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IN THE INTERNATIONAL COURT OF JUSTICE

PEACE PALACE, THE HAGUE

THE NETHERLANDS

THE CASE CONCERNING THE DIFFERENCES BETWEEN THE STATES ARISING OUT OF THE INTERPRETATION OF THE RAZVANA FREE TRADE AGREEMENT.

THE INDEPENDENT REPUBLIC OF AZANIA

APPLICANT

V.

THE REPUBLIC OF ENRODA

RESPONDENT

MEMORIAL FOR THE APPLICANT

THE INDEPENDENT REPUBLIC OF AZANIA

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List of Abbreviations

¶	Paragraph
ADA	Agreement on the Implementation of Article VI of the General Agreement on Tariffs and Trade, 1994. Also known as Anti Dumping Agreement
ARO	Advance Release Orders
BTAs	Border Tax Adjustments
CCRA	Commissioner of Customs and Revenue
CVD	Countervailing Duty
DEPB	Duty Entitlement Pass Book
FTZ	Free Trade Zone
GATT	General Agreement on Tariffs and Trade, 1994
GOI	Government of India
OECD	Organization for Economic Cooperation and Development
PPM	Process and Production Methods
RATG	Razvana Agreement on Trade in Goods
RFTA	Razvana Free Trade Agreement
RSCM	Razvana Agreement on Subsidies and Countervailing Measures
SCM	Agreement on Subsidies and Countervailing Measures
SION	Standard Input- Output Norms
TVA	Total Value Added
UNFCCC	United Nations Framework Convention on Climate Change
WTO	World Trade Organization

Index of Authorities

ARTICLES, PAPERS AND REPORTS

1. Border Tax Adjustments: Report of the Working Party adopted on 2 December 1970
2. Hoda, Anwarul, Agreement on Subsidies and Countervailing Measures: Need for clarification and improvement, Working Paper No. 101, May, 2003, Indian Council for Research on International Economic Relations.
3. Trade and Climate Change, report by the United Nations Environment Programme And the World Trade Organization, 2009

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2. *Brazil - Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R.
3. Appellate Body Report on *Canada — Aircraft*, WT/DS70/AB/RW
4. *Canada— Autos*, WT/DS142/AB/R
5. *Chile — Alcoholic Beverages*, WT/DS87/AB/R
6. Appellate Body Reports on *Japan — Alcoholic Beverages II*, WT/DS11/AB/R
7. *Korea – Various Measures on Beef*, DS161/AB/R and DS169/AB/R.
8. *US — FSC (Article 21.5 — EC*, WT/DS108/AB/RW
9. *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R (12 October 1998)
10. Appellate Body Report on *US — Lead and Bismuth II*, WT/DS138/AB/R
11. *United States - Standards for Reformulated and Conventional Gasoline* WT/DS2/AB/R

PANEL REPORTS

1. *Brazil — Aircraft (Article 21.5 — Canada II)* , WT/DS46/RW/2
2. *Canada — Aircraft Credits and Guarantees*, WT/DS222/R .

3. *EC — Bed Linen (Article 21.5 — India)*, WT/DS141/RW
4. *EC — Tube or Pipe Fittings*, WT/DS219/R
5. *Thailand — H-Beams*, WT/DS122/R
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3. *United States - Restrictions on Imports of Tuna*, GATT B.I.S.D. (39th. Supp.) at 155 (1993)

TREATIES AND AGREEMENTS

1. Anti- Dumping Agreement
2. Agreement on Subsidies and Countervailing Measures

WEBSITES

1. http://www.wto.org/english/res_e/booksp_e/analytic_index_e/subsidies_01_e.htm#article2
   (as visited on 18.12.2009 at 1500 hrs)
2. http://www.wto.org/english/tratop_e/envir_backgrnd_e/c3s3_e.htm,
   (as visited on 12.12.2009 at 1500hrs.)

Statement of Jurisdiction

The Independent Republic of Azania and the Republic of Enroda have submitted the present dispute to the International Court of Justice pursuant to the Joint Notification, dated August 1, 2009 along with the Compromis dated July 15, 2009.

The Court has jurisdiction to decide the present case under Article 36 of the Statute of the International Court of Justice, 1950 read along with Article 27 of the Agreement on Settlement of Disputes arising out of the Razvana Free Trade Agreement.

The Court's jurisdiction has been invoked under the provisions of Article 40(1) of the Statute of the International Court of Justice, 1950.

The Parties have agreed to act in accordance with the findings and conclusions of the Court.

Statement of Facts

BACKGROUND:

The continent of Razvana comprises the independent nation states of Elduars, Randaz, Senteranna, Azania and Enroda, all located in close geographical proximity to each other facilitating regional trade and interdependence amongst states in the region. These nation states concluded the Razvana Free Trade Agreement (RFTA) in 1997 to regulate their regional trade.

The Republic of Azania ("Azania") is a developing nation rich in natural resources, however their commercial exploitation started late in the 1950's. It was not industrialized and there existed large scale violence and corruption till the 1970's. The Republic of Enroda ('Enroda") is a developed nation neighbouring Azania. It is much larger in size, however has extremely limited natural resources. For centuries, it has imported Diamonds and Iron ore from Azania and converted it into finished product at very low prices leading to particularly high profit margins of Enrodean enterprises.

INDUSTRIALIZATION OF AZANIA:

The Azanian Government through the Industrial Policy 1976 put forth a framework of industrialization in order to increase the number of industries especially in iron and steel to ten times its present number. As a result, the Iron ore exported to Enroda at cheap prices began to be consumed in the domestic industry of Azania. This lead to the enormous growth and economic prosperity in Azania. The per capita income which had been abysmally low increased three times over a short period of ten years. However, this lead to degradation of the environment as the energy resources for the industry was met through the burning of coal and natural gas in the country making one of the largest emitters of green house gas.

ENVIRONMENTAL OBLIGATIONS:

Azania signed and ratified the United Nations Framework Convention on Climate Change, 1995 as a non Annex I member country. The Government in 2003 introduced the Climate Change Executive Order, 9288 which introduced certain regulations with an objective of limiting emission of green house gases.

As a result of Azania's industrialization, the supernormal profits made by manufacturers in Enroda have eroded and by 1992 exports of steel from Azania had started to compete with exports from Enroda in third country markets. Furthermore as a result of the environmental regulations and Carbon tax imposed, the production costs of the Enrodean industries increased.

FREE TRADE ZONES:

In order to revive the Enrodean supremacy in the international steel market, the government set up Free Trade Zones ("FTZ") regulated by the Free Trade Zones Act 2000, passed by the Parliament of Enroda. Manufacturing units located in the FTZ would be allowed to import inputs used in the manufacturing process without payment of customs duty or any duty applicable on imports as long as he final product was destined for exports. As a result, the cost of production decreased significantly while exports increased by almost five times. The cheap exports from Enroda started to displace steel manufactured in Azania not only from third country markets but also the domestic market in Azania.

COUNTERVAILING DUTY:

Due to the surge in steel imports from Enroda, the Azanian Commission, on the domestic manufacturers of Azania initiated a countervailing duty investigation against steel import from Enroda. Probing allegations of prohibited export subsidies under the Razvana Agreement on Subsidies and Countervailing Measures as well as allegations that the FTZ ACT did precious little to ensure that the duty exempt raw materials imported into the FTZ was used for the manufacture of destined exports thereby avoiding the possibility of excess remission.

The Commission determined that the exemption of duty on raw materials for steel manufactured in an FTZ did indeed comprise a prohibited export subsidy. It was further established that the subsidized import of steel from Enroda had caused material injury to the domestic industry of Azania. A countervailing duty of sixty percent – eighty percent was imposed on three exporters of steel products from Enroda.

