I. INTRODUCTION

There is a growing concern that carbon dioxide emissions could cause the greenhouse effect, which may be harmful to the environment. In order to slow down or eventually stop the development of the greenhouse effect, the carbon dioxide emissions have to be reduced. This could be done by using alternative energy sources such as water and the sun, or by using existing energy sources more efficiently. Imposition of a tax on energy as an economic disincentive is sometimes considered in order to encourage a more efficient use of energy. The idea is that people will consume less energy if they have to pay a tax on it. Both Japan and the United States have considered such energy taxes, but neither has pursued them due to concerns about their negative influence on the competitiveness of the energy industry.


2 See Guruswamy, supra note 1, at 271. For possible alternative energies, see Peters, supra note 1, at 71-72.

and their effectiveness in reducing the greenhouse effect.4

Despite the reluctance in Japan and the United States, the Commission of the European Community pursued its idea for such a tax. It was seen as an important step in realizing the goal of the EC to stabilize the carbon dioxide emissions by the year 2000 at the 1990 level. In accordance with this goal, the EC signed the Framework Convention on Climate Change.5 Shortly after the signature of this document, the Commission proposed to the Council of the EC to issue a directive introducing a tax on carbon dioxide emissions and energy at the community level.6 However, some of the member states had similar fears as Japan and the United States concerning the consequences of the tax on their industries, and opposed the proposal by the Commission.7 At the EC Summit in Essen in late-1994, the Council decided to abandon this proposal and instead invited the Commission to develop a new scheme which takes the concerns of the member states into

4 For a critical evaluation of the American plans from a trade perspective, see Karl D. Jackson, “Green” Protectionism, Clinton’s Hidden Tariff, WALL ST. J., May 24, 1993, at A10. See also Clean and Green, or Lean and Mean?, THE ECONOMIST, December 12, 1992, at 73.

5 United Nations Conference on Environment and Development: Framework Convention on Climate Change, Apr. 30 to May 9, 1992, 31 I.L.M. 849. One of the objectives of this convention was to stabilize the greenhouse gas concentrations in the atmosphere at a level which does not endanger the climate system. The EC committed itself to adopt policies and corresponding measures for the mitigation of climate change, recognizing that, inter alia, the reduction of carbon dioxide would contribute to the objective of the convention. Id. at 854, 856.

A convention aiming especially at the reduction of carbon dioxide was planned for the UN follow-up meeting of the Rio conference in Berlin from March 27 to April 7, 1995. This project failed due to the so far irreconcilable standpoints of the participating countries. The conference resulted only in a mandate for further negotiations regarding such a convention. See Caroline Möhring, Ziel Verfehlt, Aber ein Fundament für Künftige Bemühungen Geschäffen, FRANKFURTER ALLGEMEINE ZEITUNG, April 10, 1995, at 6.


7 See Environment Can Act As “Primary Lever” for EU Economic Growth, Paleokrassas Says, 17 INT’L ENVTL. REP. (BNA) No. 3, at 102 (February 9, 1994); Environment Ministers Claim Progress on Union-Wide Carbon Dioxide/Energy Tax. 17 INT’L ENVTL. REP (BNA) at 298 (April 6, 1994); Klimaschutz Entzweit die EU-Partner, FRANKFURTER ALLGEMEINE ZEITUNG, October 5, 1994, at 17; Die Europäische Union Nimmt Einen Neuen Anlauf zum Klimaschutz, FRANKFURTER ALLGEMEINE ZEITUNG, November 25, 1994, at 17.
The Commission responded with a new proposal, which was submitted to the Council in mid-1995. This new proposal provides for the taxation of fossil sources of energy, i.e., all solid, viscous or gaseous fuels, excluding renewable energy sources. Best described as an energy tax, it consists of two parts: one portion of the tax would be based on carbon dioxide emissions emanated at the combustion process of the energy sources, while the other part would be based on the calorific value of the energy sources.

Unlike the old proposal, the new proposal envisages a transitional period from January 1, 1996, to December 31, 1999, during which the member states are not bound by the tax rates specified in the proposal. Instead, these tax rates are purely meant as targets so that the member states are free to levy any rate which they deem appropriate. Only after the expiration of the transitional period shall a harmonized tax system be instituted within the EC.

