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Green Taxes and the WTO: Creating Certainty for the Future

Mark Liang*

I. INTRODUCTION

On August 21, 2008, China announced a tax that classifies vehicles by engine size, taxing larger engine vehicles at a higher rate than vehicles with smaller engines.¹ It is anticipated that the tax will disproportionately affect imported vehicles, since imported vehicles in China tend to have larger engines. Consequently, the US and EU, two major exporters of large engine vehicles to China, are expected to file a World Trade Organization (“WTO”) complaint² alleging that China’s engine size tax violates Article III:2 of the General Agreement on Trade and Tariffs (“GATT”), which bars discriminatory tax measures.³

Article III of the GATT implements the nondiscrimination doctrine. The nondiscrimination doctrine obligates WTO members to treat competing domestic and foreign products equally with respect to internal (nontariff) taxation.⁴ However, the precise reach of Article III:2 in regulating members’ authority to impose internal taxes on industries and products is unclear under

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¹ *Car Taxes in China: Taking Another Road*, The Economist (Aug 21, 2008), available online at <http://www.economist.com/business/displaystory.cfm?story_id=11967001> (visited Apr 23, 2009).

² Id. See also Simon Lester, *Taxing Big Engine Cars*, International Economic Law and Policy Blog (Aug 24, 2008), available online at <<http://worldtradelaw.typepad.com/ielpblog/2008/08/gas-guzzlers.html>> (visited Apr 22, 2009).

³ General Agreement on Tariffs and Trade, 61 Stat A-11, TIAS 1700, 55 UN Treaty Ser 194 (1947), art III:2 (“GATT”).

⁴ Nicholas DiMascio and Joost Pauwelyn, *Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?*, 102 Am J Intl L 48, 59–60 (2008).

existing WTO jurisprudence.⁵ Confusion over Article III:2's reach will become problematic in light of current global concerns over climate change and energy shortages. In response to these environmental and energy concerns, nations are expected to promulgate green taxes that incentivize lower energy consumption and emissions.⁶ These green taxes may be facially nondiscriminatory since they are unlikely to explicitly classify and tax products by national origin. However, green taxes may in effect impact importing nations disproportionately, thereby raising issues about compliance with Article III:2. China's engine size tax creates precisely this dilemma of disproportionately impacting imports, thereby risking noncompliance with Article III:2.

To further complicate matters, GATT Article XX permits various enumerated exceptions to other GATT provisions, including Article III's nondiscrimination provisions. Of particular relevance are Article XX(b) and (g). Together, Article XX(b) and (g) articulate Article XX's environmental exceptions.⁷ However, the scope of Article XX has been limited by its preamble, or chapeau.⁸ The chapeau ensures that Article XX is not abused by member states to avoid GATT obligations.⁹

China's engine size tax might present the first of what will likely be many green tax disputes in the coming years. The interplay between Article III:2, environmental concerns, and Article XX is expected to create numerous and difficult WTO disputes. The WTO's possible adjudication of a dispute concerning China's engine size tax would set important precedent. This Comment seeks to determine what types of green taxes should be acceptable given the WTO's case law, and what factors should be relevant to this determination.

The Comment is divided into seven sections. Section II explores the confusion surrounding the WTO's jurisprudence over Article III:2. Section III discusses Article XX's exemptions from the GATT and Article III, particularly the environmental exemptions embodied in Articles XX(b) and XX(g), and explains how Article XX's chapeau narrows the scope of these exemptions. Section IV discusses the WTO's adoption of the "precautionary principle" and how this doctrine may signal greater WTO deference to domestic environmental policies. Section V merges the previous three parts and advocates for a step-by-step test that a WTO Panel should use in evaluating a "green tax" dispute.

⁵ Id.

⁶ See, for example, *Car Taxes in China*, *The Economist* (cited in note 1).

⁷ GATT, art XX(b), art XX(g).

⁸ Dukgeun Ahn, *Environmental Disputes in the GATT/WTO Before and After US-Shrimp Case*, 20 *Mich J Intl L* 819, 833 (1999).

⁹ Id.

Section VI applies this proposed test to the Chinese engine size tax and draws some conclusions on what types of green taxes will comply with the GATT. Section VII concludes that facially neutral green taxes should usually be upheld by the WTO.

II. GATT ARTICLE III:2

Article III:2 presents a potential obstacle to green taxes by prohibiting all internal or nontariff tax measures that discriminate against foreign imports. Article III:2 provides,

The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.¹⁰

Article III embodies the nondiscrimination or “national treatment” provision of the GATT.¹¹ The national treatment doctrine stands for the proposition that nations must not place foreign imported goods at an economic disadvantage to domestic goods. That is, the doctrine requires nations to put domestic and imported goods on equal competitive footing.¹² Article III:2 addresses internal or nontariff taxes. Consider an archetypical Article III:2 violation where Country A passes a tax that explicitly imposes a sales tax rate of 50 percent on all foreign imported beef and a 10 percent rate on all domestic beef. Such a statute would violate Article III:2 since it clearly imposes a higher and therefore discriminatory internal tax on foreign imports. Country A’s tax, which explicitly places a higher tax burden on foreign imports, is considered *de jure* discriminatory, or, facially discriminatory.¹³ Facially discriminatory taxes are plain violations of Article III:2.

A. DE FACTO DISCRIMINATION

Complex Article III:2 cases arise over disputes concerning non-facially discriminative taxes. These taxes are not explicitly set based on the national origin of the goods.¹⁴ However, such non-facially discriminatory measures are de

¹⁰ GATT, art III:2.

¹¹ DiMascio and Pauwelyn, 102 Am J Int L at 59–60 (cited in note 4).

¹² *Id.*

¹³ Henrik Horn and Petros C. Mavroidis, *Still Hazy after All These Years: The Interpretation of National Treatment in the GATT/WTO Case-Law on Tax Discrimination*, 15 Eur J Int L 39, 60 (2004).

¹⁴ Won Mog Choi, *Overcoming the “Aim and Effect” Theory: Interpretation of “Like Product” in GATT Article III*, 8 UC Davis J Int L & Poly 107, 116 (2002).

facto discriminatory if the effect of the taxation scheme discriminates against foreign imports.¹⁵ Thus, while a de facto discriminatory tax does not explicitly discriminate against imports, the tax may effectively impose a higher tax rate on goods that tend to be imported, thereby having a discriminatory effect on imports.

The WTO's jurisprudence concerning non-facially discriminatory taxation schemes reveals no per se rule. For example, in *United States—Taxes on Automobiles* (“*US—Autos*”), the EU argued that the US “gas guzzler tax” was de facto discriminatory since, as a factual matter, EU auto exports to the US tended to have lower gas mileage and would be disproportionately affected by the tax.¹⁶ The WTO Dispute Panel nevertheless found the US gas guzzler tax in compliance with Article III:2. Other cases have similarly held that non-facially discriminatory tax measures that disproportionately impacted foreign imports were in compliance with Article III:2.¹⁷ By contrast, the WTO has also found non-facially discriminatory tax measures in violation of Article III:2.¹⁸ The conflicting results of these cases indicate that there is no per se rule on taxes that are not facially discriminatory, but are discriminatory in effect.

The WTO's lack of a per se rule on non-facially discriminatory taxes strikes a balance between respecting member states' political autonomy and preventing circumvention of Article III:2's intent to enforce the national treatment doctrine. However, an analysis of the WTO's jurisprudence reveals not only that there is no bright-line rule that governs alleged de facto discrimination disputes, but also that there is a lack of consistent guidelines or factors. The WTO has stated that Article III:2 disputes concerning non-facially discriminatory taxes must be evaluated on a case-by-case basis.¹⁹ Such an

¹⁵ See World Trade Organization, Report of the Appellate Body, *Chile—Taxes on Alcoholic Beverages* ¶ 25, WTO Doc No WT/DS87/AB/R, WT/DS110/AB/R (Dec 13, 1999) (“*Chile—Alcoholic Beverages*”); World Trade Organization, Report of the Appellate Body, *Japan—Taxes on Alcoholic Beverages* 29, WTO Doc No WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R (Oct 4, 1996) (“*Japan—Alcoholic Beverages*”).

¹⁶ World Trade Organization, Report of the Panel, *United States—Taxes on Automobiles* ¶ 3.29, WTO Doc No DS31/R (Sept 30, 1994) (“*US—Autos*”).

¹⁷ See World Trade Organization, Report of the Panel, *United States—Taxes on Petroleum and Certain Imported Substances*, WTO Doc No BISD/34S/136, L/6175 (June 17, 1987); World Trade Organization, Report of the Panel, *Thailand—Restrictions on Importation of and Internal Taxes on Cigarettes*, WTO Doc No BISD/37S/200, DS10/R (Nov 7, 1990).

