Graduate Institute of International and Development Studies, Geneva

TRADE LAW CLINIC

Treatment and monitoring of the European Union and United States of America Emissions Trading Systems under the Agreement on Subsidies and Countervailing Measures of the World Trade Organisation[1]

To: Jun KAZEKI

From: Ilias PNEVMONIDIS / Megan QUEK

Date: June 11th, 2010

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EXECUTIVE SUMMARY

As recently illustrated in the joint 2009 WTO and UNEP report, the link between trade and the environment is an issue that has attained international prominence due to the impact that climate change legislation has on trade, the maintenance of a level-playing field and the competitive advantage of states. The EU and the U.S. have created climate change legislations regarding the reduction of greenhouse gas (GHG) emissions in their effort to tackle global warming, where certain provisions that pertain to trade and energy intensiveness may be challenged as subsidies under the SCM Agreement.

This paper first analyses whether the relevant provisions amount to subsidies, such as provisions regarding emission allowances and rebate programs. Regarding the existence of a financial contribution by the government, it is proposed that this may be found by reasoning that there is government revenue foregone, a direct transfer of funds, or a transfer of goods. Regarding a benefit, it would likely be determined that certain sectors that are eligible for free emission allowances or rebates do receive a benefit, in comparison to domestic competitors or certain foreign industries operating in states enacting strict climate change legislations.

The most contentious requirement is the issue of specificity. Both the EU and U.S. systems introduce explicit criteria for the possibility of receiving free emission allowances, which may arguably be objective or specific. They may be deemed objective because any criteria are selective by nature and the criteria may be applied in a neutral manner. At the same time, it could be submitted that the criteria are specific because they appear to favour trade and energy intensive industries. A ruling in favour for or against the finding of a subsidy will probably hinge upon this requirement, where the decision could tip in either direction based on the arguments submitted.

If the provisions amount to subsidies, they may be either prohibited or actionable subsidies dependant on whether the subsidies are based on export or trade performance (prohibited) or energy intensity (actionable). With respect to the requirements in finding an actionable subsidy, it would be preferable for an affected WTO member to base its

argument on the finding of a serious prejudice, rather than an injury, as this would involve meeting a lower threshold.

As for obtaining a remedy for the injury, the affected WTO member could either obtain satisfaction by resorting to the Dispute Settlement Process or unilaterally imposing countervailing duties (CVDs). Although the Dispute Settlement Process will likely be politically less favourable as it openly challenges an environmental measure, the option of imposing CVDs presents more disadvantages. First, CVDs involve an investigative process that requires a considerable amount of data that may not always be available. Second, they impede diplomatic dialogue due to their unilateral nature. Third, they do not address the adverse effects of the subsidy. Lastly, they fail to provide a solution for the global market as they only address problems in the domestic market.

A controversial defence for the implementing state, such as the EU and the U.S., would be to resort to the exception under GATT article XX. Despite current evolutions under the *China-Audiovisuals* case or the broad language of GATT article XVI that could cover subsidies that fail to meet the specificity requirement, it is unlikely that a defence would be successful under GATT article XX for a SCM violation. This is mainly due to the specific language of the Agreement, the lapse of the application of article 8 ('green box' of non-actionable environmental subsidies), and the fact that there are explicit cross-references to other GATT articles but none to article XX.

Regarding the notification and monitoring of subsidies, the SCM Committee and the Trade Policy Review Mechanism (TPRM) are mechanisms created to foster notification and transparency; however, in spite of the mechanisms, Members still fail to submit notifications and comply with the requirements. In consideration of the gaps in the system, certain reforms to the SCM Committee and TPRM could be undertaken, such as creating a more active role for the bodies; requiring the notification of subsidies prior to implementation; exploring a possible link between the SCM Committee and the notification obligations under GATT article XVI; implementing enforcement mechanisms, or compiling a database that contains information from various international fora that focus their attention on international trade.

In consideration of the link between trade and climate change legislations, this paper also explores possible reforms to the WTO framework and their feasibility, mainly

amended or new 'green' provisions in the SCM Agreement or a new Code on Trade and the Environment, under the form of a Multilateral or Plurilateral Trade Agreement.

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I. Introduction

The link between trade and climate change is an issue that has obtained national, regional, and international attention. This linkage was recently addressed in a joint 2009 report between the World Trade Organization (WTO) and United Nations Environment Programme (UNEP), where it sought to analyze "how trade and climate change policies interact and how they can be mutually supportive."[2] The report discusses how trade and climate change may be mutually supportive, rather than mutually exclusive objectives. Certain WTO Member states have created national legislation on climate change, in order to combat global warming. In addition to combating climate change, these pieces of environmental legislation may also have an impact on trade. Therefore, they may impact the rights and obligations of Members, where Members may be potentially scrutinized through the lens of WTO law.

This paper will focus on environmental legislation of the European Union (EU) and the United States of America (U.S.), specifically provisions that may amount to environmental subsidies. The respective pieces of legislation have been introduced in order to attain environmental objectives and limit the negative spill over of the activities of some of their most carbon-intensive enterprises; however, certain provisions may constitute subsidies. These subsidies are of interest because they may affect the comparative advantage of other states and amount to a competitive advantage for the implementing state, which are counter certain objectives of the WTO, such as maintaining industry competitiveness, ensuring a level playing field, and increasing the competitive advantage of Members. Our effort will be directed at presenting the conflict between the spirit and the structure of subsidies linked to carbon emissions allowances in legislation by the EU and the U.S., and the need for effective regulation and monitoring so as to avoid future disputes on this matter under WTO law.

[2] United Nations Environment Program and the World Trade Organization, "Trade and Climate Change", Geneva, 2009, page v

In general, this paper will address the issue of the impact of environmental subsidies on trade by first giving a factual explanation of the EU and U.S. climate change legislation. Second, it will describe what is required to find the existence of a subsidy and whether the provisions of the EU and U.S. legislation amount to a subsidy. Third, we will discuss whether the provisions amount to actionable or prohibited subsidies. Fourth, we will explore a possible defense for the implementing state under a GATT article XX exception and possible courses of action for a Member that has been affected by the subsidy of an implementing state, such as through a dispute settlement hearing or the unilateral implementation of countervailing duties. Fifth, we will discuss the monitoring mechanisms at the WTO for subsidies and countervailing duties. Lastly, we will explore recommended reforms to the WTO system, in light of the important, interconnected, and relevant nature of environmental measures on trade.

II. Issues

The first issue is whether or not the measures adopted by the EU and the U.S. in their climate change legislation constitute subsidies that may be challenged under GATT and the Agreement on Subsidies and Countervailing Measures, if they are found to be specific and actionable or prohibited.

Assuming that an actionable or prohibited subsidy is found, the second issue is regarding the possible remedies that an injured state may seek under the SCM Agreement and a possible defence under GATT article XX for the implementing state.

The third issue is the efficacy and effectiveness of the existing monitoring and notifications systems for subsidies at the WTO, especially in terms of ensuring good governance and transparency.

The fourth issue is whether or not there are reforms to the WTO system that may be implemented, in order to address trade-related environmental subsidies.

III. Brief answer

Notwithstanding the fact that the measures introduced by the EU and the U.S. claim to have a specific purpose for their implementation, namely the protection of the environment and the reduction of annual carbon emissions by industrial sectors, their

provisions could meet the requirements of what constitutes a subsidy under the SCM Agreement.

The design of the proposed U.S. bills and EU system and the implementation of the EU ETS to date have created the possibility for injured states to seek remedies through the dispute settlement system or the imposition of countervailing duties under the SCM Agreement. Each option has its pros and cons, which have to be weighed by the injured state when seeking a remedy, such as political considerations, challenges in terms of obtaining accurate data when assessing injury, and monetary costs. The implementing state may opt to advance a defense under GATT article XX, which is an innovative but improbable approach, due to the wording of the article, the lapse of the application of article 8 "green box" of environmental subsidies, and the fact that the SCM Agreement does not explicitly refer to GATT article XX.

Regarding monitoring under the SCM Committee and the Trade Policy Review Mechanism, the system lacks efficiency, hindering its correct application and the necessary cooperation by Members, whose policies and negligence render the requirements for subsidies notification *lettre morte* under the agreements.

In consideration of the aforementioned problems, the need for specific reforms in order to better accommodate trade measures that have a positive environmental impact under the GATT and the SCM Agreement is necessary. These proposed reforms could vary from changes to the notification procedures followed by the SCM Committee to the *"greening"* of the SCM Agreement or to the creation of a multilateral or plurilateral Agreement that deals with the interaction between trade and the environment.

IV. Facts assessment

A. The European Union Greenhouse Gas Emission Trading System (EU ETS)

The European Union Greenhouse Gas Emission Trading System was established under *Directive 2003/87/EC* and commenced operations on January 1st 2005 as the largest multi-country, multi-sector GHG emission trading system worldwide. It creates obligations for large emitters of carbon dioxide (CO2) to monitor and annually report their CO2 emissions. It targets enterprises that are currently responsible for about half of the EU's CO2 emissions and in general for 40% of its total GHG emissions.[3]

[3] See at http://ec.europa.eu/environment/climat/emission/index_en.htm

The EU ETS was established as a response to the priorities set by the United Nations Framework Convention on Climate Change (UNFCCC) and the subsequent Kyoto Protocol regarding the reduction of the GHG emissions.[4]

Under the EU ETS, EU member states set national emission caps for their domestic industrial sectors, which if approved by the European Commission, will then lead to the allocation of allowances for those enterprises, where individual states will be responsible for monitoring and validating these emissions.[5]

In order to attain an actual reduction of CO2 emissions and gain the Commission's approval, EU governments must ensure when drafting their national allocation plan (*NAP*) that the allowances granted to their domestic industries will amount to a decrease in emissions, in comparison with what would have been produced under their usual business practices. In every member state, a national registry had been created so as to keep accurate accounts of all domestic allowances,[6]and at the same time the EU Commission appointed a *Central Administrator* to monitor state practices.[7]

To make the procedure more transparent and predictable, the Commission issued *Decision 2007/589/EC* establishing specific guidelines addressed to the EU vis-à-vis monitoring and reporting of the emissions of the recipients of allowances.[8]

To date there have been two phases towards the implementation of the EU ETS. The first one took place from 2005 to 2007 with the participation of almost 12,000 installations. The allocation of the allowances under this period was known as the process of *"grandfathering"* as at least 95% of them were granted for free. The second phase, which began in 2008 and will continue until December 31st 2012, consists of a quota of free allocation that decreased to an amount of at least 90% of the allocation of allowances in Phase I.[9]

The system is constructed in such a way so as to enable mainly companies of the energy field, such as oil refineries and coke ovens; mineral, pulp and paper industries; and enterprises specializing in the field of metals processing to become recipients of the

[4] See article 17 of the Kyoto Protocol to the United Nations Framework Convention on Climate Change, available at http://unfccc.int/resource/docs/convkp/kpeng.pdf
[5] See article 9 and 11, European Parliament and Council Directive 2003/87/EC, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:275:0032:0046:EN:PDF
[6] Ibid, article 19
[7] Ibid, article 20
[8] See full text available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:275:0032:0046:EN:PDF
[9] Ibid, article 10

allowances.[10] For each sector covered under Annex I, the Directive establishes different thresholds vis-à-vis the minimum production capacity or industrial output, so that an enterprise will be considered eligible to receive free allowances but the Directive remains silent regarding GHG emissions benchmarks. Energy intensiveness as a necessary element can be derived from the general overview of the heavy industrial sectors covered as well as from the high production capacities established. It becomes apparent that trade intensive operators, and as a result energy intensive too, will likely fall under the Directive's regulations.

The Directive as amended under Phase III will provide for a procedure of auctioning for the period of 2013 onwards, in an attempt to correct the deficiencies of the system as it stands now. The EU has been heavily criticized for its practice of granting allowances free of charge, which has adverse effects. For example it does not motivate the industrial sector to reduce its emissions.

The industrial sectors covered by the amended Directive are the same as under Phase II, but the future process will also cover one of the main GHG emitters within the EU, namely the aviation industry.

The application for an emission allowance to the state authorities should include a description of the installation and its activities, the raw and auxiliary materials used, the sources of emissions of gases mentioned in *Annex I* and the measures by the sector to monitor and report the emissions.[11]The calculation of emissions for the eligibility of a sector is based on this data following the method of *Annex IV* to the Directive. The state authorities can review these allowances every five years.

Another change introduced for the period of 2013 onwards is the process that allows states to deal with their industries carbon leakage issues. The stricter provisions about to apply from 2013, raised fears among the governments of the EU that many of their industries would face significant costs in order to address the new situation and as a result they might prefer to move their installations outside the EU, thus creating the problem of carbon leakage.

