Annex I

The EU CBAM Proposal and WTO Law

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I. Introduction

1. Since border carbon adjustment (BCA) measures applied to imports and exports affect international trade, their application must be consistent with WTO rules. Uncertainty with respect to compliance of BCA measures with WTO rules has long been a key factor restraining countries from putting the measure into practice. The Carbon Border Adjustment Mechanism (CBAM) proposed by the EU is a game changer that is going to turn BCA from an abstract concept to a concrete measure that is associated with climate action but that can nevertheless be put on trial in WTO dispute settlement.

2. The EU positions its CBAM as a climate measure enacted in good faith to achieve the climate policy objective of GHG reduction. The EU Commission explains in particular:

   This mechanism is an alternative to the measures that address the risk of carbon leakage in the EU’s Emissions Trading System (footnote omitted) (‘EU ETS’) and is meant to avoid that the emissions reduction efforts of the Union are offset by increasing emissions outside the Union through relocation of production or increased imports of less carbon-intensive products. Without such a mechanism, carbon leakage could result in an overall increase in global emissions.¹

3. In this respect, the introduction of a CBAM can be seen as necessary to meet the EU obligation under the Paris Agreement, particularly to cut its emissions by 55% against the 1990 level by 2030, as fixed in its nationally determined contribution (NDC) submitted under Article 4.3 of the Paris Agreement. The introduction of a CBAM is also in line with the EU domestic climate policy priorities, fixed in the European Climate Law to make the EU carbon-neutral by 2050. In other words, the proposed CBAM is an essential element of the toolbox that will be used by the EU to achieve the carbon neutrality target.

4. Thus, the purpose of the CBAM is to enable the EU to take ambitious climate action without facing the problem of carbon leakage, where production and consumption emissions would be increased because of the relocation of carbon-intensive production to countries with no or lower carbon restrictions, in the former case, or substitution of more expensive low-car-

bon domestic products with the same but cheaper carbon-intensive imported products in consumption, in the latter case. As shown in section IV, the purpose will have an important bearing on the possibility to justify a CBAM as an environmental exception and, consequently, its general compliance with WTO rules.

5. It should be noted that the EU places a great importance on the compliance of its CBAM with WTO law. As early as at the stage of introducing its Green Deal strategy in 2019, the EU noted that the EU CBAM will be designed to comply with WTO rules and other international obligations of the EU.2 WTO law compliance is also stressed multiple times in the EU Commission CBAM Proposal.3

6. This Annex examines issues of legal compatibility with WTO law as they arise in relation to specific design features of the proposed EU CBAM. The measure is novel and has not been previously addressed in WTO disputes. Our conclusions are largely based on case law related to measures that have some similarities with a CBAM. Yet, the EU CBAM is unique in many features and its exact design is still to be finalized based on the outcome of the ‘trilogue’ among the European Commission, the European Parliament and the Council. Our assessment of its compatibility with WTO law will therefore contain some degree of uncertainty.

II. Legal Status of the EU CBAM under WTO Law

A. Concept of border adjustment

7. Under WTO law, border adjustment measures are traditionally perceived as fiscal measures that put into effect the destination principle of taxation for indirect taxes (‘taxes are paid where products are consumed’) in order to avoid double taxation and create a level playing field for domestic and foreign production in the home and world markets.4 WTO rules set limitations to the types of measures that can be adjusted and the manner in which adjustment can be done. A fundamental principle of border adjustment is the rule of even-handedness, whereby border adjustment measures are imposed in parallel to domestic measures.5

8. Border adjustment on importation and border adjustment on exportation are regulated separately (i.e. under different WTO provisions). An import-side border adjustment is subject to the non-discrimination rules, including the MFN and national treatment principles spelled out in GATT Articles I and III, whereas an export-side border adjustment falls under the WTO subsidy disciplines set forth in the GATT and the SCM Agreement. Moreover, border adjustment of domestic regulations linked to product characteristics, as well as labelling schemes, fall under the disciplines of the TBT Agreement.

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3 See e.g. CBAM Proposal, Explanatory Memorandum, p. 3 and Ingress, para. 13.
9. The possibility of applying import-side border adjustment to internal fiscal measures is provided by GATT Article II:2(a) and Ad Article III. Article II:2(a) allows, on the importation of any product, the imposition of ‘a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III [footnote omitted]…’, whereas, according to Ad Article III, ‘(a)ny internal tax or other internal charge … which applies to an imported product and to the like domestic product and is collected … at the time or point of importation, is nevertheless to be regarded as an internal tax or other internal charge…’.

10. The permissible nature of export-side border adjustment follows from the provisions of Article VI:4 and Ad Article XVI of the GATT and footnote 1 of the SCM Agreement. Pursuant to Article VI:4, export rebates cannot be subject to anti-dumping or countervailing duties. Furthermore, Ad Article XVI of the GATT and footnote 1 to the SCM Agreement reinforce the statement that export rebates are not deemed to be a subsidy. Yet, it should be noted that imposing taxes on importation and giving tax rebates on exportation is only possible for indirect taxes, i.e. taxes levied on products, whereas it is prohibited for direct taxes, i.e. taxes imposed on producers (such as royalties, corporate, payroll, income and other direct taxes). Border adjustment is thus a widespread practice for value-added taxes (VATs), sales taxes and excise duties on alcohol, cigarettes, gasoline and other products. Border adjustment of indirect taxes has traditionally been done to increase budget revenues (fiscal purposes) and to offset negative effects on competitiveness of national producers subject to paying taxes in the situation where foreign producers do not pay taxes on their products in countries where the products were produced. In other words, a border adjustment of indirect taxes levels the playing field between national and foreign producers.

11. However, a border adjustment can also be applied to non-fiscal measures. The WTO legal framework provides for the border adjustment, particularly on importation, of domestic regulations, including product requirements, standards etc. In addition to fiscal measures, GATT Ad Article III refers to the situation of border adjustment of internal laws, regulations and requirements. According to GATT Ad Article III, together with any internal tax or other internal charge, ‘any law, regulation or requirement … which applies to an imported product and to the like domestic product and is collected or enforced in the case of the imported product at the time or point of importation’ (italics added) is subject to the provisions of Article III. GATT Ad Article III is thus evidence that the adjustment at the border of internal regulations under WTO law is permissible. In fact, GATT Ad Article III is the general border adjustment principle, which applies to the relationship between Articles III:2 and II:1 (for fiscal measures), as well as between Articles III:4 and XI:1 (for non-fiscal measures).

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6 This rule stems from the wording of all border tax adjustment-related provisions in the GATT, which refer only to taxes and charges on products (and not on producers). This rule was also confirmed by the findings of the 1970 Working Party on Border Tax Adjustment. See GATT, Report by the Working Party on Border Tax Adjustments, L/3464, 2 December 1970, BISD 18S/97, para 14. Moreover, a border adjustment of direct taxes is unacceptable under ASCM provisions. Under letter (e) in the Illustrative List of Export Subsidies contained in Annex I of the ASCM, “(t)he full or partial exemption remission, or deferral specifically related to exports, of direct taxes [footnote omitted] or social welfare charges paid or payable by industrial or commercial enterprises [footnote omitted]” is an export subsidy.

7 K Holzer, Carbon-related border adjustment and WTO law (Edward Elgar 2014), pp. 68-72.
B. EU CBAM – issues of legal characterization

12. The legality of the CBAM may be assessed under different GATT provisions depending on the legal characterization of the measure. As seen above, WTO law admits the border adjustment of both fiscal and non-fiscal measures, but different conditions need to be met based on different provisions. The matter is relevant to the extent that the CBAM is a new, experimental measure and therefore it is not easy to anticipate how it would be characterized under WTO law. The issue boils down to whether the CBAM would be considered a fiscal measure or a regulatory measure. In the former case, the CBAM could either qualify as a border measure (that is, a duty or any other charge) as per Article II GATT or as an internal tax as per Article III:2 GATT. In the latter case, the CBAM could either fall under Article XI:1 GATT (in the case it were considered a border measure) or as an internal regulation under Article III:4 GATT. The main difference is that, if the CBAM were to be considered a border measure, a violation could be triggered even if the measure is not discriminatory, whereas internal measures could be allowed only insofar as they do not discriminate against foreign products based on the national treatment principle.

13. Opinions on whether the CBAM can qualify as a border measure or as an internal measure differ among experts. On the one hand, a number of scholars have argued that the CBAM can be considered a border measure of a fiscal nature for it amounts to a pecuniary burden imposed ‘on or in the connection with the importation’. It would thus qualify as a charge other than ordinary custom duties under Article II:1 (b) GATT, given that the EU did not schedule it in its consolidated GATT list. In this case, it could only be admitted if it is a charge equivalent to an internal tax imposed consistently with Article III:2 GATT. It is at best uncertain, however, whether this condition could be met as the ETS itself can hardly be equated to an internal tax, as the European Court of Justice (ECJ) already ruled. Another possibility to

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9 The main argument for considering the CBAM as a ‘charge’ imposed at the border rather than an ‘internal measure’ lies in the consideration that there is a direct, inextricable link between the amount of the charge (i.e. the amount paid to cover embedded emissions of imports through CBAM certificates) and the amount of emissions embedded in the covered imports. D Coppens and N Lockhart, ‘WTI Summer Academy course on the European Union’s Proposed Carbon Border Adjustment Mechanism’, 22 June 2022. In other words, the authorized declarants will always be subject to the burden arising out of the obligation to cover emissions embedded in imports through the purchase of CBAM certificates. This is because, contrary to EUAs, the CBAM certificates cannot be traded (they can only be sold back in very limited cases and always at the same price they were purchased in the first place based on Article 23 of the CBAM Proposal) and therefore importers could never make a profit out of the mechanism. In the case of the ETS, the opposite is true. This was indeed explicitly recognized by the ECJ: ECJ Case C-366/10, Air Transport Association of America and others v. Secretary of State for Energy and Climate Change [2011], paras 142-144.

10 Based on WTO case law, the nature of the CBAM as a border measure or as an internal measure would be determined by ascertaining whether the obligation to buy the CBAM certificates is triggered by an ‘internal’ factor, that is, something that takes place within the EU territory or by an ‘external’ factor, that is, something that occurs outside the EU territory. China – Auto Parts, Appellate Body report, paras 159-164. According to this view, the CBAM would be triggered by an external factor, namely the emissions produced in fabricating the covered products in third countries. Coppens and Lockhart, footnote 9.

11 ECJ Case C-366/10, Air Transport Association of America and others v. Secretary of State for Energy and Climate Change [2011], paras 142-144. For an overview of how the issue has been tackled in the
scrutinize the CBAM as a border measure could consist of invoking Article XI:1 GATT to the extent that it could be argued that it amounts to a quantitative restriction imposed on the importation subject to an elimination obligation. A consolidated WTO jurisprudence on Article XI:1 GATT has in fact interpreted broadly this prohibition as to encompass any measure having a restrictive or limiting effect. While it is likely that the CBAM will have a restrictive effect on the importation of covered products, it is again uncertain whether it could qualify as such as a border measure of a quantitative nature or rather whether only specific aspects of the CBAM could be captured under Article XI:1 GATT. As explained below (see section V), in the latter case it is the administration of the CBAM, in particular, that has the highest chances to fall under Article XI:1 GATT (and the Agreement on Import Licensing) as amounting to import licensing.

14. On the other hand, the proposed CBAM can qualify as an internal measure as either a border adjustment of a domestic tax as per Article III:2 GATT or a border adjustment of a domestic regulation as per Article III:4 GATT. Under this scenario, the obligation to surrender CBAM certificates would be triggered by an internal event, that is, the EU emission trading system. Depending on whether the ETS itself could qualify as a tax or as a regulation, one or the other provision would apply. As mentioned earlier, the qualification of the ETS is not yet established under WTO law, although the European Court of Justice has already convincingly argued that the ETS cannot be equated to a tax for two reasons. First, a conventional tax has a fixed rate that a person or a firm must pay, whereas the costs of emissions allowances for a firm vary depending on the number of allowances initially allocated to it for free and the market price of an allowance. Second, unlike a tax, the emissions allowance requirement is not primarily intended to generate revenue in the budget.  

15. While the final qualification of the ETS, and therefore of the EU CBAM, is to be made by an adjudicative body in a WTO dispute, it is worth noting that the EU Commission has presented the EU CBAM as an adjustment of a domestic regulation at the border. As explained by the EU Commission, the EU CBAM involves the application on imports of a system that replicates the EU ETS regime applicable to domestic production. This option entails – similar to the system of allowances under the EU ETS – the surrendering of certificates (‘CBAM certificates’) by importers based on embedded emission intensity of the products they import into the


12 India – Quantitative Restrictions, panel report, para. 5.129; China – Raw Materials, panel report, paras 7.917-7.918.

13 In this sense, see R Quick, ‘Carbon Border Adjustment: A Dissenting View on its Alleged GATT-compatibility’ (2020) 4 ZEuS, p. 567.

14 See ECJ Case C-366/10, Air Transport Association of America and others v. Secretary of State for Energy and Climate Change [2011], paras 142-144.
Union, and purchased at a price corresponding to that of the EU ETS allowances at any given point in time.\textsuperscript{15}

16. Moreover, in its explanatory memorandum to the proposed CBAM regulation, the EU Commission has stressed several times that the CBAM would mirror the EU ETS ‘to ensure an equivalence between the carbon pricing policy applied in the EU’s internal market and the carbon pricing policy applied on imports’.\textsuperscript{16} Thus, with some adjustments for practical feasibility, the EU CBAM will be imposed in the form of an extension of the EU ETS to imports in some sectors covered by the ETS, and as such will constitute a border adjustment of an existing domestic regulation, i.e. the obligation under the EU ETS to surrender emission allowances.\textsuperscript{17}

17. In support of this view, it should also be mentioned that the EU has allegedly construed the CBAM as an adjustment of a regulation at the border given that the measure would otherwise be illegitimate under EU law: as a matter of fact, were the CBAM a tax, its approval would require unanimity pursuant to art 192(2) of the Treaty on the Functioning of the European Union. It remains to be seen, however, whether the EU’s argument will succeed, considering that there are a number of critical differences between the ETS (EUAs) and the CBAM (certificates). First, the ETS is imposed on installations so that EUAs cover emissions released during production, whereas the CBAM covers emissions embedded in covered imported products. Second, the EUAs are tradable while the CBAM certificates are not. Third, and controversially, the CBAM is charged on process emissions that occurred outside the European Union, which are only ’virtually’ embedded into covered imports.\textsuperscript{18}

18. While it cannot in principle be excluded that the same measure qualifies as an internal regulation under EU law and as a charge imposed at the border under WTO law, the final qualification of the EU CBAM is to be made by an adjudicative body in a WTO dispute.

