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The Polluter Pays Principle under WTO Law: The Case of National Energy Policy Instruments

by

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Summary[1]

This study addresses the compatibility of the Polluter Pays Principle (PPP) with obligations under world trade law as administered by the World Trade Organization (WTO). In particular we look at the instruments of German domestic and international energy policy.

The Polluter Pays Principle

The PPP is an environmental policy guideline stipulating that the costs of pollution prevention and control should be borne by the polluter. The OECD has included the PPP in its environmental policy guidelines and it can also be found in European Law and in the UNCED Rio Declaration (1992). The PPP is applied to differing degrees by various countries around the world.

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Application of the PPP to the global problem of climate change would require that every country reduced emissions stemming from its territory. The Kyoto-Protocol (1997) aims at an international solution to this problem. However, any climate policy measures would still have to be implemented at the national level. Germany and the European Union are acting as forerunners in international climate change policy. This is reflected in several German energy policy laws.

The PPP is not part of the WTO rules, which are concerned with facilitating international trade. This does, however, not hinder PPP-application per se, but has some implications for national policy instruments which require that polluters should bear the environmental costs of their activities. We therefore discuss the following instruments: standards on products and on production methods (command and control policies), labels, taxes, and subsidies.

Command and Control Policies

Command and control measures include laws and regulations on environmental standards, which address products as well as processes and production methods. They force polluters to keep their emissions at a certain level.

Under WTO rules every country is free to protect its population from environmental damages through national standards as long as they are not applied in a discriminatory manner to foreign products. When interpreting WTO rules, three types of standards can be identified: product standards, product related and non-product related standards. Only the application of non-product related standards on imports, i.e. standards prescribing production methods which do not determine the physical characteristics of a product, are not compatible with current interpretation of WTO law. Electricity from different sources (e.g. nuclear and solar power) is regarded as a "like product" and imported electricity must not be discriminated against based on its production method. Currently, such discrimination is not part of any German command and control policy.

The regulation of processes or production methods (PPM) will remain an important instrument for energy and climate policies on a national level. Recent WTO case law indicates that the application of non-product related standards to imported goods and services depends on the underlying environmental rationale and the way in which standards are applied. *Unilateral* standards on PPMs that discriminate for example between electricity imports based on energy generation, currently seem not to be compatible with WTO regulations. If it is deemed necessary to take action in this regard in order to force polluters to reduce their emissions, consensus should be reached in the context of a *multilateral* environmental agreement, i.e. the Kyoto-Protocol. Multilateral agreements could constitute an exception to WTO rules, if WTO members will reach consensus on this issue in forthcoming trade negotiations.

Labelling and Certification

Labelling and certification are market-based instruments. Labels help to inform consumers and other interested parties about the environmental impacts of a product. Certificates warrant an environmentally friendly production method. Both tools help to hold polluters responsible through the market mechanism.

We distinguish between *voluntary* labels based on labelling programmes, *compulsory* labels (e.g. proof of origin), and *green certificates*. The TBT Agreement and the basic principles of the GATT determine the compatibility of labels with WTO law. Compulsory labels are covered by WTO law as long as there is no discrimination against foreign suppliers. It is, however, not clear whether voluntary labels with specific emphasis on non-product related process and production methods are covered by WTO law. Therefore, a clear statement on the legality of "green" electricity labelling is not possible. If voluntary labelling initiatives for electricity generation, which regard the production method as a characteristic of electricity itself, were enacted under public German law, it has to be kept in mind, that other WTO

members, which feel discriminated by such labels, can ask for a clarification by the WTO dispute settlement bodies.

Green certificates are still in their infancy. They warrant a certain amount of electricity from renewable sources, which can be traded among power generators in order to fulfil domestic quotas for "green" electricity. It is not clear whether these certificates are "goods" or "services" under WTO law. In any case, a preliminary conclusion is that first, a *green certificate* trading system which should go along with WTO rules would have to apply the WTO principles of non-discrimination and most-favoured-nation treatment. This could be achieved best by aiming at harmonisation or mutual recognition of green certificates awarded to producers from different countries. Second, it seems appropriate to find criteria for an international “green single subject label” for power generation methods, because coordinating energy labelling and certification across countries would lead to greater transparency in electricity production. This measure could be closely linked to negotiating energy production standards at the international level.

Taxes

Environmental taxes are levied in order to charge a polluter for the damages caused by his activities. In theory, they help to fully internalise the environmental costs of consumption and production. However, national taxation of energy consumption – like the German Ecological Tax Reform - faces difficulties in open economies, as non-taxed imports are available as substitutes for domestic products. As long as international tax harmonisation is not possible, border tax adjustments could help to offset competitive disadvantages without watering down the environmental objectives of taxation, e.g. the reduction of carbon dioxide emissions. Whether or not border tax adjustments for energy taxes are permitted under world trade law is not entirely clear given the lack of precise legal provisions and case law. The balance of evidence points to the conclusion that unilateral border adjustments for energy taxes are permissible under world trade law. Yet to prevent conflicts between WTO members and to clarify legal uncertainties, it is advisable to address this situation through multilateral agreement and to consider two possibilities. First, governments could agree on similar climate and energy policies, for example uniform carbon dioxide taxes, which would make border tax adjustments unnecessary. However, this first best option seems to be difficult to implement in the near future. Second, a process could be initiated to reach a multilateral understanding on the permissibility of border tax adjustments for energy taxation and also for other inputs that are not physically incorporated in the final product. In this process it could be useful to integrate the PPP as a guideline in WTO rules on BTA to prevent inefficient tax rules.

Subsidies

A subsidy can be defined in a broad sense as an economic benefit received by a private agent from public funds. Subsidies are in general not compatible with the PPP. They are, however, often applied as a temporary measure to enable producers to avoid emissions in the long run. The WTO definition of a subsidy is regulated in the GATT and in the Agreement on Subsidies and Countervailing Measures (ASCM). It comprises direct subsidisation (financial contribution) and income or price support by a government. Prohibited are all subsidies that are based on export performance or contingent upon the use of domestic over imported goods. We have shown that the German price guarantees for renewable energy in the EEG and KWK cannot be considered as subsidies under WTO law. Even if this were the case, they would be regarded as non-actionable, unless a WTO member could prove serious adverse effects to the domestic industry which are difficult to repair. Furthermore, it is also unlikely that the direct German price supports for electricity from renewable energy sources will be challenged in a WTO dispute, because currently, trade in this electricity is low and such subsidies were considered to be non-actionable under Article VIII (2) ASCM up until 1999.