World Trade and the Environment: The CAFE Case

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WORLD TRADE AND THE ENVIRONMENT: 
THE CAFE CASE

Eric Phillips*

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INTRODUCTION

"[T]he recent GATT panel report on the European Community's challenge to three U.S. automobile laws laid to rest fears that WTO panels will interpret the GATT in a way that challenged [sic] our ability to safeguard our environment."

Debate has raged over the compatibility of increasingly liberalized trade under the General Agreement on Tariffs and Trade (GATT) with environmental protection. Whether the GATT system has limited a country's ability to pass laws to protect its own environment or the global commons, the very success of the GATT system will increase the need for environmental protection, at least in the short run. By opening markets, the GATT/World Trade Organization (WTO) system will increase living standards all over the world. As people gain greater wealth, they will use more electricity and purchase more cars. This will place greater strain on the environment. Although the GATT/WTO system may not pose the dangers to the environment that many have claimed, even some of its strongest supporters believe that it should be improved to become more compatible with environmental protection.

Ambassador Kantor's comment above reflects a sensitivity to concerns about the effect of international trade rules on a nation's ability to enact environmental law.

The GATT panel decision in the case United States — Taxes on Automobiles (CAFE case) promised to fuel the debate about the effect of international trade rules on environmental protection. This panel examined three U.S. laws relating to the sale of autos: the luxury tax, the gas guzzler tax, and the Corporate Average Fuel Economy law (CAFE law). This Note focuses on the decision with regard to the CAFE law because it plays a central role in the United States' effort to address environmental problems. The CAFE law requires manufacturers

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4. The creation of the Committee on Trade and the Environment with the WTO indicates that the institution itself recognizes the importance of environmental protection. See Jennifer Schultz, Environmental Reform of the GATT/WTO International Trading System, 18 L. & ECON. REV. 77, 80 (1994).
of autos to meet certain minimum fuel efficiency standards for the entire fleet of autos that they sell in the United States.

The dispute settlement panel did find important elements of the CAFE law to violate the GATT, but found much of the law to be compatible with the GATT. Ambassador Kantor clearly regarded the decision as evidence that the WTO should be adopted. The Office of the Trade Representative called the provisions that were found to be incompatible with the GATT "technical," and decided that since the effect of the law was "trade neutral," the United States would not amend the CAFE law.6 Many opponents of the WTO similarly concluded that the panel decision on CAFE did not support their argument that the WTO would limit efforts to protect the environment.7 Few voiced concern about the panel's decision.8 The widespread approval of the panel decision by environmentalists is odd considering that key elements of the CAFE law were found to be incompatible with the GATT.

There are some elements of the panel report that support those who believe that the GATT/WTO system can be compatible with strong environmental protection.9 The panel's interpretation of the Article XX(g) general exception to the GATT promises to allow greater application of those general exceptions for environmental matters. At the same time, however, the panel decision presents much to worry about with regard to the compatibility of the WTO and environmental concerns. The panel noted that although the CAFE law, as such, did not violate the GATT, two provisions of the law were found to be incompatible with the GATT. These provisions, though perhaps "technical," are vitally important. Without these provisions, the CAFE law would be severely weakened.

The CAFE law promotes energy efficiency which, beyond conserving resources, also reduces the emission of greenhouse gases. Despite elements of the law that have been deemed protectionist, it, as a whole,


7. Peter Behr, Trade Panel Upholds U.S. Auto Fuel Law: Challenge on Behalf of European Car Manufacturers is Rejected, WASH. POST, Oct. 1, 1994, at D1 ("In a statement yesterday, [Ralph] Nader's Public Citizen organization said the CAFE ruling shows that global trade panels are free to 'micro-manage' U.S. environmental laws. The statement was later withdrawn after organization lawyers read the entire ruling.").

8. For one of the few pieces emphasizing that the panel found the CAFE law to be inconsistent with the GATT, see Paul Stanton Kibel, GATT Fouls the Air, RECORDER, Nov. 14, 1994, at 8.

9. Although this paper will not discuss the decision with regard to the "gas guzzler" tax, it is worth noting that the panel found it to be compatible with the United States' obligations under the GATT. CAFE Panel Report, supra note 5, para. 6.1. The gas guzzler law imposes a tax on manufacturers of cars that do not meet minimum fuel efficiency standards. 26 U.S.C. § 4064 (1994) (gas guzzler tax).
damages U.S. manufacturers’ ability to compete with foreign producers. The law placed U.S. automakers at a competitive disadvantage with all its major competitors. By requiring U.S. automakers to sell a fleet of cars that averaged over twenty miles per gallon, it called for expensive changes for U.S. producers that most foreign producers did not have to make.\textsuperscript{10} The provisions found to violate the GATT were an effort to lessen the harmful effect this law would have on the competitiveness of domestic producers.

This Note examines the CAFE case in the context of the debate over trade and the environment. It argues that the panel decision has aspects that support the notion that the international trading system can be compatible with efforts to protect the environment, and also has aspects that demonstrate that these do indeed clash, limiting efforts to protect the environment. Part I of this Note describes the CAFE law and places it in the context of domestic and international efforts to prevent global warming. Part II examines the panel’s decision, arguing that the panel acted well within the scope of past practice in interpreting Article III, and notes how that practice can result in a situation in which imported products are given better treatment than domestic products. Part II also examines the panel’s findings with regard to the exceptions under Article XX. It points out that the panel’s suggestion that part of the law that violates Article III could be saved represents an important breakthrough in GATT panel interpretation. Part III of this Note describes what the CAFE law would look like if the United States were to make it compatible with the GATT. This demonstrates that if the United States had to change the law to comply with the panel’s recommendation, the CAFE law might not survive. Part IV presents a proposal to change GATT interpretation of Article XX(g). It argues that previous panels have interpreted the exception too narrowly because they have examined individual provisions of the law in isolation from the overall effect. By examining the overall effect of the law on trade — and providing that it does not discriminate on balance — panels can make the exception viable while protecting against protectionism.

\textsuperscript{10} In 1978, shortly after the CAFE law went into effect, autos produced abroad and sold in the United States averaged 27.3 miles per gallon; U.S.-made autos averaged 18.7 miles per gallon. CAFE Panel Report, \textit{supra} note 5, para. 3.262.
I. CAFE AND THE ENVIRONMENT

A. The CAFE Law

1. Statutory Scheme

In 1975, when the CAFE law was passed by Congress, the United States was in the midst of the energy crisis it suffered after the OPEC oil embargo in 1973. Gas prices skyrocketed and some areas experienced shortages of oil. At the time, it appeared as if the crisis would worsen. Quite a few people projected dire consequences for the U.S. economy if energy consumption were not reduced dramatically. Oil received special attention from Congress. Thus, the CAFE law was primarily a response to concern for energy conservation. Only later were its benefits for the environment touted as a major achievement.

The CAFE statute requires auto manufacturers to meet a minimum fuel economy standard for all cars they sell. The law currently requires automakers to sell cars that average twenty-seven and one half miles per gallon for passenger vehicles, and twenty-one miles per gallon for light trucks. Each car need not meet these minimum levels; rather, the entire fleet of autos or light trucks sold by each producer must meet these standards. In other words, large low gas mileage cars can be offset against smaller higher mileage cars in order to meet the minimum. This is accomplished through the so-called “fleet averaging” provision. This was one of the two provisions that the European Community challenged and that the panel found to be incompatible with the United States’ GATT obligations. This provision requires the calculation of a

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11. President Ford stated in January, 1975 that “[w]e face a future of shortages and dependency which the nation cannot tolerate and the American people will not accept.” 31 CONG. Q. ALMANAC 173 (1975) [hereinafter Ford Statement].


13. The CAFE law may yield other benefits as well. For example, exposure to “manganese, which is contained in vehicle exhaust emissions[,] . . . has been linked to violent behavior in prisoners.” The February Almanac, THE ATLANTIC, Feb., 1995, at 18.

14. The lower standard for light trucks is another source of tension with regard to foreign producers. U.S. automakers dominate sales of light trucks, which for this calculation includes minivans and recreational vehicles. Some argue that the lower CAFE standard for this category of vehicles effectively protects U.S. manufacturers. DANIEL C. ESTY, GREENING OF THE GATT: TRADE, ENVIRONMENT, AND THE FUTURE 269 (1994). The Panel did not address this argument, though the EC raised the issue. CAFE Panel Report, supra note 5, para. 3.254.

15. At the time the complaint was filed what is now called the European Union was called the European Community. The GATT panel describes that party as the European Community and this Note will also do so when discussing the panel’s reasoning. European Union or EU will be used when discussing actions taken since the group changed its name. See Howard LaFranchi, ‘European Union’ Takes Over for EC, CHRISTIAN SCI. MONITOR, Dec. 13, 1993, at 3.
Each automaker's cars are placed into one of two categories in determining the fleet average, depending on where the car is produced. The separation of autos into a domestic fleet and an import fleet is accomplished through the "fleet accounting" requirement. This provision was the second element challenged by the EC. Autos that are domestically produced — which means at least seventy-five percent of the value of the car has come from the United States — are placed in one category; while imported cars — any car made of less than seventy-five percent U.S. value added — are placed in another category. The nationality of the automaker is not important in determining the fleet; the location of production is. An auto manufactured in the United States by a foreign company would be defined as a "domestic" car if it met the value added requirement.

