Some reflections on the consistency of the European Union Carbon Border Adjustment Mechanisms with the General Agreement on Tariffs and Trade

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In their fight against climate change, States have repeatedly declared that reducing greenhouse gas (GHG) emissions is a priority with "global reach". However, since the entry into force of the 1992 United Nations Framework Convention on Climate Change, States have opted for an individualistic and differentiated approach, particularly with regard to climate mitigation. As a result, climate change agreements provide only procedural obligations and lead States to choose how to determine and how to achieve substantial obligations. Against this backdrop, in 2021 the European Commission proposed the adoption of a particularly controversial unilateral trade-related climate measure: the Carbon Border Adjustment Mechanism (CBAM), with the dual intent of combating carbon leakage and levelling the playing field. Given its expected restrictive impact on trade flows in the sectors concerned, the CBAM was from the outset considered by several WTO members to be contrary to WTO law. The purpose of this paper is to analyse the compatibility of the CBAM with the non-discrimination and trade liberalisation commitments undertaken by the EU in the WTO, by reconstructing what could be the outcome of a potential dispute in the light of previous WTO case law.

Keywords: Climate Change; EU Carbon Border Adjustment Mechanism; General Agreement on Tariffs and Trade; Non-Discrimination; General Exceptions

1. The backdrop

Climate change is one of the most troubling crisis affecting our world today[1] and it represents a major obstacle to the achievement of the Sustainable Development Goals (SDGs).[2] The latest events of 2022, such as the persistent heatwaves affecting parts of Europe and the catastrophic flooding in Pakistan, confirmed the need for a stronger (re)action against climate change and particularly greenhouse gases (GHGs) emissions.

In line with the objectives of the Paris Agreement on Climate Change (PA),[3] the European Union (EU) has decided to take the lead in environmental action and to turn the continent into the first climate-neutral area by 2050.[4] In this respect, the EU pledged to reduce emissions by at least 55% by 2030 compared to 1990 levels.[5] In December 2019, the EU launched the Green Deal initiative.[6] Approved in 2020 by the European Parliament, the Green Deal was designed from the United Nations 2030 Agenda for Sustainable Development. It, therefore, consists of a growth strategy with the objective "to transform the EU into a fair and prosperous society, with a modern, resource-efficient and competitive economy, where there are no net emissions of GHGs in 2050 and where economic growth is decoupled from resource use."[7] The strategy covers all economic sectors and encompasses initiatives focused on cutting GHGs emissions, investing in research and innovation, and preserving the European environment.[8]

Against this backdrop, on 14 July 2021, the European Commission adopted an ambitious package of legislative proposals known as "Fit for 55".[9] It is not by chance that the package aims to make the EU's climate, energy, land use,

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1 *Statement by the Secretary-General at the conclusion of COP27 in Sharm el-Sheikh*, in *United Nation Statements*, 19.11.2022.

2 Transforming Our World: The 2030 Agenda for Sustainable Development, A/RES/70/1, United Nations, 25.09.2015, (Agenda 2030), Sustainable Development Goal 13; Intergovernmental Panel on Climate Change, *Climate Change 2022 – Impacts, Adaptation and Vulnerability: Summary for Policymakers,* WGII Sixth Assessment Report, 28.02.2022.

3 Paris Agreement to the United Nations Framework Convention on Climate Change, U.N.T.S. 3156, 12.12.2015, (Paris Agreement 2015), Art. 2(1)(a).

4 European Council meeting conclusions, EUCO 29/19, 12.12.2019; *Update of the NDC of the European Union and its Member States*, Submission by Germany and the European Commission on behalf of the European Union and its Member States, 17.12.2020; Regulation (EU) 2021/1119 of the European Parliament and of the Council, OJEU, L 243/1, 09.07.2021.

5 Ibid.

6 Communication from the European Commission: The European Green Deal, (COM(2019) 640 final), 11.12.2019.

7 Ibid, p. 2.

8 Ibid, p. 18.

9 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions "Fit for 55", (COM(2021)550 final), 14.07.2021.

transport, and taxation policies "fit for reducing net GHGs emissions by at least 55% by 2030 in respect of 1990 levels."[10] Practically, the "Fit for 55" package points at reforming all existing EU climate and energy strategy instruments and introducing new tools to bridge the gap between existing policies and revised overall targets.[11]

Among the legislative proposals presented by the Commission, one of them is significantly troublesome: the Carbon Border Adjustment Mechanism (CBAM).[12] Indeed, the CBAM has proven to be questionable not only from the point of view of the World Trade Organization (WTO) law but also with respect to principles of international environmental law.

Despite much criticism and difficulties, on 13 December 2022, the EU Council and the European Parliament reached a provisional political agreement on the measure.[13] Nonetheless, at the time of the writing, the two EU institutions still have to formally approve the agreement before the new Regulation can come into force.[14] The newcomer Regulation will then become effective 20 days after its publication in the EU Official Journal.[15]

The up-to-date agreed features of the CBAM are a combination of the EU Commission Proposal, the EU Council General Approach of 15 March 2022,[16] and the amendments advanced by the EU Parliament on 22 June 2022.[17]

The purpose of this paper is to provide some food for thought regarding the newly conceived mechanism. In this regard, opposition and concern about the legality of the measure under trade rules have been expressed by several WTO

10 Ibid.

11 *Fit for 55*, in *European Council website*, last reviewed on 23.03.2023.

12 Proposal for a Regulation of the European Parliament and of the Council establishing a Carbon Border Adjustment Mechanism by the European Commission, (COM(2021) 564 final 2021/0214 (COD)), (CBAM Proposal), 14.07.2021.

13 Provisional Agreement resulting from Interinstitutional Negotiations, Proposal for a regulation of the European Parliament and of the Council, (COM(2021)0564 – C9-0328/2021 – 2021/0214(COD)), (Provisional Agreement), 08.02.2023.

