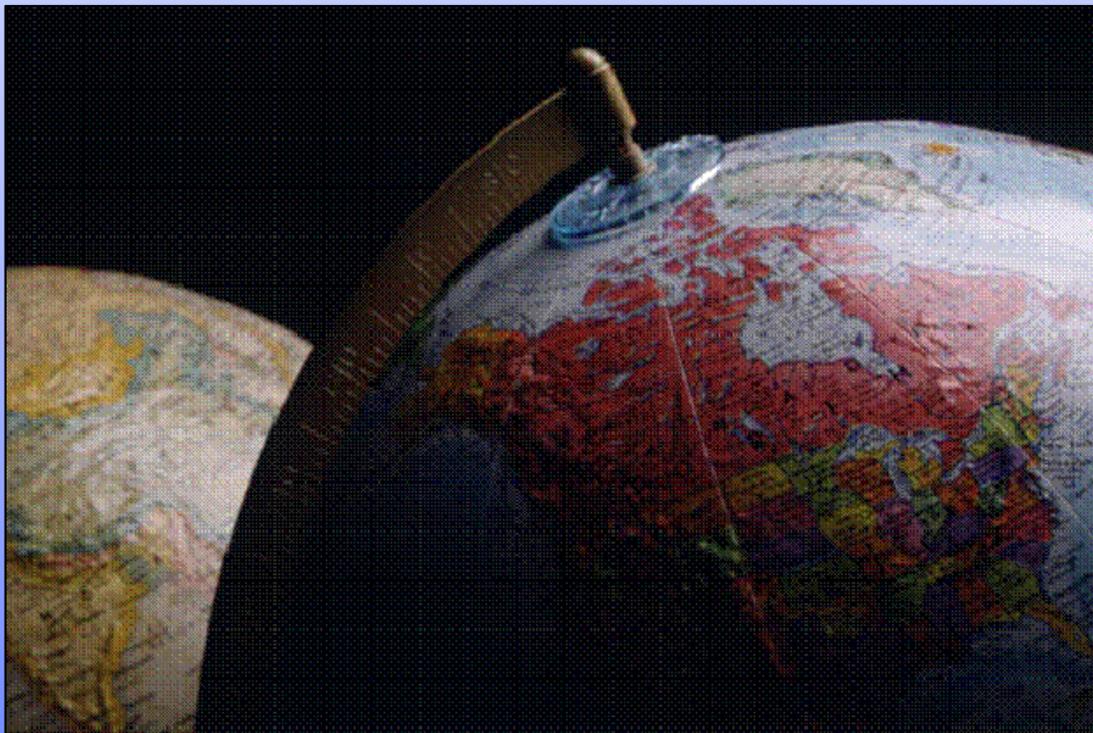




## **WTO – Compatibility of Four Categories of U.S. Climate Change Policy**

---



**National Foreign Trade Council, Inc.**

---

December 2007  
National Foreign Trade Council, Inc.  
1625 K Street, N.W.  
Washington, DC 20006-1604  
Tel: (202) 887-0278 Fax (202) 452-8160  
[www.nftc.org](http://www.nftc.org)

**The National Foreign Trade Council** advocates an open, rules-based world economy. Founded in 1914 by a group of American companies that supported an open world trading system, the NFTC now serves nearly 300 member companies through its offices in Washington and New York. The NFTC represents its member companies on trade and investment, export finance, economic sanctions and international tax policies that affect the competitiveness of U.S. companies overseas. It supports open markets, opposes unilateral sanction restrictions on trade, and assures U.S. business access to needed risk insurance and export and project finance.

Copyright © 2007, National Foreign Trade Council  
All rights reserved

This paper, or parts thereof, may not be reproduced in any form without prior permission from The National Foreign Trade Council, Inc.

## **WTO – Compatibility of Four Categories of U.S. Climate Change Policy**

**by Alina Syunkova  
National Foreign Trade Council**

December 2007

*This analysis will demonstrate that U.S. domestic energy and climate change policy must be envisioned from a global perspective; it will propose ways to ensure that some of the most effective policy tools, as expressed in recent U.S. legislation, are consistent with international trade law.*

## EXECUTIVE SUMMARY

U.S. domestic policies to address climate change can, in principle, be compatible with World Trade Organization (WTO) rules and the multilateral trading system. However, certain climate change policy tools can be more trade-distorting than others and conflict with specific WTO provisions, raising the costs and jeopardizing the long-term success of comprehensive climate change abatement programs in the United States.

This paper analyzes key climate change proposals in the U.S. Congress from the perspective of their compatibility with WTO rules. The analysis reaches the following conclusions:

- Energy efficiency requirements and standards, such as the renewable fuel standard found in H.R. 6, are likely to violate GATT Article III on national treatment. In fact, similar measures adopted in the United States in the 1990s were successfully challenged in a landmark WTO dispute. By contrast, CAFE standards in H.R. 1509 appear to be more WTO-compatible.
- Government-administered eco-labeling schemes in H.R. 6 may violate Article II of the WTO Agreement on Technical Barriers to Trade for constituting measures that are “more trade-restrictive than necessary” to protect the environment, even if this objective is “legitimate.”
- Subsidies for renewable energy are very likely to violate the WTO Agreement on Subsidies and Countervailing Measures. For example, loan guarantees for renewable fuels facilities in H.R. 6 are financial contributions targeting specific industries and commodity products; they may act to increase the U.S. world market share in biofuels while decreasing foreign countries’ U.S. market share in conventional fuels. Any subsidy that affects the export performance of a U.S.-produced climate-friendly good is likely to be prohibited under WTO rules.
- Government procurement of climate-friendly goods, such as the program included in H.R. 3221, may be covered by the WTO Agreement on Government Procurement, to which the U.S. is a party. This Agreement contains numerous flexibility measures that seem to accommodate most climate-friendly government procurement programs. The measures in H.R. 3221 do not appear to be in direct violation of the treaty – especially if the U.S. government employs transparent international product standards and participates in international standardization efforts.
- National greenhouse gas emissions cap-and-trade programs, such as the one envisioned in S. 2191, involve trade in emissions permits, which are neither a “good” nor a “service” subject to WTO regulation. Although in theory, emissions trading may be one of the most WTO-compatible policy instruments available, in practice, such programs are accompanied by standards and regulations, eco-labeling, subsidies, and other measures that raise WTO-compatibility concerns. A particularly alarming provision in S. 2191 creates a reserve of emissions permits for U.S. importers of foreign goods, which is

separate and additional to the national reserve. It effectively imposes a tax on imports from WTO Members who do not utilize clean production processes and methods. This is very likely to violate GATT Article III on national treatment and will probably be challenged by industry-intensive developing countries where environmental standards are not as stringent as in the United States.

This paper highlights concrete provisions in current bills that, from a multilateral trade perspective, may stand in the way of successful U.S. climate change policy. Domestic climate change policy that is WTO-compatible will not only deter costly WTO disputes in the future; multilateral engagement may be the only way to reach U.S. and global emissions reduction targets, and will serve to enhance the international position of American enterprise. If it acts promptly in area, the United States has an opportunity to significantly influence the development of multilateral law and regulation in this area.

## Introduction

Policies to combat climate change and achieve energy independence are key priorities for U.S. legislators. Comprehensive energy and climate change bills must strike a balance between goals as diverse as protecting the environment, keeping U.S. businesses and industries competitive, and ensuring long-term U.S. energy security. The resulting policy packages can include provisions that inevitably impact international trade in goods and services – from corporate average fuel economy (CAFE) standards for automobiles, to emissions permit trading systems, to financial incentives for renewable sources of energy. Some of these measures have the potential to conflict with World Trade Organization (WTO) rules. The crossroads of international trade and environmental law are as yet relatively uncharted territory – not only for U.S. legislators, but for international lawyers and the WTO itself. This regulatory uncertainty, in itself, is detrimental to international commerce, because it makes it difficult for global companies and industries to assess the full implications of pending legislative proposals.

Nevertheless, the WTO should not be perceived as an obstacle to climate change policy. As stated in the mandate for the current WTO negotiations, “enhancing the mutual supportiveness of trade and environment<sup>1</sup>” has for years been a fundamental priority of the WTO. Instead of fearing the WTO, U.S. legislators drafting climate change bills should recognize that, like the global climate itself, climate change policy is fundamentally international. In order for any domestic measure to achieve its abatement goals, it must be met with reciprocal or complementary legislation by other countries. The WTO and other international institutions present an opportunity for U.S. legislators to lead the way in abating climate change by engaging multilaterally. This, in turn, will make WTO disputes less likely to arise in response to aggressive domestic provisions.

## Climate Change Legislation Guidelines for the 110<sup>th</sup> Congress and Beyond

This paper suggests that effective domestic climate change policies can be compatible with WTO rules, but some provisions will be more problematic than others from an international law perspective. This paper analyzes international trade-impacting provisions found in climate change bills passed or proposed in 2007 – namely, the House and Senate versions of H.R. 6, H.R. 3221 and H.R. 2776, S. 280, S. 2191, and H.R. 1506 – by placing them into four basic categories<sup>2</sup> (see Table I). The four policy tool categories do not exhaust the long list of domestic climate change policy tools but contain those with the greatest potential to impact international trade. Each category is vulnerable to specific WTO/GATT 1994 provisions and may potentially clash with international trade law because of one “problematic” provision or another.

---

<sup>1</sup> Stoler, Andrew. “The Doha Round Negotiations on the MEA-WTO Interface: Shared Perceptions or Ulterior Motives?” Institute for International Business, Economics, & Law. The University of Adelaide, Australia. 26 October 2004. Paper presented at the International Bar Association Conference, Auckland, New Zealand.

<sup>2</sup> See a 2001 assessment of various policy tools that countries who signed the Kyoto Protocol dispose of to meet greenhouse gas emissions reduction targets. In their analysis, the authors find that measures are, for the most part, WTO-compatible. See Buck, Matthias and Verheyen, Roda. “International Trade Law and Climate Change – A Positive Way Forward.” *FES-Analyse Ökologische-Marktwirtschaft*. Research Unit for Environmental Law, Hamburg University. July 2001.

Nevertheless, past WTO dispute outcomes suggest that the flexible interpretation of WTO provisions makes it possible and well worth U.S. policymakers' efforts to draft domestic energy bills in a WTO-compatible way.

Prior efforts have analyzed the WTO implications of various policy tools in the abstract, yielding important international legal insights<sup>3</sup>. By citing concrete examples of policy tools from current U.S. legislation, this paper goes beyond their scope. It provides an alternative assessment of the international trade implications of a growing number of climate change bills, as U.S. policymakers, industries, and enterprises seek to reduce the uncertainty of international commerce in a new era of climate change debate.