In addition to the requirements for foreign fleet accounting and fleet averaging, there is a system of credits and waivers that can be applied to determine an automaker's corporate average fuel economy. Credits are offered to reward producers who innovate in ways that protect the environment. For example, fuel economy for cars powered by less polluting alternative fuels is calculated differently from the fuel economy of cars powered by gasoline. The statute exempts "specialty" automakers that sell fewer than 10,000 cars per year in the United States. These producers are exempt because they do not have the resources to invest in the costly technology necessary to meet the fuel economy standards.

The CAFE standards are enforced by a penalty that increases as an automaker's average fuel economy decreases. Automakers are punished proportionally to how close or far they are to the CAFE requirement.
Manufacturers who do not meet the CAFE standards must pay a penalty of five dollars for each tenth of a mile below the standard for each car sold in the United States.\textsuperscript{22}

\section*{2. Effect of the CAFE Law}

\subsection*{a. Effect on the U.S. Auto Market}

The CAFE law intended to promote fuel efficiency by both encouraging automakers to develop more efficient technology and by providing an incentive for U.S. automakers to build and sell more small cars. Both of these goals would have been undermined if U.S. automakers could have purchased small cars from abroad and resold them under U.S. nameplates in the United States.\textsuperscript{23} At the time the CAFE law was approved, the United States was at a severe disadvantage competitively in the small car market with regard to both European producers and Japanese producers. Congress feared that unless the fleet accounting provision was included, U.S. manufacturers would meet the CAFE requirements by purchasing small cars produced abroad and reselling them in the United States, thus offsetting the low fuel efficiency of the large cars it produced in the United States.\textsuperscript{24} Purchasing and reselling imported small cars would have been the preferred option because U.S. automakers claim that they actually lose money on small car production in the United States.\textsuperscript{25}

Were U.S. companies permitted to resell small foreign cars they would have had no need to make expensive investments in increasing fuel efficiency. U.S. automakers have spent billions of dollars over the past twenty years to meet these requirements. Ford, for example, estimates that it spent twelve billion dollars over one ten-year period to ensure that it met the CAFE requirements.\textsuperscript{26} U.S. automakers have often begrudgingly undertaken this task and have consistently claimed that this law has hurt their ability to compete with foreign producers.\textsuperscript{27} Yet, they have developed technology that has improved the fuel efficiency of all cars they have sold.

\begin{itemize}
\item \textsuperscript{22} \textit{Id.} The Secretary of the Department of Transportation may impose additional penalties in certain situations. 49 U.S.C. § 32912(c) (1994).
\item \textsuperscript{24} 121 CONG. REC. H18700 (daily ed. June 12, 1975) (statements of Reps. John D. Dingell and Phil Sharp).
\item \textsuperscript{25} America's Carmakers: An Exhausting Time, ECONOMIST, Oct. 6, 1990, at 76.
\item \textsuperscript{26} CAFE Panel Report, supra note 5, para. 3.232.
\item \textsuperscript{27} 46 CONG. Q. ALMANAC 280 (1990).
\end{itemize}
In addition to the "technology forcing" aspect of the law, CAFE provides incentive for a market-based approach to meeting the requirements. As the cost of making marginal improvements in technology increases and it becomes more expensive to make large cars more fuel efficient, automakers can meet the CAFE requirements by selling more small domestic cars. As with the incentive to improve technology, the incentive to require auto companies to sell small cars has worked — the sales of small cars produced in the United States has increased since the CAFE law took effect. Again, it is important to note that the sales of small cars has come at a cost to U.S. manufacturers. Apparently, U.S. auto companies are "full-line" producers in large part to ensure that they meet the CAFE standards.

But if the goal of the CAFE law was protectionism, it has failed in certain respects. By separating domestic cars from foreign cars sold by U.S. automakers, the CAFE law created an incentive to produce some larger cars abroad. U.S. companies, through joint ventures, have imported cars and resold them under U.S. nameplates. Because these cars in practice have been small high-mileage vehicles, the foreign fleets of U.S. automakers have easily exceeded the CAFE requirements. The CAFE law does not reward automakers for averages in excess of the minimum; as a result, there is an incentive for a U.S. producer to build lower mileage cars abroad in order to take advantage of the surplus over the CAFE minimum and to move them out of the domestic category,

28. The gas guzzler law sets a minimum level of fuel efficiency for each individual car, below which automakers are subject to fines. 26 U.S.C. § 4064 (1994).

29. The fleet accounting provision can be challenged as a violation of Article III most persuasively for this effect. As the EC noted in its argument to the GATT panel, Congress acknowledged this problem. A report approved by the House of Representatives Ways and Means Committee stated that Congress rejected a direct tax on low mileage cars because "of the danger of a major loss of jobs . . . [and the Committee] did not want to provide a stimulus to increased imports of autos, in view of the depressed state of the U.S. auto industry." CAFE Panel Report, supra note 5, para. 3.266; see also Peter Behr, Trade Case Poses Threat to Environmental Law, GATT, WASH. POST, June 10, 1994, at F1. The United States was not concerned about competition from large cars from Europe — it was concerned about Japanese small car imports. See, e.g., 121 CONG. REC. S22851 (daily ed. July 15, 1975) (statement of Sen. Robert W. Griffin) ("I am very concerned that one of the effects of the enactment of this legislation is to encourage even greater sales here in the United States of imported automobiles in the period immediately ahead.")


31. In the terminology of the CAFE Panel Report, "full-line" producers make and sell both large and small cars. See CAFE Panel Report, supra note 5, para. 3.56.
which is weighted toward larger cars. Ford has done this. In 1989, it moved a portion of the production of the Grand Marquis, one of its biggest cars, to Canada so that its domestic content would fall below seventy-five percent and thus be classified as an import for CAFE purposes. The sole reason for the move in production, according to Ford, was the CAFE requirement. Likewise, Nissan, a Japanese company, has been discouraged from adding more U.S. content into the production of the Sentra because it does not want it to become classified as a “domestic” car under the CAFE standards. If it were to be classified as a domestic car, it would face CAFE penalties.

b. Effect on the Environment

The CAFE law has been extremely effective in meeting its environmental goals. The average fuel efficiency of an auto driven in the United States has nearly doubled since the early 1970s. In 1978, autos sold in the United States averaged eighteen miles per gallon; less than a decade later, they averaged almost twenty-eight miles per gallon. This means that far fewer barrels of oil are being used for each mile driven and far fewer pollutants are being pumped into the air than there would be in the absence of the law. This in turn means there is less pollution and comparatively less need for oil imports from abroad. In addition,

32. See Alex Taylor, Do You Know Where Your Car Was Made?, FORTUNE, June 17, 1991, at 52.

33. See Warren Brown, Ford to Convert Two Cars into Imports, WASH. POST, June 20, 1989, at D1 (paraphrasing Ford’s manager of fuel economy and compliance: “Shifting those cars from domestic to import slots would help the company improve the CAFE rating of its domestic fleets by nearly one mile per gallon, while reducing the rating of its import fleet.”); David Everett, Fuel Law Backfires; It Cuts Jobs, Mileage, DET. FREE PRESS, Sept. 30, 1991, at 1A, 7A.


36. Id.


38. Oil is the single largest good imported into the United States in terms of cost. THE WORLD ALMANAC AND BOOK OF FACTS 202 (Robert Famighetti ed., 1995). The growth in sales of light trucks, which includes sport utility vehicles, has increased fuel consumption as this category of vehicles is subject to a lower CAFE standard. Brad Knickerbocker, As Drivers Shift to Guzzlers, Nation’s Fuel Efficiency Stalls, CHRISTIAN SCI. MONITOR, Oct. 6, 1995, at 1. In light of the growth in sales of light trucks, the National Highway Traffic Safety Administration proposed to increase the CAFE standards by 35 percent by 2006. A law was passed in 1995 that prohibits the Department of Transportation from spending any money on a rule that would lead to higher CAFE standards for light trucks, effectively scuttling efforts to increase fuel efficiency. Phil Frame, Big Three Win Battle in CAFE War, AUTOMOTIVE NEWS, Nov. 6, 1995, at 3. Many have argued that the CAFE law has increased fuel consumption by making it cheaper to drive. See, e.g., Passell, supra note 35.
the CAFE law has produced these benefits at no net cost to consumers. The cost of the technology to increase fuel economy has been offset by the savings from purchasing less gasoline.\textsuperscript{39} Both of these achievements reflect the primary goals of the CAFE law.\textsuperscript{40}

B. CAFE, Global Warming, and the Environment

The CAFE law is unusual in that it is domestic law, applied domestically,\textsuperscript{41} that has a directly positive effect not only in the United States, but across all borders. The CAFE law, by reducing the consumption of gasoline,\textsuperscript{42} helps to preserve a limited natural resource that is an integral part of essentially every economy in the world. In reducing gasoline consumption it reduces auto emissions, which create greenhouse gases, which in turn cause global warming. Transportation is a particularly large source of greenhouse gases, as about one-third of all man-made carbon dioxide emissions from industrial countries come from the transportation sector.\textsuperscript{43}

Global warming, of course, is an issue that has raised deep concern internationally and has been a focus of cooperative efforts to protect the environment.\textsuperscript{44} The first serious effort to develop an international approach to resolving this problem began in 1991 through the creation of the Framework Convention on Climate Change.\textsuperscript{45} The United States, members of the European Union, and Japan were among the countries that participated in the creation of the document.\textsuperscript{46} This work produced an agreement that was signed at the Earth Summit in Rio de Janeiro. The agreement negotiated in Rio de Janeiro aimed for each nation to

\textsuperscript{39} Gregg Easterbrook, \textit{Here Comes the Sun}, NEW YORKER, Apr. 10, 1995, at 38, 40. \textit{But see} Passell, \textit{supra} note 35, at C2 (stating that the CAFE law has cost between 30 and 60 cents for each gallon saved).


