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OPINIONS

Trade tactic could unlock climate negotiations

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An export duty on carbon-intensive products, similar to that recently imposed by China on textiles, could help overcome the key obstacle to Southern participation in the upcoming 'post-Kyoto' climate change negotiations, say *Benito Müller* and *Anju Sharma*.

One of the key points US opponents of the Kyoto Protocol use to argue against the United States adopting targets limiting greenhouse gas emissions is that the protocol does not require developing countries, particularly China and India, to do so.

Adopting targets without 'meaningful participation' by these developing countries would, it is claimed, give these nations an unfair competitive advantage.

Increasingly, the issue of developing country commitments to reduce emissions is also becoming contentious among countries that *are* party of the Kyoto Protocol, and is impeding progress in climate negotiations.

The response of China and the G77 group of developing countries to proposals that they should make commitments has been unambiguous.

To quote the G77 chair at a climate meeting in Delhi, India, in 2002: "We specifically and clearly refuse to open at this time any dialogue or process — or indeed any wording — that could be in any way interpreted as accepting to open discussions on new commitments on non-Annex I countries."

Non-Annex 1 countries are those that, unlike the industrialised countries listed in Annex 1 of the Kyoto Protocol, are not obliged to reduce their emissions of greenhouse gases.

A recent development in international trade in textiles could offer a way out of the impasse. If adapted to the climate change context, the issue of competitiveness that arises if developed countries take on commitments but developing countries do not might be overcome.

Learning from international textile and lumber trade examples

In the run-up to removal of all textile import quotas under the World Trade Organization (WTO) on 1 January 2005, it was generally expected that textile production would migrate from countries in the North and the small developing country producers such as Bangladesh and Vietnam, to the large low-cost producers, mainly China and India.

Textile producers, chiefly in Northern importing nations, were vociferous about imports from countries such as these two having an unfair competitive advantage.

China was keenly aware of these accusations, and repeatedly denied them.

Yet it also seemed to accept that the projected surge of its textile exports, particularly to the United States, could affect bilateral relations, and ultimately allow WTO members such as the United States apply safeguards (such as import quotas) to protect their own industry.

Possibly for this reason, China announced a rather uncommon policy for an exporter: to impose a (small) export duty on its textile exports, to be paid by the foreign consumers. This meant, for instance, that US consumers would pay more for Chinese products in order to protect US producers.

The move was meant to reduce the likelihood that countries importing Chinese textiles would re-introduce import quotas to avoid international markets being flooded with Chinese textiles.

As it happens, the duty was too small to have the desired effect, with the consequence that China and the European Union recently agreed to temporarily re-introduce such quotas.

Yet the strategy has been proven. In the mid 1990s, the US threatened to impose import duties on lumber coming from Canada, claiming that Canada was giving its lumber industry unfair subsidies.

The resulting dispute was resolved in the 1996 US-Canadian Softwood Lumber Agreement, under which Canada imposed a substantial duty, amounting to more than 10 percent, on its lumber exports to the US. (The Agreement expired in 2001 and was not renewed because of a WTO ruling that the US concern about unfair subsidies was unsubstantiated).

Applying the lessons to climate change

If developing countries that are not required to reduce greenhouse gas emissions imposed a similar duty on the export of goods, such as steel, cement and fertilizers, whose production generates a large amount of greenhouse gases, the industrialised countries' concerns about unfair competitive advantages might be overcome.

China, for instance, could alleviate the worries of US producers of carbon-intensive goods that, if they were forced to reduce their emissions Chinese products would be 'unfairly' cheap, by introducing a duty on exports to the United States.

As well as protecting the US producer, China would potentially receive more in payments from US consumers than it would otherwise — particularly if the alternative is a US *import* tax.

The level of the export tax could be negotiated bilaterally so that both, say, the US and Chinese government are happy with it, but it would in general be more efficient, and probably more equitable, if the system was implemented under the UN Framework Convention on Climate Change.

