

Regulating for Globalization

Trade, Labor and EU Law Perspectives

Fighting climate change: the case for a renewed discussion on Processes and Production Methods (PPMs) at the WTO – Part 1

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Processes or production methods (PPMs) of goods are connected to many environmental crises the world is facing. The most notable in this respect are PPMs leading to greenhouse gas (GHG) emissions. Naturally, many of the measures of environmental protection that are increasingly taken or under consideration by governments (especially those taken to comply with their obligations under the Paris Agreement) concern PPMs.

Countries are designing national measures such that their positive impact at the global level is not undermined by their trading partners' inaction, and such that they do not result in a loss of competitiveness for the domestic industry subject to additional costs ("leveling the playing field" is considered as a condition of enacting and applying them). Therefore, national measures affect trade. And the question whether and how these measures can comply with multilateral trade rules is being posed.

This question is particularly acute for measures discriminating between products based on their processes or production methods that do not leave a physical trace in the products ("non-product-related" PPMs) such as GHG emission-based measures or measures affecting products associated with deforestation. In this case, discrimination between products is not based on their intrinsic properties (like their noxiousness, their recyclability, or other factors), but solely on the global environmental and climate footprint of their production.

1. Discrimination based on non- product-related PPMs and WTO law

With respect to internal taxation and regulation, WTO rules requires non- discrimination – *de jure* or even *de facto* – among imported "like" products (this is application of the most favoured nation principle), and between imported and domestic "like" products (pursuant to the "national treatment" principle).

The purpose of national treatment – expressed in Article III:1 of the GATT – is to prevent WTO Members from applying internal measures in a manner which affects the competitive relationship, in the marketplace, between imported and domestic products, "so as to afford protection to the latter". (emphasis added).^[1]

A determination of likeness must be informed by this principle. It is a determination “about the nature and extent of a competitive relationship between and among the products at issue”^[2], because it serves to delineate the scope of products that should be compared to establish whether less favourable treatment is being accorded to imported products.

Some criteria (none of which being decisive on its own) have been suggested by case law for determining, on a case-by-case basis, whether products are “like.” These are the products’ end-uses, consumers’ tastes and habits in the relevant market, the products’ properties, nature and quality, and their tariff classification. As of today, non-product-related PPMs have not been considered as a criterion to assess “likeness.”

This suggests that the way goods are produced is not relevant in determining the competitive relationship between goods at issue. It is logical: unless consumers are able to distinguish between products based on their PPMs (which they are not, absent relevant consumer information), such PPMs have no impact on consumers’ perception and choices.

Where products involved have been found to be in a sufficiently close competitive relationship, it remains to be determined;

i) whether imported products are applied internal taxes or internal charges of any kind in excess of those applied to like domestic products (if the measure qualifies as an internal indirect tax measure, applied at the border).^[3]

But would a tax on the amount of carbon resulting from the production of products – not the products themselves – be considered as an indirect tax measure? If not, it would qualify as a border measure, inconsistent with GATT Article II:1 prohibiting countries from imposing duties and other charges in excess of those agreed in their schedules of concessions.

ii) whether the measure that discriminates (even *de facto*) between products based solely on their PPMs accords “less favourable treatment” to imported products, if the measure at hand is a regulatory, non-tax measure.

Case-law in the context of the Agreement on Technical Barriers to Trade (TBT Agreement) is interesting in this respect. The TBT Agreement (which includes the national treatment principle) applies only to “technical regulations,” which are measures laying down the products’ characteristics. This sub-set of regulatory measures covers *inter alia* labelling requirements relating to PPMs whether or not product-related (they modify the appearance of the products and provide information to consumers, impacting thereby their preferences). Where the measure at issue results in a *de facto* detrimental impact on competitive opportunities for imported products, it can still be found non-discriminatory if such a detrimental impact “stems exclusively from a legitimate regulatory distinction”, following the Appellate Body’s case law.

Measures based on non-product-related PPMs that do not regulate the intrinsic characteristics and/or appearance of products would fall outside the scope of the TBT Agreement and should be governed only by GATT rules on national treatment (Article III).^[4] Logically, one may think that in a similar manner, the regulatory objective of a measure would be a factor to be considered in assessing whether it results in “less favourable treatment” for imported products. After all, the broad and fundamental purpose of national treatment – as expressed in Article III:1- is to avoid

protectionism in the application of internal measures. The Appellate Body has even recognized that the principles set forth in this paragraph shall inform the rest of Article III (including provisions on “less favourable treatment”).^[5]

However, the Appellate Body failed to draw practical conclusions therefrom, as evidenced by the test applied by the Appellate Body for “less favourable treatment” determination: it suffices to determine whether the measure at issue modifies the conditions of competition to the detriment of imported products, no matter the regulatory objective (with the notable exception of Article III:2, second sentence).