C. CBAM as a carbon tariff

19. To the extent that CBAMs exceed the level of domestic taxation and thus goes beyond compensation, the measure turns into a tariff and thus falls under the rules and disciplines of Art I GATT. Such impositions need to remain within bound tariffs for the products at hand. Applied tariffs may vary but must not exceed bound tariffs for the product.

20. Finally, we note that CBAM could be designed as a tariff measure from the outset by way of introducing split carbon tariffs for conventionally produced goods and for sustainably produced goods, based on non-product related production and process methods (npr-PPMs),

\textsuperscript{15} CBAM Proposal, Explanatory Memorandum, p. 7.

\textsuperscript{16} See e.g. CBAM Proposal, Explanatory Memorandum, p. 4.

\textsuperscript{17} In response to those arguing that there is an inextricable link between the amount of the CBAM charge and the amount of emissions embedded in the covered imports, one could opine that this is not always true due to the CBAM ‘discount’ feature as per Article 9 of the CBAM Proposal. According to this feature, as explained in section IV.B.1, the number of CBAM certificates that would have been requested based on the amount of embedded emissions is corrected to account for the carbon price paid in the country of origin. Furthermore, there are also some imports (namely, imports from EEA countries) that are not exposed to the supposed CBAM charge, irrespective of their embedded emissions: see section III.B.

\textsuperscript{18} D Coppens and N Lockhart, ‘WTI Summer Academy course on the European Union’s Proposed Carbon Border Adjustment Mechanism’, 22 June 2022.
discussed shortly. Such carbon tariffs are independent from domestic taxation and thus the ETS system. The idea is to remove tariffs for products produced carbon-free, while keeping tariffs for conventionally produced products. The latter may entail de-consolidation and a need to increase tariffs with a view to address carbon leakage and create incentives, combined with transfer of technology, to restructure processes abroad with a view to avoid tariff impositions. Split tariffs can be introduced in digits 6-8 of the Harmonized System. They are novel and amount to a new type of incentive (Lenkungszoll). They were introduced for the first time in the EFTA Indonesia Free Trade Agreement to address the problem of unsustainable production of palm oil.\(^{19}\) Carbon tariffs can be designed in a WTO compatible manner, justifying the splitting and exemptions from MFN under Article XX(g) GATT.\(^{20}\) They offer an alternative to border tax adjustment, delinking domestic taxation and tariff imposition.

III. Compliance of the EU CBAM with the WTO principles of non-discrimination

A. Most favoured nation and national treatment requirements and the PPM issue of CBAMs

21. Border adjustment measures (BAMs) must be consistent with the MFN rule expressed in GATT Article I, which prohibits discrimination between “like” products of different trading partners. More specifically, Article I:1 obliges a country to give products coming from all other countries the same benefits as given to like products coming from any other country with respect to matters of importation and exportation, including the imposition of internal measures on imports in the sense of Article III:2 and III:4. It is in this latter context that the MFN obligation is relevant for CBAMs. With respect to the export-side border adjustment, GATT Article I requires that taxes should be reimbursed (or exempted) on exports to all destinations.

22. BAMs must also compatible with the national treatment (NT) rule expressed in GATT Article III. The discrimination, which is prohibited under Article III, is the discrimination against foreign products vis-à-vis ‘like’ domestic ones. The key requirement of Article III, not to apply internal taxes and regulations ‘so as to afford protection to domestic production’, is expressed in paragraph 1 of Article III. This first paragraph is part of the content of paragraphs 2 and 4 and informs these other paragraphs of the article. However, it informs them in different ways.\(^{21}\) Under Article III:2, discrimination implies either ‘taxes in excess of’ (under the first sentence) or ‘not similarly taxed’ and ‘applied protectively’ (under the second sentence), while under Article III:4, discrimination implies ‘treatment less favourable’.

23. However, whether or not a CBAM applied to carbon-intensive imports from countries with no carbon constraints violates the MFN and NT obligations will largely depend on the


\(^{21}\) *Japan-Alcoholic Beverages II*, AB report, p. 17.
acceptance or non-acceptance of likeness of carbon-intensive and low-carbon products. If carbon-intensive and low-carbon products are found to be like, the EU CBAM will be found to violate the MFN and NT rules, i.e. will be found to be discriminatory.

24. The EU CBAM is a measure imposed on, or in relation to, the carbon footprint of products, which is the amount of CO\textsubscript{2} emissions emitted during the manufacture of products. As the amount of emissions depends on the production method (technology) used for the production of the product, the EU CBAM can be viewed as a measure linked to processes and production methods (PPM measure). In the past, measures linked to PPMs were viewed as ones falling outside the scope of GATT/WTO provisions or violating them.\textsuperscript{22} These views were framed under the so-called “product-process” doctrine,\textsuperscript{23} under which it was considered to be illegal to make distinctions on the basis of PPMs, which do not leave any traces on physical qualities of the product. Such PPMs are called non-product-related PPMs (npr-PPMs). This is due to the fact that according to the determination of likeness carried out by WTO adjudicative bodies, products having the same physical qualities, consumer preferences, end-uses and tariff classification qualify as like products and, as such, must not be discriminated against with respect to tariffs, taxes and other regulatory measures.\textsuperscript{24} Regulatory discrimination between like products of different origin entails the violation of the MFN rule, while discrimination between foreign and like domestic products leads to the violation of the NT rule.

25. To a large extent, the reluctance to accept the legality of npr-PPMs has political and economic grounds. PPM-based trade restrictions usually constitute measures with extraterritorial jurisdiction, i.e. the effects of the measures are felt in exporting countries, even though the measures are enforced on the territory of an importing country.\textsuperscript{25} For instance, the imposition of the EU CBAM on imports of steel, if designed based on the actual amount of emissions in the imported product, would force steel-producing companies exporting steel to the EU to reduce the carbon footprint of their steel by switching to a low-carbon technology. This may also induce these exporting countries to impose carbon restrictions on their producers.

26. Besides the coercive effect on policies of other countries, which under the principles of international public law shall enjoy their sovereign rights and regulatory autonomy, PPMs also inflict considerable costs on exporting countries. To comply with the PPM requirements of an importing country, exporting countries would likely need to invest in technological modernization and upgrading of their health and environmental standards. For developing


\textsuperscript{23} Hudec (1998), footnote 22, pp. 8-11.

\textsuperscript{24} Japan-Alcoholic Beverages II, AB report, p. 114; EC-Asbestos, AB report, para. 101.

countries with limited financial resources this might be difficult. Consequently, the acceptability of PPMs with extraterritorial jurisdiction is often denied, especially by developing countries.  

26. The doctrine of illegality of npr-PPMs was supported by early GATT adjudicative bodies. At the beginning of the 1990s, a GATT panel had to decide on two disputes related to non-product-related (npr) PPMs. Consequently, it confirmed the then prevailing opinion of non-admissibility of measures imposed in connection to the production methods, which do not influence the physical characteristics of a product. In addition, in 1992, the GATT Secretariat issued a Study on Trade and the Environment with the conclusion that conditioning the access to the markets of importing countries on the environmental policies and conditions of exporting countries is not allowed.  

27. However, since the late 1990s WTO adjudicative bodies have started developing more tolerant views on the use of npr-PPMs. The new perception of npr-PPMs and their legality under WTO law was formed in the wake of the Shrimp/Turtle dispute. This case made clear that even if measures linked to npr-PPMs violate rules of the GATT, they might still be justified under GATT Article XX exceptions foreseen for measures taken with moral, health, environmental and other public policy objectives, provided that a sufficient nexus between the concern addressed by a measure and the risks for a country imposing a measure exists and provided that all the conditions under Article XX are met. Such a perception of the legality of PPMs under the GATT still persists. But more recently, new approaches to the assessment of likeness of products have been followed by WTO adjudicative bodies that might even render carbon-intensive and low-carbon products unlike.  

28. One approach is a disregard of the PPM-nature of measures. As follows from the outcomes of the dispute in Canada-Autos and US-Tuna II (Mexico), a benchmark for the acceptability of npr-PPMs under WTO law is their neutrality with respect to the origin of products, i.e. their conformity with WTO non-discrimination rules. For the panel in Canada-Autos, it was not the PPM-nature of the measure as such, which was decisive for determining compliance of the measure with WTO law, but rather its non-discriminatory character with respect to

26. See e.g. the statement of Mexico, the complaining party in the Tuna/Dolphin dispute before the panel. US-Tuna (Mexico), GATT panel report (unadopted), para. 3.31.  

27. The panel in the Tuna/Dolphin disputes found a PPM-based measure enacted by the US violating the NT principle under GATT Article III:4. See US-Tuna (Mexico), GATT panel report (unadopted), para. 5.14.  

28. A couple of years later, non-product-related PPMs were also found to fall outside the scope of Article III:2. See Mexico-Taxes on Soft Drinks, panel report, paras. 8.42-45.  


the origin of products. When judging compliance of the Canadian measure, which provided exemptions from customs duties for certain automobile producers, with the MFN principle, the panel found that the panel decisions and other sources referred to by Japan do not support the interpretation of Article I:1 advocated by Japan in the present case according to which the word "unconditionally" in Article I:1 must be interpreted to mean that subjecting an advantage granted in connection with the importation of a product to conditions not related to the imported product itself is per se inconsistent with Article I:1, regardless of whether such conditions are discriminatory with respect to the origin of products. Rather, whether conditions attached to an advantage granted in connection with the importation of a product offend Article I:1 depends upon whether or not such conditions discriminate with respect to the origin of products.

The US-Tuna II (Mexico) case focused on the US labelling schemes linked to methods of fishing of tuna (dolphin-safe label requirements), which by its nature fell under the category of npr-PPMs. Like in the Canada-Autos case, the panel and the AB did not pay attention to the PPM-character of the measure and only looked at whether the measure discriminated against imported products or not.

Another approach that might open the door for considering carbon-intensive and low-carbon products unlike is the consideration of consumer preferences. Consumer preference for low-carbon products, which are strong in developed country markets, can make, for instance, steel produced in open blast furnaces and steel produced in electric arc furnaces 'unlike products'. Uncertainty exists, however, whether consumer preferences in the case of products from upstream industries, such as steel and other CBAM-covered sectors, can be identified strongly enough to prevail over other likeness criteria (physical qualities, end uses and the tariff code), which are otherwise the same for low-carbon and carbon-intensive products.

In Canada-Renewable Energy, when assessing the compliance of Ontario’s feed-in tariff scheme with the WTO rules on subsidies, the AB found that electricity generated from solar photovoltaic (PV) and wind power technology and electricity generated from fossil fuels were sold in different markets. The markets were considered to be different because of the differences in the type of power, the differences in contracts and the differences in consumers’ sizes. Yet, the biggest difference was in the supply-side factors. According to the AB, ‘supply-side factors suggest that wind-power and solar PV producers of electricity cannot compete with other electricity producers because of differences in cost structures and operating costs’.

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34 Canada-Autos, panel report, para. 10.29.
35 In the end, the measure was deemed inconsistent with the NT principle under TBT Article 2.1. See US-Tuna II (Mexico), AB report, para. 299.
36 Holzer et al., footnote 32, pp. 366-367. Consumer preferences can also be linked with health (or even environmental) risks from carbon-intensive products. In EC-Asbestos, the Appellate Body found health risks to be relevant when examining physical properties of the product (carcinogenicity), rejecting, however, the proposal to consider health risks as a separate criterion of likeness. See EC-Asbestos, AB report, paras 113 and 116.
and characteristics’. If WTO adjudicative bodies follow this approach to determining likeness, carbon-intensive and low-carbon products will be found to be unlike products and there will be no violation of the MFN and NT rules.

33. But even if products with different degrees of carbon intensity were found to be like resulting in a violation of the MFN and NT rules, PPM-based CBAMs would have chances to be justified under the general exceptions to GATT rules. The possibility of the EU CBAM to be justified as an exception is assessed in section IV.

B. Compliance of the EU CBAM with the MFN obligation

34. Irrespective of the results of the likeness assessment of carbon-intensive and low-carbon products (or products with different degrees of carbon-intensity), the compliance of the EU CBAM with the MFN rule (and, as shown below, also with the NT rule) depends on some specific features of its design and implementation.

35. One of the key features influencing the MFN compliance is the exclusion of some imports from the CBAM application scope. On the one hand, the EU CBAM exempts imports from certain countries, namely the European Economic Area (EEA) countries (Iceland, Liechtenstein and Norway) and Switzerland, which are all countries that have been either integrated in, or linked to (in the case of Switzerland), the EU ETS. On the other hand, the proposed CBAM scheme will provide a sort of CBAM discount by reducing the number of CBAM certificates for the carbon costs already paid in the country of origin of imported products. The rationale behind both types of exclusion (or correction mechanism) is simple: to the extent that carbon leakage risks only materialize out of carbon price differences, and that the CBAM aims at bridging these gaps in the carbon prices to address those risks, imported products can only bear the price that results out of that difference. It should be noted that the exclusion of imports from countries with an ETS integrated or linked with the EU ETS could arguably be regarded as a special case of crediting given that in such cases the carbon price imposed to covered imported is identical to the EU carbon price. Moreover, the idea of these types of import exclusion responds to the need to avoid double charging for the carbon in the covered imported goods.

36. Based on consumer preferences, carbon-intensive and low-carbon products can alternatively be found to be in a competitive relationship in the market, and as such not completely identical (like) products but rather products that are directly competitive or substitutable. In Canada-Renewable Energy, the AB particularly noted that directly competitive or substitutable products in the sense of GATT Article III:2, second sentence, are ‘products that are in a competitive relationship. What constitutes a competitive relationship between products may require consideration of inputs and processes of production used to produce the product’. See Canada-Renewable Energy, AB report, para. 5.174. If a CBAM were considered to be a tax (not a regulation), that would make a difference, as taxation of directly competitive or substitutable products is subject to a more lenient set of NT rules (Art. III:2, second sentence) than those applicable to the category of like products.


38. CBAM Proposal, Art. 2.3 and Annex II.

39. CBAM Proposal, Art. 9. Art. 9.1 particularly reads: ‘An authorised declarant may claim in its CBAM declaration a reduction in the number of CBAM certificates to be surrendered in order for the carbon price paid in the country of origin for the declared embedded emissions to be taken into account’.

36. Thus, the rationale behind the exclusion features of the EU CBAM responds, at least formally, to its asserted objectives of carbon leakage avoidance. The scope for full or partial exclusion depends on the existence of differences in carbon prices between the EU and the countries of origin of imported covered products. Following the logic that there is no (or minimal) risk of carbon leakage where carbon prices are the same, the EU Commission proposes to exclude imports from countries having an ETS, which is either integrated in the EU ETS or linked with it. At the same time, if the (explicit) carbon price paid by imports in their countries of origin is lower than the EU carbon price, imports are not fully excluded but rather credited for the carbon price already paid so the price borne by imported products corresponds to the difference between the EUA price and the (effective) imposed in their country of origin.

