion reached in the National Treatment

[74] At 158.

[75] Holzer "Carbon-related Border Adjustment", above n 69, at 73; and *United States—Taxes on Petroleum and Certain Imported Substances* GATT BISD 34S/136, 17 June 1987 (Report by the Panel) at [5.2.7]: citing the protocol E/PC/T/TAC/PV/26 of the Second session of the preparatory committee of the UN Conference on Trade and Employment (25 September 1947) at 21.

[76] *India—Additional and Extra-Additional Duties on Imports from the United States* GATT BISD WT/DS360/12, 30 October 2008 (Report of the Appellate Body Adopted on 17 November 2008) at [175].

discussion under Section E of this Chapter will be highly relevant to whether the EU's proposed adjustment can be classified as a charge equivalent to an internal tax for the purposes of Article II:2(a) (and consequently whether or not it will be permissible by virtue of this exception).

D Is an Internal Carbon Tax the Type of Tax Which is Permitted to Be Adjusted at the Border Under Articles II and III?

Crucially, not every internal tax can be adjusted at the border and also imposed on imports.[77] Article II:2(a) specifies that the tax must be one "in respect of… *product[s]* or… article[s] from which the imported *product* has been manufactured or produced" (emphasis added). Similarly, Article III:2 requires the tax to be "applied… to… *products*" (emphasis added).[78]

What this means is that EU *product* taxes can be adjusted and applied to imports, but not EU *producer* taxes.[79] Adjustable product taxes are also referred to as 'indirect taxes' (such as excise and value-added taxes). Meanwhile, *non*-adjustable producer taxes are otherwise known as 'direct taxes' (like income, corporate or wealth taxes).[80]

The justification for this distinction between adjustable product (or, indirect) taxes, and non-adjustable producer (or, direct) taxes, is the 'destination principle' of taxation.[81] According to the destination principle, "tax is ultimately levied only on the final consumption that occurs within the taxing jurisdiction".[82] In other words, products are taxed where they are consumed, not produced. The application of this principle is said to achieve neutrality in international trade.[83] This distinction is supported by the economic theory that, typically, product taxes are passed on to

[77] Pauwelyn "Carbon Leakage Measures", above n 50, at 25.

[78] Working Party Report, above n 46, at [14].

[79] Pauwelyn "Carbon Leakage Measures", above n 50, at 25-26.

[80] At 26.

[81] Working Party Report, above n 46, at [4].

[82] *International VAT/GST Guidelines*, November 2015 (OECD) at 1.8.

[83] At 1.9.

consumers via the price of products, whereas producer taxes are usually not.[84] Whilst this is a fairly crude account, on this view, producer taxes do not affect the competitiveness of products, hence there is no need to make adjustments for imports in order to level the playing field economically.[85]

1 Is the EU's internal carbon tax likely to be considered an adjustable product *(i.e. indirect) tax, or a non-adjustable* producer *(i.e. direct) tax?*

A key issue is that the tax is directed at carbon emitters themselves, rather than their output. Prima facie, this suggests that it is a producer tax. However, as discussed in Chapter I, the purpose of a carbon tax (or in the present case, a requirement to hold emissions allowances) is to internalise the social cost of carbon, by incentivising producers to limit the production of carbon-intensive products. As the tax makes carbon-intensive products more expensive to produce, producers will want to pass on this burden to consumers where possible.[86] From an economic perspective at least, the tax can therefore be said to indirectly apply to products. Moreover, since the tax is likely to affect the competitiveness of products, it could in principle be adjusted at the border for imports, in order to ensure trade neutrality.[87] As Pauwelyn puts it, the "nexus between the tax and the products concerned appears to be tight enough" in order to allow adjustment.[88]

(a) The Agreement on Subsidies and Countervailing Measures (the SCM)

A potential source of guidance is the SCM, which has provisions governing BTAs on *exports* (being the remission of taxes on exports).[89] Footnote 58 of the SCM provides

[84] For example, we can compare a 15 per cent goods and services tax being factored into the price of goods at the supermarket, with a 28 per cent corporate tax levied on Foodstuffs, which would not be passed on to consumers.

[85] Christian Pitschas "GATT/WTO Rules for Border Tax Adjustment and the Proposed European Directive Introducing a Tax on Carbon Dioxide Emissions and Energy" (1994-1995) 24 Ga J Int'L & Comp L 479 at 485.

[86] Although note that this is dependent on factors like the nature of the market and elasticity of supply and demand.

[87] Hillman, above n 27, at 6; and Holzer "Carbon-related Border Adjustment", above n 69, at 103.

[88] "Carbon Leakage Measures", above n 50, at 29.

[89] Agreement on Subsidies and Countervailing Measures (Signed 15 April 1994, entered into force 1995) 1869 UNTS 14 at Annex I; and Pauwelyn "Carbon Leakage Measures", above n 50, at 25.

exhaustive definitions for both "direct taxes" and "indirect taxes", with the latter said to encompass "all taxes other than direct taxes". The carbon tax being imposed on emitters under the EU ETS does not fall under any of the types of taxes listed in the "direct taxes" definition,[90] thus, it could be deemed an indirect (i.e. a *product*) tax, merely by virtue of being "other than" a direct tax.[91] However, while there is a case for import-export equivalence based on the Working Party Report, there remains a question about the extent to which these definitions in the SCM relating to export-side border adjustment can (and should) be relied upon to interpret *GATT* provisions on import-side border adjustment.[92]

(b) The potential relevance of "*taxes occultes*"

Another problem is attributable to the intangible nature of carbon emissions: the domestic carbon tax is being levied in relation to emissions that are released during various stages of the production process, but these emissions are not physically incorporated into the final product.[93] Can such a tax still be considered a product tax?

One option is to classify it under a third category of taxes that the Working Party touches on in its Report, namely, "*taxes occultes*" (or "hidden taxes").[94] Importantly, *taxes occultes* target the process or production methods (PPMs) of a product, rather than its physical features.[95] Unfortunately, the Working Party Report left open the question of whether these hidden taxes are eligible for border adjustment,[96] and no WTO panel has had the opportunity to resolve this issue since. The closest relevant case is the *U.S.—Superfund* dispute, in which the United States imposed a domestic

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[90] This includes taxes on rents, royalties and the ownership of real property.

[91] Pauwelyn "Carbon Leakage Measures", above n 50, at 25.

[92] "It was agreed that *GATT* provisions on tax adjustment applied the principle of destination identically to imports and exports" (emphasis added): Working Party Report, above n 45, at [10].

[93] Holzer "Carbon-related Border Adjustment", above n 69, at 99.

[94] At 98-99; and Mehling, above n 17, at 458.

[95] *Taxes occultes* can include consumption taxes on capital equipment, auxiliary materials and services used in the transportation and production of other taxable goods, and taxes on energy, machinery and transport: Working Party Report, above n 46, at [15](a).

[96] The Report merely noted that there was a "divergence of views" on the matter at [15].

tax on certain chemicals and also on imports that had used those chemicals as inputs.[97] The panel found that taxes on substances used in the production process of the final product could be adjusted at the border. However, the panel did not specify whether the chemicals still had to be physically present in the final product, or whether they could be exhausted in the production process.[98]

(c) Conclusion

Ultimately, whether or not border adjustment of an EU internal carbon tax will be permitted under the GATT depends on how broadly a future WTO panel is willing to interpret the concept of an indirect product tax, and/or its readiness to extend the application of border adjustment to *taxes occultes*. Nonetheless, it certainly seems like there is reasonable scope for this. In the event that a panel did allow for border adjustment – in which case we can appropriately refer to the EU's proposed measure as an "EU carbon BTA", or "EU BTA" – we must then consider whether an EU BTA is likely to comply with the National Treatment obligation in Article III:2 and the Most-Favoured-Nation obligation in Article I:1.

E National Treatment

The purpose of the National Treatment obligation is to ensure that imported products are not discriminated against vis-à-vis "like" domestic products. Article III:2 is comprised of two sentences, which set similar, but relevantly different legal tests to be complied with. This means an EU BTA needs to be carefully designed to avoid a violation of either sentence.

1 Article III:2, first sentence

For the proposed EU BTA to violate this clause, three elements would have to be satisfied:

[97] Mehling, above n 17, at 458.

[98] *United States—Taxes on Petroleum and Certain Imported Substances*, above n 75, at para. 2.5 and para. 5.2.4.

(a) the measure must be an internal tax

As we have already seen in Section B, the legal position in regards to this first element is uncertain. However, we will assume that it is an internal tax for the purposes of completing the analysis.