Table I

	<b>Category of Domestic Policy Tool</b>	<b>Relevant WTO/General Agreements on Tariffs and Trade 1994 Provisions</b>
I.	Energy efficiency regulations and standards; government-administered eco-labeling	GATT 1994 Article III: National Treatment; GATT 1994 Article XX: General Exceptions; WTO Agreement on Technical Barriers to Trade
II.	Subsidies to encourage climate-friendly investments	WTO Agreement on Subsidies and Countervailing Measures
III.	Public procurement of climate-friendly goods and services	Agreement on Government Procurement Articles III.1 and III.2: Non-discrimination, VII-XVI: Transparency and other procedural requirements, VI.1-VI.2 and footnotes: Technical Specifications, VIII.4: Tenders, XXIII.2: Exceptions to Agreement
IV.	Emissions trading	Undefined area in international law; consensus currently forming; potentially subject to TBT

## **FOUR CATEGORIES OF DOMESTIC POLICY TOOLS TO ADDRESS CLIMATE CHANGE**

### I. Energy Efficiency Regulations and Standards; Government-Administered Eco-labeling

Gains in energy-intensive consumer product efficiency result in reduced consumption of

<sup>3</sup> See Buck and Verheyen 2001, Stoler 2004; Green, Andrew: "Climate Change, Regulatory Policy and the WTO: How Constraining Are Trade Rules?" *Journal of International Economic Law*.2005; 8: 143-189. Oxford University Press, 2005; "Trade and Environment at the WTO" 23 April 2004. Background document prepared by the Secretariat. [http://www.wto.org/english/tratop\\_e/envir\\_e/envir\\_wto2004\\_e.pdf](http://www.wto.org/english/tratop_e/envir_e/envir_wto2004_e.pdf); Zarili, Simonetta. "WTO Doha Declaration and Trade in Energy Goods & Services". *Oil, Gas & Energy Law Intelligence*, Vol. 1 Issue # 01. January 2003.

fossil fuels, and lower associated emissions of greenhouse gases, such as carbon dioxide. Energy efficiency standards regulate electric appliances such as computers, refrigerators, and light bulbs; they may include CAFE standards for autos, renewable energy generating requirements imposed on utilities, renewable fuel standards, and “green” building codes, among other things. Energy efficiency standards can be voluntary or mandatory. They can also be product-based, targeting the in-use energy efficiency performance of a product; or they can be based on the processes and production methods (PPMs) that are used in manufacturing a product. Examples of energy efficiency standards in the United States include the CAFE standards in H.R. 1506, the “Fuel Economy Reform Act” and the renewable fuel standard in the Senate’s version of H.R. 6, the “Renewable Fuels, Consumer Protection, and Energy Efficiency Act of 2007.”

Because energy efficiency standards may limit U.S. imports of energy-inefficient products, exporting countries may contend that the regulations constitute a protectionist measure. PPM-based measures, distinguishing between otherwise-like products exclusively on the basis of the way in which they were produced, may be particularly difficult to defend under WTO rules. On the other hand, PPM-based energy efficiency standards may also face domestic opposition because higher standards imposed on U.S. manufacturers may cause them to raise prices, undermining the international competitiveness of U.S.-manufactured products<sup>4</sup>.

Eco-labels are complementary to energy efficiency standards and regulations. They inform consumers about the environmental characteristics of products and the environmental impact of their performance over time. Eco-labels may change consumer preferences and behavior. The wholesale purchasing decisions of large retailers may shift in response to changing consumer demand, significantly affecting patterns of international trade. All producers will need to adapt to these changes, but producers in developing countries may have disproportionate difficulties in adjusting their production methods to the new requirements and in qualifying for eco-labeling schemes. Thus, eco-labeling is a potential source of dispute at the WTO.

It is important to distinguish between governmental and non-governmental eco-labeling schemes. *WTO rules apply only to eco-labeling schemes administered and regulated by the government*, not voluntary, private sector-administered schemes. Also, like standards, eco-labels can be product-based or PPM-based. In recent years, the controversy over using PPM-based criteria in eco-labeling has become more pronounced at the WTO. An emerging consensus seems to be that the WTO preserves the right to regulate PPMs if and only if finished products are distinguishable from each other as a result of different manufacturing processes. Such PPMs are called “incorporated PPMs,” as opposed to “unincorporated PPMs,” which leave no trace in the end product.

Overall, WTO regulations and standards appear to be increasingly process-oriented, rather than product-oriented<sup>5</sup>. Developing countries, where manufacturing standards are notoriously lax, have resisted this trend by calling for a prohibition on criteria based on unincorporated PPMs. A debate over the scope of the Technical Barriers to Trade (TBT) Agreement, which governs regulations, standards, and eco-labels, has resulted.

---

<sup>4</sup> Stokes, Bruce. “Trade Winds Hit Climate Bills.” *National Journal* 7/7/2007. Page 52.

<sup>5</sup> p. 17, “Trade and Environment at the WTO” 23 April 2004. Background document prepared by the Secretariat. [http://www.wto.org/english/tratop\\_e/envir\\_e/envir\\_wto2004\\_e.pdf](http://www.wto.org/english/tratop_e/envir_e/envir_wto2004_e.pdf).

Example 1: Renewable fuel standard (RFS) in the Senate version of H.R. 6, the “Renewable Fuels, Consumer Protection, and Energy Efficiency Act of 2007”<sup>6</sup>

Renewable fuel standards are increasingly employed in U.S. climate change legislation, and may violate GATT Article III on National Treatment. On June 21, 2007, the Senate passed its version of H.R. 6<sup>7</sup>, Title I of which includes a mandatory renewable fuel standard (RFS), or “regulations to ensure that motor vehicle fuel and home heating oil sold or introduced into commerce in the United States contains the applicable volume of renewable fuel<sup>8</sup>.” Renewable fuels<sup>9</sup> “are used to replace or reduce the quantity of fossil fuel present in a fuel or fuel mixture used to operate a motor vehicle or furnace<sup>10</sup>.” The legislation calls for U.S. fuels to contain 36 percent renewable biofuels by 2022, with 21 percent being advanced biofuels. It is worth noting that refineries that process 75,000 barrels of crude oil per day or less, on average, are excluded from the RFS until 2013; furthermore, “small refineries” are exempt until 2015<sup>11</sup>. These exemptions are subject to two-year extensions if compliance with the RFS is determined to levy “disproportionate economic hardship.”

The mandatory RFS in H.R. 6 may violate GATT 1994 Article III for several reasons. The RFS is likely to qualify as an “internal quantitative regulation” that arguably requires “the mixture, processing, or use of products” – conventional fuels and biofuels – “in specified amounts or proportions.” As such, under GATT Article III Paragraph 1, the RFS must not be applied “so as to afford protection to domestic production.” Furthermore, under Paragraph 5 of this article, the RFS must not “directly or indirectly” require that some amount or proportion of these fuels “be supplied from domestic sources.” However, among the stated goals of H.R. 6 is that, by 2025, “the agricultural, forestry, and working land of the United States should provide from renewable resources not less than 25 percent of the total energy consumed in the United States<sup>12</sup>.” This and similar language in H.R. 6 may be interpreted as a bias in favor of domestic fuels over foreign fuels. In effect, the RFS in H.R. 6 may be requiring that 36 percent of U.S. fuel is domestically-produced. As international trade in biofuels expands, renewable fuel standards will be increasingly vulnerable to challenges on National Treatment grounds. In addition to the RFS, H.R. 6 provides financial assistance for the U.S. biofuels industry through the year 2022 with loan guarantees (up to \$250 million) for renewable fuels facilities, research and development funding, and biofuels infrastructure pilot programs. These provisions are subject to the WTO Agreement on Subsidies and Countervailing Measures (SCM), which will be

---

<sup>6</sup> Renewable Fuels, Consumer Protection, and Energy Efficiency Act of 2007 (Engrossed Amendment as Agreed to by Senate) – [www.thomas.gov](http://www.thomas.gov).

<sup>7</sup> The Senate version of H.R. 6 passed by incorporating the Senate’s own comprehensive energy bill, S. 1419, into the House version of H.R. 6.

<sup>8</sup> Renewable Fuels, Consumer Protection, and Energy Efficiency Act of 2007 (Engrossed Amendment as Agreed to by Senate) Title I – [www.thomas.gov](http://www.thomas.gov).

<sup>9</sup> Biofuels are defined as being made from renewable biomass, and include conventional biofuels (corn ethanol) and advanced biofuels (non-corn ethanol, cellulosic biomass, biogas, butanol, etc.)

<sup>10</sup> Section 102, “Definitions”, H.R. 6 (Engrossed Amendment as Agreed to by Senate)

<sup>11</sup> “small refineries owned by a small business refiner as defined in Section 45H( c ) of the Internal Revenue Code of 1986”. Section 111, “Renewable Fuel Standard”, H.R. 6 (Engrossed Amendment as Agreed to by Senate)

<sup>12</sup> Section 113, “Sense of Congress Relating to the Use of Renewable Resources to Generate Energy” H.R. 6 (Engrossed Amendment as Agreed to by Senate)

discussed in the next section.

A second question arises from the six-year minimum exemption of “small refineries” from the RFS requirements in H.R. 6. Of the 149 refineries operating in the United States as of January 1, 2007, 77 would fall under the H.R. 6 definition of a “small refinery” because they process at most 75,000 barrels of crude oil per average day<sup>13</sup>. It would be feasible to assess the relationship between U.S. refinery size and the proportion of foreign fuel to domestic fuel processed there. It may be that imported crude oil tends to be processed at large refineries, rather than at small refineries<sup>14</sup>. If so, then H.R. 6 places foreign oil imports at a disadvantage by exempting from the RFS, for an extendable six-year period, facilities that process mostly-domestic oil. This would violate GATT Article III Paragraph 4, which states that imported products “shall be accorded treatment no less favorable than that accorded to like products of national origin” – particularly in terms of regulations “affecting their internal sale, offering for sale, purchase, transportation, distribution or use.”

Renewable fuel standards employed in the United States. have already been challenged at the WTO. In 1996, a landmark WTO dispute found the Gasoline Rule in the U.S. Clean Air Act to violate GATT 1994 Article III on National Treatment<sup>15</sup>. In many ways similar to the RFS provided for in H.R. 6, the Gasoline Rule allowed only gasoline of a specified “cleanliness” to be sold to consumers in the most polluted parts of the United States, and applied to all refiners, blenders, and importers of gasoline. Brazil and Venezuela argued that the Gasoline Rule discriminated against their products in U.S. markets. The United States appealed the panel’s findings, arguing that, even if it discriminated against foreign products, the Gasoline Rule was a permissible exception under Article XX (g) on General Exceptions, because it was intended to “preserve an exhaustible resource” – clean air. The Appellate Body subsequently agreed that the primary aim of the Gasoline Rule was to conserve clean air, and that clean air is an “exhaustible resource” that can potentially qualify a domestic measure as a GATT Article XX General Exception. Ultimately, however, the Appellate Body found the Gasoline Rule to be WTO-incompatible due to the *manner* in which it had been applied. Because the United States had not sought to cooperate with Brazil and Venezuela in passing the Gasoline Rule, the measure did not pass the Chapeau of Article XX on General Exceptions. In effect, the measure was found to constitute “arbitrary [and] unjustifiable discrimination between countries where the same conditions prevail.” Pursuing the Chapeau of Article XX further, the Appellate Body found the Gasoline Rule to constitute a “disguised restriction on international trade” because the United States failed to eliminate costs for foreign producers that it had eliminated for domestic refiners. This particular argument may be extended to the RFS in H.R. 6, and in particular the provision to exclude small refineries, if it is found to impose greater costs on foreign producers than on domestic producers.

---

<sup>13</sup> EIA, 2007.

<sup>14</sup> Even without statistical data, such a suggestion is not far-fetched. The means of transporting foreign and domestic oil are very different. According to EIA statistics, pipelines are used to transport nearly-equal amounts of foreign and domestic oil in the U.S.; trucks and tank cars carry almost exclusively domestic oil; and foreign oil is imported in tankers and barges. While large refineries tend to be able to accommodate large tankers and barges, small refineries may be more accessible via trucks and tank cars. Therefore, most of the oil imported into the United States is likely to be processed in relatively large refinery facilities.

<sup>15</sup> United States - Standards for Reformulated and Conventional Gasoline, Appellate Body Report and Panel Report, adopted on 20 May 1996.

The Chapeau of Article XX on General Exceptions must be considered when choosing the language and context of climate change policy measures. The Chapeau is concerned not so much with the *fact* that discrimination is occurring, but rather with the *manner* in which discrimination occurs when it is inevitable. For example, the Appellate Body has ruled in the past that a measure that otherwise qualified as a general exception constituted “unjustifiable discrimination” because it was applied inflexibly, and because the country applying the measure had failed to make efforts at negotiation<sup>16</sup>. The measure therefore failed to pass muster under the Chapeau of Article XX on General Exceptions.