[10] Ibid, Annex I

[11] Article 5, of the consolidated version of the Directive 2003/87/EC, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2003L0087:20090625:EN:PDF

The classic notion of the threat of carbon leakage is linked to two major concerns for a state, namely the delocalisation to third states of crucial industries, diminishing its efforts to improve environmental conditions and also the gradual diminution of its exports, substituted by increasing import levels of products not produced now on its soil. This threat of a double damage, both for the environment and the trade of a state, is echoed in the Commission Decision of 24/12/2009 determining certain sectors and sub-sectors which are deemed to be exposed to the risk of carbon leakage,[12] as well as at the qualitative assessment followed by the EU in order to decide on the eligibility of certain industrial sectors to fall under the provisions protecting them from carbon leakage.[13]

Under this threat, the EU decided to become more lenient with industries facing the high costs of adaptation, by granting free allowances[14] and the option for member states to adopt further financial measures in order to deal with this issue. If states wish to adopt financial measures, their industrial sectors have to meet specific requirements linked to ex-ante benchmarks of the indirect emissions of CO2 per unit of production, calculated as the product of electricity consumption and of the CO2 emissions of the relevant European electricity production mix, as well as to an increase of their production costs vis-à-vis their gross value added or their total value of exports and imports, in the last three years before granting the allowance.[15]The starting point for setting the benchmarks is the average emissions performance of 10% of the most efficient installations in an industrial sector.[16] Hence, energy intensity and trade intensity seem to be interrelated.

The results achieved so far, mainly regarding the overall reduction of emissions, have been rather disappointing with *Phase I* considered a disaster, due to problems of over-allocation of allowances and thus violations by most member states of their National Allocation Plans.[17]

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[12] Commission Decision of 24 December 2009 determining, pursuant to Directive 2003/87/EC of the European Parliament and of the Council, a list of sectors and subsectors which are deemed to be exposed to a significant risk of carbon leakage

[13] Annex II of the Commission Decision of 24 December 2009, determining pursuant to Directive 2003/87/EC of the European Parliament and of the Council a list of sectors and sub-sectors which are deemed to be exposed to a significant risk of carbon leakage, explaining the qualitative assessment of the Commission

[14] Ibid, Article 10a, para.12

[15] Ibid, article 10a, para. 6, 12, 15 and 16

[16] Ibid, article 10a, para.2, al.1

[17] See report available at http://ecofys.co.uk/uk/publications/documents/Interim_Report_NAP_ Evaluation_180804.pdf

During the initiation of *Phase II*, ECOFYS, a leading company specializing in energy saving and renewable energy solutions, again produced evidence that all but three member states allocated emissions of an amount around 7% more than those produced under current business processes.[18] There have even been allegations resulting from EUROPOL research that as much as 90% of the emission trading in certain states could be a result of fraudulent practices.[19]

However, the system has lately shown signs of success, as in 2008 the amount of total EU emissions dropped by about 5%.[20]But criticism has been mounting for its future application, as there are fears that the provisions regulating the issue of carbon leakage could be the final blow for the EU ETS.

All in all, the EU initiative to adopt the emissions trading system was hailed by the United Nations as the most positive step to cut down GHG emissions but its implementation so far has shown little gains regarding environmental protection.

B. The U.S. Bills

i. Climate Change and Competitive Advantage

This section will focus on climate change and energy efficiency legislation in the U.S., especially provisions that may be considered subsidies under WTO law. There are primarily three U.S. bills that address environmental issues and carbon emissions: the *American Clean Energy and Security Act of 2009* (Waxman – Markey Bill, H.R. 2454), the *Clean Energy Jobs and American Power Act* (Kerry – Boxer Bill, S.1733), and the draft *American Power Act* (Draft Kerry-Lieberman Bill) (collectively "the Proposed Bills"). It should be noted that none of the bills are yet *in effect*; therefore, the following review and analysis is based on the potential impact of the Proposed Bills.[21]

The Proposed Bills have environmental, economical, and political interests at stake, where balancing and reconciling those interests is a tricky business and challenge for legislators. The proposed bills seek to ebb global warming by reducing GHG

[18] See report available at http://www.ecofys.com/com/publications/gate.asp?fn=documents/Ecofys_Summary_InitialNAP2_Assessment.pdf

[19] Phillips, L., EU emissions trading an open door for crime EUROPOL says, available at http://euobserver.com/885/29132

[20] Kanter, J., EU carbon trading system shows signs of working, available at http://www.nytimes.com/2009/04/02/business/global/02climate.html

[21] The Waxman-Markey Bill was passed by the House in 2009 and it is currently scheduled to appear before the Senate. The Kerry-Boxer Bill has been introduced and reported in Senate. The Kerry-Lieberman Draft Bill was released on May 12, 2010.

emissions; yet, the realities of economic concerns requires the U.S. to remain competitive in the global arena.

A concern is that the establishment of emission allowances for specific sectors would result in a competitive disadvantage for U.S. manufacturers. For example, manufacturers that exceed their allocated emission allowances will likely purchase emission units, which will increase their production costs[22] in comparison to foreign manufacturers that do not have emission targets. It creates a tug-of-war between balancing the need to mitigate global warming and maintaining a competitive advantage, which is a current that runs throughout all of the bills, especially in consideration of the current economic situation and emergence of the BRIC (Brazil, Russia, India, and China) nations. At the same time, the U.S. could potentially be at a competitive advantage in comparison to other countries with climate change legislation, if the proposed bills do provide subsidies or its target amounts are higher. In comparison to the EU, the U.S.' suggested cuts in carbon emissions are less aggressive; therefore, this could be a competitive advantage for the U.S.[23]

Another issue is that a unilateral system may not be the best method to tackle climate change because it is a global concern.[24] The Proposed Bills are forms of unilateral action because they are pieces of domestic legislation that will only be implemented in the U.S. The impact of GHG emissions on climate is not limited by geographical boundaries; hence, it would be preferential to have a multilateral agreement to address what is considered a global common – the environment.

Another concern is carbon leakage, which would occur when U.S. manufactures move the manufacturing of goods to a country without emission targets.[25] This would in effect simply redistribute the GHG emissions. U.S. manufacturers would technically be meeting their emission allowances in the U.S. in accordance with a bill, but would be polluting in another jurisdiction beyond the permitted allowances.

Consideration of the above mentioned factors are necessary to balance the different interests at play. There is an increasing social concern for the environment, which is a

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[22] Windon, J., *The allocation of free emissions units and the WTO subsidies agreement*, Georgetown Journal of International Law, (2009)

[23] House, T., *Green and Mean: Can the New US Economy be both Climate-Friendly and Competitive?, Testimony before the Commission on Security and Cooperation in Europe*, US Congress, March 10, 2009, Peterson Institute for International Economics, p.4

[24] Ibid

[25] Ibid

matter that has become politicized; yet, the economic concerns of the U.S. require that it remain competitive in the marketplace.

ii. Waxman-Markey Bill

The objective of the Waxman-Markey Bill (the WM Bill) is to establish clean energy, reduce global warming, and reduce GHG emissions to 83% of 2005 levels by 2050. It seeks to achieve its objective through provisions that may be challenged at the WTO as subsidies under the SCM Agreement, specifically the establishment of emission allowances and rebate programs.

The WM Bill allocates specific emission allowances to trade vulnerable and energy-intensive sectors. [26] It prohibits emissions beyond those allocated but there are certain variables that are excluded in the calculations that will impact the final figures, such as the exclusion of petroleum-based or coal-based liquid fuel, natural gas liquid, renewable biomass or gas derived from renewable biomass, and petroleum coke or gas derived from petroleum coke when calculating the amounts of emissions.[27]

The WM Bill grants rebates that are sector specific in that they are distributed to energy intensive industries. Industries that are energy or greenhouse gas intensive are presumptively eligible for emission allowance rebate programs.[28]The eligibility criteria for the rebate programs are based on energy or greenhouse gas intensity, trade intensity, and very high energy or greenhouse gas intensity.[29]An industrial sector is considered energy or greenhouse gas intensive, if: (I) it has "an energy intensity of at least 5 percent, calculated by dividing the cost of purchased electricity and fuel costs of the sector by the value of the shipments of the sector" or (II) "a greenhouse gas intensity of at least 5 percent, calculated by dividing the number 20 multiplied by the number of tons of [CO2] equivalent [GHG] emissions of the sector, by the value of the shipments of the sector".[30]

A sector would be eligible if it had a "trade intensity of at least 15 percent, calculated by dividing the value of the total imports and exports of such sector by the value of the shipments plus the value of imports of such sector".[31]

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[26] Section 782(e) of the WM Bill
[27] Ibid, Section 722
[28] Ibid, Section 763(b)
[29] Ibid, Section 763(b)(2)(A)
[30] Ibid, Section 763 (b)(2)(A)(ii)
[31] Ibid, Section 763(b)(2)(A)(iii)

A sector is considered to be of "very high energy or greenhouse gas intensity", when it has an energy or greenhouse gas intensity of at least 20 percent, on the basis of the above method of calculation.[32]

More specifically, emission allowance rebates have been allocated to petroleum refineries in the U.S. to promote energy efficiency and a reduction in GHG emissions.[33] Traditionally, the petroleum industry has been a carbon intensive industry.

iii. Kerry-Boxer Bill

The objective of the Kerry-Boxer Bill (the KB Bill) is to create clean energy jobs, promote energy independence, reduce global warming pollution, transition to a clean energy economy, and reduce U.S. emissions by 20% by 2020 and by 83% by 2050.

Similar to the WM Bill, the KB Bill provides for emission allowances and rebate programs that may constitute subsidies. The eligibility criteria for the rebate programs are based on the energy or greenhouse gas intensity, trade intensity, and very high energy or greenhouse gas intensity (the Criteria).[34] The calculations that would be used to determine whether or not sectors are eligible in accordance with the criteria is the same as under the WM Bill, as described above.

The allocation of emission allowances targets certain sectors, one of which is domestic petroleum refineries.[35] It does not explicitly state that allowances are allocated to trade vulnerable and energy intensive industries, as in the WM Bill, but it could be reasoned that refineries are both trade vulnerable (the end product) and energy intensive. Further, the KB Bill generally prohibits excess emissions but when calculating emissions, it excludes petroleum-based or coal-based liquid fuel; natural gas liquid; renewable biomass or gas derived from renewable biomass; or petroleum coke for certain energy sources, which may not give an accurate figure of absolute emissions.[36]

In comparison, the framework of the WM Bill is more specific in terms of emission allowances and rebates to energy-intensive sectors as whole, while the KB Bill targets petroleum refineries specifically. Arguably, the emission allowances and rebate programs to energy intensive sectors could be challenged as subsidies under WTO law.

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[32] Ibid, Section 763 (b)(2)(A)(iv)
[33] Ibid, Section 787
[34] Section 763(b)(2)(A) of the KB Bill
[35] Ibid, Section 771(a)(4)(A)
[36] Ibid, Section 722

iv. Draft Kerry-Lieberman Bill

A proposed bill to keep on the radar is the Draft Kerry-Lieberman Bill. There are two documents that have been issued to date and they are the "Framework for Climate Action and Energy Independence in the U.S. Senate" dated December 10, 2009 (the Framework) and the Draft Kerry-Lieberman Bill (Draft KL Bill). Similar to the WM Bill and KB Bill, the Draft KL Bill seeks to reduce GHG emissions to 83% of 2005 levels by 2050.

In comparison to the WM and KB Bill, the Draft KL Bill will also grant emission allowances and rebate programs. The industrial sectors that will be eligible for emission allowance rebates will be according to a proposed list of eligible industrial sectors that shall be published in the Federal Register by June 30, 2011 (the Proposed List).[37] The Proposed List of shall be updated on February 1, 2013 and subsequently updated every 4 years.[38] The Proposed List will be based on eligibility criteria and calculations that are a replica of the WM and KB Bill. The eligibility criteria are based on energy or GHG intensity, trade intensity, and very high energy or GHG intensity.[39] Similar to the WM and KB Bills, these provisions may be challenged under WTO law as subsidies.

V. Rules

The examination of the measures will take place in accordance with the SCM Agreement, namely articles 1 and 2 regarding the definition of the measures as subsidies and their specificity, articles 3, 5 and 6 vis-à-vis their characterization as prohibited or actionable subsidies, articles 4 and 7 for their treatment under the WTO framework according to the category in which they fall in and articles 10 to 23 regarding the investigation process and the probable imposition of countervailing duties. GATT articles VI and XVI will also be part of the analysis when it comes to a possible defence introduced under GATT article XX.

Coming to the issue of notification of subsidies and trade measures, we will resort to the use of articles 24 to 26 of the SCM Agreement and Annex 3 of the WTO Agreement regulating the practice of the Trade Policy Review Mechanism.