(b) the measure must be in respect of domestic and imported products that are "like"

It is this second element that is likely to prove the most controversial. To put the problem in context: can, say, steel produced in Germany using mostly renewable energy be treated as "like" steel imported from China that is made from coal, despite the latter having a much higher carbon footprint?[99]

While the GATT does not define what constitutes "like" products, the analysis of 'likeness' has been the topic of ample GATT/WTO jurisprudence. The Working Party Report sets out the basic approach for determining 'likeness', which has subsequently been confirmed and developed by numerous WTO panels and the AB.[100] The Report established that whether imported and domestic products are "like" is to be determined on a case-by-case basis, and suggested that the following interrelated criteria be taken into account:[101]

(i) the products' properties, nature, and quality;

(ii) the products' end-uses in a given market;

[99] Assuming that the steel produced in Germany would not otherwise have used renewable energy were it not subject to the EU ETS requirements.

[100] For example, by the Appellate Body in *European Communities—Measures Affecting Asbestos and Products Containing Asbestos* GATT BISD WT/DS135/AB/R, 12 March 2001 (Report of the Appellate Body Adopted on 5 April 2001) [hereinafter *EC—Asbestos*] at [101]; as noted by Mehling, above n 17, at 460.

[101] Working Party Report, above n 46, at [18].

(iii) consumers' tastes and habits (i.e. the extent to which consumers perceive and treat the products as alternative means of performing the same function(s) in order to satisfy a particular want or demand[102]); and

(iv) the international classification of the products for tariff purposes.[103]

While this is a non-exhaustive list, these criteria should all be taken into account, even when they are thought to provide "conflicting indications" as to 'likeness'.[104] Helpfully, the AB in *Japan—Alcohol* clarified that Article III:2, first sentence, should be construed narrowly, due to the broader ambit of Article III:2's second sentence (discussed below). That being said, it has been recognised that such an inquiry will always involve an "unavoidable element of individual, discretionary judgement" on the part of WTO panels.[105]

Subject to this discretionary element, can anything be said for how an EU BTA might fare in light of these criteria? Insofar as the first two criteria are concerned (products' physical features and end-uses), there does not seem to be any legally relevant difference between, taking the above example, the German aluminium produced using renewable energy and the imported Chinese aluminium produced using coal. Similarly, while tariff classifications for aluminium prove complex and lengthy to wade through, they do not appear to make any distinction between such products based on their carbon emissions.[106]

The consumers' tastes and habits criterion probably offers the greatest scope for

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[102] *EC—Asbestos*, above n 100, at [101].

[103] Note that the fourth criterion, tariff classification, was not mentioned in the Working Party Report, but was added by subsequent WTO panels, for example, *EEC—Measures on Animal Feed* Proteins GATT BISD L/4599 - 25S/49, 2 December 1977 (Report by the Panel Adopted on 14 March 1978) at [4.2]; and *Japan—Taxes on Alcoholic Beverages* GATT BISD WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R 22, 4 October 1996 (Report of the Appellate Body Adopted on 1 November 1996) [hereinafter *Japan – Alcohol*] at 21.

[104] *EC—Asbestos*, above n 100, at [102], [109], [120].

[105] *Japan—Alcohol*, above n 103, at 20-21.

[106] "Chapter 76 | ALUMINIUM AND ARTICLES THEREOF" Taric Support <https://www.taricsupport.com/nomenclatuur/7600000000.html>. Meanwhile, in the case of cement-based products, which can be subject to similar carbon-intensive versus non-carbon intensive production-related issues, tariff classifications remain the same. See *EC—Asbestos*, above n 100, at [146].

climate-related BTAs. As the climate emergency has gained traction, consumer activism has emerged in the form of 'green purchasing' (i.e. displaying a preference for low-carbon products).[107] Perhaps it is therefore only a matter of time before consumer preferences on the whole change so drastically that carbon-intensive and low-carbon products are rendered 'unlike'. However, the chance of this sort of shift occurring is possibly product-dependent. For example, green purchasing may become more prevalent among consumer-facing products, such as cleaning products or cars, but what about in the case of non-consumer-facing products, like steel hollows or galvanised coil? In regards to the latter, the 'consumers' are likely to be corporations who manufacture products, and whose 'bottom lines' will probably be prioritised. We might hope that they become increasingly concerned with the carbon footprint of such products – perhaps as part of a Corporate Social Responsibility policy – but this will not necessarily be the case. The same probably goes for products used by local governments to build infrastructure, such as cement or aluminium. Governments may start promoting sustainable procurement, which could lead them to consider the differences between carbon-intensive and low-carbon versions of such products, but it may take a long time for this to occur on a large scale.

Whilst discussed in the context of GATT Article III:4 (which has a slightly broader scope than Article III:2), the AB in *EC—Asbestos* also suggested that consumers' tastes and habits "are very likely to be shaped by health risks associated with a product."[108] Given the considerable health risks posed by climate changed,[109] this may also spur greater green purchasing in years to come. Of course, this finding by the AB was made in relation to the direct health effects of imported asbestos (and products containing asbestos). Comparatively, the health effects of carbon-intensive products are of a more indirect nature, resulting from the emissions released in their production processes, rather than the products themselves.[110]

In the meantime, products with differing carbon intensities are likely to be regarded

[107] Connie Roser-Renouf and others "The Consumer as Climate Activist" (2016) 10 Int J Commun 4759 at 4760.

[108] *EC—Asbestos*, above n 100, at 122.

[109] See "Climate change and health" (1 February 2018) World Health Organisation <https://www.who.int/news-room/fact-sheets/detail/climate-change-and-health>.

[110] Mehling, above n 17, at 461.

as "like" for the purposes of Article III:2, first sentence, even where 'likeness' is construed narrowly. Such a determination might be avoided where there is empirical evidence of consumers treating carbon-intensive and non-carbon-intensive products differently, but this would presumably need to be on a large scale. Alternatively, criteria such as health effects would need to be interpreted widely, and gain pre-eminence in GATT/WTO 'likeness' jurisprudence more generally. It hardly seems unreasonable to argue for such an approach, given the gravity of the climate emergency.

(c) the measure must tax imports "in excess of" domestic products.

As for the final element required to contravene Article III:2, the AB has ruled that any "even the smallest amount of 'excess' is too much".[111] Holzer contends that a violation is likely to arise in the context of an ETS, given the "peculiarities of an ETS as an emissions reduction policy instrument".[112] For the EU ETS in particular, participating installations bear differing costs with respect to emissions allowances, because there are a number of different methods for reducing such costs.[113] The proposed EU BTA would therefore need to be based on the lowest 'taxes' (i.e. emissions allowance costs) incurred by domestic producers subject to EU ETS requirements, if it is to stand any chance at avoiding a violation. However, this is much easier said than done. As noted earlier, this will in turn have implications for whether an EU BTA can be deemed a charge "equivalent" to an internal tax under Article II:2(b).

2 Article III:2, second sentence

Even if an EU BTA was found not to violate Article III:2, first sentence, it would still need to comply with the Article's second sentence. The purpose of this sentence is to cover the situation where products are deemed 'unlike' (and so differential taxes are not discriminatory according to the test in the first sentence), but nevertheless, the taxes in the importing country still have a negative impact on the competitive

[111] *Japan—Alcohol*, above n 103, at 23.

[112] Holzer "Carbon-related Border Adjustment", above n 69, at 132.

[113] For example, firms could cut production volumes to reduce emissions and sell surplus allowances on the carbon market. Alternatively, they may switch to low-carbon technologies in some aspects of their production process, again reducing the number of allowances required.

opportunities of imported products.

Leaving aside the fact that the measure must be an "internal tax", a violation of Article III:2, second sentence requires that three elements be satisfied.[114] These are as follows:

(a) that the measure concerns domestic and imported products which are "directly competitive or substitutable"

This first element is broader than that of "like" products, although just how much broader is to be determined on a case-by-case basis.[115] It requires a WTO panel to look not only at matters such as the products' physical characteristics, common end-uses and tariff classifications, but also at the "market place".[116] That being said, the AB confirmed that the decisive criterion in determining whether two products are directly competitive or substitutable is the commonality of their end-uses, *inter alia*, as shown by the elasticity of substitution of the products.[117] This focus on end-uses is substantively different to, and less onerous than, the 'likeness' test in Article III:2, first sentence, and will likely prove challenging for an EU BTA to surmount. Continuing with the aluminium example, it would be incredibly difficult to argue that the Chinese aluminium with the greater carbon footprint is not readily substitutable for the 'greener' German aluminium, insofar as it is needed for, say, architectural purposes. However, the AB has also opined in a more recent case that "what constitutes a competitive relationship between products may require consideration of inputs and processes of production".[118] This statement is significant in that it could open up the possibility for a policy-based argument that GATT/WTO jurisprudence should evolve to accommodate contemporary challenges like climate change, such that products' relative carbon intensities are able to be considered in determining whether a competitive relationship exists.