Finally, the “disguised trade restriction” safeguard of the Chapeau has also been consequential in past WTO panel decisions. A measure must be made public and transparent; deliberation over its potential to discriminate must be made apparent; and it must not be intentionally trade-restrictive by “design, architecture and revealing structure. In other words, WTO law places great emphasis on the perceived intent and the manner of application of measures. Applying a domestic measure in an “inflexible, rigid manner” can render it “arbitrary discrimination” that violates the Chapeau of Article XX. By contrast, demonstrating “serious efforts in good faith” to resolve issues through negotiations and international agreements may ensure favorable dispute resolution outcomes<sup>17</sup>. U.S. legislators can alter the rhetoric of climate change bills to show that the United States favors cooperative outcomes and multilateral engagement over protectionism. Such precautions may substantially bolster the international legal defense of U.S. domestic climate change measures.

Example 2: Corporate average fuel economy (CAFE) standards in H.R. 1506, the “Fuel Economy Reform Act”<sup>18</sup>

Several comprehensive energy and climate change bills include CAFE standards for automobiles, including H.R. 1506, the “Fuel Economy Reform Act.” In a 1994 GATT dispute, *U.S.-Automobiles*<sup>19</sup>, similar U.S. CAFE regulations were struck down by a Panel decision for violating GATT Article III on National Treatment. Although never adopted, this ruling has often been cited by international lawyers and provides insights into future WTO treatment of CAFE standards. Specifically, according to *U.S.-Automobiles*, CAFE regulations like the ones employed in the United States in 1994 risk violating Article III.4 of the GATT.

In 1994, an amendment to the 1990 Clean Air Act required both domestic and imported car fleets to meet corporate average fuel efficiency regulations of at least 27.5 mpg. The CAFE regulations affected “the internal sale, offering, purchase, transport, distribution, or use” of foreign and domestically-produced automobiles on U.S. territory, making them subject to GATT Article III. While not directly purporting to govern them, in effect, the CAFE regulations affected the conditions of competition between domestic and imported automobiles. Domestic

---

<sup>16</sup> For example, in the *Shrimp-Turtle* case in “Trade and Environment at the WTO” 23 April 2004. Background document prepared by the Secretariat.

<sup>17</sup> Ibid.

<sup>18</sup> Fuel Economy Reform Act (Introduced in House) – <http://www.thomas.gov/cgi-bin/query/z?c110:H.R.1506>.

<sup>19</sup> United States - Taxes on Automobiles (hereinafter US - Automobiles), circulated on 11 October 1994, not adopted.

manufacturers and importers of automobiles were directed to calculate corporate average fuel economies of their fleets differently. Companies that both manufactured domestically and imported from abroad were required to average the efficiencies of the foreign and domestic fleets separately. Ultimately, the origin of the cars and the control-ownership relationship of the manufacturer and importer, rather than a characteristic intrinsic to the cars, determined the fleet accounting mechanism. This mechanism, in turn, put foreign manufacturers at a disadvantage vis-à-vis domestic manufacturers<sup>20</sup>. The 1994 CAFE standards were found by the panel to violate GATT Article III.

H.R. 1506 departs slightly from the earlier structure of CAFE regulations. It requires a 35 mpg fuel efficiency by 2018 of “all cars and light trucks of gross vehicle weight equal to or under 10,000 lbs<sup>21</sup>.” Unlike other bills, which continue the 1994 CAFE standards’ distinction between foreign and domestic manufacturers, H.R. 1506 is structured to impose a more equal burden on domestic and foreign manufacturers<sup>22</sup>. H.R. 1506 is less likely to violate the WTO’s National Treatment provisions than the approach to CAFE regulations used in 1994, which used separate foreign and domestic fleet accounting. However, it is possible that this “safeguard” may still, in effect, discriminate between foreign and domestic producers, in violation of GATT Article III.

Article III, Paragraph 4 mandates that imported products “be accorded treatment no less favorable than that accorded to like products of national origin in respect of all laws, regulations, and requirements...” The WTO Appellate Body has suggested in the past that three elements amount to a GATT Article III Paragraph 4 violation: the imported and domestic products at issue must be “like products;” the measure at issue must be a “law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use;” and the imported products must be treated “less favorably” than domestic products<sup>23</sup>. The “likeness” between domestic and foreign products has been the subject of extensive debate at the WTO. Ad Article III, Paragraph 2, seems to imply that “likeness” depends on whether two products are market-competitive substitutes. Ultimately, “likeness” has been determined by WTO panels and the Appellate Body on a case-by-case basis by factoring in the qualities and end uses of a product, consumer preferences, and a product’s international tariff classification. In any case, for the purposes of CAFE regulations, foreign and domestic cars were treated as competing, “like” products on U.S. markets. The CAFE regulations that affected the sale of automobiles in the U.S. based on whether they were produced domestically or imported, rather than on some intrinsic “un-likeness” between the automobiles, violated Article III Paragraph 4. In the case of the CAFE standards, the regulation could still be permissible by qualifying under GATT 1994 Article XX, Paragraph (b) or (g). However, having scrutinized the manner in which the 1994 CAFE regulations had been applied, the panel found that they did not qualify for an exception. This suggests that although they are meant to preserve clean air, CAFE standards must be applied in a non-arbitrary, non-discriminatory manner in order to be justifiable under GATT Article XX.

---

<sup>20</sup> "Trade and Environment at the WTO" 23 April 2004. Background document prepared by the Secretariat. [http://www.wto.org/english/tratop\\_e/envir\\_wto2004\\_e.pdf](http://www.wto.org/english/tratop_e/envir_wto2004_e.pdf).

<sup>21</sup> Section 2 – Findings, Paragraph 6 on [www.thomas.gov](http://www.thomas.gov)

<sup>22</sup> Cohen, Richard E. "Power Surge" Cover Story of National Journal, June 21, 2007. P. 20-25.

<sup>23</sup> Appellate Body Report on *Korea-Various Measures on Beef* referenced in WTO Analytical Index (2007).

Example 3: Efficiency labeling for electronic consumer products in the Senate version of H.R. 6, the “Renewable Fuels, Consumer Protection, and Energy Efficiency Act of 2007”

Although it has not been invoked in past WTO disputes relating to environmental measures, the WTO Agreement on Technical Barriers to Trade (TBT) deals extensively with regulations and standards. In the future, it may be invoked in disputes involving energy efficiency standards and eco-labeling requirements, both of which are a “technical regulation” as defined by TBT Article 2. According to Article 2.2, a technical regulation constitutes an “unnecessary obstacle to international trade” if it is “more trade restrictive than necessary to fulfill a legitimate objective.” Among possible “legitimate objectives,” TBT Article 2.2 explicitly mentions “protection of the environment.” However, whether a measure in question is deemed “more restrictive than necessary” to fulfill this objective is likely to vary from case to case. Overall, U.S. legislators should note that the Preamble of the TBT Agreement explicitly calls for international standards applied in a transparent manner, as opposed to national standards that are not clearly defined for other WTO Members. Furthermore, TBT Article 2.6 calls on Members to partake in “the preparation by appropriate international standardizing bodies of international standards for products for which they either have adopted, or expect to adopt, technical regulations.” As U.S. legislation increasingly aims to adopt government-administered eco-labeling schemes, CAFE standards, energy efficiency requirements for consumer appliances, and other energy efficiency regulations, it may be beneficial to internationalize U.S. standards.

Seizing the initiative in setting international standards can have two substantial benefits: one from the perspective of international law and the other from the perspective of international competitiveness. First, failure to participate in international standards schemes will only make U.S. domestic measures more difficult to defend using existing WTO provisions when disputes arise. WTO law is not written, interpreted, and applied in a diplomatic vacuum, and the United States’ ability to pursue its domestic energy and environment-related goals will be substantially improved if it is willing and able to be internationally-engaged<sup>24</sup>. From the perspective of enhancing the competitiveness of U.S. enterprises, manufacturers, and industries, international engagement presents an extraordinary opportunity for U.S. legislators. If they seize the initiative in setting international standards and transparent, uncertainty-reducing procedures related to commerce in energy and climate change-related products, they will enhance the competitiveness of American products abroad. Energy efficiency and environmental standards, overall, present an opportunity for U.S. companies to become leaders on newly-created, high value-added “niche” markets for environmentally-friendly goods. Short of leading the process of international standardization, participating in the schemes will make American products more appealing to foreign purchasers. International eco-labeling schemes will similarly cater to international consumers of U.S.-manufactured products.

## II. Subsidies to encourage climate-friendly investments

Within the WTO, subsidies are defined and regulated by the Agreement on Subsidies and Countervailing Measures (SCM). The SCM is premised on the notion that some forms of

---

<sup>24</sup> Buck, Matthias and Verheyen, Roda. "International Trade Law and Climate Change: A Positive Way Forward". FES-Analyse Okologische Marktwirtschaft. July 2001. <http://library.fes.de/pdf-files/stabsabteilung/01052.pdf>

subsidies, but not others, distort, or have the potential to distort, international trade<sup>25</sup>. In principle, any U.S. government measure supporting climate-friendly investment interferes with free-market forces. However, not all government measures have international trade implications. First, in order to fall under the scope of the SCM Agreement, a government measure must contain three elements: it must be a “financial contribution,” or subsidy, conferring “benefits” (SCM Article 1), and it must be “specific to certain industries or enterprises” (SCM Article 2)<sup>26</sup>. Of those subsidies that fall under its scope, the SCM prohibits specifically those that are either export-dependent, or favor the use of domestic goods over foreign goods (SCM Article 3)<sup>27</sup>.

Presently, some subsidies for encouraging climate-friendly investments would fall under the “prohibited” category (SCM Article 3). Subsidies that are “prohibited” are “contingent, in law or in fact,” on export performance. That is, they are either legally contingent upon export performance, or are in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to exporting enterprises is not sufficient to determine that it favors exports; empirical study and factual evidence are required. Also, subsidies that are “contingent, whether wholly or as one of several other conditions, upon the use of domestic over imported goods” are expressly “prohibited” by the SCM.

As governments increasingly seek to provide incentives for the development of climate-friendly goods and services, ways to change or broaden the scope of the SCM are being proposed. In the meantime, U.S. legislators must be mindful of the WTO’s limited capacity to accommodate climate-friendly subsidies, although they are often a preferred and domestically-acceptable policy tool for achieving legitimate environmental policy goals<sup>28</sup>. If legislators choose to pursue domestic climate-friendly subsidies, they could encourage the Administration to negotiate internationally-accepted climate-friendly subsidy schemes, minimum taxation thresholds for energy imports, etc. The United States could negotiate with other WTO Members to mutually agree to allow a specified range of flexibility vis-à-vis WTO rules in enacting climate change policies.

Example 1: Strategic Energy Efficiency and Renewables Reserve in H.R. 6, “CLEAN Energy Act of 2007”; Renewable energy subsidies in the Senate version of H.R. 6, the “Renewable Fuels, Consumer Protection, and Energy Efficiency Act of 2007”

The CLEAN Energy Act of 2007 also contains provisions for imposing new energy taxes on the oil and gas industries, and channeling these Federal revenues into a Strategic Energy Efficiency and Renewables Reserve, which will cover the costs of subsequent legislation to promote climate-friendly investments<sup>29</sup>. From an environmental policy perspective, this is effective. The fossil energy taxes discourage polluting economic activity, while clean energy

---

<sup>25</sup> [Panel Report on Canada - Aircraft](#), para. 9.119.