\textsuperscript{42} \textit{See} Passell, \textit{supra} note 35.


\textsuperscript{44} \textit{See, e.g.}, Adam A. Aronson, \textit{Note}, \textit{From "Cooperator's Loss" to Cooperative Gain: Negotiating Greenhouse Gas Abatement}, 102 YALE L.J. 2143, 2144 (1993) (arguing that despite some scientific uncertainty, global warming presents a serious problem to world welfare).


reduce its greenhouse gas emissions to 1990 levels by the year 2000.\textsuperscript{47} In other words, each nation was to take unilateral measures to address the problem.\textsuperscript{48} The "Rio Treaty" called for these plans to be developed by 1995.\textsuperscript{49}

Fifteen industrialized countries released their plans to address global warming at a 1995 conference in Berlin.\textsuperscript{50} Nine of the fifteen nations, including the United States, were unable to detail how they would meet the goal set out at the Earth Summit.\textsuperscript{51} The inability of many nations to even develop a plan, much less make difficult and expensive changes in energy consumption, illustrates the extreme difficulty of meeting this environmental goal.\textsuperscript{52} The uncertainty inherent in the problem has made a number of nations reluctant to aggressively address the issue. Like many other environmental policies involving complex scientific analysis that cannot produce certainty, the desire to combat global warming has been tempered by a small number of studies that conclude that it may not be as serious a problem as it once was believed.\textsuperscript{53} Tied to the uncertainty is the lack of will to address issues that will have consequences far into the future. Global warming will begin to have serious effects late in the next century if adequate steps are not taken.\textsuperscript{54}

Addressing global warming is especially difficult because of collective action problems. The fundamental problem is encouraging cooperation among many participants. When seeking to address a problem such as global warming, the benefit from taking action may be large but costly. Since benefits accrue only when many countries act, cooperation is necessary. Obtaining cooperation is difficult because each individual


\textsuperscript{48} The agreement does allow for nations to work together to reduce emissions. Barratt-Brown, supra note 47, at 111. At this point, however, joint efforts appear to be rare.

\textsuperscript{49} William K. Stevens, Nations to Consider Toughening Curbs on Global Warming, N.Y. TIMES, Feb. 21, 1995, at B8.

\textsuperscript{50} Id.

\textsuperscript{51} Id.

\textsuperscript{52} In an effort to implement policies that would meet the goals of the Earth Summit, the Clinton Administration created an advisory panel that included federal and state government officials, as well as industry and environmental representatives, to find acceptable policies to reduce greenhouse gas emissions from cars. Increasing the CAFE standards was among the issues before the panel. Without reaching agreement on any issue, the panel disbanded. Jayne O'Donnell, Auto Future Hits Roadblock: Washington Meetings Devolve into Car Not Talks, AUTOWEEK, Oct. 2, 1995, at 4, available in LEXIS, News library, Autowk file.

\textsuperscript{53} Passell, supra note 35.

\textsuperscript{54} See, e.g., Stevens, supra note 49.
country may not believe that its participation is necessary and that the problem can be solved without them. Thus, these countries are unwilling to incur the cost and will “free-ride” on the efforts of others. This problem recurs in environmental policy, particularly in issues that cross national borders or extend into global commons. The international effort to limit global warming represents a classic case in point. Even though 120 nations agreed to address the problem, there is no guarantee that all will take the agreed-upon (costly) steps.\(^5\) As long as some nations refuse to honor their obligations, there will be an incentive for more nations to do less than their share. These nations can allow others to incur the cost of reducing emissions and reap the benefits for free.

Those countries that do not take measures to reduce the threat of global warming will obtain a competitive advantage in producing goods for trade. Producers in nations with lower environmental standards will have fewer costs as compared to their economic competitors. There is thus an incentive for each nation to reduce costs incurred by producers by reducing environmental standards below their competitors’.\(^5\) Whether the GATT/WTO system provides much of an incentive to race-to-the-bottom is a hotly contested issue.\(^5\) There is no question, however, that the thrust of the GATT/WTO has been to permit lower environmental standards as a legitimate form of comparative advantage.\(^5\) It is troubling that there may still be a race-to-the-bottom when there is a widely accepted international agreement on an environmental issue, as there is on global warming.

The CAFE case implicates all of these issues. The elimination of the CAFE law would make it even more difficult for the United States to meet its Rio obligations. As the world’s largest emitter of man-made carbon dioxide, it must play a central role in the world’s effort to limit

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55. See, e.g., Victor and Salt, supra note 45, at 30.

56. See Richard B. Stewart, Environmental Regulation and International Competitiveness, 102 YALE L.J. 2039, 2041 (1994). Consumers state that they are willing to buy environmentally friendly products. See Thomas C. Downs, Note, “Environmentally Friendly” Product Advertising: Its Future Requires a New Regulatory Authority, 42 AM. U. L. REV. 155, 155 n.2 (1992). However, this market appears to be quite small. “[I]f the coming year follows recent trends, [the] top 10 [most] fuel-efficient cars will account for less than 1 percent of those sold.” Knickerbocker, supra note 38, at 5. Even autos made with high fuel efficiency may be produced in nations with low environmental standards and thus the production process may add a relatively large amount of pollution.


global warming. As the recent conference in Berlin demonstrated, the United States has been unable to develop a strong enough plan to reduce greenhouse gases — even with the CAFE law already in place. Were the CAFE law to be repealed, the United States might face insurmountable problems in meeting its obligation. Moreover, beyond concerns about the United States meeting its obligation, setting fuel economy standards could be a method taken around the world to reduce greenhouse gases. Some have suggested creating a protocol that calls on other nations to set fuel economy standards.

II. GATT PANEL DECISION

The EC claimed that the CAFE law violated Article III of GATT, the national treatment obligation. The EC argued that the CAFE law had had a disproportionate impact on European car makers because of certain provisions that favor U.S. automakers. These provisions — requiring “fleet accounting” and “fleet averaging” — the EC argued, violated Article III paragraph four, which prohibits measures that treat imported products less favorably than domestic products.

The national treatment obligation is at the very core of the GATT/WTO regime. It helps to ensure that laws and regulations do not

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60. Victor & Salt, supra note 45, at 28.
61. CAFE Panel Report, supra note 5, paras. 3.220–3.313. Paragraphs two and four of Article III were at the heart of the challenge. Article III, para. 2, reads as follows:

The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.


Article III, para. 4, reads as follows:

The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use. The provisions of this paragraph shall not prevent the application of differential internal transportation charges which are based exclusively on the economic operation of the means of transport and not on the nationality of the product.

GATT, supra, art. III, para. 4.
62. CAFE Panel Report, supra note 5, paras. 3.266, 3.290.
favor domestic products at the expense of imports. The proper scope of the national treatment obligation is a matter of debate, however. One might legitimately ask whether Article III has been interpreted in a way that effectively requires comparatively more favorable treatment for foreign products. The CAFE panel decision, which is fundamentally consistent in its reasoning with previous Article III cases, illustrates a situation in which Article III can be interpreted to provide more favorable treatment for imported products.

A. Origin of the Dispute

After consultations between the EC and the United States failed to resolve the controversy over the CAFE law and the gas guzzler and luxury taxes, the EC called for the establishment of a panel under Article XXIII. Article XXIII allows for the dispute settlement procedure to be invoked if a member of the GATT believes that "any benefit . . . under [the] Agreement is being nullified or impaired . . . ." Some automakers in the EC have incurred penalties for failing to meet the CAFE requirements. In 1992, at the time the case was brought, automakers in the EC reportedly had paid over two hundred million dollars in fines to the U.S. government for CAFE violations. The EC pointed to the disparate effect of the law. It claimed that 99.99 percent of the penalties paid under the law had been paid by European producers and that no U.S. company has ever paid any fines for failing to meet the CAFE standards. In particular, the EC argued that the "fleet accounting" and "fleet averaging" provisions did not comport with the GATT. Sweden, which exports cars of similar fuel economy to the United States and at the time was not a member of the European Union, joined as a third party in claiming that the CAFE law violated the national treatment obligations of Article III of GATT.