The proposal is especially aware of the possible repercussions of the tax on those industries which need a great deal of energy to produce their products, such as the steel industry. If these industries had to bear the tax, their cost of production would increase substantially, leading to competitive disadvantages. Therefore, the proposal allows an exemption or an

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8 EU-Umweltminister für Energiesanierung, FRANKFURTER ALLGEMEINE ZEITUNG, December 17, 1994, at 14.
10 Changed Proposal, supra note 9, art. 3, at 11-14. Electricity and heat which are generated by water power plants of more than ten megawatt are subject to the tax according to Article 3(2). Id. at 13.
11 Id., art. 7, at 18.
12 Id., art. 8, at 5, 19; Considerations. Id. at 5.
13 Id., art. 8(3), at 21; Considerations. Id. at 5.
14 Considerations. Id. at 9.
15 For this reason it is sometimes asserted that commitments to reduce the carbon dioxide emissions by the industries concerned would be the better alternative. See Klaus R. Kabelitz, Kohlendioxid-/Energiesteuer - die Richtige Weichenstellung für Effizienten Klimaschutz?, 44 ENERGIEWIRTSCHAFTLICHE TAGESFRAGEN 264, 268-270 (1994). However, this assertion does not withstand critical evaluation. See IWH: Die Selbstverpflichtung Genügt Nicht, FRANKFURTER ALLGEMEINE ZEITUNG, June 8, 1995, at 15.
equivalent remission of the tax for the enterprises that consume high amounts of energy, in case distortions in the trade relations with other member states appear or if imports from non-member states increase.\footnote{16} Furthermore, attention has been paid to the energy-producing industry, since the tax would also be imposed on energy sources imported into the Community.\footnote{17} In other words, the proposal explicitly clears the way for tax adjustments which will equalize the anti-competitive consequences of this tax.

However, the possibility of tax adjustments has to be in accordance with the community law and international obligations of the EC. This article will address the questions arising out of the international obligations of the EC\footnote{18} and investigate whether these tax adjustments are compatible with the rules of GATT/WTO\footnote{19} that are binding upon the EC and its member states.\footnote{20}

\footnote{16} Changed Proposal, \textit{supra} note 9, art. 10(2), at 25. If the enterprises concerned make substantial efforts in reducing their carbon dioxide emissions or in saving energy, they could even benefit from total tax exemption or remission. \textit{Id.} art. 10(2), para. 2, at 25.

The proposal demands also for tax neutrality by stating that there shall be no increase in the total tax burden. Considerations. \textit{Id.} at 8. The former proposal made the introduction of the tax dependent on the implementation of such a tax or similar measures in the rest of the OECD member states. This provision is ruled out in the new proposal. \textit{Id.}, art. 1, at 9.

\footnote{17} \textit{Id.}, art. 4, at 14-15.

\footnote{18} For an assessment of the problems relating to environmental taxation at the EC level, see Eberhard Grabitz \& Christian Zacker, \textit{Scope for Action by the EC Member States for the Improvement of Environmental Protection under EEC Law: The Example of Environmental Taxes and Subsidies}, 26 COMMON MKT. L. REV. 423, 440-446 (1989).


\footnote{20} Even though the GATT 1947 had never been ratified by the EC, the European Court of Justice considered it binding upon the EC. See Cases 21-24/72, International Fruit Company NV v. Produktshap voor Groenten en Fruit, 1972 E.C.R. 1219. The Court held that "in so far as under the EEC Treaty the Community has assumed the powers previously exercised by the Member States in the area governed by the General Agreement, the..."
The justification for asking whether the proposed tax adjustments comply with GATT/WTO law lies in the fact that it is the most important international institution dealing with international trade.\textsuperscript{21}

The GATT/WTO has been challenged by the concern over the status and the future of the global environment\textsuperscript{22} since the beginning of the 1990s and was forced to take environmental issues into consideration.\textsuperscript{23} Yet, the provisions of that agreement have the effect of binding the Community.” \textit{Id.} at 1227. The EC has ratified the WTO Treaty. \textit{See} Focus (GATT Newsletter), Jan. 1995.


In his address to the World Economic Forum in Davos from January 28, 1994, the former Secretary-General of GATT/WTO, Peter Sutherland said that “[e]nvironmental policy-making is one of the most rapidly evolving areas of national and international policy-making, and it is entirely appropriate that emphasis should be placed now in GATT/WTO on ensuring better policy coordination and multilateral cooperation over the linkages between trade and environment.” News of the Uruguay Round, January 28, 1994, at 5.
impact on the relationship between trade and environment has been minimal so far, even after the Uruguay Round. That is why the GATT/WTO in its current shape is still the starting point for any evaluation of environmental measures affecting international trade.

The second part of this article shows which taxes are eligible under the GATT/WTO-regime for border tax adjustment (hereinafter BTA) and what requirements must be met for such BTA. The third part of this article explores whether the proposed European tax adjustments fit into the scheme demonstrated in the second part.