<sup>26</sup> [Panel Report on US - Exports Restraints](#), para 8.63.

<sup>27</sup> [Panel Report on Brazil - Aircraft](#), para. 7.26.

<sup>28</sup> More information can be found in Green, Andrew, "Trade Rules and Climate Change Subsidies" (2006) [World Trade Review](#), 5: 377-414 Cambridge University Press.

<sup>29</sup> Title II – Royalties Under Offshore Oil and Gas Leases, or “Royalty Relief for American Consumers Act of 2007” and Title III – Strategic Energy Efficiency and Renewables Reserve. H.R. 6 (EH – CLEAN Energy Act of 2007 Engrossed as Agreed to or Passed by House). [www.thomas.gov](http://www.thomas.gov).

subsidies encourage climate-friendly economic activity. By some estimates, the revenues transferred from the oil and gas industries into the Strategic Energy Efficiency and Renewables Reserve could amount to \$14 billion over five years<sup>30</sup>. These funds would be appropriated “to accelerate the use of domestic renewable energy resources and alternative fuels,” “to promote the utilization of energy-efficient practices and conservation,” and “to increase research, development, and deployment of clean renewable energy efficiency technologies<sup>31</sup>.” While this financial aid is clearly intended to speed the transition to an environmentally-friendly U.S. economy, WTO rules do not distinguish between “good” and “bad” subsidies.<sup>32</sup>

Comparing the broad goals that H.R. 6 envisions pursuing through subsidies with what is allowed in the SCM Agreement, future conflict seems very likely unless the scope of the SCM broadens. Alternatively, the United States could negotiate treaties with other WTO Members to circumvent the SCM’s limitations on climate-friendly subsidies.

Most types of subsidies for climate-friendly investments are likely to be found “actionable” or even “prohibited” by the SCM Agreement. For example, the Senate version of H.R. 6 contains a provision for renewable fuel facilities loan guarantees (H.R. 6, Senate version, Section 124). Facilities may receive loans of up to \$250 million, covering up to 80% of the total cost of the facility. This federal “financial contribution” is “specific to certain industries or enterprises” in the sense of Article 2 of the SCM, as it is intended for the biofuels industry. However, the loan guarantees provision is aimed at “a particular subsidized primary product or commodity” - ethanol and other biofuels - and affects another primary product, conventional fuels. If it is found to be empirically-provable that international trade in biofuels and/or conventional fuels is substantially affected by this loan guarantee program (alone or in conjunction with other similar provisions in H.R. 6), they may become a WTO dispute issue. In such circumstances, a dispute panel may determine that loan guarantees, besides providing domestic “technological and economic benefits” to renewable fuels facilities (which in itself does not mean that they have international trade consequences), also serve to increase the U.S. share of the world market in ethanol and other biofuels “as compared to the average share it had during the previous period of three years, and this increase follows a consistent trend over the period that subsidies have been granted.” (SCM Article 6.3 (d)). In this case, the loan guarantees would constitute an “actionable” subsidy, which could be successfully challenged under WTO rules.

Section 204 of H.R. 6 could also be determined to be “contingent in law or in fact” on export performance, or “the use of domestic goods over foreign goods.” The WTO governs only those subsidies which it determines to have international trade implications; however, it has little flexibility for such subsidies. Thus, Section 204 could constitute a “prohibited” subsidy, especially if U.S. biofuels producers decide to take the path of expanding and exporting their products and advanced biofuels technologies to foreign markets. The WTO-compatibility of federal subsidies for renewable fuels research and development and production is complicated by

---

<sup>30</sup> Robert McElroy, “[Managing America: Energy.](#)” *TheWeekInCongress*, June 8, 2007.

<sup>31</sup> Title III – Strategic Energy Efficiency and Renewables Reserve. H.R. 6 (EH – CLEAN Energy Act of 2007 Engrossed as Agreed to or Passed by House). [www.thomas.gov](http://www.thomas.gov).

<sup>32</sup> See Green, Andrew. “Trade Rules and Climate Change Subsidies” (2006) [World Trade Review](#), 5: 377-414 Cambridge University Press. Green’s conclusions are that WTO rules currently do not provide adequate scope for “legitimate” subsidies as part of climate change legislation. He advocates reform of current WTO law concerning subsidies.

the involvement of both agricultural and energy commodity products, as well as both international trade and national security interests. Subsidies and agriculture are contentious issues at the WTO; energy commodities and national security have traditionally been WTO non-issues altogether. Trade in biofuels is one example of how comprehensive energy and climate change legislation is posing fundamental institutional challenges to the multilateral trade system. The SCM Agreement may be one of the first WTO documents revised in overcoming this challenge.

### III. Government Procurement of Climate-Friendly Products and Services

Government activity accounts for a significant percentage of industrialized countries' gross domestic product and is capable of creating robust markets for climate-friendly products and services. Governments also account for a significant percentage of energy consumption and greenhouse gas emissions: for example, the U.S. government is America's largest energy consumer and emits 100 million metric tons of polluting carbon dioxide-equivalent gases per year<sup>33</sup>. Markets and patterns of international trade will be altered if industrialized country governments base their economic decisions on the environmental effects of purchased goods and services. Examples of climate-friendly public procurement may include government purchases, either domestically or abroad, of electricity generated from renewable resources, energy-efficient electric appliances for public buildings and facilities, low fuel-consuming vehicle fleets for public transportation, and strict insulation requirements in public buildings. Developing countries, where environmental standards are low to start with and the cost of complying with foreign standards is relatively high, may seek to defend the competitiveness of their domestic industries by challenging public procurement programs under WTO law. Developing countries are also under-represented in the voluntary WTO discipline governing public procurement.

Government procurement is regulated by the plurilateral Agreement on Government Procurement (GPA), a reciprocity-based treaty that only applies to WTO Members who have chosen to participate in it. It establishes minimum substantive and procedural requirements that prevent purchasing governments from discriminating between domestic and foreign suppliers. Parallel to the language of the GATT, the GPA contains Non-Discrimination and National Treatment provisions. Much of the treaty is aimed at establishing transparent, consistent, and non-discriminatory tendering and reporting procedures for government purchasing abroad. The GPA is designed with limitations in scope that may give government procurement programs, as envisioned in recent climate change legislation, substantial leeway vis-à-vis WTO law.

- Membership in the GPA is voluntary, and participation is not universal. The United States signed the treaty in 1996, and as of January 1, 2007, other parties to the GPA included Canada, European Communities with respect to its 27 member States, Hong Kong, China, Iceland, Israel, Japan, Korea, Liechtenstein, the Netherlands with respect to Aruba, Norway, Singapore, and Switzerland.<sup>34</sup>

---

<sup>33</sup> Title VI – “Carbon-Neutral Government”, Renewable Energy and Energy Conservation Tax Act of 2007 (Engrossed as Agreed to or Passed by House). [www.thomas.gov](http://www.thomas.gov).

<sup>34</sup> See footnote to Article VI on page 7 of the Agreement on Government Procurement, available at: <http://www.worldtradelaw.net/uragreements/governmentprocurement.pdf>.

- Parties reserve the option to limit the treaty’s applicability between themselves and other Parties if they so choose<sup>35</sup>.
- Parties that sign the treaty must specify procurement entities within their jurisdictions, such as specific public utilities, that will be the subjects of the treaty<sup>36</sup>.
- Parties specify the threshold values below which individual procurements are not subject to GPA regulation.
- The GPA’s scope in covering services is extremely limited; it mainly covers government-procured products.

When the GPA is relevant, it permits government procurement programs to employ technical specifications if and only if they do not become “unnecessary obstacles to international trade”. Permissible technical specifications, include “quality, performance, safety and dimensions, symbols, terminology, packaging, marking and labeling, or the processes and methods for their production<sup>37</sup>...” This suggests that the GPA can accommodate some process and production method (PPM) based specifications, thereby allowing, e.g., requirements that government-purchased electricity come from renewable sources. The mention of “terminology, symbols, packaging, marking or labeling requirements as they apply to a product, service, process or production method<sup>38</sup>” suggests eco-labeling based government procurement programs are also permissible. It should be noted that, like the Agreement on Technical Barriers to Trade (TBT)<sup>39</sup>, the GPA encourages the development of international standards for government procurement specifications.

Although as of January 1, 2007, all of the Parties to the GPA were industrialized countries, the treaty in principle provides “special and differential treatment” for developing countries<sup>40</sup>. Provisions call on Parties to facilitate imports from developing, and particularly least-developed, countries; and to supply, upon request, technical assistance to developing countries seeking to comply with government procurement technical specifications. The GPA further allows *least*-developed Parties to by-pass their non-discrimination and national treatment commitments in relation to certain other Parties and specified goods. The GPA permits offsets and domestic content requirements that promote local economic development<sup>41</sup>. However, no least-developed countries signed or ratified the GPA, so these provisions have yet to be applied in practice.

Overall, government procurement programs are not as likely as energy efficiency

---

<sup>35</sup> GPA Article XXIV.11.

<sup>36</sup> GPA Appendix I, Annexes 1-3.

<sup>37</sup> GPA Article 6

<sup>38</sup> See footnote to Article VI on page 7 of the Agreement on Government Procurement. 15 April 1994, registered in accordance with Article 102 of the UN Charter in Marrakesh.

<http://www.worldtradelaw.net/uragreements/governmentprocurement.pdf>

<sup>39</sup> Preamble, Article 2.6. Please refer to Appendix II of this paper for selected climate change legislation-related provisions of the TBT.

<sup>40</sup> GPA Article V.

<sup>41</sup> GPA Article XVI.2.

regulations, eco-labels, or climate-friendly subsidies to be challenged on WTO legal grounds. This is due in part to the fact that the WTO's jurisdiction over government purchases is less direct than when a variety of competitive enterprises and governments engage in global trade. Since 1994, the GPA has been one of the less-referenced WTO treaties; its flexibility and limited scope suggest that U.S. government procurement programs are not as likely to be inconsistent with its provisions as in other areas of WTO jurisdiction.

Example 1: The “Carbon-Neutral Government Act of 2007” (Title VI) of H.R. 3221, “Renewable Energy and Energy Conservation Tax Act of 2007”<sup>42</sup>

House Speaker Nancy Pelosi's comprehensive energy bill, H.R. 3221, which passed the House on August 4, 2007, includes a government procurement program, the “Carbon-Neutral Government Act of 2007.” Provisions of the Act include a Federal inventory of greenhouse gas emissions and progressive reduction targets for all Federal agencies that arrive at zero emissions of greenhouse gases by 2050<sup>43</sup>. Furthermore the Act mandates that “no [office of the legislative branch] shall acquire a light duty motor vehicle or medium duty passenger vehicle that is not a low greenhouse gas emitting vehicle.” It has provisions for Federal procurement of energy-efficient products, and mandates energy efficiency performance standards that progressively reduce the “fossil fuel-generated energy consumption” of all Federal buildings<sup>44</sup>.

Should a WTO dispute arise over one of the provisions in H.R. 3221, a panel might first address whether the entities concerned are explicitly listed on the United States' GPA Schedule<sup>45</sup>. Next, the panel might assess whether relevant threshold values are met. The GPA does not apply to government purchases that involve financial sums below certain levels<sup>46</sup>. For the United States and each GPA Party, Appendix I, Annexes 1-3 of the GPA contain a “Schedule” of domestic entities that procure in accordance with the treaty's provisions<sup>47</sup>. As of October 1, 2004, 79 U.S. “central government entities” were listed as being subject to the GPA, including the Department of Agriculture<sup>48</sup>, the State Department, the Environmental Protection Agency, the Department of Commerce, etc. Annex II also listed “sub-central government entities,” or state agencies in the case of the United States; finally, Annex III listed “other entities” such as utilities and port authorities in several U.S. states<sup>49</sup>. The relevant threshold values for procurement of “goods and services” listed in Annexes 1, 2, and 3 are \$193,000, \$526,000, and \$593,000 (with some country-specific exceptions), respectively. The GPA does not regulate government procurement transactions by listed entities if they do not reach these values.