14 Please note that this paper was drafted prior to the adoption of the final text of the Regulation establishing a carbon border adjustment mechanism by the EU Council and is hence based on the text of the Provisional Agreement. The adoption by the EU Council occurred on 20.04.2023, for more information visit 'Fit for 55': Council adopts key pieces of legislation delivering on 2030 climate targets, *European Council Press Releases*, 25.04.2023. The final text of the Regulation was adopted with some minor changes to the Provisional Agreement and is available on the European Council website as "Regulation establishing a Carbon Border Adjustment Mechanism". The Regulation will now be signed by the EU Council and Parliament and published in the Official Journal of the EU before entering into force.

15 Provisional Agreement, Art. 36.

16 Draft regulation of the European Parliament and of the Council – General approach, (2021/0214(COD), (General Approach), 15.03.2022.

17 Amendments adopted by the European Parliament, (COM(2021)0564 – C9-0328/2021 – 2021/0214(COD)), (CBAM Amendments), 22.06.2022.

Member States (WTO Members or Members), inter alia, Brazil, South Africa, India, and China.[18] It is therefore clear that if the CBAM will be fully implemented by the EU, there is a high risk that the measure will be challenged under the WTO dispute settlement mechanism for violation of WTO law. Against this backdrop, this study aims to offer an analysis of some of the most critical aspects of the CBAM from the point of view of the 1994 General Agreement on Tariffs and Trade (GATT),[19] limiting the scrutiny to the application of the rules as interpreted in previous cases by the WTO dispute settlement organs.

1.1. The European Carbon Border Adjustment Mechanism

The EU CBAM consists of a Border Carbon Adjustment (BCA) mechanism, namely a trade measure conceived to equalize carbon pricing on foreign goods with carbon policies imposed on domestic production.[20] Hence, it will impose a cost on imported products proportional to the carbon price differential between the carbon price applied internally to "like" domestic products and the carbon price enforced in the country of origin of the imported products.[21]

1.1.1. The EU CBAM: some relevant features and its functioning

According to the EU, the CBAM will prevent the risk of carbon leakage and support the EU increased ambition on climate mitigation while ensuring WTO compatibility.[22] Carbon leakage refers to a situation where companies based in a country where ambitious environmental regulations to limit GHGs emissions are enforced offshore their production to States with laxer environmental legislations, thus frustrating the environmental efforts undertaken in their country of "origin", besides distorting competition. In this respect, the EU Commissions has deemed it essential to create a "leveled playing field" for the relevant sectors to ensure a well-functioning internal market when the EU increases its climate ambition.[23] It is no wonder that the legal grounds invoked

18 D. Dybka, *Status of the Border Carbon Adjustments' international developments*, in *European Roundtable on Climate Change and Sustainable Transition*, 01.06.2021; Ministry of Ecology and Environm ent of the People's Republic of China, *Joint Statement issued at the BRICS High-level Meeting on Climate Change*, 24.05.2022; South African Government, *Joint Statement issued at the conclusion of the 30th BASIC Ministerial Meeting on Climate Change hosted by India on 8th April 2021*, 2021; S. Morgan, *Russia warns EU against carbon border tax plan, citing WTO rules*, in *Climate Home News*, 2020; M. Xu, D. Stanway, *China says EU's planned carbon border tax violates trade principles*, in *Reuters*, 26.07.2021.

19 General Agreement on Tariffs and Trade 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, U.N.T.S. 187, 15.04.1994, (GATT 1994).

20 I. Ozai, *Designing an Equitable Border Carbon Adjustment Mechanism*, in *Canadian Tax Journal*, vol. 70.1, 2022, pp. 1-33; Provisional Agreement, Art. 1(1).

21 It consists of the domestic price of a product minus the price in the country of origin of the imported product.

22 Provisional Agreement, [8, 13], Art. 1(1).

23 CBAM Proposal, p. 49.

for the adoption of the CBAM are Articles 191 and 192(1) of the Treaty on the Functioning of the European Union (TFEU),[24] which confer on the EU a shared competence in the area of environmental protection, including the fight against climate change. However, it is also true that the EU Commission has explicitly stated that the measure was designed also with competition regulation in mind.[25] It is precisely this "two-faced Janus" nature of the measure that makes it subject to strong accusations of protectionism.

Under the political agreement reached in December 2022, the CBAM would enter into force in its interim phase as of 1 October 2023.[26] Due to its announced purpose to prevent carbon leakage, the CBAM will cover sectors that are highly exposed to this phenomenon.[27] Over its transitional period, the CBAM will cover imports of iron and steel, cement, fertilisers, aluminium, electricity, and hydrogen,[28] together with selected precursors and a limited number of downstream products,[29] whose production is carbon intensive.[30] Upon expiration of the transitional period, the material scope will be reviewed to assess the feasibility of including additional products, sectors and subsectors at risk of carbon leakage from 2026 on,[31] with the aim to include, by 2030, all sectors covered by EU Emission-Trading System (EU ETS or ETS).[32] In any case, the Commission will regularly evaluate the application of the CBAM Regulation and report to the EU Parliament and the Council.[33]

With regard to the origin of the imported goods,[34] the CBAM will apply to all products specifically listed in Annex I to the Regulation, originated in a third country,[35] when these goods, or processed products from these goods are imported into the EU customs territory.[36] Only goods originating from the countries and territories expressly listed in Annex II of the Commission

24 Treaty on the Functioning of the European Union, OJEU, C 326/47, 26.06.2012, (TFUE); Ibid., p. 2.

25 CBAM Proposal, p. 49.

26 Provisional Agreement, Art. 36.

27 Ibid., [34].

28 Ibid., Annex I. These are the five sectors proposed in the CBAM Proposal and General Approach, [30], together with hydrogen which was suggested, among others, by the EU Parliament in the CBAM Amendments, [30].

29 Yet, the coverage of chemicals and polymers as urged in CBAM Amendments will not be included, at least during the interim period.

30 Provisional Agreement, [30, 34, 35].

31 Ibid., [11a].

32 Ibid., [52b]; Directive 2003/87/EC of the European Parliament and of the Council, OJEU, L 275/32, (Directive 2003/87/EC), 25.10.2003.

33 Provisional Agreement, [52].

34 Importation in this text indicates the release for free circulation provided in Regulation (EU) No 952/2013 of the European Parliament and of the Council, OJEU, L 269/1, 09.10.2013, Art. 201.