II. BORDER TAX ADJUSTMENT AND CORRESPONDING GATT/WTO RULES

A. Border Tax Adjustment

Article III:2 of GATT, on the one hand, enables the contracting parties to impose internal taxes on imported products. An interpretative note to Article XVI of GATT, on the other hand, provides that the exemption or remission of internal taxes for exported products is not a subsidy in terms of Article XVI:4 of GATT. Both provisions are interpreted as allowing BTA


27 Article III:2 of the GATT speaks of “internal taxes or other internal charges of any kind.” An internal charge is equivalent to an internal tax if it is imposed on both imported and domestic products, whereas a charge imposed solely on imported products is a custom. See JOHN H. JACKSON, WORLD TRADE AND THE LAW OF GATT 281, para. 12.3. (1969) [hereinafter LAW OF GATT]. Even if the internal charge is “collected or enforced . . . at the time or point of importation,” it is an internal tax pursuant to an interpretative note to Article III of GATT, Annex I, Ad Art. III, supra note 26.

28 GATT, Annex I, Ad Art. XVI, B.I.S.D., supra note 26, at 68.

29 B.I.S.D., supra note 26, at 27.
according to the destination principle.\textsuperscript{30} It means that imported products can be charged with the same amount of internal taxes as similar domestic products, whereas exported products can be relieved of the internal taxes borne by similar products destined for domestic consumption. Therefore, products are taxed at their place of destination, not at their place of origin. By removing the difference in tax burden between competing products, a neutrality of trade in goods is established,\textsuperscript{31} at least with respect to fiscal charges.

The remaining question is: which taxes are eligible for this kind of BTA? In other words, are all internal taxes eligible for BTA or only certain forms of internal taxes? Both Article III:2 of GATT and the interpretative note to Article XVI of GATT refer to "products." Thus, only taxes on products, i.e., indirect taxes, are eligible for BTA. These taxes include, for example, sales, excise, turnover, franchise and value added taxes.\textsuperscript{32} Taxes which are not imposed on products, i.e., direct taxes, are not eligible for BTA. These taxes include taxes on all sorts of income and on the ownership of real property.\textsuperscript{33}

One economic theory tried to explain the distinction made by the GATT between indirect and direct taxes on the ground that indirect taxes are shifted forward to the consumer, whereas direct taxes are not passed on into the price of a product.\textsuperscript{34} Yet, it is acknowledged today that even direct taxes are to a certain degree reflected in the price of a product.\textsuperscript{35} It is more likely that GATT made the distinction because indirect taxes were used for protecting domestic industries, whereas direct taxes were not.\textsuperscript{36} It was only possible to tax the imported goods through indirect taxes, since the

\textsuperscript{31} Report on BTA, supra note 25, at 99; Jackson, supra note 30, at 194.
\textsuperscript{33} Id.
\textsuperscript{34} Jackson, supra note 30, at 195.
production process of the imported products was beyond reach. Likewise, it was only possible to rebate the tax on exported goods, using indirect taxes, because a rebate of direct taxes would have had a general effect and would not be limited to those industries which should be subsidized. Additionally, it is easier to adjust indirect taxes than direct taxes for administrative purposes.

Once a tax has been clarified as an indirect tax eligible for BTA, the BTA for imported products must comply with the national treatment principle in Article III:2 of GATT, whereas the BTA for exported products must comply with the conditions of the interpretative note to Article XVI of GATT.

B. National Treatment of Imported Products

Article III of GATT secures the national treatment of the products of the contracting parties imported into the territory of other contracting parties with respect to internal taxation and regulations. The second paragraph of Article III of GATT deals with internal taxation of the contracting parties on the imported products from other contracting parties.

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37 Id.
38 Id.

The scope of Article 95 is, however, broader than that of Article III:2 of the GATT in two respects. First, products which are imported from nonmember states also enjoy the protection of Article 95, since Article 95 and Article 9(2) show that "products which are in free circulation are definitely and wholly assimilated to products originating in Member States." Case 193/85, Cooperativa Co-Frutta Srl v. Amministrazione Delle Finanzo Dello Stato, 1987 E.C.R. 2085, 2112. Furthermore, Article 95 as well as Article 113(1) of the EC Treaty, which confers the EC an exclusive authority in the area of commercial policy, demonstrate that "Member States cannot remain free to charge discriminatory taxation on products which originated in non-member countries but are in free circulation in the Community." Id. at 2113. Thus, "any interpretation of Article 95 which precluded it from applying to products in free circulation would lead to a result which would be contrary both to the spirit of the
1. Article III:2(1) of GATT

Article III:2(1) of GATT prohibits internal taxes on other member states' products from being "in excess of those . . . applied to like domestic products." Thus, products of a member state are protected against discriminatory charges by another member state. However, the national treatment of the imported products is guaranteed only if they are like domestic products. This does not mean that the imported and the domestic products have to be identical. They just need to be similar. In order to determine whether the imported product is a like domestic product, the Treaty expressed in Articles 9 and 10 and to the system of the Treaty."