As part of the deal, developing countries could use the funds generated from the export duty for a green investment scheme, which would ensure a further clean-up of the production methods of these carbon-intensive goods, and thus contribute to reducing the emissions in these developing countries.

In short, trade in textiles and lumber may have revealed a way out of one of the key impasses in the forthcoming 'post-2012' international climate change negotiations: how to avoid a refusal by industrialised countries to carry out (further) mitigation efforts because of competitiveness concerns in the absence of developing country targets.

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environmental negotiations.

Ins and outs: the international textile trade regulations

The international rules governing trade in textiles have long been controversial. Between 1974 and 1994, the trade was subject to bilaterally negotiated quotas governed by the 'Multifibre Arrangement'. Under the rules, if a surge in imports caused, or threatened, market disruption in an importing country, it could impose 'selective quantitative restraints' such as import quotas.

In 1995, the World Trade Organization's Agreement on Textiles and Clothing (ATC) changed everything, setting up a 1 January 2005 deadline for the removal of all quantitative restraints.

But until the deadline passed, ATC retained safeguard measures for situations where surging imports of specific products cause (or threaten to cause) serious damage to the domestic industry of an importing country.

These could be used on specific products from specific countries. In 1995, the first year of the agreement, the US invoked the provisions 24 times against 14 exporting developing countries.

Possibly because of concerns about competitiveness, the transitional ATC safeguard mechanism was extended to 2008 for China, when it joined the World Trade Organization in 2001.

Photo Credit: SciDev.Net

Dossiers:
Climate Change

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Legality of export tariffs

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This advice is provided in response to ***Query 240 - Legality of export tariffs***.

Query:

1. Taking into account the recent WTO decision on China's export tariff on several kinds of high carbon and high polluting materials, are export duties on carbon intensive goods illegal under the WTO regime?

2. Can the exceptions under Article XX GATT - normally granted on import restrictions for specific environmental purposes - be applied to export restrictions?

Summary:

1. Export duties on carbon intensive goods may be legal under the WTO regime, provided that the conditions under the relevant GATT Articles for imposing such restrictions are met.

2. Article XX (b) and (g) of GATT applies to all "measures" and not just those dealing with import restrictions. The measures considered in the recent WTO decision related to export restrictions (and the question of whether they were export measures was not at issue), so in our view there are provisions under Article XX of GATT that could be applied to export restrictions for environmental purposes.

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The recent WTO decision referred to in the Query is China - Measures Related to the Exportation of Various Raw Materials (**Panel Decision**). Recent press indicates that the Chinese government intends to appeal against the Panel Decision to the Appellate Body. It has 60 days to appeal. Therefore this advice may need to be reviewed in the light of any subsequent decision by the Appellate Body.

The key issue in this case is that China committed under its Accession Protocol (the terms under which it joined the WTO) to eliminate all non designated export duties once it became a member of the WTO. This commitment overrode China's right to rely on the provisions of Article XX to impose export duties. This restriction on the right of China to impose export duties would not necessarily apply to other countries.[1]

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[1] Members who have given commitments in their Accession Protocols and Working Party Reports regarding export duties: Croatia, Kingdom of Saudi Arabia Latvia, Mongolia, Ukraine, Vietnam. The nature and extent of the commitments on export prices are not set out in the Panel Decision.

The two exceptions relied on by China to justify its export restriction measures were Article XX (b) and (g). These provisions deal with the protection of human, animal or plant life or health (Article XX (b)) and conservation of exhaustible natural resources, if such trade restriction measures are made effective in conjunction with a corresponding restriction on domestic production or consumptions (Article XX (g)).

In relation to Article XX(g) one of the key limitations on imposing export measures is that, apart from having to establish that the measures apply to exhaustible resources, limitations on exports must be made and be effective in conjunction with restrictions on domestic production or consumption (the so called 'even handedness test').