37. The CBAM import exclusion based on the carbon risk logic has some chances to be found compatible with the MFN requirement. The question is whether the application of the CBAM only to imports from countries with carbon price differences to the EU constitutes a violation of the MFN obligation. To put it differently, the question is whether products originated from countries having an ETS that is integrated or linked to the EU ETS, and thus exempted from the EU CBAM, would be viewed as receiving a (prohibited) advantage over products originated from other countries.

38. WTO jurisprudence does not give a clear answer to this question. On the one hand, in Canada-Autos, for example, the panel found that the MFN treatment could not be conditioned on the circumstances existing in countries (e.g. existence or absence of emissions constraints and hence carbon price differences) and this finding was not appealed. On the other hand, the interpretation of ‘unconditionally’ by WTO adjudicatory bodies in a number of disputes and the text of the preamble to the WTO Agreement may suggest that conditions in the context of MFN treatment can be accepted as long as they are imposed in a non-discriminatory manner. It is clear that the conditions for a derogation from the MFN principle, which are based on the origin of products, are not acceptable. This conclusion was made long time ago by the GATT panel in Belgian-Family Allowances and it was later confirmed in the WTO dispute on Indonesia-Autos, where the panel held that the derogation ‘cannot be made conditional on any criteria that are not related to the imported product itself’. However, with respect to PPM-based conditions that apply irrespective of origin, the conclusions of WTO adjudicatory bodies seem to be less categorical.

39. On the basis of the analysis of previous panel reports, which found conditional advantages inconsistent with the MFN obligation under Article I:1, the panel in Canada-Autos

42 Canada-Autos, panel report, para 10.23.
43 The text of the preamble to the WTO Agreement refers to the need for optimal use of the world's resources in a sustainable manner. Restrictions put on npr-PPMs (i.e. how-produced conditions) seem to be indispensable for meeting this objective. See C Benoit, ‘Picking Tariff Winners: Non-product-related PPMs and DSB Interpretations of “Unconditionally” within Article I:1’ (2011) 42(2) Georgetown Journal of International Law, pp. 601-602.
44 Ibid., p. 603.
45 Belgian-Family Allowances, GATT panel report, para 8; Indonesia — Autos, panel report, paras 14.143-144.
46 In Canada-Autos, the panel wrote that ‘The statement that an advantage within the meaning of Article I “cannot be made conditional on any criteria that is not related to the imported product itself” must therefore in our view be seen in relation to conditions which entailed different treatment of like products depending upon their origin. See Canada-Autos, panel report, para 10.28.
concluded that ‘(a) review of these reports shows that they were concerned with measures that were found to be inconsistent with Article I:1 not because they involved the application of conditions that were not related to the imported product but because they involved conditions that entailed different treatment of imported products depending upon their origin’. These statements of the panel give grounds to believe that the panel might find truly origin-neutral conditions, such as how-produced PPMs reflected in different carbon footprint of products, to be permissible for derogation under GATT Article I:1.47

40. That said, the chances of avoiding a *de facto* infringement of the MFN obligation in the case of carbon-related BAMs, which would be imposed only on imports from countries that have not taken ‘comparable actions’, are not high. Moreover, a CBAM scheme only allowing for crediting explicit carbon pricing policies of third countries (that is, those based on carbon taxes or ETSs), while excluding the recognition of implicit carbon prices resulting from non-pricing climate policy measures will most likely be found discriminatory with respect to certain imports.49

41. It should be noted, however, that excluding Switzerland and the EFTA States may still be defended under WTO law through the 1972 EU-CH Free Trade Agreement (FTA) and the EEA Agreement based on Article XXIV GATT. This Article expressly excludes from MFN treatment free trade agreements (and custom unions) if they essentially cover all the trade in accordance with Art. XXIV(8)(a)(ii)(b) GATT. In the case of the 1972 EU-CH FTA, it is still disputed whether this condition could be considered fulfilled to the extent that agricultural products have only partially been liberalized.

C. Compliance of the EU CBAM with the national treatment obligation

42. If the EU CBAM mirroring the EU ETS qualifies as a regulation, the EU CBAM will fall under the scrutiny of GATT Article III:4, which requires a treatment of imported products not less favorable than the treatment of like domestic ones. Compared to the NT requirement under Article III:2 for taxes (which requires exactly the same amount of tax rate for imported products and like domestic products), the requirement for regulations is less stringent. Importantly, a different treatment of like imported products can still be no less favourable and can still be in full compliance with the requirements of Article III:4.50 ‘No less favourable’ treatment does not imply “identical” treatment.51 Thus, in the context of the EU CBAM, it might allow some variations in the treatment of like imported products52, should it be needed solely out of practical feasibility. This is what the EU Commission for example means by the ‘need (of the CBAM) to be complemented by a possibility to base calculations on a set of default values to be used in situations when sufficient emission data will not be available’, or

47 [Canada-Autos](#), panel report, para 10.25.
48 [Benoit](#), footnote 43, pp. 597-598. See also [Charnovitz](#), footnote 25, p. 85.
49 Espa and Holzer, footnote 42.
50 [Korea–Various Measures on Beef](#), AB report, para. 137.
51 [EC-Asbestos](#), AB report, para. 100.
52 As discussed above, we assume here that imported products that are more carbon intensive have been found to be like products with less-carbon intensive EU products of the same physical quality, end use and tariff code.
‘during an initial transitional phase, where importers may not be able to produce yet the data required by system on actual emissions, a default value could also apply’.53

43. Moreover, in the Dominican Republic-Import and Sale of Cigarettes dispute, it was admitted that a less favourable treatment would not be implied if a detrimental effect on imports can be explained ‘by factors or circumstances unrelated to the foreign origin of the product, such as the market share of the importer…’.54 In relation to the EU CBAM, one could interpret this presumption so that if imported products turn out to be less competitive in the market than like domestic ones due to their higher carbon footprint and not because of the mere fact that they are of foreign origin, this would not necessarily imply a violation of the NT rule under GATT Article III.4. Carbon footprints of products in the context of emission reduction policies might be viewed as “circumstances unrelated to the foreign origin of the product”.55 If this were so, a carbon tax/charge could pass the test under Article III:4, even if the same products with different degrees of carbon intensity qualify as like.56

44. That said, as with the MFN requirement discussed above, there are certain design features of the EU CBAM that might influence the outcome of the NT compliance test.

1. INCLUSION SCOPE

45. The EU CBAM, as proposed by the EU Commission, will initially apply to products from a limited number of sectors and only to direct emissions.57 According to Annex I of the proposed regulation, the EU CBAM will apply to imports of five sectors, namely cement, electricity, fertilisers, iron and steel, and aluminium. As explained by the Commission, ‘the CBAM builds on the climate logic of the EU ETS starting with sectors where emissions are the highest in absolute numbers and therefore where it would matter most’.58 The proposed CBAM product scope is much smaller than that of the EU ETS. It does not cover all sectors considered at high risk of carbon leakage.59

54 Dominican Republic – Import and Sale of Cigarettes, AB report, para. 96.
55 Pauwelyn, footnote 11, p. 30.
56 Another important element of the NT compliance test under GATT Art. III:4 concerns the selection of products for comparison in treatment and the detection of any possible disproportionate impacts. It is likely that when the EU CBAM is examined, the “asymmetric impact” approach rather than the “diagonal impact” test will be used. This means that a comparison of treatment of like products would be between groups of imported products and like domestic products and not between single products. See Holzer, footnote 7, pp. 128-129. Consequently, a violation of the NT rule will be found when less favourable treatment is accorded to a larger proportion of imported (carbon-intensive) products than to domestic (low-carbon) ones. See EC-Asbestos, AB report, para. 100.
57 As explained by the EU Commission, ‘before the end of the transitional period, the Commission will report to the European Parliament and the Council on the application of the Regulation and, if appropriate, will make a legislative proposal to extend the CBAM to other goods than those listed in Annex I and possibly also to other emissions, and introduce other possible changes to improve its functioning.’ See CBAM Proposal, Explanatory Memorandum, p. 11.
58 Ibid., p. 4. Thus, the choice of sectors is aimed to achieve the highest environmental impact at relatively low administrative effort, as these are the sectors most exposed to carbon leakage risks due to both their carbon and trade intensities.
59 At the same time, some covered sectors include an extended list of products. For instance, the iron and steel (CN chapter 72) scope extends not only to carbon steel but also to stainless steel and special steels.
The limited inclusion scope does not seem to be in tension with the NT obligation. First, it covers those sectors that are also included in the EU ETS.\textsuperscript{60} In fact, it would also be consistent to include all EU ETS sectors in the CBAM (and it would be desirable for an effective prevention of carbon leakage\textsuperscript{61}). Yet, such a CBAM scheme would not be feasible from the cost-effectiveness perspective (high administrative costs), given the difficulty of tracing emissions in the majority of products, especially in products from downstream sectors.\textsuperscript{62} Theoretically, the product scope of a CBAM scheme could be based on a certain threshold for carbon intensity and trade exposure, whereby a CBAM obligation would apply only to those products whose carbon footprint is above a minimum threshold.\textsuperscript{63} To the extent that the threshold would ease the burden on imports, it will add legitimacy to a CBAM. But, in any case, the practical feasibility of tracing emissions would impose some constraints on the choice of sectors.

Second, like the obligation under the EU ETS for domestic producers, the CBAM only covers direct emissions. Extending the scope to indirect emissions (so-called scope 2 emissions) would create a tension with the NT rule. The adjustment of indirect costs would include increased prices of energy inputs used in the production process, i.e. emission costs of inputs bought from suppliers. For some industries (e.g. aluminium), indirect emissions costs constitute a significant portion of their general production costs. Therefore, to create a truly level playing field and create an incentive for foreign producers to decarbonize the electricity they

\textsuperscript{60} To be in line with the non-discrimination rules, all products subject to a BCA should be products that are subject to a corresponding internal measure in the domestic market. Yet, the reverse side of this rule does not need to hold true for a BCA on importation. In other words, not all the products that are subject to the corresponding internal measure must be included in the import-side border adjustment scheme. See Ecoplan et al., \textit{Border tax adjustments: Can energy and carbon taxes be adjusted at the border?} Study prepared for SECO, 2013, pp. 106-107.

\textsuperscript{61} The limited scope makes border adjustment a less effective tool for achieving the objective of emissions reduction, given that the lion’s share of emissions are contained in high value-added products (e.g. cars made of steel and plastic components). Moreover, limiting a CBA to products from upstream sectors (raw materials) puts domestic producers of high value-added products at a competitive disadvantage compared with their foreign competitors on both the internal and world markets. There is therefore a trade-off between the practical feasibility of a CBAM scheme and its environmental integrity and economic expediency. See A Cosbey, ‘Chapter Two: Border Carbon Adjustment: Key Issues’ in A Cosbey (ed), \textit{Trade and Climate Change: Issues in Perspective}, Final Report and Synthesis of Discussions at the Trade and Climate Change Seminar, Copenhagen, 18-20 June 2008), p. 25.


\textsuperscript{63} A percentage threshold based on the contents of final products was included in the design of the US Superfund BTA. The threshold was not discussed by the panel in the \textit{US-Superfund} case. See M Genasci, ‘Border Tax Adjustments and Emissions Trading: The Implications of International Trade Law for Policy Design’ (2008) 1 \textit{Carbon and Climate Law Review}, p. 36.
consume, a country would need to adjust the increased price of electricity for domestic producers.\textsuperscript{64}

48. However, adjustment of indirect costs of emissions reductions faces practical and legal obstacles. First, it is difficult to precisely calculate indirect costs. Besides the calculation of emission costs paid by energy suppliers, a proper calculation might require an assessment of the degree to which these costs have been passed on to energy consumers taking into account the amount that has been absorbed by suppliers.\textsuperscript{65} Second, there are concerns that the inclusion of Scope 2 emissions would allow for widespread resource shuffling, i.e. a rearrangement of existing trade patterns so that that goods produced with clean electricity would be exported to the EU and dirty goods to other markets without any change in production patterns.\textsuperscript{66} Third, and this concerns legal aspects, the inclusion of indirect costs in the CBAM scheme would run afoul of WTO rules both in the form and in the manner of border adjustment. An increase in the electricity costs or in the costs of other inputs is neither a tax nor a charge imposed by the government and thus cannot be adjusted at the border.\textsuperscript{67} Moreover, such an adjustment would be in violation of the NT rule, as importers would have to buy certificates for emissions for which domestic producers do not have to buy allowances. In this respect, the CBAM would not mirror the ETS, because EU producers are not forced to purchase emission allowances to cover the embedded emissions in their inputs.\textsuperscript{68}

2. \textbf{DIFFERENCES WITH THE EU ETS OBLIGATION AND ADJUSTMENTS FOR PRACTICAL FEASIBILITY}

49. While the Commission did its best to replicate the EU ETS in the design of the CBAM scheme (including structure, operation, data collection, and procedures) to avoid any elements of discrimination against imports, it had to make some adaptations to ensure practical feasibility of operating the scheme. These adaptations resulted in some differences with the EU ETS. One difference is that the emission allowance obligation under the CBAM applies to products

\begin{itemize}
\item \textsuperscript{64} Scope 1 emissions of EU industries are small compared to their counterparts in other countries. Without expanding the CBAM to cover scope 2 emissions, incentives for improving production processes in foreign countries will be lacking. See P Lamy et al., \textit{Domestic and international aspects of the EU CBAM: two sides of the same coin}, Europe Jacques Delors, February 2022, pp. 8-9.

\item \textsuperscript{65} Importantly, some EU Member States give their producers compensations for indirect emission costs from revenues received from auctioning emission allowances. Some experts believe that to avoid eliciting a more complex type of emissions data from foreign producers, EU Member States could continue the practice of compensation for indirect costs. Moreover, they argue that the biggest argument put forward against the inclusion concerns the amount of compensation. ‘The CBAM adjustment would be limited to the costs of embedded indirect emissions, but the EU’s marginal electricity pricing model means that firms are often paying costs that are considerably higher than that. EU electricity markets price electricity at the margin (something that not all jurisdictions outside the EU do), so prices for consumers in the EU are determined by the highest cost producer – the last in the dispatch order, which is typically a gas- or coal-fired generator that incurs high costs under the ETS’. See A Marcu et al. (2022), \textit{Border Carbon Adjustment in the EU: Indirect Emissions in the CBAM}, ERCST Report, 5 July 2022, pp. 7-8.

\item \textsuperscript{66} \textit{Ibid.}, p. 8.

\item \textsuperscript{67} See also Ecoplan et al., footnote 60, pp. 108-109.