The Trade Minister of Enroda in a sharp response to the same affirmed that duty exemption in goods destined for exports were accepted norms of international trade accepted by international trade organizations. Consultations were initiated between Enrodean and Azanian authorities; however they did not make much headway with both countries remaining adamant about their positions.

IMPOSITION OF CARBON TAX:

On 25th November 2008 the Carbon Tax Regulation Act was passed by the Enrodean Parliament, providing for the imposition of a carbon tax on imports of goods equivalent to the level of tax charged to the domestic industry of the like goods. This tax was to be charged to all nations included in Annex I of the UNFCCC, developed nations not part of the UNFCCC as well as developing nations in an advance stage of development including Azania.

The Minister for Trade of Azania in response described the Carbon Tax Regulation Act as nothing more than a disguised barrier to trade, a violation of the scheduled commitments undertaken by Enroda and a reaction to the justified steps taken by Azania to impose countervailing duties on subsidized steel from Enroda.

SETTLMENT OF DISPUTE:

Hoping to arrive at an amicable settlement to the trade dispute, consultations, negotiations and mediations were held between the two states, however they made little headway. Following their failure to resolve the dispute both parties agreed to submit their dispute to the International Court of Justice on March 2009 and be bound by the Judgment of the court.

Issues Raised

1. **The duty exemptions on import of raw materials for the steel industry is a subsidy prohibited under the Razvana Agreement on Subsidies and the imposition of countervailing duties is consistent with the provisions of the Agreement.**

    1.1 The exemption of import duty is a subsidy

    1.2. The import duty exemption is a specific subsidy

    1.3 The Subsidy is a Prohibited Export Subsidy

    1.4. Imposition of Countervailing duties is consistent with the provisions of the Agreement

2. **The imposition of a border tax on imports is in violation of the market access commitments undertaken by Enroda and is not justified by the General Exceptions to the Razvana Agreement on Trade in Goods**

    2.1 That the imposition of a border tax on imports is in violation of the market access commitments undertaken by Enroda

    2.2 That the imposition of border tax on imports is not justified by the General Exceptions to the Razvana Agreement on Trade in Goods

Summary of Arguments

ISSUE 1:

The duty exemptions on import of raw materials for the steel industry is a subsidy prohibited under the Razvana Agreement on Subsidies and the imposition of countervailing duties is consistent with the provisions of the Agreement.

1.1 The Subsidy is a Prohibited Export Subsidy

The import duty exemption is a subsidy under Article 1 of the Agreement as it confers a financial contribution and also a benefit upon the recipient. Also it is a prohibited export subsidy under Article 2.3 of the Agreement as it is contingent upon export performance and also it is covered under item (i) of Annex I and allows for excess remission due to non-compliance with the guidelines of Annex II relating to consumption of inputs in the manufacturing of exported products.

1.2. Imposition of Countervailing duties is consistent with the provisions of the Agreement

The imposition of countervailing duties is consistent with the provisions of the Agreement as there exists a specific subsidy, the subsidised imports have caused material injury to the domestic market of Azania and also there exists a causal link between the subsidised imports and the material injury caused.

ISSUE 2:

The imposition of a border tax on imports is in violation of the market access commitments undertaken by Enroda and is not justified by the General Exceptions to the Razvana Agreement on Trade in Goods.

2.1 That the imposition of a border tax on imports is in violation of the market access commitments undertaken by Enroda.

2.1.1 That the imposition of a border tax on imports is in violation of Article IV.2 of the Razvana Agreement on Trade in Goods.

Article IV.2 permits a product tax but not a process tax. The tax adjustment sought to be done by Enroda is in relation to the tax which Enroda calls a Carbon tax which is charged on actual usage of coal, oil and other fossil fuels at a fixed rate. This qualifies as a process tax as opposed to a product tax (which is allowed under the above Article). Under existing GATT rules and jurisprudence, 'product' taxes and charges can be adjusted at the border, but 'process' taxes and charges by and large cannot. For example, a domestic tax on fuel can be applied perfectly legitimately to imported fuel, but a tax on the energy consumed in producing a ton of steel cannot be applied to imported steel.

2.1.2 That the imposition of a border tax on imports is in violation of Article III.2(a) of the Razvana Agreement on Trade in Goods.

By no stretch of imagination, can the fuel used in the process of production of a particular product be considered to be *an article from which the imported product has been manufactured in whole or in part* as used in the Article above. Thus, the border tax on imports fails to satisfy this requirement and is thus illegal.

2.1.3 That the imposition of a border tax on imports is in violation of Article IV.1 of the Razvana Agreement on Trade in Goods.

Imposing the carbon tax on imports of products from Azania will lead to a situation where the domestic goods of Enroda will gain an advantage and hence, this policy measure is violative of Article IV of RATG.

2.2 That the imposition of border tax on imports is not justified by the General Exceptions to the Razvana Agreement on trade in Goods.

2.2.1 That the imposition of the border tax on imports is in violation of the chapeau of Article XX of the Razvana Agreement on Trade in Goods.

Rigidity and inflexibility in the application of the measure (e.g. by overlooking the conditions in other countries) constituted unjustifiable discrimination which is a requirement for the chapeau of Article XX to be satisfied. Enroda by unilaterally imposing the border tax on imports from Azania without entering into good faith negotiations over the same with Azania have violated the chapeau of Article XX of the RATG.

2.2.2 Arguendo the chapeau of Article XX was met, Enroda still has to establish that its measure falls under at least one of the exceptions under Article XX.

A connection needs to be established between its stated climate change policy goal and the measure at issue. In the present matter, Enroda has failed to demonstrate how its policy measure of imposing a border tax on the imports is related to achieving any of the environmental goals under Article XX of the RATG. In the absence of this link being established, the measure cannot be justified under Article XX.

2.2.3. That there are lesser trade restrictive measures which could have been applied by Enroda towards achieving the environmental objective under Article XX.

The Kyoto Protocol includes three "flexibility mechanisms" namely, Emission Trading, Joint Implementation, and the Clean Development Mechanism (CDM) to help parties meet their obligations and achieve their emission reduction commitments in a more cost efficient manner and less trade restrictive manner (as compared to imposition of a carbon tax and consequently border tax adjustment). Either of these mechanisms would have been less trade restrictive than the border tax on imports and hence the border tax on imports policy cannot be justified under Article XX of the RATG.

Arguments Advanced

1. The duty exemptions on import of raw materials for the steel industry is a subsidy prohibited under the Razvana Agreement on Subsidies and the imposition of countervailing duties is consistent with the provisions of the Agreement.

It is contended that the duty exemptions on import of raw materials for the steel industry is a prohibited export subsidy under the Razvana Agreement on Subsidies (hereinafter referred to as the Agreement) as it contingent upon export performance and also because it does not adhere to the guidelines under Annex II of the Agreement and the imposition of a countervailing duties is consistent with the provisions of the Agreement as there exists a specific subsidy imposed on imports in Azania from Enroda and it has caused material injury to the domestic market of Azania.

1.1 The exemption of import duty is a subsidy

Article 1.1 of the Agreement defines a Subsidy[1]. In *Brazil — Aircraft case*, the Appellate Body indicated that "a 'financial contribution' and a 'benefit' as two separate legal elements in Article 1.1 of the *SCM Agreement*, which *together* determine whether a subsidy *exists*".[2]

1.1.1. Financial Contribution

Article 1.1(a)(ii) considers as a "financial contribution" the situation in which government revenue that is "otherwise due" is foregone. The Appellate Body on *US — FSC (Article 21.5 — EC) case*[3] stated that:

[1] A subsidy as defined by Article 1.1, in the relevant part, is:
"*1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:*
(a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:...
(ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits);
...and
(b) a benefit is thereby conferred."