64. CAFE Panel Report, supra note 5, para. 1.1.
65. GATT, supra note 61, art. XXIII, para. 1. The following paragraph states that "[i]f no satisfactory adjustment is effected between the contracting parties concerned within a reasonable time . . . the matter may be referred to the CONTRACTING PARTIES. The CONTRACTING PARTIES shall promptly investigate any matter so referred to them and shall make appropriate recommendations to the contracting parties which they consider to be concerned, or give a ruling on the matter, as appropriate." Id. at para. 2.
66. Paying the Price: Gas Guzzlers Rack up $233 Million in Government Fines, DET. FREE PRESS, Nov. 11, 1992, at 1E. Mercedes and BMW were the principal violators of the CAFE law. See, e.g., Kibel, supra note 8, at 16. The Department of Transportation sets the penalties for violation of the CAFE law. 49 U.S.C. § 32912(b) (1994).
67. CAFE Panel Report, supra note 5, para. 3.220.
B. National Treatment

1. Goals

The national treatment obligation requires that "nations, when applying their domestic taxes and regulations, treat imports no less favorably than they treat their domestically produced goods." The goal is to protect the importing nation's sovereign right to regulate its market while at the same time ensuring that domestic law is not used as a non-tariff barrier to trade. One of the basic goals of the trading system created by GATT is to force all trade barriers into the open so nations can negotiate mutually beneficial reductions. Article III is designed to eliminate non-tariff barriers and to protect the integrity of the tariffs. Making trade barriers apparent also helps to ensure that the trade system is fair. Each side knows what the other has given and what it retains.

Non-tariff barriers, or disguised discrimination, undermine the goals set out by GATT. The number of non-tariff barriers is staggering. Researchers have identified hundreds of non-tariff barriers that nations have erected; the number of non-tariff barriers that could be conceived of and implemented is far larger. One example of a disguised trade barrier arose between the United States and Canada over lobster fishing. "[T]he U.S. banned imports of Canadian lobsters that did not meet the minimum size requirements . . . despite evidence that Canadian lobsters are naturally smaller because Canadian waters are colder." This placed Canadian fishermen at a disadvantage, and the issue was heard under the dispute settlement procedure set up as part of the Canada-U.S. Free Trade Agreement. Designing trade rules that eliminate these hidden barriers while ensuring that a nation may pass laws to address its needs has proven difficult. Often, there is a tension between non-discrimination and enabling a nation to have flexibility in designing a law to address its problems. This tension is at the core of the controversy over the CAFE law.

69. Id. If the GATT is evaluated on how dramatically tariff barriers have fallen, it has been an enormous success. JOHN H. JACKSON, THE WORLD TRADING SYSTEM: LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS 117 (1989).
70. CAFE Panel Report, supra note 5, para. 5.53; JACKSON, supra note 69, at 189.
71. See JACKSON, supra note 69, at 130.
72. Stewart, supra note 56, at 2043.
2. Article III:4

The EC's challenge to the CAFE law was based on Article III Paragraph four (Article III:4) which states that imported products "shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale . . . ."\(^{74}\) The entire CAFE law was not challenged by the EC; the EC stated that it favored the environmental goals of the law.\(^{75}\) Instead, it challenged two specific provisions. First, it claimed that the separate fleet accounting provision violated Article III:4. The separate foreign fleet accounting provision violated GATT, the EC argued, because it afforded protection to small domestic cars\(^{76}\) and treated large imported cars less favorably than large domestic cars, because importers could not combine large imported cars with small domestic cars.\(^ {77}\) The United States argued that domestic products were also discriminated against because U.S. firms could not combine large domestic cars with small foreign cars to meet the requirement.\(^ {78}\) Second, the EC argued that the fleet averaging provision violated Article III because it treated like products differently.\(^ {79}\) The EC claimed that the fact that U.S. automakers could increase the average fuel economy of the fleet by adding sales of small domestically produced cars, while "limited-line" European producers could not because they do not produce small cars, indicated that the law violated Article III, because it allowed like products to be treated differently depending on the company that manufactured them.\(^ {80}\)

3. Panel's Findings on Article III Claims

a. Fleet Accounting Provision

The panel found that the requirement calling for separation of an automaker's cars into a foreign fleet and domestic fleet violated Article III because it treated both small foreign cars less favorably than small domestic cars and large foreign cars less favorably than large domestic cars.

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74. GATT, supra note 61, art. III, para. 4.
75. CAFE Panel Report, supra note 5, para. 3.314.
76. Id. para. 3.290.
77. See id. para. 5.47.
78. Id. para. 3.298.
79. Id. para. 3.269.
80. Id.
Small foreign cars were treated less favorably because, unlike small domestic cars, they could not be used to offset the low fuel efficiency of large domestic cars. Likewise, large foreign cars were treated less favorably because unlike large domestic cars they could not have their poor fuel efficiency offset by small domestic cars.

The reasoning of the panel was consistent with previous GATT interpretation of Article III:4 on this issue. Although there is no rule of stare decisis under the GATT and previous cases do not bind later GATT panels, panels have relied on the reasoning of past panels. Here, the panel decision United States — Section 337 of the Tariff Act of 1930 is relevant. The panel held in the Section 337 dispute that less favorable treatment in one part of a law cannot be balanced against more favorable treatment in another part of the law. Even though the CAFE law provides foreign producers more favorable treatment than domestic producers in practice — because large foreign cars can be averaged with small foreign cars while large domestic cars cannot be averaged with small foreign cars — the GATT makes no attempt at determining the net effect of the entire statutory scheme.

Balancing the provisions that favor domestic products against provisions that favor imported products would be inconsistent with the GATT’s interest in protecting the expectations of the parties, according to the Section 337 panel. The panel reasoned that balancing would lead to uncertainty because it might result in situations in which a panel might allow less favorable treatment in one case and more favorable treatment in another. This analysis has another consequence: in protecting certainty a panel seeks to evaluate laws prospectively. Thus, a com-

81. Id. para. 5.47.
82. Id. para. 5.48.
85. Id. paras. 5.11–14.
86. Id. para. 5.14.
plaining party need not demonstrate a negative impact, it need only demonstrate that a law conflicts with the GATT. In the CAFE case, even though the EC presented facts that showed that EC automakers had been fined far more than U.S. automakers, it did not need to show how the penalties affected actual trade.

b. Fleet Averaging Provision

The panel also found the fleet averaging rule to violate Article III because like products were not treated equally. The CAFE statute calls for an averaging of fuel efficiency over all of a manufacturer's auto sales in the United States. Large cars are averaged with small and medium-sized cars. This results in situations in which similar cars can be treated differently. The EC had argued, for example, that the Mercedes-Benz 500 SL was similar, with respect to fuel efficiency, to the Cadillac Allante, but because of the fleet averaging rules, the Mercedes was penalized, while the Cadillac was not. The fact that a product was treated differently on the basis of something not related to the product as a product violated Article III. In this example, General Motors' sales of more fuel efficient cars prevented it from incurring a penalty, while the similarly situated foreign car producer was penalized. This disparate treatment of like products violated GATT. The panel stated that "to the extent that treatment under the CAFE measure was based on factors relating to the control or ownership of producers/importers, it could not in accordance with Article III:4 be applied in a manner that also accorded less favorable treatment to products of foreign origin." The "less favorable treatment" in itself was sufficient to constitute a violation of GATT; the panel did not find it necessary to determine whether the law had the effect "so as to afford protection" to domestic producers.

4. Scope of the Panel's Reasoning — More Favorable Treatment

The CAFE decision provides support to the argument that in seeking to prevent discrimination between imported and domestic goods, Article

87. J ACKSON ET AL., supra note 63, at 519.
88. A strong argument could be made that U.S. companies would be more profitable if they did not have to comply with the CAFE law. See discussion supra part I.A.2.a. Thus, the net effect of the CAFE law on trade may actually favor foreign producers.
89. CAFE Panel Report, supra note 5, para. 3.271.
90. Id. para. 5.55.
91. Id. para. 5.54.
92. Id.
III can require comparatively more favorable treatment for imports. One clearly needs more than formal legal equality to meet the requirements of Article III. A statute that does not explicitly discriminate against imports can violate Article III. In order to eliminate disguised discrimination, Article III would have to reach beyond facially discriminatory laws. As in the Canadian Lobster case discussed earlier, nations might design laws in a way to unfairly exclude foreign goods. Difficulty arises when differences in the markets of foreign and domestic companies cause facially neutral laws to have different effects even when a nation does not try to discriminate.

Different approaches taken by EC and U.S. automakers were at the heart of the dispute. A major argument made by the United States was that the EC automakers were penalized under the CAFE law not because the law intended to discriminate against them, but because the companies made a business decision to accept the penalties rather than improve fuel efficiency. Indeed, at the time the CAFE law was enacted, Mercedes and BMW, the companies that supported the complaint, met the CAFE standards. The United States argued that to accept the EC's complaint would essentially require the United States to alter the rules specifically for the EC's benefit. The result would be that EC producers would be given favorable treatment.