[114] GATT Article III:1 and *ad* Article III:2.

[115] *Japan—Alcohol*, above n 103, at 25.

[116] At 25.

[117] At 25-26. Elasticity of substitution refers to changes in the quantity demanded of one product associated with a change in price of the other product.

[118] *Canada—Certain Measures Affecting the Renewable Energy Generation Sector* GATT BISD WT/DS412/AB/R, WT/DS426/AB/R 6 May 2013 (Report of the Appellate Body Adopted on 24 May 2013) at [5.63].

(b) the products are "not similarly taxed"

Significantly, "not similarly taxed" is a far more lenient requirement than the "in excess of" condition contained in the first sentence. The AB has held that the tax differential must be "more than *de minimis*" to contravene this element.[119] An EU BTA is therefore likely to have greater scope for compliance under this standard, but those designing and calculating the tax should still err on the side of caution.

(c) dissimilar taxation is applied "so as to afford protection to domestic production"

In the event that an EU BTA is found to tax directly competitive or substitutable products dissimilarly, the EU could attempt to argue that it does not afford protection to domestic production. Whilst there is no single test for making this evaluation, the AB offered some guidance in *Japan—Alcohol,* requiring that a "comprehensive and objective analysis" of the design, the architecture, and the revealing structure of a measure be conducted.[120] In other words, it is not about the *intent* behind the measure. Importantly, the AB also noted that where there the tax differential is significant, it will be clear that the dissimilar taxation was applied "so as to afford protection", but that in some cases, others factors will be just as relevant, if not more relevant to making this determination.[121]

Like most of the foregoing analysis, ascertaining whether or not an EU BTA will be applied "so as to afford protection to domestic production" is a fairly speculative exercise, given no EU BTA presently exists. What is interesting though is that the discussion in Chapter I suggests that the primary rationale behind import-side BCAs is to prevent imports that are not subject to a carbon pricing scheme from gaining an unfair competitive advantage over domestic products that are so subject. It would therefore seem contradictory for the EU to claim that it needs a carbon-focused BTA

[119] *Japan—Alcohol*, above n 103, at 27. *De minimis* is understood as being 'something of little or no importance': Holzer, "Carbon-related Border Adjustment", above n 69, at footnote 459.

[120] At 29.

[121] At 30.

in part to address competitiveness concerns, but then turn around and contend under an Article III investigation that low-carbon and carbon-intensive products do not compete in the first place. However, because the design and application of an EU BTA is to be assessed objectively, it is not necessarily the case that this contradictory position would actually reveal itself.

3 Conclusion on the likelihood of compliance with Article III:2 in its entirety

In summary, an EU BTA would likely contravene both sentences of Article III:2. In the case of Article III:2, first sentence, a violation would mainly be attributable to the fact that products with differing carbon intensities are – in the short-term at least – likely to be regarded as "like". Similarly, such products are also likely to be regarded as "directly competitive or substitutable" for the purposes of Article III:2, second sentence, unless a WTO panel accepts a policy-based argument that relative carbon intensities should be a relevant factor for making this determination (and subsequently gives this factor enough weight so that no competitive relationship is found).

F Is an EU BTA Also Likely to Violate the MFN Obligation in Article I:1?

Another core non-discrimination obligation is the MFN principle set out in Article I:1, which requires States to avoid discriminating *between* imports from different countries. For an EU BTA to contravene this principle, the following elements would all need to be satisfied:[122]

1 It must be the type of measure regulated by Article I

Article I:1 applies "to customs duties and charges of any kind imposed on or in connection with importation… and with respect to all matters referred to" in Article III:2. This element is therefore likely to be satisfied, in light of the conclusions drawn from Sections B and C.

2 The measure must create an "advantage"

[122] These elements are all paraphrased from the text of Article I:1.

This element poses significant challenges for an EU BTA. On the one hand, applying a BTA only on imports from countries with weak or no climate policies (such as China, Brazil or India) would be granting an advantage to countries with stricter climate policies (like NZ). On the other hand, if a BTA applied uniformly to all imports, regardless of the existence and/or stringency of any climate policies, the EU would presumably be in compliance with its MFN obligations. However, this sort of BTA would likely be challenged by countries with emissions-reductions instruments in place, on the grounds that their exports are paying the price of carbon twice: once under their domestic climate policies (for example, under the NZ ETS); and again upon entry into the EU. In that scenario, it is the exporters from countries like China that would be granted an advantage.[123]

A possible response to this latter issue of 'double taxation' would be for countries like NZ to rebate any tax borne by their products upon exportation to the EU. This is, after all, the flip side of BTAs: NZ goods would be granted a rebate upon exportation, but under the destination principle of taxation, would pay the EU border carbon tax when imported into the EU. Thus, if New Zealand exports are doubly taxed, it is not because the EU is taxing imports, but because New Zealand failed to rebate exports.[124] But there are problems with this sort of response. For one, it imposes an additional administrative burden on countries that have elected to implement some form of carbon pricing plan in order to reduce emissions. This in turn may disincentivise trading partners that are already 'free-riding' on these efforts from taking comparable climate action. Moreover, reimbursing emissions costs makes no sense from the perspective of climate change mitigation policy, as it does not stimulate emissions reductions in the country imposing the BCA/BTA scheme, nor in exporting countries.[125]

3 The products affected by the measure must be "like"

In light of the analysis in Section E.1(c), this element would likely be satisfied.

[123] Applying similar reasoning to that seen in Pauwelyn "Carbon Leakage Measures", above n 50, at 42.

[124] Again applying similar reasoning to that seen in Pauwelyn at 42.

[125] Karapinar and Holzer, above n 22, at 23.

4 *There must be a failure to offer the advantage to all products "unconditionally"*

This final element is also likely to prove troublesome, should an EU BTA be based on the carbon footprints of products. In *Indonesia—Autos,* the Panel held that MFN treatment "cannot be made conditional on any criteria that are not related to the imported product itself."[126] Prima facie, it would therefore be inadmissible for the EU to distinguish between countries based on non-product-related PPMs (npr-PPMs) like relative carbon intensities.[127] At the same time, a subsequent panel arguably opened up the possibility for such PPM-related measures, provided they are genuinely origin-neutral.[128] An EU BTA that is based on the objectively determined carbon footprint of a product or its producer could well meet this test. However, Krenek submits that an EU BTA, insofar as it is based on individual carbon footprints, is "doomed". He attributes this both to the impracticality of such a measure, and the fact that establishing 'production method' as the main criterion for discrimination between products is too radical an approach to the MFN inquiry, and therefore is unlikely to be accepted.[129] No doubt such a BTA would be administratively burdensome to implement, and therefore an important consideration for the EU to keep in mind. Nonetheless, a policy-based argument similar to that discussed in Section E.2(a) could be advanced, namely, that if there was any time to take a 'radical' approach to GATT/WTO rules, it is in the face of a climate crisis.

In summary, however, there is a strong possibility that an EU BTA would also violate the MFN principle in Article I:1.

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[126] *Indonesia—Certain Measures Affecting the Automobile Industry* GATT BISD WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, 2 July 1998 (Report by the Panel Adopted on 23 July 1998) at [14.143].

[127] Mehling, above n 17, at 463.

[128] *Canada—Certain Measures Affecting the Automotive Industry* GATT BISD WT/DS139/R, 11 February 2000 (Report by the Panel Adopted on 19 June 2000) at [10.25]. The Panel suggested that if conditions do not relate to the country of origin, they may be permissible.

[129] Alexander Krenek "How to implement a WTO-compatible full border carbon adjustment as an important part of the European Green Deal" (February 2020) ÖGfE <https://oegfe.at/2020/01/wto-compatible-bca-green-deal/#_ftn7>.

G Is an EU BTA Likely to Be Justifiable Under GATT Article XX (General Exceptions)?

As an EU BTA is likely to violate both the National Treatment and MFN obligations in Articles III:2 and I:1, respectively, we must consider whether the measure could nonetheless be justified under Article XX.

Article XX provides a closed list of public policy exceptions to GATT-inconsistent measures. Historically, GATT panels have construed these exceptions narrowly, noting that they are "limited and conditional".[130] However, post-1995 GATT/WTO jurisprudence is regarded as being much more flexible and 'greener', which is a promising development for the purposes of an EU BTA.[131]

Importantly, WTO Members hoping to rely on an Article XX exception must pass a two-tier test.[132] First is what is known as 'provisional justification', whereby a country must prove that its measure comes under one of the exceptions listed in Article XX. Countries can choose which exception(s) to invoke, and they need only succeed under one. Provided it can do so, the measure is then assessed for compliance with the requirements of the Article XX chapeau.