[2] Appellate Body Report on *Brazil — Aircraft* WT/DS46/AB/R 157; also affirmed in Panel Report on *Brazil — Aircraft (Article 21.5 — Canada II),* WT/DS46/RW/2 ¶. 5.18; Panel Report on *US — Exports Restraints*, WT/DS194/R 8.20; Panel Report on *Canada — Aircraft Credits and Guarantees*, WT/DS222/R

[3] Appellate Body Report on *US — FSC (Article 21.5 —EC),* WT/DS108/AB/RW

"In our view, the 'foregoing' of revenue 'otherwise due' implies that less revenue has been raised by the government than would have been raised in a different situation, or, that is, 'otherwise'. Moreover, the word 'foregone' suggests that the government has given up an entitlement to raise revenue that it could 'otherwise' have raised... There must, therefore, be some defined, normative benchmark against which a comparison can be made between the revenue actually raised and the revenue that would have been raised 'otherwise'. We, therefore, agree with the Panel that the term 'otherwise due' implies some kind of comparison between the revenues due under the contested measure and revenues that would be due in some other situation. We also agree with the Panel that the basis of comparison must be the tax rules applied by the Member in question."[4]

The principles stated in the US- FSC case were applied by the Appellate body in the case of Canada- Autos case[5] where import duty exemption on imported vehicles was in question under a particular government measure. The Appellate Body observed as follows:

"We note.., that Canada has established a normal MFN duty rate for imports of motor vehicles of 6.1 per cent. Absent the import duty exemption, this duty would be paid on imports of motor vehicles. Thus, through the measure in dispute, the Government of Canada has..., "given up an entitlement to raise revenue that it could 'otherwise' have raised."... through the import duty exemption, Canada has ignored the "defined, normative benchmark" that it established for itself for import duties on motor vehicles under its normal MFN rate and, in so doing, has foregone "government revenue that is otherwise due"[6].

Similarly, in the present instance duties have to be paid on imports into Enroda. However, Enroda has, under the FTZ Act, exempted the manufacturers in FTZs from paying import duties on import of inputs used to manufacture export products. Thus, it is clear that absent this provision, an exporter in the FTZ would have had to pay the customs/ import duties, which is the "normative benchmark". This clearly establishes the presence of a financial contribution as some revenue is being not collected that would otherwise have been due.

[4] See Appellate Body Reports on *Japan — Alcoholic Beverages II*, WT/DS11/AB/R ¶ 16; and *Chile — Alcoholic Beverages*, WT/DS87/AB/R, ¶ 59 and 60.
[5] Appellate Body Reports on *Canada— Autos*, WT/DS142/AB/R
[6] Appellate Body Reports on *Canada— Autos*, WT/DS142/AB/R ¶ 91.

1.1.2. A benefit should have been conferred

As provided by Article 1.1 a benefit should also have been conferred along with a financial contribution. In *Canada – Measures Affecting the Export of Civilian Aircraft* ("*Canada – Aircraft* "),[7] the Appellate Body quoted approvingly the Panel's definition of 'benefit' and its focus on the recipient of the subsidy in its interpretation of the term "benefit" under Article 1.1(b):

> *"The ordinary meaning of 'benefit' clearly encompasses some form of advantage…. In order to determine whether a financial contribution confers a 'benefit', i.e., an advantage, it is necessary to determine whether the financial contribution places the recipient in a more advantageous position than would have been the case but for the financial contribution... Accordingly, a financial contribution will only confer a 'benefit', i.e., an advantage, if it is provided on terms that are more advantageous than those that would have been available to the recipient on the market."* [8]

With regard to the existence of a benefit in *US — Softwood Lumber III*,[9] the Panel opined that the prevailing market conditions to be used as a benchmark are those in the country of provision of the goods.[10]

Thus, every measure to qualify as a subsidy should confer on every recipient of such a measure some benefit, i.e. an advantage. However, this advantage cannot be measured in isolation but the measure should be conferring an advantage on its recipient as compared to his counterparts in the domestic market.

In the present instance, a benefit has been conferred on the FTZ manufacturers (recipients), by the Enroda government as the exemption from import duties on inputs for export goods gives these manufacturers an advantage over other manufacturers in the market in Enroda. Owing to the duty exemption the FTZ manufacturers incur a lower cost of production as against their counterparts in domestic market.

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[7] Appellate Body Report on *Canada — Aircraft*, WT/DS70/AB/RW

[8] Appellate Body Report on *Canada — Aircraft*, WT/DS70/AB/RW 161; Also discussed in Appellate Body Report on *US — Lead and Bismuth II*, WT/DS138/AB/R

[9] Panel Report on *US — Softwood Lumber III*, WT/DS236/R

[10] http://www.wto.org/english/res_e/booksp_e/analytic_index_e/subsidies_01_e.htm#article2 last visited on 18.12.2009 at 1500 hrs

Conclusively, as both the elements of "financial contribution" and "benefit conferred" have been fulfilled by the impugned import duty exemption therefore the duty exemption is a subsidy under Article 1.1

1.2. The import duty exemption is a specific subsidy

Article 1.2 of the Agreement states a "subsidy...shall be subject to the provisions of Part II or shall be subject to the provisions of Part III or V only if such a subsidy is specific in accordance with the provisions of Article 2."

Article 2 in the relevant provision, Article 2.3, states that "any subsidy falling under the provisions of Article 3 shall be deemed to be specific." Article 3 defines Prohibited Subsidies. Therefore, if the import duty exemption is established to be a prohibited subsidy it shall also establish that the exemption is a specific subsidy, thus the provisions of Part V relating to Countervailing Measures would be applicable in the present instance.

1.3 The Subsidy is a Prohibited Export Subsidy

Article 3.1(a) of the Agreement provides that "subsidies contingent, in law or in fact... upon export performance, including those illustrated in Annex I" shall be prohibited.[11]

1.3.1 The Subsidy is "contingent... in law... upon export performance"

In Appellate Body in *Canada — Aircraft case*,[12] noted that the key word in Article 3.1(a) is "contingent" and stated that "…the ordinary connotation of "contingent" is "conditional" or "dependent for its existence on something else".

Expounding the meaning of export contingency "in law" the Appellate Body in *Canada – Aircraft* held that "*de jure* export contingency is demonstrated on the basis of the words of the relevant legislation, regulation or other legal instrument."[13] Further interpreting the meaning of *de jure* export contingency the Appellate Body in *Canada- Autos case* [14] held:

> *"We believe, however, that a subsidy is also properly held to be de jure export contingent where the condition to export is clearly, though implicitly, in the*

[11] Affirmed by the Appellate Body on *US — FSC (Article 21.5 — EC*, WT/DS108/AB/RW
[12] Appellate Body Report on *Canada — Aircraft*, WT/DS70/AB/RW
[13] Affirmed in Appellate Body Reports on *Canada— Autos*, WT/DS142/AB/R
[14] Appellate Body Reports on *Canada— Autos*, WT/DS142/AB/R

instrument comprising the measure. Thus, for a subsidy to be de jure export contingent, the underlying legal instrument does not always have to provide expressis verbis that the subsidy is available only upon fulfilment of the condition of export performance. Such conditionality can also be derived by necessary implication from the words actually used in the measure."[15]

Hence, for a subsidy to be declared as a prohibited export subsidy it is essential to establish that the subsidy was dependent for its existence upon export performance either *de jure* or *de facto*. In the present instance it is contended that the subsidy in question was dependant on export performance *de jure* and would not have been granted had not the final products been destined for exports.