The United States pointed out that the EC automakers that had been fined had actually lowered the fuel economy of the cars they sold in the United States during the 1980s. It was not that the standard was too high for the Europeans to meet, it was that they had decided that they would make a greater profit with other designs. The EC responded by stating that European companies were "limited-line" manufacturers, that is, they only produced large cars. Because they were "limited-line" manufacturers they were fundamentally different from U.S. companies, which produced a "full-line" of auto products. The panel's rejection of the United States' argument suggests effective advocacy by the EC. There is nothing inherent in an auto company that makes one "limited-line" and another "full-line." The composition of the cars made and sold reflects both an evaluation of the market and legal rules, such as the CAFE law. U.S. companies undoubtedly would manufacture fewer small cars in the United States — and become more like "limited-line" manu-

93. Section 337 Panel Report, supra note 84.
94. See supra note 73 and accompanying text.
95. CAFE Panel Report, supra note 5, para. 3.243.
96. Id. para. 3.243.
97. See id. para. 3.269.
facturers — if the CAFE law were repealed. After all, as noted, U.S. companies have sold some small cars at a loss in order to meet the CAFE requirements. In short, were the panel report to be adopted, the EC producers would be given more favorable treatment because they do not choose to sell small cars as the U.S. companies do.

The United States' business decision argument, while it shows how the effect of a decision may be to give foreign producers an advantage, ultimately failed. First, the United States could not find an adequate basis for the argument in the GATT rules. The support it offered was off-point. The United States pointed to a statement made by the panel in United States — Measures Affecting Alcoholic and Malt Beverages that "'[t]he Article III:4 requirement was one addressed to relative competitive opportunities created by the government in the market, not the actual choices made by enterprises in that market.'" By quoting that excerpt in this context, the United States subtly misstated what the panel meant. In the Malt Beverages case, the panel was concerned about opportunities in the market, not about the decisions made by businesses. Unlike the CAFE case, the law at issue there was facially discriminatory. Some importers made a business decision that made the effect of the law non-discriminatory. In finding the law to conflict with the GATT, the panel at least implicitly ignored the business decisions of the importers.

Second, and more fundamentally, if the argument were accepted, it would constrain foreign producers much more than the GATT envisioned. Unless a law explicitly stated that imports were to be treated less favorably than domestic products, a nation could in every case defend a discriminatory law by claiming that the foreign producer did not comply simply because it had made faulty business decisions. There would be no way to contain the argument. Furthermore, it would strike at the heart of the premise underlying the world trading system — that we should maximize the value of comparative advantage. Under this theory, businesses around the world should be given wide latitude in developing and producing goods so that they can emphasize the things they do most efficiently. Were the GATT to uphold discriminatory laws

98. See supra note 25 and accompanying text.

99. The argument is also appealing given the decision of some European automakers to reduce fuel economy instead of improve it.


101. CAFE Panel Report, supra note 5, para. 3.233.

102. See JACKSON, supra note 69, at 10–14.
on the basis of a "business decision" argument, nations would have to alter their own behavior more than the GATT requires. Too much oversight over a company's business decisions could eviscerate comparative advantage and undermine the gains of trade.

The most convincing argument that Article III can require comparatively more favorable treatment for imported products arises from the narrow reasoning of the panel. The panel refused to balance less favorable treatment for imports against the less favorable treatment accorded domestic products. Requiring imports to be treated at least as favorably as domestic products, but ignoring the less favorable treatment that domestic products may receive, puts domestic products at a disadvantage. In other words, if foreign products can at worst be treated as well as domestic products, but at the same time domestic products can be treated worse than foreign products, domestic products can be comparatively worse-off than imported products. The CAFE case illustrates this phenomenon. The panel concluded that the fleet accounting provision violated Article III because large imported cars could not be averaged with small domestic cars. At the same time, the CAFE law placed U.S. automakers at a disadvantage because large domestic cars could not be averaged with small imported cars. However, the panel only found the former to be in violation of the GATT; there is no requirement that the United States remedy the damage its own automakers suffer.

One might respond that Article III does not require comparatively more favorable treatment because a nation can amend its law to ensure that domestic producers are not disadvantaged. In theory, and often in practice, a nation will be able to reform its law to ensure that its own producers are treated as well as foreign producers. Here, the United States could amend the CAFE law to allow large domestic cars to be averaged with small foreign cars. But as is argued in Part III of this Note, this is not realistic, both in light of the goals of the law and political considerations. In order to gain fuel efficiency, the CAFE law damaged the competitiveness of U.S. companies. The provisions that were found to violate the GATT were meant to soften the blow which the United States imposed on its own producers. Even with the separate fleet accounting provision, U.S. industry would be damaged. Without the ability to balance less favorable provisions with more favorable

103. CAFE Panel Report, supra note 5, para. 5.48.
104. Id. paras. 5.47-49.
provisions, it is doubtful that the law would have been approved. One sees here that the effort to address environmental concerns directly clashes with trade concerns.\textsuperscript{106}

C. General Exception — Article XX(g)

Although the panel concluded that the fleet averaging provision violated Article III, the panel strongly suggested that under the proper circumstances, the fleet averaging provision could be saved by Article XX(g).\textsuperscript{107} This represents an important step in the evolution of Article XX(g). No panel had found that the exceptions applicable to environmental laws under either Article XX(b) or Article XX(g) had applied.\textsuperscript{108} In part, as a consequence of the narrow interpretation of these exceptions, some environmentalists have criticized them for being ineffective.\textsuperscript{109}

Article XX provides a series of exceptions to GATT obligations. The exceptions that the United States claimed applied in this case were Articles XX(b) and XX(g). Article XX(b) allows for measures "necessary to protect human, animal or plant life or health\textsuperscript{110} to stand under certain circumstances even though they may violate other GATT obligations. Article XX(g) provides an exception for measures "relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption[.].\textsuperscript{111}

These exceptions are modified somewhat by the language in the preamble to Article XX that states that the exceptions are "[s]ubject to the requirement that such measures are not applied in a manner which

\textsuperscript{106} For a proposal to prevent some conflicts between trade and the environment, see discussion \textit{infra} part IV.

\textsuperscript{107} The panel did not indicate what a GATT-consistent law using fleet averaging would look like.

\textsuperscript{108} "There have been seven GATT [decisions] where Article XX(b) and (g) exceptions have been raised; none of them have been successful." William J. Snape, III & Naomi B. Lefkowitz, \textit{Searching for GATT's Environmental Miranda: Are "Process Standards" Getting "Due Process?",} 27 \textit{CORNELL INT'L L.J.} 777, 797 n.124 (1994). See, \textit{e.g.}, Report of the GATT Panel, Thailand — Restrictions on Importation of and Internal Taxes on Cigarettes, GATT Doc. DS10/R (Nov. 7, 1990); Report of the GATT Panel, Canada — Restrictions on Exports of Unprocessed Herring and Salmon From the United States, GATT Doc. L/6268 (Mar. 22, 1988); Report of the GATT Panel, United States — Prohibiting of Imports of Tuna and Tuna Products from Canada, GATT Doc. L/5198 (Feb. 22, 1982).

\textsuperscript{109} Jeffrey L. Dunoff, \textit{Institutional Misfits: The GAT, the ICJ & Trade Environmental Disputes}, 15 \textit{MICH. J. INT'L L.} 1043, 1064–66 (1994). Dunoff also notes that the EC parliament approved a two year moratorium on GATT panel environmental decisions. This action was taken after the CAFE dispute was submitted to the panel.

\textsuperscript{110} GATT, \textit{supra} note 61, art. XX(b).

\textsuperscript{111} \textit{Id.} art. XX(g).
would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade[.]

This language has been described as a "soft" most favored nation clause and national treatment obligation. In other words, a measure properly falling under Article XX would have to meet some most favored nation and national treatment standard, but not as high a standard as a measure falling outside Article XX. In a case involving Article XX(g), a GATT panel stated that this language is necessary because "the purpose of including Article XX(g) in the General Agreement was not to widen the scope for measures serving trade policy purposes but merely to ensure that the commitments under the General Agreement do not hinder the pursuit of policies aimed at the conservation of exhaustive [sic] natural resources."

The panel applied a three step approach to the provisions that violated Article III: first, whether the policy of the measure was one to conserve exhaustible natural resources; second, whether the measure "related to" the conservation of exhaustible natural resources and was one to conserve exhaustible natural resources and whether it was made effective 'in conjunction' with restrictions on domestic production or consumption"; and third, whether the measure conformed with the soft MFN and national treatment obligations of the introductory paragraph of Article XX.

1. Fleet Accounting Provision Under Article XX(g)

The panel found rather conclusively that the separate foreign fleet accounting provision could not be justified under Article XX(g). First, the panel decided that the United States had offered no evidence that the provision prohibiting the averaging of large foreign cars with small cars produced in the United States by the foreign owner enhanced the goals permitted under Article XX(g). The less favorable treatment of large imported cars did not pass muster because that treatment was not primarily aimed at the conservation of natural resources. Second, the
panel ruled Article XX(g) inapplicable because the fleet accounting provision inhibited the import of small cars.\textsuperscript{118} This, of course, was one of the goals of the law. The panel concluded that this provision was not "primarily aimed" at the conservation of exhaustible natural resources, but rather made it more difficult to conserve exhaustible natural resources.\textsuperscript{119} By inhibiting the import of small, more fuel efficient cars, the fleet accounting provision reduced the number of fuel efficient cars sold in the United States and consequently increased the consumption of oil.