Since the government procurement programs provided for in H.R. 3221 appear to be

---

<sup>42</sup> Title VI – “Carbon-Neutral Government”, Renewable Energy and Energy Conservation Tax Act of 2007 (Engrossed as Agreed to or Passed by House). [www.thomas.gov](http://www.thomas.gov).

<sup>43</sup> H.R. 6 Sections 6101-6102. [www.thomas.gov](http://www.thomas.gov).

<sup>44</sup> Ibid.

<sup>45</sup> Appendix I, Annexes 1-3. [Panel Report on Korea - Procurement](#), para. 7.59

<sup>46</sup> For the document specifying U.S.-pertinent GPA procurement threshold values, in U.S. currency, for the period 2006-2007, see GAP/W/295/Add. 2. 14 December 2005. Available by search at [www.wto.org](http://www.wto.org).

<sup>47</sup> U.S. Appendix to the GPA – Annex I, see [http://www.wto.org/english/tratop\\_e/gproc\\_e/usa1.doc](http://www.wto.org/english/tratop_e/gproc_e/usa1.doc); Annex II, see

<sup>48</sup> Purchasing by the Department of Agriculture is exempt from GPA coverage if it involves procurement of agricultural products made in furtherance of agricultural support programs or human feeding programs.

<sup>49</sup> U.S. Appendix to the GPA – Annex II, see [http://www.wto.org/english/tratop\\_e/gproc\\_e/usa2.doc](http://www.wto.org/english/tratop_e/gproc_e/usa2.doc); Annex III, see [http://www.wto.org/english/tratop\\_e/gproc\\_e/usa3.doc](http://www.wto.org/english/tratop_e/gproc_e/usa3.doc).

covered by the GPA, the technical specifications for products must not be “unnecessary obstacles to international trade” in violation of GPA Article 6. Product design specifications based on performance as well as “design or descriptive characteristics” are allowed, although the former are explicitly preferred over the latter. In the “Carbon-Neutral Government Act of 2007,” technical specifications for the Federal vehicle fleet appear to be performance-based: the EPA is to identify models and makes of vehicles considered to be “low greenhouse gas emitting.” In doing so, the EPA must apply “the most stringent standards for vehicle greenhouse gas emissions applicable to and enforceable against motor vehicle manufacturers for vehicles sold anywhere in the United States,” based on manufacturers’ fleet averages<sup>50</sup>. H.R. 3221 does not elaborate further on Federal vehicle fleet technical specifications; as Title VI amends Section 303 of the Energy Policy Act of 1992, the 1992 legislation should be consulted for more detailed technical specifications.

Amending the National Energy Conservation Policy Act<sup>51</sup>, H.R. 3221 also contains provisions for Federal procurement of energy efficient products, based on the Energy Star program and Federal Energy Management Program. The GPA allows governments to award contracts not only to the lowest tenders, but also to “the most advantageous” tenders in terms of the specific evaluation criteria listed in “Technical Specifications<sup>52</sup>.” This means that the U.S. government would be justified in purchasing products based on their ability to meet energy efficiency specifications, even if they are not the cheapest products available, without Parties appealing this as “collusive behavior.” The standards that H.R. 3221 employs, e.g. Energy Star ratings, are not international standards, which the GPA encourages. U.S. legislators should encourage U.S. participation in international standards development, because this would facilitate international commerce in general, and make U.S. climate change legislation more WTO-compatible.

The GPA allows for measures “necessary to protect public morals, order, or safety, human, animal, or plant life, health, or intellectual property<sup>53</sup>.” This article parallels the language of GATT Article XX on General Exceptions, which has been applied to measures for preserving clean air by past WTO panels. Nevertheless, government procurement programs, such as the energy efficient product purchasing, must not be applied so as to “arbitrarily” and “unjustifiably” discriminate between “countries where the same conditions prevail” or as a “disguised restriction on international trade<sup>54</sup>.” This language suggests that government procurement program specifications are more likely to qualify for GPA exceptions if governments demonstrate their intent to engage multilaterally.

#### IV. Cap-and-Trade Systems for Greenhouse Gas Emissions

In the Congressional debate over global warming policy, there is a growing consensus

---

<sup>50</sup> Title VI – “Carbon-Neutral Government”, Renewable Energy and Energy Conservation Tax Act of 2007 (Engrossed as Agreed to or Passed by House). [www.thomas.gov](http://www.thomas.gov).

<sup>51</sup> Specifically, Sec. 6203 of H.R. 6 amends the National Energy Conservation Policy Act, Section 553, (42 U.S.C. 8259b). [www.thomas.gov](http://www.thomas.gov).

<sup>52</sup> GPA Article 8.

<sup>53</sup> GPA Article XXIII.

<sup>54</sup> Agreement on Government Procurement. 15 April 1994, registered in accordance with Article 102 of the UN Charter in Marrakesh. <http://www.worldtradelaw.net/uragreements/governmentprocurement.pdf>

that nothing short of an economy-wide, comprehensive, and mandatory solution will be enough to reduce U.S. greenhouse gas emissions by 60 to 80 percent by 2050<sup>55</sup>. Increasingly, comprehensive climate change legislation has focused on the concept of a national cap-and-trade system of emissions allowances<sup>56</sup>, also known as emissions trading. Existing emissions trading programs include the landmark cap-and-trade program for sulfur dioxide emissions in the United States, pursuant to the Montreal Protocol; the EU Directive on Emissions Trading, which went into force in 2005; and the Kyoto Protocol.

Emissions trading programs are not only more comprehensive, but arguably more cost-effective and environmentally-beneficial compared to traditional forms of regulation such as energy subsidies and efficiency standards. Cap-and-trade programs guarantee that a specified level of emissions reductions will be met, while encouraging covered entities to come up with optimal, cost-effective ways to reduce their emissions. From the perspective of WTO-compatibility, cap-and-trade systems are ambiguous. On the one hand, international trade law is very unlikely to impose restrictions on national or regional cap-and-trade systems; on the other hand, in order to be effective, cap-and-trade systems may incorporate auxiliary provisions that directly conflict with WTO law.

At its simplest, a cap-and-trade system is “a method for tracking and accounting for greenhouse gas emissions and having their cost factored into economic decisions<sup>57</sup>.” A white paper released in October 2007 by the House Committee on Energy and Commerce discusses what an economy-wide, mandatory U.S. cap-and-trade system might look like. The program would regulate emissions of four greenhouse gases that together account for all U.S. emissions: carbon dioxide, methane, nitrous oxide, and fluorinated gases. It would extend to all direct sources of emissions in the U.S. economy: electricity generation, transportation, industrial, commercial, residential, and agricultural sectors<sup>58</sup>. The economy-wide emissions “cap” would be divided into “allowances” or “permits,” and allocated among covered entities in emitting sectors of the economy. The transfer, or trading, of excess permits among covered entities would be allowed, motivating entities to emit less and sell excess permits for a profit<sup>59</sup>. The cap would be scaled back progressively until, by 2050, total U.S. greenhouse gas emissions would reach a level that is 60 to 80 percent below present levels<sup>60</sup>.

One of the key challenges of designing a cap-and-trade program is that even the most accurately-administered cap-and-trade program cannot account for all sources of emissions in the U.S. economy. For example, while it is relatively easy to track the emissions of large electricity generating facilities, it is virtually impossible to track the emissions of the entire U.S. vehicle fleet, or the emissions of every residential building<sup>61</sup>. A comprehensive system is best able to cover sectors where there is a low number of very high emitters. Other areas of the economy may

---

<sup>55</sup> “Climate Change Legislation Design” Committee on Energy and Commerce, Subcommittee on Energy and Air Quality. White Paper. October 3, 2007. P. 3.

<sup>56</sup> Emissions trading-based legislation introduced by 110<sup>th</sup> Congress includes S. 280, S. 309, S. 317, S. 485, S. 1766, H.R. 620, H.R. 1590, and others. <http://www.environmentaldefense.org/page.cfm?tagID=1075>.

<sup>57</sup> Ibid.

<sup>58</sup> “Climate Change Legislation Design” p. 2.

<sup>59</sup> “Climate Change Legislation Design” p. 3.

<sup>60</sup> “Climate Change Legislation Design”

<sup>61</sup> Ibid., p 21.

be left uncovered, requiring additional measures to be included in the cap-and-trade policy package. In addition, because of the breadth and impact of the cap-and-trade system on the U.S. economy, transitional support from the government in the form of financial incentives and aid is often added into cap-and-trade legislative packages. Traditional forms of government regulation are therefore an integral part of an effective cap-and-trade system. This policy design characteristic, arrived at by pragmatic limitations, should be a key concern of policymakers in designing climate change legislation that is compatible with international law.

From the perspective of international law compatibility, three points should be observed that encourage cap-and-trade systems over other forms of regulation:

- Few, if any, WTO provisions explicitly prohibit a cap-and-trade system.

The law on regulating cap-and-trade systems that impacts international commerce in goods and services is still forming. If the United States chooses to implement a cap-and-trade system, it would be in its long-term interest to do it sooner rather than later so that it can more effectively participate in forming this body of law. Emissions permits have yet to be defined as a good subject to the GATT 1994, a service subject to the GATS, a financial contribution from government to industry subject to the SCM Agreement, or a non-tariff barrier to trade subject to the TBT. Emissions trading-related measures are excellent candidates for General Exceptions clauses under any WTO agreement they invoke, because they intend to “protect the environment<sup>62</sup>.” However, no WTO case law pertaining to emissions trading exists, and the first such case will likely impact the design of cap-and-trade programs for decades to come. The sooner the United States enacts some form of emissions trading domestically, the greater will be its contribution to the international law of emissions trading.

- Emissions trading schemes (e.g. the Montreal Protocol, the Kyoto Protocol, and the E.U. Emissions Trading Scheme) embody the multilateralism encouraged by international law.

The United Nations Framework Convention on Climate Change (UNFCCC) embodies many WTO principles, and explicitly promotes WTO goals<sup>63</sup>. The Kyoto Protocol, which emerged out of the UNFCCC, encourages national and regional emissions trading schemes because they promote broader participation in international emissions trading<sup>64</sup>. Under Kyoto, cap-and-trade systems “can be established as climate change policy instruments at the national or regional level;” entities in Annex I Parties may use Kyoto emissions reduction units to fulfill

---

<sup>62</sup> Buck, Matthias and Verheyen, Roda. “International Trade Law and Climate Change: A Positive Way Forward”. FES-Analyse Okologische Marktwirtschaft. July 2001. <http://library.fes.de/pdf-files/stabsabteilunt/01052.pdf>. Buck and Verheyen attempt to “restrict” emissions trading using various WTO provisions, but conclude that “overall, it is unlikely that discrimination regarding the trading of emission permits in international markets will occur”, since countries involved are likely to be “global players” and no WTO provision seems to directly apply to emissions trading.

<sup>63</sup> E.g., Article 3.5 of the UNFCCC states that “Means taken to combat climate change, including unilateral ones, should not constitute a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade.” This language parallels the objectives of the World Trade Organization. Implicitly, this suggests that a policy promulgated in accordance with the UNFCCC will also be compatible with WTO principles.

<sup>64</sup> Buck and Verheyen, p. 25.

all or part of their obligations to reduce emissions<sup>65</sup>. This suggests that emissions trading is, in general, compatible with international trade law. An economy-wide cap-and-trade program in the U.S. is not likely to be challenged at the WTO, although it would likely be monitored for international trade impacts<sup>66</sup>.