Section 16 of the Enroda Free Trade Zones Act, 2001 (henceforth referred to as the FTZ Act) mentions that "the grant of exemption on import duties on imports of raw material and inputs" utilized in FTZs shall be subject to the condition that the Manufacturing Unit sign a "Bond-cum-Legal Undertaking... regarding achievement of positive net foreign exchange earnings."Thus, it is clear that a manufacturer would receive import duty exemption only on the condition of earning foreign exchange, which can be done only by exporting and selling of goods in the international market. Therefore, the impugned duty exemption is a *de jure* export subsidy dependent on export performance for its existence. Conclusively, it is established that as the import duty exemptions given to the manufacturers of FTZs is contingent in law upon export performance it satisfies the definition of Prohibited Subsidies under Article 3.1(a).

1.3.2 The import duty exemption is a prohibited export subsidy under Item (i) Annex I of the Agreement

Annex I of the Agreement provides an Illustrative List of Export Subsidies and Article 3.1(a) of the same mentions that these subsidies are also to be regarded as prohibited export subsidies. It is contended that the impugned import duty exemption falls under Item (i) of the List[16]as the FTZ Act imposing it does "precious little to ensure that the duty exempt raw

[15] Appellate Body Reports on *Canada— Autos*, WT/DS142/AB/R ¶ 100; See also Panel Report on *Canada — Aircraft Credits and Guarantees*, WT/DS222/R.

[16] "(i) *The remission or drawback of import charges in excess of those levied* on *imported inputs that are consumed in the production of the exported product (making normal allowance for waste); provided, however, that in particular cases a firm may use a quantity of home market inputs equal*

materials imported into the FTZ was used for the manufacture of destined exports thereby avoiding the possibility of excess remission."

The item is to consider any exemption of import duties that is in excess of that levied on imported inputs that are used in the manufacture of the exported product as an export subsidy and hence is to treat it as a prohibited subsidy. In order to determine whether inputs are being consumed in the manufacturing process of exported goods the item states that it is to be interpreted in accordance with Annex II of the agreement which provides for guidelines on consumption of inputs in the manufacturing process. Item (i) also deals with substitution drawback systems, however, those are not a matter of contention in the present matter.

Annex II provides guidelines for consumption of inputs for manufacturing. During a countervailing duty investigation it is checked whether these guidelines are being followed or not to prevent excess remission. These include having a proper and effective system item keep an account of all imported goods and their quantities and also it directs maintenance of proper records of waste and scraps comprising these duty exempted inputs.

In the present instance the FTZ Act does not adhere to the guidelines mentioned in Annex II as it does not provide for an effective system to ensure that the import duty exemptions would only be given to those imports that are consumed in the manufacturing of exported products.

1.3.2.1 Absence of a proper and effective system to ensure that the imports were consumed in manufacturing exports

With regards to the requirement of having a proper effective system in place to track the usage of the duty free imported goods in the "Final Affirmative Countervailing Duty Determination: Certain Cut-to-Length Carbon-Quality Steel Plate from India" (December 29, 1999) the US Department of Commerce countervailed against the duty exemption under Advance Licence. The Advance Licence system being one where a manufacturer was provided with an a licence to import inputs consumed in production of exported goods duty free and the manufacturer had to account for the exports within a stipulated time period. The

to, and having the same quality and characteristics as, the imported inputs as a substitute for them in order to benefit from this provision if the import and the corresponding export operations both occur within a reasonable time period, not to exceed two years. This item shall be interpreted in accordance with the guidelines on consumption of inputs in the production process contained in Annex II and the guidelines in the determination of substitution drawback systems as export subsidies contained in Annex III."

Department held that Government of India (GoI) have did not have a system in place confirming that inputs imported under the advance licence were used to produce the exported product.[17] The US Department of Commerce concluded as follows:

> *"In summary, the GOI has no way to know whether imported inputs are consumed in subsequently exported products as required under Annexes II and III to the SCM agreement or whether an amount imported was equal to the home market substitutes consumed in the exported product. Consequently, the entire amount of the benefit conferred is countervailable, as directed under section 351.51 of the CVD Regulations and reflected in Annexes II and III to the SCM Agreement."*

In the EEC the Indian Advance Release Orders (ARO) Scheme (a form of Advance License system) came under scrutiny in the investigation against Sulphanilic Acid originating in India. In the EC Council Regulation No 1338/2002 of 22 July 2002, the EEC countervailed against duty exemption under the ARO scheme because there was no system or procedure in place to confirm whether and which inputs, obtained against AROs, were consumed or whether an excess benefit of import duties occurred and it was held that a scheme could be considered as a bona fide duty drawback scheme only in cases in which there was a link between the imported input and the exported goods. [18]

In Canada, in May 2000 in the countervailing duty (CVD) investigation with respect to Certain Hot-Rolled Carbon Steel Plate exported from India the Commissioner of Customs and Revenue (CCRA) took the view that a particular Duty Entitlement Pass Book (DEPB) Scheme was not a duty refund or drawback programme because the GOI did not have a system or procedure to confirm which imported inputs were consumed in the production of the exported goods. It had recognised that the GOI relied on standard input-output norms (SION) for determining DEPB rates and the monitoring system it followed ensured conformity with the norms. However, the system did not go beyond that to verify whether the actual proportion of each input to the finished product reflected the norm.[19]

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[17] Hoda, Anwarul, Agreement on Subsidies and Countervailing Measures: Need for clarification and improvement, Working Paper No. 101, May, 2003, Indian Council for Research on International Economic Relations.

[18] Ibid

[19] Ibid

Thus, it can be gauged from the above mentioned decisions of the various investigating committees that every import duty exemption should accord proper system to evaluate that the imports are being consumed in the manufacture of exported goods and also that there should be a verifiable link between the imports and exported goods to ensure that the imports are being utilised only in the manufacture of exported product. If these guidelines are not followed then not only can such an import duty exemption be qualified as a prohibited export subsidy but also such a subsidy becomes countervailable.

In the present instance the FTZ Act, merely mandates that the imported goods, the waste scraps, the manufactured goods etc are properly accounted for. However, nowhere does it establish any system or procedure that would ensure that the duty free imports are used only for manufacturing the goods to be exported. Infact, in Section 16(d) the Act mentions that "at no point of time the units shall be required to co-relate every import consignment with its exports, transfer to other units in the FTZ, sales in the DTA and balance in stock." This clause clearly breaches the guidelines of Annex II of the Agreement as the Act completely disregards the establishing of link between the imports and the exported goods, thus, in fact establishing a system that is ineffective in checking excess remission of duties.

1.3.2.2 **Import duty exemption on Capital Goods is not permissible under item (i) and is prohibited**

In the EEC the post-export DEPB scheme has been countervailed against in all the cases where it has been investigated viz., Certain Broad Spectrum Antibiotics (1998), Polyethylene Tetraphthalate (PET) Film (199), Polyethylene Tetrapthalate (2000), Certain Flat Rolled Products of Iron or Non-alloy Steel (2000), and Sulphanilic Acid (2002).[20] The reasons given in all these cases are substantially the same but these have been most succinctly stated in the Sulphanilic Acid case:

> *"The analysis revealed that DEPB on post-export basis is not a drawback or a substitution drawback scheme. This scheme lacks a built-in obligation to import only goods that are consumed in the production of the exported goods (Annex II of the basic Regulation) which would ensure that the requirements of Annex I of item (i) were met. Additionally, there is no verification system in place to check whether the imports are actually consumed in the production process."*

[20] Ibid

The Indian Export Promotion Capital Goods Scheme (EPCG) allows import of new capital goods at five per cent customs duty subject to some conditions. In the final CVD determinations in Certain Cut-to-Length Carbon Steel Plate from India (1999) and Certain Hot-Rolled Carbon Steel Flat Products from India (2001) the US Department of Commerce countervailed against the scheme. In the EEC the scheme has been found to be countervailable in the CVD investigations relating to Certain Broad Spectrum Antibiotics (1998), PET film (1999), Certain Flat Rolled Products of Iron or Non-alloy Steel (2000) and Certain Polyethylene Tetrapthalate (2000).[21]

Similarly, in this case import duty exemptions on Capital Goods do not come within the definition of "inputs consumed" as under item (i) of Annex I nor does it come under any other exception in Annex I. Hence import duty exemption on capital goods is a prohibited export subsidy.