2. Fleet Averaging Provision Under Article XX(g)

The panel noted that under Article XX(g), the fleet averaging provision wouldn’t have to be necessary to conserve an exhaustible natural resource; that even if "other less trade restrictive measures . . . could be used equally and more effectively,"\textsuperscript{120} the measure may still pass muster under GATT. First, the panel found that the policy underlying the CAFE law was designed to conserve a natural resource. Second, and more significantly, the panel found that the specific measure — the fleet averaging provision — could meet the second part of the test under Article XX(g).\textsuperscript{121} The fleet averaging served to ensure that the law would meet its goal of conserving exhaustible resources. Without this provision, there would be no way to ensure that the fuel economy standards would be met.\textsuperscript{122} There would be no way under the law to ensure that large foreign cars did not lower overall fuel efficiency in the United States. However, the panel did not find the specific measure as it is constructed in the CAFE law to meet the requirements under Article XX(g) because it is intertwined with the fleet accounting provisions, which could not be justified under Article XX(g).\textsuperscript{123} Because the provision as structured did not pass the second test, it did not examine it under the third step (the soft MFN and national treatment). Thus, although the panel found that the fleet averaging provision in the CAFE could not be saved by Article XX(g), it opened the possibility that a CAFE law with a fleet averaging provision would be permitted under Article XX(g).

\textsuperscript{118} Id. para. 5.60.

\textsuperscript{119} Id.

\textsuperscript{120} Id. para. 5.63. The panel contrasted this with the exceptions under Articles XX(a) and XX(b) which do require a measure to be necessary. Id.

\textsuperscript{121} Id. para. 5.66.

\textsuperscript{122} Id. para. 5.65.

\textsuperscript{123} Id.
D. Summary of the Panel Report

In summary, although the CAFE rules as such were not found to violate GATT, two aspects of the statutory structure were found to violate the national treatment obligations of GATT. Both the rule calling for the CAFE averages to be determined by first separating cars produced outside the United States from cars produced inside the United States, and the rule requiring these separate categories to be averaged violated Article III of GATT. As applied in this case, Article III may require imported products to receive more favorable treatment than domestic products.

Neither of the provisions could be saved by the exception under Article XX(g) allowing for certain laws that were designed to conserve exhaustible natural resources. Nonetheless, the panel strongly suggested that a law with a fleet averaging provision would be permitted under Article XX(g). If so, it would represent a breakthrough in the application of that exception. At present, no measure has been saved by the Article XX(g) exception.

III. IMPLICATIONS AND POTENTIAL CONSEQUENCES OF THE DECISION

A. Status of the Panel Report

The panel decision recommended that the provisions of the CAFE law that did not comply with GATT be brought into conformity. Under most circumstances, the United States would have to revise the law, negotiate with the EU for compensation, or allow the EU to suspend concessions in a way that harms the United States.\(^\text{124}\) However, the panel report has not been adopted by the CONTRACTING PARTIES to the GATT.\(^\text{125}\) Adoption of a panel report prior to the Uruguay Round and the creation of the WTO required a consensus of all parties.\(^\text{126}\) This meant that any one party — even the losing party — could ensure that the panel report would not be adopted.

The results in this case — including the sections on the luxury tax and the gas guzzler law — have produced an odd dynamic. The United


\(^{125}\) In GATT style, "contracting parties" is capitalized when referring to the members of GATT when they are acting jointly under Article XXV. GATT, \textit{supra} note 61, art. II, para. 6.

\(^{126}\) Understanding on Rules and Procedures Governing the Settlement of Disputes, \textit{supra} note 124, at 656.
States, the subject of the complaint and a losing party on one part of the case, favored the report's adoption, while the EU has opposed its adoption.\textsuperscript{127} The United States was pleased that the luxury tax and the gas guzzler laws were found to comport with GATT and it has declared victory as to the CAFE part of the case, even though the law was found to violate the GATT.\textsuperscript{128} Although the EU prevailed with regard to the CAFE law, its complaint was rejected with regard to the luxury tax and the gas guzzler tax. The EU rejected the panel report as it believes that the panel members misread its legal brief.\textsuperscript{129} The EU asked the WTO Council to review the matter. Sweden, which acted as a third party, also called for the issues to be examined again.\textsuperscript{130} At this point, the GATT Council has not taken action in response to those requests.

There are a number of possible future developments in this case. It might remain dormant and the panel report may never be adopted. Given the United States' position on the case, the United States is unlikely to negotiate an agreement with the EU on the CAFE law. The WTO Council could agree with the EU's argument and reopen the case. No rule in the GATT would prohibit this. The principle of \textit{res judicata} has been rejected in the past by the GATT Council; panels have been established that have examined the same law prior panels had addressed.\textsuperscript{131} If the case were to be reopened it is likely that the GATT

\begin{thebibliography}{131}
\bibitem{129} \textit{After Free Trade Euphoria, Now Comes the Hard Part}, [Jan.–June] Int'l Trade Rep. (BNA) No. 3, at 129 (Jan. 18, 1995). The panel's reasoning and conclusion with regard to the luxury tax part of the case in particular has drawn sharp criticism from the EC.
\bibitem{131} In 1991, the GATT Council established a panel to hear a second claim by Brazil against a U.S. law affecting the import of non-rubber footwear. A GATT panel had rejected Brazil's argument that the law violated the 1979 Subsidies Code. Brazil had asked that it be given a second chance to challenge the law, this time as a violation of Article 1 of the GATT.
\end{thebibliography}
rules on dispute settlement would apply.132

B. Potential Consequences of the Report

At this point, the United States need not conform the CAFE law to GATT because of the panel decision. The panel report has not been adopted; and even if it were, the United States is not compelled under the GATT or the WTO to amend its law.133 And, indeed, the Clinton Administration has stated that it will not amend the law to conform with its GATT obligations.134 There is no indication that Congress will amend the law to comply with the panel report.135 The panel decision would carry no weight in a domestic proceeding and thus a U.S. court cannot compel the law to be changed.136

Yet whether or not the case will be reopened, examining how the CAFE law would likely appear if it were to conform to the GATT is useful because it demonstrates how our obligations under the GATT/WTO system affect our ability to enact environmental law.137


132. The WTO Dispute Settlement Understanding states that disputes arising under the GATT must follow the past rules and procedures. This applies even to panel reports that have not been adopted. Understanding on Rules and Procedures Governing The Settlement of Disputes, supra note 124, at 656.

133. See generally JACKSON ET AL., supra note 63, at 318–48.


135. As of November 2, 1995, 3,971 bills have been introduced in the current session of Congress — none of them would amend the CAFE law to conform with the panel report. 141 CONG. REC. D1298, D1301 (daily ed., Nov. 2, 1995). See O'Donnell, supra note 52 (noting failure of efforts to reach common ground on policies to reduce greenhouse gases from autos).

136. It is important to note that even though the panel found that the CAFE law violates the United States' GATT/WTO obligations, and the WTO has force as U.S. law, this conflict does not make the CAFE law invalid. In the event that GATT/WTO rules conflict with a U.S. law, U.S. courts have ruled that U.S. law applies. See, e.g., Suramerica de Aleaciones Laminadas, C.A. v. United States, 966 F.2d 660, 667–68 (Fed. Cir. 1992). Provisions of the CAFE law clearly conflict with GATT rules and there is no plausible way to read them as being consistent with the United States' obligation under GATT. Under the reasoning of U.S. courts, however, there is no question that the CAFE law would prevail in a challenge in the United States on the basis of GATT. In short, the U.S. courts, whose decision would be binding, cannot be used to invalidate the CAFE law.

137. One should remember that neither of the Tuna-Dolphin reports was adopted and the United States has not changed the Marine Mammal Protection Act, the law at issue there. Those panel reports clearly were important.
When one examines what a CAFE law that conformed with the GATT would look like, one concludes that Ambassador Kantor's statement that the panel decision "laid to rest fears that WTO panels will interpret the GATT in a way that challenged [sic] our ability to safeguard our environment"138 cannot withstand scrutiny. In short, the panel decision does limit our ability to safeguard our environment. Examining what would need to be done to make the CAFE law compatible with the GATT makes this point clearer.

C. Bringing U.S. Law into Compliance With the GATT

1. A CAFE Law that Would Conform With the GATT

This section sets forth an amendment to the CAFE law that would conform with the requirements of the GATT. In light of the reluctance in the United States to alter the CAFE law, the amendment would alter the CAFE law as little as possible. The amendment would eliminate the separate fleet accounting provision, but retain the fleet averaging provision.

The separate fleet accounting for foreign and domestic autos cannot survive GATT in any form. The panel found that it was discriminatory because like products — small cars, for example — were treated differently on criteria unrelated to "cars as products."139 In this case, treating the products differently because the manufacturers were different was unacceptable. There is no plausible way to define imported cars as different "products" from domestically produced cars under GATT rules. A revised CAFE law would have to classify imported small cars in the same way as domestically produced small cars. Likewise, large imported cars would have to be classified in the same way as large domestic cars. Separating them on the basis of the place of manufacture is impermissible.