\item \textsuperscript{68} ‘Even if EU producers face indirect emission costs via increased prices of their input materials and EU producers ultimately do pay those costs (since EU electricity producers must purchase allowances and they pass on to their customers most or all of the costs of that purchase), it is not clear that the WTO would regard those costs as being imposed by the ETS’. See Marcu et al., footnote 65, p. 8.
\end{itemize}
rather than producers. While the EU ETS covers installations (i.e. firms), the EU CBAM covers products or sectors. This is however not critical for the compliance with the NT obligation, so long as the list of products covered by the CBAM corresponds to the list of products subject to the requirement under the EU ETS in the EU market. In other words, a CBAM can only be applied to those products that are produced by firms with ETS obligations in the domestic market.

50. CBAM certificates for importers are also not identical to emission allowances for EU producers. The important difference is that they are not tradable. Whether this difference would entail a less favourable treatment of imports in violation of GATT Article III:4 is doubtful however, as this difference has no relation to imports’ origin but merely made for practical reasons. As explained by the Commission, ‘the CBAM system has some specific features compared with the EU ETS, including on the calculation of the price of CBAM certificates, on the possibilities to trade certificates and on their validity over time. These are due to the need to preserve the effectiveness of the CBAM as a measure preventing carbon leakage over time and to ensure that the management of the system is not excessively burdensome in terms of obligations imposed on the operators and of resources for the administration, while at the same time preserving an equivalent level of flexibility available to operators under the EU ETS’. More specifically, the EU needs to keep a separate pool of emission allowances (i.e. CBAM certificates), specially created for these purposes, where the importers can buy them to place on their accounts and surrender in due course, in order to avoid the distortion of the carbon price within the EU. Importantly, CBAM certificates will be purchased at an average price of EU ETS emission allowances for the week preceding the importation, thus mirroring the weekly average price of emission allowances auctioned under the EU ETS. As explained by the Commission, ‘such weekly average prices reflect closely the price fluctuations of the EU ETS and allow a reasonable margin for importers to take advantage of the price changes of the EU ETS while at the same ensuring that the system remains manageable for the administrative authorities’.

51. Another difference is the use of default values for the carbon footprint in imports ‘when actual emissions cannot be adequately determined’ and for electricity imports as a standard method of determining the carbon content. The choice of combining a method based on actual embedded emissions and a method based on default values reflects a trade-off between accuracy and administrative feasibility and in addition signals awareness of the legal constraints arising out of non-discrimination obligations. The use of default values raises a

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69 Ecoplan et al., footnote 608, pp. 106-107.
70 CBAM Proposal, Ingress para. 20.
71 CBAM Proposal, Ingress para. 21.
72 CBAM Proposal, Art. 7(2).
73 For electricity, the calculation of actual emissions is permitted only through a number of strict conditions laid down in para. 5 of Annex III of the Proposal. This is to avoid circumvention (see Ingress 46), as electricity trade is different from trade in other goods, given that it is traded via interconnected electricity grids, using power exchanges and specific forms of trading. It is impossible to determine the carbon content of energy taken from the grid.
number of issues under the NT obligation. First, while a system based on actual emissions ensures a fair and equal treatment of all imports and a close correlation to the EU ETS\textsuperscript{74}, the determination of the carbon footprint based on default values constitutes a deviation from the treatment of domestic products. As long as importers are always given the opportunity to demonstrate that they perform better than such value based on their actual emissions, the compliance with the NT obligations can be ensured.\textsuperscript{75} There is, however, a possibility that firms might be induced to opt for default values if the way of emission verification is too complex or costly for the EU.\textsuperscript{76} Second, the calculation of default values based on the average emission intensity of each exporting country for each of the goods covered by the CBAM may be difficult, whereas the alternative calculation of default values\textsuperscript{77} based on the average emission intensity of the 10 per cent worst performing EU installations for that type of goods could be found rather ‘punitive’, so that a violation of the NT rule cannot be excluded.\textsuperscript{78} At the same, the possibility to provide the information on actual emissions could arguably allow stricter thresholds for default values of embedded emissions.\textsuperscript{79}

52. In sum, these deviations of the CBAM with the EU ETS obligation raise some questions. But, as explained in section III B, while these design elements result in a different treatment of imports compared to domestic products, it will not necessarily entail a less favourable treatment of imported products and a violation of the NT rule, for these deviations seem to be indispensable for the CBAM operation.

3. \textbf{Parallel use of free allocation}

53. Free allocation of emission allowances has been the main tool to address carbon leakage concerns related to the EU ETS from the very inception of the ETS. The EU has been

\textsuperscript{74} Nevertheless, the obligation imposed on importers to provide actual information on GHGs emitted during the production of carbon-intensive products could in itself be seen as a violation of GATT Art. III:4, as it is imposed on foreign producers/importers only, while domestic producers are not subject to the same requirement. The information on emissions in EU installations had been furnished before the ETS was introduced or at the beginning of every further phase of the EU ETS. Though not examined by the GATT panel, such a requirement on importers was criticized by the parties to the Superfund dispute: “Canada and the EEC noted that … the importer would benefit from the normal rates only by providing the Secretary with sufficient information to determine the appropriate level of tax. Domestic producers were not subjected to such a requirement. Given the complexity of the production processes, … the additional administrative burden imposed on importer could place foreign producers at competitive disadvantage relative to producers in the United States”. See \textit{US-Superfund}, GATT panel report, para. 3.2.14.

\textsuperscript{75} The opportunity to demonstrate actual emissions also gives an incentive for foreign producers to reduce their emissions.

\textsuperscript{76} \textit{Espa, Francois and van Asselt}, footnote 8, p. 26.

\textsuperscript{77} \textit{CBAM Proposal}, Annex III, para. 4.1.

\textsuperscript{78} \textit{Espa, Francois and van Asselt}, footnote 8, p. 24. This would punish foreign producers who produce more efficiently and therefore discourage them from shifting to cleaner technologies. In this sense, least discriminative would be default values based on best available technology (BAT) levels. At the same time, they would be least effective against carbon leakage. Another benchmark for default values could be a predominant method of production (PMP), which was accepted as a basis for the calculation of a border tax by the GATT panel in the Superfund case as not being in violation of the NT principle under GATT Article III:2, first sentence. See \textit{US-Superfund}, GATT panel report, paras. 5.2.9-5.2.10. See \textit{Holzer}, footnote , pp. 228-232.

\textsuperscript{79} Holzer, footnote 5, p. 638.
providing free allowances to a significant number of energy-intensive and trade-exposed sectors (EITE) where the risk of carbon leakage had been assessed as significant. In addition, some EU Member States have been providing compensation to EITE for increases in electricity prices (indirect costs of emissions).

54. The EU CBAM is meant to substitute free allocation of emission allowances as an alternative safeguard to carbon leakage. The view of the Commission, ‘to allow producers, importers and traders to adjust to the new regime, the reduction of free allocation should be implemented gradually while the CBAM is phased-in, in order to ensure that they are not cumulative’. The latter is important to ensure consistency with WTO law. Continuing to provide free allocation while simultaneously imposing a CBAM on imports would run contrary to the NT principle and lead to a violation of GATT Article III:4. Under free allocation of emission allowances to some installations, a CBAM would impose a disproportionate burden on imports of the respective products, while granting ‘double protection’ to EU producers.

55. Therefore, a CBAM on imports can only be applied for the part of emissions of EU producers, which are not covered by free allocation. The proposed EU CBAM is designed to meet this requirement. Article 31 of the EU CBAM foresees a deduction of free allowances received by EU producers from the CBAM based on calculation methodologies laid down in separate implementing acts:

56. The CBAM certificates to be surrendered in accordance with Article 22 shall be adjusted to reflect the extent to which EU ETS allowances are allocated free of charge in accordance with Article 10a of Directive 2003/87/EC to installations producing, within the Union, the goods listed in Annex I.

57. Thus, as long as ‘with regard to the phase-in of the CBAM and the corresponding phase-out of the free allowances, it will (be) ensured that at no point in time over this period, imports are afforded less favourable treatment than domestic EU production’, there would be no inconsistency with non-discrimination rules of the WTO. On the one hand, the issue is temporary, given that the EU plans to phase out free allocation in initially covered sectors by 10% each year starting from 2026 to achieve the complete phase-out of free allocation by the

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80 Emissions allowances have been distributed for free based on the benchmark for each product that rewards most efficient installations (the average level of emissions of the 10% most efficient installations).

81 While being a reliable carbon leakage safeguard, free allocation weakens the carbon price signal and lowers emission reduction ambition. From a WTO law perspective, it also raises issues of actionable subsidy. See e.g. the US Department of Commerce decision to treat certain free allowances under the EU ETS as a countervailable subsidy. U.S. DOC, “Issues and Decision Memorandum for the Final Affirmative Determination of the Countervailing Duty Investigation of Forged Steel Fluid End Blocks from the Federal Republic of Germany”, December 7, 2020.

82 CBAM Proposal, Explanatory Memorandum, p. 3.

end of 2035 at the latest.\textsuperscript{84} On the other hand, this feature remains controversial and according to some probably the weakest element in the CBAM design.\textsuperscript{85}

D. The Prohibition of Quantitative Restrictions

58. The ban on quantitative restrictions under Article XI GATT arguably is relevant in the present context, even if the measures fall under Article I or III GATT. Countries have a right to market access within the limits of bound tariff rates for conventionally produced products falling short of CO\textsubscript{2} reductions. The costs of CBAM certificates, as well as procedural costs must not achieve a level which de facto amounts to an import ban of conventionally produced products. It is unclear where boundaries as to carbon pricing lie under this aspect.

IV. Justification of the EU CBAM under general exceptions of the GATT

59. There is a high probability that the EU CBAM will violate the basic principles of non-discrimination and will need to be defended under the exceptions. There is a fair degree of uncertainty over the outcome of the likeness test of the same products with a different degree of carbon intensity (see section III.A) and the adjustments in the design of the EU CBAM that had to be made for practical feasibility of the measure (see section III.B and III.C). Such exceptions (at least for the rules of the GATT) are available for measures taken for certain public policy objectives under a number of conditions, set out in GATT Article XX.

A. Requirements for justification and the EU CBAM

1. REQUIREMENTS UNDER PARAGRAPHS OF ARTICLE XX

60. Exceptions to GATT rules are available for measures taken in pursuit of one of non-trade policy objectives specified in paragraphs of GATT Article XX. An important initial step in the analysis of whether a measure can be justified as an exception is therefore the determination of its objective.\textsuperscript{86}

61. As stated by the EU Commission,

(i)n the context of the ‘Fit for 55 Package’ the CBAM is not a self-standing measure. It is a climate policy measure aiming at preserving the integrity of the EU’s climate ambition towards the ultimate goal of climate neutrality. The role of the CBAM is to address the risk of carbon leakage and reinforce the EU ETS.\textsuperscript{87}

\textsuperscript{84} If changes proposed by the European Parliament are accepted, it may accelerate the phase-out pace to bring free allocation down to 100% phase-out already in 2032. See European Parliament, ‘Amendments adopted by the European Parliament on 22 June 2022 on the proposal for a regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism’ P9_TA(2022)0248.

\textsuperscript{85} J Bacchus (2021), ‘Legal Issues with the European Border Carbon Border Adjustment Mechanism’ (Cato Institute 2021), p. 4, also noting that ‘the free emissions allowances currently granted to domestic producers by the EU through the ETS are arguably already illegal’ under ASCM rules.

\textsuperscript{86} See e.g. US-Gasoline, panel report, para 6.20.

\textsuperscript{87} CBAM Proposal, Explanatory Memorandum, p. 2.
62. The objective of the EU CBAM ‘to serve as an essential element of the EU toolbox to meet the objective of a climate-neutral Union by 2050 in line with the Paris Agreement by addressing risks of carbon leakage resulting from the increased Union climate ambition’ is also explicitly set in para 9 of the preamble to the proposed CBAM regulation.

63. In fact, a CBAM by its nature is a multi-purpose measure. It is well established in the WTO case law that domestic regulators may accommodate within a single measure several policy interests and objectives. In the EC-Seal Products case, several objectives of the measure were even competing, as there was a trade-off between protecting seal welfare and preserving Inuit cultural identity. In that dispute, the AB considered addressing EU public moral concerns regarding seal welfare to be the principal objective of the EU seal regime, while it found accommodating inuit concerns and other interests being necessary to mitigate the impact of the measure on those interests. In the case of a CBAM, the different objectives of preventing carbon leakage and preserving a level playing field are inextricable intertwined. Admittedly, for the purposes of justification under Article XX(g), it is the environmental objective of addressing carbon leakage and not the economic objective of establishing a level playing field that can be viewed as legitimate. Yet, as the risk of carbon leakage stems from the lack of a level playing field, addressing carbon leakage is not possible without restoring a level playing field, which makes levelling playing field part of the legitimate objective of addressing carbon leakage. Like in the Seals case, the trade-off pertaining to objectives can be seen as inherently needed from a regulatory perspective. For that reason, the EU CBAM regulation can lawfully be assigned to Article XX(g) GATT.

64. Thus, although a CBAM can be viewed as a multi-purpose measure, which by preventing carbon leakage as an environmental goal relies on the idea of levelling the playing field between domestic and foreign producers and thus inevitably fulfils an economic/industrial objective, the draft CBAM regulation the EU carefully positions its CBAM as an environmental measure aimed at enabling higher climate policy ambition and avoiding carbon leakage. This is important, because for a CBAM to fall under the GATT Article XX exceptions, it is necessary that the objectives of the measure are explicitly set as relating to non-trade-related goals. It is non-trade-related public policy objectives that give a measure a shelter under GATT Article XX exceptions, and it is therefore the environmental objective and not the economic rationale that needs to be associated with a CBAM for a successful defence as an exception to WTO rules.

65. Aimed at preventing carbon leakage, the EU CBAM thus have good chances to be defended either as a measure relating to the conservation of exhaustible natural resources under paragraph (g) or as a measure that is necessary to protect human, animal or plant life or health under paragraph (b) of Article XX.