¹⁸ See World Trade Organization, Report of the Appellate Body, *Canada—Certain Measures Concerning Periodicals*, WT/DS31/AB/R (June 30, 1997) (“*Canada—Periodicals*”); *Chile—Alcoholic Beverages*, Report of the Appellate Body; *Japan—Alcoholic Beverages*, Report of the Appellate Body.

¹⁹ Raj Bhala, *The Precedent Setters: De Facto Stare Decisis in WTO Adjudication (Part Two of a Trilogy)*, 9 J Trans L & Poly 1, 100–01 (1999). See also *Japan—Alcoholic Beverages*, Report of the Appellate Body at 20.

individualized and fact-intensive inquiry is problematic. Member states face constant doubts over whether any given or proposed tax risks being struck down by the WTO as a violation of Article III:2. It is costly for member states to have to check Article III:2 compliance and investigate the impact a proposed tax will have on imports relative to domestic goods.

An analysis of WTO jurisprudence on Article III:2 does suggest that certain considerations are relevant. These considerations include: (1) the likelihood and extent of the disproportionate impact on foreign imports, and (2) whether the tax measure has a graduated progression of tax rates based on product classifications motivated by legitimate policy goals. A member state's tax only complies with Article III:2 if it complies with both the first and second sentence of Article III:2. A discussion of each Article III:2 sentence follows below.

B. ANALYSIS OF ARTICLE III:2'S FIRST SENTENCE

Article III:2's first sentence has been the subject of much confusion in WTO disputes. The sentence states: "The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products."²⁰ Most Article III:2 disputes turn on the Dispute Body's interpretation of the word "like."²¹ In typical Article III:2 disputes, the complainant country will argue that the defendant country is taxing the complainant's imported products at a higher rate than defendant's "like" domestic products.²² The "like" inquiry often determines the outcome of Article III:2 cases. Once a foreign product is considered "like" a domestic product, the mere showing that the foreign product is taxed "in excess of" of the "like" domestic good is sufficient to show an Article III:2 violation.²³

Broadly speaking, imported and domestic products are "like" each other if they share similar characteristics that suggest consumers in the defendant nation would be expected to make purchasing decisions between them.²⁴ Intuitively, two products are "like" if consumers consider them to be comparable goods that meet the same consumer needs. The "like" inquiry becomes complicated

²⁰ GATT, art III:2.

²¹ See, for example, *Canada-Periodicals*, Report of the Appellate Body.

²² Id.

²³ *Japan-Alcoholic Beverages*, Report of the Appellate Body at 20 (explaining de minimis defense does not apply to "in excess of"; any amount higher is sufficient).

²⁴ See *Canada-Periodicals*, Report of the Appellate Body at 29.

with non-facially discriminative taxes. In *US–Autos*, the US gas guzzler tax set rates based on gas mileage. The EU complained that this tax disproportionately affected EU export vehicles in the US since their exports tended to have lower gas mileage.²⁵ The US countered on lack of “likeness” grounds arguing that low- and high-gas mileage vehicles were not “like” products.²⁶ For example, vehicles with a sub-12.5 miles per gallon (“mpg”) rating facing a \$7,700 tax did *not* compete with 22.5 and higher mpg-rated vehicles facing no tax.²⁷ The Panel agreed with the US argument. High- and low-mileage vehicles were sufficiently distinct and noncompetitive that they were not “like.”²⁸

Other past Article III:2 disputes further illustrate the complexity and fact-intensive nature of the likeness inquiry.²⁹ These disputes present the same archetypical facts. Defendant nation’s tax divides a broad category of products into certain origin-neutral classifications. Each classification will be taxed at a class-specific rate and the classifications taxed at higher rates will tend to be imports. The key inquiry is whether the individual classifications of products are sufficiently similar and competitive to be considered “like.”³⁰ If so, then the complainant and defendant’s products are considered “like.”

A review of the WTO’s jurisprudence on Article III:2’s first sentence presents two competing “likeness” tests: (1) the “border tax adjustment factors” test and (2) the “aims and effects” test.³¹

The border tax adjustment factors test employs the following factors in determining whether two products are “like”: (i) whether the products’ end uses are the same or similar; (ii) consumers tastes and habits; (iii) the products’ properties, nature, and quality; and (iv) whether tariff schemes typically categorize the products as part of the same classification.³² The border tax adjustment factors focus on whether defendant nation’s internal taxation scheme is likely to result in a disparate tax burden on foreign goods. If so, then the two products are “like.” The test is objective. It does not conduct a subjective inquiry

²⁵ *US–Autos*, Report of the Panel ¶ 3.53.

²⁶ *Id.*, ¶ 3.177.

²⁷ *Id.*, ¶ 2.7.

²⁸ *Id.*, ¶ 5.26.

²⁹ *Chile–Alcoholic Beverages*, Report of the Appellate Body (whether alcoholic beverages with content below 35° were like beverages above 39°); *Japan–Alcoholic Beverages*, Report of the Appellate Body (whether various types of alcoholic beverages were like).

³⁰ See *Japan–Alcoholic Beverages*, Report of the Appellate Body 21–22.

³¹ Choi, 9 UC Davis J Intl L & Poly at 111 (cited in note 14).

³² Reinhard Quick and Christian Lau, *Environmentally Motivated Tax Distinctions and WTO Law*, 6 J Intl Econ L 419, 428 (2003).

into the motivation underlying the disputed tax.³³ Rather, it inquires only into the tax's likely market effect, with some analysis into similarity of the products' features and qualities. The Appellate Body applied the border tax adjustment factors in *Japan—Taxes on Alcoholic Beverages* (“*Japan—Alcoholic Beverages*”), anticipating that consumers would shift more of their purchases to domestically produced beverages and away from foreign beverage types as a result of the tax.³⁴ The end uses of the beverages were the same and the Appellate Body found that the beverages' properties were sufficiently similar.³⁵

In contrast to the “border tax adjustment factors” test, the “aims and effects” test considers (i) the market effect of the defendant nation's tax measure, and (ii) the purpose underlying the tax measure.³⁶ The purpose half of the inquiry makes the test more subjective than the border tax adjustment factors test. Under the aims and effects test, if a tax measure's aim is to effectively tax imports at a higher rate and the measure achieves this aim, then the two products are “like.” The aims of a tax measure are primarily determined by investigating the tax measure's legislative history.³⁷ The WTO applied the aims and effects test in *US—Autos* and concluded complainant parties were unable to demonstrate that defendant US had any protectionist intent in implementing the gas guzzler tax.³⁸ The panel noted that even if complainant parties had demonstrated that the tax disproportionately burdened imports and thus had discriminatory impact, they had failed to demonstrate discriminatory purposes underlying the tax measure.³⁹ Because the US did not intend to discriminate against foreign imports, the US did not treat the pertinent foreign and domestic products as “like.” Therefore, the products were not “like” and the disputed tax did not violate Article III:2's first sentence.⁴⁰

US—Autos demonstrates that while the aims and effects test is more subjective than the objective border tax adjustment factors test, the test is less intrusive of member states' autonomy than the border tax adjustment factors.⁴¹ The aims and effects test adds another prong or burden of proof that complainant must satisfy. Namely, in addition to proving discriminatory market

³³ DiMascio and Pauwelyn, 102 Am J Intl L at 63 (cited in note 4).

³⁴ Report of the Appellate Body, *Japan—Alcoholic Beverages* at 20, 22–23.

³⁵ *Id.*

³⁶ Elizabeth Trujillo, *Mission Possible: Reciprocal Deference between Domestic Regulatory Structures and the WTO*, 40 Cornell Intl L J 201, 219–20 (2007).

³⁷ *US—Autos*, Report of the Panel ¶ 3.192.

³⁸ *Id.*, ¶ 3.47.

³⁹ *Id.*, ¶ 5.26.

⁴⁰ *Id.*

⁴¹ DiMascio and Pauwelyn, 102 Am J Intl L at 63 (cited in note 4).

impact, the complainant must also prove discriminatory intent. Discriminatory effect alone is insufficient to create a finding of “likeness” under the aims and effects test.⁴²

C. ANALYSIS OF ARTICLE III:2’S SECOND SENTENCE

Article III:2’s second sentence provides a separate distinct requirement from the first sentence that the promulgating state must satisfy in order to avoid an Article III:2 violation. Article III:2’s second sentence states: “no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.”⁴³ The second sentence references Paragraph 1 of Article III, thereby requiring member states to comply with the provisions of Article III:1.⁴⁴ The Appellate Body has laid out a three-step inquiry for determining whether a member state’s tax regime complies with Article III:2’s second sentence: (1) whether the pertinent foreign and domestic products are directly competitive or substitutable, (2) whether the foreign and domestic products are not similarly taxed, and (3) whether the tax differential was meant to afford protection to domestic production.⁴⁵ While both Article III:2 sentences attempt to get at the same idea of preventing discriminatory taxation, there are differences in their respective requirements. In short, the directly competitive or substitutable inquiry is broader and more favorable to a complainant nation than the “like” inquiry. However, the second sentence is also less favorable to a complainant nation by offering a defendant nation *de minimis* and good-faith defenses.