- U.S. cap-and-trade bills can include provisions based on international mechanisms, such as cross-border trading of emissions permits and clean development projects that increase their compatibility with international law.

As discussed in the next section, climate change policy presents an opportunity for U.S. global leadership. Through cooperation and transfer of clean technologies and knowledge abroad, the United States will accelerate the meeting of environmental targets while expanding the role of U.S. enterprises in the emerging global marketplace for environmental goods and services. Positioning itself as a global player is also the best way to ensure that international law does not infringe on U.S. domestic climate change policies. Over time, international law may come to incorporate successful U.S. policy designs.

However, two important caveats should be noted by U.S. legislators:

- Cap-and-trade systems are often proposed along with traditional forms of federal support and regulation of affected industries. Such provisions are subject to WTO provisions, as discussed in previous sections of this paper.

While WTO law may not prohibit emissions trading, most comprehensive cap-and-trade systems proposed by U.S. legislators are supplemented by traditional forms of government regulation: subsidies, tax-based incentives, efficiency standards, eco-labeling, and other potentially trade-impacting measures. For example, S. 280, the “Climate Stewardship and Innovation Act of 2007” (the Senate version of H.R. 620), augments a cap-and-trade program with transitional support for low-carbon alternative fuels, including nuclear power. Other cap-and-trade bills feature longer transitional assistance provisions. S. 1766, the “Low Carbon Economy Act of 2007,” establishes an Energy Technology Deployment Fund to accelerate the marketability of methane utilization technologies, low and zero-carbon technologies, advanced coal, cellulosic ethanol, and advanced vehicles<sup>67</sup>. S. 309, the “Global Warming Pollution Reduction Act,” incorporates vehicle emissions standards, renewable fuels requirements, energy efficiency and renewable portfolio standards, and low-carbon electricity generation requirements<sup>68</sup>. While few of these provisions are likely to violate WTO principles, it is important to realize that in practice, cap-and-trade systems may not avoid trade-impacting forms of government regulation.

- Opening the national program to international trading heightens the need for U.S. legislation to be compatible with international law from the outset.

---

<sup>65</sup> “Kyoto Mechanisms: Emissions Trading.” UNFCCC International website.  
[http://unfccc.int/kyoto\\_protocol/mechanisms/emissions\\_trading/items/2731.php](http://unfccc.int/kyoto_protocol/mechanisms/emissions_trading/items/2731.php).

<sup>66</sup> Buck and Verheyen, p. 25.

<sup>67</sup> “Climate Change Bills of the 110<sup>th</sup> Congress.” Environmental Defense.  
<http://www.environmentaldefense.org/page.cfm?tagID=1075>.

<sup>68</sup> Ibid.

An example of this design caveat is presented below.

Ex. 1: Emissions Trading and Other Provisions in S. 2191 – “America’s Climate Security Act of 2007”<sup>69</sup>

Introduced on October 18, 2007, S. 2191 establishes a cap-and-trade system covering the electricity generation, transportation, and manufacturing sectors, which together account for over 80% of U.S. emissions. By 2050, the bill aims to cut America’s emissions of carbon dioxide, methane, nitrous oxide, and fluorinated gases by 70% from 2005 levels. Besides the cap-and-trade system, the bill provides for transition assistance that includes \$500 billion of financial incentives for companies and individuals to reduce their emissions through 2030. This transition assistance, more than the cap-and-trade program itself, may invoke WTO concerns. Also, the bill contains international provisions that may simultaneously resonate with international legal principles and significantly impact international trade.

S. 2191 allocates 55 percent of proceeds from national emissions allowance auctioning to an Energy Technology Deployment program<sup>70</sup>. The program provides financial incentives to manufacturers of high-efficiency consumer products and low-carbon electricity generators (45 percent of funds); facilitates the deployment of carbon capture and sequestration projects (28 percent of funds); provides loan guarantees and production payments to encourage cellulosic biomass ethanol technologies (7 percent of funds); and provides incentives for manufacturing advanced technology vehicles (20 percent of funds)<sup>71</sup>.

Federal incentives for utilities and carbon sequestration projects largely affect domestic economic activity, but federal incentives for the manufacture of certain types of automobiles and consumer products may impact international commerce in these goods. If WTO jurisdiction is invoked, “modernization assistance” would become a subsidy “specific to an enterprise or industry”, e.g. automobile manufacturers. Such a subsidy may, for example, be found to be “actionable” from causing “serious prejudice” to foreign manufacturers if they lost market share in the U.S. as a result of the financial incentives.

S. 2191 also provides for efficiency codes for buildings and appliances, such as boilers, used in buildings because the cap-and-trade program does not cover the residential sector. Although building codes are not likely to disrupt international commerce, strict appliance codes may be seen as disadvantageous for foreign manufacturers of these appliances. In particular, space heating and air conditioning products are subjected to regional standards and region-specific labeling requirements, in absence of which these products cannot be distributed commercially<sup>72</sup>. This may implicate GATT 1994 Article III or the TBT Agreement.

Perhaps the most interesting features of S. 2191 from an international legal standpoint are two of its international provisions: international emissions trading that incorporates existing

---

<sup>69</sup> S. 2191 “America’s Climate Security Act of 2007” (Introduced in Senate). [www.thomas.gov](http://www.thomas.gov).

<sup>70</sup> S. 2191 establishes the Climate Change Credit Corporation, a federal government agency, to carry out the auctioning of emission allowances and then to distribute the proceeds from the auctioning of allowances.

<sup>71</sup> S. 2191. Sec 4201-4405. [www.thomas.gov](http://www.thomas.gov).

<sup>72</sup> S. 2191. Sec 5101-5201. [www.thomas.gov](http://www.thomas.gov).

foreign emissions trading schemes, and the International Reserve Allowance Program<sup>73</sup> that aims, among other things, to “ensure that greenhouse gas emissions occurring outside of the U.S. do not undermine the objectives of the U.S. in addressing climate change<sup>74</sup>.” The first provision may indirectly bolster the WTO-compatibility of S. 2191; the second provision, however, may directly violate WTO principles.

First, the cap-and-trade system in S. 2191 enables covered entities in the United States to meet up to 15% of their emissions requirements with allowances or credits obtained on foreign emissions trading markets. This provision explicitly “takes into consideration the protocols adopted in accordance with the United Nations Framework Convention on Climate Change<sup>75</sup>” of which the Kyoto Protocol is one example. S. 2191 raises the possibility of reconciliation between international programs, such as Kyoto, and a U.S. emissions trading system. WTO case law suggests that the Appellate Body may consider the broad orientation and manner in which national policies are conducted to determining how “unjust” or “discriminatory” Members’ policy measures are. In adopting a more global, cooperative stance in climate change policy, legislators make it less susceptible to international legal challenges. However, an internationalized cap-and-trade system is also more likely to impact international trade and invoke WTO jurisdiction.

As previously stated, is not certain at this point that emissions allowances will eventually be treated as “goods” or “products” subject to the GATT 1994. If this were so, then international allowance trading under S. 2191 would risk violating GATT 1994 Article III most-favored nation, national treatment, and non-discrimination principles. This is because S. 2191 accepts only allowances from foreign countries that are determined to have climate change programs of “comparable stringency, including monitoring, compliance, and enforcement<sup>76</sup>” as in the United States. Affected WTO Members might challenge prohibitions on trade in emissions allowances on grounds of “unjust and arbitrary discrimination” as they have challenged trade in goods.

Furthermore, international emissions trading schemes have their own requirements and standards with which the United States should be prepared to comply. The Kyoto Protocol requires that “all international transfers under the realm of regional or domestic trading schemes fit under the umbrella formed by the emissions trading set out in Article 17 of the Protocol<sup>77</sup>.” A U.S. emissions trading program must take measures to not arbitrarily discriminate among countries in selecting who is eligible, and must also prepare to meet the requirements of foreign programs with which it chooses to engage.

Another feature of the cap-and-trade system established under S. 2191 is the International Reserve Allowance Program. Beginning in 2019, allowances from a reserve that is “separate from, and established in addition to” the national reserve will be offered for sale to U.S. importers of “covered goods.” Such goods would include primary products like “iron, steel,

---

<sup>73</sup> S. 2191. Sec 2501-2503; 3802; 6001-6006. [www.thomas.gov](http://www.thomas.gov).

<sup>74</sup> S. 2191. Sec 6002, “Purposes”. [www.thomas.gov](http://www.thomas.gov).

<sup>75</sup> The U.S. remains a signatory to the UNFCCC, however, since 1992.

<sup>76</sup> S. 2191, Sec 2502. [www.thomas.gov](http://www.thomas.gov).

<sup>77</sup> “Emissions Trading: Relationship to Domestic and Regional Emissions Trading Schemes.” UNFCCC online. [http://unfccc.int/kyoto\\_protocol/mechanisms/emissions\\_trading/items/2731.php](http://unfccc.int/kyoto_protocol/mechanisms/emissions_trading/items/2731.php).

aluminum, cement, bulk glass, or paper;” goods that generate, “in the course of the manufacture of the good,” “a substantial quantity” of direct and indirect greenhouse gas emissions; and goods closely related to goods “the cost of production of which in the United States is affected by a requirement of this Act<sup>78</sup>.” U.S. importers will be prohibited from withdrawing covered goods from warehouses unless they submit to the EPA and U.S. Customs and Border Protection the required number of international reserve allowances<sup>79</sup>. Covered goods from all WTO Members and observer countries will be impacted by this provision; the exceptions are the least-developed countries and an “excluded list” of the world’s lowest greenhouse gas emitters<sup>80</sup>.

Among the stated purposes of the International Reserve Allowance Program is “to promote a strong global effort to reduce greenhouse gas emissions” through “measures... that comply with applicable international agreements<sup>81</sup>.” However, several features of the Program may place it in violation of fundamental WTO principles. The Program may restrict the import of covered foreign goods into the United States by raising U.S. importers’ transaction costs and placing quantitative restrictions (a “cap”) on the total amount of covered goods that can be imported into the United States. This may contradict GATT 1994 Article III because it imposes “internal regulations affecting the offering for sale, purchase, or distribution” of imported products that may be “in excess of those applied to like domestic products.” Although the Program relates “to the conservation of exhaustible natural resources” – clean air – and is done “in conjunction with restrictions on domestic production or consumption,” such a cap on imports may not pass the Chapeau of GATT 1994 Article XX on General Exceptions because it may be seen as “arbitrary or unjustifiable discrimination” or a “disguised restriction on international trade.” In determining this, a WTO Appellate Body might resort to a “necessity test” and a “proportionality test<sup>82</sup>.” the contribution of the Program to the success of the U.S. cap-and-trade system would be weighed against the degree of impact that the Program has on imports of covered goods. If the Program’s incremental contribution to the overall success of emissions trading in the United States, by U.S. entities, is seen to be insignificant, then it may not qualify as a “least trade-restrictive measure” and may not qualify for an Article XX restriction, even as part of a comprehensive climate change-abatement system.

The International Reserve Allowance Program also specifies “covered goods” in a WTO-incompatible way. It may violate GATT 1994 Article III by “capping” imports of goods whose manufacture releases large amounts of emissions in foreign countries. In WTO language, this suggests discrimination among products based on non-product related processes and production methods (PPMs). In general, WTO law prohibits the use of non-product related PPMs to distinguish among products that are commercial substitutes<sup>83</sup>. The Program also defines

---

<sup>78</sup> S. 2191, Sec 6001, “Definitions”. [www.thomas.gov](http://www.thomas.gov).

<sup>79</sup> The price of international allowances cannot exceed the price of U.S. domestic allowances.

<sup>80</sup> I.e. those countries that the EPA determines to be contributing less than 0.5 percent to total global emissions.