35 Provisional Agreement, Art. 3(6).

36 Ibid., Art. 2.

Proposal will fall outside the scope of the CBAM.[37] These will be Iceland, Liechtenstein, Norway, and Switzerland,[38] together with the territories of Büsingen, Heligoland, Livigno, Ceuta, and Melilla[39] that are, so far, third countries or territories fully integrated into, or linked, to the EU ETS.[40]

Concerning its practical functioning, the CBAM will require EU importers to buy certificates (CBAM certificates) corresponding to the carbon price that would have been paid, had the goods been produced within the EU or under the EU ETS. As a matter of fact, the price of such certificates will be based on the average weekly auction price of EU ETS allowances expressed in €/ tonne of CO2 emitted.[41] In principle, from its full implementation, importers will have to register, individually or through a representative, with the competent authorities from which they will have the possibility to purchase the CBAM certificates.[42] Once authorized, EU importers will have the exclusive right to import Annex I goods into the Union territory.[43] However, they will have to declare by the 31 May of each year (i) the total quantity of each type of goods imported during the calendar year preceding the declaration; (ii) the total embedded emissions; and (iii) 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 and the adjustment necessary of the extent to which EU ETS allowances are allocated free of charge. Consequently, they will have to surrender the CBAM certificates they have purchased in advance to cover the amount of embedded emissions declared.[44] Throughout the transitional period from 1 October 2023 to 31 December 2025, importers will have to report every quarter their import of the selected products, detailing direct and indirect emissions embedded therein, as well as any carbon price effectively paid abroad, without making any financial payments or adjustments.[45] It shall be underscored that according to

37 Ibid., [15].

38 As of January 2020, Switzerland has become the first country to link its domestic carbon trading system with the EU ETS, providing an example for possible future integrations. J. Store, *Linking of Switzerland to the EU emissions trading system – entry into force on 1 January 2020,* in *European Council Press Releases*, 09.12.2019.

39 Provisional Agreement, Annex II.

40 Ibid., [14,15].

41 Ibid., [21].

42 Ibid., Arts. 5, 10, 11, 20, 22.

43 Ibid., Art. 4.

44 Ibid., Art. 6.

45 Ibid., [38b, 50]. The main purpose of this interim period is to serve as a "pilot" and learning period for all stakeholders and to gather useful information on embedded emissions to refine the methodology for the definitive period. This is in line with what was done for the EU ETS, before its effective implementation.

the provisional agreement, both direct and indirect emissions[46] will be covered from the very interim phase.[47]

1.1.2. The CBAM and EU ETS relationship in a nutshell

As mentioned above, the functioning of the CBAM will be strictly connected with the EU ETS. The latter is a market-based mechanism and consists of a "cap-and-trade" system. It came into force in 2005 and since then has been implemented in different phases. The system is now in its fourth phase of implementation (2021-2030).[48]

The EU ETS sets a cap on the total amount of certain GHGs[49] that can be emitted in the EU by the 10.000 installations in the energy and manufacturing sectors,[50] as well as by aircraft operators operating between the EU countries and Iceland, Liechtenstein, and Norway.[51] These latter are countries party to the European Economic Area (EEA) established in 1994 with the States parties to the European Free Trade Association. In this context, the cap is reduced over time so that total emissions decrease.[52]

Within the cap, operators buy "allowances",[53] namely rights to emit GHGs into the atmosphere, from the competent national authorities. The price of the allowances released into the market is determined weekly by supply and demand. As a matter of fact, auctioning is the default method for allocating emission allowances to companies participating in the EU ETS.[54] Observe that this aspect is relevant in the case of the CBAM since the price of the latter will depend on the weekly average of the EU ETS price.

At the end of each year, an operator must surrender allowances per tonne of carbon dioxide equivalent emissions, to fully cover its emissions.[55] Failure to comply with this obligation results in heavy fines being imposed on the operator.[56] Under the EU ETS, installations that reduce their emissions can keep the

46 Ibid., Art. 3(28).

47 Ibid., [17]. As suggested in Recital [17] of the CBAM Amendments, the immediate coverage of both type of emissions was deemed critical to ensure coherence between the CBAM and the EU ETS and, thus, to comply with WTO principles. On the contrary, the EU Commission and Council had recommended postponing the coverage of indirect emissions until after the end of a transition period.

48 *EU Emissions Trading System (EU ETS)*, in *European Commission website*, visited on 28.02.2023.

49 Those are CO2, nitrous oxide, and perfluorocarbons.

50 As regards CO2 specifically, the sectors covered by the EU ETS are electricity and heat generation, energy-intensive industry sectors, including oil refineries, steel works, and production of iron, aluminium, metals, cement, lime, glass, ceramics, pulp, paper, cardboard, acids and bulk organic chemicals, aviation within the European Economic Area.

51 Directive 2003/87/EC.

52 Ibid., Art. 9.

53 Ibid., Art. 3(a).

54 Ibid., Arts. 10-10c.

55 Ibid., Arts. 2, 3(a), 6 (2)(e), 12(3).

56 Ibid., Art. 16.

spare allowances to cover their future needs or sell them to another operator short of allowances. Since 2019, a Market Stability Reserve stabilises the market by removing surplus allowances from it.[57] The limit on the total number of allowances available ensures that they have a value. The price signal provides an incentive to reduce emissions and promotes investment in innovative, low-carbon technologies, while allowance trading provides the flexibility to reduce emissions where it costs less to do so. Nonetheless, the EU ETS provides also allocation of "free allowances" for specific sectors, to safeguard the competitiveness of the regulated industries and to avoid carbon leakage.[58] Industrial sectors receive free allowances according to emission efficiency benchmarks and depending on the sectoral risk of carbon leakage.[59] Precisely in this context, the CBAM will come into play. The existing mechanisms adopted by the EU to address the risk of carbon leakage in sectors or sub-sectors at risk of carbon leakage are the transitional free allocation of EU ETS allowances together with financial measures to compensate for indirect emission costs incurred from GHGs emission costs passed on in electricity prices.[60] The CBAM will seek "to replace these existing mechanisms by addressing the risk of carbon leakage in a different way, namely by ensuring equivalent carbon pricing for imports and domestic products."[61] To ensure a gradual transition from the current system of free allowances to the CBAM, "the CBAM should be progressively phased in while free allowances in sectors covered by the CBAM are phased out."[62] Therefore, it is not by chance that the phasing-in of the CBAM in the period 2026-2034 will take place in parallel with the phasing-out of free allowances allocation under the EU ETS and, in principle, the CBAM will apply to all sectors covered by the ETS. Hence, it is evident that the CBAM is strongly tied to the EU ETS, indeed the former "complements" the latter and, to some extent, it "replaces" it in the sense outlined above.

