Veblen Institute for Economic Reforms

The treatment of measures discriminating between products based on the sustainability of their production processes or methods (PPMs)

I- The PPM issue

A. The need for PPM-based measures

The way goods are produced is central to the issues of climate change and environmental protection. Measures discriminating goods based on the sustainability of their production process should be a tool of choice in the arsenal available to States to combat global warming, environmental degradation, and biodiversity loss. They aim at disincentivizing the use of unsustainable production processes and incentivizing the use of more sustainable processes. In order to be effective at the global level, these measures must equally apply to all like products (domestic and imported) competing in the marketplace, irrespective of their origin. An even-handed application is also a way to compensate for the extra burden imposed on domestic goods by higher sustainability standards, and avoid granting a competitive advantage to foreign products. This makes the adoption of these measures politically acceptable.

Examples of PPM-based measures include the EU CBAM, and the proposal for an EU regulation on imported deforestation.

B. The controversy over PPM-based measures

Even origin-neutral measures may *de facto* affect the conditions of competition between imported and domestic like products and/or among imported products from different origin. This is so because the predominant production process of a product (and its associated environmental impact) varies by country. Such a disparate impact on competitive opportunities – which restricts market access – make PPM-based measures controversial.

Their opponents (especially developing countries) claim that they infringe thereby the non-discrimination obligations - the most-favored nation (MFN) and national treatment rules. It has also been argued that they cannot be justified under GATT Article XX on "General Exceptions" absent internationally recognized methods to assess the environmental impact, and common sustainability criteria and standards. PPM-based measures are perceived as a means for the regulating country to impose on others not only its objectives and values, but also its own practices and standards. And compliance with foreign requirements comes with a cost.

Proponents, on the contrary, claim that they are WTO-compliant as long as they do not discriminate based on origin and are apply even-handedly to imported and domestic products.

C. Their legality

Actually, the truth lies in-between. The legality of PPM measures must be assessed on a case-by-case basis. PPM measures are not prohibited *per se*. They are allowed if they comply with the non-discrimination requirements: the issue is that of the contours of the non-discrimination obligations. In any event, PPM-based measures are eligible for a defence under Article XX should they be found *prima facie* in violation of the GATT (especially Article XX(g) covering measures relating to the conservation of exhaustible natural resources). While case-law is still uncertain to date, and has only addressed this question obliquely (1), the Veblen Institute has, in an amicus curiae brief submitted in the palm oil disputes (the first WTO case concerning climate measures), supplied its interpretation of the legal requirements[1] (2).

1. The state of WTO case-law

With regards to compliance with the principle of non-discrimination: the objective is to ensure an effective equality of competitive conditions between imported and domestic products (and/or among imported products from different origin) which are in a sufficiently close relationship (they are "like" products). Therefore, this raises two issues:

i) Interpretation of "like" products: so far, case-law does not consider the production process as a criterion in determining whether two products are "like", unless the production process has an impact on consumers' perception and choices, and as a result, the competitive relationship between these products. This would be the case only if the production process has an impact on the physical characteristics of the product or if consumers are otherwise informed about the production process of each product and the associated environmental impact.

ii) The legality of *de facto* discrimination: if products have been found to be "like" products, non-discriminatory treatment shall apply. Non-discrimination provisions would be made largely ineffective if *de facto* discriminatory treatment could never be found illegal. However, the question is whether the mere disparate impact on competitive opportunities is enough to find a violation. The Appellate Body said that there is no need to consider the regulatory purpose of the measure in determining whether a measure comply with national treatment (in its most recent jurisprudence).

With regards to justifications under GATT Article XX ("General Exceptions"): the Appellate Body's ruling in *US-Shrimp* implied that non-product related PPM measures can be justified under Article XX. The measure at hand was an import ban on shrimp and shrimp products not

[1] https://www.veblen-institute.org/Intervention-of-the-Veblen-Institute-in-palm-oil-disputes-at-the-WTO.html.

caught using methods the US considered as not leading to incidental killing of turtles beyond a certain level. The measure was provisionally justified under Article XX(g).