66. To fall under paragraph (g), a CBAM should relate to the conservation of exhaustible natural resources. Whether the EU CBAM will pass the ‘relating to’ test under paragraph (g)

89 EC – Measures Prohibiting the Importation and Marketing of Seal Products, WT/DS 401/AB/R (22 May 2014) para 5.167.
requires an analysis of the relationship between an ‘end’, which is a policy objective the government aims to achieve, and a ‘means’, which is a type of measure being employed to achieve the objective. Given that the public policy objective of the EU is to achieve a carbon-neutral society by 2050, the EU CBAM, which puts carbon restrictions on imports, seems to accurately reflect a close and genuine relationship between an ‘end’ and a ‘means’. There is little doubt that climate can be viewed as an exhaustible natural resource. In US-Gasoline, clean air was found to be an exhaustible natural resource, based on the following logic: clean air is a resource because it has a value; despite the fact that it is a renewable resource, it is depleted, and hence it is exhaustible. The climate can also be viewed as an exhaustible natural resource from the perspective used by the panel in the US-Gasoline case. Climate is defined as average weather conditions is a natural resource. Given that changes in the climate lead to the depletion of forests, fisheries and other exhaustible natural resources, climate change can be viewed in terms of exhaustibility of the safe climate needed to preserve biodiversity and life on the planet. Paragraph (g) also requires a measure on imports to be ‘made effective in conjunction with restrictions on domestic production and consumption’. This is a requirement of even-handedness, which implies that domestic producers and/or consumers must share with foreign producers a burden of restrictions in the pursuit of a policy objective. Given that the CBAM will be applied to imports in parallel to the EU ETS obligation to domestic producers, the EU CBAM will meet this requirement. A crucial question is also whether a CBAM could be defended under paragraph (g) if it targets production activities causing emissions on the territory of other countries. In US-Shrimp, the AB found that Article XX exceptions could be available for measures with extraterritorial jurisdiction. However, for an extraterritorially applied measure to pass the test of being viewed as an ‘exhaustible natural resource’, there should be a sufficient nexus between the situation happening in exporting countries and the risks for the importing country introducing the measure. The question is whether a CBAM, which is aimed at preventing carbon leakage, i.e. the increase of emissions abroad, could be viewed as a measure having a sufficient nexus with the risks for the importing country. It can be argued that the extraterritorial application of the measure is justifiable on the grounds of the need to protect climate as a global common, given that climate change caused by emissions resulting from production affects not only the exporting country but also the importing one.

67. Justification of the EU CBAM might also be sought under paragraph (b) of Article XX as measures ‘necessary to protect human, animal or plant life or health’. This exception clause can be invoked on the grounds that climate change causes heat waves, storms, floods and other natural disasters that endanger human, animal and plant life. To be justified under paragraph (b), a measure must be deemed to be necessary. The ‘necessity test’ under paragraph (b) is more demanding than the ‘relating to’ test under paragraph (g). The evaluation of necessity
of a measure involves a process of weighing and balancing a series of factors, including the contribution by the measure to the pursued objective, the importance of the common interests or values protected by the measure, and the existence of a reasonably available alternative measure, which is less trade-restrictive.\(^{97}\) The chances of the EU CBAM to be justified under paragraph (b) would be much higher, if there were concrete estimates of the contribution of the EU CBAM to the prevention of carbon leakage. In the absence of such estimates, justification under paragraph (g) is a more reliable option.

68. Another option that has arguably been overlooked so far is the possibility to seek justification for the EU CBAM under paragraph (a) on public morals with a view to intergenerational equity. According to some scholars, paragraph (a) could be invoked in combination with either paragraph (b) or (g) as a means to strengthen a climate defence by resorting to a value-based approach that seeks to present the CBAM as a response to the moral imperative and intergenerational equity to take sufficient action on climate change.\(^{98}\) In a similar vein, paragraph (a) has already been invoked by the EU in the context of the pending disputes EU-Palm Oil (Indonesia) and EU and Certain Member States-Palm Oil (Malaysia).\(^{99}\)

69. Finally, justification of CBAM measures may fall under Article XX(d) GATT. This provision is shaped in a way to justify flanking measures necessary to implement internal market regulations, provided that the regulation itself is not inconsistent with WTO law. The provision thus is in particular suitable to address the problem of maintaining the level playing field. Until recently, Article XX(d) has been rarely invoked, perhaps because measures inconsistent with Article III:4 GATT were considered to disqualify for the exemption\(^{100}\). Article XX(d), however, does not relate in circular manner to the technical rule found inconsistent with Article III:4 GATT, but as to whether the overall objective of the measure is compatible with WTO law.\(^{101}\) Given the preamble of the WTO, which includes the goal of sustainable development and the protection of natural resources, climate change measures in principle are likely to be found compatible. In particular, CBAM serves the purpose to establish a level playing field, corresponding to the underlying principle of equal conditions of competition inherent to WTO law. The measure in addition needs to pass the necessity test, involving a comprehensive weighing and balancing test\(^{102}\) of a number of factors, such as the importance of the objective, the restrictiveness of the measure, and the contribution of the measure to the stated objective. Finally, they have to comply with the requirements of the chapeau of Article XX GATT.

\(^{97}\) Korea-Various Measures on Beef, AB report, para. 164; Dominican Republic-Imports and Sale of Cigarettes, AB report, para. 70.

\(^{98}\) P van den Bossche, ‘What Perspectives for The Dispute Settlement System Between Multilateralism And Regionalism?’, Conference on From Bocconi SIEL 2021 to the WTO 12th Ministerial Conference, Bocconi University, 11 October 2022.

\(^{99}\) EU-Palm Oil (Indonesia) and EU and Certain Member States-Palm Oil (Malaysia).

\(^{100}\) Thailand-Cigarettes, AB Report, para. 134.


\(^{102}\) Korea–Various Measures on Beef, AB report, para. 166.
2. Requirements under the Chapeau of Article XX

70. Once a measure has fallen within the scope of the paragraphs, it also needs to satisfy the conditions of the chapeau of Article XX.\textsuperscript{103} The chapeau requires that a measure does not constitute ‘a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade’. When assessing whether a measure constitutes an arbitrary or unjustifiable discrimination or a disguised restriction on trade, a panel would likely look at both the design of the measure and the manner in which it is implemented.\textsuperscript{104} In simple terms, the rule of the chapeau that prohibits arbitrary discrimination ‘between countries where the same conditions prevail’ requires differentiation in the design and the implementation of a measure between countries where conditions are not the same. The conditions meant here are policies implemented by exporting countries with respect to a policy objective pursued by an importing country, the situation in exporting countries regarding the risks addressed by a policy of the importing country, and even the level of economic development of countries.\textsuperscript{105} Importantly, where discrimination between countries with the same conditions exists, the reasons for such discrimination should have a link to the objective reflected by a paragraph of Article XX.\textsuperscript{106} If, for instance, an exporting country enacts carbon legislation, which gives grounds to believe that it makes a real contribution to the emissions reduction objective, an importing country should exclude products imported from that country from coverage by a CBAM scheme.\textsuperscript{107}

71. Given that the main objective of the EU CBAM is preventing carbon leakage, the CBAM design should be flexible enough to exclude imports from countries having a carbon leakage safeguard in place.\textsuperscript{108} Therefore, the exclusion of imports from countries listed in Annex II of the CBAM regulation, which have ETSs integrated into or linked with the EU ETS and thus the same carbon price as under the EU ETS, is consistent with the requirements of the chapeau. Such an exclusion has a connection to the objective of carbon leakage prevention, for there is no reason in relocating the production to countries where emissions costs are the same. It also induces other countries to put a national price on carbon by adopting a carbon tax or an ETS and thereby support the achievement of the goals of the Paris Agreement.

72. At the same time, it is important that a measure being defended under Article XX does not have a coercive effect on domestic policies of exporting countries. The conditions of the chapeau were met by the US import ban on shrimp caught by fishing methods that killed dolphins only after the US changed its measure so that it no longer required, from trading partners, the adoption of ‘essentially the same program’ on the conservation of turtles but just ‘a program comparable in effectiveness’ to the US one. In the view of the AB, it then allowed

\textsuperscript{103} \textsc{US-Gasoline}, AB report, p. 22.

\textsuperscript{104} \textit{Ibid.} See also \textsc{US-Shrimp}, AB report, paras. 149 and 160 and \textsc{US-Shrimp (Article 21.5 – Malaysia)}, AB report, para. 140.


\textsuperscript{106} \textsc{Brazil-Retreaded Tyres}, AB report, para. 227.

\textsuperscript{107} \textsc{Ecoplan et al.}, footnote 60, p. 102.

\textsuperscript{108} \textsc{Holzer}, footnote 5, p. 638.
‘for sufficient flexibility in the application of the measure so as to avoid ‘arbitrary or unjustifiable discrimination’. 109 This means, for example, that the EU should not require from its trading partners for the exclusion from the import coverage the adoption of the same type of ETS, but should instead accept exporting countries’ own climate policies if they are comparable in effectiveness with measures taken by the EU.

73. Crediting imports with a CBAM discount for paying carbon prices in countries of import origin is problematic in this respect. Article 9 of the EU CBAM Proposal states that ‘the EU can negotiate agreements with third countries to facilitate the recognition of their carbon pricing systems and the reductions accorded to their exporters’. At the same time, Article 3 of the EU CBAM Proposal defines the carbon price as ‘the monetary amount paid in a third country in the form of a tax or emission allowances under a greenhouse gas emissions trading system, calculated on greenhouse gases covered by such a measure and released during the production of goods’. In other words, the EU CBAM foresees only crediting for explicit carbon pricing policies, which has a coercive effect in violation of the chapeau requirement. This is one of the EU CBAM features discussed in the next sub-section that might hamper a successful justification under GATT Article XX.

74. Also, the following characteristics of a measure are essential for a successful justification under Article XX. 110 First, the implementation of a measure should reflect ‘basic fairness and due process’. 111 A measure should be administered in a transparent manner and there should be a reasonable length of time between the adoption of a measure and its coming into force, which should allow exporting countries to make certain adjustments to the importing country’s measure. 112 What ‘phase-in’ period could be considered to be reasonable depends on the type of measure, onerousness of the burden it presents for exporting countries, and the ability of exporting countries to adjust to a measure, e.g. adopting climate legislation, looking for alternative export markets, or upgrading their production standards to be able to avoid the application of a measure to their products. 113 The transitional period of 3 years, as foreseen in the EU CBAM Proposal, is likely to be viewed as reasonable.

75. Second, it is important that a country, before introducing a measure, attempts to enter into negotiations with its trading partners with the aim to conclude an agreement on the subject regulated by the measure. 114 This means that the EU has to make attempts to negotiate with its trading partners the subject of carbon leakage and its prevention through introducing carbon prices bilaterally or initiate negotiations at a multilateral forum (for instance, in the UNFCCC or the WTO). Only when such negotiations fail, may the EU proceed with the imposition of a CBAM unilaterally.

110 Ecoplan et al., footnote 60, pp. 102-103.
112 Ibid., para. 174.
113 Ibid.
114 Ibid., para. 171, footnote 174.
B. Design features that might hamper justification of the EU CBAM under environmental exceptions

1. DISREGARD OF NON-PRICING CLIMATE POLICIES IN THE CALCULATION OF A CBAM DISCOUNT

As discussed above, a key condition laid down in the chapeau of GATT Article XX is that a measure should not be applied in a manner which constitutes a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail. Considering the conditions in other countries that are relevant for the pursued objective, as required by the chapeau, imposes an obligation to take into account the carbon prices paid in the country of origin of imported products (even if these prices are lower than the EU carbon price). A carbon price abroad, which is lower than the EU carbon price, while being not a perfect carbon leakage safeguard, can still play a role in the prevention of carbon leakage. This is what is meant by the EU by providing crediting for carbon prices paid abroad under Article 9 of the EU CBAM Proposal. However, the determination of carbon prices in other countries raises the question about the role of non-pricing mechanisms in their formation and in the prevention of carbon leakage in general, so that excluding the relevance of the latter for the purposes of determining CBAM discounts may lead to allegations of arbitrary or unjustifiable discrimination in violation of GATT Article XX.

The rationale behind the choice to disregard non-pricing mechanisms of emission reduction or non-pricing climate policy measures in general is caution, given that implicit, or effective, carbon prices are not obvious. They are hidden behind many policies and regulatory measures, even those with no direct relation to climate policy. For instance, energy saving and air pollution measures, including relevant product standards, are not directly related to carbon reduction policy but nevertheless they have a significant impact on it. Would they be included in the list of relevant measures to be considered when calculating effective carbon prices? Moreover, as the EU itself relies on various non-pricing mechanisms, particularly in sectors subject to effort sharing at the national level of EU Member States, crediting for an effective carbon price will make the EU calculate the carbon costs of its own non-pricing emission reduction mechanisms. The more policies are accounted for, the higher the risk of arbitrariness, especially considering the difficulty of expressing non-pricing mechanisms in prices. Even if a list of measures relevant for calculating the effective carbon price were set up, what methodologies should be used to calculate implicit prices? And how to treat voluntary carbon offsetting? Should carbon credits earned from offset projects be also accepted as a basis for receiving a ‘CBAM discount’? In short, crediting for implicit carbon prices raises many questions that make it difficult to implement in practice.

Symmetrically, the European Parliament’s proposed amendment on the inclusion of export rebates also envisages them to be granted to EU products destined for exports in third countries without carbon pricing mechanisms similar to the EU ETS. See Section VII.

Espa and Holzer, footnote 41.

O Sartor et al. (2022), Getting the transition to CBAM Right: Finding pragmatic solutions to key implementation questions, Agora Industry.
However, not considering third countries’ measures different from an ETS or a carbon tax may likely create grounds for accusation of arbitrariness, which goes contrary to the requirements of the chapeau of Article XX GATT. In the Shrimp-Turtle dispute, an import ban passed the test on arbitrariness under the chapeau only after it had been modified to become flexible enough to require from trading partners ‘the adoption of a program comparable in effectiveness’ rather than ‘the adoption of essentially the same program’ as a domestic one. This suggests that a CBAM should be flexible enough to take into account in the calculation of a CBAM discount all measures (pricing and non-pricing) of trading partners that are as effective as the EU ETS. For instance, the US, which does not have a federal ETS in place but instead it has cap-and-trade systems operating at the sub-federal (state) level, as well as a variety of energy efficiency and air pollution regulations and extensive green transition incentives and funding schemes, may argue that its national climate policy measures are in no way less effective than the EU ETS or carbon pricing mechanisms in general. This sounds like a valid argument that can be substantiated by answering the question of whether pricing and non-pricing mechanisms are comparable. This would require a comparison of the impacts of the measures on emission reduction, a task to be performed by economists. Intuitively, the possibility that a non-pricing mechanism be found comparable in effectiveness to carbon pricing mechanisms cannot be excluded.

One could argue that the EU CBAM will indirectly consider non-pricing instruments. This is because ‘by taking actual emissions into account, the EU CBAM does implicitly recognize the impact of third countries’ regulatory frameworks on imports’. Faced with compliance obligations under non-pricing policies, foreign producers bear costs of these policies and attempt to reduce their carbon footprint, which is reflected in a lower CBAM charge. Therefore, it has been contended that the EU ‘in no way discriminates against countries that have not introduced a carbon-pricing scheme, but rather aims to ensure that all domestic and foreign producers are subject to an equivalent carbon price’. The question again to economists is whether the actual emission footprint of imports will necessarily reflect the total costs incurred by foreign producers under non-pricing policies. If not, part of the costs would remain uncaptured in the calculation of the amount of CBAM certificates to be purchased and surrendered, which would then result in discrimination.