1.2. Some of the challenging aspects

The CBAM is a unilateral trade measure implemented to both tackle climate change and ensure equal competition conditions between EU and foreign producers of some identified products at risk of carbon leakage. Given its trade nature and trade-environmental purpose, the measure has a twofold soul. Thus,

57 Ibid., Art. 10; Decision (EU) 2015/1814 of the European Parliament and of the Council, OJEU, L 264/1, 09.10.2015.

58 On free allowances see Commission Delegated Regulation (EU) 2019/331, OJEU, L 59/8, 27.02.2019; C. Marcantonini, J. Teixido-Figueras, S. F. Verde, X. Labandeira, *Free allowance allocation in the EU ETS*, in *Energy & Climate*, vol. 2017/02, 2017.

59 C. Marcantonini, J. Teixido-Figueras, S. F. Verde, X. Labandeira, n. 58.

60 Directive 2003/87/EC, Arts. 10a(6), 10b. See Provisional Agreement, [10].

61 Ibid., [11].

62 Ibid.

its legality should be assessed under both international trade and environmental law. To a certain extent, the 1992 United Nation Framework Convention on Climate Change acknowledges that unilateral environmental measures having trade effects on other WTO Members are still governed by WTO rules.[63] Article 3(5) explicitly provides for the possibility to undertake unilateral trade actions having direct or indirect effects on trade as long as the measures in question "do not constitute arbitrary or unjustifiable discrimination or a disguised restriction on international trade."[64] On the other hand, Deputy Director-General of the WTO Jean-Marie Paugam recently confirmed that the multilateral trade rules do not preclude the implementation of an ambitious environmental policy by any WTO Member, on condition that the measures adopted "are not discriminatory or do not disguise primarily competitive or protectionist motives."[65]

Unfortunately, right from the start, the CBAM has been criticized under both systems of law. Inter alia, some States have claimed violations of the non-discrimination principle under WTO law as well as the principle under international environmental law of the Common but Differentiated Responsibility and Respective Capability, in light of Different National Circumstances (CBDRRC-NC). However, due to the vastness of the subject matter, it will be provided here only a flavour of some of the issues arising under the GATT, without touching upon the legality of the measure under other WTO Agreements and the PA.

Precisely, amidst the questionable characteristics of the CBAM under the GATT, the fact that only some third countries[66] will be exempted from the CBAM and its complex administrative obligations, has raised much controversy in relation to the rule of Most-Favoured Nation (MFN) on three stages. Firstly, WTO Members that adopt explicit carbon pricing mechanisms, which are not linked to the EU ETS, will be subject to the CBAM unlike Members affiliated to the EU ETS. Secondly, countries that do not implement an explicit carbon pricing mechanism linked to or similar to the one set for within the EU, but equally adopt different measures i.e. regulatory measures, to address carbon leakage and climate change, will not be exempted from the application of the CBAM, unlike Members affiliated to the EU ETS. Thirdly, the aforementioned two categories of countries will be subject to the CBAM as well as countries

63 R. Howse, A. Eliason, *Domestic and international Strategies to address climate change: an overview of the WTO legal issues*, in T. Cottier, O. Nartova, SZ. Bigdeli, (eds.), *International trade regulation and the mitigation of climate change: World Trade Forum*, Cambridge University Press, 2009, p. 52.

64 United Nations Framework Convention on Climate Change, U.N.T.S. 107, 09.05.1992, Art. 3(5).

65 J.-M. Paugam, Deputy Director-General of the WTO, *DDG Paugam: WTO rules no barrier to ambitious environmental policies*, in *WTO news*, 16.09.2021.

66 Provisional Agreement, Art. 2(3). These are the countries that are explicitly listed in Annex II to the CBAM Regulation that participate to the EU ETS, or have systems linked to it. To date, they are only Members of the EEA.

that do not take any sort of climate policy measures aimed at GHGs emissions reduction.

Another challenging aspect of the CBAM regards its compliance with the GATT National Treatment (NT) obligation. Indeed, from 1 January 2016 until 2034,[67] the EU producers of the sectors covered by the CBAM will benefit from free allowances under EU ETS triggering a "discriminatory treatment" between domestic and foreign "like" products.

It is interesting to notice that, besides complaining about WTO law violations, on several occasions, and especially during WTO Committees Meetings, Members have equally complained about the violation of principles of international environmental law as enshrined in the PA, in particular the principle of CBDRRC-NC. Unlike violations of WTO law, for which the WTO dispute settlement mechanism is certainly competent, it is doubtful and controversial whether the same mechanism could adjudicate violations of principles of international environmental law.[68] In any case, the WTO dispute settlement mechanism can take international environmental law rules into account whether these latter are either enshrined in the WTO system or relevant to the interpretation of WTO law.[69]

2. The CBAM legal assessment under the GATT

Before focusing on the rules allegedly violated by the CBAM, a preliminary remark is necessary. The qualification of the measure at stake as a border tariff or internal regulation, rather than a border restriction is far from being clear. In fact, the CBAM comprises elements characterising all the aforementioned types of measures and this makes a clear-cut qualification difficult. This aspect, however, is crucial to understanding which rules will apply in the analysis of the legality of the CBAM under the GATT. In this section, an attempt will be made to provide a general framework to further elaborate later on some relevant aspects in the following sub-sections. That premised, under the GATT, the CBAM would most likely be challenged in respect of two provisions that are the expression of the non-discrimination principle, namely Articles I and III of the GATT. On one hand, Article I also known as the MFN clause prohibits discrimination among "like products" originating in or destined for different

67 These are respectively the dates for the phasing-in and full implementation of the CBAM.

68 Dispute Settlement Rules: Understanding on Rules and Procedures Governing the Settlement of Disputes, Marrakesh Agreement Establishing the World Trade Organization, Annex 2, U.N.T.S. 401, 15.04.1994, (DSU), Art. 1(1).