Accordingly, a regulatory measure differentiating between products based on their non-product-related PPMs, origin-neutral on its face (treating imported and domestic products whose carbon footprints are equivalent in the same way) and intended to address climate change, would be found to violate the national treatment obligation – irrespective of whether it is applied in a protective manner – if it has been determined that it has a de facto disparate impact on competitive opportunities.

Such a finding would be possible if, overall, a heavier burden is placed on imported products as compared to domestic products as a result of the GHG emissions “content” of imported products being higher, on average, than that of domestic products (while the regulatory objective is precisely to mitigate/curb GHG emitted globally).

The Appellate Body has given two successive explanations for not considering the regulatory purpose. First, Appellate Body has ruled that unless the relevant provision of Article III (paragraph or sentence) specifically invokes Article III:1 (which is the case of Article III:2, second sentence, which forbids WTO Members to apply internal taxes or charges to imported or domestic products “*in a manner contrary to the principles set forth in paragraph 1*”), the presence of a protective application need not be established separately from the specific requirements set out in the applicable provision.^[6]

In an effort to give effect to “textual differences,”^[7] the Appellate Body constructed a theoretical distinction between (i) Article III:1 as a general principle informing the rest of Article III; and, (ii) Article III:1 as a stand-alone requirement in Article III:2, second sentence only.^[8] In practice, this simply deprives Article III:1 of any effect (except in the latter case), in contravention with the fundamental principle of effectiveness in treaty interpretation.

Indeed, it is hard to figure out how national treatment provisions (especially on “less favourable treatment”) could be interpreted in light of their fundamental purpose – which is to avoid protectionism in the application of internal measures – without considering a measure’s protectionist application (or absence thereof). The practical application of this purportedly rigorous, textualist interpretation has led to negate the spirit of GATT’s national treatment provisions. A measure that is not applied so as to afford protection to domestic production could still be found in violation of a provision whose fundamental purpose is to avoid protectionism.

The second justification advanced by the Appellate Body for not considering the regulatory purpose is that Members’ right to regulate trade is enshrined in Article XX, and therefore, Article I:1 and III:4 do not involve an examination of whether the detrimental impact of a measure on competitive opportunities for like imported products stems exclusively a legitimate regulatory

distinction.^[9]

This reasoning by the Appellate Body seems to contradict its approach to textual interpretation described above. In the context of Article III:1 analysis, it went out of its way to give meaning to textual differences and “omissions” with a view to “respecting, and not diminish in any way the meaning of the words” used in the text.^[10] Now, the existence of a General Exception alone suffices to not interpret and apply Article III on its own terms.

The Appellate Body recalled that, by contrast, consideration of the regulatory objective in applying the national treatment rule under the TBT Agreement is justified by the absence in the TBT Agreement of “general exceptions” such as those contained in Article XX of the GATT, while the object and purpose of the TBT Agreement is to strike a balance between trade liberalization and Members’ right to regulate trade.^[11] According to the Appellate Body, “in the GATT 1994 this balance is expressed by the national treatment rule as qualified by the exceptions in Article XX, while, in the TBT Agreement, this balance is to be found in the national treatment provision itself, read in the light of its context and its object and purpose”.^[12]

This jurisprudence seems to suggest that the GATT national treatment rule qualified by the exceptions in Article XX is in fine equivalent to the TBT national treatment rule as developed by case-law. This is not the case.

First, if a measure deemed discriminatory under the GATT may still be “justified” under Article XX (General Exception) in certain conditions, Article XX can only be used as a defense: it can be invoked only when the measure at issue has been challenged before the Dispute Settlement Body and has been found to be *prima facie* inconsistent with GATT rules. This entails that a WTO Member applying a measure that is non-protectionist, clearly justified, and which may have a disparate impact on conditions of competition bears the political burden of applying a measure that will likely be considered WTO-incompatible, until it is challenged at the WTO and justified.

Second, the list of regulatory objectives in Article XX is exhaustive. By contrast, the list of legitimate objectives in the TBT Agreement – considered in the national treatment analysis – is not. It follows that pursuant to case-law, not all internal measures pursuing a non-protectionist regulatory objective could be justified under Article XX. Is this really the spirit of the GATT?

Should PPMs measures to address climate change and environmental protection at the global level be left to a WTO judge examining a defence under Article XX?

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