<sup>81</sup> S. 2191, Sec 6001, “Purposes”. [www.thomas.gov](http://www.thomas.gov).

<sup>82</sup> As was done in the *EC Asbestos* case – see Appendix II, p. 30.

<sup>83</sup> Non-product related PPMs are not reflected in the final product. They result in commercially-substitutable, or “like”, products, and WTO law prohibits discrimination between “like” products. The emissions incurred in producing a good is a perfect example of a PPM that does not distinguish the good from a similar good produced using “clean” PPMs. Discrimination based on non-product related PPMs has been an increasing concern of developing and third-world WTO Members. “Environmental Standards and Process and Production Methods.” Environment and Trade: A Handbook. UN Environmental Programme/International Institute for Sustainable

“covered goods” based on their “close relation” to domestic goods whose production costs rise due to emissions trading in the United States Under WTO scrutiny, such a measure is likely to be in violation of GATT 1994 Article III, Paragraph I, because it applies internal regulations to imported products “so as to afford protection to domestic production.”

Overall, S. 2191 embodies the ambiguous status of cap-and-trade programs in international law: while they are not explicitly prohibited, and may even be encouraged over traditional climate change policy instruments, cap-and-trade systems are largely unable to escape the same international trade-related challenges that traditional climate change legislation faces. This is because in order to reduce emissions and be cost-effective, cap-and-trade systems are supplemented by measures like federal financial transitional assistance and manufacturing incentives, building codes, product efficiency requirements, renewable fuel standards, labeling schemes, etc. Also, ambitious cap-and-trade bills may include provisions that internationalize them, making international trade impacts of the legislation more probable. Domestic and international emissions trading present tremendous opportunities for the U.S. environment and economy. The compatibility of cap-and-trade legislation with fundamental principles of international trade law will increase its effectiveness and reduce its costs in the long run.

#### U.S. Global Leadership through Climate Change Policy

*“National authorities should endeavour to promote the internalization of environmental costs and the use of economic instruments, taking into account the approach that the polluter should, in principle, bear the cost of pollution, with due regard to the public interest and without distorting international trade and investment.”*

*Rio Declaration on Environment and Development (Principle 16) – 12 August 1992*

Climate change is fundamentally a global problem requiring comprehensive, global solutions. The goal of this analysis has been to demonstrate that domestic climate change policy can be envisioned from a global perspective, and how some of the most effective energy and environment policy tools can be reconciled with international trade law. Global climate change is an unprecedented challenge for all governments, but it also presents unprecedented opportunities, not the least of which are related to international commerce. The volume and diversity of climate change bills proposed by the 110<sup>th</sup> Congress demonstrate that Americans’ increasing calls to preserve not only the environment, but our common health, safety, and prosperity, are being met with intellectual endeavor and growing political will.

Climate change policy models that the United States and other countries ultimately adopt have the capacity to influence international trade patterns. International trade law, namely WTO rules, must ultimately reconcile emerging climate change policies and desired patterns of economic growth and development. From the international trade perspective, engaging multilaterally will further U.S. economic interests by facilitating commerce between all nations and making American goods and services among the first to adapt to new standards that, in view of environmental realities, are inevitable. From the environmental perspective, failure to engage multilaterally will mean giving up the fight before it has begun. U.S. domestic climate change

policies will not attain their ambitious environmental objectives unless greenhouse gas emitters like Brazil, Russia, India, and China enact analogous policies.

America possesses the technological prowess, diplomacy, the human capital and natural resources to lead the rest of the world towards common environmental policy goals. This is clearly demonstrated by recent legislation such as the “New Direction for Energy Independence, National Security, and Consumer Protection Act,” H.R. 3221. In this bill suggests a United States determined to fight climate change through international cooperation. Many of its provisions can be found in other bills – reducing the U.S. economy’s dependence on fossil fuels, public funding for renewable energy R&D, development of alternative fuels for transportation, energy efficiency requirements and standards for consumer products and buildings, government eco-labeling programs, and other commonly-recognized solutions. However, these provisions are embedded in a context of forward-looking leadership and international cooperation, observing the significant role of the UN Framework Convention on Climate Change (UNFCCC), the Intergovernmental Panel on Climate Change (IPCC), and envisioning a U.S. leadership role in the next Convention of the Parties in December 2007<sup>84</sup>.

By virtue of being a model of multilaterally-oriented domestic policy, H.R. 3221 may be less likely to conflict with the various agreements in WTO law (for examples of specific provisions, see Appendices II-V). For example, climate change policies with trade-distorting ramifications may be permissible by virtue of being “necessary” to “conserve clean air,” applying Article XX of the GATT 1994. For this provision specifically, WTO law appears to be adopting a tradition, whereby “the more vital the common values or interests pursued,” the more likely measures are to be found “necessary” exceptions to standard WTO practice<sup>85</sup>. In view of the growing urgency of abating anthropogenic climate change, it is significant that WTO rules are not interpreted and applied in a political vacuum<sup>86</sup>. In explicit terms, H.R. 3221 states that the United States sees protection of the global climate as a “vital common interest” – as opposed to a chance to escape the multilateral system – which makes it difficult to question the legislation on WTO grounds<sup>87</sup>. In the past, WTO disputes established that a “serious and substantial effort” to cooperate internationally may influence the Appellate Body’s consideration of the WTO-compatibility of domestic legislation.

International competitiveness concerns of U.S. firms and energy-intensive industries will play a key role in the U.S. debate over climate change legislation. Opponents claim that policies to address climate change tend to result in higher energy prices that put at a competitive disadvantage vis-à-vis countries like India and China, who have not yet enacted similar measures. In this respect, legislation that is multilaterally-oriented and WTO-compatible can allay these domestic competitiveness fears because it is more likely to engage India, China, and

---

<sup>84</sup> Renewable Energy and Energy Conservation Tax Act of 2007 (Engrossed as Agreed to or Passed by House). [www.thomas.gov](http://www.thomas.gov).

<sup>85</sup> *EC-Measures Affecting Asbestos and Asbestos-Containing Products*. Paragraph 173, p. 62. Appellate Body Report. WT/DS135/AB/R. 12 March 2001. <http://docsonline.wto.org/DDFDocuments/t/WT/DS/135ABR.doc>. In this WTO landmark case, an environmental measure passed the “necessity” test to qualify as a GATT Article XX (b) exception for the first time.

<sup>86</sup> Buck, Matthias and Verheyen, Roda. “International Trade Law and Climate Change: A Positive Way Forward”. FES-Analyse Ökologische Marktwirtschaft. July 2001. <http://library.fes.de/pdf-files/stabsabteilung/01052.pdf>

<sup>87</sup> “Trade and Environment at the WTO.” Background paper prepared by Secretariat. 23 April 2004.

other countries than unilaterally WTO-incompatible measures. While decreasing the likelihood that WTO disputes will arise in response to "discriminatory" U.S. environmental regulations, such legislation also may make it a diplomatic liability for other countries not to implement analogous domestic measures. If so, U.S. policymakers will find that their bills are used as an international standard of climate change policy; U.S. enterprises will find themselves on an international "level playing field." Furthermore, U.S. enterprises will have had more time to adapt to the new environmental regulations by the time they become universal in scope. Thus, multilaterally-oriented climate change policy can be both a diplomatic victory for U.S. legislators, and an economic victory for American enterprise<sup>88</sup>. In the end, passage of domestic legislation that is WTO-compliant will accelerate the meeting of U.S. national energy and climate change policy imperatives; will level uncertainties for U.S. enterprises, furthering their leadership in international commerce; and will give the United States a positive international reputation that could positively affect areas of diplomacy outside the sphere of climate change.

---

<sup>88</sup> Stokes, Bruce. "Trade Winds Hit Climate Bills." *National Journal* 7/7/2007. Page 52.

## Appendix I.

### Selected Energy and Climate Change Legislation Introduced in the 110<sup>th</sup> Congress

#### S. 280 – “Climate Stewardship and Innovation Act of 2007” – **Lieberman** (I-CT)

- Introduced January 12
- *A bill to provide for a program to accelerate the reduction of greenhouse gas emissions in the United States by establishing a market-driven system of greenhouse gas tradable allowances, to support the deployment of new climate change-related technologies, and to ensure benefits to consumers from the trading in such allowances, and for other purposes.*
- Co-sponsors: 11 including McCain (R-AZ), Obama (D-IL), Snowe (R-ME), Lincoln (D-AR), Collins (R-ME)
- Committee on Environment and Public Works

#### S. 1766 – “Low Carbon Economy Act of 2007” – **Bingaman** (NM)

- Introduced July 11
- *A bill to reduce greenhouse gas emissions from the production and use of energy, and for other purposes.*
- Co-sponsors: 6
- Committee on Environment and Public Works

#### S. 2191 – “America’s Climate Security Act of 2007” – **Lieberman** (I-CT)

- Introduced October 18
- *A bill to direct the Administrator of the Environmental Protection Agency to establish a program to decrease the emissions of greenhouse gases, and for other purposes.*
- Co-sponsors: 9 including Warner (R-VA)
- Committee on Environment and Public Works

#### HR 6 House – “Creating Long-Term Energy Alternatives for the Nation Act of 2007, or the CLEAN Act of 2007” – **Rahall** (D-WV)

- passed House on January 18
- *An Act to move the United States toward greater energy independence and security, to increase the production of clean renewable fuels, to protect consumers from price gouging, to increase the energy efficiency of products, buildings, and vehicles, to promote research on and deploy greenhouse gas capture and storage options, and to improve the energy performance of the Federal Government, and for other purposes.*
- Co-sponsors: 198
- Ways & Means, Natural Resources, Budget, Rules Committees

#### H.R. 6 Senate – “Renewable Fuels, Consumer Protection, and Energy Efficiency Act of 2007”

- passed Senate on June 21 with an amendment incorporating provisions of the Senate’s energy bill, S. 1419, sponsored by Sen. Reid (D-NV)

#### HR 1506 – “Fuel Economy Reform Act” – **Markey** (D-MA)

- *To increase fuel economy standards for automobiles, and for other purposes.*
- Co-sponsors: 153
- Energy & Commerce Committee

HR 3221 – New Direction for Energy Independence, National Security, and Consumer Protection Act – **Pelosi** (D-CA)

Passed House on August 4.

- *Moving the United States toward greater energy independence and security, developing innovative new technologies, reducing carbon emissions, creating green jobs, protecting consumers, increasing clean renewable energy production, and modernizing our energy infrastructure, and to amend the Internal Revenue Code of 1986 to provide tax incentives for the production of renewable energy and energy conservation.*
- Co-sponsors: 18
- Energy & Commerce, Education & Labor, Foreign Affairs, Small Business, Science & Technology, Agriculture, Oversight & Government Reform, Natural Resources, Transportation & Infrastructure, Armed Services Committees

HR 2776 – “Renewable Energy and Energy Conservation Tax Act of 2007” – **Rangel** (D-NY)

- Passed House on August 4, appended at the end of HR 3221
- *To amend the Internal Revenue Code of 1986 to provide tax incentives for the production of renewable energy and energy conservation.*
- Co-sponsors: 21

## Appendix II.

### Selected WTO/GATT 1994 provisions relating to energy efficiency standards and eco-labeling<sup>89</sup> :

#### **GATT 1994 Article III: National Treatment on Internal Taxation and Regulation**

##### **Paragraph 1**

- “...internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.”

##### **Paragraph 2**

- “The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.”

##### **Ad Article III, Paragraph 2**

- “A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed.”

##### **Paragraph 4**

- “The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.”