However, a provisionally justified measure must also comply with the requirements of the *chapeau*: it shall not apply in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade. In *US-Shrimp*, the Appellate Body ruled that the measure at hand was unjustifiably discriminatory because *inter alia* the methods to catch shrimp were unilaterally prescribed, without regards for the performance of foreign practices. It is worth noting that the Appellate Body referred to Principle 12 of the Rio Declaration which provides that *"environmental measures addressing transboundary or global problems should, as far as possible, be based on an international consensus"*.

In any event, there are questions left unanswered, and there is no sure way to foresee how a panel, supplied with specific facts, would rule in the first ever case involving PPM-measures on climate change mitigation.

2. The Veblen Institute's stance

The Veblen Institute, in its amicus curiae brief, recalled that the fundamental purpose of GATT Article on "National Treatment", as expressed in Article III:1, is to avoid protectionism in the application of internal measures. It is to strike down internal measures that aims at protecting the domestic industry and shield internal measures that pursue a legitimate objective in good faith. It follows that WTO Members should be allowed to assume a *de facto* disparate impact on conditions of competition whenever it is required to fulfil a legitimate objective or if the detrimental effect on imported products is an unavoidable effect of such a legitimate, non-protectionist policy.

In order to give effect to this principle, a panel shall either:

- Interpret the terms so as to filter out protectionist measures and let non-protectionist measures pass. For example, "likeness" between imported and domestic products should be understood very strictly, so as not to strike down non-protectionist measures. It should be understood as referring to a situation where the products that are being compared are almost identical, in all respects, including in view of a measure's legitimate policy purpose;

  or

- Examine the regulatory purpose of the measure at hand. If a disparate impact is observed, a panel could examine the design, architecture and structure of the measure at issue in relation to its declared objectives. This would allow the panel to determine whether the measure has been deliberately designed to protect the domestic production identified by the complainant.

Concerning Article XX on "General Exceptions" and absent international consensus on sustainability criteria: as long as there is a rational basis, in view of the declared objective, for

the distinctions made between and among products resulting in discrimination, that discrimination should not be seen as "arbitrary" or "unjustifiable".

Moreover, in resolving the question of where to draw this "line of equilibrium" between the right of a regulating State to invoke an exception and the rights of other WTO Members, one should consider the perspective embodied in the preamble of the WTO Agreement - which declares sustainable development and the preservation of the environment fully-fledged goals of the WTO - read in light of contemporary concerns (as expressed in the Paris Agreement).

II- The need to address PPM measures

The uncertainties surrounding PPMs measures' legal status under WTO raises several risks.

A. Risks posed by an extensive interpretation of non-discrimination obligations

If what mattered to find a violation was the mere disparate impact on imported products versus domestic like products, this would entail those countries (to ensure GATT-compliance) would design their legitimate policy measures based not only on the regulatory objective, but also market shares, the market structure and conditions of competition… In turn, this would entail that governments would be required to adjust their regulatory measures as these market conditions change, so as to make sure that they have no side effect at any time (i.e. disparate impact on competitive opportunities for imported and domestic products). Most importantly, this would diminish the effectiveness of legitimate policies. Sometimes, disparate impact is an unavoidable collateral damage of a regulatory measure.

The Veblen Institute is of the view that an appropriate balance between trade interests and climate and environmental concerns can be achieved only if WTO Members retain sufficient regulatory autonomy to apply non-protectionist measures that they consider adequate to fulfil their legitimate objectives, pursuant to an objective assessment. Otherwise, the fulfilment of the objectives of sustainable development and preservation of the environment enshrined in the preamble of the WTO Agreement would be jeopardized.

B. Risks posed by a loose legal framework and an uncertain case-law

1. Chilling effect

The issue of the assessment of non-product-related PPMs measures under the GATT is critical for environmental policies and trade.

