

**Design Options for Border Tax Adjustment Measures (BTA):
Current Proposals and Appraisal**

**Questions from the Devil's Advocate:
Is a BTA only the Third-Best Option (Out of Three)?**

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1. Environmental and Economic Effectiveness of a BTA

- The environmental and economic effectiveness of a BTA¹ is not entirely clear. Further clarification should be sought on the following questions:
 - Depending on the sector, trade flows and exact BTA measure, BTAs probably yield only modest leakage reductions and offer little to protect European industries.
 - It is not always clear to what extent competitiveness losses of European industries can be attributed to the impact of climate change policies/carbon prices (or other factors such as labour costs etc.): in the case of aluminium for example, no additional capacities have been created in the EU over the last 15 years, although climate change politics had no impact on electricity prices in that period due to long term contracts.
 - Lessons from Phase 1 of the EU ETS do not necessarily provide evidence of leakage.
- To meet WTO rules, benchmark levels must be „generous“, which in turn weakens the instruments' ability to prevent leakage.

2. Calculating a BTA

- In a globalised economy and due to lacking data, it is probably very difficult to calculate the carbon content of manufactured goods. Interestingly, Parties to the Montreal Protocol decided to exclude manufactured goods that require ozone-depleting chemicals (ODCs) during production but do not contain ODCs in their final form (due to calculation difficulties).

¹ Design Options include: 1) Tax or charge equalising cost arising from taxes/charges or ETS, 2) Obligatory purchase of Allowances upon Importation (scenario reflects the approach contemplated by the Commission's proposal for a Directive amending the ETS) or 3) tax rebate upon exportation. Scope: BTAs are generally only considered for primary products manufactured with high energy intensity, exposed to international trade and subject to climate change policies. They are NOT considered for manufactured products, as the calculation of embedded carbon would be impossible.

- Benchmarks or default values might be an alternative. For instance, reference to Best Available Techniques (BAT) could serve as a relevant benchmark for calculating carbon contents and thus a BTA. However, the use of benchmarks raises the following questions:
 - Determining a BAT is a challenge in itself, in particular because such a scheme would introduce a moving target. For this reason, some suggest mandating an independent body of experts to establish benchmarks/default values, but the composition of such a body, the rules and procedures of its operation and accountability/legal redress, as well as the substantive criteria for the benchmark itself would have to be clarified.
 - It is noteworthy that a GATT panel struck down a US regulation assigning imports a standardised baseline while domestic producers were allowed to present individualised data (US - Gasoline). Applying this logic, the question arises why countries hostile to a BTA would present data on GHG emissions of their imports.
 - BAT benchmarks will probably reduce the instruments' ability to reduce leakage and would have to find ways on how to deal with imports cleaner than BAT.

3. Legal Aspects: Article III GATT (National Treatment)

- A BTA designed as an internal charge must comply with GATT Article III:2, first sentence. III.2.1 GATT stipulates that the amount of the tax or charge imposed on imported and **like** domestic products has to be **identical**.
 - There is long standing discussion what like "means".
 - Even if assumed that different production methods could render products "unlike", the challenge is to design BTAs in a way that imposes *identical* burdens on imported and domestic products. This is arguably an insurmountable task, however, because it is very difficult to calculate the exact carbon content/price paid by domestic producers (and importers). In any case, it would probably require full allowance auctioning for EU industries.
- GATT Article III:2 second sentence regulates directly competitive products and is more lenient: the amount of imposed BTA may be slightly dissimilar (*de minimis*). However, III.2.2 GATT additionally requires that the internal tax or charge is NOT applied in a protective manner. For this reason, official rhetoric on BTAs as a tool to level the competitiveness playing field of EU or US industries might pose a further challenge for the measure's legality.
- BTAs that are not taxes or charges must comply with GATT Article III:4. The obligation to purchase allowances imposed on imported products would face similar calculation difficulties as a tax or charge, since it would also be based on the carbon embedded in the imported product.
- Both in the US and in the EU, the BTA-discussion has shifted from imposing a tax or charge on imported products to requiring importers to purchase allowances or allocating free allowances to domestic producers affected by international competition. Both options raise similar legal concerns to border adjustment based on taxes or charges.

