

## **A Call for a WTO Climate Waiver**

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Two separate international institutions might be positioned to ensure that international trade and climate change mitigation are aligned. But these two regimes—centered on the World Trade Organization (WTO) and the United Nations Framework Convention on Climate Change (UNFCCC)—are instead on a collision course. The WTO and the parties to the Paris Agreement need to find ways to make their rules, procedures, and action agendas mutually supportive—ideally working together to ensure alignment. If the inescapable connections between trade and climate change are not addressed, a clash will occur as the world simultaneously endeavors to continue to trade within the WTO framework and fight against climate change through the UNFCCC—putting both regimes at risk.

Neither of these two international regimes has considered the likely consequences of the trade restrictions that will surely be a part of many national measures that will be enacted to address climate change.<sup>1</sup> Yet these consequences will soon become real. Unavoidably, much of the climate change action will restrict or otherwise affect trade. “Trade-related elements feature prominently in climate contributions under the Paris Agreement,” and, by one reckoning, “around 45 percent of all climate contributions include a direct reference to trade or trade measures.”<sup>2</sup> As countries everywhere begin to increase their climate change ambitions and add to their national climate pledges, trade-related climate change measures will emerge and multiply.

Climate change measures affecting trade will fall within the scope of the WTO agreement and, as these measures begin to impede the flow of trade, they will surely lead to WTO dispute

settlement. Some of these trade-restrictive national climate change measures will be adopted purely for climate change reasons and solely in furtherance of national pledges made under the Paris Agreement. Others will result from domestic fears of “carbon leakage” and a loss of national competitiveness if domestic climate change actions are not matched by similar climate change actions by foreign trading partners. Still other national measures will be motivated by both climate and competitiveness concerns, making it difficult to discern one purpose from the other in assessing their legitimacy as climate change actions. WTO disputes resulting from all these measures will confront numerous unanswered legal questions due to the absence of relevant WTO jurisprudence and the inadequacy of trade rules written some seventy years ago, long before the emergence of climate change as a global concern.

To minimize the political and economic risks of such a collision for both the WTO and the UNFCCC, WTO members must adopt a WTO climate waiver. A climate waiver permitting trade restrictions in specific national measures taken to advance the struggle against climate change would do the most to help slow climate change while posing the least risk to the indispensable basic rules of non-discrimination that underpin the WTO-based world trading system.<sup>3</sup>

To enact a WTO climate waiver, the separate silos of trade and climate change must be united by bringing together the negotiators on both topics to discuss the trade-climate nexus. The topic of the relationship between trade and climate change must be high on the WTO agenda. A committed group of WTO members must request a collective waiver of the application of certain obligations of the Multilateral Trade Agreements to climate change measures due to the “exceptional circumstances” created by climate change. A group of WTO members must then be tasked by all WTO members with framing and proposing such a WTO climate waiver. Next, a

draft of a waiver decision must be prepared and submitted by this member group. That waiver decision must then be adopted by the members of the WTO.<sup>4</sup> In addition to this process for securing a climate waiver, it is important to remember that a climate waiver must be only the first of many ways in which WTO Members revise and realign WTO rules in accordance with the global objectives of sustainable development. A successful conclusion to the negotiations on an agreement to eliminate duties on environmental goods would be a good start—but only a start.

The content of a WTO climate waiver will be shaped according to the legal characteristics of Article IX:3 of the WTO Agreement. Article IX:3 provides that “[i]n exceptional circumstances, the Ministerial Conference may decide to waive an obligation imposed on a Member by this Agreement or any of the Multilateral Trade Agreements, provided that any such decision shall be taken by three-fourths of the Members...”<sup>5</sup> A waiver permits WTO members to take actions that, in the absence of a waiver, could be judged inconsistent with their WTO obligations. A waiver does not change WTO rules, but rather waives certain trade obligations in certain defined situations for certain defined kinds of measures. The trade obligations in the WTO treaty can be changed only if WTO members adopt an amendment to the WTO covered agreements.<sup>6</sup> Thus, the adoption of a climate waiver will offer WTO members the greatest opportunity to experiment by realigning relevant trade rules for the sole purpose of addressing climate change without changing those rules.