Second, products which are exported from member states of the EC to other member states are equally protected by Article 95. The context of Articles 95-98 of the EC Treaty indicates "that the aim of the treaty in this field is to guarantee generally the neutrality of systems of internal taxation with regard to intra-community trade . . . ." Case 142/77, Statens Kontrol med Aedle Metaller v. Preben Larsen, 1978 E.C.R. 1543, 1558. Giving regard to this context and the purpose of Article 95 to ensure the free movement of goods between the member states of the EC, "it therefore seems necessary to interpret Article 95 as meaning that the rule against discrimination . . . also applies when the export of a product constitutes . . . the chargeable event giving rise to a fiscal charge." Id.

The difference in interpretations between Article III:2 of the GATT and Article 95 of the EC-Treaty, despite their almost identical wording, finds explanation in the integrated economic system of the EC, which is missing in the case of the GATT.

43 JACKSON, supra note 27, at 280, para. 12.3.
44 Panel Report on Japan, Customs Duties Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages, GATT Panel Rept. L/6216 (Nov. 10, 1987), B.I.S.D., 34th Supp., at 83 [hereinafter Japanese Tax on Alcoholic Beverages Case]. Since 1953, the contracting parties have utilized a "panel system" to complement Articles XXII and XXIII of the GATT, which provide for consultations and negotiations if there is any dispute about the application of the GATT rules. The dispute settlement procedure within the GATT was not a judicial review, *stricto sensu*, since the contracting parties were not bound by the reports of the panels. Nevertheless, the panels contributed considerably to the interpretation of the GATT provisios. See generally Werner Meng, *Streitbeilegung im GATT*, 41 ZEITSCHRIFT FÜR AUSLÄNDISCHES ÖFFENTLICHES RECHT UND VÖLKERRECHT 69 (1981). However, "Understanding of Rules and Procedures Governing the Settlement of Disputes," which is contained in the second Annex of the WTO, 33 I.L.M., supra note 19, at 1226, will lead to a more judicial character of the review by the panels. See Pierre Pescatore, *The GATT Dispute Settlement Mechanism: Its Present Situation and its Prospects*, 27 J. WORLD TRADE L. 5 (1993); see Stoll, supra note 21, at 266-277.

45 This is confirmed by the French text of the GATT which speaks of "produits similaires." See Japanese Tax on Alcoholic Beverages Case, supra note 44, at 113.
following criteria can be used: the product's tariff classification, the product's end-uses in a given market, the product's properties, nature, and quality, and the consumer's tastes and habits.\textsuperscript{46} The difference in the production process of a product cannot be taken into account for determining the likeness of the imported and the domestic product as long as this production process does not affect the product as such.\textsuperscript{47}

2. Article III:2(2) of GATT

Article III:2(2) of GATT also prohibits the application of internal taxes in a manner "so as to afford protection to domestic production."\textsuperscript{48} Compared to the first sentence, the second sentence of Article III:2 of GATT is based on a more general criterion, namely the protective nature of the system of


Article 95 of the EC Treaty is interpreted in the same way as Article III:2 of the GATT in this respect. Article 95 speaks of similar products, which means "that the application of that provision is based not on a strict requirement that the products should be identical but on their similarity." Case 148/77, H. Hansen Jun. & Balle GmbH & Co. v. Hauptzollamt Flensburg, 1978 E.C.R. 1787, 1806. This similarity in turn means that the products "have similar characteristics and meet the same needs from the point of view of consumers." Case 45/75, Rewe-Zentrale des Lebensmittelgroßhandels GmbH v. Hauptzollamt Landau/Pfalz, 1976 E.C.R. 181, 193.


\textsuperscript{48} \textit{Supra} note 25.
internal taxation. Article III:2(2) of GATT therefore applies only if the imported and the domestic products are not like products. In order to find out whether the imported and the domestic products are alike, Article III:2(1) of GATT has to be applied first. Article III:2(2) of GATT only comes into play if the examination of the specific case under Article III:2(1) of GATT reveals that the products are not alike.

However, Article III:2(2) of GATT lends its protection only to those products which are directly competitive or substitutable to domestic products which are not similarly taxed. Yet, if these requirements are met, Article III:2(2) of GATT is violated regardless of the quantitative trade effects, since Article III:2(2) of GATT protects "expectations on the competitive relationship between imported and domestic products rather than expectations on trade volumes."  

C. Exemption and Remission of Internal Taxes for Exported Products

1. Exemption of Internal Taxes

The interpretative note to Article XVI of GATT states that products can be exempted from internal taxes if such taxes are "borne by the like product when destined for the domestic consumption . . . ." Thus, three conditions must be met. First, only those internal taxes which are actually imposed on domestic products are exempted for exported products. Second, the exemption must not exceed the tax rate which is levied on the domestic products. Third, the exported and the domestic products must be alike.

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49 JACKSON, supra note 27, at 281, para. 12.3. The same difference is present in the relationship between the first and second paragraph of Article 95 of the EC Treaty.