[37] Section 773(a)(1) of the Draft KL Bill
[38] Ibid, Section 773 (a)(2)
[39] Ibid, Section 773(b)(2)(A)(ii),(iii), and (iv)

Finally under the part of proposed reforms, attention will be drawn to articles 8 and 9 of the SCM Agreement and the general formulation of GATT article XX.

VI. Analysis

A. Existence of a subsidy

i. Government measure

In order to challenge a measure under the provisions of the SCM Agreement it must be proven that a subsidy exists by meeting all the requirements of its definition introduced in article 1. The first requirement is that there is an explicit financial contribution by the government.

a. The EU ETS

The issue of government measures that could be described as subsidies should be addressed with caution, as not every government intervention could be deemed a subsidy for the purpose of the SCM agreement.[40]For example, it would be difficult to tell the difference between general government measures that are used to correct a market failure or that have an objective that is positively valued by the society, such as the use of subsidies to protect the environment, where in spite of their positive objectives, the subsidies may also have trade distorting effects.[41]

The EU ETS is regulated and approved by the European Commission, a multilateral body, which does not constitute a state. However, the European Communities are part of the WTO and have been granted the status of a *"state"* within its system. As a result, it could be reasoned that the EU ETS derives from explicit governmental involvement and thus the first requirement is met.

b. The U.S. Bills

With respect to the Proposed Bills, the emission allowances and rebate programs would likely constitute a government action because they would be established in accordance with government bills, be implemented by government action, and be administered by a government agency (the *Environment Protection Agency*).

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[40] Panel Report, *United States- Measures treating export restraints as subsidies*, WT/DS194/R, 23/08/2001, para.8.62

[41] Hernandez Luengo, E., *Regulation of subsidies and state aids in WTO and EC Law: conflicts in international trade law*, The Netherlands, Kluwer Law International, 2006, p.9

ii. Financial contribution

Secondly, the government measure has to consist of a financial contribution, as governed by article 1.1(a)(1) and (2) of the SCM Agreement, which contain an exhaustive list regarding the definition of financial contribution. Regarding the EU ETS, it is beyond any doubt that we do not deal in most cases with a pure *de jure* subsidy, where the state proceeds to a direct transfer of funds, an income or price support or a payment to the recipients of the carbon emission allowances. Notwithstanding this issue, it should be assessed as to whether certain measures could constitute a form of *de facto* financial contribution.

a. Phase II of the EU ETS

Beginning with the scenario of the existence of a direct transfer of funds, it may occur under a cap-and-trade market system because carbon has been commoditized and given a monetary value; hence, it could be reasoned that the allocation of allowances is equivalent to a transfer of funds. The wording of the Directive obliging the state authorities to **issue** GHG emission permits[42] and also to **issue** and to **allocate** the allowances[43] for the eligible industrial sectors, followed by the requirement for these sectors to surrender each year a number of allowances equal to their total emissions during the preceding calendar year,[44] could fulfill the legal aspect of the notion of transfer under this Phase of the EU ETS. This reasoning, based on carbon being a commodity and the allowances having a monetary value, and thus being considered as funds, is further supported by the panel decision in *Brazil-Export Financing Program for Aircraft,* where it was established that the term *"funds"* includes *"resources of, belonging to, or having relation to money"*.[45] Even though industries may never sell their allocated allowances in a cap-and-trade system and receive actual money for it, the allowances have a monetary value regardless of whether or not industries sell their excess allowances on the market. Therefore, there is the potential to reason that emission allowances amount to a direct transfer of funds.

Apart from the arguably finding a direct transfer of funds by the EU Commission or member states under this Phase, we will also explore the possibility of finding a

[42] Article 6.1, European Parliament and Council Directive 2003/87/EC, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:275:0032:0046:EN:PDF
[43] Ibid, article 11
[44] Ibid, article 12.3
[45] Panel Report, *Brazil-Export Financing Program for Aircraft,* WT/DS46/R, 20/08/1999, para.7.72

financial contribution through other means. We will start with the possibility of there being government revenue foregone. The Appellate Body in *U.S.-Tax Treatment for "Foreign Sales Corporations"* mentioned that 'the word *"foregone"* suggests that the government has given up an entitlement to raise revenue that it could *"otherwise have raised"*.[46]The Appellate Body continued to mention that this entitlement cannot be in the abstract and that there should exist *"some defined, normative benchmark against which a comparison can be made between the revenue actually raised and the revenue that would have been raised 'otherwise''. We, therefore, agree with the Panel that the term 'otherwise due' implies some kind of comparison between the revenues due under the contested measure and revenues that would be due in some other situation'*.[47]

It could not be maintained here that certain states might be following a different practice regarding the granting of allowances to their national companies covered by the Directive because National Allocation Plans have to be approved by the Commission. At this stage, there seem to be two categories of allocations: most companies need to buy their emission allowances but the industrial sectors falling under the Directive receive a preferential treatment and free emission allowances. It could be advanced that the EU introduced various specific rules for the granting of emissions for certain sectors that are excluded from the general scheme by establishing certain trade and energy intensiveness benchmarks, rendering thus the application of the general "but for" test of the *FSC* Report impossible.

However, it was for such cases, that the Appellate Body maintained that the "but for" test cannot be used in every situation as it could be circumvented by a state through the application of no general or of specific rules for the revenues in question.[48]

The language of the Directive is rather unclear regarding the treatment of sectors excluded from its scope. Such operators, which would need to buy emission allowances, will normally have to resort either to the private market or to administrative authorities of a state, which must also be involved in any process of transfer of allowances between

[46] Appellate Body Report, *United States- Tax Treatment for Foreign Sales Corporations*, WT/DS108/AB/R, 14/03/2006, para.90
[47] Ibid
[48] Appellate Body Report, *United States- Tax Treatment for Foreign Sales Corporations*, WT/DS108/AB/R, 14/03/2006, para.91

companies, according to the language of the Directive.[49] In the second case, the 90% or more carve out for the enterprises covered by the Directive will constitute revenue foregone.

Another possible way to establish a financial contribution would be to describe the aforementioned procedure adopted by states to issue carbon emission allowances in excess of their obligations under the Directive as services provided to certain sectors.[50] It may be reasoned that *"services"* were provided by the state when certain sectors were able to engage in more competitive production processes in comparison to situations when carbon emissions allowances were not granted in excess of the amounts stipulated in the Directive. However, this idea would hardly address the classic notion of service.

Another viable option would be to consider the trading of carbon dioxide emissions as the trading of a specific good. The current system of carbon emission allocations and the trading of the surplus quotas treats carbon dioxide as a good, because it becomes commoditized with a certain value attached to it. The Appellate Body in *U.S.-Softwood Lumber* mentioned that there was no need for the goods to be tradable or actually imported,[51] which is a test that could apply for the case of excess carbon allowances. In the cases of over-allocation of allowances by the states to certain industries, which were estimated to reach the sum of 500 million Euros, this practice could be considered as the granting of certain goods by the states in excess of their obligations under the system introduced by the EU. The companies that benefit from the over-allocation of allowances can then use this surplus of goods in order to make a profit and distort competition in the carbon dioxide trading market, as they will be able to continue more energy intensive production. As a result, this scenario of treating carbon dioxide as a good could meet the definition of subsidy under article 1.1(a)(1)(iii) of the SCM Agreement, for the practices of over-allocation of carbon emission quotas by the governments.

In order to find a financial contribution by one of the means described above, the affected WTO members will probably face serious difficulties in collecting data for these incorrect applications of the environmental measures. In most cases, the

[49] Article 12 of the European Parliament and Council Directive 2003/87/EC, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:275:0032:0046:EN:PDF

[50] Article 1.1(a)(1)(iii) of the SCM Agreement

[51] Appellate Body Report, *United States-Final Countervailing Duty Determination with respect to certain softwood lumber from Canada*, WT/DS257/AB/R, 17/02/2004, para.64

Commission is not aware of the practices followed by States after their National Allocation Plans have been approved. Even if certain situations become known, they might remain confidential between the Commission and the member state.

Amongst the possible options, the most plausible course of action will be to challenge the measures at issue as a direct transfer of funds or revenue foregone as the National Allocation Plans provide all the data regarding the percentage of free allowances granted to industrial sectors.

b. Phase III of the EU ETS

Allowances for the industrial sectors or subsectors threatened by carbon leakage will be granted for free,[52]so this requirement seems to fulfil the notion of revenue foregone as the Commission sets auctioning as the basis for the granting of emissions allowances. The articles of the Directive are formulated in such a way so as to provide for an exception regarding sectors threatened from carbon leakage, despite the existence of a general rule of auctioning allowances for the totality of industrial sectors covered by the Directive, confirming thus the test for the existence of revenue foregone applied by the Appellate Body in the *FSC* case.

Regarding types of financial contribution, article 10a.6 of the consolidated version of *Directive 2003/87/EC* is explicit on this issue as it allows member states to adopt any financial measures they consider proper in order to deal with the threat of carbon leakage. States decide on the form of this financial contribution and thus this scenario would be covered by article 1.1(a)(1)(i), as there will be a direct transfer of funds. The language of the Directive is ambiguous and vague, whether loans should be preferred over direct grants. As a result the injured state trying to prove the existence of a subsidy will need to go into the spirit and structure of the measure, as even a loan could be characterized as a financial contribution for the purpose of the SCM Agreement, if it is granted in more convenient terms for the recipient industry than those already applied in the business practice.

Hence, the provisions of *Phase III* seem to fulfil the second requirement of the definition of a subsidy.

c. The U.S. Bills

[52] Articles 10a.12 and 10b, of the consolidated version of the Directive 2003/87/EC, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2003L0087:20090625

In the Proposed Bills, it could be reasoned that the rebate programs and emission allowances for carbon-intensive industries constitute a financial contribution due to a direct transfer of funds by the U.S. government on the basis of Article 1.1(a)(1)(i) of the SCM Agreement or revenue foregone on the basis of Article 1.1(a)(1)(ii) of the SCM Agreement.

Similar to the EU system, a direct transfer of funds may be found as a result of the proposed cap-and-trade market system, in accordance with the reasoning in the Panel decision of *Brazil-Export Financing Program for Aircraft.* As a result of the creation of a carbon market is that a monetary value is given to emission allowances; hence, the emission allowances may constitute 'funds'. Therefore, the granting of allowances to industries by the government may constitute a direct transfer of funds. An issue may arise as to whether the allocation of emission allowances would constitute a "direct" transfer of emission allowances. It is uncertain how the emission allowances will be allocated in practice and whether or not an account of sorts will be created for industrial sectors into which emission allowances will be "directly" transferred. However, even if this does not occur, it may be possible that there has been a *de facto* "direct" transfer as a result of the allocation of emission allowances. The allocation of emission allowances could arguably create a credit of sorts for industries, where even if there is no physical direct transfer of emission allowances, there is a *de facto* direct transfer.

A financial contribution may also occur when revenue is foregone as a result of the allocation of free emission allowances that are granted by the government. In the Appellate Body decision *U.S.-FSC*, as discussed above, it was determined that there has to be a normative benchmark. In the case of the Proposed Bills, it would be the auction price of emission allowances. Instead of the U.S. government auctioning emission units to industries and making revenue, they are allocating them for free and revenue is foregone. The government would have foregone revenue that it *"otherwise [could] have raised"*.[53]

Based on the above reasoning, it is likely that a financial contribution would be found in the provisions of the Proposed Bills.

iii. <u>Benefit</u>

[53] Appellate Body Report, *United States- Tax Treatment for Foreign Sales Corporations*, WT/DS108/AB/R, 14/03/2006, para.90

The third requirement in order to find a subsidy is that there has to be a benefit in accordance with article 1.1(b) of the SCM Agreement. In determining what constitutes a *"benefit"*, the Appellate Body in *Canada-Aircrafts* reasoned that a benefit occurs when a financial contribution has been received, *"on terms more favourable than those available for the recipient in the market"*,[54] and so a benefit needs to be determined in relation to the market place.

a. <u>The EU ETS</u>

It would be easy to conclude that the recipients of the allowances have a clear advantage as compared to their domestic competitors, as in any event they were granted these rights for free and they can continue emitting carbon through intensive production processes. As they save huge sums spent for this process, they can continue operating under their normal or more intensive production rhythms, compared to other sectors, which will acquire allowances through auctioning. In the end, they are better off and they gain a comparative advantage from any other industry that has to invest substantial sums to meet the environmental reforms. Furthermore, under Phase II they were able to sell their over-allocated or excess quotas of allowances to other enterprises and thus make a net economic profit by carbon trading rights, which were acquired by them for free.

They fall under the idea of benefit expressed in *Canada-Aircrafts* by the Appellate Body, following the test of how industries would stand, absent the financial contribution by the states.[55]

What could also be said here is that the notion of benefit as construed in article 1.1(b) of the SCM Agreement and interpreted by the Panels and the Appellate Body could not totally address measures that have an explicit environmental objective. In the SCM Agreement there is no provision regarding the definition of the subsidy designed in such a way to address the positive externalities that could be generated by it, the overall external benefit to the environment in this case, as in general the majority of subsidies tend to create external harm.