69 Ibid., Art. 3(2); Vienna Convention on the Law of Treaties, 23.05.1969, U.N.T.S. 1155, Art. 31; Appellate Body, WT/DS2/AB/R, *United States-Standards for Reformulated and Conventional Gasoline*, (Appellate Body, US-Gasoline), 29.04.1996, p. 17.

countries.[70] It is worthwhile premising here that Article I is applicable to both price-based border measures under Article II GATT, and price-based domestic measures under Article III GATT.[71] On the other hand, Article III or the NT clause aims to avoid protectionism in the application of internal taxes and regulatory measures. As expressed in Article III(1), the general purpose of the provision is to ensure that internal measures are not applied to imported or domestic products "so as to afford protection to domestic production."[72] In addition to the aforementioned rules, Article II GATT entitled "Schedules of Concessions" prevents WTO Members from according to the commerce of the other Contracting Parties treatment no less favourable than that provided for in the appropriate Part of the proper Schedule annexed to the WTO Agreement.

Finally, Article XI GATT prohibits, inter alia, quantitative import restrictions.

As laid out above, the CBAM provides blurred features that make a net qualification of the measure challenging.[73] The fact that the CBAM applies to "goods imported into the customs territory of the Union from third countries"[74] suggests that the obligation to pay the carbon price[75] "on importation" arises independently of its distribution in the domestic market and, therefore, that the measure could be qualified as *import tariff* at the border according to Article II(1) GATT.[76]

However, since on an annual basis authorized declarants must submit a CBAM declaration containing the total quantity of imported goods embedded emissions, and the CBAM certificates shall be surrendered consequently,[77] the obligations triggered by the CBAM could be considered occurring *within* the EU's territory.[78] Thus, one might infer that the CBAM would consist in an "*internal tax or other internal charge of any kind*"[79] in the meaning of Article III(2) GATT.

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70 Appellate Body, WT/DS139/AB/R, *Canada-Certain Measures Affecting the Automotive Industry*, (Appellate Body, Canada-Autos), 31.05.2000, [84].

71 GATT 1994, Art. I. P. Low, G. Marceau, J. Reinaud, *Interface between the Trade and Climate Change Regimes: Scoping the Issues*, in *J. World Trade*, vol. 46, 2012, p. 485, ff.

72 Panel, WT/DS8/R, *Japan-Taxes on Alcoholic Beverages*, (Panel, Japan-Alcoholic Beverages II), 11.07.1996, [5.10].

73 Due to the complexity of the matter, we will limit ourselves here to simplifying the issue, in order to allow us to move forward with the analysis under the WTO case law. For a more in-depth analysis, see P. Low, G. Marceau, J. Reinaud, n. 71.

74 Provisional Agreement, [14], Art. 2.

75 By purchasing and surrendering the CBAM certificates.

76 (Emphasis added). Nevertheless, tariffs are usually designed to collect revenue for governments or to give a price advantage to a domestic product over an imported one. See P. Low, G. Marceau, J. Reinaud, n. 71.

77 Provisional Agreement, Art. 6(2).

78 (Emphasis added).

79 Ibid.

At the same time, the CBAM "ensure[s] that imported products are subject to a regulatory system that applies carbon costs equivalent to the ones borne under the EU ETS, resulting in an equivalent carbon pricing for imports and domestic products."[80] This aspect might suggest that it would be more appropriate to consider the CBAM under Article II(2)(a) GATT a "charge equivalent to an internal tax imposed consistently with the provisions of Article III(2) in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part", triggering the application of Article III(2). In light of this interpretation, however, a question would arise regarding whether the EU ETS can be considered a tax.[81] If the answer were negative, by reading the text of the provision literally, an adjustment at the border would no longer be possible.

Nonetheless, if we consider the obligations of the CBAM occurring *within* the EU's territory, at least to a certain extent, it will remain open whether the measure can be qualified as an *"internal* law, regulation or requirement"[82] subject to Article III(4) GATT.[83]

Furthermore, if the CBAM would not qualify under Articles II and III, notice that it could be assessed under Article XI GATT. Article XI(1) does not refer to laws or regulations but more broadly to measures. Accordingly, "any measure instituted or maintained by a Contracting Party which restricts the exportation or sale for export of products" is covered by this provision, "irrespective of the legal status of the measure."[84] In the case at hand, due to the characteristics of the CBAM, especially the fact that it imposes administrative and financial burdens on CBAM declarants, the measure could be challenged as a *de facto* restriction provided that complaining parties are able to "establish a causal link between the contested CBAM and the low level of exports and persuasively explain precisely how the measure at issue causes or contributes to the low level of exports."[85] Indeed, the scope of the term "restriction" has been interpreted by the WTO dispute settlement organs as "a limitation on actions, a limiting

80 Provisional Agreement, (13).

81 In C-366/10/EC, *Air Transport Association of America and others*, [147], the European Court of Justice explicitly concluded: "by reason of its particular features, [the EU ETS] constitutes a market-based measure and not a duty, tax, fee, or charge."

82 (Emphasis added).

83 (Emphasis added). See sub-section 2.2.2. See also N. L. Dobson, *(Re) framing Responsibility? Assessing the Division of Burdens Under the EU Carbon Border Adjustment Mechanism* in *Utrecht Law Review 18*, no. 2, 2022, p. 168.