##### **Paragraph 5**

- “No contracting party shall establish or maintain any internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions which requires, directly or indirectly, that any specified amount or proportion of any product which is the subject of the regulation must be supplied from domestic sources. Moreover, no contracting party shall otherwise apply internal quantitative regulations in a manner contrary to the principles set forth in paragraph 1.”

##### **Ad Article III, Paragraph 5**

- “Regulations consistent with the provisions of the first sentence of paragraph 5 shall not be considered to be contrary to the provisions of the second sentence in any case in which all of the products subject to the regulations are produced domestically in substantial quantities. A regulation cannot be justified as being consistent with the provisions of the second sentence on the ground that the proportion or amount allocated to each of the products which are the subject of the regulation constitutes an equitable relationship between imported and domestic products.”

##### **Paragraph 7**

- “No internal quantitative regulation relating to the mixture, processing or use of products in specified amounts or proportions shall be applied in such a manner as to allocate any such amount or proportion among external sources of supply.”

#### **GATT 1994 Article XX: General Exceptions**

##### **Chapeau**

---

89 Throughout this paper, specific WTO provisions are cited from *WTO Analytical Index – Guide to WTO Law and Practice*. Volume 2. September 2007, online version available through the WTO’s official website at [http://www.wto.org/english/res\\_e/booksp\\_e/analytic\\_index\\_e/analytic\\_index\\_e.htm](http://www.wto.org/english/res_e/booksp_e/analytic_index_e/analytic_index_e.htm).

- “Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade,” allows Members to adopt and enforce measures:

#### **Paragraph (b)**

- “necessary<sup>90</sup> to protect human, animal or plant life or health;

#### **Paragraph (g)**

- “relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.”

### **WTO Agreement on Technical Barriers to Trade (TBT)**

#### **Preamble**

- “*Desiring*... to encourage the development of international standards and conformity assessment systems” as they “improve efficiency of production and facilitate international trade”, while ensuring that “technical regulations and standards, including packaging, marking and labeling requirements, and [associated] procedures for assessment of conformity... do not create unnecessary obstacles to international trade...”
- “*Recognizing* that no country should be prevented from taking measures necessary to ensure the... protection of human, animal or plant life or health, of the environment, at the levels it considers appropriate, subject to the requirement that they are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade...”

#### **Article 1.3**

- “All products, including industrial and agricultural products, shall be subject to the provisions of this Agreement.”

#### **Article 2.1**

- “Members shall ensure that in respect of technical regulations, products imported from the territory of any Member shall be accorded treatment no less favourable than that accorded to like products of national origin and to like products originating in any other country.”

#### **Article 2.2**

- “Members shall ensure that technical regulations are not prepared, adopted or applied with a view to or with the effect of creating unnecessary obstacles to international trade. For this purpose, technical regulations shall not be more trade-restrictive than necessary to fulfil a legitimate objective, taking account of the risks non-fulfilment would create. Such legitimate objectives are, *inter alia*: national security requirements; the prevention of deceptive practices; protection of human health or safety, animal or plant life or health, or the environment. In assessing such risks, relevant elements of consideration are, *inter alia*: available scientific and technical information, related processing technology or intended end-uses of products.”

#### **Article 2.6**

- “With a view to harmonizing technical regulations on as wide a basis as possible, Members shall play a full part, within the limits of their resources, in the preparation by appropriate international standardizing bodies of international standards for products for which they either have adopted, or expect to adopt, technical regulations.”

---

90 The “necessity test” of Article XX, Paragraph b, has gradually evolved from the “least trade-restrictive” into the “less trade-restrictive” approach. It is supplemented by a “proportionality test” of “weighing and balancing factors” such as the contribution of a given measure to the regulation of the trade at stake, the importance of the affected values or interests, and the degree of impact of the measure on imports and exports, etc. That is, there has been more flexibility in applying Article XX Paragraph b following several WTO dispute cases. In the *EC Asbestos* case, an environmental measure passed the necessity test for the first time, the Appellate Body noting that “the more vital the common values or interests pursued”, the likelier the measure is to pass the “necessity test”. See “Trade and Environment at the WTO” 23 April 2004. Background document prepared by the Secretariat. [http://www.wto.org/english/tratop\\_e/envir\\_e/envir\\_wto2004\\_e.pdf](http://www.wto.org/english/tratop_e/envir_e/envir_wto2004_e.pdf). Article XX Paragraph b is likely to become more applicable to climate change measures, rather than less applicable, because the “importance of affected values or interests” behind climate change measures has grown substantially in recent years.

## Article 2.8

- “Wherever appropriate, Members shall specify technical regulations based on product requirements in terms of performance rather than design or descriptive characteristics.”

## Annex I: Terms and their Definitions for the Purposes of this Agreement

- *Technical regulation*: “Document which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method.”
- *Standard*: “Document approved by a recognized body, that provides, for common and repeated use, rules, guidelines or characteristics for products or related processes and production methods, with which compliance is not mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production methods.”

## Selected WTO/GATT 1994 provisions relating to subsidies for climate-friendly investments:

### WTO Agreement on Subsidies and Countervailing Measures (SCM)

#### Article 1: Definition of a Subsidy<sup>91</sup>

- “For the purpose of this Agreement, a subsidy shall be deemed to exist if: (A) there is a financial contribution by a government... where: a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees); government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits)<sup>92</sup>; a government provides goods or services other than general infrastructure, or purchases goods; a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments; or (A-2) there is any form of income or price support in the sense of Article XVI of GATT 1994; and (B) a benefit is thereby conferred.
- A subsidy as defined in paragraph 1 shall be [subject to classification as ‘prohibited’, ‘actionable’, or ‘non-actionable’] only if such a subsidy is specific in accordance with the provisions of Article 2.

#### Article 2: Specificity

- ...a subsidy... is specific to an enterprise or industry or group of enterprises or industries (“certain enterprises”) [when]: (a) the granting authority explicitly limits access to a subsidy to certain enterprises; (b) there are no [official] objective criteria... (neutral, economic in nature, and horizontal in application) governing eligibility for, and amount of, a subsidy; (c) if, notwithstanding any appearance of non-specificity, there are reasons to believe that a subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy...”
- “A subsidy which is limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific...”

#### Article 3: Prohibition (relates to ‘prohibited’ subsidies)

- “Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited: (a) subsidies contingent, in law or in fact\*, solely or as one of several other conditions, upon

<sup>91</sup> The following citations may not replicate exactly, or may omit parts of, the actual provisions. For more detail, please refer to the paper or online source, which itself does not have the authority of the WTO legal documents it replicates. All WTO provisions in this paper are obtained from *WTO Analytical Index – Guide to WTO Law and Practice*. Volume 2. September 2007, online version available at [http://www.wto.org/english/res\\_e/booksp\\_e/analytic\\_index\\_e/subsidies\\_02\\_e.htm#article6](http://www.wto.org/english/res_e/booksp_e/analytic_index_e/subsidies_02_e.htm#article6).

<sup>92</sup> However, “the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued” is not a “subsidy”. This is in accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of the SCM Agreement.

export performance, including those illustrated in Annex I; (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.”

- \*footnote to Article 3.1: “This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.”
- “A Member shall neither grant nor maintain subsidies referred to in paragraph 1.”

#### **Article 5: Adverse Effects (relates to ‘actionable’ subsidies)**

- “No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.: (a) injury to the domestic industry of another Member; (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994; (c) serious prejudice to the interests of another Member.”

#### **Article 6: Serious Prejudice (relates to ‘actionable’ subsidies)**

- Serious prejudice... may arise in any case where: (a) the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member; (b) the effect of the subsidy is to displace or impede the exports of a like product of another Member from a third country market; (c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market; (d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted; etc.

### Selected WTO/GATT 1994 provisions relating to Government Procurement of Climate-Friendly Products and Services:

#### **Agreement on Government Procurement (GPA)<sup>93</sup>**

##### **Article I: Scope and Coverage**

- “This Agreement applies to any law, regulation, procedure or practice regarding any procurement by entities covered by this Agreement, as specified in Appendix I.”

##### **Article III.1: National Treatment**

- “With respect to all laws, regulations, procedures and practices regarding government procurement covered by this Agreement, each Party shall provide immediately and unconditionally to the products, services and suppliers of other Parties offering products or services of the Parties, treatment no less favourable than: (a) that accorded to domestic products, services and suppliers; and (b) that accorded to products, services and suppliers of any other Party.

##### **Article III.2: Non-Discrimination**

- “With respect to all laws, regulations, procedures and practices regarding government procurement covered by this Agreement, each Party shall ensure: (a) that its entities shall not treat a locally-established supplier less favourably than another locally-established supplier on the basis of degree of foreign affiliation or ownership; and (b) that its entities shall not discriminate against locally-established suppliers on the basis of the country of production of the good or service being supplied, provided that the country of production is a Party to the Agreement in accordance with the provisions of Article IV.”

##### **Article VI.1: Technical Specifications**

---

<sup>93</sup> The following citations may not replicate exactly, or may omit parts of, the actual provisions. For more detail, please refer to the paper or online source, which itself does not have the authority of the WTO legal documents it replicates. All WTO provisions in this paper are obtained from *WTO Analytical Index – Guide to WTO Law and Practice*. Volume 2. September 2007, online version available at: [http://www.wto.org/english/res\\_e/booksp\\_e/analytic\\_index\\_e/gpa\\_01\\_e.htm#pA](http://www.wto.org/english/res_e/booksp_e/analytic_index_e/gpa_01_e.htm#pA).

- “Technical specifications laying down the characteristics of the products or services to be procured, such as quality, performance, safety and dimensions, symbols, terminology, packaging, marking and labeling, or the processes and methods for their production and requirements relating to conformity assessment procedures prescribed by procuring entities, shall not be prepared, adopted or applied with a view to, or with the effect of, creating unnecessary obstacles to international trade.”
- “Technical specifications prescribed by procuring entities shall, where appropriate: (a) be in terms of performance rather than design or descriptive characteristics; and (b) be based on international standards, where such exist; otherwise, on national technical regulations, recognized national standards, or building codes.”

### **Article XIII: Submission, Receipt, and Opening of Tenders and Awarding of Contracts**

- (b) “Unless in the public interest an entity decides not to issue the contract, the entity shall make the award to the tenderer who has been determined to be fully capable of undertaking the contract and whose tender, whether for domestic products or services, or products or services of other Parties, is either the lowest tender or the tender which in terms of the specific evaluation criteria set forth in the notices or tender documentation is determined to be the most advantageous.”

### **Article XV: Limited Tendering**

- (j) [limited tendering is allowed] “provided that [it] is not used with a view to avoiding maximum possible competition or in a manner which would constitute a means of discrimination among suppliers of other Parties or protection to domestic producers or suppliers: (j)in the case of contracts awarded to the winner of a design contest provided that the contest has been organized in a manner which is consistent with the principles of this Agreement, notably as regards the publication, in the sense of Article IX, of an invitation to suitably qualified suppliers, to participate in such a contest which shall be judged by an independent jury with a view to design contracts being awarded to the winners.”

### **Article XXIII: Exceptions to this Agreement**

- Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent any Party from imposing or enforcing measures: necessary to protect public morals, order or safety, human, animal or plant life or health or intellectual property; etc.

## Additional WTO provisions

### **General Agreement on Trade in Services (GATS)**

#### **Article II: Most Favored Nation Treatment**

- “With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.”
- “A Member may maintain a measure inconsistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions.”
- “The provisions of this Agreement shall not be so construed as to prevent any Member from conferring or according advantages to adjacent countries in order to facilitate exchanges limited to contiguous frontier zones of services that are both locally produced and consumed.”





Copyright © 2007, National Foreign Trade Council  
All rights reserved

This paper, or parts thereof, may not be reproduced in any form without prior  
permission from The National Foreign Trade Council, Inc.