[54] Appellate Body Report, *Canada- Measures affecting the export of civilian aircraft*, WT/DS70/AB/R, 20/08/1999, para.157

[55] Appellate Body Report, *Canada-Measures affecting the export of civilian aircraft*, WT/DS70/AB/R, 20/08/1999, para.157

But despite its efforts to address environmental objectives, the overall structure of the EU ETS and the practice of emissions over-allocation, can result in trade distorting practices.

b. The U.S. Bills

It is submitted that whether or not a benefit is found is relative to whether or not the other state has implemented climate legislation and if so, whether the provisions of the other state are more stringent relative to the Proposed Bills. For instance, it may be difficult to assert that as a result of the rebate programs or emission allowances to energy-intensive sectors that U.S. manufacturers have benefited, especially when certain competitors do not have climate change legislation that address emission targets in the first place. Competitors would theoretically be able to produce, manufacture and pollute without consideration of the environment or legal obligations and at a lower cost. On the other hand, it could be reasoned that U.S. manufacturers would potentially receive a benefit in relation to countries with climate change legislation, such as the E.U. with its climate change Directive.

B. Specificity

Assuming that the requirements of a subsidy have been met, the next step in the analysis pertains to the issue of specificity, where a subsidy has to be specific, in order for it to be subject to the SCM Agreement. Article 2 of the SCM Agreement introduces four distinct types of specificity, namely enterprise specificity, industry specificity, regional specificity and specificity linked to the existence of a prohibited subsidy.[56]

i. Phase II of the EU ETS

Proving the existence of specificity is a complicated procedure involving the consideration of elements that could be challenged, and as a result possibly lead to arguable results. It is true that *Annex I* of *Directive 2003/87/EC* explicitly numbers the categories of industries falling under the scheme established by the EU ETS, so it could easily be inferred that the measures deemed as subsidies are definitely specific under article 2.1(a) of the SCM Agreement. There is however the exception introduced under

[56] Van den Bossche, P., *Subsidies and Countervailing measures*, in *The law and policy of the World Trade Organization: text, cases and materials*, Cambridge, Cambridge University Press, 2008, p.568

article 2.1(b) of the SCM Agreement regarding the issue of objective criteria for the eligibility of a sector to receive a subsidy, as established under Directive 2003/87/EC. These objective conditions according to footnote 2 to the SCM Agreement need to be economic in nature and horizontal in application. Trade intensiveness definitely has an economic aspect but energy considerations do not fulfil these criteria and they favour enterprises, which are large polluters.

One could argue that by following this reasoning any criteria established by government measures will always be selective by nature, and as a result they will always lead to the case of a subsidy, to the finding of specificity. However, in the case of the EU ETS, this issue of specificity could be maintained, despite the existence of objective criteria vis-à-vis the free allocation of allowances, based on the whole structure of the system favouring extremely energy and trade intensive industries. In general, these sectors represent a specific quota of European enterprises, which are extremely profitable and could also suffer significant economic damages compared to foreign competition if they needed to reduce their emissions or move significant monetary sums from the production process so as to meet the EU requirements for environmental protection.

Finally, the practice of state over-allocations to certain sectors was a result of government discretion. The Directive does not set any objective criteria for states to follow regarding their choice of installations or whole sectors, when they decide to grant free allowances at a level of for example 92% or 95%, forcing 8% or 5% of the recipients to buy their emission allowances.

ii. Phase III of the EU ETS

Paragraphs 2, 6, 15 and 16 of article 10a of the consolidated version of *Directive 2003/87/EC* establish the requirements for a sector or sub-sector to be considered to be exposed to a significant risk of carbon leakage, and therefore enjoy the beneficial treatment of the free allocation of emission allowances and further financial aid from its country of operation. These conditions for eligibility are linked to the indirect CO2 emissions per unit of production, calculated as the product of the electricity consumption per unit of production, under a further initial ex-ante benchmark of emissions representing the average performance of 10% of the most efficient installations and the percentage of increase of production costs when related to gross added value or to overall intensity of trade with third countries, taking into

consideration the level of imports and exports as well as the market size for the Community.

One of the requirements contained in paragraphs 15 and 16 of the EU ETS regarding the eligibility of industrial sectors that are prone to risks of carbon leakage is their total value of exports to third countries. This value is also linked with that of the imports from non-EU markets in order to calculate the trade intensity of that sector, but it is beyond any doubt that the export performance is of paramount importance for the granting of further state financial aid. As mentioned by the Appellate Body in *Canada-Aircrafts, 21.5*, *"subsidy is prohibited….if it is dependent for its existence on export performance"*.[57]

Part of the subsidies under the EU ETS seem to meet this test applied by the Appellate Body and thus, if the risk for carbon leakage is calculated based on the intensity of the exports trade of certain sectors, than the subsidies provided will be prohibited ones.

It could be argued that as the eligibility criteria are linked to the available trade data of the sector from the three previous years,[58] the Commission does not expect from the industry a specific export performance in the future, and thus the subsidy is not export contingent. On the other hand, the Directive provides for a process of revision of this procedure,[59] and as a result a sector needs to remain export active in order to have the possibility to be reconsidered for free allowances. As a result, the subsidies should be considered export contingent, thus prohibited and specific under article 2.2.3 of the SCM Agreement.

In addition, for any other subsidy, Article 2.1(b) of the SCM Agreement exempts from the notion of specificity, any subsidy that is granted following the establishment of an objective criterion by the granting authority. At a first reading, the Commission Decision of 24/12/2009, establishing a list of sectors and subsectors deemed to be exposed to the risk of carbon leakage,[60] covers a broad spectrum of numerous sectors, thus eliminating the prospect of specificity. Furthermore, the provisions of the EU ETS

[57] Appellate Body Report, *Canada-Measures affecting the export of civilian aircraft-Recourse by Brazil to article 21.5 of the DSU*, WT/DS270/AB/RW, 04/08/2000, para.47

[58] Article 10a, para.14 of the consolidated version of the Directive 2003/87/EC, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2003L0087:20090625

[59] Ibid, article 10a, para.12, in fine, 'every five years'

[60] Commission Decision of 24 December 2009 determining, pursuant to Directive 2003/87/EC of the European Parliament and of the Council, a list of sectors and subsectors which are deemed to be exposed to a significant risk of carbon leakage

appear to have introduced such an objective system of determining the industrial sectors falling under a specific treatment due to the threat of carbon leakage. However, article 2.1(b) should be read in accordance with footnote 2 to the SCM Agreement, which states that these objective criteria should be neutral and avoid the favouring of certain enterprises over others. In light of the footnote, it could be said that the way the Directive is formulated could benefit certain companies over others, such as extremely productive industries that are large emitters of GHG and also market active and profitable for European trade.

The Commission Decision of 24 December 2009 mentions that qualitative assessments have been undertaken for specific sectors such as the manufacturing of panels and boards, plastics in primary forms, and the casting of iron and of light metals[61] **before** a decision was made to include them in a list comprised of sectors threatened by carbon leakage. Based on elements found under these assessments such as experienced trade losses by those sectors in the recent years, a significant drop in their production, the fact that the international trade of certain products has significantly increased with diminished participation by the EU sectors, international competitive pressure or their limited potential to address additional costs,[62]the Commission formulated the list of the sectors and subsectors deemed to be at risk of carbon leakage. Furthermore, it is explicitly mentioned that due to time restrictions only certain sectors and subsectors could be completely analysed for the time being,[63] raising concerns regarding the criteria the Commission used to select certain sectors to focus on before examining others. These aforementioned considerations could form a substantive argument for the specificity of the subsidies, as the Commission established certain trade and CO2 emission criteria of eligibility by first checking the position of certain EU sectors within the international trade environment and in consideration of international competition vis-à-vis crucial EU products, and picked the most trade and energy vulnerable industries as those to be eligible to receive free allowances.

As a result, article 2.1(b) finds no application and the measures introduced by the EU ETS for the period 2013 onwards could be deemed to be specific, fulfilling the last

[61] Ibid, Paragraphs 18-21 of the Preamble
[62] Ibid
[63] Ibid, Paragraph 16 of the Preamble

requirement for the establishment of the notion of subsidy, subject to a challenge under the SCM Agreement.

On the other hand, it could be argued that the list of sectors introduced by the Commission Decision is very wide. Thus, it can be advanced that the coverage of a broad spectrum of industrial and trade activities should abolish any issue of the existence of specificity. Regarding this argument, one could maintain that in any event these sectors presented under the Decision can be grouped under specific smaller categories such as the extractive industries, manufacturers of various kinds of garments, manufacturers of machineries, biochemical industries etc. Furthermore, although deemed to be exposed to the risk of carbon leakage, all these industries specified in the Decision would need to further fulfil the criteria of energy and trade intensiveness set by article 10a of the Directive in order to receive free allowances. So, under these determinations linked to annual CO2 emissions and trade importance for the Commission, the issue of specificity could reappear regarding the established benchmarks set by the EU.

Taking into consideration both aforementioned arguments, it is evident that finding specificity could be a very controversial and demanding exercise whose outcome would be greatly influenced by the specific industrial sector put into question under a certain WTO case and the linkage between its operational characteristics or position in the international market and the final criteria of the Directive providing for free allowances, which seem to favour trade and energy vulnerable activities. An intensive facts assessment regarding the final recipients of the free allowances under the future operation of the EU ETS, despite the Decision establishing a broad list of eligibility, could provide the answer to the riddle of finding specificity.

iii. The U.S. Bills

Based on the approach taken, it would be possible to reason that the emission allowances and rebate programs either do or do not amount to specific subsidies. On one hand, it could be submitted that the criteria for the Proposed bills are objective in application; therefore, they are not specific. Even though only certain industries may be eligible for rebate programs in accordance with the criteria, the objective application of the criteria would not amount to specific subsidies. Whenever there are criteria to be met, there will always be certain sectors that qualify while others do not.

On the other hand, the emission allowances and rebate programs appear to be sector specific because they target trade vulnerable and energy-intensive sectors; hence, they meet the definition under Article 2.1(a) of the SCM. As an example, the WM Bill establishes rebates for petroleum refineries and industries that are of certain GHG emission intensity and the eligibility criteria for the Proposed Bills are based on trade and energy intensity.

C. Category of the subsidy

Subsidies are either prohibited or actionable, where the first is regulated by article 3 of the SCM Agreement and the later by article 5.

A subsidy is prohibited if it is export contingent or contingent upon the use of domestic goods, as stated in article 3. The Appellate Body in *Canada-Aircraft* addressed the issue of contingency, where it was stated that a subsidy is export contingent *"if it is dependent for its existence on export performance"*.[64]

On the other hand, article 5 introduces the notion of actionable subsidies, which in order to be challenged have to result in adverse effects causing injury to the domestic industry of another state, or nullification or impairment of a right or serious prejudice to its interests.

i. Phase II of the EU ETS

The measures at issue have nothing or little to do with issues of export performance or the exclusive use of domestic products. In general it is not the intention of the persons adopting the measure that will lead to a judgment of its export contingency but the way the measure is tailored or applied. There is no proof whatsoever, that the implementation of the EU ETS system was tied to the export performance of certain enterprises.

On the other hand, the provisions would likely constitute actionable subsidies. The main issue rendering actionable subsidies problematic is their impact on other countries.[65]This impact can be translated into a) injury to the domestic industry of

[64] Appellate Body Report, *Canada-Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to article 21.5 of the DSU*, WT/DS70/AB/RW, 04/08/2000, para.47

[65] Guzman, A., Pauwelyn, J., *Subsidies and Countervailing Duties*, in *International Trade Law*, New York, Aspen Publishers, 2009, p.421

another state, b) nullification or impairment of a benefit accruing to another member under GATT 1994 or c) serious prejudice to the interests of another member.[66]

The case of injury is further explained under footnote 45 to the SCM Agreement, necessitating material injury or a threat of it or material retardation to the domestic industry of another member. Regarding the measures at stake here, it would be a great challenge to prove material injury to a foreign industry in cases of over-allocation or free allocation of allowances, due to the need to gather an important amount of information establishing causality between the subsidy and the injury.

The most viable solution would be to use the option of a serious prejudice or threat of serious prejudice to the interests of another member in order to challenge the measure. A clearer definition of aspects of prejudice is presented under article 6.3 of the SCM Agreement, as application of article 6.1, presenting situations where prejudice is deemed to exist, lapsed in 31/12/1999 according to article 31. The article covers cases where a subsidy displaces or impedes the imports of a like product of another member in the market of the subsidising state or the market of a third country, or causes a price undercutting or significant price suppression or depression in comparison to the price of a like product of another member, or lost sales in the same market or it may increase world market share of the subsidising state vis-à-vis the subsidised product. When a state proceeds under the basis of serious prejudice, it should bear in consideration some factors excluding prejudice presented under article 6.7.