50 Interpretative note to Article III of the GATT, Annex I, Ad Art. III, supra note 27, at 113. The protection of Article III:2(2) of the GATT in this regard is narrower than that of Article 95(2) of the EC-Treaty. Whereas Article III:2(2) of the GATT covers only directly competitive or substitutable products, "(t)he function of the second paragraph of Article 95 is to cover . . . all forms of indirect tax protection in the case of products which, without being similar within the meaning of the first paragraph, are nevertheless in competition, even partial, indirect or potential, with certain products of the importing country." Case 168/78, Commission v. French Republic, 1980 E.C.R. 347, 360 (emphasis added).


52 B.I.S.D., supra note 26, at 68.
which is the same requirement as in the case of national treatment requirement. There is no reason why the notion of likeness should mean something different in this context, since the exemption or remission of internal taxes is the counterpart to the imposition of internal taxes. Therefore, the same objective and subjective criteria that are in Article III:2(1) of GATT can be used to determine the likeness of the exported and the domestic products.

2. Remission of Internal Taxes

Pursuant to the interpretative note to Article XVI of GATT, internal taxes which are borne by like domestic products can be remitted for exported products if the remission is “not in excess of those [amounts] which have accrued [to the exported products].” Hence, three conditions have to be fulfilled here as well. First, internal taxes must have been imposed on the exported products. Second, the remission of these internal taxes must not exceed the amounts which were imposed on the exported products. And third, the same internal taxes are imposed on other like domestic products.

D. Border Tax Adjustment and Energy Taxes

1. Energy Taxes as Taxes on Inputs

As was previously discussed in Section II-A of this article, only indirect taxes are eligible for BTA. Since energy itself is a product, a tax on energy is a tax on a product, and therefore an indirect tax. As long as energy is traded as its own product, there are no difficulties in applying the BTA rules listed above to energy taxes. However, the application of the BTA rules to energy taxes is less obvious once energy is used to produce other products. In this case, a tax on energy is also a tax on the production process of those products, but not on the

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53 Supra notes 45-47 and accompanying texts.
54 See Report on BTA, supra note 25, at 100.
55 Supra note 46 and accompanying text.
56 Supra note 26, at 68.
57 As in the case of exemption of internal taxes, the notion of “like products” means the same as in the case of Article III:2(1) of the GATT. See supra notes 44-46 and accompanying texts.
products themselves. It is therefore questionable whether energy taxes are eligible for BTA under these circumstances.

In the Superfund Case, the GATT Dispute Panel concluded that a tax on an input is eligible for BTA. This approach might be transferable to energy taxes because energy is an input in the production process. The inputs in the Superfund Case were certain chemicals. These chemicals were taxed in the United States. At the same time, the United States Superfund Act imposed a tax on certain imported substances which were made from these chemicals. The amount of tax imposed on the imported substances was equal to the amount of tax which would have been imposed on the chemicals if they had been used in the United States in the production process of these substances.

The United States argued that the tax on the imported substances was eligible for BTA according to Article II:2(a) of GATT, which explicitly allows the imposition of a charge equivalent to an internal tax "in respect of an article from which the imported product has been manufactured or produced in whole or in part . . . ." The EC argued that the tax was inconsistent with the "polluter pays" principle. According to this principle, they argued, producers have already paid for the pollution created by the production process at the place of production. The GATT panel rejected the argument of the EC by saying that the GATT rules for BTA do not differentiate between taxes with different policy purposes. It did not

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59 Superfund Case, supra note 51.
60 Id. at 139.
61 Id. at 146.
62 Id. A charge is equivalent to an internal tax if it is imposed on the input of the imported product equal to the amount of tax which is imposed on the same input of the like domestic product. See the example from the drafting history of the GATT cited by the US.
63 Id. at 147. The EC pointed out that the polluter pays principle had been adopted by the OECD. Id. See David A. Wirth, A Matchmaker's Challenge: Marrying International Law and American Environmental Law, 32 VA. J. INT'L L. 377, 405 n.104 (1992).
65 Superfund Case, supra note 51, at 161. See also US Tuna Ban Case, supra note 47. The panel noted that "a contracting party may not restrict imports of a product merely because it originates in a country with environmental policies different from its own." Id. at
therefore examine whether the tax imposed on the imported substances served environmental purposes. But the panel noted that the contracting parties are free to follow the "polluter pays" principle for domestic production.\textsuperscript{66} With respect to the question whether the tax imposed on certain imported substances was eligible for BTA, the panel endorsed the reasoning of the United States, stating that the tax was imposed directly on products and therefore eligible for BTA.\textsuperscript{67}

However, the \textit{Superfund Case} dealt with inputs which were physically incorporated in the imported product. Energy, in contrast, is an input which is consumed during the production process and therefore not physically incorporated in the product. Thus, the ruling of the GATT panel in the \textit{Superfund Case} is not exactly transferable to energy taxes.\textsuperscript{68}

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\textsuperscript{66} Superfund Case, \textit{supra} note 51, at 161. In the US Tuna Ban Case, \textit{supra} note 47, at 204, the panel observed that the GATT imposes "few constraints on a contracting party's implementation of domestic environmental policies" as long as the imported products are treated as domestic products.