WTO Members wishing to implement non-product related PPMs measures will likely be blamed for infringing WTO law, regardless of the protectionist intent of the measure. This may deter WTO Members from adopting ambitious climate and environmental measures. In addition, they may design their regulations so as to mitigate the detrimental effect on

competitive opportunities for imported products. This requires a considerable amount of time and entails significant administrative costs. Most importantly, this may result in a loss of national competitiveness and undermine the effectiveness of these measures, compromising thereby their adoption.

2. Fragmentation of environmental law and extra costs

Absent any multilateral agreement on what is a measure discriminating products based on the sustainability of their PPMs deemed consistent with WTO law and insufficient case-law, there is a risk of proliferation of disparate unilateral measures. Regardless of their presumed legality, governments will continue adopting and implementing PPM measures based on different criteria and standards. This will lead to a fragmentation of environmental law, which will, in turn, result in uncertainty and increased compliance costs for businesses. This will be especially costly for exporters from developing countries. In addition, it undermines the effectiveness of climate and environmental policies by impairing investments.

3. Retaliatory measures

This can also generate trade tensions which could materialize in retaliatory measures and trade disputes. This could contribute to shifting the attention from a much-needed international cooperation to build the bridge between the environment protection and the trade regimes.

III- Policy recommendations

In devising solutions to address these concerns, it is essential to consider and reconcile both the needed regulatory autonomy of States in taking climate and environmental action and the legitimate interests of developing countries. WTO members should further work on a substantive articulation between environmental policies, development policies, and multilateral trade disciplines, including core principles such as national treatment, MFN and the right to special and differential treatment. The PPM issue should be discussed in the Committee on Trade and the Environment, the Committee on Technical Barriers to Trade and in the framework of the plurilateral trade and environmental sustainability structured discussions (TESSD).

- Clarifying the non-discrimination provisions: there is no time to wait for case-law to develop incrementally (on a case-by-case basis). Many WTO Members are determined to adopt and implement ambitious climate mitigation and environmental measures. There is therefore an urgent need to clarify and delineate the regulatory space of governments. This could be done by adopting authoritative interpretations, which resides in the Ministerial Conference and the General Council (they must be adopted by three-fourth majority of the Members). It is in the interest of regulatory Members (to avoid the chilling effect and trade tensions) and of developing countries (which are subject to rules adopted by others, regardless of their legality) to participate in the discussion.

- Adoption of guidelines on the measurement of GHG emissions and agreement on climate measures or sustainability criteria/standards: potential political blockage with respect to the adoption of authoritative interpretations, as well as the uncertainties of case-law could be resolved through harmonization and consensus in the framework of the United Nations Framework Convention on Climate Change (UNFCCC) and agree on guidelines on the measurement of GHG emissions, and to the extent possible on acceptable unilateral measures to tackle carbon leakage. In the same way, it would be useful to develop specific guidelines on biodiversity within the framework of the CBD (Convention on Biological Diversity). WTO judges could rely on these internationally agreed guidelines, or the WTO legal corpus could incorporate them by reference. It would also help to have international sustainability standards (and an environmental certification system) for production processes and methods, which could be reviewed under GATT Article III and if necessary, Article XX.

- Strengthening the inter-institutional dialogue and the dialogue with standard-setting organizations: this can only be achieved if the WTO identifies the sticking points and Members' concerns and communicates these effectively to multilateral specialized institutions and standard-setting organizations. This way, these organizations will be able to identify pressing issues concerning the articulation between trade rules and the climate regime and put them on their agenda.

- Discussing compliance with developing countries: better articulate policies focused on sustainable production with development policies to provide technical and financial support as well as transfer of technology. For instance, this could extend to a discussion on relaxations on intellectual property protection measures for green technologies. This could constitute interesting counterparts for developing countries in a PPM negotiation.

- Clarifying how the principle of common but differentiated responsibilities recognized in the Paris Agreement (and the recognition in the preamble of the WTO Agreement that the objectives of sustainable development and preservation of the environment should be pursued in a manner consistent with the needs and concerns of countries at different levels of development) could be translated into the right of developing countries to special and differential treatment.

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