China relied in particular on its sovereign rights - especially in view of its status as a developing country - to manage its resources and impose such measures to benefit its domestic industry even if the result was to disadvantage other countries through the imposition of such measures.

However, for the reasons given below the Panel, whilst acknowledging the sovereign right of a country to manage its resources, decided that China could not act in a manner that was inconsistent with the WTO agreement and in particular the provisions of Article XX.

The Panel found that, as a matter of fact, the export measures in this case were not designed to be effective in conjunction with restrictions on domestic production or consumption.

In relation to the provisions of Article XX(g), the Panel found that the measures that China had relied on did not even mention environmental concerns so they were not justified under that Article.

This query arises out of developing countries' concerns about their ability to manage their environmental policies - in particular in relation to export of goods and the emphasis placed by China on the sovereign right of countries to manage their resources to account for environmental concerns. Therefore more detailed consideration of the Panel Decision and these issues have been provided below. This detailed consideration does not cover all the issues raised in that case; its focus is on Article XX(b) and (g) and on those issues of principle that will have continuing application in the future for those countries seeking to rely on Article XX(b) and (g).

Advice:

The relevant provisions of Article XX that deal with environmental issues that were considered in the Panel Decision were Article XX(b) and (g), which state:

Article XX

<u>General exceptions:</u>

Subject to the requirements 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 disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

(b) necessary to protect human, animal or plant life or health;

……

(g) relating to the <u>conservation</u> of <u>exhaustible natural resource</u>s if such measures are <u>made effective in conjunction with restrictions on domestic production or consumption</u>….

Article XX(g) conservation exception

The Even Handed Test

The Appellate Body decided in *US – Gasoline* that:

"*[t]he clause [Article XX(g)] is a requirement of even-handedness in the imposition of restrictions, in the name of conservation, upon the production or consumption of exhaustible natural resources*".[2]

In considering what is an even handed treatment the Panel stated:

"*Although there is no textual basis requiring identical treatment under Article XX(g), it is difficult to see how - if no similar or parallel restrictions are imposed at all on domestic users or on domestic consumption and all limitations are placed upon the foreign consumers alone - the export restrictions can be considered even-handed. Nor would they appear to be primarily aimed at or even substantially designed for implementing conservationist goals; on the contrary "the measure would simply be naked discrimination locally [interests]".[3] In order to show even-handedness, China would need to show that the impact of the export duty or export quota on foreign users is somehow balanced with some measure imposing restrictions on domestic users and consumers. In our view China has not met this burden*." (Para. 7.465)

In the *US-Gasoline* decision the Panel found that the measures on exporters and domestic users were in fact even handed.

China argued that its export restrictions on fluorspar and refractory grade bauxite were justified because they were both exhaustible natural resources which China interpreted as "scarce and "*not easily substitutable*" and therefore needed to be "*managed and protected*".

At a broader level China stated that "nothing should interfere with their sovereignty over such natural resources". (para. 7.356)

China also emphasised the need for developing countries to make optimum use of their natural resources for their development, as they deemed appropriate, including the processing of their raw materials"(para. 7.356)

Finally China stated that these products are "*a key input into the production of steel and aluminium*" and that "*without these measures….. the burden of China's supply limitations would be borne unduly by China's domestic users, which would undermine China's development*". (para. 7.411)

Sovereignty argument

In essence China argued that the provisions of Article XX (g) must be read as recognising a WTO member's "*sovereign rights over their own natural resources*". In particular China stated that:

"*sustainable development requires that economic development and conservation be aligned through the effective management of scarce resources, as the term 'conservation' refers to the management of a limited supply of exhaustible natural resources over time.*"

China stated that its export restraints "*relate to conservation*" because "*they are part and parcel of China's measures that manage the limited supply of refractory-grade bauxite and fluorspar, which are exhaustible natural resources.*" (par. 7.363-364)

[2] Appellate Body Report, *US – Gasoline*, p. 21, DSR 1996:I, 3, at p. 19.
[3] Appellate Body Report, *US – Gasoline*, p. 21, DSR 1996:I, 3, at p. 19.