Peter Sutherland reminded the contracting parties to "respect the fact that different countries have different environmental priorities and different environmental endowments, and they are not, and should not be, expected to all meet the same environmental standards . . . ." \textit{Supra} note 23, at 6.

\textsuperscript{67} Superfund Case, \textit{supra} note 51, at 161.

\textsuperscript{68} The Working Parties in their report on BTA noted "that there was a divergence of views with regard to the eligibility for adjustment of certain categories of tax," including taxes on energy, \textit{supra} note 25, at 101. Yet, they felt that "the importance [of this area of taxation] was not such as to justify further examination." \textit{Id.}
2. Taxes on Physically Incorporated and Not Physically Incorporated Inputs

a. Inputs of Imported Products

With respect to imported products, Article III:2 of GATT allows BTA for indirect taxes which are applied "directly or indirectly" to like domestic products. It can be inferred from this provision that taxes on inputs of imported and like domestic products are eligible for BTA because they are indirect taxes indirectly applied to products. However, Article III:2 of GATT does not answer the question whether the taxed inputs have to be physically incorporated into the products. Instead, the context of Article II:2(a) of GATT shows that only taxes on inputs "from which," and not "with the help of which," the imported and the like domestic products have been produced are eligible for BTA, indicating that only taxes on the inputs physically incorporated into the products can be adjusted. Since energy taxes are taxes on inputs not physically incorporated into the products, they cannot be imposed on imported products.

b. Inputs of Exported Products

With respect to exported products, the interpretative note to Article XVI of GATT allows BTA for indirect taxes which are "borne" by the like domestic products. It can be inferred from this note that taxes on inputs of the exported products are eligible for BTA, since they are indirect taxes borne by the like domestic products. But as with Article III:2 of GATT, the note is inconclusive as to the question whether these inputs have to be physically incorporated into the products. Yet, the 1979 GATT Subsidies Code revealed that even under the old GATT regime certain taxes imposed on inputs not physically incorporated into the exported or the like domestic products were eligible for BTA.

The "Illustrative List of Export Subsidies" annexed to the 1979 GATT

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69 Demaret & Stewardson, supra note 39, at para. 29.
71 Id.
72 B.I.S.D., supra note 32.
Subsidies Code\textsuperscript{73} distinguished between two types of taxes: value-added taxes (VAT) in paragraph (g) and prior stage cumulative taxes in paragraph (h). Paragraph (g) prohibited exemption or remission of VAT with respect to the production of the exported products in excess of those imposed on the production of the like domestic products. Paragraph (h) allowed exemption or remission of prior stage cumulative taxes with respect to the goods that were physically incorporated into the exported products even if these taxes were not exempted or remitted for physically incorporated inputs of the like domestic products.

Taking into account the nature of a VAT, paragraph (g) could be read to allow the exemption or remission of VAT for all types of inputs in exported products, even if these inputs were not physically incorporated into the product,\textsuperscript{74} provided that the exempted or remitted VAT does not exceed the VAT on the inputs of like domestic products. Paragraph (h), however, allowed the exemption or remission of prior stage cumulative taxes only for those inputs which were physically incorporated in the exported product.

Energy taxes are neither VAT nor prior stage cumulative taxes. Instead, they are excise taxes, which are a typical form of specific taxes. Under the old GATT regime, specific taxes were treated as prior stage cumulative taxes\textsuperscript{75} so that they could only be adjusted if they were imposed on incorporated inputs of the exported products. Thus, energy taxes could not be exempted or remitted for exported products according to paragraph (h) of the 1979 GATT Subsidies Code.

The "Agreement on Subsidies and Countervailing Measures" contained in the first Annex of the WTO\textsuperscript{76} (hereinafter 1994 GATT Subsidies Code) does away with the clash between the VAT and prior stage cumulative taxes. Paragraph (h) of the "Illustrative List of Export Subsidies"\textsuperscript{77} annexed to the 1994 GATT Subsidies Code provides for the exemption or remission of prior stage cumulative taxes imposed on the inputs that are consumed during the

\textsuperscript{73} Id., at 80-81.
\textsuperscript{74} Demaret & Stewardson, supra note 39, at para. 32.
\textsuperscript{75} Id. para. 34.
\textsuperscript{77} Id.
production process of the exported product. Thereby, this provision abolishes the requirements of the 1979 GATT Subsidies Code that the inputs have to be physically incorporated. Yet, the potential range of the new paragraph (h) is somewhat diminished by footnote 59 to the “Guidelines on Consumption of Inputs in the Production Process,” also annexed to the 1994 GATT Subsidies Code. Footnote 59 states “[i]nputs consumed in the production process are inputs physically incorporated, energy, fuels and oil used in the production process and catalysts which are consumed in the production process and catalysts which are consumed in the course of their use to obtain the exported product.” Nonetheless, it appears that the gap between the VAT and prior stage cumulative taxes is closed for the inputs listed in footnote 59. Since specific taxes have been treated as prior stage cumulative taxes, energy taxes are eligible for BTA with respect to exported products pursuant to the 1994 GATT Subsidies Code.