4. Legal Aspects: Article I GATT (Most Favoured Nation)

- A BTA is likely to target imports from countries with no/less ambitious climate change policies. A BTA therefore raises concerns under the Most Favoured Nation principle (MFN), because it differentiates between imported products of different national origins, either directly (e.g. by differentiating between Kyoto signatories and non-signatories) or indirectly (e.g. by using requirements or procedures that *de facto* favour one country of origin over another).
- The notion that BTAs refer to specific domestic climate change policies and NOT to the country of origin is problematic: BTAs would be imposed on imports from specific countries (with certain climate change policies), a scheme prohibited by I GATT as *de facto* discrimination (“unconditional”).
- Given (1) the caveats in comparing climate and energy policies of different countries and (2) the broad interpretation of Art. I GATT, the Appellate Body (AB) is likely to assume *de facto* discrimination if BTAs are imposed on the levels of ambition of national climate change policies.

5. Legal Aspects: Article XX GATT

- Climate Change policies fall under Article XX b) and g).
- XX g): „related to (the conservation of exhaustible natural resources)“, i.e. a substantial relation to the measures (environmental) purposes is required (AB US Gasoline). Given the BTAs' limited environmental performance (potential to reduce leakage), it is not clear yet whether climate change policies would be less effective without a BTA (as required by XX g). However, the AB has not engaged in a detailed analysis of the environmental effects of the measure in question (Member States have a wide discretion).
- The “chapeau” of Article XX serves to prevent an abuse of the right to take exceptional measures for general policy purposes (“no unjustifiable or arbitrary discrimination and disguised trade restriction”). In GATT/WTO case law, the chapeau has been a critical hurdle (US - Gasoline, Brazil - Tyres or US - Shrimp). The provision requires that BTAs only differentiate between countries for purposes of climate protection. Hence, legal problems could stem, inter alia, from the chapeau:
 - BTAs that simultaneously reduce or eliminate the burden on domestic producers (e.g. through the free allocation of allowances) and cumulatively burden imports of competing products will most likely be considered as a disguised trade restriction (Brazil - Tyres).
 - To avoid arbitrary discrimination, importers must be allowed to prove their individual emissions, and national circumstances in exporting countries need to be taken into account. If BTAs were to allow for such exemptions, that might help render the scheme WTO compatible, but is likely to further reduce its effectiveness.
 - XX GATT requires negotiations between trade partners before introducing a BTA. While the failure of negotiations on a new Post-2012 climate regime might meet such

a requirement, it is unclear how to deal with a new regime that differentiates between Parties and creates no level playing field.

6. Legal Aspects: Use of Revenues

- If revenues were used for the general state budget and/or other non environmental purposes, the required environmental purpose of the BTA would be undermined, raising additional legal uncertainties under the GATT.
- If the revenues were recycled back to affected industries, it could be alleged that the EU subsidizes particularly dirty industries. If these subsidies are trade-distorting and industry-specific, WTO law could be violated.

7. Political Aspects

- It has been argued that a BTA could create an incentive for laggard countries to join a new climate change regime, but many fear that a BTA would have negative political repercussions on climate change and trade negotiations:
 - Many developing countries see a BTA as proof that climate change policies are in fact a protectionist agenda for industrialised countries, in particular because BTAs are driven i.a. by the US, the world's largest per-capita emitter of GHG.
 - The WTO is undergoing a difficult period, and its legitimacy and effectiveness are under scrutiny; it should not be forced to address yet another contentious issue, not to mention be faced with trade wars between major trading countries (overburdening of trade negotiations).
 - The BTA discussion is driven by the North and offers little to developing countries, in particular because it does not address agriculture and tourism.
 - BTAs could undermine the credibility of Europe's climate change policies and the value of market-based instruments: Climate change policies are largely viewed as a driver for innovation and competitiveness. BTAs, in turn, imply that climate change policies are in fact a burden for industries.
 - In case a new climate change regime is agreed upon (ideally next year), it would seem awkward to accept such a deal on the one hand and impose BTAs on Parties (!) of the same climate regime on the other hand (obviously in an effort to achieve through the backdoor what was not agreed at the COP).

8. Conclusions

- The BTA discussion has the potential to divert attention from the real problems and undermine the notion of environmental policies as a driver of innovation and competitiveness (in times of high energy prices).
- As a global problem, climate change requires multilateral solutions that might be harmed by unilateral approaches, in particular if these have confrontational elements. Differentiation through targets and policies and measures (PAMs) is key to address leakage and competitiveness concerns.

- For these reasons, it is questionable whether we should continue the BTA discussion. However, given the current dynamics of international and domestic climate change politics, some form of BTA is likely to remain on the political agenda (and the more ambitious the climate change policies under discussion, the higher the position of BTAs on the agenda).