Although some may object that a waiver is not an effective choice because of its temporary nature, a climate waiver need not be temporary. Waivers are generally only granted for one year. The WTO Agreement provides that “[a]ny waiver granted for a period of more than one year shall be reviewed by the Ministerial Conference not later than one year after it is granted, and thereafter annually until the waiver terminates.”<sup>7</sup> However, non-temporary waivers

have been enacted. In 2003, the WTO waived some WTO intellectual property rules to permit compulsory licensing of certain drugs needed to ensure public health. This waiver was set to terminate on the date when an amendment to the intellectual property rules replacing the provisions of that waiver took effect.<sup>8</sup> A WTO climate waiver should be similarly crafted: the waiver would apply unless and until an amendment was adopted by WTO members replacing the provisions of the climate waiver with new and revised rules.

Others have observed that, with exceptions such as the public health waiver, WTO waivers have generally been granted for limited purposes, and usually to one country involving one discrete trade issue. A WTO climate waiver will not be an individual waiver; it will be a collective waiver.<sup>9</sup> And, however carefully it may be circumscribed, a WTO climate waiver will be sweeping in its impact as climate change actions spread worldwide. Consistent with the WTO rules for waivers, a WTO climate waiver, at the outset, “shall state the exceptional circumstances justifying the decision, the terms and conditions governing the application of the waiver, and the date on which the waiver shall terminate.”<sup>10</sup> The “exceptional circumstances” are those presented by the unique global challenge of climate change that create the necessity for realigning trade rules to help confront that challenge. The terms and conditions are the specific trade obligations identified that are to be waived for the application of specific national climate change measures, also identified in the waiver. The date on which the waiver shall terminate will be the date on which an amendment is adopted by two-thirds of WTO members replacing the provisions of the climate waiver with new and revised rules.

Another likely source of objection to a WTO climate waiver is the requirement that three-fourths of the WTO members must take the decision to grant the waiver. In practice, a consensus of all WTO members has been sought in support of a waiver, making this hurdle even higher. No

doubt it will be no easy task to muster the needed support of the WTO membership to adopt a WTO climate waiver. The considerable political difficulties of doing so must not be underestimated. Yet, this conceded, the current political hurdles to other conceivable legal options under WTO rules for reconciling trade and climate change are much higher. However difficult it may be to enact a climate waiver, it would, for instance, be far more difficult to secure a sweeping amendment of existing WTO rules to align them more with countering climate change. It is far better, too, to face these hurdles to enact a climate waiver than to flail in the fallout of legal confrontation in WTO dispute settlement.<sup>11</sup> A dispute between two WTO members over the legitimacy of a climate change measure restricting trade without WTO guidance would likely result in grave consequences for the trade and climate change regimes.

To facilitate carbon pricing and a green transition in the global economy, nations should negotiate a waiver of the application of WTO trade rules to trade-restrictive national measures that:

- Discriminates based on the amount of carbon and other greenhouse gases consumed or emitted in the making of a product,
- Fits the definition of a climate change response measure as defined by UNFCCC, and
- Does not discriminate in a manner that constitutes a means of arbitrary or unjustifiable discrimination or a disguised restriction on international trade.

For a WTO climate waiver to work, we must know which national measures can be justified as climate response measures, and which cannot. The specifics of what would qualify are unknown. Climate change rules speak of “response measures” but do not define them. Trade rules speak of environmental measures only in terms of technical regulations and of the same

longstanding environmental exceptions that have been in the GATT since 1947. Many climate change response measures will undoubtedly fit within the roomy bounds of these provisions, but should WTO members leave it to WTO judges to decide whether they do or do not fit on a case-by-case basis in WTO dispute settlement? Ideally, the UNFCCC should define the term itself in consultation with the WTO. The WTO would then adopt the UNFCCC definition in the content of a WTO climate waiver. Some climate change negotiators have begun to see the need for an agreed definition of a “response measure”—yet the forum created under the Paris Agreement to improve understanding of the impacts of response measures and to increase resilience to them is nowhere near to agreeing on a definition.<sup>12</sup> Indeed, it has hardly grappled with this task, even though we cannot know precisely which impacts and which resiliency we must consider unless we first identify *from what* the impacts and the resiliency result.