That said, achieving compliance with the requirements of the chapeau by considering non-pricing mechanisms in crediting of importers seems to be difficult, if not impossible, due to the administrative complexity of such an option and the absence of unified methodologies for the comparison of climate policy measures among countries. To mitigate the risk of a failure of justification of a CBAM under the environmental exceptions, the EU should intensify

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118 It should be noted that nonConsidering non-pricing policies would also run contrary to climate change law to the extent that it contradicts the bottom-up approach of the Paris Agreement. The Paris Agreement parties are free to choose any measures suitable for them to achieve their NDCs ‘reflecting common but differentiated responsibilities and respective capabilities, in the light of different national circumstances’. In other words, the Paris Agreement does not accord any preference to carbon pricing mechanisms over non-pricing mechanisms. See Espa and Holzer, footnote 114.


120 Ibid., p. 199.

121 Espa and Holzer, footnote 41.
diplomatic efforts and cooperation with its trading partners on rules and modalities for the application of CBAMs, including as part of building climate clubs.

4. NEGOTIATIONS PRIOR TO ENTRY INTO FORCE OF CBAM

81. In this vein, the question arises whether the EU, prior to the entry into force of CBAM, has undertaken sufficient efforts to seek a negotiated solution with Members of the WTO affected, as required under the chapeau of Art. XX, and also in line with obligations under the Agreement on Trade Facilitation (Section V below).

82. The EU has been making general efforts to meet this requirement. Since 1992, the EU has been active in promoting climate action and negotiating international climate change agreements. Currently, the EU and its Member States is promoting in the international arena the idea of cooperative climate clubs as a platform for negotiating, *inter alia*, common rules on the use of CBAMs.\(^\text{122}\) It has been active in negotiating with its trading partners since the announcement of the CBAM and admits that active outreach to third countries would be important with regard to the understanding of and compliance with CBAM requirements. Moreover, the EU will engage with third countries whose trade to the EU is affected by this Regulation to explore possibilities for dialogue and cooperation with regard to the implementation of specific elements of the Mechanism. It should also explore possibilities for concluding agreements to take into account their carbon pricing mechanism.\(^\text{123}\)

83. The fact remains that specific negotiations on carbon pricing are scheduled upon the entry of the CBAM measure, and not prior to the entry into force, under the current schedule. Unless subsequent negotiations during the implementation phase until 2026 are open to bilaterally or multilaterally define carbon prices, and fail to do so, unilateral imposition may be not in line with the standard set in the case law.\(^\text{124}\)

2. USE OF REVENUES

84. As explained by the EU Commission, most revenues generated by the EU CBAM will go to the EU budget.\(^\text{125}\) It means that revenues from the EU CBAM will not be specifically earmarked to support transfer of technology to third countries to help decarbonise their industries and accelerate emission reduction globally. This is a significant drawback of the EU CBAM design, which can hamper justification of the measure under GATT Article XX. Earmarking of CBAM revenues for climate change mitigation or adaptation purposes would strengthen the climate policy objective of the measure. Transfer of revenues to climate change funds or its use in any other way to finance the deployment of clean technologies and investments in alternative energy sources, especially in developing countries, would serve as evidence that CBAMs are applied not for the sake of protectionism but with the objective of mitigating climate change.\(^\text{126}\)


\(^\text{123}\) *CBAM Proposal*, Explanatory Memorandum, pp. 2-3.

\(^\text{124}\) Footnote 114.

\(^\text{125}\) *CBAM Proposal*, Explanatory Memorandum, p. 10.

\(^\text{126}\) Ecoplan et al., footnote 60, p. 114.
3. ABSENCE OF A CLEAR COMMITMENT OF FINANCIAL ASSISTANCE TO LESS DEVELOPED COUNTRIES AND TRANSFER OF LOW-CARBON TECHNOLOGY

85. The requirement of the chapeau to take into account the conditions prevailing in different countries might enable a country imposing a CBAM to differentiate the strictness of the measure between countries based on their development, and even exempt imports of less developed countries. The language of the chapeau allows distinctions to be made between imports from different countries as long as ‘different conditions’, such as levels of economic development, prevail in those countries. The list of possible conditions for regulatory differentiation can arguably also include historic levels of emissions, per capita emissions levels, emissions per unit of GDP etc. A more lenient carbon measure on products from poor countries could not only be justified because ‘the same conditions’ do not prevail in those countries, but also because the Enabling Clause permits developed countries to give tariff preferences to developing countries on a non-reciprocal basis. The Enabling Clause gives a right (albeit not an obligation) to provide ‘discriminatory’ preferential treatment among countries in a Generalised System of Preferences (GSP) scheme based on development criteria, so long as countries having similar conditions are treated in a similar manner. It can even be argued that the differential treatment of imports from different countries is acceptable (also under the MFN obligation discussed in section III.B), as long as it is based on objective factors related to a country’s situation, including its level of development, and not to the origin of imports. In fact, the application of CBAMs should be consistent with the special and differential treatment provisions of the GATT, which give special rights and favourable treatment to developing countries. GATT Article XXXVII:1(b) and (c) particularly requires that developed countries avoid applying new fiscal measures and non-tariff import barriers to products currently or potentially of considerable export importance for less developed WTO members. The same holds true for transfer of technology, which under the TRIPS Agreement is required for least developed members of the WTO (section VIII).

86. A more favourable treatment of developing countries in the context of CBAMs would also be in line with the language of the preamble to the WTO Agreement. The parties to the agreement seek ‘both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development’. And finally, as discussed in Annex II of this legal opinion, it

127 More precisely, to take ‘into consideration different conditions which may occur in the territories of … other Members’, as was formulated by the AB in *US-Shrimp*, AB report, para 164.
129 Pauwelyn, footnote 11, p. 43.
131 *EC-Tariff Preferences*, AB report, para 173.
132 Pauwelyn, footnote 11, p. 12.
133 *Holzer*, footnote 7, p. 77.
would also be in line with the UNFCCC CBDR principle, building coherence between the climate and trade regimes.

87. However, the EU Commission has chosen not to exclude imports of less developed countries from the EU CBAM. The Commission has justified this choice by the ineffectiveness of this approach, claiming that it would disincentivise these countries to reduce their emissions and run counter to the overarching objective of the CBAM and long-run interests of the third countries. We agree with this approach but submit that from a climate law perspective, the omission of less developed countries should be addressed by a clear EU commitment to provide financial assistance and transfer of low-carbon technology to these countries helping them to comply with the EU CBAM. From a WTO law perspective, while not directly required, it is lawful and strongly encouraged under special and differential treatment provisions contained in many WTO agreements. Such financial assistance would accommodate specific needs of developing countries by contributing to decarbonisation of their industries and mitigating the negative impact of the CBAM on their economies. Decarbonisation in developing countries could be funded from CBAM revenues allocated to a special climate change-related fund. In doing so, the EU would also improve the prospects for successful justification of the CBAM under GATT Article XX as a climate-motivated measure in a WTO dispute.

4. INTENDED EXPORT REBATES

88. While the Article XX requirements are quite stringent, a defense of the EU CBAM on importation as an exception seems quite realistic (especially if the above-discussed design elements – crediting for non-pricing policies, recycling of revenues and financial assistance to less developed countries – are added). There however is one nuance. It will be more difficult

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135 It should be noted that the European Parliament has urged the Commission to take into account the impact of the EU CBAM on LDCs and SIDSs, stressing that ‘Least Developed Countries and Small Island Developing States should be given special treatment in order to take account of their specificities and the potential negative impacts of the CBAM on their development’. See European Parliament (2021), Resolution towards a WTO-compatible EU carbon border adjustment mechanism of 10 March 2021, para 8. Also, the European Parliament has explicitly called on the EU to support LDCs. See European Parliament (2022), ‘P9_TA(2022)0248Carbon border adjustment mechanism*** I:Amendments adopted by the European Parliament on 22 June 2022 on the proposal for a regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism’, Amendment 40.


137 This financial assistance must be in addition to climate finance that the EU as a developed country union is obliged to provide to developing countries under the UNFCCC and the Paris Agreement, and also in addition to Official Development Aid (ODA). It should be noted that the CBAM Proposal refers to ODA as a means to support developing countries: ‘[T]he introduction of CBAM certificates based on actual emissions would protect against the risk of carbon leakage while incentivising third country producers to move towards cleaner production processes, with the support of Official Development Assistance when applicable’. See CBAM Proposal, Explanatory Memorandum, pp. 10-11.

138 WTO Secretariat, Special and Differential Treatment Provisions in WTO Agreements and Decisions, Note by the Secretariat, Committee on Trade and Development, WT/COMTD/W/258, 2 March 2021.

139 Ecoplan et al., footnote 60, p. 114.
to justify a CBAM under Article XX, if a requirement to submit emissions allowances for importers is coupled with export rebates of emissions allowances.\textsuperscript{140} Giving exports rebates, which are actually costs of emissions, does not seem to make sense from the perspective of climate policy, which seeks to put the costs on emissions. Even though it can be argued that for preventing carbon leakage there needs to be a level playing field also in the export market (and this is what the export rebates are for)\textsuperscript{141}, the emissions allowances rebates on exportation might be viewed as contrary to the emission reduction policy spirit.

89. Consequently, the whole CBAM would be perceived as a measure meeting the economic objective of facilitating the competitiveness of domestic producers rather than serving the environmental purposes. This could be viewed as a significant deficiency of the WTO legal framework, given the economic benefits of the symmetrical application of CBAMs to imports and exports from the perspective of fully addressing competitiveness concerns of developed countries’ industries, addressing the trade interests of developing countries and achieving a high level of global efficiency in general.\textsuperscript{142} A possible way out here could be a partial provision of export rebates, where export rebates are provided only for the most efficient producers in a sector.\textsuperscript{143} The determination of the most efficient producers can be based on today’s benchmarks for free allocation of emissions allowances and imply (gradual) substitution of free allowance allocation. An argument here could be that such a partial rebate of emissions allowances would minimize undesirable incentives for carbon-intensive exports and stimulate domestic producers to undertake further emissions reductions, which would establish a closer link with the environmental objective of CBAM necessary for justification’.\textsuperscript{144} We discuss further legal implications below in the context of the Agreement on Subsidies and Countervailing measures. (Section VII).

\section*{V. Issues under the Agreement on Import Licensing}

90. To the extent that the EU CBAM sets conditions for importation of covered products through authorized importers and requires information on the carbon footprint of covered products, it may be considered to amount to import licensing within the meaning of the WTO Agreement on Import Licensing (AIL).\textsuperscript{145} AIL covers both ‘automatic’ licensing systems, 

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\textsuperscript{140} Espa, François and van Asselt, footnote 8, p. 15. An important remark to be made here is that the justification under Article XX is unlikely to be possible for rebates of emissions allowances \textit{per se}, should they fail to satisfy the rules on subsidies (see section VII). This is because GATT Article XX is unlikely to apply to violations under the ASCM. See M Wilke, ‘Feed-in Tariffs for Renewable Energy and WTO Subsidy Rules: An initial legal review’, ICTSD, 2011, pp. 19-20.

\textsuperscript{141} As mentioned in section VII, it could be argued that not giving export rebates would cause carbon leakage. But the evidence of carbon leakage resulted from the absence of such rebates would first need to be provided. See Holzer, footnote 5, p. 639.

\textsuperscript{142} Ecoplan et al., footnote 60, p. 104.

\textsuperscript{143} L Garicano, A proposal for the Design of an European Carbon Border Adjustment Mechanism (CBAM), Bruegel event on 4 February 2021. It should be noted that this option was suggested by the European Parliament as part of its changes to the Commission EU CBAM Proposal. See Section VII.

\textsuperscript{144} Holzer, footnote 5, p. 639.

\textsuperscript{145} It is important to note that AIL provisions discipline licensing procedures, and do not directly address the WTO consistency of the underlying measures that are being implemented through licensing. Licen-
which are intended only to monitor imports (but not regulate them), and ‘non-automatic’ licensing systems, under which certain conditions must be met before a license is issued. Non-automatic licensing is used to administer import restrictions such as quotas and tariff-rate quotas (TRQs), or to administer safety or other requirements (e.g., for hazardous goods, armaments, antiquities etc.). The administration of carbon restrictions on traded products, such as CBAMs, in our view, follows the same logic as the administration of safety requirements, and can qualify as non-automatic licensing for the following reasons.

91. According to Article 4 of the EU CBAM Proposal, imports of goods covered by the EU CBAM cannot enter the EU market automatically but ‘shall only be imported into the customs territory of the Union by a declarant that is authorised by the competent authority in accordance with Article 17 (‘authorised declarant’). Article 5 further specifies that any declarant shall, prior to importation, apply to the competent authority following the established procedure for an authorisation to import those goods into the EU. Importantly, under Article 17, an authorisation of the declarant is not automatic but can be refused if the required information about the declarant is incomplete or certain requirements to the declarant are not fulfilled. Also, the competent authority can revoke the authorisation for a declarant who no longer meets the conditions laid down in the CBAM regulation, or who fails to cooperate with that authority. The authorization requirement will be enforced by customs authorities. According to Article 25 of the EU CBAM Proposal, ‘(t)he customs authorities shall not allow the importation of goods unless the declarant is authorised by a competent authority at the latest at the release for free circulation of the goods’.

92. Moreover, in Article 6, the EU CBAM requires an annual submission by the authorized importer (declarant) of a CBAM declaration containing the information on (a) the total quantity of each type of goods imported during the calendar year preceding the declaration, expressed in megawatt hours for electricity and in tonnes for other goods; (b) the total embedded emissions, expressed in tonnes of CO2e emissions per megawatt-hour of electricity or for other goods per tonne of CO2e emissions per tonne of each type of goods and (c) the total number of CBAM certificates corresponding to the total embedded emissions, to be surrendered, after the reduction due on the account of the carbon price paid in a country of origin in accordance and the adjustment necessary of the extent to which EU ETS allowances are allocated free of charge. This information is subject to review by the competent authority with the help of customs authorities. Where a CBAM declaration has not been submitted, the competent authority will assess the CBAM obligations of that declarant on the basis of the information at its disposal and calculate the total number of CBAM certificates due requesting the authorised declarant to surrender CBAM certificates in due quantities. The failure to do so will result in penalties.

146 Office of the United States Representative, Import Licensing.
147 CBAM proposal, Art. 19. Importantly, the authorized declarants shall ensure that the total embedded emissions declared in the CBAM declaration are independently verified by accredited verifiers. Ibid., Art. 8, based on the on the verification principles set out in Annex V.
148 Ibid., Art. 19.
93. It should be noted that the requirement of authorization of importers and submission of carbon footprint information will be imposed already at the transition period, i.e. in 2023-2025, when the EU CBAM will merely apply as a reporting obligation to imports and not as a CBAM certificate submission obligation with a financial adjustment. In 2023-2025, authorized declarants will have to report on a quarterly basis the total quantity of imported goods, the total emissions embedded in the products, including indirect emissions (i.e. emissions from electricity, heating and cooling in the production process), as well as the carbon price due in the country of import origin which is not subject to an export rebate or other form of compensation on exportation. This information called ‘the CBAM report’ will have to be independently verified by accredited verifiers and failure to provide the CBAM report will result in a proportionate and dissuasive penalty by the competent authority.