It is submitted that the impugned exemptions satisfy the definition of prohibited export subsidy under Article 3.1(a) of the Agreement as it is contingent upon export performance and also because it does not come under the exception under Item (i) of Annex I for its non-compliance with the guidelines of consumption as under Annex II.

Also they fulfil the definition of Specific Subsidy under Article 2.3 and hence provisions under Part V relating to Countervailing duties can be applied on the impugned provisions.

1.4. Imposition of Countervailing duties is consistent with the provisions of the Agreement

For the application of a countervailing duty the following three points are essential to be established: 1) The existence of a subsidy, 2) An injury within the meaning of Article VI of GATT and 3) A causal link between the subsidized imports and the alleged injury.

1.4.1. The Existence of a subsidy

It has already been established that the import duty exemptions is a subsidy within the meaning Article 1.1, also it is a "specific subsidy" under Article2.3 and hence the provisions

[21] Ibid

relating to Countervailing duties may be applied in the instant case and its application by the Applicants is so far not inconsistent with the provisions of the Agreement.

1.4.2. An injury within the meaning of Article VI of GATT 1994 as interpreted by this Agreement

As per Article 15.1 the determination of material injury shall depend on the "volume" of subsidized imports and their "effect" on the like products in the domestic market and also the impact of these imports on the domestic producers.

It is imperative over here to mention that it in decisions like that by the Panel on *US — Softwood Lumber VI case* [22] the clauses in the Agreement on Subsidies and Countervailing Measures (which is pari materia to the Agreement) and the Anti Dumping Agreement (ADA) dealing with the determination of material injury and have been interpreted in the same fashion leading to the conclusion that decisions regarding interpretation of determination of injury concerning either of the Agreements maybe used as a valid interpretation under the other agreement also.

1.4.2.1.(a). The volume of subsidized imports

According to Article 15.2 regarding the volume of subsidised imports "the investigating authorities shall consider whether there has been a significant increase in subsidized imports, either in absolute terms or relative to production or consumption in the importing Member". In *Thailand — H-Beams case*,[23] the Panel considered that Article 3.2 of the ADA (pari materia to Article 15.2 of the Agreement) does not require that the term "significant" be used to characterize a subject increase in imports in the determination of an investigating authority. The Compromis states that the domestic manufacturers of steel in Azania had petitioned for a countervailing duty investigation due to "the surge in the imports from Enroda." Thus, the Azanian market faced a significant increase in the subsidised imports from Enroda in a short space of time. Moreover, the fact that the Enrodean steel had started displacing the domestic steel in Azanian market is a clear indication that there had been increase in imports in relative terms with respect to the consumption in Azania. Thus, it is established beyond doubt that there had been a significant increase in volume of subsidised imports in Azania.

[22] Panel Report on *US — Softwood Lumber IV*, WT/DS277/R
[23] Panel Report on *Thailand — H-Beams*, WT/DS122/R

1.4.2.1.(b). Their effect on the like products in the domestic market

Article 15.2 mentions that the effect of the subsidised imports on the like products in the domestic market shall be determined by considering "whether there has been a significant price undercutting by the subsidized imports as compared with the price of a like product of the importing Member." As per the Oxford Dictionary 'undercut' means "sell or work at lower price than". The Panel on *EC — Tube or Pipe Fittings* explaining the rationale behind the undercutting analysis stated:

> *"One purpose of a price undercutting analysis is to assist an investigating authority in determining whether dumped imports have, through the effects of dumping, caused material injury to a domestic industry... Sales at undercutting prices could have an impact on the domestic industry (for example, in terms of lost sales..."*[24]

The Compromis states that "Cheap exports from Enroda started to displace steel manufactured in Azania... from... the domestic market in Azania."[25] This clearly means that the Enrodean imports were being sold at a lower price than Azanian imports in the domestic markets thus leading to price undercutting. Moreover, the effect of the price undercutting could be seen in the loss of sales being incurred by Azanian products in their own domestic market as the Enrodean imports kept displacing them.

1.4.2.2. The impact of these imports on the domestic producers

For ascertaining the impact of the subsidised imports on the domestic producers Article 15.4 of the Agreement lists fifteen factors that are to be taken into consideration while calculating the impact. However, The Panel in *EC — Bed Linen (Article 21.5 — India) case*,[26] with regards to impact of dumped imports on domestic producers underlined that "there is no requirement in Article 3.4 that each and every injury factor, individually, must be indicative of injury". The Panel concluded that:

> *"... Nor is it necessary that all factors show negative trends or declines. Rather, the analysis and conclusions must consider each factor, determine the relevance of each factor, or lack thereof, to the analysis, and consider the relevant factors*

[24] Panel Report on *EC — Tube or Pipe Fittings*, WT/DS219/R
[25] Compromis, ¶ 20
[26] Panel Report on *EC — Bed Linen (Article 21.5 — India)*, WT/DS141/RW

together, in the context of the particular industry at issue, to make a reasoned conclusion as to the state of the domestic industry."[27]

Similarly, in the case of subsidised imports also all factors need not show negative trends but what is to be seen is that the relevance/ irrelevance of the factors has been considered.

Taking into consideration the facts, that "market share" of Azanian products has declined as the cheap imports from Enroda have started displacing them in the domestic market; this as a result would affect the "sales" and "profits" of the domestic industry in Azania as the sales will decrease and so will the profits that are dependent on the sales. As an effect of the price undercutting being carried on by the cheap Enrodean products the domestic industry's "return on investments" will also be negatively affected as the domestic industry will be forced to slash down the prices of its goods lest it face lower sales and lesser profits. In a similar way, "factors affecting domestic prices" will also be hit negatively due to the price undercutting. Consequently, the "growth" of the domestic steel industry will be hampered as if there are lesser sales and lower profits the industry will lack capital to develop itself. In the absence of adequate evidence in the Compromis regarding the impact on the other factors these factors may not be looked into for the purpose of assessment of impact in the instant matter.

Accordingly, from the above stated it is evident that the Azanian Domestic industry has suffered a material injury due to increased volume of subsidised imports, the price undercutting and its impact on the market shares, profit, growth of the industry etc.

1.4.2.3. There should be a causal link between the injury and the subsidised imports.

There exists a causal link between the injury to the domestic market and the subsidised imports from Enroda. The facts clearly mention that "cheap exports from Enroda started to displace steel manufactured in Azania from the domestic market in Azania." This establishes that after importing the subsidised imports from Enroda the Azanian domestic industry started to suffer material injury. Had the subsidised imports not entered Azanian market there would not have been a decline in sales and market share of Azanian products in the domestic market. Thus, it was only because of the subsidised imports that the material injury was cause thus establishing a causal link between the injury and the subsidised imports.

[27]Panel Report on *EC — Bed Linen (Article 21.5 — India)*, WT/DS141/RW

Conclusively, it is submitted that the import duty exemption conferred by Enroda on its FTZs is not only a prohibited export subsidy as it breaches the guidelines on consumption of inputs under Annex II of the Agreement and results in excess remission of duties. Moreover, the countervailing duties applied on the Enrodean imports in Azania were justified as there the subsidised imports were causing material injury to the domestic industry of Azania.

2. The imposition of a border tax on imports is in violation of the market access commitments undertaken by Enroda and is not justified by the General Exceptions to the Razvana Agreement on Trade in Goods.