We must also agree on how to measure carbon emissions. No WTO climate waiver will succeed without such agreement, for it will be difficult to make trade distinctions based on carbon and other greenhouse gas emissions if we do not agree on a common approach for tracking and verifying them. What is more, it will be doubly difficult to do so if there are competing approaches for measuring those emissions. There is no universally agreed way of calculating carbon dioxide and other greenhouse gas emissions from production and consumption, and thus there is no consensus on how to track national progress toward keeping climate change promises and accelerating international progress toward reducing carbon and other greenhouse gas emissions under the Paris Agreement. Metrics for measuring the amount of carbon dioxide and other greenhouse gas emissions adopted by the UNFCCC Conference of Parties should be incorporated by reference in the content of a WTO climate waiver and used by the WTO for all purposes relating to the waiver.

A substantive concern about a WTO climate waiver is that the adoption of such a waiver could signal that trade-related climate change measures are all illegal in the absence of a waiver, and that this could “narrow down existing flexibility under WTO law.”<sup>13</sup> This concern should be eliminated in the content of the climate waiver, which should state that nothing in the waiver should be construed in WTO dispute settlement as suggesting that a waiver is needed because, without one, all climate change-related trade restrictions will necessarily be inconsistent with WTO rules. With respect to trade in goods, it should be emphasized in the climate waiver that the environmental and other defenses in Article XX of the General Agreement on Tariffs and Trade remain in full force and are available to justify climate change actions affecting trade.

Another substantive concern is that adoption of a WTO climate waiver will legitimize and unleash a global wave of direct “disguised protectionism” mainly by developed countries against the trade of developing countries.<sup>14</sup> To assuage this concern, the content of a WTO climate waiver should include a statement in the beginning that nothing in the waiver should be construed to support disguised trade protection. Moreover, the content of the climate waiver should also include a statement that, notwithstanding what else is included in the waiver, measures must continue to comply with the chapeau of Article XX of the GATT and with Article 3.5 of the UNFCCC, which should both then be referenced and quoted in the text of the waiver.

The chapeau of GATT Article XX sets out obligations relating to the application of national measures that fall within the general exceptions to the WTO obligations relating to trade in goods. It provides that the environmental and other general exceptions listed in Article XX are “[s]ubject 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.”<sup>15</sup> In parallel with this key

provision in the trade rules, Article 3.5 of the UNFCCC states, “Measures 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.”<sup>16</sup> Even if a measure taken by a WTO member is of a kind for which a climate waiver might otherwise be justified, it should not be eligible for the climate waiver if it is applied in a manner that results in arbitrary or unjustifiable discrimination or a disguised restriction on international trade.

The wording of a WTO climate waiver will need to be precise in setting out these requirements so that the applicability of the waiver will be confined to true climate change response measures. Developed countries will be tempted to employ a climate waiver as a cloak for mere protectionism. Developing countries will be rightly apprehensive that they will do so. With these considerations in mind, if a WTO climate waiver is carefully crafted and scrupulously limited only to measures that meet these requirements, it will do the most toward addressing climate change while risking the least to the trading system. A WTO climate waiver will enable the continuation of the flow of trade while also imposing a justifiable price on trade when it is fueled by greenhouse gas emissions.

A climate change waiver could permit trade restrictions as part of climate change actions while avoiding the “slippery slope” of redefining the pivotal trade concept of “like products.”<sup>17</sup> Dealing with carbon emissions by redefining the traditional notion of “like products” in trade law is not desirable because it would open Pandora’s box to other trade restrictions sought for any number of other reasons. However well intentioned each one of them might be when viewed one by one, an accumulation of such WTO waivers would have the effect of undermining the overall foundation of non-discrimination upon which the rules-based trading system is based.

Such a climate waiver will also give WTO judges the legal tools they will need to be able to distinguish a climate change measure from any other measure, and a justifiable climate change measure from one that is not. Without a WTO waiver, and without a UNFCCC agreement on a definition of climate change “response measures” and a common measurement of carbon and other greenhouse gas emissions, WTO judges will be left largely to draw these lines themselves. This will be especially true when they are presented with a dispute where one country claims a trade restriction is a WTO violation, while the another country insists that the measure is a legitimate climate change measure and therefore justified under the exceptions in Article XX of the GATT, the provisions in the Agreement on Technical Barriers to Trade, or both.