Although there is no GATT exception directly relating to climate policy measures, Articles XX(b) and XX(g) are the most relevant for the purposes of an EU BTA.[133] These exceptions will now be addressed in turn.

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[130] *United States—Import Prohibition of Certain Shrimp and Shrimp Products* GATT BISD WT/DS58/AB/R, 12 October 1998 (Report of the Appellate Body Adopted on 6 November 1998) [hereinafter U.S.—*Shrimp*] at [157]; and Holzer "Carbon-related Border Adjustment", above n 69, at 149.

[131] Pauwelyn "Carbon leakage measures", above n 50, at 44-45.

[132] *United States—Standards for Reformulated and Conventional Gasoline* GATT BISD WT/DS2/AB/R, 29 April 1996 (Report of the Appellate Body Adopted on 20 May 1996) [hereinafter *U.S.—Gasoline*] at 22.

[133] Note that Holzer, "Carbon-related Border Adjustment", above n 69; Mehling, above n 17; and Pauwelyn "Carbon leakage measures", above n 50 all agree that these are the most relevant exceptions, however their discussions concern BCA measures more generally (rather than an EU-specific BTA).

1 *Article XX(b)*

Article XX(b) provides an exception for measures that are "necessary to protect human, animal or plant life or health". At this point, there can – or at least should – be no doubt that climate change threatens each of these objectives, given the overwhelming evidence about the risks associated with rising sea levels and increased frequency of extreme weather events.[134] Indeed, the panel in *Brazil—Taxation* clearly stated that:[135]

> "the reduction of CO_2 emissions is one of the policies covered by subparagraph (b) of Article XX, given that it can fall within the range of policies that protect human life or health."

This is to be distinguished from an economic rationale (for example, restoring the competitiveness of domestic producers in energy-intensive industries), which would not be regarded as a legitimate objective under Article XX(b).[136] Whilst there is nothing to stop a measure being justifiable even where it does have a dual objective, the EU should nonetheless exercise caution, characterising its proposed BTA as a measure seeking to encourage emissions reductions (via the prevention of carbon leakage), first and foremost.

Where the real challenge will lie for the EU under Article XX(b) is proving that its BTA is a *necessary* measure. Based on the findings from various WTO disputes, the necessity test is one that requires a "weighing and balancing" of at least three key elements.[137]

(a) Effectiveness

In *Korea—Beef*, the AB held (albeit in the context of paragraph (d)) that necessity does

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[134] See "Global Warming of 1.5°C" (2018) Intergovernmental Panel on Climate Change <https://www.ipcc.ch/sr15/>.

[135] *Brazil—Certain Measures Concerning Taxation and Charges* GATT BISD WT/DS472/R, WT/DS497/R, 30 August 2017 (Report by the Panel Adopted on 11 January 2019) at [7.880]. However, the finding in this case was largely related to the effects of transport emissions on air quality, rather than on the climate or atmosphere.

[136] Tracey Epps and Andrew Green *Reconciling Trade and Climate: How the WTO Can Help Address Climate Change* (Edward Elgar Publishing, Cheltenahm, UK, 2010) at 144–47.

[137] Mehling, above n 17, at 465.

not require a measure to be "indispensable" or "of absolute necessity" or "inevitable".[138] However, the AB in *Brazil—Retreaded Tyres* emphasized that the measure should nonetheless make a "material contribution" to achieving its objective.[139] In other words, there must be a "genuine relationship of ends and means between the objective pursued and the measure at issue".[140] That being said, the AB was prepared to treat trade-restrictive measures designed to offset complex health or environmental problems – the contributions of which may not be immediately observable – with some latitude.[141] Significantly, it even noted that "the results obtained from certain actions – for instance, measures adopted in order to attenuate global warming and climate change … can only be evaluated with the benefit of time."[142] This is particularly promising for an EU BTA, given that it is difficult at present to establish a close nexus between such a measure and the objective of preventing carbon leakage (as carbon leakage is, for the most part, a theoretical phenomenon). Provided an EU BTA is directed at the most carbon-intensive, (presumed) leakage-exposed sectors, it may stand a good chance of proving a material contribution to this objective, at least in the future.[143]

That being said, Holzer draws attention to the complications arising from the fact that generally, carbon-related border adjustment measures are foreseen as being measures linked to production and process methods (PPMs) abroad.[144] She notes that this extraterritorial element may weaken the causal link between such measures and their respective policy objectives, meaning they fail to pass the necessity test.[145] This is

[138] *Korea—Measures Affecting Imports of Fresh, Chilled and Frozen Beef* GATT BISD WT/DS161/AB/R, WT/DS169/AB/R, 11 December 2000 (Report of the Appellate Body Adopted on 10 January 2001) [hereinafter *Korea—Beef*] at [161].

[139] *Brazil—Measures Affecting Imports of Retreaded Tyres* GATT BISD WT/DS332/AB/R, 3 December 2007 (Report of the Appellate Body Adopted on 17 December 2007) [hereinafter *Brazil—Tyres*] at [151].

[140] *Brazil—Tyres*, above n 139, at 145.

[141] Granted this case was not about climate change as such, but the health and environmental effects of retreaded tyres.

[142] *Brazil—Tyres*, above n 139, at 151.

[143] Mehling, above n 17, makes a similar point about BCAs more generally at 465.

[144] Holzer "Carbon-related Border Adjustment", above n 69, at 154.

[145] At 154.

certainly an important consideration for an EU BTA. While the EU bloc likely has the economic power capable of influencing the PPMs of some of its trading partners, under the WTO principle of equality of Member States, a country's economic power cannot be a legitimate consideration in the application of exceptions under Article XX.[146] Notwithstanding, the point made in Chapter I about the world's atmosphere being a global commons – with carbon emissions being equally dangerous no matter where emitted– could support an argument of necessity here, as climate change is ultimately a collective action problem.

(b) Proportionality

Secondly, the measure must be proportionate to the values it seeks to protect.[147] In *Korea—Beef*, the AB found that "[t]he more vital or important [the] common interests or values pursued [by the measure] the easier it would be to accept as 'necessary' measures designed to achieve those ends".[148] Climate change deniers and certain Paris Agreement withdrawals aside, an EU BTA should satisfy the proportionality test fairly easily, in light of the immense global importance attached to the climate emergency. However, it would still be advisable that the EU take care in how it charactersises its objective here: if it is to prevent climate change, it may be more difficult to say a BTA specifically is necessary, but if its objective is something less – namely, to limit carbon leakage – it will likely be easier to prove a BTA's necessity.

The AB has also displayed an appreciation for the level of circumspection with which some Member States might approach issues falling under paragraph (b). In *EC—Asbestos*, it was held to be "undisputed that WTO Members have the right to determine the level of protection that they would consider appropriate in a given situation".[149] Moreover, academics have noted that there is no real 'proportionality' test in WTO law, according to which the reasonableness of protection levels could be measured.[150] Some have gone so far as to say that a WTO panel or the AB would accept

[146] Christine Conrad *Processes and Production Methods (PPMs) in WTO Law: Interfacing Trade and Social Goals* (Cambridge University Press, Cambridge, UK, 2011) at 391-394.

[147] Holzer "Carbon-related Border Adjustment", above n 69, at 152.

[148] *Korea—Beef*, above n 138, at [162].

[149] At [168].

[150] Patrick Low, Gabrielle Marceau, and Julia Reinaud "The Interface between the Trade and Climate Change Regimes: Scoping the Issue" (paper presented to TAIT second conference on Climate Change,

a level of protection corresponding to zero risk, particularly where human health is concerned.[151] The EU could take advantage of this general position to argue that the proposed BTA is considered to be an appropriate level of protection relative to the risks posed by climate change (or more specifically, carbon leakage). It could even try and argue that, given the gravity of the climate crisis, it could have gone even further than introducing a BTA, therefore this measure should be justified. Given that the AB has previously taken an evolutionary approach to the interpretation of the GATT exceptions,[152] it could feasibly accept a novel argument like this regarding proportionality.

(c) Available alternatives

Finally, proving necessity requires the absence of an "alternative measure that would achieve the same end and that is less restrictive of trade."[153] Here, the burden of proof shifts to the complainant, who must prove the reasonable availability of such an alternative.[154] As there is a lot of policy development going on in the climate space, there are likely to be various alternatives that a complainant might suggest, although this will require considerable research.[155] In the context of an EU BTA, perhaps the most obvious alternative would be the free allocation of emissions allowances to all domestic producers. But there is a problem with this: why would the EU ETS (and similarly the NZ ETS) have adopted a 'grandfathering' approach to phase out the free allocation of emissions allowances, if not for the fact that free allocation fails to incentivise firms to undertake ambitious emissions reductions?[156] Moreover, critics

Trade and Competitiveness: Issues for the WTO, Geneva, June 2010) at 12-13 and footnote 27.