The Panel's interpretation of the sovereignty argument was that:

"*One of the fundamental principles of international law is the principle of state sovereignty, denoting the equality of all states in competence and independence over their own territories and encompassing the right to make laws applicable within their own territories without intrusion from other sovereign states*."(para. 7.378)

However the Panel stated that

- Sovereignty is exercised when a country enters into international agreements, such as the WTO agreement.

- Conservation and economic development are not necessarily mutually exclusive policy goals; they can operate in harmony. So too can such policy goals operate in harmony with WTO obligations, for Members must exercise their sovereignty over natural resources consistently with their WTO obligations. (para. 7.382).

- The right to manage natural resources cannot be at the expense of the obligations contained in Article XX (g).

  China stated that:

  (1) "*Article XXXVI:5 and its Ad Note confirm that Article XX(g) does not require identity between the restrictions on domestic and foreign supply of natural resources*" and *"recognizes[s] the objective of achieving economic diversification of developing country economies through the development of industries to process primary products*"; and

  (2) "*export restrictions are needed to support its economy and to enable it to diversify," and thus "a proportionately higher burden on foreigners is justified.*" (*See* para. 7.403)

  The Panel responded by acknowledging that resource-endowed countries are entitled to manage the supply and use of those resources through conservation-related measures that foster the sustainable development of their domestic economies, but noted that countries must do so consistently with general international law and WTO law. (para. 7.404)

  However the Panel stated that:

  - China's right to economic development and its sovereignty over its natural resources are not in conflict with China's rights and obligations as a WTO Member. (para. 7.405)

  - China chose to join the WTO in full exercise of its sovereignty, China made the concurrent decision that its sovereign rights over its natural resources would thereafter be exercised within the parameters of the WTO provisions, including those of Article XX(g). (para. 7.405)

  - China was aware of the terms of Article XX, as interpreted by the Appellate Body in its *Gasoline* and *Shrimp* reports, in particular with respect to the requirement that restrictions for which Article XX(g) is invoked could be justified only if they are made

effective in conjunction with restrictions on domestic production or consumption. (para. 7.405)

Relationship between Article XX(g) and XX(i)

In the report the Panel stated:

7.384. "*The Panel refers now, as part of the immediate context of Article XX(g), to the provisions of paragraph (i) of Article XX, which deal with situations where the exports of domestic materials can be restricted to assist the affected domestic industry. Even in such a situation where a Member is explicitly protecting its downstream industry, Article XX(i) ensures consideration of the interests of foreign producers*."

7.385. Article XX(i) provides an exception for measures:

"*…involving restrictions on exports of domestic materials necessary to ensure essential quantities of such materials to a domestic processing industry during periods when the domestic price of such materials is held below the world price as part of a governmental stabilization plan;* Provided that *such restrictions shall not operate to increase the exports of or the protection afforded to such domestic industry, and shall not depart from the provisions of this Agreement relating to non-discrimination*".

7.386. "***Article XX(i) provides explicitly that any export restrictions on domestic materials cannot be imposed to increase the protection of the domestic industry. Hence the restrictions remain subject to the core GATT principles of non-discrimination. In the Panel's view, Article XX(g), which provides an exception with respect to "conservation", cannot be interpreted in such a way as to contradict the provisions of Article XX(i), i.e., to allow a Member, with respect to raw materials, to do indirectly what paragraph (i) prohibits directly. In other words, WTO Members cannot rely on Article XX(g) to excuse export restrictions adopted in aid of economic development if they operate to increase protection of the domestic industry.*** "

In summary, any argument based on the sovereign right of a country to rely on the conservation exception in Article XX(g) is limited by the principle of non discrimination as reflected in the provisions of Article XX(i) exception.