A WTO climate change waiver would apply to trade in goods. To the extent that a nexus could be shown with carbon and other greenhouse gas consumption or emissions, a climate waiver could also apply to trade in services and to intellectual property. Preferential trade agreements concluded outside the legal scope of the WTO treaty by WTO Members can often be proving grounds for new, “WTO-plus” approaches in advancing international trade. Trade restrictions that meet these requirements in preferential trade agreements among WTO Members could also be included within the coverage of a WTO climate waiver.

A WTO climate change waiver should also employ WTO rules to combat climate change by imposing some new and more specific disciplines on fossil fuel subsidies. Estimates of the annual amount of fossil fuel subsidies globally range from the hundreds of billions of dollars to trillions of dollars—a perverse situation at a time when it is urgent to move away from fossil fuels.<sup>18</sup> At the WTO Ministerial Conference in Buenos Aires in December 2017, 12 of the 164 members of the WTO issued a declaration expressing the need for fossil fuel subsidy reforms in the existing WTO rules. Including such reforms in a climate waiver would be a beginning on

which the WTO could build in limiting fossil fuel subsidies as part of the global battle against climate change.

Inspired by a desire to support a swift transition to the low-carbon and eventually no-carbon world of a green and sustainable economy, the governments of many WTO members have subsidized the development of solar, wind, and other forms of renewable energy. In a growing number of WTO disputes, these green subsidies have run afoul of WTO rules that discipline market-distorting subsidies.<sup>19</sup> A climate waiver should permit the right kinds of green subsidies while continuing to discipline the wrong kinds.

The right kind of green subsidy is one that supports the green transition even though it may distort trade. The wrong kind of green subsidy is one that distorts trade without facilitating and furthering the green transition, or, worse, that does so while frustrating the green transition. One example of this type of subsidy is one that contains domestic content requirements, privileging domestic production over imports. These requirements distort trade while denying domestic producers and consumers alike the benefits of the competition, lower prices, and broader choices of the more effective energy and environmental alternatives offered by foreign trade and foreign direct investment.<sup>20</sup> The WTO climate change waiver should deny domestic content subsidies.

Michael Trebilcock and James Wilson suggest that a climate change waiver should be structured such that it accepts the use of green subsidies only when the rules governing their use would be considered “winner-neutral.”<sup>21</sup> Instead of green subsidies that target specific *technologies*, they advocate green subsidies that target specific *outcomes*. The reason for this is that although new technologies may seem promising in concept and at the outset, they may or may not fulfill their initial promise and succeed. Moreover, markets should be picking

technological winners, not governments. The overall goal of a climate waiver would be to reduce greenhouse gas emissions. A WTO climate waiver should draw a legal line that waives only those green subsidies that achieve this goal. Especially, the necessary line-drawing in the waiver in pursuit of this goal should permit subsidies for basic research and development, which is indispensable to innovation in clean energy.<sup>22</sup>

To make a WTO climate waiver fully successful, it will also be necessary for the Members of the WTO to agree at the same time when they approve the waiver on a legal interpretation of the existing GATT rule on border tax adjustments. Issuing this legal interpretation separately but simultaneously with the adoption of a WTO climate waiver will maximize the support provided by the world trading system for climate change action.

Generally, WTO rules require that tax measures be applied consistently with obligations of non-discrimination and with the trade concessions made and listed in each WTO member's schedule of concessions attached to and incorporated into the WTO treaty. Since the birth of the multilateral trading system in 1947, however, trade rules have permitted border tax adjustments as an exception to these general obligations. Under the GATT, a border tax adjustment equivalent to an internal tax is permitted as a charge on imported products. Likewise, a border tax adjustment is permitted also as a remission on exported products.<sup>23</sup> Under the GATT, only indirect taxes on products—such as sales taxes—may be adjusted at the border, while direct taxes on producers may not be.