[151] At footnote 27.

[152] This will be mentioned in relation to Article XX(g) under Section G.2(a), based on *U.S.—Shrimp*, above n 130.

[153] *EC—Asbestos,* above n 100, at [174]; and *Brazil—Tyres*, above n 139, at 211.

[154] *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services* GATT BISD WT/DS285/AB/R, 7 April 2005 (Report of the Appellate Body Adopted on 20 April 2005)at [309].

[155] One alternative would be the use of carbon regulations on imports. However, as previously noted, an in-depth discussion on regulations is outside the scope of this dissertation.

[156] "EU emissions trading: 5 reasons to scrap the ETS" (26 October 2015) Corporate Europe Observatory <https://corporateeurope.org/en/environment/2015/10/eu-emissions-trading-5-reasons-scrap-ets>.

have highlighted that free allocation under the EU ETS has resulted in a number of unintended consequences. These include windfall profits, muted policy signals along the value chain, perverse incentives to increase production, and downward pressure on the price of allowances.[157] Thus, it is not entirely clear whether a complainant could successfully prove the existence of an alternative measure here. It is also highly dependent on the greater policy context of an EU BTA and how its various components would interact, which we cannot presently determine.

Overall, it would seem that an EU BTA has decent prospects for justification under Article XX(b). That being said, passing all three elements of the necessity test (and any other considerations a WTO panel might deem relevant) is still no easy feat.

2 *Article XX(g)*

In light of the above, the EU might have a simpler time defending a carbon-focused BTA under Article XX(g) instead, as this paragraph is considered to offer a more lenient assessment.[158] Under paragraph (g), a GATT-inconsistent measure may be justified if it is one "relating to the conservation of exhaustible natural resources," provided the measure is also "made effective in conjunction with restrictions on domestic production or consumption."

(a) "Exhaustible natural resource"

If the EU were to invoke Article XX(g) to justify its BTA, the first question that would arise is whether a 'safe' climate[159] can be considered an "exhaustible natural resource". In *U.S.—Shrimp*, the AB took an evolutionary approach to this term, opining that it should be interpreted "in light of the contemporary concerns of the community of nations about the protection and conservation of the environment."[160] It seems a straightforward argument for the EU that if a safe climate were not an exhaustible natural resource, the international community would not have given such high

[157] Karsten Neuhoff and others *Inclusion of Consumption of carbon intensive materials in emissions trading – An option for carbon pricing post-2020* (Climate Strategies, May 2016) at 3.

[158] Mehling, above n 17, at 466.

[159] In other words, a climate that does not pose any risks – to borrow the wording of Article XX(b) – to human, animal or plant life or health.

[160] *U.S.—Shrimp*, above n 130, at [129].

priority to climate change issues, and we would not have international treaties such as the Paris Agreement or the United Nations Framework Convention on Climate Change (UNFCCC).

U.S.—Shrimp is a particularly interesting case for the purposes of carbon BTAs. The case involved a U.S. ban on shrimp imports where the shrimp had been harvested with technologies known to kill endangered turtles. This ban was deemed provisionally justifiable under Article XX(g), even though the migratory nature of these turtles meant they were not always found in U.S. waters.[161] Academics have reasoned that if the U.S. was permitted to protect turtles in the Indian Ocean that occasionally migrated to U.S. waters, a sufficient nexus should also be considered to exist between carbon emitted abroad and the regulatory measure of another country seeking to mitigate the effects of these emissions.[162] This case therefore provides useful guidance for Members wanting to justify future measures aimed at conserving exhaustible natural resources *abroad*. Moreover, it is important to note the *PPM*-related nature of the U.S. measure (in particular, the requirement that exporters of shrimp to the U.S. prove that their shrimp trawlers used 'Turtle Excluder Devices' (TEDs)[163]). Holzer contends that this dispute therefore demonstrated that WTO panels or the AB could, in principle, permit the unilateral imposition of PPM-related measures under this paragraph.[164]

Meanwhile, the *panel* report in *U.S.—Gasoline* ruled that clean air is an exhaustible natural resource for the purposes of Article XX(g).[165] It reached this conclusion having

[161] Pauwelyn "Carbon Leakage Measures", above n 50, at 45-46.

[162] Particularly when science has shown that emissions are detrimental to the climate regardless of where they are emitted. Referring to this case, Stiglitz noted that "if one can justify restricting importation of shrimp in order to protect turtles, certainly one can justify restricting importation of goods produced by technologies that unnecessarily pollute our atmosphere: Joseph Stiglitz "New Agenda for Global Warming" (2006) 3 Econ Voice 1 at 2. Holzer "Carbon-related Border Adjustment", above n 69, at 154; and Mehling, above n 17, at 466-467 also make similar arguments.

[163]It is important to note, however, that the U.S. did ultimately *lose* this case, but this was because it violated the Article XX chapeau, not because it sought to protect the environment.

[164] Holzer "Carbon-related Border Adjustment", above n 69, at 154.

[165] *U.S.—Gasoline* WT/DS2/9, 29 January 1996 (Report by the Panel Adopted on 20 May 1996) at 6.37. This ruling was made in relation to the panel's consideration of air pollution, an environmental issue with obvious parallels to climate change. While this dispute was subsequently decided upon by the Appellate Body, who did not approve of some of the panel's reasoning regarding the other legal tests under Article XX(g), the Appellate Body did not specifically address this issue of whether clean air is

found that clean air has a value (hence, it is a resource), it is natural, and because even though it is renewable, it can be depleted (therefore it is exhaustible).[166] The same could be said for the climate. What is more, climate change itself is associated with the depletion of other exhaustible natural resources, such as forests, fisheries and biodiversity.[167] Importantly, the panel in *U.S.—Gasoline* also confirmed that "the fact that the depleted resource was defined with respect to its qualities [is] not… decisive".[168] The climate can similarly be viewed in terms of atmospheric quality, because it is commonly defined as the average weather, or atmospheric conditions over longer periods of time.[169] Thus, if a policy to limit the depletion of clean air can be regarded as conserving a natural resource, by analogy, so too should an EU BTA aimed at reducing carbon emissions that cause climate change.

It therefore seems fair to say that it would come as a surprise if a WTO panel did not deem the climate an exhaustible natural resource for the purposes of Article XX(g).

(b) "Related to"

The second element of this provision requires that the EU BTA "relate to" the conservation of a safe climate. Much like under the necessity test in Article XX(b), the EU would need to demonstrate "a close and genuine relationship of ends and means".[170] In particular, the legislation governing the BTA must not be "disproportionately wide in its scope and reach in relation to the policy objective of protection and conservation", nor can it just be "incidentally or inadvertently aimed at" this objective. As Pauwelyn notes, this test was easily met in both *U.S.—Gasoline* and *U.S.—Shrimp*, prompting him to conclude that, "unless there are blatant inconsistencies or protectionist features in the domestic legislation, climate change

an exhaustible resource or not, hence there is still some scope here for the climate argument.

[166] Holzer "Carbon-related Border Adjustment", above n 69, at 155.

[167] Mehling, above n 17, at 467.

[168] Above, n 165, at [6.37].

[169] See Susan Solomon and others *Climate Change 2007: The Physical Science Basis. Contribution of Working Group I to the Fourth Assessment Report of the Intergovernmental Panel on Climate Change* (Cambridge University Press, 2007) at Glossary.

[170] *U.S.—Shrimp,* above n 130, at [136].

legislation should normally pass this 'related to' test."[171] Whilst such a verdict remains at a WTO panel's discretion, it nonetheless seems that an EU BTA would pass the "related to" test, so long as the EU takes cake care to emphasise the environmental (and not the economic) objectives of a BTA.[172]

(c) "Made effective in conjunction with restrictions on domestic production and consumption"

An EU BTA must also comply with Article XX(g)'s final qualifier, above. At a general level, if a BTA is being implemented to address carbon leakage concerns arising out of the EU ETS, it would seem logical to call this a measure made effective in conjunction with restrictions on the domestic market. From a legal standpoint, the AB in *U.S.—Gasoline* explained this as a "requirement of even-handedness," but not "identical treatment of domestic and imported products."[173] The AB has since qualified this statement by noting that "a measure that would impose a significantly more onerous burden on foreign consumers or producers" is unlikely to pass this element of the Article XX(g) test.[174] Thus, in the case of an EU BTA, provided it is carefully designed so as not to be unduly burdensome on imported products, it would still meet this test, even if imported and domestic products are not treated equally.[175]

In conclusion, an EU BTA is highly likely to satisfy all three elements of the Article XX(g) test.