III. EVALUATION OF THE PROPOSED EUROPEAN ENERGY TAX IN LIGHT OF THE GATT/WTO RULES ON BORDER TAX ADJUSTMENT

A. Tax Adjustment on the Import Side

Article 4 of the proposed directive states that generation of energy sources within the Community or their importation into the Community constitutes a chargeable event. Article 4 concerns the taxation of energy as an imported product of its own, not as an input for the production process of other imported products. Hence, the national treatment principle of Article III:2(1) of GATT must also apply here, that is, the tax rate imposed on imported energy sources should not exceed the rate which is levied on like domestic energy sources.

Article 4 refers to Article 3 for the taxable energy sources which does not differentiate between energy sources imported from the third countries and the ones from the member states of the EC. The energy sources from

78 Id.
79 The Office of the U.S. Trade Representative maintains the position, however, that “[i]t was never intended to fundamentally expand the right of countries to apply border adjustments for a broad range of taxes on energy . . . .” US Secures Agreement not to use GATT to Allow Energy Tax Rebate, INSIDE US TRADE, Jan. 28, 1994.
80 COM (95) 172 final, supra note 9, at 19.
81 See supra notes 42-47 and accompanying text.
82 Amended Proposal, supra note 9, at 11-14.
third countries are subject to the same rate of taxation as the taxed energy sources from within the Community. Article 8(3)\textsuperscript{83} of the proposed directive contains the applicable tax rates. Thus, insofar as the proposed directive provides for tax adjustment on the import side, it is compatible with the GATT/WTO rules for the BTA.

However, the tax rates specified in the directive are only suggested targets, and the member states are not bound by them. If the member states should decide to apply tax rates other than the suggested ones, they would have to refrain also from discriminating against energy sources from third countries. 

B. Tax Adjustment on the Export Side

Article 9(2)\textsuperscript{84} of the proposed directive allows the member states to exempt or remit the energy tax for enterprises with high energy consumption under certain conditions.\textsuperscript{85} It does not concern energy as an exported product,\textsuperscript{86} but only as an input in the production process of other exported products. This is so because the tax rebate will lessen the tax on the exported products which are made through the use of the energy. This is different from Article 4, which does not lead to a tax increase for imported products other than energy sources.

Since Article 9(2) makes no distinction between energy which is used in the production process of products for domestic consumption and products destined for exportation, it is submitted, \textit{argumentum e contrario}, that the provision embraces both categories. Thus, the tax adjustment provided in Article 9(2) has to comply with the BTA rules for taxes on inputs not physically incorporated into exported products. Two situations have to be differentiated in this regard: exportation to third countries and exportation to other member states.

\textsuperscript{83} Id.
\textsuperscript{84} Id. at 24 and accompanying text.
\textsuperscript{85} See supra note 16 and accompanying text.
\textsuperscript{86} It is interesting to note that the proposed directive does not envisage a tax adjustment for energy sources which are destined for exportation. This would be possible if the exemption or remission of tax was not in excess of the tax rate which is imposed on like domestic energy sources. See supra notes 52-57 and accompanying text.
1. **Exportation to Third Countries**

Under the old GATT regime the exemption or remission of the European energy tax would not have been compatible with the GATT rules for the BTA, since these rules allowed the exemption or remission of specific taxes only for inputs which were physically incorporated in exported products.\(^{87}\)

According to the 1994 GATT Subsidies Code,\(^{88}\) the exemption or remission of the European energy tax is now possible. The 1994 GATT Subsidies Code considers the energy used in the production process to be an input consumed in the production process.\(^{89}\) Prior stage cumulative taxes on such inputs are eligible for BTA pursuant to paragraph (h) of the "Illustrative List of Export Subsidies" annexed to the 1994 GATT Subsidies Code.\(^{90}\) Since specific taxes have been treated so far as prior stage cumulative taxes, the European energy tax would also be eligible for BTA with respect to the exported products to third countries.

2. **Intra-Community Exportation**

Even under the former GATT system the exemption or remission of the European energy tax would have been possible in intra-community exportations, since it would have been an *inter se* modification of the GATT rules for BTA, and would not have infringed upon the rights of the other GATT member states.