94. Thus, the administration of the EU CBAM falls in the definition of non-automatic import licensing and needs to be consistent with the requirements of AIL. The authorization of importers for the purposes of the CBAM and the requirement to submit a CBAM declaration (and, in the transitional phase, a CBAM report) that includes carbon footprint information can qualify as import licensing to the extent that import licensing is defined as ‘administrative procedures … requiring the submission of an application or other documentation (other than those required for customs purposes) to the relevant administrative body as a prior condition for importation’ of goods. Once falling under the AIL, the administration of the EU CBAM needs to be compatible with the AIL rules on transparency and non-discrimination.

95. As regards transparency, AIL imposes a general obligation to publish the rules and all information concerning the administration of the CBAM (i.e. the conditions for obtaining the authorization to import, including the requirements to meet in the preparation of the CBAM reports during the transitional phase and the CBAM declarations after 2025) at least 21 days prior to the effective date of the requirement. The Agreement also includes specific transparency provisions for non-automatic import licensing schemes. In particular, AIL requires that in those cases where licensing requirements are imposed for purposes other than the implementation of quantitative restrictions, as it is the case for the administration of the CBAM, sufficient information is published so that other Members and traders know on which basis the authorization to import will be granted and upon which financial adjustment after the transitional phase. Based on these provisions, it becomes important that the requirements envisaged in the CBAM proposal remain unchanged in the final CBAM regulation, at least with respect to the procedures applicable during the transitional phase, given that the ‘trilogue’ is still ongoing and many expect it to end only by the end of the year.

96. As regards non-discrimination, the AIL requires that the rules for import licensing procedures be neutral in application and administered in a fair and equitable manner. With respect to non-automatic import licensing, more specifically, the Agreement requires that any entity which fulfils the legal and administrative requirements of the importing Member shall

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150 Ibid., Art. 35.
151 Ibid.
152 Art. 1.1 of the AIL.
153 Art. 1.4 of the AIL.
154 Art. 3.3 of the AIL. See also Art. 5.
155 Art. 1.3 of the AIL.
be equally eligible to apply and to be considered for a license. On this point, an aspect that could be critical concerns the procedures required to verify the emissions declared in the CBAM reports during the transitional phase and in the CBAM declarations after 2025. The CBAM proposal specifies that, in both cases, the embedded emissions declared must be verified by an accredited verifier pursuant to Implementing Regulation 2018/2067. In the case of embedded emissions in goods produced in registered installations in a third country, in particular, authorized declarants are entitled to fulfill the verification obligation by means of using the information provided by operators of non-EU installations on verified embedded emissions. This possibility, however, depends on (i) whether the non-EU operators that authorized declarants import from have requested the European Commission to get registered in the central database of third country operators; (ii) whether the non-EU operators have chosen to disclose the information on verified embedded emissions to the authorized declarant/s. Given the high costs and administrative complexities entailed in handling plant-by-plant verification of embedded emissions, it remains to be seen to which extent non-EU operators – and especially those coming from developing countries, where there are currently no registries of facility-level emissions – will engage in providing such information. For those products imported from non-registered third country installations, authorized declarants would very likely resort to default values in order to avoid a verification of emissions abroad, which is a sensitive issue related to extraterritorial jurisdiction. Because the default values indicated in the CBAM proposal are punitive (see section III.C), there is a risk that the administration of the CBAM may be considered discriminatory. Considering that this may likely occur in the case of installations located in developing countries, the administration of the CBAM could also run counter to AIL Article 1.2’s requirement that account should be taken of ‘economic development purposes and financial and trade needs of developing country Members’. Furthermore, these aspects of the administration of the CBAM could be considered to induce ‘trade distortive effects on imports additional to those imposed by the imposition of the restriction’ as per Article 3.2 of the AIL. Based on WTO jurisprudence, however, a causal relationship would need to be established between the administration of the CBAM and the claimed distortions resulting out of the need to resort to default values in cases of administrative complexity.

97. It should furthermore be noted that the AIL is by virtue of Article 1.2 largely duplicative of the GATT obligations. This means that, to the extent that the specific aspects of the CBAM administration are not in conformity with GATT provisions, there will be an inconsistency with the requirements of Article 1.2 of the AIL. In this context, in addition to the

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156 Art. 3.5(e) of the AIL.
157 CBAM proposal, Art. 18.
158 Ibid., Art. 10.5.
159 Ibid., Art. 10.1.
160 Ibid., Art. 10.7.
164 EC-Poultry, Appellate Body report, para. 67.
165 See EC-Bananas III, panel report, paras. 7.270-7.271.
aspects discussed in Sections III.B and III.C with regard to Article I GATT and Article III GATT, the EU CBAM may also raise issues under Article XI GATT on the prohibition of quantitative restrictions. Based on a consolidated WTO jurisprudence, non-automatic import licensing schemes fall within the scope of Article XI:1 to the extent that they have a restrictive or limiting effect.\textsuperscript{166} As mentioned above, the possibility that specific aspects of the administration of the CBAM have a restrictive effect cannot be excluded. For the reasons stated earlier, furthermore, other potential issues may arise under Article X GATT on transparency, which requires WTO members to publish promptly laws, regulations, judicial decisions and administrative rulings of general application, including those pertaining to requirements on imports or exports and to administer them in a uniform, impartial and reasonable manner.

98. Finally, to the extent that the administration of the CBAM can be characterized as non-automatic import licensing it shall also comply with the provisions of Article VIII GATT and the 2015 Agreement on Trade Facilitation. Under Article VIII GATT, import formalities should not be more onerous than is required (paragraph 1, letters (b) and (c)) since administrative costs must not exceed the services provided (paragraph 1, letter (a)). Furthermore, substantial penalties for minor breaches of procedural requirements are not permitted (paragraph 3). The 2015 Agreement on Trade Facilitation (in force for the EU and Switzerland) confirms and expands these requirements by virtue of Article 6 and also provides in Article 2 that Member States shall provide opportunities and an appropriate time period to traders and other interested parties to comment on the proposed CBAM to the extent practicable and in a manner consistent with their domestic law and legal system (paragraph 1.1). It furthermore requires the Member States to provide for regular consultations (paragraph 2).

VI. Relevance of the TBT Agreement

99. The EU CBAM in its proposed design does not fall in the regulatory scope of the WTO TBT Agreement, as it falls neither under the definition of a technical regulation, nor the definition of a standard or a conformity assessment procedure. To be a technical regulation, the EU CBAM would need to be a “(d)ocument which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory. It may also include or deal exclusively with … labeling requirements as they apply to a product, process or production method.”\textsuperscript{167}

100. Similarly, to be a standard, the EU CBAM would need to contain guidance or rules about product characteristics, with which compliance is not mandatory.\textsuperscript{168} Conformity assessment procedures would be procedures used to determine that relevant requirements in technical regulations or standards are fulfilled.\textsuperscript{169}

101. This is not what the EU CBAM is about. The EU CBAM puts restrictions on imports depending on their characteristics (emission intensity) but it does not prescribe what these

\textsuperscript{166}\textit{India–Quantitative Restrictions}, panel report, para. 5.129; \textit{China – Raw Materials}, panel report, paras 7.917-7.918.

\textsuperscript{167}Annex 1.1 of the TBT Agreement.

\textsuperscript{168}Annex 1.2 of the TBT Agreement.

\textsuperscript{169}Annex 1.3 of the TBT Agreement.
product characteristics should be, nor does it prohibit the sales or importation of carbon-intensive products as a whole. As such, the EU CBAM is a regulation mainly falling in the regulatory scope of non-discrimination provisions of the GATT.

102. However, to the extent that the measure as extended to indirect emissions contains implied standards for sustainable development of products, it may amount to a standard or possibly even a technical regulation. Such standards define thresholds for importation free of CBAM certificates, stating that the production of the goods imported must be using carbon free sources of energy.

103. Foreign producers may be de facto compelled to produce in accordance with such implied or explicit standards in the future in order to successfully export to the EU or other countries operating CBAMs. According to the case law of the WTO, voluntary standards may, in such configurations, amount to a binding technical regulation. The measure therefore needs to comply with Article 2 TBT Agreement and in particular respond to the requirements of proportionality in light of the purpose and the impact of the measure on international trade.

104. Finally, to the extent that labelling requirements should be used under an extension to indirect emissions, they will also fall under the disciplines of the TBT Agreement. The CBAM Proposal of the EU does not propose any such measures for the time being, and we simply flag the issue for future considerations.

VII. Compliance with WTO subsidy rules

105. As mentioned in Section II.A, the EU CBAM may also raise issues under the WTO Agreement on Subsidies and Countervailing Measures to the extent that it includes some form of adjustment on exportation. The inclusion of export rebates has remained one of the most contentious issues all throughout the legislative process and is not yet been solved at the time of writing. Under the European Commission’s proposal, it is not envisaged that the CBAM be extended to exports. Despite industrial requests, the European Commission explicitly discarded this option, arguing that ‘[t]he inclusion of refunds of a carbon price paid in the EU would undermine the global credibility of EU’s raised climate ambitions and further risk to create frictions with major trade partners due to concerns regarding compatibility with WTO obligations’. The topic however featured prominently in discussions at the European Parliament so that the Parliament’s position adopted on 22 June 2022 includes a specific proposed provision on export rebates:

“Article 31 – paragraph 1(b) new
1b. In order to ensure a level playing field, by way of derogation from paragraph 1 (a), first and second subparagraphs, the production in the Union of products listed in Article 31 – paragraph 1(b) new

171 CBAM Proposal, Art. 2.1. See also Annex 1.
173 European Parliament, footnote 76, Amendment 262 (Article 31, para 1b (new)).
nexion I to this Regulation shall continue to receive free allocation, provided such products are produced for export to third countries without carbon pricing mechanisms similar to the EU ETS.

By 31 December 2025, the Commission shall present a report to the European Parliament and to the Council in which it shall provide a detailed assessment of the effects of the EU ETS and CBAM on the production in the Union of products listed in Annex I to this Regulation that are produced for export to third countries and on the development of global emissions, as well as an assessment of the WTO compatibility of the derogation laid down in the first subparagraph.

The Commission shall, where appropriate, accompany that report with a legislative proposal providing for a protection against the risk of carbon leakage that equalises carbon pricing for the production in the Union of products listed in Annex I to this Regulation that are produced for export to third countries without carbon pricing mechanisms similar to the EU ETS in a way that is WTO compatible by 31 December 2026, assessing in particular potential export adjustment mechanisms for installations belonging to the 10% most efficient installations as laid down in Article 10a of Directive 2003/87/EC, in the light of WTO compatibility or any other proposals the Commission deems appropriate."

106. According to the Parliament’s proposed amendment, the CBAM-covered products produced in the EU for export in those third countries that do not have explicit carbon pricing policies will continue to receive free ETS allowances irrespective of the phase-out trajectory set out for covered products produced and consumed in the EU (see Section III.C). If approved, the proposed amendment would imply that export rebates in the form of free allocation of ETS allowances will apply as from the transitional period, whereas it is not clear what form would export rebates take after 2025. The proposed amendment hints at the possibility to maintain so-called green export rebates, that is, export adjustment mechanisms for the 10% most efficient EU installations as laid down in Article 10a of Directive 2003/87/EC, but issues of WTO compatibility feature prominently so that any future legislative proposal on export rebates shall be designed ‘in a way that is WTO compatible’.

107. The caution surrounding the Parliament’s propositions and the reluctance on the part of the Commission to even engage in the topic reflect, first, the ambiguity of export rebates, whatever their actual form, in addressing carbon leakage. Unless clearly ring-fenced from domestic consumption, export rebates are likely to cross-subsidise domestic production destined for domestic consumption and thus upset the balance and level-playing field of ETS and CBAM on the internal market. Theoretically, excluding exports from the CBAM scope could reduce the CBAM’s ability to counteract carbon leakage to the extent that cleaner EU products are replaced by dirtier products coming from countries with no or less stringent carbon constraints in foreign markets. At the same time, however, carbon leakage is very hard to demonstrate and there is to date no conclusive evidence pointing to the need to include export rebates to preserve or even increase the environmental effectiveness of the CBAM. In prin-

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175 Ibid., noting, however, that existing ex-post analyses have focused on the first and second trading period of the EU ETS where prices were much lower than it is now and than it is expected in the future.
ciple, including adjustments on exports may also provide an incentive for EU producers to export carbon-intensive products and thus discourage emission reductions in export-oriented sectors. In this case, export rebates may prove at odds with the carbon leakage narrative of the CBAM. Ultimately, there is no definitive answer on the effects of including adjustments on the exportation.

108. Related to this is the second reason for caution around export rebates, that is, uncertainty on the compatibility prospects under WTO law, namely under GATT rules and ASCM rules. As regards to GATT rules, the main problem lies in the fact that the granting of free allowances, as the European Parliament advocates, would de facto provide for cross-subsidization of ‘internal’ costs borne by EU installations covered by the EU ETS: in other words, because EU installations would get free allowances to cover for the emissions embedded in products destined for exportation, but would still be required to purchase allowances to cover for the emissions of the same products destined for EU consumption, export rebates would ultimately reduce the overall burden arising out of the EU ETS for EU firms. This would practically lessen the cost that would have been imposed to EU installations based on the emissions of covered products and thus potentially raise issues under the national treatment principle under either Article III:2 or Article III:4 depending on the legal characterization of the CBAM (see Section II.B). The ambiguity of rebating exports in determining the environmental effectiveness of the CBAM, furthermore, may also weaken an Article XX GATT-based defense, as explained in Section IV.B.4.

109. As regards to ASCM rules, the issue boils down as to whether export border adjustments could constitute an export subsidy conferring an unfair advantage to EU products in foreign markets and hence a prohibited subsidy under Article 3 ASCM. In order for that to happen, however, they would need to qualify as subsidies within the meaning of the Agreement in the first place.