3 Article XX chapeau

While the preceding analysis suggests that an EU BTA could be provisionally justified under Article XX(b) and XX(g) – albeit with a greater chance of success under the latter

[171] "Carbon Leakage Measures", above n 50, at 47.

[172] These being, as discussed, preventing carbon leakage and generally reducing emissions (with the economic objective being to level the playing field for domestic producers subject to the EU ETS).

[173] Above, n 132, at [21]; and referred to in Mehling, above n 17, at 467.

[174] *China— Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum* WT/DS431/AB/R, WT/DS432/AB/R, WT/DS433/AB/R, 7 August 2014 (Report of the Appellate Body Adopted on 29 August 2014) at [5.134].

[175] The fact that the GATT can accommodate for variation in the carbon restrictions imposed is especially significant, given the earlier tension around whether or not the EU ETS can properly be characterised as a 'tax' on domestic producers.

– that is not the end of the story. In either case, it will still need to comply with the requirements in the chapeau of Article XX. What this means for an EU BTA is that it cannot be applied in a manner that would constitute "a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade".

Before looking at this clause in more detail, we must take heed of the fact that the AB has placed considerable emphasis on Article XX's chapeau in the past, being known to adopt a restrictive approach.[176] Indeed, Pauwelyn argues that the chapeau may be the most important provision in the GATT regarding the legality of BCAs/BTAs.[177] The burden on the EU to prove that a BTA complies with the chapeau's requirements is therefore heavier than the burden of showing that a BTA falls under one of the Article XX paragraphs in the first instance.[178] This is because the chapeau is considered to be an articulation of the principle of good faith: it ensures that WTO Members do not abuse the right to invoke the GATT exceptions, thus giving due regard to the rights of other Members to market access under the GATT.[179] Consequently, a chapeau analysis not only looks at the manner in which a measure is applied, but the measure's design, contents and nature.[180]

These general principles aside, GATT/WTO jurisprudence offers little guidance as to how the chapeau's three conditions should be interpreted, nor an explanation of the differences between them.[181] We can, however, make some preliminary points. Firstly, the "discrimination" to be avoided under the chapeau is different from the discrimination targeted by the National Treatment (Article III) and MFN (Article I) obligations.[182] The latter are concerned with the discriminatory *effect(s)* of a measure,

[176] Holzer "Carbon-related Border Adjustment", above n 69, at 165-166; and Pauwelyn "Carbon Leakage Measures", above n 50, at 47.

[177] At 47.

[178] In accordance with the principles established in *U.S.–Gasoline* (AB Report) above, n 132, at 23.

[179] Ludivine Tamiotti and others *Trade and Climate Change* (United Nations Environment Programme and the World Trade Organization, DTI/1188/GE, 2009) at 109.

[180] Pauwelyn "Carbon Leakage Measures", above n 50, at 47.

[181] Holzer "Carbon-related Border Adjustment", above n 69, at 167-168.

[182] The chapeau concerns "arbitrary or unjustifiable discrimination between *countries* where the same conditions prevail", whereas Articles I and III focus on discrimination between "like *products*"

meanwhile the former addresses discriminatory *intent*. Secondly, and quite logically, the discrimination under the chapeau must be different in "nature and quality", or "go beyond" the discrimination established under Articles I and/or III.[183]

(a) Arbitrary or unjustifiable discrimination

In testing to see whether an EU BTA arbitrarily or unjustifiably discriminates between countries where the same conditions prevail, there are a number of questions a WTO panel might raise.[184]

(i) What kind of climate policies does the EU require from exporting countries?

A panel may begin by asking whether the measure requires exporting countries to copy the EU's climate policies, or if it takes into account climate efforts of exporting countries that differ from the EU's own. This inquiry emerges from the various *U.S.–Shrimp* disputes: the AB initially rejected the U.S. ban on shrimp imports because it required all exporting countries to adopt "essentially the same policy" (use of TEDs), while "other specific policies and measures that an exporting country may have adopted for the protection and conservation of sea turtles [were] not taken into account".[185] However, once the ban was modified to require "the adoption of a program *comparable in effectiveness*" to the U.S. one, it no longer constituted "arbitrary or unjustifiable discrimination".[186]

For present purposes, it would be both absurd and wholly unworkable if the EU required countries to have an ETS in place to avoid a BTA on their carbon-intensive exports to the EU. So, for example, while certain products exported from NZ might be exempt from a BTA where they have already paid similar emissions costs under the NZ ETS, the EU would also need to acknowledge the heterogeneity of climate policy

(emphasis added): Pauwelyn "Carbon Leakage Measures", above n 50, at 48.

[183] At 48.

[184] The general framework for examining a measure under the chapeau is attributed to Pauwelyn "US Federal Climate Policy", above n 11, at 38.

[185] *U.S.—Shrimp,* above n 130, at [161].

[186] At [161] and [163] (emphasis added).

measures among its other trading partners, and factor these into a BTA's application. Of course, this is much easier said than done. Some countries might have price-based carbon measures in place,[187] others might have non-price-based measures.[188] Some countries might have a combination, and others, no climate policies whatsoever. Even in countries where there is an ETS, how can the EU know that the *same* conditions prevail? Drafting a BTA that takes into account all this variation will be a complex and lengthy task, complicated further by asymmetric information. In theory though, such a measure would pass this requirement in the chapeau.

(ii) "Basic fairness and due process"

Another important question is whether an EU BTA is administered in accordance with "basic fairness and due process".[189] This requires a "transparent" and "predictable" process that offers formal opportunities for any concerned countries "to be heard, or to respond to any arguments". [190] In the present context, this could involve a collaborative effort between the EU and its key trading partners to establish what constitutes a climate policy measure comparable to the EU ETS, with the chance to appeal any decisions.[191] A less onerous alternative (for the EU at least) would perhaps be to allow foreign producers to prove that the carbon intensity of their products is lower than similar EU products subject to the ETS.[192] Furthermore, academics have suggested that any country implementing a border carbon adjustment measure should allow a reasonable 'phase-in period' to reduce the burden on countries affected by the measure and afford them time to scale up their own climate efforts.[193]

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[187] For example, carbon taxes and ETSs.

[188] For example, emissions regulations.

[189] *U.S.—Shrimp,* above n 130, at [181].

[190] At [180].

[191] This is similar to a suggestion made about BCAs more generally by Harro van Asselt, Thomas Brewer and Michael Mehling "Addressing Leakage Competitiveness in US Climate Policy: Issues Concerning Border Adjustment Measures" (2009) 38 Energy Policy 42 at 56. The purpose of such an exercise would be to determine whether a country exporting carbon-intensive products to the EU qualifies for a lower BTA rate or perhaps an exemption entirely.

[192] Mehling, above n 17, at 468. However, I think this suggestion is probably too simplified and would probably ignite the "like" products debate (from Articles I and III) once more.

[193] At 468; and Holzer "Carbon-related Border Adjustment", above n 69, at 175. Similar sentiments were echoed in *U.S.—Shrimp,* above n 130, at [174], albeit not in relation to BCAs.

(iii) "Serious, across-the-board negotiations"

Crucially, the EU would also be expected to have engaged in "serious, across-the-board negotiations with the objective of concluding bilateral or multilateral agreements" on climate action before introducing a BTA.[194] This requirement reflects the WTO ethos of preferring multilateral solutions over unilateral measures.[195] These negotiations should be conducted on a non-discriminatory basis and involve all affected countries (of which, presumably, there would be many).[196] There is, however, an important caveat: "serious good faith efforts to reach an agreement" are required, but an agreement itself does not have to be concluded.[197] It has been suggested that participation in climate talks under the auspices of the UNFCCC, or the negotiations which led to the Paris Agreement, would count as sufficient multilateral efforts to reach a solution before imposing a BCA measure.[198] However, given the restrictive approach the AB has taken to the conditions of the Article XX chapeau, it would be prudent for the EU to engage in negotiations addressing a BTA specifically, if it is to avoid allegations of arbitrary or unjustifiable discrimination.

(b) "Disguised restriction on international trade"

GATT/WTO jurisprudence has tended to place the emphasis on the "disguised", rather than "restriction" component of this condition in the chapeau.[199] With this in mind, three criteria have been devised for determining whether a measure constitutes a disguised restriction on international trade.

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[194] At 166: albeit this requirement was not made in the context of a BCA/BTA dispute.

[195] Holzer "Carbon-related Border Adjustment", above n 69, at 174.

[196] *U.S.—Shrimp,* above n 130, at [169]-[172].