The first step of the Article III:2 second sentence inquiry is whether the pertinent foreign and domestic products are directly competitive or substitutable. This inquiry considers the following non-exhaustive list of factors: (i) elasticity of demand, (ii) elasticity of substitution, (iii) end-uses, (iv) consumers’ tastes and habits, and (v) the products’ properties and nature.⁴⁶ The foregoing list shares many of the same considerations as the border tax

⁴² Steve Charnovitz, *The Law of Environmental “PPMS” in the WTO: Debunking the Myth of Illegality*, 27 *Yale J Intl L* 59, 89 (2002).

⁴³ GATT, art III:2.

⁴⁴ Article III:1 provides: “The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production.” GATT, art III:1.

⁴⁵ See *Canada-Periodicals*, Report of the Appellate Body; *Japan-Alcoholic Beverages*, Report of the Appellate Body.

⁴⁶ Horn and Mavroidis, 15 *Eur J Intl L* at 52 (cited in note 13).

adjustment factors test for likeness. As *Japan—Alcoholic Beverages* and other cases⁴⁷ find, though, the directly competitive or substitutable inquiry is broader than the “like” inquiry of the Article III:2 first sentence. That is, it is easier to show two products are directly competitive or substitutable than to find that they are “like.” The distinction between “like” and directly competitive or substitutable is that the directly competitive or substitutable inquiry considers elasticity of demand and substitution. If taxing the foreign product at a higher rate is likely to lead to a shifting of consumer preference to the domestic product, then the two products are directly competitive or substitutable. For example, fish and carrots are not “like” given their different physical characteristics and end uses since they serve different dietary needs. Consumers would not view fish and carrots as comparable goods between which they make purchasing decisions. However, they may be considered directly competitive or substitutable if raising taxes on fish causes consumers to purchase more carrots.

The second step of the Article III:2 second sentence inquiry is whether the two pertinent goods are “not similarly taxed.”⁴⁸ This inquiry is distinct from Article III:2’s first sentence’s inquiry into whether the foreign goods were taxed at a level “in excess of” that of “like” domestic goods. Recall that “in excess of” does not offer a *de minimis* defense; the foreign good cannot be taxed at any non-zero amount more than comparable domestic good. By contrast, “not similarly taxed” has been interpreted to allow a *de minimis* defense.⁴⁹ In order to violate this step of the second sentence inquiry, the difference in taxation levels effectively levied on directly competitive or substitutable foreign and domestic goods must be substantial enough so as to have a material effect on consumer purchasing decisions.⁵⁰

The third step of the Article III:2 second sentence inquiry is whether the foreign and domestic goods are not similarly taxed in a manner “so as to afford protection” to domestic production.⁵¹ The “so as to afford protection” step is distinct from the objective border tax adjustments test, which, as described in Section II.B, does not inquire into the underlying intent of the tax. By contrast, the key issue in the “so as to afford protection” inquiry is whether the member state had protectionist intent in promulgating this tax measure.⁵² The inquiry is therefore subjective. The WTO usually considers the tax measure’s legislative

⁴⁷ See, for example, *Canada—Periodicals*, Report of the Appellate Body.

⁴⁸ *Japan—Alcoholic Beverages*, Report of the Appellate Body at 26.

⁴⁹ *Id.* at 27.

⁵⁰ *Id.*

⁵¹ *Id.* at 28.

⁵² *Id.* at 27–28.

history and the text of the tax measure in determining whether this step is violated.⁵³

In summary, Article III:2 second sentence's analysis is a well-established three-step inquiry: (1) whether the products are directly competitive or substitutable, (2) whether they are not similarly taxed, and (3) whether they are taxed in a manner meant to afford protection to domestic production. Further, while analysis of Article III:2's first sentence shares many of the same considerations as the second, the two sentences present distinct and separate requirements. Compared to Article III:2's first sentence, the second is more favorable to a complainant nation in some respects and less favorable in others. The directly competitive or substitutable inquiry is broader than "like" and therefore easier for the complainant nation to satisfy. However, the latter two second sentence inquiries offer the defendant nation *de minimis* and good-faith defenses and are therefore less favorable to the complainant nation. In any case, a tax measure must satisfy both sentences to satisfy Article III:2.

D. EVOLUTION OF ARTICLE III:2 JURISPRUDENCE AND THE MODERN TEST

Section II.B discussed the two competing Article III:2 first sentence "likeness" tests, namely the objective border tax adjustment factors test and the more subjective aims and effects test. Over time, the WTO has wavered between objective and subjective tests in its "likeness" analysis. Since deciding *Chile—Taxes on Alcoholic Beverages* ("*Chile—Alcoholic Beverages*") in 1999, the Appellate Body has employed the border tax adjustment factors test, with the addition of considering the tax's purpose.⁵⁴ While purpose is part of the Article III:2 inquiry, the Appellate Body's current test is not akin to the aims and effects test. Rather, it has added a fifth factor of purpose to the existing border tax adjustment factors.

According to *Chile—Alcoholic Beverages*, purpose is determined entirely by analyzing the design, architecture, and structure of the tax measure's text.⁵⁵ The purpose inquiry therefore differs from the aims prong of the aims and effects test. As discussed, a tax measure's "aims" are determined by considering the tax measure's legislative history and text. *Chile—Alcoholic Beverages* limits the sources used to determine purpose solely to the tax measure's text, without resorting to

⁵³ Id.

⁵⁴ *Chile—Alcoholic Beverages*, Report of the Appellate Body. See also DiMascio and Pauwelyn, 102 Am J Intl L at 65 (cited in note 4).

⁵⁵ *Chile—Alcoholic Beverages*, Report of the Appellate Body ¶ 62.

legislative history.⁵⁶ By adopting a textualist approach to determining purpose, the Appellate Body has reduced the judicial cost and difficulties associated with investigating legislative history.

In practice, this textualist approach to analyzing purpose results in upholding taxes that classify products in a graduated manner based on criteria that directly address legitimate policy goals, and where the differential in taxation levels between product classes is not drastic. By contrast, taxes that classify products arbitrarily with stark differences in taxation levels between the product classes are likely violations of Article III:2. Consider the tax measure disputed in *Chile–Alcoholic Beverages*. A 27 percent value added tax (“VAT”) was imposed on beverages with alcohol content below 20 percent and a 47 percent VAT was imposed on beverages with alcohol content above 22.3 percent.⁵⁷ The Appellate Body found the tax’s distinction between 20 percent alcohol content and above 22.3 percent alcohol content to be arbitrary and the 20 percent differential in VATs between beverages separated by only 2.3 percent to be excessive. Accordingly, the Appellate Body concluded the tax measure had a protectionist purpose.

In contrast, consider again the gas guzzler tax in *US–Autos*. The Energy Tax Act of 1978 imposed a per-vehicle tax on auto manufacturers based on an automobile’s gas mileage.⁵⁸ Table 1 below shows the tax’s product classifications and associated tax burdens provided by the act as amended in 1990.

⁵⁶ Id, ¶ 63.

⁵⁷ Id, ¶¶ 1–3.

⁵⁸ *US–Autos*, Report of the Panel ¶ 2.1.

Gas Mileage (mpg)	Tax Burden (\$)
Greater than 22.5	0
21.5 to 22.5	1,000
20.5 to 21.5	1,300
19.5 to 20.5	1,700
18.5 to 19.5	2,100
17.5 to 18.5	2,600
16.5 to 17.5	3,000
15.5 to 16.5	3,700
14.5 to 15.5	4,500
13.5 to 14.5	5,400
12.5 to 13.5	6,400
Less than 12.5	7,700

Table 1: The US Gas Guzzler Tax⁵⁹

The WTO Dispute Panel concluded based on the tax measure's design and structure that the gas guzzler tax did not have a protectionist intent, but was genuinely motivated by environmental and energy independence concerns.⁶⁰ Automobiles were classified by gas mileage, a criteria that directly addresses concerns over fuel efficiency and emission levels. The classifications were gradual with 1.0 mpg increments and there were twelve classifications. Tax rates were similarly graduated between classification levels. These graduated classifications were unlike the sudden thresholds found in *Chile-Alcoholic Beverages*. Further, at the time of the original 1978 act, the majority of domestic US-produced vehicles would have been subject to the tax.⁶¹ The fact that the 1990 amendment seemed to build upon the 1978 act suggested a concerted long-term effort to address environmental and energy concerns.