110. Under the ASCM, there are two main provisions that could be relevant for the purposes of excluding that the CBAM would be a prohibited export subsidy. Under the so-called exclusion clause contained in both the Ad Note to GATT Article XVI and footnote 1 to the ASCM, export rebates in the form of ‘exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or charges in amounts not in excess of those which have accrued shall not be deemed to be a subsidy’. Whether this clause could be applicable to the CBAM ultimately depends on: (i) whether the EU ETS could qualify as a ‘duty’ or a ‘tax’; (ii) in the affirmative, whether it could be considered a duty or a tax ‘borne by the like product’; (iii) whether it complies with the ‘not in excess’ rule. Issues surrounding the legal characterization of the EU ETS and the CBAM have already been discussed in Section II.B; in the context of this analysis, a further element of uncertainty lies in the fact that the exclusion clause requires that the duty or tax be


177 Espa, Francois and van Asselt, footnote 8, p. 15.
borne by the product’, whereas the EU ETS is imposed on production process emissions rather than on products as such.\textsuperscript{178} As noted by others, Annex II of the ASCM allows border adjustment of prior-stage cumulative indirect taxes levied on inputs consumed in the production of the exported products, including ‘inputs physically incorporated, energy, fuels and oil used in the production process’.\textsuperscript{179} It remains, however, uncertain whether a tax occulte on process emissions could be considered an indirect tax on inputs.\textsuperscript{180} Even considering this argument would fly, furthermore, there seems to be a relatively high chance that export rebates could result to be ‘in excess’ of taxes accrued to ‘like’ products when sold in the EU market, as the complexities entailed into the calculation of the ETS-induced costs make overcompensation scenarios very likely.\textsuperscript{181}

111. To the extent that export rebates are not covered by footnote 1 to the ASCM, export rebates could be prohibited if they qualify as a subsidy within the meaning of Article 1 ASCM and, in the affirmative, as subsidies ‘contingent … upon export performance’ under Article 3 ASCM. The subsidy determination would ultimately depend on the exact form that the export adjustment mechanism would take. A number of options have been illustrated in the literature, ranging from exemptions in the form of free allocation of allowances to monetary rebates or non-monetary rebates granted through so-called adjustment allowances or certificates.\textsuperscript{182} For the time being, however, the discussion remains theoretical given that the only option explicitly envisaged by the European Parliament in the proposed amendment is free allocation of allowances.

112. Free allocation of allowances under the EU ETS has been extensively analysed through the lens of ASCM rules leading to conflicting views. Scholars differ as to whether it could constitute a financial contribution under Article 1.1.(a)(1) in the form of a direct transfer of fund,\textsuperscript{183} revenue foregone\textsuperscript{184} or provision of a good or service.\textsuperscript{185} While the revenue foregone variant under Article 1.1(a)(1)(ii) ASCM could likely be the best fit based on how it

\textsuperscript{178} Marcu, Mehling, Cosbey and Maratou, footnote 174, p. 13.

\textsuperscript{179} See Footnote 61, cited by Marcu, Mehling, Cosbey and Maratou, footnote 174174, p. 13.

\textsuperscript{180} Ibid., citing Genasci, footnote 63, p. 30.

\textsuperscript{181} Espa, Francois and van Asselt, footnote 8, citing Marcu, Mehling, Cosbey and Maratou, footnote 174 p. 13: ‘the ETS-induced cost is “the variable market price of allowances purchased at auction or in the secondary market, typically in multiple individual transactions”: p. 13. On the issue raised by the concept of likeness when it comes to products with different carbon intensities, see Section III.A.

\textsuperscript{182} For a more detailed overview, see Marcu, Mehling, Cosbey and Maratou, footnote 174, p. 17.

\textsuperscript{183} See, for all, R Ismer, Hvan Asselt, J Haverkamp, M Mehling, K Neuhoff and A Pirlot (2021), Climate Neutral Production Free Allocation of Allowances under Emission Trading Systems and the WTO, DIW Discussion Papers, No. 1948, p. 7, excluding this possibility by drawing a comparison to India-Export Related Measures, panel report, para. 7.432.


\textsuperscript{185} Cf., among others, Marcu, Mehling, Cosbey and Maratou, footnote 171, p. 14, who contemplate this possibility and Ismer, van Asselt, Haverkamp, Mehling, Neuhoff and Pirlot, footnote 180, p. 7, almost categorically excluding this option.
has been interpreted in WTO case law, it is worth noting that the European Commission has put forward a set of solid arguments in the context of the US Department of Commerce investigation into countervailing duties on the import of forged steel fluid end blocks from Germany and Italy. In particular, the Commission opined that free allocation cannot be seen as revenue foregone because they are ‘an inherent component of the ETS’ so that ‘the government has not given up its entitlement to collect revenue since there never was such entitlement in the first place’. Similarly, it contended that it could not constitute any other form of financial contribution, such as direct transfer of funds and goods or services provision, given that free allowances never enter as an asset in the EU or national budgetary accounts. In this vein, it could be argued that export rebates ‘calibrate the regulatory obligation and lessen the net regulatory burden imposed under integrated regime created by the EU ETS’. 113.

113. Similarly, this argument could be played with respect to the benefit analysis under Article 1.1(b) ASCM. The European Commission has indeed contended that free allocation does not confer a benefit because it forms an integral part of a single system which ought to be looked at in its entirety: in other words, free allocation ‘diminishes what remains a net burden for domestic producers’. And yet, this argument seems a bit stretched considering that the granting of free allowances undisputedly makes ‘the recipient “better off” than it would otherwise have been, absent that contribution’. Not surprisingly, the US Department of Commerce ultimately rejected the Commission’ arguments and considered free allocation a countervailable subsidy. It remains still uncertain, however, how the measure would fare under WTO scrutiny. Were free allocation considered a subsidy within the meaning of Article 1 ASCM, it would most likely qualify as a prohibited export subsidy under Article 3 ASCM given that the granting of free allowances would be available with respect to EU products produced for exportation.

186 In US-FSC, the Appellate Body clarified that ‘the word “foregone” suggests that the government has given up an entitlement to raise revenue that it could otherwise have raised. This cannot, however, be an entitlement in the abstract, because governments, in theory, could tax all revenues. There must, therefore, be some defined normative benchmark against which a comparison can be made between the revenue actually raised and the revenue that would have been raised “otherwise”’ (Appellate Body report, para. 90). In this perspective, the general rule (i.e. the normative benchmark) is the auctioning of allowances, whereas free allocation constitutes the ‘exception’ leading to foregoing of revenue otherwise due: Ismer, van Asselt, Haverkamp, Mehling, Neuhoff and Pirlot, footnote 180, p. 8.


193 US-FSC, panel report, 7.108. See also Ecoplan et al., footnote 60, p. 104.
In conclusion, export rebates remain controversial and it is still uncertain whether they will be incorporated – and, if so, in which form – into the CBAM design. In the affirmative, including export rebates in the form of free allocation of allowances would likely pose issues under the ASCM to the extent that the granting of free allowances might qualify as an export subsidy prohibited under Article 3 ASCM. In addition, it may raise problems under the national treatment principle as per Article III GATT. Finally, the ambiguity of rebating exports in determining the environmental effectiveness of the CBAM may also weaken an Article XX GATT-based defense, as explained in section IV.

VIII. Obligations under the TRIPS Agreement to transfer of low-carbon technology and expertise

Article 66:2 of the TRIPS Agreement obliges developed countries to provide transfer of technology and expertise to least developed countries:

Developed country Members shall provide incentives to enterprises and institutions in their territories for the purpose of promoting and encouraging technology-transfer to least-developed country Members in order to enable them to create a sound and viable technological base.

This mandatory requirement has not been effectively implemented in practice, as governments normally do not dispose of intellectual property owned by the private sector. The EU CBAM proposal again refrains from making appropriate commitments, which in parallel are also required by the UNFCCC and the Paris Agreement (See Annex II to this Legal Opinion). The EU CBAM proposal is an opportunity missed to develop appropriate means to transfer low-carbon technology. A number of options exist and have been developed in the literature.194

IX. Conclusions

A. General assessment of WTO compliance

The proposed EU CBAM regulation is designed in good faith to address climate change concerns through enabling necessary emission reductions. It is generally in line with WTO law, except for some features of the measure requiring improvements based on recommendations listed below.

A CBAM as designed by the EU Commission may qualify as an adjustment of a domestic regulation at the border, a border tax adjustment or an import duty or charge. While the EU Commission has arguably construed the CBAM in view of contending that it is an adjustment of domestic regulation at the border for the purposes of WTO law, the final decision on qualification of a CBAM based on an ETS will be made by a WTO adjudicative body in a dispute.

Whether or not a CBAM applied to imports depending on their carbon footprint violates the MFN and NT obligations will largely depend on the acceptance or non-acceptance of

likeness of carbon-intensive and low-carbon products. If products of the same physical quality with different degrees of carbon intensity are found to be like, the EU CBAM will violate the MFN and NT rules. But consideration of consumer preferences for low-carbon products and supply-side factors in the determination of likeness may lead to qualify carbon-intensive and low-carbon products as unlike products. MFN and NT violations would then stem only from specific (discriminatory) design features of the CBAM rather than from the CBAM being a measure linked to process and production methods (PPMs).

120. Tensions with the MFN clause are likely to arise from the exclusion of some imports linked to climate policy measures in countries of import origin. On the one hand, there is a chance that a different treatment of imports would be found MFN-compliant based on conditional MFN approach, i.e. a derogation of the MFN rule could be allowed based on origin-neutral conditions. On the other hand, allowing for an exclusion of imports from EEA countries and for price crediting based only on explicit carbon prices paid by imports in their countries of origin while disregarding implicit carbon prices (costs of non-pricing climate policies in third countries) are likely to be found discriminatory features in violation of the MFN rule.

121. The NT requirements for domestic regulations, unlike for taxes, do not require identical treatment of imports and like domestic products. Accordingly, some variations in treatment could be allowed for the sake of practical feasibility in the CBAM application. This might allow, for example, the use of default values of the carbon footprint in situations where sufficient emission data is not available. A less favourable treatment is not necessarily implied in situations where a detrimental effect on imported products is explained by factors or circumstances unrelated to the origin of the products. In the context of CBAM, this could mean that if imported products turned out to be less competitive in the market due to their higher carbon footprint compared to like domestic products, this would not necessarily imply a violation of the NT rule (carbon footprints of products in the context of emission reduction policies can be viewed as circumstances unrelated to the foreign origin of the products). Yet, jurisprudence is ambiguous, and every case will be decided based on the facts of the particular situation. A feature that is likely to prove crucial to this end is the extent to which the administration of the CBAM and the compliance costs implied by the measure are to induce firms to resort to (punitive) default values.

122. Given the uncertainty about compliance with the MFN and NT rules, we believe that a CBAM as proposed by the EU Commission will be in need of justification under the GATT general exception clauses. Such exceptions (at least for the rules of the GATT) are available for measures taken with certain public policy objectives under a number of conditions, as set out in GATT Article XX. The EU CBAM can almost undoubtedly be justified under Article XX (g) as a measure relating to the conservation of exhaustible natural resources. Also, Article XX(d) can be invoked in defense of the measure. However, some adjustments in the design of the measure are needed to meet the requirements of the chapeau of Article XX.

123. The inclusion of export rebates in the CBAM design as suggested by the European Parliament raises uncertainties with regard to ASCM compatibility prospects. The granting of free allowances to products produced for export to third countries without carbon pricing mechanisms similar to the EU ETS runs the risks to be considered as an export subsidy prohibited under Article 3 ASCM and, more generally, to compromise a GATT Article XX-based defense of the CBAM as a whole.

124. It is likely that the EU CBAM will be challenged in WTO dispute settlement due to components of the mechanism potentially incompatible with WTO law and due to the lack of
considering the principles of differential treatment and of shared but differentiated responsibility under the UNFCCC and the Paris Agreement. Switzerland may participate as a third party in these proceedings. It is likely that the dispute will extend over several stages, subject to a process of trial and error in its application until a satisfactory solution eventually will be found.

125. Whether or not a complaint will be brought against Switzerland depends on the architecture of its own CBAM and the economic interests at stake. If the Swiss CBAM fully mirrors EU law, a complaint in parallel or subsequently to the EU is more likely than if Switzerland uses the policy space available to accommodate producers in developing countries from the outset. Finally, the matter depends upon market size. From this angle, Switzerland may be spared a complaint, as legal resources of complainants will focus on the EU.

B. Recommendations to strengthen WTO compliance

126. Not considering third countries’ measures, which are different from an ETS or a carbon tax, may likely create grounds for accusation of arbitrariness, which goes contrary to the requirements of the chapeau of Article XX GATT. This is because the possibility that a non-pricing mechanism be found comparable in effectiveness to carbon pricing mechanisms cannot be excluded. Yet, achieving compliance with the requirements of the chapeau by considering non-pricing mechanisms in crediting of importers seems to be difficult, if not impossible, due to the administrative complexity of such an option and the absence of unified methodologies for the comparison of climate policy measures among countries. To mitigate the risk of a failure of justification of a CBAM under the environmental exception clause of Article XX, we recommend to intensify diplomatic efforts and cooperation with trading partners on rules and modalities for the application of CBAMs, including as part of building climate clubs and creating an international platform for discussing comparability of pricing and non-pricing mechanisms.

127. We also recommend in line with Annex II to this Legal Opinion to direct part of revenues to climate change mitigation and adaptation funds. The earmarking of CBAM revenues for climate change action would strengthen the nexus with the climate policy objective required for a successful justification of the measure under Article XX. Transfer of revenues to climate change funds or its use in any other way to finance the deployment of clean technologies and investments in alternative energy sources, especially in developing countries, would serve as evidence that CBAMs are applied not for the sake of protectionism but with the objective of addressing the global climate change problem.

128. The CBAM proposal needs to be accompanied by a clear and binding commitment on financial aid to developing countries, in addition to climate finance and ODA, to support decarbonisation of their industries and mitigate the negative impacts of CBAM on their economies. This would ease trade tensions over CBAMs, mitigate the risk of trade disputes and trade retaliations and would be in line with the WTO regime on special and differentiated treatment for developing countries, as well as with the UNFCCC principle of common but differentiated responsibilities, enhancing coherence between the climate and trade regimes.

129. The transitional phase should not contemplate the granting of free allowances (in derogation of the envisaged phase-out trajectory for free allocation) upon exportation. The possibility to introduce green export rebates after the end of the transitional period, that is, export adjustment mechanisms for the 10 percent most efficient EU installations, should follow an assessment of the effects of the EU ETS and the CBAM on EU exports, including the effects
of the phasing down of free allocation in the EU ETS more generally, and on the environmental effectiveness of the measure overall in order to avoid GATT and ASCM incompatibility prospects and reinforce a GATT Article XX-based environmental defense of the CBAM as such.

130. Should the EU CBAM be challenged in the WTO dispute settlement, it is advisable for Switzerland to be involved as a third party in a CBAM-related dispute brought against the EU with a view to both seize the opportunity to defend the mechanism in principle and join the EU in building a CBAM-centred climate coalition (climate club). The introduction of CBAMs by the EU, Switzerland, the UK (and possibly other countries) more or less simultaneously would add the market power weight to CBAM-related negotiations with trading partners and as such would help mitigate the risk of legal and political challenges.195

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195 Holzer, footnote 5, pp. 642-643.