[197] *United States—Import Prohibition of Certain Shrimp and Shrimp Products (Recourse to Article 21.5 by Malaysia)* GATT BISD WT/DS58/AB/RW, 22 October 2001 (Report of the Appellate Body Adopted on 21 November 2001) [hereinafter *U.S.—Shrimp (Recourse to Article 21.5 by Malaysia)*] at [134].

[198] Mehling, above n 17, at 468-469; and Holzer "Carbon-related Border Adjustment", above n 69, at 174.

[199] Holzer at 175-176.

First is the 'publicity' test, which examines whether or not a measure has been publicly announced by official sources.[200] Given the European Commission's "Green Deal" and proposal to implement a border carbon tax has been widely publicised, a future EU BTA should have no problem passing this test.

Secondly, as all three of the chapeau's conditions are considered to inform each other, the AB has held that whether a measure amounts to arbitrary or unjustifiable discrimination should also be taken into account.[201] The previous discussion is therefore relevant.

Finally, "the design, architecture and revealing structure" of a measure should be considered.[202] Again, we can only speculate on this. It may well be that certain industries in the EU would benefit more than others (perhaps because they are genuinely cleaner than their foreign counterparts), and their foreign counterparts would therefore take issue with the scheme. Meanwhile, others might not. In other words, an EU BTA would presumably cover a wide range of industries, and the impacts would likely be industry-dependent. However, provided an EU BTA does not appear overtly protectionist in its drafting, it should clear this last test.

Ultimately, provided great care is taken in the negotiations, drafting and application of a climate-focused BTA, the EU may well be found to have complied with the conditions of the Article XX chapeau.

E Conclusion

In conclusion, this Chapter has shown that – while by no means a straightforward process – it is entirely possible that the proposed EU BTA will be deemed WTO-compliant, by virtue of being a justifiable (albeit discriminatory) measure, most likely under GATT Article XX(g).

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[200] *United States—Prohibition of Imports of Tuna and Tuna Products from Canada* L/5198 (Report by the Panel Adopted on 22 February 1982) at [4.8].

[201] *U.S.—Gasoline,* above n 132, at [25].

[202] *U.S.—Shrimp (Recourse to Article 21.5 by Malaysia)* at [142].

CHAPTER III: SUGGESTIONS FOR A NEW ZEALAND RESPONSE TO AN EU BORDER CARBON TAX

A Third Party Involvement in a WTO Dispute

The legal analysis in Chapter II has demonstrated that it would be possible for an EU BTA to be designed so that, even if it is regarded as discriminatory, it could nonetheless be justified under one of the GATT Article XX exceptions. It has also been suggested that, to the extent such an outcome requires a flexible interpretation of the exceptions, this would would be desirable from a global climate change perspective. It would ensure that the WTO is in step with non-trade priorities. Nonetheless, it is highly likely that a BTA would aggrieve certain industries who will convince their governments to file a WTO complaint in response.[203] Should this happen, NZ would need to consider its position, including whether or not to involve itself as a third party. In light of the discussion in Chapter I, it would be surprising if NZ did not want the opportunity to have an input on a WTO panel's approach to the issue. This raises the question of what position NZ should take in such a dispute. It is suggested below that it would be in New Zealand's broader interests – and consistent with its trade policy interests – to support a BTA.

To this end, provided the EU can demonstrate that its BTA can and will achieve legitimate environmental objectives, NZ should, if the opportunity arises, make submissions in support of the measure. At this point, the climate emergency is of such magnitude that countries cannot afford to keep impeding others' emissions-reduction efforts, including where those efforts involve trade measures such as a BTA. This is not to say that countries should not be alive to the risk of green protectionism when it comes to measures like BCAs/BTAs, but that they should be adopting a cooperative, problem-solving-focused approach to such initiatives. For NZ in particular, the Rt Hon Jacinda Ardern has confirmed that trade cannot sit outside our work to tackle

[203] For example, Russia, China and the U.S. have all stated their opposition to the proposal and have asked the WTO to make the EU reconsider its plans: Isabelle Gerretsen "IMF endorses EU plan to put a carbon price on imports" (17 September 2020) Climate Home News <https://www.climatechangenews.com/2020/09/17/imf-endorses-eu-plan-put-carbon-price-imports/>.

climate change both at home and abroad, noting that international trade rules are uniquely placed to be part of the solution.[204] Aligning with the EU here would therefore demonstrate our commitment to this rhetoric.

Accordingly, as part of a third party submission, NZ should call for a shift in focus to the ways in which existing trade rules can be supportive of climate policies. This could involve encouraging a WTO panel to interpret more liberally the GATT provisions discussed in Chapter II, particularly Articles II:2(a), III:2 and XX. After all, when the GATT was first drafted – and subsequently amended – problems relating to climate policy, and structural, regulatory and governance challenges associated with decarbonisation, were not in contemplation.[205] In particular, NZ could argue that the 'likeness' and "directly competitive or substitutable" determinations under GATT Article III:2 be interpreted so as to accommodate contemporary climate-related challenges. For example, NZ could contend that it is no longer tenable for npr-PPMs – such as differing carbon intensities and their corresponding environmental impacts – to not be regarded as relevant to the likeness or substitutability (or ideally, un-likeness or un-substitutability) of carbon-intensive versus low-carbon products.

NZ could also suggest that existing criteria be tempered with normative considerations. For example, the analysis of consumers' tastes and habits could import a consideration of what consumers *should* see (or not see) as 'like' or substitutable products, in light of certain countries' efforts to transition to a low-carbon economy.[206] This argument would essentially be inverting the AB's finding in *Korea–Alcohol*. In that case, the AB held that "directly competitive or substitutable" denoted products that were "interchangeable", but that this should not be analysed exclusively by reference to current consumer preferences. In other words, the requisite relationship may exist between two products, even where consumers do not *currently* consider them to be

[204] Rt Hon Jacinda Ardern "New Zealand leading trade agreement driving action on climate change and the environment" (press release, 26 September 2019).

[205] Mehdi Abbas "Decarbonising Trade Policy. Options towards a European Decarbonized Trade Policy" (9 March 2020) HAL archives-ouvertes <https://hal.archives-ouvertes.fr/hal-02502577/document> at 9. For reference, the GATT was introduced in 1948, and the last and largest round of GATT negotiations, the Uruguay Round (which led to the creation of the WTO) spanned from 1986-1994.

[206] *Korea – Taxes on Alcohol Beverages* GATT BISD WT/DS75/AB/R, 18 January 1999 (Report of the Appellate Body Adopted on 17 February 1999) at [32] – [33].

substitutes. While these arguments may be novel, and pushing the boundaries of existing law and GATT/WTO jurisprudence, if there was ever a time to make them it is surely in the context of a climate crisis.

Importantly, making these sorts of submissions is not the same as accepting an EU BTA without question. NZ can still make clear that the measure needs to be subjected to considerable scrutiny to weed out protectionism – doing so is of course critical for our own export interests. However, we could also suggest that this be done with the intent of helping, rather than hindering the measure. With this sort of approach, international trade law could begin to encourage a balance between the orthodox objective of promoting trade liberalisation, and the contemporary objective of providing WTO Members with sufficient legal latitude to not only pursue domestic climate policies but encourage others to do the same. Of course, caution must still be taken to ensure that this does not tip the scales towards excessive protectionism.

B Seeking an International Agreement on the Use of BCAs/BTAs

Since it cannot be guaranteed that an EU BTA will be deemed WTO-compliant in the event of a dispute, it is worth considering how NZ could otherwise utilise the trade space to generate greater acceptance of BCAs/BTAs, and establish itself as a world leader in tackling climate change. Crucially, NZ could advocate for the conclusion of an international agreement on the use of BCAs/BTAs, addressing, for example:[207]

- Their sectoral coverage (both in the short-term and long-term);
- The method for calculating the carbon content of products;
- The method for comparing carbon policies across countries;
- The method for calculating adjustment levels;
- How revenue is to be used;
- The sort of dispute settlement mechanism to be relied upon; and

[207] These are factors I have identified as relevant, but by no means is this intended to be an exhaustive list of all the terms that would need to be agreed upon regarding the use of BCAs/BTAs.

- Accession arrangements that allow other countries to join if they can match the standard of commitments set by the original parties to the agreement (i.e. a form of 'open plurilaterliasm'[208]).