Thus, the WTO's current test on Article III:2 is likely governed by the objective border tax adjustment factors, with the added consideration of the disputed tax measure's purpose. The border tax adjustment factors assess whether the tax will impose a larger tax burden on imports. The purpose prong asks whether the tax has a graduated progression of tax rates based on product classifications that directly address legitimate policy goals, or instead, creates

⁵⁹ Id, ¶ 2.7.

⁶⁰ Id, ¶ 5.26.

⁶¹ Id, ¶ 3.200.

arbitrary product distinctions and imposes starkly different tax rates based on these distinctions.

III. GATT ARTICLE XX

Article XX of the GATT provides member states with a list of enumerated exemptions from compliance with other GATT provisions, including Article III:2. Article XX is organized into two parts. First, the chapeau narrows the applicability of Article XX's exemptions so as to prevent abuse of Article XX's enumerated exemptions. Following the chapeau is the enumerated list of exemptions, running (a) through (j).⁶²

The purpose of Article XX is to provide member states with exemptions from GATT requirements where the member state's national interest would be unfairly and excessively burdened by having to comply with those requirements.⁶³ In effect, Article XX offers defendant member states an affirmative defense in WTO disputes.⁶⁴ Whether a member state qualifies for an Article XX defense against an Article III:2 complaint is a two-step inquiry: (1) whether the member state's tax measure meets the objectives of the asserted enumerated exemption; and (2) whether the tax measure meets the requirements of Article XX's chapeau.⁶⁵

Given this Comment's focus on environmentally motivated green tax measures, the enumerated defenses in Article XX(b) and Article XX(g) are relevant. Together, these defenses form the "environmental exemptions" of Article XX. Section III.A compares Articles XX(b) and XX(g). Section III.B discusses the requirements of Article XX's chapeau.

A. ARTICLE XX(G) OFFERS A MORE LIKELY EXCEPTION THAN ARTICLE XX(B)

Though Articles XX(b) and XX(g) both provide environmental exemptions and nothing stops a defendant member state from asserting both defenses together, an affirmative defense using Article XX(g) is more likely to succeed in a dispute over a green tax. Article XX(b) provides an exemption from all other GATT provisions—including Article III:2—where the disputed policy is "necessary to protect human, animal or plant life or health."⁶⁶ Article XX(g) provides an exemption to Article III:2 where the disputed tax measure is

⁶² GATT, art XX.

⁶³ Quick and Lau, 6 J Intl Econ L at 455 (cited in note 32).

⁶⁴ Bhala, 9 J Trans L & Poly at 24 (cited in note 19).

⁶⁵ Quick and Lau, 6 J Intl Econ L at 438 (cited in note 32).

⁶⁶ GATT, art XX(b).

“relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.”⁶⁷

Note that Article XX(g) uses the language “relating to,” while Article XX(b) uses the language “necessary to.” According to the panel decision in *Argentina—Measures Affecting the Export of Bovine Hides and the Import of Finished Leather*,⁶⁸ the “necessary to” standard requires that the defendant state’s disputed policy address an urgent problem requiring immediate remedy.⁶⁹ The defendant state must meet the burden of proving that no alternative policy measures, which would not violate other GATT provisions, are feasible.⁷⁰ By contrast, in *US—Autos*, the Dispute Panel distinguished “relating to” as a more relaxed standard when compared to the “necessary to” standard.⁷¹ All that is required to satisfy the “relating to” standard is for the member state asserting an XX(g) affirmative defense to prove the disputed policy is “primarily aimed” at resolving the environmental problem.⁷² The environmental problem addressed by the tax need not be urgent and it is immaterial whether alternative policy remedies that do not violate other GATT provisions are feasible.⁷³

The Dispute Panel in *US—Autos* laid out the following three-step test for assessing compliance with Article XX(g): (1) whether the policy alleged to be promoted by the disputed tax measure falls within XX(g)’s scope, (2) whether the tax measure is sufficiently related to the policy, and (3) whether the tax measure complies with Article XX’s chapeau.⁷⁴ The Panel considered “clean air” an exhaustible natural resource under Article XX(g).⁷⁵ Thus, improving air quality satisfies the first step of the inquiry, since the policy of conserving clean air falls within Article XX(g)’s scope. In *US—Autos*, the Panel found that the US’s Corporate Average Fuel Efficiency regulation, which sought to improve fuel efficiency and reduce emissions, satisfied the second step.⁷⁶ That is, regulations which improve fuel efficiency and lower emissions of air pollutants were

⁶⁷ GATT, art XX(g).

⁶⁸ World Trade Organization, Report of the Panel, *Argentina—Measures Affecting the Export of Bovine Hides and the Import of Finished Leather*, WTO Doc No WT/DS155/R (Jan 5, 2001).

⁶⁹ *Id.*, ¶¶ 11.299–11.308 (the case actually concerned Article XX(d), but this exemption uses the same “necessary to” language).

⁷⁰ Ahn, 20 Mich J Intl L at 828 (cited in note 8).

⁷¹ *US—Autos*, Report of the Panel ¶¶ 5.56–5.58.

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.*, ¶ 5.56.

⁷⁵ *Id.*, ¶¶ 3.316–3.323.

⁷⁶ *Id.*, ¶ 5.58.

sufficiently related to the purported policy of improving clean air. The third step, compliance with Article XX's chapeau, is discussed in greater detail below. The point is, though, that compliance with the enumerated Article XX(g) exemption is not difficult to achieve. Any tax likely to significantly improve air quality by improving energy efficiency and reducing emissions of air pollutants should qualify.

B. ARTICLE XX CHAPEAU

Article XX's chapeau is intended to prevent abuse of Article XX's enumerated exemptions.⁷⁷ All of Article XX's enumerated exemptions are subject to Article XX's chapeau.⁷⁸ Article XX's chapeau states:

Subject to the requirement that such measures are not applied 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, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of [the following] measures[.]⁷⁹

The chapeau prevents Article XX from becoming a means of circumventing the GATT's other provisions by pretending protectionist policies are actually based on urgent and important national interests. There are two tests to determine whether a measure impermissibly circumvents other GATT provisions and therefore violates the chapeau: the "discrimination test" and the "disguised restriction" test.

United States—Import Prohibition of Certain Shrimp and Shrimp Products ("US—Shrimp")⁸⁰ provides the two-step inquiry for the discrimination test: (1) application of the measure in question must result in discrimination arbitrary or unjustifiable in character, and (2) discrimination must occur between countries where the same conditions apply.⁸¹ The first step of the discrimination test evaluates the severity of the discrimination. The arbitrary prong evaluates procedural discrimination.⁸² A tax results in arbitrary discrimination if, as

⁷⁷ Ahn, 20 Mich J Intl L at 833–34 (cited in note 8); Quick and Lau, 6 J Intl Econ L at 439 (cited in note 32).

⁷⁸ Ahn, 20 Mich J Intl L at 833 (cited in note 8).

⁷⁹ GATT, art XX.

⁸⁰ World Trade Organization, Report of the Appellate Body, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc No WT/DS58/AB/R (Oct 12 1998) ("US—Shrimp").

⁸¹ Id., ¶¶ 148–50. See also Julia Ya Qin, *Defining Nondiscrimination under the Law of the World Trade Organization*, 23 BU Intl L J 215, 269 (2005).

⁸² Charnovitz, 27 Yale J Intl L at 96 (cited in note 42).

implemented, the tax lacks transparency or due process.⁸³ For example, in *US–Shrimp*, the disputed policy was a US administrative procedure which granted certification to certain nations’ shrimp imports.⁸⁴ The Appellate Body found the administrative procedure lacked transparency and due process since the administrative officials did not have to disclose the rationale for their decisions on whether to grant certification.⁸⁵ As implemented, certification results demonstrated a lack of consistency or clear decisionmaking criteria.⁸⁶ The “unjustifiable in character” prong of step one evaluates substantive discrimination. A policy or tax measure is unjustifiable if it is coercive, unilateral, rigid, and inflexible.⁸⁷ These adjectives suggest that unjustifiable discrimination refers to a severe level of discriminatory effect, greater than that required for a finding of an Article III:2 violation.⁸⁸ Thus, while Article XX’s enumerated exemptions allow for some discrimination, the “unjustifiable” prong of the chapeau provides an outer bound on the level of discriminatory effect.