It is not clear from the limited WTO jurisprudence on this issue whether a carbon tax is a direct tax on a producer or an indirect tax on a product. Therefore, there is no legal certainty as to whether a carbon tax is a permitted border tax adjustment under WTO rules. There is also no WTO case law or other agreed statement that tells us whether a tax on inputs—such as fossil

fuels—that are not physically incorporated into a final product is a tax that can be adjusted at the border consistently with obligations under the GATT. These two uncertainties in the meaning of international trade law are powerful disincentives to the enactment by any WTO member of a carbon tax.

The WTO Ministerial Conference and the WTO General Council have the exclusive authority to adopt legal interpretations of WTO obligations either by consensus or, if there is no consensus, by vote of a three-fourths majority of the WTO membership.<sup>24</sup> To date, no such legal interpretation has ever been adopted, and, without question, adopting one will not be easily achieved. Yet a failure to adopt a legal interpretation could—if there is a clash in WTO dispute settlement—have political consequences much more challenging than those posed by the political hurdles to the adoption for the first time of a legal interpretation of WTO obligations.

In concert with the adoption of a WTO climate waiver, the members of the WTO should adopt a formal legal interpretation clarifying that a tax on inputs such as fossil fuels that are not physically incorporated into a final product is a tax that can be adjusted at the border under WTO law and, furthermore, that a carbon tax or any other similar tax based on the amount of carbon consumed or emitted in making a product is an indirect tax on a product that is eligible for a border tax adjustment.

Additional examples abound throughout the WTO treaty of how trade rules must be reimagined to reflect the intertwining and inescapable relationship between economy and environment. This is especially important if our trade regime is to support climate change action and other actions to achieve our goals for global sustainable development.<sup>25</sup> The economy and the environment are one and the same, and they must be treated as one and the same when developing international rules for global governance. Our economic future cannot be separated

from our environmental future, and vice versa. An understanding of this basic truth must become central to all that is done by the WTO. Any truly relevant discussion of bringing the WTO fully into the 21<sup>st</sup> century must begin with a reimaging of the trade rules to support global sustainable development.

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## Notes

<sup>1</sup> James Bacchus, *Special Report: The Case for a WTO Climate Waiver*, (Waterloo, Canada: Centre for International Governance Innovation, 2017), 1-4.

<sup>2</sup> Clara Brandi, *Trade Elements in Countries' Climate Contributions under the Paris Agreement*, (Geneva: International Centre for Trade and Sustainable Development, 2017), vii; Rana Elkahwagy et al., *UNFCCC Nationally Determined Contributions: Climate Change and Trade*, (Geneva: Centre for Trade and Economic Integration Working Paper 2017-02, 2017).

<sup>3</sup> James Bacchus, *Global Rules for Mutually Supportive and Reinforcing Trade and Climate Regimes*, (Geneva: International Centre for Trade and Sustainable Development and World Economic Forum, 2016); James Bacchus, *Triggering the Trade Transition: The G20's Role in Reconciling Rules for Trade and Climate Change*, (Geneva: International Centre for Trade and Sustainable Development, 2018).

<sup>4</sup> James Bacchus, *Special Report: The Case for a WTO Climate Waiver*; James Bacchus, "The Content of a WTO Climate Waiver," *CIGI Papers*, No. 204 (Waterloo, Canada: Centre for International Governance Innovation, 2018); James Bacchus, *The Willing World: Shaping and Sharing a Sustainable Global Prosperity* (Cambridge: Cambridge University Press, 2018), 236-245.

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<sup>5</sup> Marrakesh Agreement Establishing the World Trade Organization, General Agreement on Tariffs and Trade, Article IX:3, 1867 UNTS 154, 33 ILM 1144 (1994).

<sup>6</sup> Marrakesh Agreement, Article X.

<sup>7</sup> General Agreement on Tariffs and Trade, Article IX:4, Marrakesh Agreement Establishing the World Trade Organization, 1869 U.N.T.S. 183, 33 I.L.M. 1167 (1994).

<sup>8</sup> WTO General Council, Implementation of Paragraph 6 of the Doha Declaration on the TRIPS Agreement and Public Health, Decision of 30 August 2003, WTO Doc. WT/L/540, (2003).

<sup>9</sup> Bacchus, *The Case for a WTO Climate Waiver*, 23.