The article is formulated in such a way so as not to exclusively cover the issue of prejudice. In its introduction, the drafters used the word *"may"*, which creates the idea that the list that follows is not exhaustive and that even in case any provision of article 6.3 is fulfilled, there is still the possibility to challenge the application of article 5(c). However, the Panel in *US-Cotton* considered the fulfilment of a condition of article 6.3 as sufficient so as to establish prejudice under article 5(c).[67]So far, there has been no ruling as to whether or not the list of article 6.3 is illustrative or exclusive.

The article also covers cases of a threat of serious prejudice, found when the issue of prejudice is imminent.

The existence of prejudice results from the information submitted to or obtained by a Panel. Annex V to the SCM Agreement contains more detailed procedures for

[66] Article 5 of the SCM Agreement

[67] Panel Report, *United States-Subsidies in Upland Cotton*, WT/DS267/R, 08/09/2004, para.7.1390

developing information concerning serious prejudice based on an information gathering process necessitating the cooperation of the subsidising or even a third country member. Panels are allowed to come to a judgment based on the best available information and they can even draw adverse inferences, in case of non-cooperation by any party to the procedure.[68]So far, the Appellate Body has not formulated any specific evidentiary rules or set the standard of proof regarding the issue of serious prejudice, proceeding to an evaluation on a case-by-case basis.

In any event, serious prejudice should influence products originating exclusively from the complaining member in a dispute[69]and causality should be established between the subsidy and the effects on imports or the prices of a like product of another member.[70] Issues like the magnitude of the production of the subsidising state or the export volumes of the subsidised product could influence the judgment on the existence of causality.[71]

All in all, for the examination of claims under the SCM prejudice provisions, a very fact intensive analysis is essential. This analysis will involve not only legal interpretations but also the gathering of substantial economic data that focuses on issues of trade displacement or impairment and thus trade competitiveness. For example, for cases falling under 6.3(a) or (b), market share data is crucial in order to determine sales for the product at issue. For situations of price undercutting or suppression under article 6.3(c), Panels would have to examine the actual price levels of the products at issue and compare them with those existing before any issue of subsidisation came up.

Prejudice for third states regarding import or export capacities could result due to the improved competitiveness of the European industries or the market distortions due to free or excessive allowances granted to enterprises, thus making them more production-efficient.

Furthermore, the practice of selling excessive allowances to other industries, even non-EU ones - which might be obligated under their state legislation to cut down on carbon

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[68] Annex V, Agreement on Subsidies and Countervailing Measures, paras.6-7

[69] Panel Report, *Indonesia-Certain measures affecting the automobile industry,* WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, 23/07/1998, paras.14.201-202

[70] Ibid, para.14.224

[71] Panel Report, *United States-Subsidies on Upland Cotton,* WT/DS267/R, 08/09/2004, paras.7.1347-52. However, the Appellate Body in its report explained that a more detailed analysis on this matter should have been followed by the Panel, without finding in any event any legal error in the Panel's analysis, in Appellate Body Report, *United States-Subsidies in Upland Cotton,* WT/DS267/AB/R, 21/05/2005, para.458

emissions, and thus are now able to pollute more and produce more intensively -could destabilize the conditions of competitiveness in the world market and cause prejudice to certain state. This practice caused carbon-trading prices to crash, enabling numerous sectors to buy more emissions for cheaper prices and thus become more competitive at their production methods, than they would be if the carbon prices were expensive. As a result, the scenario of a serious prejudice seems to be the most convincing in order to establish the notion of an actionable subsidy.

ii. Phase III of the EU ETS

As discussed above, the provisions in paragraphs 15 and 16 of article 10a of the Directive for the eligibility of industrial sectors for subsidies is based partially on their total value of exports to third countries. Based on the reasoning in *Canada-Aircrafts*, provisions that combat carbon leakage are prohibited because they are export contingent.

Furthermore, subsidies that are granted by the EU members to sectors characterized as threatened by the issue of carbon leakage, according to their increase in production costs vis-à-vis their gross add value, can be challenged as actionable subsidies under article 5 of the SCM Agreement.

We do not think it is necessary to once again go through the requirements set by article 5 in order to establish the existence of an actionable subsidy. It suffices to say that these measures adopted under the EU ETS can definitely be the reason behind serious prejudice or injury to the trade of another WTO member or trade and competition distortion, as they cover sectors of extreme importance not only for the European but also for the global market.

iii. The U.S. Bills

Assuming the emission allowances and rebate programs constitute subsidies, they may amount to either prohibited or actionable subsidies dependent on the criterion that was met, whether it was based on trade intensity, or energy or GHG intensity.

If the subsidy was based on trade intensity under the WM Bill or KB Bill then this would likely amount to a prohibited subsidy. This is because the criterion for trade intensity would be export contingent, specifically “the total value of imports and

exports" as stated in the WM Bill and KB Bill[72]. The export contingent nature of the subsidy would likely amount to a prohibited subsidy in accordance with Article 3 of the SCM Agreement.

If the subsidy was based on energy or GHG intensity then it would likely fall under the category of actionable subsidies. In this case, the ability for a Member to take action would hinge on the adverse effects of the provisions on other Members. The most plausible argument for a Member would be that a subsidy, such as the allocation of emission allowances to energy-intensive industries, has caused injury to a domestic injury or "serious prejudice" to the interest of another Member in accordance with Article 5 of the SCM Agreement. For a claimant, it would be more preferable to base its argument on there being "serious prejudice" rather than an actual injury, as this would be a lower threshold to prove.

D. The possibility to invoke the defence of GATT article XX

GATT article XX enables the defendant state in a dispute settlement procedure to justify adopted measures, which actually violate the GATT Agreement.

The words *"nothing in this Agreement"* in GATT article XX, the absence of any reference in the SCM Agreement to other articles of the GATT apart from article VI and XVI, as well as the absence of a panel or Appellate Body report on this matter so far never facilitated the application of the article outside of the GATT scope. States have to prove the inconsistency of a measure with the provisions of the GATT Agreement, in order for the defendant to have the possibility to invoke the defence of article XX.

A similar matter was addressed by the Panel in *Brazil-Desiccated Coconut*, where the Philippines resorted directly to GATT article VI in order to challenge the Brazilian measures without any mention to the SCM Agreement. The Panel ruled and the Appellate Body upheld that between the SCM Agreement and GATT article VI *"an inseparable package of rights"* is created and that GATT article VI could not be applied on its own.[73]What we can infer from this report is that both GATT and the SCM Agreement govern a member's establishment of a subsidy. Based on this reasoning, for a possible application of GATT article XX, apart from an SCM agreement provision, GATT article VI would have to be violated. GATT article VI regulates the issue of

[72] Section 763(b)(2)(A)(iii) of the WM Bill and Section 763(b)(2)(A)(iii) of the KB Bill
[73] Panel Report, *Brazil-Measures affecting desiccated coconut*, WT/DS22/R, 17/10/1996

injury especially vis-à-vis countervailing measures, adopted by the claimant in a dispute under the SCM agreement, so the defence of GATT XX could only be advanced by the claimant of the original case and would not be available for the EU or the U.S. in order to justify their practices, in a case against them.

However, a recent Appellate Body ruling in *China-Publications and Audiovisual Products* introduces a new dimension to the application of GATT article XX as a defence. In this case, one of the claims submitted by the U.S. was that certain measures upheld by the Chinese government restricted trading rights with respect to imported films and audiovisual products, thus violating the commitments undertaken by China under the provisions of paragraphs 5.1, 5.2 and 1.2 of its Protocol of Accession. The Appellate Body found the Chinese measures to be inconsistent with China's obligations under its Protocol of Accession but it proceeded to examine if GATT article XX could be applied as an exception. In its report, the Appellate Body relied on a phrase in paragraph 5.1 of the Accession Protocol which states that China shall progressively liberalize the right to trade *"without prejudice to China's right to regulate trade in a manner consistent with the WTO Agreement"* and implied that if the relevant WTO provisions allowed China to be exempted under GATT article XX, then it would apply the article to the Protocol of Accession.[74]The Appellate Body also mentioned that as long as there was a *"clearly discernable, objective link"* between the measures at issue and the regulation of trade in goods, then GATT article XX could be applied.[75]

The report raised criticism regarding the interpretative scheme followed by the Appellate Body, in a situation where it could actually first try to show a violation under the GATT agreement and then use the GATT article XX exception.[76]

Another scenario linked with the application of GATT XX could be put into practice in cases where the subsidies in question, granted by the EU or the U.S., failed to meet the requirement of specificity established under article 2 of the SCM Agreement. As pointed out by the discussion under the relevant part, the criteria introduced under the EU ETS and the proposed U.S. Bills may meet the specificity requirements, however as

[74] Appellate Body Report, *China-Measures affecting trading rights and distribution services for certain publications and audiovisual entertainment products*, WT/DS363/AB/R, 19/01/2010, para.216-223

[75] Ibid, para.229-230

[76] Professor Petros Mavroidis during the 3rd WTO Annual Update expressed the opinion that the Appellate Body could have found an obvious violation of GATT article III:4 due to the Chinese measures against foreign audiovisual products and then resort to GATT article XX in order to justify an exemption.

these considerations involve the interpretation of terms of an arguable nature, they could lead to the opposite result of failing to find specificity, and thus the SCM Agreement would not be violated. Hence, these measures could be interpreted as a legitimate means of protecting the environment.

The problem with this scenario would be that environmentally friendly measures in question would not be easily linked to the GATT Agreement. They would not likely lead to a violation of a GATT provision such as the MFN principle, the principle of national treatment or the rules regarding quantitative restrictions. Further, subsidies do not constitute measures amounting to taxes, duties, or other restrictions linked to import, distribution and sale of a foreign product. The only viable option would be to resort to GATT article XVI:1, which provides a very broad spectrum of the notion of subsidies vis-à-vis the obligation of WTO members to notify them. As a result, a member whose interests are prejudiced or threatened to be prejudiced could invoke the violation of the notification requirement set by GATT article XVI:1. In such an event, the EU or the U.S. could in their turn apply GATT article XX as a defence in order to justify their measures. There would not be any issue regarding the application of the SCM Agreement due to its specificity, as we established that in cases where article 2 of the SCM Agreement would not be applicable, then we could not talk of a subsidy measure fulfilling the SCM provisions. However, article GATT XVI:1 could be described as a 'toothless' provision due to the fact that even in cases of non-notification, it simply obliges the implementing member and the affected WTO members to discuss solutions on this matter, without providing any enforcement mechanism for non-notification or substantial means of satisfaction for prejudiced members.

GATT article XX provides a second chance for non-GATT-consistent measures to survive if they manage to pass through the two-step analysis it establishes. The measure at issue needs to satisfy the conditions of the introductory paragraph (called the *"chapeau"*) as well as one of the specific exceptions listed in paragraphs (a) to (j).[77]Regarding measures that might have a positive impact on the environment, exceptions formulated under paragraphs (b) and (g) can be relevant, although they do not refer to general environmental protection. As the list of exception introduced under GATT article XX is an exhaustive one, the panels and the Appellate Body engaged in a

[77] Panel Report, *United States-Standards for Reformulated and Conventional Gasoline*, WT/DS2/R, 29/01/1996, para.6.20

process of a rather broad interpretation of them, arriving finally at a more positive and open-minded position by the Appellate Body in the *US-Shrimps* case, where it did not either condemn a unilateral measure to protect the environment or declare it illegal per se.[78]

On the other hand, GATT article XX has been criticized for its rather limited scope of application, providing prominence to trade goals over environmental ones and introducing a wrong way of viewing the evolutions within general international law. Part of the debate revolved around the Appellate Body's unwillingness to consider environmental measures without using trade considerations, implying that even in these cases it is the possible trade impacts of the measure that will influence the decision for or against it.[79]Its current application however shows a radical transformation of this idea, with the Appellate Body reasoning in the *Brazil-Tyres* case that any measure, even if its contribution to health or environmental policies is not immediately observable, could fulfil the necessity test under article XX.[80]

Coming back to the issue of the application of GATT XX for a SCM violation, following the general interpretative note to Annex 1A of the Marrakesh Agreement establishing the WTO, the provisions of the SCM Agreement, as specific, will be those to be applied in case of a possible conflict with GATT articles. The SCM is a self-standing agreement and prevails over GATT. For example, the more specific language of the SCM Agreement would preclude GATT article XVI from applying, and thus open the way for the further application of GATT article XX. However, between the SCM and the GATT agreements there has always been an ambiguous silence, with no provision establishing the primacy of one over the other, in situations of the possible application of both.