The second step of the discrimination test is to determine if the discrimination applies to “countries where the same conditions prevail.” *US–Shrimp* suggests that this inquiry stands for the proposition that member states, prior to promulgating a policy that may be discriminatory in effect and in violation of GATT, must consider the conditions prevailing in other member states.⁸⁹ That is, the promulgating nation must account for the circumstances and views of other member states that may be discriminated against by the policy.⁹⁰ In *US–Shrimp*, the Appellate Body found that the US failed to comply with the chapeau partly because the US did not consult with other member states about the potential discriminatory effect of its certification procedure.⁹¹ The rationale for the “same conditions” prong is to minimize the discriminatory effect of policies by encouraging member states to negotiate *ex ante*.⁹² As a general matter, the WTO prefers regulations that are a product of multilateral negotiation, rather than unilateral measures. Forcing multilateral negotiation should ensure that the disputed measure is not more discriminatory than

⁸³ Id.

⁸⁴ *US–Shrimp*, Report of the Appellate Body ¶¶ 183–84.

⁸⁵ Id.

⁸⁶ Id.

⁸⁷ Id, ¶¶ 161–76; Qin, 23 BU Intl L J 215 at 269 (cited in note 81).

⁸⁸ See Qin, 23 BU Intl L J 215 at 269 (cited in note 81).

⁸⁹ *US–Shrimp*, Report of the Appellate Body ¶ 54.

⁹⁰ Id.

⁹¹ Id.

⁹² Id; Ahn, 20 Mich J Intl L at 833 (cited in note 8).

necessary. At the very least, obligatory consultation guarantees that other member states have an opportunity to approve of the disputed measure.

In addition to the discrimination test, to comply with Article XX's chapeau, a measure also cannot constitute a "disguised restriction on international trade." The "disguised restriction" requirement is similar to the "aims" prong of the (now defunct) aims and effects test of Article III:2. It bars measures which have protectionist intent.⁹³ This prong is sensible given the chapeau's objective of preventing abuse of Article XX. Legislative history and the text of the disputed policy are viable sources to determine if a policy is a "disguised restriction on international trade."⁹⁴ In *US-Shrimp*, the Appellate Body found the disputed policy was not a disguised restriction because: (1) environmental groups initiated the policy, (2) US producers were subject to comparable constraints, and (3) US producers gained little commercially due to the policy.⁹⁵ The policy therefore lacked protectionist intent. Note, a measure can be considered a "disguised restriction" if the promulgating nation was *negligent* about the protectionist effects of the measure.⁹⁶ In other words, a measure can be a disguised restriction if the promulgating nation knew or had reason to know that the disputed policy risked having discriminatory effect, yet implemented the policy anyway.⁹⁷ Note further that both Article XX's chapeau and Article III:2 (at least the second sentence since the first sentence now uses the border tax adjustment factors and disregards discriminatory intent) test for discriminatory intent. It may seem redundant or odd that qualifying for an Article XX exception requires compliance with Article III:2, the very provision from which an exception is sought. However, Article XX is an exception not just from Article III:2, but all other GATT provisions. In addition, an Article III:2 violation could arise for any number of reasons, discriminatory intent only being one of them, in which case Article XX's chapeau further assures that the disputed measure is not motivated by protectionist objectives.

In summary, Article XX of the GATT provides member states with exemptions from other GATT provisions. Given this Comment's focus on environmentally motivated "green" taxes, Article XX(b) and XX(g)'s exemptions offer the most likely defenses. Article XX(g) is more promising to the defendant

⁹³ Qin, 23 BU Intl L J 215 at 267–68 (cited in note 81).

⁹⁴ Id.

⁹⁵ Laurent A. Ruessmann, *Putting the Precautionary Principle in its Place: Parameters for the Proper Application of a Precautionary Approach and the Implications for Developing Countries in Light of the DOHA WTO Ministerial*, 17 Am U Intl L Rev 905, 923–24 (2002); World Trade Organization, Report of the Panel, *US-Shrimp* ¶ 5.143, WTO Doc No WT/DS58/R (May 15, 1998).

⁹⁶ Quick and Lau, 6 J Intl Econ L at 442 (cited in note 32).

⁹⁷ Id.

nation because it only requires that the disputed tax measure be “related to” environmental and resource conservation. Assuming the tax measure qualifies for Article XX(g)’s exemption, the tax measure also needs to satisfy Article XX’s chapeau. First, the tax measure must not result in arbitrary (procedural) or unjustifiable (substantive) discrimination against other countries where the same conditions prevail. Second, the tax measure must not be a disguised restriction on trade, meaning the tax measure must not be motivated by protectionist objectives. If the tax measure meets both Article XX(g) and the chapeau’s requirements, the tax measure is exempt from Article III:2 requirements and will be upheld as compliant with GATT’s provisions.

IV. THE PRECAUTIONARY PRINCIPLE: LENIENCY FOR ENVIRONMENTAL POLICIES

A review of WTO jurisprudence reveals increasing acknowledgement of the “precautionary principle.”⁹⁸ In the context of WTO disputes and environmental issues, the precautionary principle permits a defendant nation to claim the existence of an environmental risk, even if this environmental risk has not been acknowledged by scientific unanimity or even by a majority of the scientific community.⁹⁹ Further, a nation may allege the existence of an environmental risk even if the severity and probability of the risk cannot be quantified.¹⁰⁰ In effect, the precautionary principle eases the burden of proof on WTO members in asserting an affirmative defense on environmental grounds. Scientific certainty of the environmental risk is unnecessary. All that is required is for the allegation of the environmental risk to be based on good-faith reliance on scientific analysis and opinion.¹⁰¹ The rationale guiding the precautionary principle is that environmental risks are too grave to require certainty of information.¹⁰²

The precautionary principle should make it easier for defendant nations to assert an Article XX(b) or XX(g) defense on environmental grounds. For

⁹⁸ Marie-Claire C. Segger and Markus W. Gehring, *Precaution, Health and the World Trade Organization: Moving toward Sustainable Development*, 29 Queen’s L J 133, 135 (2003) (note however, that the WTO has not formally recognized or adopted the precautionary principle but their recent jurisprudence suggests they are inclined to grant greater deference to environmentally motivated policies).

⁹⁹ Id at 135; World Trade Organization, Report of the Appellate Body, *European Community—Measures Affecting Asbestos and Asbestos-Containing Products* ¶ 178, WTO Doc No WT/DS135/AB/R (Mar 12, 2001) (“*EC-Asbestos*”).

¹⁰⁰ Segger and Gehring, 29 Queen’s L J at 135 (cited in note 98); *EC-Asbestos*, Report of the Appellate Body ¶ 178.

¹⁰¹ Segger and Gehring, 29 Queen’s L J at 135 (cited in note 98); *EC-Asbestos*, Report of the Appellate Body ¶ 178.

¹⁰² Segger and Gehring, 29 Queen’s L J at 135 (cited in note 98).

example, a member state passing a tax on fuel consumption need not prove with high certainty that air quality will necessarily decrease if the tax is not implemented. The member state also need not attempt to quantify the likelihood or severity of the decrease in air quality. The precautionary principle will justify the member state's assertion of an environmental risk so long as the assertion is based on the view of a substantial segment (not necessarily a majority) of the scientific community.¹⁰³ More importantly, the precautionary principle's modern prevalence suggests that the WTO gives significant weight to environmental considerations in its policies and disputes.

In *European Community—Measures Affecting Asbestos and Asbestos-Containing Products* (“*EC—Asbestos*”), the Appellate Body stated that whether an Article XX exemption (environmentally motivated or not) should be granted depends on the following factors: (1) the importance of the common interests and values protected, (2) the likely efficacy of the measure, and (3) the level of market impact on trade flows.¹⁰⁴ Professor Joost Pauwelyn argues that an environmental measure is likely to receive Article XX protection if (1) the environmental risk is globally established, (2) the environmental measure is facially neutral, (3) there is a nexus between the environmental risk and the regulating nation, and (4) there is a nexus between the environmental risk and the environmental measure.¹⁰⁵

Taken together, *EC—Asbestos* and Pauwelyn's analysis suggest that the WTO uses a two-step process to evaluate whether an environmental measure qualifies for an Article XX(b) or XX(g) defense. First, the WTO examines the environmental risk that the measure purports to address. A defense is certain if the environmental risk is globally established and known. Second, the environmental measure itself is examined. In the Article III:2 context, a tax is more likely to receive Article XX protection if the tax directly and effectively remedies the alleged environmental risk. The tax measure's directness and effectiveness are balanced against any finding that the tax fails to comply with Article XX.