Even though the panel found that the fleet averaging provision violated Article III, it is possible to retain a fleet averaging provision in a corporate average fuel economy law. The panel suggested that such a provision could be saved by Article XX(g).140 Thus, the amended law

138. See supra note 1 and accompanying text.
139. CAFE Panel Report, supra note 5, para. 5.55.
140. Id. para. 5.66. The panel did not state how it could be saved by Article XX(g):

This analysis suggested to the Panel that in the absence of separate foreign fleet accounting it would be possible to include in a revised CAFE regulation an averaging method that would render the CAFE regulation consistent with the General Agreement. As such a revised method was only hypothetical at this time (since fleet averaging did not exist independently of separate foreign fleet accounting),
would retain a fleet averaging provision. As a result, all of the cars sold by the manufacturer, whether they were produced in the United States or abroad, would be placed into one category to determine corporate average fuel economy.141

2. Likely Effect of a Revised CAFE Law

Even though only a small part of the statute would be eliminated to conform with the GATT, a revised CAFE law would be far different from the current law. Domestic automakers would be more likely to import small fuel efficient cars and sell them in the United States; United States manufacturers would probably import more cars they produce abroad and enter into more joint ventures with foreign companies.142 In the absence of an increase in the CAFE minimum, U.S. automakers could meet the requirement by selling in the United States more small cars produced abroad.143 This would likely be the choice given the large expense of developing new technology. As a result of this change in the market, the incentive to develop energy efficient technology would be undermined. To the extent that producing small cars is more expensive in the United States, that production would be eliminated and the goal of encouraging greater small car production in the United States would also be undermined.144 The market would likely produce U.S. auto companies that, in terms of domestic production,
would more closely resemble limited-line European automakers. Because of the potential for lost manufacturing of small cars, it is unlikely that a revised CAFE law would garner much political support from many of those who have supported the law in the past.

The amended law would give EU automakers no new way to meet the CAFE requirements, unless they plan on purchasing small U.S.-built cars and reselling them in the United States. That is not likely. A revision that retains the fleet averaging provision does not leave the EU producers who pay the penalties in a better position. In fact, inasmuch as U.S. automakers can more cheaply meet the requirements under the revised law, EU manufacturers may be worse off in comparison to U.S. producers. In the absence of the CAFE law, U.S. automakers would likely put more resources into the development of larger cars which compete directly with the EU automakers who raised the complaint.145

In challenging the CAFE law before the panel, perhaps the EC hoped for one of three things to happen. The first would be that revision of the law would be impossible, and that the CAFE law would be eliminated entirely. The second would be that U.S. companies would be forced to build more small cars in their plants in Europe.146 This is suggested by the fact that the “limited-line” manufacturers in Europe would at best be no better off under a CAFE law that conforms to GATT. Since U.S. automakers already produce a great number of small cars in Europe, economies of scale might make it cheaper for them to meet new CAFE requirements by importing small cars from their European plants. The third possibility is that the EC hoped that the panel would accept their argument that the combined effect of the CAFE law, the luxury tax and the gas guzzler tax violated the GATT. In other words, including the challenge to the CAFE law would bolster their arguments with regard to the other laws, which penalize European producers much more severely than the CAFE law does.147

D. A “‘Wrong’ Case?”

The consequence of eliminating the one “technical” element of the law to ensure that the CAFE law comported with Article III would require a “substantial change” in the law, as the panel noted.148 If

145. The profit margin is higher for large cars than it is for small cars. See, e.g., America’s Carmakers: An Exhausting Time, supra note 25, at 76.

146. The EC pointed out in its presentation to the panel that the U.S. “already produces quality small cars in Europe.” CAFE Panel Report, supra note 5, para. 3.290.

147. Cf. id. para. 3.345.

148. Id. para. 5.66.
amending the CAFE law to comply with GATT would cause a fundamental change in the effect of the law, one wonders whether it would survive in any recognizable form. This may be an example of what Professor Robert E. Hudec calls a "'wrong' case." These are cases in which "the complaining party may be correct in alleging a violation, but because of domestic political considerations the violator may not be in a position to comply with GATT rules." The amended law raises both political problems and substantive problems. The circumstances that conspired to enable the CAFE law to prevail have long since ceased to exist. The CAFE law was fundamentally a product of the energy crisis. The CAFE law was approved at a time in which there was widespread and deep concern about energy use. Today, the energy crisis is seen by most — inappropriately — as a thing of the past. The concern for global warming might offer a foundation for support of the law, but many believe that the uncertain threat of global warming does not justify costly environmental measures. The political dynamics have also changed dramatically. While neither political party uniformly supported or opposed the CAFE law, supporters of the law in 1975, when it was first enacted, and in 1990, when the Senate voted on amendments to strengthen the law, were disproportionately members of the Democratic party. The composition of Congress has changed dramatically — the law was approved by a very heavily Democratic Congress that was elected in the wake of Watergate. Today, of course, the Congress is controlled by the Republican Party. Beyond these changes

150. Id.
151. Passell, supra note 35, at C2. As an illustration of the perceived severity of the energy crisis, President Carter stated that it was the "moral equivalent of war." Some scoff at that bit of hyperbole now. See Kevin Phillips, Clinton's Costly Miscalculations on Health Care, BALTIMORE SUN, Aug. 3, 1994; at 15A (calling President Carter's statement a "major strategic miscalculation.") However, at the time there was great concern about our energy usage. See 121 CONG. REC. S22312 (daily ed. July 11, 1975) (Statement of Sen. Mike Mansfield); Ford Statement, supra note 11, at 173.
152. Cf. 139 CONG. REC. S258 (daily ed. Apr. 30, 1993) (Statement of Sen. Christopher S. Bond). In the 1990s, an amendment to increase the CAFE requirements was rejected even though the sponsor touted the importance vis-à-vis global warming. See Fuel Efficiency Effort Defeated in Senate, 46 CONG. Q. ALMANAC 279, 280 (1991).
153. The original CAFE law was approved with approximately 80% of Congressional Democrats supporting it and approximately 25% of the Republicans supporting it. 31 CONG. Q. ALMANAC 176-H, 90-S (1976). The last time the issue was voted on in the Senate was in 1990 when Senator Richard H. Bryan proposed increasing the CAFE minimums: In a vote to end a filibuster, 75% of Senate Democrats supported the CAFE bill, while only 33% of the Republicans supported it. Fuel Efficiency Effort Defeated in Senate, 46 CONG. Q. ALMANAC 279, 48-S (1991).
in political control of Congress, the defeat in 1990 of legislation that would have increased the CAFE requirements indicates that it would be difficult to enact a new or amended law that strengthens CAFE standards.\textsuperscript{154} It is instructive to note that the 1990 legislation clearly sought to protect the interests of U.S. companies \textit{vis-à-vis} competitors from the Pacific Rim.\textsuperscript{155} The bill called for each producer to increase the fuel efficiency by a set percentage of their current level. This provides further evidence that the CAFE approach is only politically viable if the blow to domestic companies is softened. In any case, given the changes in the environment in Washington, it would be extremely difficult to garner sufficient support for an amended CAFE law. Thus, the probable route the United States would take if the panel report were to be adopted would be to negotiate compensation or face retaliation by the EU.

IV. PROPOSAL: GIVING \textsc{Article XX}(g) \textsc{Life}

A. Need for Change

GATT panels should provide greater leeway to laws that protect the environment. International efforts to address global warming illustrate the breadth of support for protecting the environment. Increased wealth and use of resources, because of the very success of the world trading system, will also place more strain on our resources. The strong trend around the world is toward greater environmental protection. As an institution that will play a central role in determining the quality of life for people all over the globe, the WTO must allow nations to address environmental problems.

A variety of proposals have been advanced to enable the GATT/WTO system to better deal with environmental concerns. Some have called for the WTO to be amended. For example, it has been suggested that Article XX be amended to include an explicit exception for laws that protect the environment.\textsuperscript{156} Such an amendment might be qualified to include only those environmental measures that are related

\textsuperscript{154} The vote on the 1990 amendments came at an opportune time for supporters of the CAFE law as Iraq had recently invaded Kuwait and there was increased concern about the price of oil. Yet, the bill still was not enacted. \textit{Fuel Efficiency Effort Defeated in Senate, supra note 153, at 280.}

\textsuperscript{155} Id.; see \textit{Sweatin' the Details, Senator Richard Bryan's Proposal to Increase Corporate Average Fuel Economy Standards, WARD'S AUTO WORLD, Oct. 1989, at 1.}

\textsuperscript{156} Schultz, \textit{supra note 4, at 97–98.}
to widely ratified international agreements on the environment. Others have proposed that GATT panels interpret existing rules differently. It has been proposed that Article XX(b) be reinterpreted to enable broader application of environmental measures. Others have suggested requiring GATT panels to reinterpret the meaning of “product” so that products produced by different production methods are not considered “like products” under Article III. Still others look to other systems that regulate economic behavior. Some have suggested that the environmental provisions of the North American Free Trade Agreement (NAFTA) would be useful within the broader WTO system. Others have pointed to the treatment of environmental law in federal systems like the United States or the EU as a model.

B. Proposal: Reinterpret Article XX(g)

1. Mechanics of the Proposal

This Note proposes that WTO dispute settlement panels interpret Article XX(g) in a way that makes it a viable exception for laws that conserve exhaustible natural resources. This would be accomplished by altering the three step analysis currently employed by GATT panels. Two of the three steps would be left unchanged and the other step would be amended. Step one, which examines whether the overall measure supports the goal of conserving exhaustible natural resources, would be preserved. Likewise, step three, which provides the “soft” most favored nation and national treatment requirement, would also remain the same. Step two, which examines whether the specific challenged provision helps reach the goal of conserving exhaustible resources, would be altered.