Article XX(b) protects human, animal or plant life or health:

The Panel explained that it must first consider whether the challenged measure *"falls within the range of policies designed to protect human, animal or plant life or health.*" It noted that panels and the Appellate Body "*have examined both the design and structure of a challenged measure to decide whether its objective is the protection of life and health, generally showing a degree of deference to Members' policies designed to 'protect human, animal or plant life or health.*'"

The Panel noted that in the in *Brazil – Retreaded Tyres* decision the Appellate Body reiterated its view that:

"*[i]n order to determine whether a measure is 'necessary' within the meaning of Article XX(b) of the GATT 1994, a panel must consider the relevant factors, particularly the importance of the interests or values at stake, the extent of the contribution to the achievement of the measure's objective, and its trade restrictiveness.*"

The Appellate Body concluded that a measure contributes to the achievement of the objective "*when there is a genuine relationship of ends and means between the objective pursued and the measure at*

issue" and that a measure is necessary if it is "apt to make a material contribution to the achievement of its objective." (Para 7.481)

The Appellate Body has recognized that "*[t]he more vital or important [the] common interests or values*" behind the policies pursued, "*the easier it would be to accept as 'necessary' a measure designed as an enforcement instrument.*" (Para. 7.482)

As to *the contribution of the measure to the objective pursued,* the Panel cited the Appellate Body Report in *Brazil – Retreaded Tyres,* which distinguished between two types of contributions: a measure that "brings about" a material contribution to the achievement of its objective; and a measure that "is apt to produce" a material contribution to the objective pursued. In *China – Audiovisual Products,* the Appellate Body emphasized again that "the greater the contribution a measure makes to the objective pursued, the more likely it is to be characterized as 'necessary.'" (Para. 7.404)

As to the *trade restrictiveness of the measure,* the Appellate Body in *Korea – Beef* considered the measure's effect on international commerce." Essentially, "*[t]he less restrictive the effects of the measure, the more likely it is to be characterized as 'necessary.'*" (Para. 7.487)

Based on the Appellate Body's jurisprudence, the Panel understood that a panel cannot reject an environmental protection measure, or a public health measure, by pointing to a WTO-consistent or less trade-restrictive alternative, unless that alternative is both "practically and financially feasible" for the Member seeking to justify the WTO inconsistent measure and provides "an equivalent contribution to the achievement of the objective pursued." (Paras. 7.489-492)

The Panel first considered whether China's export restrictions "fall within the range of policies designed to protect human, animal or plant life or health." China claimed that its export restrictions on EPRs[4] "are justified as they will reduce pollution caused by the production of the restricted exports and lead to better health for the Chinese population." The determination on this issue, the Panel said, "should be done in light of the design and nature of the challenged measures." The Panel then reviewed the measures imposing the restrictions at issue, as well as all laws and regulations submitted by China as evidence that the goal of those export restrictions is the reduction of pollution and the protection of the health of its population. (Paras. 7.498-500)

The panel found in this case that the measures imposing the export restrictions at issue in this dispute *do not make any mention of environmental or health concerns: "we do not discern in this array of measures a comprehensive framework aimed at addressing environmental protection and health.*" More importantly, "*we do not find evidence that the export measures at issue in this dispute form part of any such framework.*" According to the Panel, a Member "*must do more than simply produce a list of measures referring,* inter alia*, to environmental protection and polluting products." It must be able to show "how these instruments fulfil the objective it claims to address.*" (Para 7.511)

The panel found that neither the measures implementing the export restrictions, nor the contemporaneous laws and regulations, convey in their texts that the export restrictions are contributing to, or form part of, a comprehensive programme for the fulfilment of its stated environmental objective." The documents submitted by China, either on their own or taken together, "do not sufficiently indicate that the export restrictions seek to reduce pollution resulting from the production of EPR products." (para. 7.512)

[4] Energy intensive, high polluting resourced based products

The Panel then turned to the issue of whether the measures "*contribute materially to the goal of protecting the health of the Chinese population*".