In addition, despite the *China-Publications* decision, it remains questionable whether or not the EU or the U.S., in defence of a violation of the SCM Agreement, may use GATT article XX as an exception. Although there are explicit cross-references in the SCM to provisions of other WTO agreements, the absence of any mention whatsoever

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[78] Matsusita, M., Mavroidis, P. Schoenbaum, T.J., *Environmental protection and trade*, in *The World Trade Organization: law, practice and policy*, New York, Oxford University Press, 2003, p.459

[79] Green, A., *Trade rules and climate change subsidies*, World Trade Review, vol.5, no.3 November 2006, p.409

[80] Appellate Body Report, *Brazil-Measures affecting imports of retreated tyres,* WT/DS332/AB/R, 17/12/2007, para.151

to GATT article XX could imply the non-intention of the drafters to apply it as a defence for a SCM violation.

Finally, the lapse of the application of SCM article 8 regulating 'green', non-actionable subsidies could also imply that environmental exceptions for subsidies could no longer be justified.

The debate remains open, but for the present the balance is tipped towards non-application of article XX outside the GATT framework. It will be interesting to see what the Appellate Body decides in future cases.

E. Possible actions for the affected state

Having established that there is a subsidy, an affected state has two possible remedies under the SCM agreement. It may either resort to a hearing before a panel under the Dispute Settlement Mechanism or unilaterally impose countervailing duties (CVDs). As to whether both forms of actions may be imposed at the same time, a state may unilaterally impose CVDs when a dispute settlement hearing is in progress, but once a decision has been rendered, the affected state may arguable have to decide between either imposing countermeasures or continue implementing CVDs.[81]

i. Dispute settlement procedure for prohibited subsidies: The process under article 4 of the SCM Agreement

Regarding the treatment of prohibited subsidies, the injured state may request consultations with the state granting the prohibited subsidy, while also providing evidence in support of its allegations.[82]If the consultations are unable to resolve the matter, the injured state can demand the establishment of a Panel, which in 90 days should submit its report.[83]

If the subsidizing state fails to comply, then the injured state will be authorized to take appropriate countermeasures.[84]Current practice in most of the cases accepts that the appropriateness addresses the amount of a subsidy and not its trade impacts on the

[81] Footnote 35 of the SCM Agreement
[82] Articles 4.1 and 4.2 of the SCM Agreement
[83] Ibid, articles 4.4 and 4.6
[84] Ibid, articles 4.7 and 4.10

complaining party, with a vivid debate however taking place, shaping the future interpretation of the term.[85]

ii. Dispute settlement procedure for actionable subsidies: The process under article 7 of the SCM Agreement

This process could apply for all of the measures deemed to be subsidies under *Phase II* of the EU ETS, certain subsidies under *Phase III* of the EU ETS, and for most measures falling under the proposed U.S. bills.

The affected state may first enter into consultations with the state applying the subsidy and during this process it shall provide evidence regarding the existence of the subsidy and the injury or prejudice to its domestic industry. This stage could be quite demanding due to the need to gather efficient and precise data on the measure and the issue of prejudice or injury.

If these consultations do not reach a mutually agreed solution after 60 days of their commencement, the affected state can resort to the DSB and ask for the establishment of a Panel, which shall circulate its report on the matter after 120 days.[86]Following the adoption of a Panel report or after an appeal, the adoption of a report of the Appellate Body, the state granting the subsidy should withdraw it within six months or remove its adverse effects.[87]

The final stage, in cases when the subsidy or its adverse effects are not removed, provides for the possibility for the injured state to adopt countermeasures that are *"commensurate with the degree and nature of the adverse effects"*, thus limiting them to the trade effects felt because of the subsidy or its effects, irrespective of the actual

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[85] The Arbitrator in *US-FSC,* pointed the importance to address the amount of the subsidy, maintaining that *"members may take countermeasures that are not disproportionate in light of the gravity of the initial wrongful act and the objective of securing the withdrawal of a prohibited export subsidy, so as to restore the balance of rights and obligations upset by that wrongful act irrespective of what might be, as a matter of fact, the actual trade effects of the complainant"*, in Article 22.6 Arbitration, *United States-Tax Treatment for ''Foreign Sales Corporations''*, WT/DS108/ARB, 30/08/2002, para.5.41

On the other hand, expressing a more innovative view by addressing the trade impact of the subsidy on the complainant, the Arbitrator in *US-Cotton* accepted that *"the amount of the countermeasure must at least be within a range of permissibly appropriate amounts, and its assessment can take into account a variety of factors which flow from the failure to withdraw the subsidy and are relevant to the trade impact on the complaining member",* in *Article 22.6 Arbitration, United States –Subsidies on Upland Cotton-Recourse to arbitration by the United States under article 22.6 of the DSU and article 4.11 of the SCM Agreement*, WT/DS267/ARB/1, 31/08/2009, para.4.94

[86] Articles 7.4 and 7.6 of the SCM Agreement

[87] Ibid, article 7.8

amount of the subsidy in question.[88] However, there has been one instance, where this rigid practice was not strictly followed,[89]raising interest for the calculation of retaliation rights under actionable subsidies by future Panels.

Even though the Dispute Settlement Mechanism might enjoy the advantages of being fast and effective, it is important to consider the political impact of openly challenging an environmental measure, which is not simply applied for trade objectives. For example, despite the serious weaknesses reported during its application, the EU ETS for example also achieved a reduction of carbon emissions within the European continent of around 5%. Therefore the prospect of a WTO member initiating a panel procedure against such measures, regardless of their minor deficiencies, could be critiqued for lack of environmental interests and disrespect of the actions proposed by various Multilateral Environmental Agreements.

A process, which actually escapes pure legalism, but could take place in such a situation would be to resort to the idea of finding a mutually satisfactory solution maintained under article 22.8 of the DSU, even after the authorization of countermeasures following the non-implementation of a panel or Appellate Body ruling.[90]

iii. Countervailing Measures

The second option for an injured state would be to seek satisfaction through the unilateral imposition of Countervailing Duties (CVDs). The main provision regarding CVDs is Article 10 of the SCM Agreement, which refers to the necessity to abide by GATT article VI and the procedural requirements of articles 11 to 23 of the SCM Agreement.

Following the language of article 10 of the SCM Agreement, referring also to GATT article VI, there are three basic conditions that have to be met in order for a countervailing duty to be implemented.[91] First, there has to be a specific subsidy. Second, there has to be injury to the domestic industry of a like product. Third, there

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[88] Ibid, article 7.9

[89] The Arbitrator in US-Cotton used benchmarks based on production and future cotton prices' regression when calculating the countermeasures, an approach differentiating from the classic trade impact calculation, in Article 22.6 Arbitration, *United States-Subsidies on Upland Cotton-Recourse to arbitration by the United States under article 22.6 of the DSU and article 7.10 of the SCM Agreement,* WT/DS267/ARB/2, 31/08/2009, paras.4.175-178 and 4.193-94

[90] Benitah, M., *The law of subsidies under the GATT/WTO system*, London, Kluwer Law International, 2001, p.55

[91] Van den Bossche, P., *Subsidies and Countervailing measures*, in *The law and policy of the World Trade Organization: text, cases and materials*, Cambridge, Cambridge University Press, 2008, p.587

has to be a causal link between the subsidized imports and the injury to the domestic industry. In order to determine whether or not these requirements are met, there is an investigative process under articles 11-14 of the SCM Agreement.

Regarding specificity, interpreted under article 2 of the SCM Agreement, it will be a challenge to determine which sectors have benefited in cases of general over-allocation of allowances. However, in the U.S. Bills, certain provisions are clearly sector specific, such as emission allowances to energy-intensive sectors in the WM Bill.

Under GATT article VI and the SCM Agreement, it is necessary to prove material injury. The test for proving an injury in order to impose a CVD is more difficult to meet than under the dispute settlement process for actionable subsidies, where the mere existence of a prejudice or threat of prejudice is sufficient to bring an action. Article 15.1 of the SCM Agreement provides clarifications on how to ascertain injury, which complicates the process of actually finding injury even more so, as it asks for considerations on the value of the subsidized imports and their impacts on the domestic industry of like products. It may prove difficult to create quantitative and qualitative variables to calculate the impacts on the domestic industry, especially when the process may be subjective and influenced by different interests. These factors make it more difficult for a state to prove that there has been injury to its domestic industry in comparison to the dispute settlement process.

Regarding causality, in an exception to the rule of there being a link between a subsidy and an injury, the Appellate Body reasoned in *Japan-DRAMS* that it was unnecessary to prove that the subsidy itself caused the injury and that it sufficed that the subsidized good was causative.[92]The Appellate Body introduced a test whose application could lead to an easier finding of injury that otherwise would justify the imposition of CVDs.

It should be noted that the amount of a countervailing duty cannot be in excess of the actual amount of the subsidy.[93]This in not an easy task for the injured state, as the determination of the actual amount of the subsidy involves many stages, including private and not only government action, and thus it can lead to very disputed results.

Since the purpose of a countervailing duty is to offset an injury, the countervailing duty may only be imposed for *"as long as and to the extent necessary"* to counteract a

[92] Appellate Body Report, *Japan-Countervailing Duties on Dynamic Random Access Memories from Korea*, WT/DS336/AB/R, 17/12/2007, para.264

[93] GATT article VI.3

subsidy that is causing injury in accordance with article 21.1 of the SCM Agreement. The requirements of article 21.1 were analyzed in the Appellate Body case *US-Carbon Steel*, where it was reasoned that it was necessary to have periodic reviews of countervailing duties to ensure that they were in effect only for a durations (*as long as*) and magnitude (*to the extent necessary*) that met its purpose (*to counteract a subsidy*).[94] At the most, a countervailing duty must be removed after a period of 5 years, as stated in Article 21.3.

However, an exception to the five years limit might be applied, when authorities determine that an injury is likely to continue if a countervailing duty is removed.

There are a number of reasons why unilaterally pursuing CVDs may not be the most favourable course of action, especially regarding climate change related subsidies. The investigative process requires the collection of a considerable amount of data. However, it may be challenging for investigative authorities to obtain accurate quantitative and qualitative date regarding carbon emissions and measuring damage. Politically it may impede diplomatic dialogue between states and further hamper trade in other areas as CVDs are unilaterally imposed.

Furthermore, the core deficiency of CVDs is that they only address problems within the domestic market of an affected WTO member whereas the Dispute Settlement process provides a solution that is able to correct the flaws of national subsidies policies in the global market.

Lastly, CVDs do not address the possible adverse effects caused by a subsidy, which might be more extensive than the actual amount of the subsidy.

To sum up, under the current circumstances it would be more preferable to resort to the dispute settlement system and avoid the time consuming, unilateral, and data intensive process of imposing countervailing duties, which in any case are only able to fix the situation in the internal market of an affected member but cannot provide a global solution.

G. Issues of subsidies notification and monitoring

Effective monitoring and notification of trade practices can be a very crucial element of transparency and judicial economy. If applied properly, they can result in a better

[94] Appellate Body Report, *United States-Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, WT/DS213/AB/R, 19/12/2002, para.70

understanding of domestic trade policies and avoidance of numerous disputes. The systems in question under this chapter will be the Committee on Subsidies and Countervailing Measures established under the SCM Agreement and the Trade Policy Review Mechanism.

i. The SCM Committee

Article 24 of the SCM Agreement establishes the Committee on Subsidies and Countervailing Measure (the SCM Committee). The responsibilities of the SCM Committee are those dictated by the SCM Agreement and by Members.

The main monitoring function of the SCM Committee is with respect to notification by Members of subsidies and countervailing laws and regulations, which the SCM Committee reviews. Article 25.1 of the SCM Agreement requires Members to submit new and full notifications of specific subsidies every three years, with updated notifications in intervening years. Even Members who believe that they do not provide subsidies should so notify. In May 2001, the SCM Committee determined that the resources of Members would be best utilized by submitting new and full notifications every two years, rather than submitting an updated list yearly. Article 32.6 of the SCM Agreement requires Members to submit their domestic countervailing laws and regulations to the SCM Committee. Members that do not have such laws should also notify as such. Article 25.11 requires Members to submit a report twice a year of all countervailing actions that have been taken and that are in force, in addition to notifications of all preliminary countervailing actions to the SCM Committee. Article 25.12 requires Members to notify the SCM Committee of its competent authorities to initiate and conduct countervailing investigations.