2.1 That the imposition of a border tax on imports is in violation of the market access commitments undertaken by Enroda.

2.1.1 That the imposition of a border tax on imports is in violation of Article IV.2 of the Razvana Agreement on Trade in Goods.

According to Article IV of the Razvana Free Trade Agreement (hereinafter referred to as "RATG"):

Article IV: National Treatment on Internal Taxation and Regulation.

> *"2. The products of the territory of any Member State imported into the territory of any other Member State 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."*

According to the above commitment undertaken by Enroda pursuant to the conclusion of the RATG, Enroda cannot impose any tax on goods imported from Azania (or from any other country party to the RATG for that matter) in excess of those applied directly or indirectly to *like domestic products*. The above Article permits a product tax but not a process tax. Now, the tax adjustment sought to be done by Enroda is in relation to the tax which Enroda calls a Carbon tax which is charged on actual usage of coal, oil and other fossil fuels at a fixed

rate[28]. These are not products used in the sense of the word in the above Article. Rather, the concept of a Carbon tax falls under a process tax as it is intended to influence the process of manufacture of a product (by incentivising a shift to more fuel efficient process of production). Further, on the WTO website[29] the following categorical statement could, until very recently, be found:

> *"Under existing GATT rules and jurisprudence, 'product' taxes and charges can be adjusted at the border, but 'process' taxes and charges by and large cannot. For example, a domestic tax on fuel can be applied perfectly legitimately to imported fuel, but a tax on the energy consumed in producing a ton of steel cannot be applied to imported steel"*

The proposition of product versus process tax was also examined by a GATT Panel in the famous *Tuna – Dolphin* dispute[30]. As was the case for possible border tax adjustment in respect of carbon taxes, the question is whether a carbon regulation which, after all, targets the process or production method of, say, imported steel -- not the physical characteristics of the steel itself -- can be classified as a regulation "*affecting … products*". Put differently, the question to be asked is border adjustment for regulations limited to "*product*" measures or does it extend also to "*process*" measures?

Two GATT panel reports found that "*process*" measures fall outside the scope of GATT Article III (in pari materia to RATG Article IV). These reports were issued in the famous *Tuna – Dolphin* dispute where a US ban on certain tuna captured in a way that risks killing dolphin was found to be beyond the scope of GATT Article III. Being violative of Article III, it was examined under GATT Article XI and the same conclusion was found with respect to Article XI and the measure was further not justified under the environmental exceptions in GATT Article XX (in pari materia to RATG Article XX). The first *Tuna – Dolphin*[31] panel explained the exclusion of "*process*" measures – such as carbon regulations – from the scope of permissible border adjustment under GATT Article III as follows:

> *"......under the national treatment principle of Article III, contracting parties may apply border tax adjustments with regard to those taxes that are borne by*

[28] Compromis, ¶ 17
[29] http://www.wto.org/english/tratop_e/envir_backgrnd_e/c3s3_e.htm, last viewed on 12.12.2009 at 1500hrs.
[30] *United States - Restrictions on Imports of Tuna*, DS 29/R, 16 June 1994, (1994) 33 ILM, 839.
[31] *United States - Restrictions on Imports of Tuna*, GATT B.I.S.D. (39th. Supp.) at 155 (1993)

products, but not for domestic taxes not directly levied on products (such as corporate income taxes). Consequently, the Note Ad Article III covers only internal taxes that are borne by products. The Panel considered that it would be inconsistent to limit the application of this Note to taxes that are borne by products while permitting its application to regulations not applied to the product as such".

Put differently, according to this panel, as is the case for taxes, regulations as well can only be adjusted at the border if they "*apply to the product as such*"; not if they regulate the producer. As the US domestic restriction on tuna harvesting "*did not regulate tuna products as such … Nor did it prescribe fishing techniques that could have an effect on tuna as a product*", the GATT panel found that the regulation could *not* be adjusted at the border for imported tuna. Hence, the US tuna ban was not covered by GATT Article III.

Now, under GATT jurisprudence on the subject a distinction has been made between direct and indirect taxes. Direct taxes are taxes levied on the producers such as income tax[32], etc whereas indirect taxes are levied directly on the product such as sales tax, etc.[33] From the above analysis, it is clear that a carbon tax is a direct tax. A 1970 GATT Working Party on Border Tax Adjustments[34] makes it clear in the following words that direct taxes are not eligible for border tax adjustments:

"14. On the question of eligibility of taxes for tax adjustment under the present rules, the discussion took into account the term "... directly or indirectly ..." (inter alia Article III:2). The Working Party concluded that there was convergence of views to the effect that taxes directly levied on products were eligible for tax adjustment. Examples of such taxes comprised specific excise duties, sales taxes and cascade taxes and the tax on value added. It was agreed that the TVA, regardless of its technical construction (fractioned

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[32] Footnote 58 of Annex I of the Razvana Agreement on Subsidies and countervailing Measures in provides useful definitions that apply in this context: "direct taxes" are "taxes on wages, profits, interests, rents, royalties, and all other forms of income, and taxes on the ownership of real property".

[33] According to a 2009 report by the United Nations Environment Programme and the World Trade Organization titled "Trade and Climate Change" published by the World Trade Organization. Can be accessed on http://www.unep.ch/etb/pdf/UNEP%20WTO%20launch%20event%2026%20june%202009/Trade_&_Climate_Publication_2289_09_E%20Final.pdf , last visited on 20.12.2009 at 1500 hrs.

[34] In the Report of the Working Party adopted on 2 December 1970. The same can be accessed on http://www.worldtradelaw.net/reports/gattpanels/bordertax.pdf , last visited on 20.12.2009 at 1500 hrs.

collection), was equivalent in this respect to a tax levied directly - a retail or sales tax. Furthermore, the Working Party concluded that there was convergence of views to the effect that certain taxes that were not directly levied on products [i.e. Direct taxes] were not eligible for tax adjustment. Examples of such taxes comprised social security charges whether on employers or employees and payroll taxes."

The above finding has been quoted with approval and is now a settled proposition in WTO jurisprudence. Further, a 2009 report by the United Nations Environment Programme and the World Trade Organization titled "Trade and Climate Change"[35] has reiterated the above finding and taken it to be a settled position in the following words:

"*Generally speaking, two types of internal taxes may be distinguished: taxes on products (called indirect taxes) and taxes on producers (i.e. direct taxes). In its examination of BTAs, the 1970 GATT Working Party indicated that taxes directly levied on products (i.e. so called indirect taxes, such as excise duties, sales taxes and the tax on value added) were eligible for adjustment, while certain taxes that were not directly levied on products (i.e. direct taxes such as taxes on property or income) were normally not eligible for adjustment.*"

Further, the above report[36] goes on to say:

"Under Article III.2, border adjustments on imported products is only allowed in respect of taxes "applied, directly or indirectly, to like domestic products" (i.e. indirect taxes)."

Lastly, in 1976, a GATT panel, in the *United States Tax Legislation (DISC) case*, [37] confirmed, in relation to GATT rules, the distinction between direct and indirect taxes and the ineligibility of direct taxes (on producers) for adjustment.

Hence, there has been a breach of the commitment undertaken by Enroda under Article IV. In light of the above arguments advance, the applicant humbly prays that this Court declare the imposition of the border tax on imports by Enroda to be invalid and strike down the same.

[35] Supra note 28.
[36] In Part IV, Pg 104
[37] *Tax Legislation – United States Tax Legislation (DISC)*, L/4422, BISD 23S/98.

2.1.2 That the imposition of a border tax on imports is in violation of Article III.2(a) of the Razvana Agreement on Trade in Goods.

According to Article III of the RATG:

Article III: Schedules of Concessions.