The Panel referred to the Appellate Body's decision in *Brazil – Retreaded Tyres* which stated that "*whether or not the export restrictions on EPRs can be considered necessary for the protection of the health of the Chinese people depends on whether such measures* ***are apt to contribute materially*** *to the realization of China's declared objective of reducing pollution caused by the production of EPRs*". (par 7.518)

China's interpretation of "contribution" of trade restrictions for the purposes of Article XX(b) was that they should be assessed "*both currently and in the future"* and that the export restrictions at issue are *currently* making a material contribution to the objective of reducing the health risks associated with the pollution generated by the production of coke, magnesium metal, manganese metal and silicon carbide.

China also asserted that export restrictions on EPR products are apt to contribute to its stated health objective in the *medium and long term*. In the medium term, China argued, "export duties on EPRs will reinforce domestic environmental rules and regulations through their selection effect, that is, by forcing small-scale inefficient firms out of the market to the advantage of large-scale, efficient and less-polluting producers." In the long term China stated that export restrictions will help the Chinese economy shift its production towards more sophisticated, higher value added goods, and away from low-value added basic materials.

China also argued that it was currently making a material contribution to the stated objective: "there is a serious health risk related to the production of EPRs, and that reducing their production would reduce pollution, which would lead to a reduction in the related health-risks." (Para. 7.525)

The Panel recognized that China's qualitative argument "relies on the standard economic theory of the effects of an export restriction: an export restriction on polluting raw materials, by reducing foreign demand for the good on which it is imposed, shifts supply of the good to the domestic market, thus putting downward pressure on the domestic price of the product. (para. 7.526) On this issue, the Panel said it had reservations on the validity of conducting an analysis of the effects of an export restriction on a product in a specific sector in "isolation" from other related sectors. Moreover, the Panel had concerns about China's estimations of the size of the effects. It was "*not persuaded by the evidence provided by China in support of its argument that its export restrictions on EPR products* currently *make a material contribution to the objective pursued.*"

Furthermore, even assuming that the quantitative analysis was reliable, the Panel was of the view that given the importance of the vertical structure of the metals industry, China's economic analysis "*should have taken into account the effects that export restrictions have on pollution through the upstream and downstream sectoral linkages, and the impact of measures that counter that of the export restrictions.*" (Paras. 7.525-538)

China argued that there are additional medium term gains due to the "selection effect".

The Panel noted that "*[t]he less restrictive the effects of the measure, the more likely it is to be characterized as 'necessary'.*" The Panel recognized that the measures in place (export quotas and export duties) are less restrictive than full "bans" would be. However, the Panel was also of the view that China's arguments "*do not confirm that the measures are not restrictive*." Thus, China's export restrictions, even if modest, "*can have an important impact worldwide.*" (para 7.558) In addition, the Panel said that China's arguments that "*the impact of its export restrictions is much lower than the effect of the United States' and the European Union's anti-dumping duties on some of these products is based on a mere comparison between export tax rates and anti-dumping duty rates*"; that "*[a]s far as the long-term effects of export restrictions are concerned, China's argument is that these measures*

are not too trade restrictive in the long term because the high world market prices will provide an incentive to new producers to enter the market"; and that while China *"does not maintain any full bans on exports…the impact of an export restriction depends on the size of the exporting country*." (Par 7.560)

The Panel recalled the findings of the Appellate Body in *Brazil – Retreaded Tyres* that "*if an analysis under Article XX(b) yields a preliminary conclusion that the measures at issue are necessary, 'this result must be confirmed by comparing the challenged measures with their possible alternatives, which may be less trade restrictive while providing an equivalent contribution to the achievement of the objective pursued.*'" (Para. 7.564)

The Panel concluded that China was not able to justify why the less trade restrictive and WTO-consistent alternatives that were available, as identified by the complainants and acknowledged to exist by China, "*cannot be used in lieu of applying export restrictions.*" (Para. 7.590)