84 Panel, L/6309 – 35S/116, *Japan-Trade in Semi-conductors*, 04.05.1988, [106].

85 Panel, WT/DS155/R, *Argentina-Measures Affecting the Export of Bovine Hides and the Import of Finished Leather*, (Panel, Argentina-Hides and Leather), 19.12.200, [11.20-11.55].

condition or regulation."[86] Thus, according to the WTO case law, a restriction may consist merely in a "condition" having a limiting effect on importation.[87]

Due to the technicality and magnitude of the subject matter, the subsequent sections will offer an overview limited to the main issues arising under Articles I, II, and III GATT. In fact, these are the provisions that are most likely to be challenged before a panel and analysed first by the latter.[88]

2.1. Legal assessment under Article II GATT

Article II(1) GATT provides that each WTO Member "(a) […] shall accord to the commerce of the other [WTO Members] treatment *no less favourable* than that provided for in the appropriate Part of the appropriate Schedule annexed to this Agreement" and that imported products "(b) shall […] be exempt from ordinary customs duties *in excess of those set forth and provided therein*. Such products *shall also be exempt from all other duties or charges of any kind imposed on or in connection with the importation in excess of those imposed on the date of this Agreement* […]."[89]

In the case at stake, for each product covered by the CBAM the EU has bound itself to a maximum rate of import duties or tariffs under its Schedule of Commitments annexed to the GATT. In light of the issue on qualification outlined above, if the CBAM is considered an import tariff, it will be found to exceed the EU's tariff binding on the targeted products. Indeed, in *Argentina-Textiles and Apparel* the Appellate Body found that "the application of customs duties in excess of those provided for in a Member's Schedule inconsistent with the first sentence of Article II(1)(b), constitutes 'less favourable' treatment under the provisions of Article II(1)(a)."[90] Nevertheless, Article II(2)(a) allows Contracting Parties to impose at any time, on the importation of any product an adjustment, namely "a charge equivalent to an internal tax imposed consistently with the provisions of Article III(2)" in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part. In this regard, the Appellate Body observed that "Article II(2)(a), subject to the conditions stated therein, exempts

86 Panel, WT/DS90/R, *India-Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, 06.04.1999, [5.128].

87 Panel, WT/DS175/R, *India-Measures Affecting the Automotive Sector*, 21.12.2001, (Panel, India-Autos), [7.269-7.270].

88 J. Bacchus, *Legal Issues with the European Carbon Border Adjustment Mechanism*, in *Cato Institute*, 09.09.2021; I. Espa, *Reconciling the climate/industrial interplay of CBAMs: what role for the WTO?*, in *American Journal of International Law*, vol. 116, 2022, pp. 208-212.

89 (Emphasis added).

90 Appellate Body, WT/DS56/AB/R, *Argentina-Measures Affecting Imports of Footwear, Textiles, Apparel and other Items*, 27.03.1998, [47]; See also Panel, WT/DS269/R, *European Communities-Customs Classification of Frozen Boneless Chicken Cuts*, 30.05.2005, [7.65]; Panel, WT/DS377/R, *European Communities and its Member States-Tariff Treatment of Certain Information Technology Products*, 16.08.2010, [7.747].

a charge from the coverage of Article II(1)(b)."[91] Consequently, Article II(2)(a) serves as a bridge between Articles II(2) and III GATT. The main difference between the two provisions lies in the fact that, while Article II deals with duties or charges "*imposed or in connection with importation*", namely applied at the border to imported products, Article III(2) concerns *internal taxes or charges*[92] and, thus, allows the imposition of taxes and regulations on both imported and domestic products.

In *China-Measures Affecting Imports of Automobile Parts*, the Panel elaborated the criteria to distinguish a border measure, in the form of a tariff governed by Article II and an internal tax governed by Article III. The Panel found that if the obligation to pay a charge accrues due to an internal event, such as the distribution, sale, use, or transportation of the imported product, then it is an internal charge governed by Article III. Conversely, if the charge is imposed "on importation" and independently from its distribution in the domestic market, it shall be considered a border measure subject to Article II.[93] Therefore, if the CBAM is considered a fiscal measure under Article II(2)(a) GATT, its legality shall be assessed according to Article III(2) that imposes stricter obligations. If instead, the CBAM is considered a regulatory measure of a non-fiscal nature, it will be examined under GATT Article III(4) which provides the WTO Member a greater degree of flexibility in the design of the measure.

As already observed the CBAM includes elements of both a fiscal and regulatory nature. For this reason, it will be provided an overview of the analysis of its legality under both GATT provisions.

To sum up, under Article II, if the CBAM qualifies as a mere duty or charge "imposed or in connection with importation", it will result applied "in excess" of those imposed on the date of the GATT and therefore in violation of Article II. On the contrary, if the CBAM is assumed to be "a charge equivalent to an internal tax imposed consistently with the provisions of Article III(2) in respect of the like domestic product […]" it could be justified according to Article II(2)(a). In this regard, the relationship between the CBAM and the EU ETS, as examined earlier, acquires relevance. However, the fact that the sectors covered by the ETS and the CBAM will not exactly overlap, at least until 2030, and that

91 Appellate Body, WT/DS360/AB/R, *India-Additional and Extra-Additional Duties on Imports from the United States*, 30.10.2008, [153], while it was assessing whether certain border charges were inconsistent with Art. II(1)(b) or if they were correlated with internal taxes and sheltered by Art. II(2)(a).

92 Panel, L/5863, *Canada-Measures Affecting the Sale of Gold Coins*, 17.09.1985, [4.15, 4.17, 4.18], (emphasis added).

93 Panel, WT/DS342/R, *China-Measures Affecting Automobile Parts* (Panel, China-Autoparts), 18.07.2008, [7.205]; Appellate Body, WT/DS363/AB/R, *China-Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, (Appellate Body, China-Audiovisual Services), 21.12.2009, [163]. See also P. Low, G. Marceau, J. Reinaud, n. 71.

EU producers will still benefit from free allowances under the ETS, certainly until 2034, raises further problems as to the justifiability of the measure under paragraph 2(a).

In conclusion, the question of the legality of the CBAM under Article II is still open, as the possibility to justify the measure according to Article XX GATT is still available in case of a breach of Article II.