In practice, the SCM Committee functions more like a *"notice board"*, where the work of the WTO on subsidies and countervailing measures and official documents are available to the public and Members, such as annual reports of the Committee, minutes of meetings, working documents, disputes, notifications by individual members,

questions and responses by Members regarding notifications submitted, and questions and replies from specific members regarding notifications submitted.[95]

A potential direct effect is that it creates a public forum and promotes transparency, where transparency is a critical component of good governance. According to the Committee on Trade and Environment, transparency is necessary in a multilateral trade context, in order to *"prevent unnecessary trade restriction and distortion from occurring, by providing information about market opportunities and by helping to avoid trade disputes from arising"*.[96] There are internal transparency (Member) and external transparency (Public) factors at play regarding access to information, such as on procedures and decisions of the WTO.[97] In this case, non-notification or delays in notification reduces transparency and undermines the international commitments of Members and the WTO system. To foster transparency, Members are *"encouraged to err on the side of notification"*.[98] In addition, the Committee introduced new standard formats for countervailing actions and made it mandatory to include certain information within semi-annual reports.[99]

A potential indirect effect is that it may compel Members to comply with the notification requirement. For example, questions have been submitted from the United States and the European Communities to China regarding non-notification of subsidies dated 6 October 2009[100] and 15 October 2009 respectively[101]. The importance of transparency was stressed in correspondence from the U.S., which stated in their opening sentence, which stated, *"China's continued failure to notify any subsidies administered by sub-central governments, as required by Article 25 of the WTO Agreement on Subsidies and Countervailing Measures ("Subsidies Agreement"), leaves*

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[95] Available at http://www.wto.org/english/tratop_e/scm_e/scm_e.htm

[96] World Trade Organization, "*Trade and Environment at the WTO*", April 2004, < http://www.wto.org/english/tratop_e/envir_e/envir_wto2004_e.pdf> as of April 6, 2010

[97] Weiss, Friedl, *Transparency as an Element of Good Governance in the Practice of the EU and the WTO: Overview and Comparison*, Fordham International Law Journal, 30, 2006-2007, p.1572

[98] World Trade Organization, *"Notifications under the Agreement on Subsidies and Countervailing Measures"*, < http://www.wto.org/english/tratop_e/scm_e/notif_e.htm> as of April 5, 2010

[99] Trade policy review Body: Overview of the developments in the International trading environment, Annual Report by the Director General, WT/TPR/OV/12, 18/11/2009

[100] World Trade Organization, "Committee on Subsidies and Countervailing Measures – Transitional Review Mechanism Pursuant to Section 18 of the Protocol on the Accession of the People's Republic of China questions from the United States to China", G/SCM/W/548

[101] World Trade Organization, "Committee on Subsidies and Countervailing Measures - Transitional Review Mechanism Pursuant to Section 18 of the Protocol on the Accession of the People's Republic of China Questions from the European Communities to China", G/SCM/W/550

a fundamental gap in China's obligation to fulfil its transparency commitments in the area of subsidies".[102] Such action by Members may have political sway at the WTO in getting all Members to comply with provisions of the SCM Agreement.

Article 25.10 of the SCM Agreement may be invoked by allowing a Member to bring to the attention of another Member its failure to submit a notification of an alleged subsidy. If notification of the alleged subsidy is still not submitted, a Member may bring the alleged subsidy to the notice of the SCM Committee. This provision creates a system of "peer governance", where Members are able to question other Members of non-notification of subsidies. To date, the European Communities has been the most active in utilizing Article 25.10 in compelling other Members to submit notifications.[103]

Other than being a body that accepts notifications, it does not have an active or proactive role in monitoring the implementation of subsidies or countervailing measures nor does it have the authority to initiate proceedings against Members that have not submitted a notification of subsidies. The SCM Committee lacks the power to enforce provisions of the SCM Agreement. If Members fail to submit a notification, the SCM Agreement does not provide for the possibility of penalties, fines, or sanctions. The SCM Committee appears to rely on *good faith* that Members will comply with the notification process. This results in an ineffective monitoring body, where good governance and legitimacy of the system are hindered.

It is arguable not necessary for there to be enforcement mechanisms for a body to be effective; however, the lack of enforcement mechanisms may impede compliance. Non-compliance of provisions leads to an undermining of the system. Therefore, in order for there to be legitimacy of the system, it is often necessary to have enforcement mechanisms to ensure compliance.

The problem of non-notification and delayed notification by Members was recently addressed at a meeting on 23 March 2009 by the SCM Committee, pursuant to a request of the Chairman of the Trade Policy Review body. The purpose of the meeting was to improve "the timeliness and completeness of notifications" in accordance with the SCM

[102] Ibid, para. 1

[103] World Trade Organization, "Committee on Subsidies and Countervailing Measures - Notification Requirements Under the Agreement on Subsidies and Countervailing Measures", G/SCM/W/546, 28/04/2009, Annex D

Agreement.[104] A study was completed in preparation for the meeting, where it was determined that new and full subsidy notifications had declined from 44% in 1995 to 38% in 2007.[105] The figure is but one example of the necessity to reform the SCM Agreement to address the shortfalls of the notification provisions.

The Committee has tried to shape better future practices and to ensure transparency. In a recent example, it introduced new standard formats for countervailing actions, through semi-annual reports and the mandatory inclusion of a minimum level of information within them.[106]

ii. The Trade Policy Review Mechanism

The Trade Policy Review Mechanism (TPRM) was established on a provisional basis in 1998, following the December 1998 Montreal Mid-Term review of the Uruguay Round.[107] Its main objective is to contribute to adherence by all WTO members to all rules, disciplines and commitments introduced under Multilateral Agreements.[108]Through this process, there is no basis for the enforcement of obligations or for the imposition of new policy commitments on members, rather Trade Policy Reviews (TPRs) mainly constitute a collective appreciation and evaluation of each member's full range of trade policies and of their impact on the multilateral trading system.[109]

Each member's ability to impact world trade determines the frequency of its obligation to undergo a trade policy review. The four major traders, i.e. Canada, the EU, Japan and USA go through this procedure every two years, the next sixteen leading traders, every four years and the remaining ones, every six years, with the possibility for longer intervals for least developing countries.[110]

The whole conduct of the reviews is organized under the supervision of the Trade Policy Review Body (TPRB), which establishes a main program for each year after

[104] Ibid, para.1
[105] Ibid, para.8
[106] Trade policy review Body: Overview of the developments in the International trading environment, Annual Report by the Director General, WT/TPR/OV/12, 18/11/2009
[107] François, J., *Trade policy transparency and investor confidence: some implications for an effective Trade Policy Review Mechanism,* Review of International Economics, vol.9, no.2, May 2001, p.303
[108] Article A(i) to Annex 3 of the WTO Agreement
[109] Ibid, article A(ii)
[110] Ibid, article C(ii)

consultations with the members concerned.[111]The TPRB is the so-called alter ego of the General Council, a sort of emanation of it.[112] The TPRB is also responsible for the annual overview of the developments within the international trading environment, contained within the annual report by the Director General of the WTO. Through this annual overview, the WTO system is able to remain informed and knowledgeable about the reality of trade practices, and at the same time oversee how policies are developing, whether the set objectives are fulfilled or whether formats in use need any revision.[113]

During the presentation of the trade policy review, each state has to bring forward a policy statement, after careful examination by the domestic administration of the overall structure and impact of its trade policies, and the WTO Secretariat introduces a report regarding its evaluation of the trade practices of the state under examination.[114]The drafting of this report by the Secretariat necessitates a time period of normally ten months, during which time questionnaires are sent to the interested state, discussions take place with senior officials during field visits and a large amount of information is collected.[115] The collection of these reports is promptly published after the TPRB meeting and they are also forwarded to the Ministerial Conference.[116]

Despite being a positive rather than a normative report, TPRs could lead the way, especially for the developing WTO members to prove their commitments to trade liberalization and to enhance foreign credibility for their trade policies and reforms, and further establish investors' interests and confidence. As a result of this increased credibility for domestic trade policies, the country's risk is minimized for its trade partners and at the same time the security of access of its products to foreign export markets is also boosted.

Furthermore, an advantage is that it may balance the power dynamics between developed and developing countries in the WTO. Developing states can use this

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[111] Ibid, article C(iv)

[112] Van den Bossche, P., *The structure of the WTO*, in *The law and policy of WTO: text, cases and materials*, Cambridge, Cambridge University Press, 2008, p.123

[113] Ratnesh, K., *Trade Policy Review Mechanism: a resume, in WTO: structure, functions, tasks and challenges*, New Delhi, Deep & Deep Publications, 2004, p.72

[114] Gallagher, P., *Monitoring of trade policies*, in *Guide to the WTO and developing countries*, London/The Hague/Boston, Kluwer Law International, 2000, p.62

[115] François, J., *Trade policy transparency and investor confidence: some implications for an effective Trade Policy Review Mechanism*, Review of International Economics, vol.9, no.2, May 2001, p.304

[116] Articles C(vi) and (vii) to Annex 3 of the WTO Agreement

mechanism as a means of peer pressure against developed countries to ensure that they will abide by their commitments and trade negotiations will remain an open process.[117]
There has been criticism, regarding mainly delays or gaps in notification and reporting, or the absence of link between monitoring and enforcement. For example, the European Communities have never proceeded to a notification under the TPRM of the EU ETS, which clearly influences trade practices, as explained above. However, such practice followed by the EU might be endorsed by the fact that even the Director General has so far not taken a clear position vis-à-vis the treatment of cap-and-trade systems, stating that further discussion on the matter is necessary due their controversial link with trade.[118]
The TPRM system provided an evolutionary approach on monitoring during the current financial crisis because a global crisis requires global and not unilateral solutions. Under the initiative of the Director General, a Task Force was established within the WTO Secretariat to assess the effects of the financial crisis in different areas of work of the WTO.[119]Most important, a process of monitoring related to stimulus packages and industrial and financial support measures was introduced under the auspices of the Secretariat but there have been complaints regarding the reliability or details of information on such measures.[120]
To sum up, the TPRs are an innovative mechanism, focused on guaranteeing information, transparency and peer pressure among the WTO members.

H. Proposed substantive and monitoring reforms

The previous part of the analysis brings to the surface important deficiencies, necessitating substantial reforms leading to better application of the agreements, the possibility for environmental measures linked to trade to be more easily accepted and the diminution of future WTO disputes, due to the more concise and predictable treatment of such measures.

i. Negotiations for amended or new, environmentally friendly provisions

[117] François, J., *Trade policy transparency and investor confidence: some implications for an effective Trade Policy Review Mechanism*, Review of International Economics, vol.9, no.2, May 2001, p.313
[118]Director General speeches and statements, 'Lamy underscores the urgency of responding to the climate crisis', 02/11/2009, http://www.wto.org/english/news_e/sppl_e.htm
[119] Director General speeches and statements, 'Lamy creates WTO Task Force on financial crisis', 14/10/2008, http://www.wto.org/english/news_e/sppl_e.htm
[120] Trade policy review Body: Overview of the developments in the International trading environment, Annual Report by the Director General, WT/TPR/OV/12, 18/11/2009, para.143-146

under the SCM Agreement

An exchange of inter-state opinions regarding the amendments of provisions of the SCM Agreement, in order to better accommodate environmental objectives, could be the object of a WTO round of negotiations. The former Director General of the WTO, Renato Ruggiero, said that the environment should shape the future work program of the WTO and eventually form a lead issue in a future multilateral negotiating round.[121]The Doha Round started its work program in 2001 and maintained that the *"aim of upholding an open and non-discriminatory multilateral trading system and acting for the protection of environment can and must be mutually supportive"*.[122]It was also stated, that *"under WTO rules, no country should be prevented from taking measures for the protection…of the environment at the levels it considers appropriate, subject to the requirements, that they are not applied in a manner which would constitute a disguised restriction on international trade"*.[123]

Despite these ambitious declarations, the Doha Round failed to provide proposals on those matters, and even in fields where action for environmental protection is urgent, such as fisheries subsidies, there seems to be a stalemate. As a result, the process of *"greening"* the SCM Agreement and other WTO agreements should be in the mandate of future rounds of negotiations.

There have been proponents of the idea that the *"green"* box of subsidies, under article 8 of the SCM Agreement, whose application lapsed on December 31st 1999, should be brought again into action. However, this box including non-actionable subsidies linked to environmental objectives had significant flaws, as the requirements set in paragraph (c) were quite strict, drastically limiting its application. This category of subsidies was very narrowly construed creating the question of how we could actually have positive results or reach environmental goals by putting such strict thresholds for their use.[124]On one hand, the creation of a new green box of environmental subsidies will surely provide for predictability and security when states grant such measures but on the other

[121] Whalley, J., *Trade and Environment beyond Singapore*, NBER Working Paper, no.5768, September 1996, p.54

[122] Goyal, A., *The WTO and international environmental law: towards conciliation*, New Delhi, Oxford University Press, 2006, p.67

[123] Ibid

[124] Kim, H.J., *Reflections on the green light subsidy for environmental purposes*, Journal of world trade, vol.33, no.3, June 1999, p.175

hand, they could become grounds for trade abuses.[125]Experience drawn from the Doha Round in the field of fisheries subsidies, shows that delegations are currently reticent to take up political commitments regarding the establishment of such a *"green box"*, despite the fact that various delegations came up with such proposals.[126]

A final proposal for the *"greening"* of the SCM Agreement would be the insertion of a GATT XX type article, as the application of GATT article XX itself is rather unlikely outside the scope of a GATT violation. Substantial doubts have been raised regarding such an evolution. Examples of the use of the article so far prove the future tendency for the coverage of environmental objectives but the Panels and the Appellate Body have not provided for the precise scope of its interpretation. A potential setback is that the creation of a GATT article XX type exception could provide for an open-ended cover for action and policy protectionism, as experience shows that safe harbours can always be abused.[127]Another challenge will be the application of such an article, as the necessity test established in the application of GATT article XX has been criticized for tipping the balance towards trade impacts. Hence, even if an exception was provided for environmental measures in the SCM Agreement, it may contain a test of such a high threshold that it would only be applied in few circumstances.