V. SUMMARY OF RELEVANT FACTORS

Up to this point, this Comment has discussed the WTO's treatment of Article III:2, Article XX, and the precautionary principle. In each discussion, the Comment sought to extract and simplify the relevant tests, factors, and considerations that the WTO has developed. This section merges these findings

¹⁰³ Ruessmann, 17 *Am U Intl L Rev* at 915–16 (cited in note 95).

¹⁰⁴ *Id.*

¹⁰⁵ Joost Pauwelyn, *Recent Books on Trade and Environment: GATT Phantoms Still Haunt the WTO*, 15 *Eur J Intl L* 575, 587 (2004).

and proposes the framework that the WTO Dispute Body should employ to adjudicate future disputes concerning facially neutral tax measures that are motivated by environmental and energy conservation concerns. Figure 1 presents a flowchart of the step-by-step test of how the WTO should adjudicate future disputes concerning facially neutral “green taxes,” like the engine size tax proposed by China. The details of each inquiry in the step-by-step test were discussed in depth in Sections II and III. However, for the purposes of understanding how these inquiries fit together in the larger WTO test, a summary of each inquiry follows.

In short, the first threshold inquiry is whether the green tax complies with Article III:2. To comply with Article III:2, the green tax must comply with both Article III:2’s first and second sentences. Compliance with Article III:2’s first sentence generally turns on whether the domestic and foreign products in dispute are in fact “like.” Likeness is determined by (1) the objective border tax adjustment factors and (2) the purpose of the tax measure. The four border tax adjustment factors, listed in Figure 1, together seek to determine whether the green tax is likely to impose a higher tax burden on foreign goods as compared to domestic goods. Two products are more apt to be considered “like” if a discriminatory effect is probable. If the purpose of the green tax is found to be protectionist, then this also favors finding “likeness.” The purpose of the green tax is determined by analyzing the tax measure’s structure and design. A green tax which contains arbitrary product classifications with drastic differences in taxation levels is more likely to be considered protectionist in purpose and therefore in violation of Article III:2 first sentence. Assuming two products are “like,” an Article III:2 first sentence violation is almost certain since the “in excess of” language does not offer a *de minimis* defense.

A green tax violates the second sentence of Article III:2 if: (1) the pertinent products are directly competitive or substitutable; and (2) the products are “not similarly taxed” so as to afford protection to domestic products. If a green tax does not violate either the first or second sentence of Article III:2, then it is in compliance with the GATT and the inquiry ends. However, if a green tax violates either sentence, the tax violates Article III:2. The promulgating state is likely, then, to assert an affirmative defense using Article XX(g) on environmental grounds.

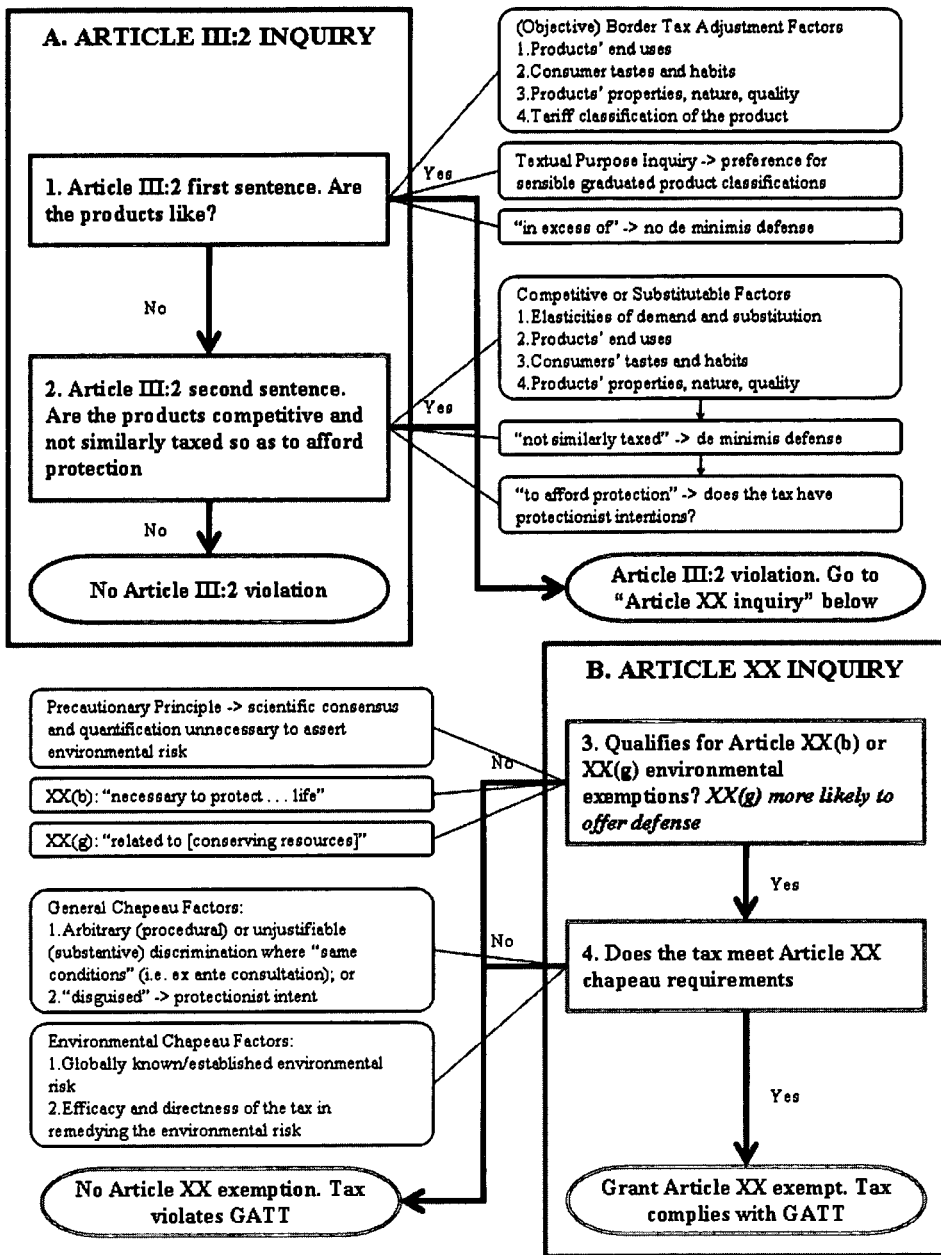


Figure 1: Multifactor Test Flowchart

Whether a green tax is entitled to an Article XX exemption depends on first, whether the green tax satisfies the requirements of one of Article XX's enumerated provisions and second, whether the green tax satisfies the

requirements of Article XX's chapeau. To satisfy Article XX(g), a green tax need only have a nexus to the environmental problem it seeks to remedy. Further, the WTO has ruled that "clean air" is an exhaustible resource within the meaning of Article XX(g), which opens the door for taxes that seek to improve fuel efficiency and air quality and decrease emissions.¹⁰⁶ The precautionary principle also eases the burden of proving the existence of the environmental risk. If a green tax meets Article XX(g)'s requirements, then the final hurdle to GATT compliance is whether the green tax satisfies Article XX's chapeau limitations. The chapeau bars green taxes that lead to (1) arbitrary or unjustifiable discrimination between countries where the same conditions prevail or (2) the green tax serves as a disguised trade restriction.

The WTO's adoption of the precautionary principle and Appellate Body's discussion in *EC-Asbestos* signal that environmental considerations may be given greater weight in future Dispute Body proceedings. Specifically, where (1) the environmental risk which the green tax purports to address is established as a matter of common global concern (for example, global warming), and (2) the green tax is direct and effective in addressing the environmental risk, the green tax will likely receive an Article XX exemption despite not strictly meeting chapeau requirements. The Dispute Body may use the foregoing two environmental factors in green tax disputes, as additional considerations in assessing whether a green tax complies with the chapeau.

VI. THE CHINA ENGINE SIZE TAX AS A HYPOTHETICAL TEST CASE

With increasing global concern over declining environmental protection, global warming, and energy shortages, it is anticipated that many nations will promulgate tax measures motivated by such concerns. These green taxes may create friction with WTO obligations. The previously discussed US gas guzzler tax, disputed in *US-Autos*, is just one example of a green tax creating friction with GATT provisions.

On August 21, 2008, China passed its own version of the gas guzzler tax ("engine size tax").¹⁰⁷ The measure imposes varying tax rates depending on a vehicle's engine size, measured in liters.¹⁰⁸ About a month earlier, on July 18, 2008, China lost its first WTO legal dispute. The WTO struck down a Chinese tax measure, which imposed a special 25 percent tariff on imported car parts, instead of the standard 10 percent rate, if the imported car parts made up more

¹⁰⁶ *US-Autos*, Report of the Panel ¶¶ 3.316–3.323.