<sup>10</sup> Marrakesh Agreement, Article IX:4.

<sup>11</sup> Bacchus, *The Case for a WTO Climate Waiver*, 20-21. See this source for an extended discussion on this point.

<sup>12</sup> United Nations Framework Convention on Climate Change, "Preamble to the Paris Agreement, Article 4.15" *United Nations Treaty Series*, registration no. I-54113, (Paris: United Nations, 2015), [https://unfccc.int/sites/default/files/english\\_paris\\_agreement.pdf](https://unfccc.int/sites/default/files/english_paris_agreement.pdf). The term "response measure" has been much discussed for decades by the climate regime, but it remains a term that means different things to different people. The importance of its meaning is reflected throughout the Paris Agreement. The preamble of the agreement itself recognizes "that Parties may be affected not only by climate change, but also by the impacts of the measures taken in response to it." Article 4.15 of the climate agreement urges parties to "take into consideration in the implementation of this Agreement the concerns of Parties with economies most affected by the impacts of response measures, particularly developing country Parties."<sup>12</sup> Likewise, the preamble of the decision by the climate Conference of Parties adopting the Paris Agreement

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acknowledges “the specific needs and concern of developing country Parties arising from the impact of the implementation of response measures.”

<sup>13</sup> Kasturi Das et al., *Making the International Trade System Work for Climate Change: Assessing the Options*, (London: Climate Strategies, 2018), 8.

<sup>14</sup> Das et al., *Making the International Trade System Work*, 19.

<sup>15</sup> Marrakesh Agreement, Article XX.

<sup>16</sup> United Nations Framework Convention on Climate Change, entered into force March 21, 1994 (UNFCCC, 1992). There is some debate within the climate community over whether Article 3.5 of the UNFCCC applies to measures taken in fulfillment of the nationally determined contributions under the Paris Agreement. See my discussion of this issue in James Bacchus, “What is a Climate Response Measure?: Breaking the Trade Taboo in Confronting Climate Change” (Waterloo, Canada: Centre for International Governance Innovation, 2019).

<sup>17</sup> Jagdish Bhagwati, *In Defense of Globalization* (Oxford: Oxford University Press, 2004), 154-155.

<sup>18</sup> “Tackling the Folly of Fossil Fuel Subsidies,” OECD Observer No. 304 (Paris: Organization for Economic Co-operation and Development, November, 2015); Damian Carrington, “Fossil Fuels Subsidized by \$10M a Minute, says IMF,” *Guardian*, May 18, 2015.

<sup>19</sup> Appellate Body Report, Canada – Certain Measures Affecting the Renewable Energy Sector / Canada – Measures Relating to the Feed-in Tariff Program, WTO Doc. WT/DS412 / WT/DS426 (Report circulated May 6, 2013).

<sup>20</sup> Robert Howse, “Securing Policy Space for Clean Energy Under the SCM Agreement: Alternative Approaches,” (Geneva: International Center for Trade and Sustainable Development, 2013), 50. Noted Swiss trade scholar Thomas Cottier has observed that, “From the point of view

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of decarbonisation, a local content requirement does not make sense as it increases costs for hardware and installations. Imported and competitive products are likely to contribute to more rapid deployment of the technology.”; Thomas Cottier, “Renewable Energy and WTO Law: More Policy Space or Enhanced Disciplines?” (Geneva: International Centre for Trade and Sustainable Development, 2015). Likewise, according to Robert Howse, “[D]omestic content requirement and other discriminatory measures actually undermine environmental objectives, by shifting production to higher-cost jurisdictions, and therefore making clean energy, or clean energy technologies, more expensive than they need to be.”

<sup>21</sup> Michael Trebilcock and James S.F. Wilson, “Policy Analysis: The Perils of Picking Technological Winners in Renewable Energy Policy,” *Energy Probe*, February 28, 2010.

<sup>22</sup> Bacchus, *The Willing World*, 254-264.

<sup>23</sup> Marrakesh Agreement, Article II:2(a).

<sup>24</sup> Marrakesh Agreement, Article IX:2.

<sup>25</sup> Bacchus, *The Willing World*, 185-403.