"2. Nothing in this Article shall prevent any Member State from imposing at any time on the importation of any product:

(a) a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article IV of the RATG in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part"

Having failed the test under Article IV the carbon tax on imported products would be invalid and it cannot be levied under the above Article III.2(a). From a plain reading of the above Article III.2(a), it is clear that if the domestic carbon tax is not in respect of a domestic product (as is our case and the fact that this carbon tax is on the producer and not the product has been proved under section 2.1.1 above), then for a charge to qualify under this Article, the internal tax must have been in respect of an article from which the imported product has been manufactured in whole or in part.

By no stretch of imagination, can the fuel used in the process of production of a particular product be considered to be *an article from which the imported product has been manufactured in whole or in part* as used in the Article above. The same has been iterated by the 2009 report[38] by the United Nations Environment Programme and the World Trade Organization titled "*Trade and Climate Change*" in the following words:

"Concerning the second type of charges, however, extensive discussion has taken place on the extent to which the energy inputs and fossil fuels used in the production of a particular product could be considered to be 'articles from which the imported product has been manufactured or produced in whole or in part'. It has been suggested by some that the wording of Article II.2(a) [which is in pari materia to Article III.2(a) of the RATG] may restrict the application of Article II to inputs physically incorporated into, or part of, the final product, which would

[38] In Part IV, Pg 104.

therefore exclude the possibility to adjust taxes on the energy or fossil fuels used during the production of goods (other than taxes on fuels themselves)."

Further, the national treatment provisions prohibit differentiation between otherwise "like products" on the basis of PPMs (Process and Production Methods) related requirements that do not change the physical characteristics of these products (OECD, 1995)[39]. Thus, if a government treats differently imports that give rise to more greenhouse gas emissions in their production than their like domestic products, it could face a sanction under the WTO rules.

In view of the above arguments there is a breach of the commitments undertaken by Enroda under Razvana Agreement on Trade in Goods under Article III.

2.1.3 That the imposition of a border tax on imports is in violation of Article IV.1 of the Razvana Agreement on Trade in Goods.

According to Article IV of the RATG:

Article IV: National Treatment on Internal Taxation and Regulation.

"1. The Member State 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."

In the *Korea – Various Measures on Beef case*, [40] the Appellate Body found that imported products are treated less favourably than like products if a measure *modifies the conditions of competition* in the relevant market to the detriment of imported products. This indeed is the situation in the present case also. Enroda has not taken into account that the imposition of the carbon tax flatly to Annex A countries will have a different effect on the competitiveness of the products from each of these countries as compared to the others in Annex A as also Enroda's domestic products. Enroda has failed taking into account that Azania is a developing country[41] far inferior in terms of technology than Enroda and other Annex A countries that are subject to the carbon tax. It is this technological superiority of the

[39] Ibid note 15.
[40] Appellate Body Report in *Korea – Various Measures on Beef*, DS161/AB/R and DS169/AB/R. ¶ 137.
[41] Compromis, ¶ 1.

developed countries such as Enroda which will give them an advantage as the technology they possess being the best and most efficient will consume lesser amounts of fossil fuels than other outdated technologies in use in Azania, a developing country. This means that Azania due to its current state of technology spends more amount of fossil fuel per unit of production and hence will have to pay more carbon tax than a developed country such as Enroda which uses lesser amounts of fossil fuel per unit of production and hence will pay lesser tax carbon tax as compared to its Azanian counterpart.

The above proposition has also been debated in the United Nations Conference on Trade and Development. In a paper titled "*Domestic climate policies and the WTO*" presented at the same by WTO experts Zhong Xiang Zhang and Lucas Assunção[42], it was said that such a practice [of imposing tax on importation of goods] seems very hard to justify in the case of energy/carbon taxes, given the wide range of technologies in use around the world and very different energy resource endowments and consumption patterns among countries. Even if the same technology were used to produce the same products among countries, the differing resource endowments could lead to a sharp difference in the energy consumption of their most economically efficient technology. For a country that relies on coal as its major source of energy, the larger amount of energy used by a coal-based technology per unit of output vis-à-vis oil/gas-based technologies occurs partly as a result of its high proportion of coal consumption, because coal based technologies are less efficient than oil/gas-based technologies. It seems unfair to penalize the country whose energy consumption is coal dominant, just because it is unfortunate to have less endowments of oil/gas that, if burned, emits less carbon that coal.

From an analysis of the above discussion, it is clear that imposing the carbon tax on imports of products from Azania will lead to a situation where the domestic goods of Enroda will gain an advantage and hence, this policy measure is violative of Article IV of RATG.

[42] MPRA Paper No. 13223, posted 06 February 2009/21:25. Can be accessed at http://mpra.ub.uni-muenchen.de/13223/, last visited on 15.12.2009 at 1200 hrs.

2.2 <u>That the imposition of border tax on imports is not justified by the General Exceptions to the Razvana Agreement on Trade in Goods.</u>

According to Article XX of the RATG:

Article XX: General Exceptions.

"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 measures:

(a) necessary to protect public morals;

(b) necessary to protect human, animal or plant life or health;

(c) Imposed for the protection of national treasures of artistic, historic or archaeological value;

(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption."

2.2.1 <u>That the imposition of the border tax on imports is in violation of the chapeau of Article XX of the Razvana Agreement on Trade in Goods.</u>

From an analysis of the above Article, it is clear that before the policy measure (a border tax on imports in our case) is allowed under Article XX, the requirements of the introductory phrase (i.e. the chapeau) must be fulfilled. This phrase requires that measures are not applied in a manner which would constitute (1) a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or (2) a disguised restriction on international trade.

Section 17 of the Carbon Tax Regulation Act provided for the imposition of a carbon tax on imports of goods equivalent to the level of tax charged to the domestic industry of the like goods. The tax was to be charged at the border and would be charged on goods originating in countries included in Annex A of the Act. Annex A countries comprised all nations included in Annex I of the UNFCCC, developed nations not part of the UNFCCC as well as developing nations in an advance stage of development. Azania was categorized as an Annex

A state.[43] Also, Azania is a member of the United Nations Framework Convention on Climate Change (hereinafter referred to as "UNFCCC"), 1995 which it joined as a non Annex I member country[44].

Now, in the *US – Shrimp case*[45], the Appellate Body was of the view that rigidity and inflexibility in the application of the measure (e.g. by overlooking the conditions in other countries) constituted unjustifiable discrimination. From an analysis of the above findings, it is clear that Azania has faced unjustified discrimination in the present matter. Azania is a developing country and by putting it at par with the Developed countries (such as the ones in Annex 1 and other Developed countries not part of the UNFCCC which were put in the same category as Azania, i.e. Annex A of the RATG), Enroda has failed to take into account the special conditions of Azania. These special conditions (which justify Azania being treated differently from developed countries including Enroda) are as follows:

1. Azania is a developing country and is hardly in a position to impose harsh regulations on its infant industries which would make their survival difficult.

2. Enroda has overlooked the policies adopted by Azania on its own initiative according to its own ability to fight climate change. In *US – Shrimp case* [46] it was deemed not acceptable that a WTO member would require another member to adopt essentially the same regulatory programme, without taking into consideration that conditions in other members' territories might be different, and that the policy solutions might be ill-adapted to their particular conditions.[47]

In *US – Shrimp case*, [48] the original US ban was faulted because of its "*intended and actual coercive effect on the specific policy decisions made by foreign governments*"; more specifically, it required that all other countries "*adopt essentially the same policy*" as the United States does and other specific policies and measures that an exporting country may have adopted for the protection and conservation of sea turtles are not taken into account. When, in response, the United States no longer required the

[43] Compromis, ¶ 24.
[44] Compromis, ¶ 14.
[45] Panel Report in *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS 58/R (15 May 1998); Appellate Body Report, WT/DS58/AB/R (12 October 1998).
[46] Supra note 45.
[47] Supra 45 at ¶ 161-164.
[48] Supra note 45.