The question then becomes whether this can – or rather, should – be done on a multilateral or plurilateral basis.[209]

1 The scope for multilateralism

NZ is a vocal advocate for multilateralism and the rules-based international order,[210] so its first preference is likely to be the negotiation of a multilateral agreement regulating the use of BCAs/BTAs, which commits all WTO Members to its terms. The problem is that WTO negotiations employ a consensus-based, rather than majority-rules, approach, meaning that "nothing is agreed until everything is agreed".[211] Given the controversy associated with BCAs/BTAs and the numerous competing interests at stake,[212] such an approach does not lend itself to the swift, decisive policymaking that the circumstances require. Indeed, increasing numbers of analysts have warned against "a flawed obsession with multilateralism as the panacea for all the world's ills".[213] Climate change is an unprecedented challenge requiring flexibility and pragmatism, so while NZ should not give up on multilateralism, neither should it let itself be paralysed by conventional wisdom that multilateralism is the only solution.

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[208] NZ has expressed an interest in advancing the concept of 'open plurilateralism' before, see David Parker, Minister for Trade and Export Growth "Trade Policy and Turbulent Times" (speech delivered to ANZ Capital Markets, Wellington, 21 March 2019) at 4

[209] Plurilateralism is understood as agreeing on rules and new market access commitments in a sizeable sub-group of WTO members: Robert Basedow "The WTO and the Rise of Plurilateralism – What Lessons can we Learn from the European Union's Experience with Differentiated Integration" (2018) 221 J Int Econ Law 411 at 414.

[210] "What is multilateralism?" Ministry of Foreign Affairs and Trade <https://www.mfat.govt.nz/en/peace-rights-and-security/multilateralism/>.

[211] "Doha Round: what are they negotiating" World Trade Organisation <https://www.wto.org/english/tratop_e/dda_e/update_e.htm>.

[212] The WTO has 164 members, after all: "Members and Observers" World Trade Organisation <https://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm#:~:text=164%20members%20since%2029%20July,trade%20policy%20reviews%2C%20and%20notifications>.

[213] Daniel W Drezner "You say multilateralism, I say minilateralism… let's call the whole thing off" (23 June 2009) Foreign Policy <https://foreignpolicy.com/2009/06/23/you-say-multilateralism-i-say-minilateralism-lets-call-the-whole-thing-off/>.

2 *A plurilateral approach instead*

NZ should therefore focus its efforts on the negotiation of plurilateral trade-climate agreements with a smaller number of like-minded countries and/or entities like the EU, with the use and regulation of BCAs/BTAs forming a key part of the discussions. Plurilateralism is not a new concept for NZ. In 2019, NZ, together with over 80 WTO Members, launched negotiations on trade-related aspects of e-commerce,[214] and we are currently leading the negotiations for the Agreement on Climate Change, Trade and Sustainability with Costa Rica, Fiji, Iceland, Norway and Switzerland (of which BCAs/BTAs could possibly be added to the agenda).[215] Pursuing a plurilateral agreement would give NZ a greater stake in how BCAs/BTAs are developed and regulated than it would in a multilateral setting, as fewer countries' interests would need to be considered. This could help NZ secure terms that are more favourable to its domestic producers, assisting them in the transition to carbon neutrality by 2050.[216] And if the Brussels Effect is anything to go by, then addressing this issue sooner rather than later will also be in NZ's interests, should the use of BCAs/BTAs become widespread following the introduction of an EU BTA.

(a) Using the recent COVAX Facility as a model for making a plurilateral BCA/BTA regime work

If the world has learned anything from the COVID-19 pandemic, it is that countries can mobilise radically in the face of crisis to do things once thought impossible. While COVID-19 is a more immediate threat than the climate emergency at present, we can draw clear parallels between the two. Importantly, both are plagued by denialism and/or have had their severity dismissed by world leaders, and both have exposed

[214] "WTO e-commerce negotiations" Ministry of Foreign Trade and Affairs <https://www.mfat.govt.nz/en/trade/our-work-with-the-wto/wto-e-commerce-negotiations/>.

[215] "Agreement on Climate Change, Trade and Sustainability (ACCTS) negotiations" Ministry of Foreign Trade and Affairs <https://www.mfat.govt.nz/en/trade/free-trade-agreements/climate/agreement-on-climate-change-trade-and-sustainability-accts-negotiations/>. Described as a "first-of-its-kind agreement", the ACCTS aims to bring together some of the inter-related elements of the climate change, trade and sustainable development agendas.

[216] In accordance with the Climate Change Response (Zero Carbon) Amendment Act 2019.

fundamental problems with the status quo.[217] This has resulted in a lack of cohesion in the global response to these phenomena. However, in the case of COVID-19, an unprecedented case of plurilateralism has emerged in the form of the COVAX Facility (the Facility): an initiative bringing together governments and manufacturers to accelerate the development, production, and equitable access to an eventual COVID-19 vaccine.[218] Despite some provisions proving bitter pills to swallow – such as the requirement to indemnify the manufacturer(s) for certain liabilities they may incur[219] – 156 economies have joined the Facility (including "Team Europe"[220] and New Zealand). Importantly, the Facility is flexible in nature, allowing "committed purchase" and "optional purchase" arrangements.[221] This is in order to attract both developed and developing countries, whose means and interests differ significantly in the response to COVID-19 (much like they differ in regards to climate change, and the use of BCAs/BTAs, too).

The Facility is an instructive example of international cooperation to watch, and could be something NZ (and like-minded partners) look to for guidance in approaching a plurilateral trade-climate agreement on the use of BCAs/BTAs. The fact that the Facility has managed to galvanise 64 percent of the total global population in only six months seems to suggest a greater global appetite for pragmatism and cooperation

[217] Ryan Hagen "Coronavirus & Climate Change" (2020) Crowdsourcing Sustainability <https://crowdsourcingsustainability.org/coronavirus-climate-10-key-similarities-differences-and-lessons/>.

[218] "Boost for global response to COVID-19 as economies worldwide formally sign up to COVAX Facility" (2020) Gavi: The Vaccine Alliance <https://www.gavi.org/news/media-room/boost-global-response-covid-19-economies-worldwide-formally-sign-covax-facility>.

[219] "Questions and Answers: Coronavirus and the EU Vaccines Strategy" (24 September 2020) European Commission | Press Corner <https://ec.europa.eu/commission/presscorner/detail/en/QANDA_20_1662>.

[220] A joint effort between the EC, 27 EU Member States, plus Norway and Iceland: "Boost for global response to COVID-19", above n 218.

[221] Under a "committed purchase" arrangement, self-financing states must agree to procure a certain number of any future vaccine they are offered at a cost of $1.60 per dose, plus a financial guarantee equivalent to $8.95 a dose. A participant can only pull out of the scheme if the all-inclusive costs more than double to greater than $21.10 a dose. Under the new "optional purchase" arrangement, self-financing countries can now choose to pay a higher upfront cost of $3.10 per dose, but retain the option to "opt out of any vaccine offered while maintaining the ability to receive its full share of doses": Donato Macini and Michael Peel "'Vaccine nationalism' delays WHO's struggling Covax scheme" Financial Times (online ed, London, 2 September 2020).

when confronted with a serious enough crisis. This bodes well for the climate emergency and a corresponding plurilateral BCA/BTA regime – an initiative that NZ could take the lead on.

CONCLUSION

There can be no denying that climate change is the greatest market failure of all time. And with the majority of countries prioritising competitiveness in the trade space over a commitment to ambitious climate action, this demonstrates a systemic failure to appreciate the fact that it will ultimately cost the world more to *ignore* climate change, than it will to address it. While coordinated global climate action at the required level of stringency will always remain preferable to unilateral efforts, the latter is the most viable option at present. We must therefore devise ways to make unilateral action more attractive (and ultimately less asymmetric). BCAs are one such method, offering a promising way to limit free-riding and reduce carbon leakage. The proposed EU border carbon tax, in particular, would likely make significant headway in addressing these issues, given the size of the EU's economy. However, its corresponding impact on international trade means it will undoubtedly trigger a WTO challenge.

Given the imperative behind facilitating these sorts of measures in order to bring about greater emissions-reductions efforts internationally, this dissertation has therefore provided a comprehensive analysis of the prospects for WTO-compliance of an EU border carbon tax, with the view that it *should* be allowed under WTO rules. However, compliance will not come easy. The devil will very much be in the details of the proposed measure's design and implementation if it is to succeed, and GATT/WTO jurisprudence would need to evolve to accommodate climate-based trade policies.

This is also of considerable relevance to NZ. We have a strong interest in ensuring that such a measure does not negatively impact our export economy, which augurs for caution in our response. However, our own climate ambitions and desire to be seen as a world leader in this space suggests that we should lend our support to the EU measure, if it is likely to be WTO-compliant. This could involve supporting the EU as a third party in a dispute, or taking the initiative in the plurilateral space to negotiate an agreement on the climate-compatible regulation of international trade (of which the use of BCAs/BTAs can form an integral part), giving NZ an opportunity to secure terms that align with our interests.

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