2.2. Legitimacy under Article III GATT

Article III(1) establishes a general principle as a guide to understanding and interpreting the specific national treatment obligations contained in Article III(2) and in the other paragraphs of Article III.[94] Indeed, the objective of Article III is "to avoid protectionism in the application of internal tax and regulatory measures,"[95] and "to ensure equality of competitive conditions between imported and like domestic products."[96] In brief, it guarantees that Members will not undermine through internal measures their commitments on custom duties and chargers under Article II.[97]

In light of this purpose, Article III contemplates different hypothesis.[98] Article III(2) refers to "internal taxes or other internal charges" and provides that Members shall not apply on imported goods direct or indirect internal taxes or other charges *in excess to those imposed*, directly or indirectly, on domestic "like" products or between imported goods and "a directly competitive or substitutable product." Article III(4) tackles instead internal regulations and laws by requiring Members to accord imported products a treatment no less favourable than that accorded to "like products" of national origin. In the next sub-sections, the CBAM will be examined precisely under these two obligations.

2.2.1. Article III(2): the CBAM an "internal tax or other internal charge of any kind"

Regarding the terms "internal tax or other internal charge of any kind" it was found that measures providing for the imposition of charges and creating a liability, as such, fall under the scope of Article III(2).[99] In this regard, the fact that in cases of non-compliance to the obligations set in the Regulation on the CBAM, violators "shall be held liable for the payment of a penalty"[100] acquires importance. Furthermore, Article III(2) requires the "charge" to be imposed on

94 GATT 1994, Art. III(1); Appellate Body, Japan-Alcoholic Beverages II, pp. 17-18.

95 Appellate Body, Japan-Alcoholic Beverages II, p. 16.

96 Appellate Body, WT/DS31/AB/R, *Canada-Certain Measures Concerning Periodicals*, 30.06.1997, p. 18.

97 Panel, Japan-Alcoholic Beverages II, [6.13].

98 For the purpose of our analysis paragraphs 1 (general provision), 2 and 4 of the provision acquire relevance.

99 Panel, Argentina-Hides and Leather, [11.143-11.144].

100 Provisional Agreement, Arts. 26-27.

goods that have already been imported and the obligation to pay to be triggered by an "internal factor."[101] The "internal factor" is intended as occurring after the importation of the product of one Member into the territory of another Member,[102] and may consist of the product then being used internally. This latter aspect can be crucial in the case of the CBAM.

The Appellate Body has also underscored that the motivation for imposing the tax is not relevant to the application of Article III(2).[103]Accordingly, whether the CBAM is considered to fulfil these requirements, it will be covered by Article III(2).

A further clarification shall be made between the first and the second sentence of paragraph 2. The first phrase indeed refers to "like products" whereas the second, by referring to "directly competitive or substitutable products", provides for "a separate and distinctive consideration of the protective aspect of a measure in examining its application to a broader category of products."[104]

In addressing the relationship between these two sentences, the Appellate Body found that to determine if a violation of Article III(2) has occurred two questions shall be answered, namely if (i) the imported and domestic products are "like" products, and if (ii) the imported products are taxed in excess of the domestic products. The Appellate Body then held that there is a violation of Article III(2) first sentence if the answers to both questions are affirmative. Whereas if the answer to the first question is negative, the measures at stake shall be examined under Article III(2), second sentence.[105]

Advancing with the analysis, it has be observed that the term "like product" can assume different connotations, especially regarding paragraphs in Article III,[106] and therefore "likeness" has to be examined on a case-by-case basis.[107]

As employed in Article III(2), first sentence, the term "like" must be construed narrowly.[108] According to WTO case law, "likeness" shall be assessed, inter alia, by looking at four general criteria: "(i) the properties, nature, and quality of the products; (ii) the end-uses of the products; (iii) consumers' tastes and

101 For instance because the product was re-sold internally or because the product was used internally.

102 Panel, China-Autoparts, [7.132].

103 Panel, Argentina-Hides and Leather; Appellate Body, Canada-Periodicals; Panel, L/6175, *United States-Taxes on Petroleum and Certain Imported Substances*, 17.06.1987, [3.2.5].

104 Appellate Body, Japan-Alcoholic Beverages II, p. 19.

105 Appellate Body, Canada-Periodicals, pp. 22-23.

106 Appellate Body, Japan-Alcoholic Beverages II, p. 25.

107 *Border Tax Adjustments*, Report of the Working Party adopted on 2 December 1970, GATT Doc L/3464, (*1970 Border Tax Adjustments*), 20.11.1970, [18]; Appellate Body, Japan-Alcoholic Beverages II, p. 21.

108 Appellate Body, Japan-Alcoholic Beverages II, p. 20; Appellate Body, Canada-Periodicals, p. 21.

habits – more comprehensively termed consumers' perceptions and behaviour – in respect of the products; and (iv) the tariff classification of the products."[109]

Notice that, in the present case, the assessment of "likeness" shall be conducted in light of one fundamental issue: whether two products can be differentiated or considered "alike" based on criteria relating to GHGs emissions.[110]

Regarding the first precondition, it shall be established if the GHGs emitted during the production process, either directly by the producer or indirectly by a producer of input e.g. electricity generation of the CBAM products,[111] have an impact on the properties, nature, and quality of the products, to the extent that these products cannot be considered "like" to the EU ETS products.[112] These GHGs emissions can be considered as a non-product-related process and production methods (NPR-PPMs), i.e. a characteristic of the production process which has no impact of the physical characteristics of a good.[113] However, whether NPR-PPMs affect the properties, nature, and quality of the products has yet to be clarified by the WTO dispute settlement mechanism. Since in this contribution the assessment of the CBAM is conducted based on pre-existing WTO case law, this aspect will not be dealt with in detail here. However, it is worth observing that if the NPR-PPMs are not considered as affecting "property, nature, or quality" *strictu sensu* for the determination of "likeness" between the goods imported from third countries not subject to the EU ETS and the products covered by the EU ETS, these goods will be deemed "like". To clarify, steel produced by less carbon-intensive production methods will be considered "like" to steel generated by carbon-intensive production methods because if

109 Panel, WT/DS392/R, *United States-Certain Measures Affecting Imports of Poultry from China*, 29.09.2010, [7.424-7.427, 7.429]; *1970 Border Tax Adjustments*, [18]; Appellate Body, Japan-Alcoholic Beverages II, p. 20; Panel, WT/DS64/R, *Indonesia-Certain Measures Affecting the Automobile Industry*, 02.07.1998, [14.109]; Panel, WT/DS403/R, *Philippines-Distilled Spirits,* 15.08.2011, [7.31-7.37, 7.124-7.127].