"*adoption of essentially the same program*" but conditioned market access for imported shrimp on "*the adoption of a program comparable in effectiveness*" to that of the U.S. program, the Appellate Body found that such "*allows for sufficient flexibility in the application of the measure so as to avoid 'arbitrary or unjustifiable discrimination'*". This would seem to require that any carbon tax or regulation on imports is sufficiently flexible and takes "into consideration different conditions which may occur" in different foreign countries.

This in turn means that Enroda should have taken into account the measures taken by Azania on its own initiative such as the introduction of the Climate Change Executive Order, 9288 in Azania. Justifying the imposition of the tax against the introduction of the Carbon tax in Enroda cannot be accepted as that would mean Enroda is forcing Azania (and other countries categorized as Annex A) to adopt the same policy measure as Enroda had adopted (of imposing a carbon tax).

3. Each WTO member has the autonomy to determine their own environmental objectives. WTO members' autonomy to determine their own environmental objectives has been reaffirmed by the WTO's Dispute Settlement Body on a number of occasions (for example, in the *US – Gasoline case* [49] and the *Brazil - Retreaded Tyres case* [50]). By imposing the unilateral carbon tax on imports of products from Azania (or any other country in Annex A), Enroda has violated Azania's autonomy to determine its own environmental objective.

4. The requirement to take "into consideration different conditions which may occur"[51] in different foreign countries, forces Enroda to consider whether developing countries (such as Azania) should, for historical reasons, carry the same burden as other countries. Under the UNFCCC, for example, protection of the climate system must be pursued "on the basis of equity and in accordance with [the parties'] common but differentiated responsibilities and respective capabilities"[52]. Further, such unilateral

[49] Appellate Body Report in *United States - Standards for Reformulated and Conventional Gasoline*, WT/DS 2/AB/R (29 April 1996), 25.

[50] Panel Report in *Brazil – Measures Affecting Imports of Retreaded Tyres*, WT/DS 332/R, 12 June 2007.

[51] Supra note 45.

[52] This principle is enshrined in Article 3(1) of the UNFCCC in the following words:

"*1. The Parties should protect the climate system for the benefit of present and future generations of humankind, on the basis of equity and in accordance with their common but differentiated responsibilities and respective capabilities. Accordingly, the developed country Parties should take the*

measures would violate the principles and provisions of the UNFCCC, including, in particular, trade and climate change (Article 3 paragraph 5); and the relationship between mitigation actions of developing countries and provision of financial resources and technology by developed country Parties (Article 4, Paragraphs 3 and 7)." The same principles are also found in the Kyoto protocol[53] to which both Enroda and Azania are parties. The principles discussed above are reflected in the specific commitments made by UNFCCC parties to stabilize their greenhouse gas concentrations. For instance, in keeping with the above-mentioned principle of common but differentiated responsibilities, the UNFCCC divides countries into Annex I countries (industrialized nations, Russia and a number of eastern European countries), Annex II countries (only the most industrialized countries) and non Annex I countries (developing countries including Azania). Each group of countries is assigned a particular set of commitments with regard to mitigation of greenhouse gas emissions and adaptation to the impacts of climate change.

All these provisions (of UNFCCC and Kyoto Protocol) oblige Enroda to impose a graduated import tax or regulation depending on the stage of economic development of the foreign country in question which it has completely failed to do in the present matter.

Further, the proposition that a country, before imposing a unilateral trade measure must negotiate with all the parties affected in good faith was laid down in the *US – Shrimp*[54] case. The failure of Enroda to negotiate with Azania on the imposition of a border tax on imports has resulted in unjustifiable discrimination which is forbidden by the chapeau of Article XX.

2.2.2 <u>Arguendo the chapeau of Article XX was met, Enroda still has to establish that its measure falls under at least one of the exceptions under Article XX.</u>

For a GATT inconsistent environmental measure to be justified under Article XX, a member must prove that its measure falls under at least one of the exceptions (e.g. paragraphs (b) and/or (g), two of the ten exceptions under Article XX)[55]. Further, a connection needs to be established between its stated climate change policy goal and the measure at issue. In the present matter, Enroda has failed to demonstrate how its policy measure of imposing a border

lead in combating climate change and the adverse effects thereof."

[53] Article 2(3) of the Kyoto Protocol.

[54] Supra note 46.

[55] Supra note 33. In part 4, pg 107.

tax on the imports is related to achieving any of the environmental goals under Article XX of the RATG. In the absence of this link being established, the measure cannot be justified under Article XX.

2.2.3. That there are lesser trade restrictive measures which could have been applied by Enroda towards achieving the environmental objective under Article XX.

If a lesser trade restrictive measure can be applied by a country to achieve a stated environmental goal under Article XX, then the more trade restrictive measure will have to be dismissed. If an analysis yields a preliminary conclusion that the trade measure is necessary, this result must be confirmed by comparing the measure with its possible alternatives, which may be less trade-restrictive while providing an equivalent contribution to the achievement of the objective pursued.[56] Now, Enroda being a party to the Kyoto Protocol of the UNFCCC is possessed of several equally effective measures under the Kyoto Protocol which would help it attain its environmental objectives.

The Kyoto Protocol includes three “flexibility mechanisms” namely, Emission Trading, Joint Implementation, and the Clean Development Mechanism (CDM) to help parties meet their obligations and achieve their emission reduction commitments in a more cost efficient manner and less trade restrictive manner (as compared to imposition of a carbon tax and consequently border tax adjustment). Emission trading allows parties to buy emission credits from other parties. These emission credits may be the unused emission allowances from other Annex I parties or they may be derived from Joint Implementation or CDM climate-mitigation projects. Joint Implementation allows an Annex I party to invest in emission-reduction projects in the territory of another Annex I party, and so earn emission reduction units that can be used to meet its own emission target. In a similar manner, the CDM allows an Annex I party to meet its obligations by earning emission reduction units from projects implemented in a developing country. Either of the above mechanisms would have been less trade restrictive than the border tax on imports and hence the border tax on imports policy cannot be justified under Article XX of the RATG.

[56] Appellate Body Report in *Brazil - Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R. ¶ 178.

Finally, there are more traditional regulatory tools and a range of technical requirements for products and production methods aimed at reducing greenhouse gas emissions and energy consumption. Technical requirements to promote energy efficiency have been adopted at the national level by most developed countries, and by a growing number of developing countries. It is estimated that energy-efficiency improvements have resulted in reductions in energy consumption of more than 50 per cent over the last 30 years[57]. Such climate change related technical requirements may take various forms (e.g. maximum levels of emissions, standards for energy efficiency for products and production methods, etc.).

In light of all the above arguments, the applicant humbly prays for this Hon'ble Court to declare that the border tax on imports as a policy is not justified under Article XX of the RATG and to strike it down.

[57] Supra note 33.

Final Submission/ Prayer

Therefore, in light of the issues raised, arguments advanced and authorities cited, it is humbly prayed that this Hon'ble Court may be pleased to hold, adjudge and declare that:

I. The duty exemptions provided by Enroda on import of raw materials for the steel industry is a subsidy prohibited under the Razvana Agreement on Subsidies.

II. The imposition of countervailing duties by Azania is consistent with the provisions of the Agreement.

III. The border tax on imports is in violation of the commitments undertaken by Enroda under the Razvana Free Trade Agreement.

IV. The border tax on imports is liable to be struck down in view of its inconsistency with the Razvana Free Trade Agreement.

All of which is respectfully affirmed and submitted

Agents for the Applicant