¹⁰⁷ *Car Taxes in China*, *The Economist* (cited in note 1).

¹⁰⁸ *Id.*

than half the value of the vehicle.¹⁰⁹ The car parts tax was meant to encourage foreign automakers to use local suppliers and reduce imports.¹¹⁰ A month later, on August 21, 2008, China promulgated the engine size tax at issue. The engine size tax provides the following tax brackets:

Vehicle Engine Size (liters)	Tax Rate
4.1 or greater	40 percent
3.0 to 4.1	25 percent
1.0 to 3.0	8 to 10 percent
Less than 1.0	1 percent

Table 2: China's Engine Size Tax¹¹¹

China couched the engine size tax as a green tax.¹¹² Typically larger engines have lower fuel economy. By taxing larger engine vehicles at a higher rate, the hope is that consumers will purchase smaller engine vehicles with higher fuel efficiency and lower emissions. In light of China's burgeoning economy, energy efficiency is of the utmost concern. China's environmental record has been very poor, with cities suffering from dangerous levels of smog and pollutants.¹¹³ Of course, the engine size tax is not facially discriminatory, in contrast to China's car part import tax, which was previously struck down by the WTO. On its face then, the engine size tax is a domestic measure intended to serve laudable policy goals of environmental protection and energy efficiency.

As it turns out, the engine size tax disproportionately affects imports. The majority of large engine cars, those that will fit in the upper two tax brackets (taxed at 25 percent and 40 percent), are imports. Meanwhile, the majority of small engine cars are domestically produced. The market impact and dilemma is therefore identical to that discussed in the US gas guzzler tax dispute, where a facially neutral tax placed a larger tax burden on imports than on domestic products. Thus, while there is no facial or de jure discrimination, the engine size tax is de facto discriminatory and an Article III:2 challenge could be raised. In addition, some observers may find it suspect that China promulgated this green

¹⁰⁹ Id.

¹¹⁰ Id.

¹¹¹ Id.

¹¹² Id.

¹¹³ Joseph Khan and Jim Yardley, *As China Roars, Pollution Reaches Deadly Extremes*, NY Times (Aug 26, 2007), available online at <<http://www.nytimes.com/2007/08/26/world/asia/26china.html>> (visited Apr 22, 2009).

tax just a month following the WTO's rejection of its car part tax. Inferably, China is simply using the engine size tax to achieve the same protectionist goals as its car parts tax, in effect circumventing the WTO's decision striking down the car parts tax on Article III:2 grounds.

It was widely anticipated, at the time of the engine size tax's announcement, that China's engine size tax would face WTO opposition.¹¹⁴ At the time of this writing, no WTO complaint has been filed. However, a future complaint is still possible and, given Article III:2 precedent, may well prove successful. The following sections apply the proposed test from Section V to determine how the WTO should adjudicate a hypothetical dispute concerning the engine size tax. The reader may find it helpful to refer to Figure 1 to follow the steps of the analysis. Sections VI.A and VI.B will argue that the WTO should find that the engine size tax violates Article III:2's first sentence, but is entitled to an Article XX(g) exemption due to its environmental and conservation benefits. China's engine size tax should therefore be upheld as in compliance with the GATT.

A. THE CHINA ENGINE SIZE TAX LIKELY VIOLATES ARTICLE III:2

The WTO should find that the engine size tax violates Article III:2's first sentence. Article III:2's first sentence analysis here turns on whether the WTO will find large engine vehicles, primarily imported, are "like" smaller engine vehicles, which are primarily domestic. Using the border tax adjustment factors, large and small engine vehicles are "like." They have the same end uses and are competing goods with, other than engine size, similar physical characteristics and qualities. It is unlikely that car buyers make purchasing decisions directly based on engine size.

The best argument against finding "likeness" is that engine size is typically a proxy for other vehicle characteristics. Larger engine vehicles tend to be larger, heavier, and have worse fuel economy "unlike" smaller engine vehicles. However, I believe this argument is unavailing. First, consumers frequently choose between larger and smaller vehicles. They are competing products despite their differences in size and fuel economy. There is not a separate market for cars of differing sizes. Second, there is no necessary correlation between engine size and vehicle size. For example, many sports cars are small and lightweight but have large engines. On the basis of the border tax adjustment factors then, small and large engine vehicles are "like." Therefore, the tax will

¹¹⁴ *Car Taxes in China*, *The Economist* (cited in note 1).

lead to a disproportionately higher tax burden on imports, which tend to have larger engines in comparison to domestic Chinese vehicles.

The modern “like” analysis also requires a determination of the tax measure’s purpose, as determined by analyzing the text of the tax measure, its design and structure. If a tax measure creates arbitrary classifications with drastic differences in tax rates between classifications, then the WTO is more likely to find the tax has a protectionist purpose. By contrast, a tax measure with graduated tax brackets is more likely to be upheld by the WTO. Applying the purpose analysis for the engine tax does not lead to a clear conclusion. On the one hand, classifying vehicles by engine size is non-arbitrary. Taxing by engine size suggests intent to discourage production and consumption of large engine vehicles, which have lower fuel economy and higher emissions. On the other hand, the engine size tax only creates four categories, with drastic differences in tax rates (10 to 15 percent differences between categories, varying from a negligible 1 percent tax rate to a punitive 40 percent rate). However, the tax measure is less suspect than that found in *Chile–Alcoholic Beverages* where alcoholic beverages separated by 2.3 percent in alcohol content were separated by 20 percent in tax rates. The WTO will likely conduct a market analysis to check if the engine size cutoffs coincide with points at which imported vehicles become more or less common. For example, if foreign imports are suddenly more prevalent in the market at the 3.0 liter or 4.1 liter cutoff points, the WTO may find a protectionist purpose.

Given that the border tax adjustment factors favor a finding of “likeness” and the purpose inquiry is not dispositive, overall the WTO is likely to find the vehicles covered by the engine size tax are “like.” Since there is no *de minimis* defense for the first sentence and the engine size tax will tax foreign vehicles in an amount “in excess of . . . like” domestic vehicles, the engine size tax violates Article III:2 first sentence. Because violating either of the two sentences of Article III:2 leads to an Article III:2 violation, it is unnecessary to check if the engine size tax violates Article III:2’s second sentence.

The result here may seem at odds with *US–Autos*. The gas guzzler tax in that dispute classified vehicles by gas mileage. The Dispute Panel found that the tax did not violate Article III:2 and served non-protectionist objectives of improving fuel efficiency and environmental protections. There are two key distinctions between *US–Autos* and this hypothetical engine size dispute. First, in *US–Autos*, the Dispute Panel did not use the border tax adjustment factors to determine “likeness.” Rather, the panel employed the more subjective aims and effects test. The aims and effects test has been debunked since 1995 when the Appellate Body was established. Since that time, the more objective border tax adjustment factors have been used to assess “likeness.” Second, the gas guzzler tax featured far more graduated classifications (twelve categories in total), suggesting its objectives were indeed non-protectionist. Further, it might be

argued that engine size is not as direct a proxy of fuel emissions and efficiency as gas mileage in *US–Autos* or other measures, such as carbon dioxide emissions. China could easily have chosen to design its tax using these more direct measures. Its choice of engine size as the basis for classification weakens its argument that the tax has a non-protectionist purpose.

China's engine size tax is therefore in violation of Article III:2. China will likely assert an Article XX affirmative defense. An analysis of whether the engine size tax is entitled to an Article XX exemption follows.

B. THE CHINA ENGINE SIZE TAX LIKELY RECEIVES AN ARTICLE XX(G) EXEMPTION

The WTO should grant China's engine size tax an Article XX(g) exemption and uphold the tax measure. In reaching this decision, the WTO should first consider whether the engine size tax qualifies under any of Article XX's enumerated exemptions, and second, whether the tax satisfies Article XX's chapeau.

The engine size tax will likely meet Article XX(g)'s requirements. Articles XX(b) and XX(g) together embody the environmental exemption to the GATT. As discussed in Section III, Article XX(g)'s requirements are easier to satisfy than Article XX(b). Article XX(g), with its "relating to" language, merely requires a nexus between the disputed tax measure and the policy goal it seeks to achieve, in this case conserving clean air. Unlike Article XX(b) and its "necessary to" language, Article XX(g) does not require that the tax measure be the only feasible means of addressing the environmental risk and the environmental risk need not be urgent. Per the precautionary principle, China need not quantify or prove by scientific unanimity or majority consensus the existence of the environmental risk. In a nutshell, Article XX(g) does not provide very stringent requirements. China will probably argue that the engine size tax conserves "clean air," which the WTO in *US–Autos*,¹¹⁵ found was an exhaustible resource under Article XX(g). With respect to proving the environmental risk, China might cite studies and data demonstrating poor air quality in its major urban centers. Given that large engine vehicles tend to have worse fuel economy and higher emissions, there is an obvious nexus between the engine size tax and its purported policy objective of conserving clean air. Therefore, China's engine size tax should satisfy Article XX(g)'s requirements. To receive an Article XX exemption, the engine size tax must also comply with Article XX's chapeau. The next step then is to determine whether the engine size tax satisfies Article XX's chapeau limitations.