In sum, it is beyond any doubt that future negotiations should be focused on the interaction between trade and environmental practices and should try to find the balance between them. The aforementioned proposals could constitute a starting basis for a fruitful debate in order to achieve a better treatment of environmental policies under the SCM Agreement. But an amendment to GATT or the SCM Agreement to create a green box would be an ambitious endeavor and would probably take years to accomplish,[128]as this arduous process will have to consider the interests of all Members.

ii. The creation of a new agreement on trade and environment

One of the most ambitious projects for future rounds of negotiations will be to strive for a new agreement that addresses most of the challenges between environmental policies

[125] Hernandez Luengo, G., *Regulation of subsidies and state aids in WTO and EC law: conflicts in international trade law*, The Netherlands, Kluwer Law International, 2006, p.550

[126] See EC proposal, TN/RL/GEN/134 or proposal from Brazil, TN/RL/79

[127] Green, A., *Trade rules and climate change subsidies*, World Trade Review, vol.5, no.3, November 2006, p.409

[128] Hufbauer, G.C., Kim, J., *The World Trade Organization and Climate Change: Challenges and Options*, Peterson Institute for International Economics, Working Paper Series, 2009, p.12

that could potentially harm trade. This would facilitate understanding, have legal weight and avoid future disputes on those matters.

However, such a heavy-handed top-down approach in order to achieve a more environmentally conscious WTO structure is prone to failure. WTO members could try to mastermind an agreement that accommodates the environmental concerns of the international community but the obvious lack of success of the Committee on Trade and Environment, which never managed to fulfil its mandate or provide for concrete policy changes, is an example of how such an effort will probably not be fruitful.[129]Furthermore, questions of coherence and fragmentation may arise, because by creating such an agreement the WTO will be adding another layer to the diverse responses of the international community to global environmental problems.

A better solution would be to opt for a plurilateral agreement (PTA), such as a WTO Code on Climate-related Trade (Code). A PTA will allow states the option to decide whether or not to adhere to such an instrument and the proponents of environmental protection through trade policies will have a means through which they may better address their concerns.

In principle, the Code would allow subscribing Members that technically violate WTO law, to not be brought before the DSU or have CVDs imposed against them.[130]

Doha may have changed the course of addressing climate change and trade towards a more plurilateral or global initiative, as subsidies encouraging energy sufficiency and punishment of polluters, resonate well among politicians when they are applied against foreign competitors but these positions are likely to change if the WTO rules will complement initiatives established by environmental accords.[131]

It would be easier to achieve a plurilateral code because it will not require a consensus. It could also be a stepping-stone towards a multilateral agreement or amendments to the GATT and the SCM Agreement. A Code would create coherence between Members who are a party to it because there would be a common standard.

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[129] Van Calster, G., *International and EU trade law: the environmental challenge*, London, Cameron May, 2000, p.548

[130] Hufbauer, G.C., et al, *Global Warming and the World Trading System*, U.S.A, Peterson Institute for International Economics, (2009), p.103

[131] Schott, J.J., Peterson Institute for International Economics, *America, Europe, and the New Trade Order*, Business and Politics, Vol. 11, Issue 3, Article 1, 2009, pp.18-19

However, consensus becomes a crucial issue linked to the subsequent application and operation of such a PTA. The incorporation of new rules created by an environmental PTA into the WTO framework could be extremely problematic due to the existing WTO rules regulating PTAs. It is believed that any PTAs negotiated in general after the Uruguay round, are created outside the WTO system, according to the interpretation of article III.2 of the WTO Agreement, encouraging the WTO to become a forum of just *multilateral negotiations.*[132] Article X.9 of the WTO Agreement maintains that PTA participants will need to receive consensus from all WTO members through a Ministerial Conference, in order to have their PTA included in Annex 4 of the WTO Agreement. Further, PTA members will be unable to utilize WTO dispute settlement procedures if they fail to receive this general consensus, as articles 1.1 and 1.2 establish that the DSU applies only to covered agreements. In addition, Appendix 1(c) to the DSU enumerates the four PTAs covered by its provisions, excluding coverage of any future PTA if we follow the rule of inclusio unius est exclusio alterius of treaty interpretation. Hence, the future application of the DSU on a plurilateral environmental code will necessitate an amendment of this multilateral agreement, which would also require consensus during a Ministerial Conference.[133]

Another contentious issue is with respect to concerns about a level playing field and competitiveness. This may impact the number of Members willing to be a party to the Code, if it would place them at a competitive disadvantage. The prospect of the creation of an agreement where only a few states will participate and the major trade partners will decide not to be bound by it, could lead us to dead-end regarding the environment and the WTO. It would be important that major emitting countries be a party to the Code, such as the U.S., E.U., Japan, Brazil, India and China.[134]

Limited participation could also be bad publicity for the WTO and members that are not participating, implying that trade takes primacy over the environment and that the WTO framework cannot accommodate concerns regarding environmental protection.

A major political challenge would be to agree on a common standard regarding GHG emissions, especially in consideration of the different interests between developed and

[132] South Centre, *The legality of creating plurilateral agreements within the WTO for Singapore Issues,* SC/TADP/AN/SI/3, November 2003, p.3

[133] Article X.8, Marrakesh Agreement establishing the WTO

[134] Hufbauer, G.C., Kim, J., *The World Trade Organization and Climate Change: Challenges and Options*, Peterson Institute for International Economics, Working Paper Series, 2009, p.11

developing countries. It could further undermine the coherence of the whole system established by the Agreements.

As a result, it will be wishful for the states to proceed to the creation of a new agreement, most preferably a plurilateral one, but it is doubtful whether the political will is ripe enough for such an evolution

iii. A new role for the SCM Committee

The challenge of good governance and transparency is a primary concern for the SCM Committee. It has not been able to instil transparency into the system due to the practice followed by members to provide little or even withhold information when it comes to the notification of certain subsidies. As a result of those practices, the SCM Committee seems unable to fulfil its mandate and the need for reforms of its activities is more crucial than ever.

The basic issue is the non-linkage between non-notification and enforcement. When WTO members violate the notification provisions of the SCM Agreement, the SCM Committee lacks any formal mechanism of enforcement to ensure compliance. The creation of suitable enforcement and sanctioning mechanisms within the system of international law has been the most successful means of achieving full state compliance. Hence, it would be logical to search for the establishment of a sanctioning mechanism introducing the penalization of non-compliance from WTO members their notification obligations under the SCM Agreement. Sanctions should be dissuasive and proportionate to the issue of non-notification so as to be more easily accepted by states, without reaching the threshold of penalties imposed through retaliation or in a trade suspension system, and enforced by the dispute settlement system. For example, compensation could be one of the possible options. Such mechanisms could be used as a warning measure for states that resort to non-notification, as for the time being they have nothing to lose in cases of non-compliance, as simple peer pressure has not been an effective tool.

Furthermore, the SCM Committee is limited to a very passive role, based solely on the good faith of states to abide by their obligations. A more active role is also possible enabling the promotion of better trade practices through the creation of guidelines for the members, when it comes to subsidies or the proposal of *de minimis* thresholds and

sound state aid policies that will not result in an overall trade distortion within the global market.[135]Under these more extended responsibilities, the Committee could analyze, after the notification process is complete, the overall systemic trade impact of each member's subsidies program. This would assist other WTO members in their evaluation of the situation and their possible courses of action, in case their interests are prejudiced.

Another option would be to establish a new system of notification, following the examples of other organizations on this matter. An example that could be used is with respect to how the EU Commission demands that states submit information on aid programs prior to implementation, in order to analyze their structure and their possible trade impacts. It is only if the measure seems compatible with the objectives of the EU market and competition policies, that the Commission will provide its approval for the adoption of the provision (standstill clause).[136] The implementation of an EU "*standstill clause"* requiring the notification of a measure prior to its adoption, although probably too ambitious for a large multilateral organization such as the WTO and definitely cumbersome for the SCM Committee, could improve the transparency and uniformity of the regulation of subsidies.

Under this idea of strengthening the notification system, an option would also be to link the obligation to notify under the SCM Agreement with GATT article XVI. The article presents a very broad general meaning of the notion of subsidies, including measures that provide an income or price support. Further, it states that if it is determined that a subsidy causes serious prejudice to a member then upon request, the members shall seek to limit the subsidization. In comparison to the SCM Agreement, GATT article XVI is broader in application with only the lower threshold of serious prejudice and not actual injury to a member; however, it too lacks enforcement mechanisms. As a result, GATT article XVI covers practically any possible support action provided through government measures; hence, it could pertain to the WTO members whose measures fail to meet the whole spectrum of requirements of the SCM Agreement and do not entail a SCM violation. For example, if subsidies provided under the EU ETS or the U.S. Bills did not

[135] Hernandez Luengo, G., *Regulation of subsidies an state aids under in WTO and EU Law; conflicts in international trade law*, The Netherlands, Kluwer Law International, 2006, p.206

[136] Article 88.3 (former article 93.3) of the Treaty establishing the European Community, available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:12002E088:EN:HTML

meet the notion of specificity under the SCM Agreement, and thus did not violate the SCM Agreement, there would still be an obligation to submit a notification under GATT article XVI, as in any event they could eventually become a source of prejudice for the trade interests of other members.

In addition, the system of notification should be revised towards creating an obligation on states to provide any information regarding possible changes in subsidies policies that have already been disclosed to the SCM Committee. This would give the Committee the possibility to implement an advance warning of policy changes that could affect the trade practices of other members or avoid a possible market shock.

Finally, the establishment of a database by the SCM Committee that groups all subsidy notifications and the coordination of its procedures with other international fora, focusing their practices on developments in international trade such as the OECD or the World Bank/ International Monetary Fund, could improve the flow of information regarding national trade policies based on subsidies, their impacts and macroeconomic conditions. Debates around the legality of subsidies and monitoring issues do take place in such multilateral fora, with the notable example of a discussion regarding steel and shipbuilding subsidies in the 2006 Annual Report of the OECD.[137]

The notification system under the SCM Committee, vulnerable as it stands, could be the primary target of an amendment project of the SCM Agreement, making the whole process more flexible, transparent and efficient.

VII. Conclusion

Through the analysis, it became apparent that striking a balance between the need for protection of the natural environment and avoiding the use of such policies as a new form of trade protectionism remains a controversial and politically sensitive issue. The climate change legislation of the EU and the U.S. contain provisions that may constitute subsidies and be challenged at the WTO under the SCM Agreement, specifically provisions regarding emission allowances and rebate programs.

In determining whether or not a subsidy exists, it will likely be found that the relevant provisions are government financial measures. The financial contribution requirement

[137] Kazeki, J., *The "Middle Pillar": Transparency and surveillance of subsidies in the SCM Committee-Reflections after the global economic crisis,* in Global trade and customs journal, The Netherlands, Kluwer Law International, 2010, p.198

may be met through a number of venues, such as arguing a direct transfer of funds, government revenue foregone or transfer of goods. The benefit requirement will also likely be met, in relation to other domestic industries or third states. The specificity requirement will likely be the main challenge. The eligibility criteria could arguably be considered specific or not, dependant on the approach taken. If a complaining member is able to meet this debatable point and prove that the provision is specific, then it is likely that the provisions will be found to constitute specific subsidies and be challenged under the SCM Agreement.

Regarding monitoring and notification mechanisms, the WTO does provide for such mechanisms through the SCM Committee and the TPRM but it is suggested that certain reforms are needed. It is suggested that members should be obligated to notify any amendments or submit information prior to implementation. Lastly, a database may be created in coordination with other international fora that address trade issues.

As for suggested reforms to the WTO framework in light of the link between trade and the environment, at this juncture, it appears more feasible that bottom-up approaches are adopted, in order to ensure that international initiatives on environmental issues are sufficiently accommodated within the WTO structure. It is suggested that members may create environmentally friendly provisions under the SCM Agreement rather than a new multilateral or plurilateral environmental and trade agreement.

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