Article 41 of the Vienna Convention on the Law of Treaties [hereinafter Vienna Convention] provides the possibility for two or more parties to a multilateral treaty to modify the treaty as between themselves if "the possibility of such a modification is provided for by the treaty . . . ."\(^{91}\) There is a problem in applying this rule here, however, because Article 4 stipulates that Vienna Convention is only applicable to the treaties concluded after the its entry into force.\(^{92}\) As the Vienna Convention entered into force

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\(^{87}\) *See supra* note 75 and accompanying text.

\(^{88}\) *Supra* note 76.

\(^{89}\) *See supra* notes 78-79 and accompanying text.

\(^{90}\) *See supra* notes 78-79 and accompanying text.


\(^{92}\) Vienna Convention, *supra* note 91, at 334.
in 1980, it would be inapplicable to GATT which has existed since 1948. Nonetheless, the rule in Article 41 of the Vienna Convention should be applicable here, since Vienna Convention reflects either the existing customary international law or is a presumptive evidence for emerging customary international law. Thus, the modification of the GATT rules for BTA by the EC as between its member states is possible according to the rule in Article 41 of Vienna Convention if GATT provides for such *inter se* modification.

Article XXIV:5(a) of GATT allows formation of customs unions if "the duties and other regulations of commerce imposed at the institution of any such union . . . in respect of trade with contracting parties not parties to such union . . . shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union . . . ." It can be inferred from this provision that Article XXIV:5(a) of GATT allows *inter se* modification of the GATT rules within a customs union as long as other member states not parties to the customs union enjoy the rights appertaining to them under GATT in their trade relations with the customs union.

Since the EC is a customs union under the terms of Article XXIV:8 of GATT, it can modify the GATT rules as between the EC member states as long as this *inter se* modification does not affect the rights of the other GATT member states in their trade relations with the EC. Thus, the EC could have exempted or remitted its energy tax even under the former GATT regime. With the entry into force of the 1994 GATT Subsidies Code, however, it is not necessary to rely upon this *inter se* modification because the European energy tax would now be eligible for BTA with respect to products exported within the Community.

93 *Id.* at 331. No 1.
94 See supra note 19. The incorporation of the GATT into the WTO does not make it to a new treaty concluded after the entry into force of the Vienna Convention.
96 *Supra* note 26, at 42. "Understanding on the Interpretation of Article XXIV of the GATT 1994", *supra* note 19, at 1161, does not change the content of Article XXIV:5(a), but instead offers an assessment method for evaluating the "general incidence of the duties and other regulations of commerce applicable before and after the formation of a customs union." *Id.*
97 *Supra* note 26, at 43.
IV. CONCLUSION

The GATT/WTO treats taxes on not-physically incorporated inputs of the imported and like domestic products differently from taxes on not-physically incorporated inputs of exported and the like domestic products. This is not consistent with traditional BTA rules which apply equally to imported and exported products. This inconsistency is not a mere theoretical concern, but has practical consequences. If energy taxes are introduced in some countries, but not in others, the domestic products of those countries which have imposed such taxes will be in a competitive disadvantage to like imported products of those countries which have not imposed such taxes.

This result may prevent the introduction of energy taxes. But since energy taxes are a useful tool in the struggle for a cleaner environment, it is important to allow BTA not only for taxes on energy consumed in the production process of exported and like domestic products, but also for taxes on energy consumed in the production process of imported and the like domestic products. Another alternative would be to abolish the instrument of BTA as a whole and to apply the "polluter pays" principle. This would simplify administrative procedures and would eliminate a potential means of trade discrimination. The burden to address this important issue lies in the hands of the WTO Committee on Trade and Environment which substituted the GATT Working Group on Environmental Measures and International Trade.98

The European energy tax proposal of the Commission deserves support insofar as it makes the introduction of the energy tax not dependent on the introduction of the tax in other OECD member states. Since four of the seven largest industrialized countries are members of the Community, the European energy tax would have an ecological impact even without a similar tax in other OECD member states. Yet, this does not mean that the EC should not pursue the aim of introducing such a tax in the rest of the OECD states. The Commission is also correct in not relying on commitments of industries alone to reduce carbon dioxide emissions because the energy tax would be more effective in reducing the carbon dioxide emissions than commitments of the industries concerned.

On the other hand, it would be better if the Commission tried to introduce a harmonized energy tax at once, although such a project is not likely to be realized right away due to the resistance by some member states. The fact that the proposed tax rates for energy sources are not mandatory threatens

98 See supra note 23.
the effectiveness of the energy tax. Some member states may levy too low tax rates to accomplish the desired ecological effect, and adherence by only a few member states would not be enough to reduce the carbon dioxide emissions. Furthermore, the administrations of the member states as well as the industries concerned would not have to adjust to different tax regimes if the Commission proposed a harmonized tax system.

99 See Ein Nationaler Alleingang bei der Energiesteuer ist Nicht Sinnvoll, FRANKFURTER ALLGEMEINE ZEITUNG, November 22, 1994, at 15.