¹¹⁵ *US–Autos*, Report of the Panel ¶¶ 3.316–3.323.

The WTO should conclude the engine size tax fails to satisfy Article XX's chapeau limitations on grounds that it creates arbitrary or unjustifiable discrimination between nations where the same conditions prevail. Arbitrary discrimination is not relevant here since the tax depends purely on objective factors (in other words, engine size) and is not applied on a discretionary basis. Whether the tax creates unjustifiable discrimination will depend on the findings of a market impact analysis. If the disproportion is sufficiently severe as to be considered coercive, then the tax creates unjustifiable discrimination. Market impact depends on (1) what percentage are imports and what percentage are domestic for each of the four engine size classifications, and (2) the differential in tax burdens between classifications. The first factor will require investigation. If it turns out a large proportion of large engine vehicles are imported (for example, over 50 percent) while a small proportion of small engine vehicles are imported (for example, less than 2 percent), then this favors finding unjustifiable discrimination. The second factor is known based on the provided tax rates. Here, the differential in tax burden is high, varying from a negligible 1 percent rate to a punitive 40 percent rate. Assuming an investigation of the first factor reveals that imports are sufficiently more likely to be burdened by the higher tax brackets, the WTO should find unjustifiable discrimination.

Per *US-Shrimp*, the "same conditions" prong of the chapeau requires the promulgating nation to take into account the conditions and interests of other member states. The prong stands for the proposition that nations, prior to promulgating policies that are potentially discriminative, should provide notice and conduct good-faith consultations with other member states. China promulgated this tax measure suddenly and without prior notice or consultation with other WTO member states. This favors finding noncompliance with the chapeau's "same conditions" prong, and thus weighs against granting an Article XX exemption.

Article XX's chapeau also prohibits tax measures that are disguised restrictions on trade. This factor addresses the issue of intent and asks whether the tax measure was intended to achieve protectionist goals despite being couched as addressing non-protectionist concerns. The facts here are not dispositive. China announced the engine size tax just one month after its car part tax was struck down by the WTO. This fact, combined with the tax's likely disproportionate impact on imports, suggests the engine size tax was intended purely to circumvent the WTO's ruling on the car part tax. Such a result is precisely what the disguised restriction requirement seeks to prevent. However, China has a strong case that its engine size tax is not intended to circumvent the WTO's ruling. First, the single fact that the engine size tax was passed a month after the WTO struck down the car part tax cannot be considered direct evidence that the engine size tax was intended to circumvent the WTO's ruling. Second, China's poor environmental record and air quality is globally recognized

and a problem China's national government has made a priority. The passage of this engine size tax would appear to directly remedy this problem. Third, the engine size tax does not directly replace the car part tax. The two measures are not mutually exclusive and could exist alongside each other. The engine size tax pursues entirely different objectives from the car part import tax. Fourth, if China is able to demonstrate that the engine size tax does not result in discrimination against imported vehicles, or at least not nearly to the same extent as the car part tax, then this counters the argument that the engine size tax is meant to achieve the same protectionist goals as the car part tax. Overall, the WTO should find that the engine size tax violates the chapeau's traditional requirements. The tax creates unjustifiable discrimination between nations where the same conditions prevail.

However, because the engine size tax is a green tax, the Dispute Body will consider the two environmental factors discussed in Section V. The first question is whether the environmental risks, which the green tax purports to remedy, are globally established and acknowledged. The pertinent environmental risks here all relate to the effects of fossil fuel emissions, such as poor air quality and global warming. Additionally, the engine size tax should reduce demand for fossil fuel energy. These risks are all globally recognized.¹¹⁶ Hazardous air quality may be a more uniquely Chinese concern, but it is a problem to which the international community is attuned.

The second question is whether the engine size tax directly and effectively addresses the environmental risk. The directness requirement is likely satisfied. There is a sufficient nexus between discouraging production of large engine vehicles, which will reduce emissions, and improving air quality, reducing the global warming phenomena, and reducing demand for fossil fuels. Complainant nations may argue that engine size is not the most direct means of reducing emissions, and that a tax on emissions or gas mileage would be more direct. However, China would likely successfully counter that (1) the nexus between the engine size tax and the environmental risks is sufficient to satisfy the directness prong, regardless of whether alternative tax measures are arguably more direct, and (2) the engine size tax is cheaper to administer as compared to gas mileage or fuel emission based taxes, and is perhaps less prone to circumvention from auto manufacturers. The effectiveness prong is likely satisfied as well. The tax's wide gulf in rates, varying from 1 percent to 40 percent, should provide a strong impetus for domestic manufacturers to produce smaller engine vehicles, and foreign manufacturers to export smaller engine vehicles to China. Ironically, the

¹¹⁶ Elizabeth Rosenthal and Andrew C. Revkin, *Science Panel Calls Global Warming 'Unequivocal'*, NY Times (Feb 3, 2007), available online at <<http://www.nytimes.com/2007/02/03/science/earth/03climate.html>> (visited Apr 23, 2009).

drastic differential in tax rates, which previously favored finding an Article III:2 violation and unjustifiable discrimination in the Article XX inquiry, may weigh in China's favor here with respect to environmental factors.

In summary, China's engine size tax should be upheld by the WTO. The tax appears to violate Article III:2 and does not strictly satisfy Article XX's requirements. However, because the engine size tax is a green tax, the WTO will consider the environmental benefit of the tax. These environmental factors weigh in favor of granting an Article XX(g) exemption. This hypothetical example suggests that the majority of facially neutral and environmentally motivated taxes should receive an Article XX exemption in future disputes. China's engine size tax is actually a difficult case due to its unique facts. China promulgated the engine size tax just one month after its car part tax was struck down, creating suspicion that the tax was meant to circumvent the WTO's ruling. Furthermore, China's engine size tax creates drastic differences in tax burdens, which suggests the tax has protectionist purposes and may lead to a finding that the tax results in unjustifiable discrimination per Article XX's chapeau. Future WTO disputes alleging a green tax violates Article III:2 are unlikely to contain these two factual characteristics. The WTO, then, should uphold most green taxes as in compliance with the GATT.

VII. CONCLUSION

The WTO's existing jurisprudence indicates no clear guidelines or per se rules on whether internal taxes that are facially neutral, but potentially discriminatory in effect, violate Article III:2 of the GATT. The confusion over Article III:2's treatment of such taxes is problematic. In coming years, it is anticipated that many WTO countries will promulgate green taxes as a means of improving environmental protections and encouraging energy conservation. Many of these green taxes could disproportionately affect imports relative to domestically produced goods. If the WTO finds that many green taxes do violate Article III:2, this may place an undue and burdensome limitation on nations' autonomy to pursue legitimate domestic objectives of environmental protection and energy conservation. However, if the WTO establishes a per se rule that all facially neutral green taxes comply with Article III:2, member states may couch protectionist tax measures as environmentally motivated.

This Comment proposed a framework for the WTO to use in adjudicating future disputes concerning green taxes. Section II fleshed out relevant considerations the WTO will employ in determining a tax's compliance with Article III:2. Section III examined the WTO's jurisprudence on Article XX. Section IV presented the precautionary principle and its implications for future green tax disputes. Section V merged the previous three sections and proposed

the test the WTO Dispute Body will likely employ in adjudicating future green tax disputes.

Section VI applied the proposed test from Section V to a hypothetical dispute concerning China's recently announced engine size tax. The specific finding of Section VI was that the WTO should find that the engine size tax violates Article III:2 but should grant an Article XX(g) exemption due to its expected effectiveness in combating recognized environmental risks, including poor air quality and global warming. The broader conclusion of Section VI and this Comment was that green taxes should be upheld in future WTO disputes. The WTO is an international organization sensitive to modern policy concerns and the shared needs of its member states. The WTO's recent jurisprudence and adoption of the precautionary principle signal the WTO's willingness to accommodate national policies addressing environmental and conservation concerns. The WTO is unlikely to intrude into member nation's autonomy when their policies address these legitimate policy goals.