Step two would be broken down into two parts. The first part would follow the current approach. Under part one, the panel would determine whether the specific challenged provision helps to meet the goal of the exception. If it does, then the panel would move to step three (“soft” MFN and national treatment). If the specific provision does not help meet the goal, the panel would then examine whether the law as a

158. See Schultz, supra note 4, at 99.
159. See, e.g., id. at 100-01.
160. Cf. id. at 107.
whole would help to conserve exhaustible natural resources in a way that does not on balance provide protection to domestic products. If it does, then it would proceed to step three; if it does not, then it would fail.

2. Likely Effect of the Proposal

This approach would enable countries to pass environmental laws more easily by enabling them to mitigate the harm to domestic producers. Because nearly every environmental law imposes costs on domestic producers, it consequently damages their competitiveness in comparison to foreign producers that do not face similar requirements. In large part because of the harm incurred by domestic producers, many nations are reluctant to approve environmental laws. The CAFE law is a prime example. It is a law that on balance probably damages the competitiveness of domestic producers.\(^2\) The fleet accounting provision was added to help limit the damage. A major irony of the conclusion that the CAFE law is incompatible with the GATT is that domestic interests, which are putatively the beneficiaries of the protection, believe that the law harms them.\(^3\) This proposal, by calling on panels to examine the law as a whole under Article XX(g), seeks to have panels better appreciate those provisions which do in fact promote the conservation of exhaustible resources. As Part III of this Note argued, the provisions softening the blow on domestic companies are integral in the effort to conserve exhaustible resources.

Giving Article XX(g) new life will help to enable nations to limit the competitive disadvantage they may incur from increased regulation. This will help to stop any potential race-to-the-bottom among competing countries.\(^4\) Countries will be less likely to follow other nations down the path to reduced environmental protection if they are able to mitigate the cost of the environmental law to their producers. The goal of the

162. See supra part I.A.2.a.

163. See Everett, supra note 33, at 1A (quoting United Auto Worker lobbyists as stating that, "[w]e think for a while the two-fleet idea worked. But the companies in some sense started standing CAFE on its head. . . . Now the gaming is costing jobs.").

164. The GATT/WTO system is premised on the notion of comparative advantage. Trade rules are designed to permit industry around the world to produce the goods it makes most efficiently. The result theoretically is the creation of greater wealth and social value. See, e.g., Jackson, supra note 69, at 10–14. One form of comparative advantage protected by the GATT/WTO system is lower environmental compliance cost. Producers in nations with low environmental standards have fewer fixed costs and are in position to produce goods more cheaply than producers in nations with higher standards. In an effort to ensure that domestic producers have an opportunity to compete effectively, there is greater pressure to lower environmental standards. See supra notes 55–56 and accompanying text.
proposal advanced here is to ensure that countries will be able to pass environmental laws that may place their own industry at a competitive disadvantage to other producers. This can be encouraged by allowing countries to mitigate the harm of a law by including provisions that may lessen the cost by favoring domestic industry.

C. Preventing Protectionism

An important goal is to ensure that this proposal does not become a way to shelter protectionism. After all, every environmental law that is meant to apply to domestic producers\textsuperscript{165} imposes costs that may damage competitiveness. Permitting protectionist provisions to be easily tacked on to these laws might open too large an escape route. Unless it is limited, the authority of GATT obligations would be undermined.\textsuperscript{166} The proposal offered here limits that possibility.

The proposal does not permit the "protection" to exceed the cost to domestic industries. To put it differently, in order for a provision to be saved under this proposal, the net effect of the law may not be to protect domestic industry from foreign competition as compared to what the situation would be like without the law. This is a "trade neutral" approach. Admittedly, quantifying the amount of protection is difficult. But a rough gauge on the effect of trade restrictions is possible. For example, in the CAFE case, the EC pointed to the level of the fines its automakers had incurred as one indication of the cost of the law.\textsuperscript{167} The United States might respond that the law as a whole has no net effect on trade flows. It would be left to the panel to determine which side made the more compelling argument. The Agreement on Technical Barriers to Trade (TBT Agreement), approved as part of the GATT package, calls for panels to make some determination as to a law's effect on trade.\textsuperscript{168} The TBT Agreement calls for a panel to decide whether a law is not "more trade-restrictive than necessary."\textsuperscript{169} Unless one knows how much a law affects trade, one cannot determine whether an alternative law would be more restrictive of trade.

By requiring a rough trade neutrality, this proposal does not go nearly as far as U.S. courts go in allowing burdens on interstate trade. In

\begin{footnotes}
\item[165] This is in contrast to domestic law meant to apply extraterritorially, such as the Marine Mammal Protection Act, \textit{supra} note 41.
\item[166] Jackson, \textit{supra} note 68, at 1241.
\item[167] CAFE Panel Report, \textit{supra} note 5, at para. 3.346.
\item[168] Understanding on Rules and Procedures Governing the Settlement of Disputes, \textit{supra} note 124, at 656.
\item[169] See Schultz, \textit{supra} note 4, at 99–100 (stating the standard for the TBT Agreement).
\end{footnotes}
Minnesota v. Clover Leaf Creamery,\textsuperscript{170} for example, the U.S. Supreme Court evaluated whether the burden on interstate commerce was "'clearly excessive in relation to its putative benefits.'"\textsuperscript{171} The proposal advanced here rejects the "clearly excessive" test because it might allow too much protectionism in the name of mitigating harmful effects. Instead it calls for a more measured "trade neutral" standard. This is meant to ensure that nations do not abuse the exception.

The potential for abuse can be limited further by requiring that the objective of the environmental law — reducing greenhouse gases, for example — is a topic in which there have been widespread international agreements.\textsuperscript{172} Under Article XX(g), this would include laws relating to global warming, species preservation, and ozone depletion. This is similar to the approach taken in the NAFTA where the parties listed international environmental agreements that would be given priority.\textsuperscript{173} Panels might take this approach, not because it would be required by a rule, (which would be extremely hard to enact),\textsuperscript{174} but rather as a demonstration of judicial discretion.

In summary, the proposal is designed to create more flexibility and advance more liberal trade in a system that can be rigid.\textsuperscript{175} It is intended to provide countries some opportunity to mitigate the harmful effects of their own environmental law in a way that is trade neutral. Under this proposal, the net result of an environmental law cannot be to favor domestic producers with regard to foreign producers as a whole. By limiting the net effect, it avoids slippery slope concerns raised by alternative proposals — such as a broad exception under Article XX for environmental laws. A much broader exception to allow for environmental protection than even that proposal would allow may be justified. However, given the opposition of many in the world community to greater leeway for environmental protection, this approach is measured and reasonable.

**CONCLUSION**

The CAFE portion of the panel decision presents a mixed bag to environmentalists and traders. It certainly does not lay to rest fears about

\textsuperscript{170} 449 U.S. 456 (1981).
\textsuperscript{171}  Id. at 457 (quoting Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970)).
\textsuperscript{172} See Hurlock, supra note 157, at 2148.
\textsuperscript{174} See Schultz, supra note 4, at 96 (indicating that obtaining "definitive interpretation" of the GATT/WTO under Article IX, paragraph 2 of the Agreement Establishing the WTO is possible, but difficult).
\textsuperscript{175} Dunoff, supra note 109, at 1067–70.
the conflict between GATT obligations and environmental law. The panel found that significant parts of the CAFE law — a fundamentally important environmental law — violated the GATT. Amending the law to bring it into compliance with the GATT would raise a series of problems both politically and substantively. Political support would wane because it would place U.S. companies in an even worse position with regard to its international competitors. The urgency that existed about the energy crisis has vanished. Though many are concerned about global warming, many others do not believe it poses a sufficient threat to justify the cost of the CAFE law.\footnote{176} The most important goal of the law would also be compromised if the law were amended to comply with the GATT, as U.S. automakers’ incentive to develop energy efficient technology would be severely weakened. Market incentives indicate that U.S. automakers would meet the standards by selling small imported cars.

At the same time, the panel report offers support to those who believe that environmental protection can coexist with the GATT/WTO system. In particular, the panel’s indication that the fleet averaging provisions might qualify under the exception under Article XX(g) of the GATT is encouraging. No panel has ever found that the exceptions in the GATT could sustain an environmental law. To the extent that these exceptions will provide a meaningful way to build flexibility into the system to allow environmental protection, the CAFE case is promising.

Finally, the case suggests a way in which Article XX(g) could plausibly be interpreted to enable nations to exercise broader latitude to enact environmental law. Under the panel’s approach, each element of the law is examined in isolation to determine whether it directly furthers the conservation of exhaustible natural resources. Ignoring aspects of the law that result in less favorable treatment to domestic products ignores real costs associated with environmental protection. One consequence of the current application of GATT rules may be that nations are reluctant to approve laws that protect the environment because they will be unable to soften the competitive harm of the law. There is, unfortunately, no race-to-the-top with regard to environmental protection. Nations are concerned about the effect environmental laws will have on their own producers’ ability to compete. The proposal contained in this Note attempts to give real meaning to Article XX(g) so that nations are not discouraged from enacting laws that protect the environment.

\footnote{176. See supra text accompanying notes 52–56, and part III.C.}