110 P. Low, G. Marceau, J. Reinaud, n. 71.

111 Henceforth, "CBAM products" will refer to the products produced in third countries (that are not covered by or linked to the EU ETS), as listed in Annex I of the Regulation on the CBAM. Thus the products that will be subject to the CBAM. According to the Provisional Agreement these will be, at least until January 2026, iron and steel, cement, fertilisers, aluminium, electricity, and hydrogen, together with selected precursors and a limited number of downstream products.

112 Hereinafter, with "EU ETS products" it will be intended the same products as listed in Annex I of the CBAM Regulation (iron and steel, cement, fertilisers, aluminium, electricity, and hydrogen, together with selected precursors and a limited number of downstream products at least until January 2026), produced under the EU ETS or an ETS linked to the EU ETS.

113 E. Vranes, *Carbon taxes, PPMs and the GATT*, in Panagiotis Delimatsis (ed.), *Research Handbook on Climate Change and Trade Law*, Edward Elgar Publishing, 2016, p. 79; T. Cottier, T. Payosova (eds.), *Common concern and the legitimacy of the WTO in dealing with climate change*; in Panagiotis Delimatsis (ed.), *Research Handbook on Climate Change and Trade Law*, Edward Elgar Publishing, 2016.

NPR-PPMs are not meant to affect the property, nature, or quality. Indeed, these latter will have the same physical features. Remark that in *EC-Asbestos*, the Appellate Body suggested that NPR-PPMs may become relevant in the likeness determination, but only if they affect the competitive relationship between two products.[114] As it will be seen, NPR-PPMs could be considered in the analysis of consumer preferences, or might be reflected in market studies. However, most often market determination will lead to the conclusion that products embodying different NPR-PPMs are competitive and, thus, like products.[115]

Proceeding with the examination of the criterion of the end-uses of the products, in the case of CBAM covered products, it would be possible to conclude for the "likeness" of the CBAM products and EU ETS products. This is because it would be hard to argue that the two physically identical products will have different end-uses because their production processes are distinct.

Another undisputed element that is in favour of concluding for "likeness" of the two products is the tariff classification. The latter will be indeed the same for the products, as the products will have the same physical traits.

With respect to consumers' tastes and habits of the products, the assessment becomes more controversial. As mentioned, the Appellate Body suggested that it is theoretically possible for two products, physically identical but produced with different NPR-PPMs, to be deemed as "unlike" if consumers perceive the products as alternatives, and thus, not in a competitive relationship in the marketplace.[116] However, it should be noted that the CBAM will essentially target raw materials and consumers in that context usually are not interested in distinguishing between products with different NPR-PPMs.[117] These latter are often price-sensitive consumers who are not willing to pay a higher price for "sustainable" NPR-PPMs products. On the contrary, they are interested in buying the cheaper product.[118]

At this stage, if at the end of the analysis, the products are considered "like", the measure will have to be assessed according to the requirements of the first sentence. Therefore, it will have to be determined if the imported products are taxed "in excess of" the domestic products. In this regard, a panel clarified that "a determination of whether an infringement of Article III(2), first sentence

114 P. Low, G. Marceau, J. Reinaud, n. 71.

115 Appellate Body, WT/DS135/AB/R, *European Communities-Measures Affecting Asbestos and Asbestos-Containing Products*, (Appellate Body, EC-Asbestos), 12.03.2001, [101].

116 Ibid. However, the Appellate Body did not rely on econometric studies or quantitative data to analyse consumer behaviour. Rather, it offered a qualitative assessment and thus, it provided its subjective judgment on how consumers perceived the two products.

117 These are for example, construction companies and product manufacturers.

118 D. Sifonios, *Environmental process and production methods (PPMs) in WTO law*, Springer, 2018, p. 150; S. Saigal, *Navigating the Global Economy towards Net-Zero within the Confines of WTO Law and Jurisprudence: A Critical Analysis of the European Union's Carbon Border Adjustment Mechanism and its Implications on International Trade*, in *European Union Law Working Papers No. 63*, 2022, p. 32.

exists must be made on the basis of an overall assessment of the *actual tax burdens* imposed on imported products, on the one hand, and like domestic products, on the other hand."[119] The idea that the phasing-in of the CBAM will be matched by a phasing-out of the ETS free allowances has not yet been worked out in detail. Consequently, it is likely that for a certain period, at least until 2034, both systems will have to co-exist with differentiated tax burdens. Existing free allowances would provide double protection for domestic EU products and put imports at a competitive disadvantage.[120] Hence, this would lead to the imposition of an "excessive tax burden on imported products" compared to "like" EU ETS products that will be covered by free allowances. In addition, the structure of the CBAM may violate this provision also to the extent that the price of the CBAM certificates is going to be calculated weekly based on the average closing prices of EU ETS allowances on the common auction platform, to minimise administrative complexity.[121] This can lead to minimal price variations compared to the EU ETS pricing mechanism for domestic producers, which is instead calculated daily. On a narrow interpretation of the first sentence of Article III(2), the CBAM will therefore be considered incompatible with the NT obligation.[122]

In view of the above considerations and on the basis of existing case law, it can be concluded that, more plausibly, a panel will consider the CBAM products and the EU ETS products as "like". For the purposes of this analysis, it shall be mentioned that if the product were considered "unlike" the measure would be assessed according to the second sentence. No such assessment will be made in this paper. However, observe that the second sentence of paragraph 2 provides "for a separate and distinctive consideration of the protective aspect of a measure in examining its application to a broader category of products that are not 'like products' […]."[123] Depending on their nature and especially on the competitive conditions in the relevant market, the products may well fall in the broader category of "directly competitive or substitutable products". This group enters within the domain of Article III(2), second sentence,[124] which imposes a less stringent non-discrimination obligation. Indeed, "directly competitive and substitutable" products must be "similarly taxed" in order to not afford protection to domestic production.[125] Consequently, if this were the case, fluctuations between the prices of the CBAM certificates and the carbon

119 Panel, Argentina-Hides and Leather, [11.182-11.184], (emphasis added).
120 J. Bacchus, n. 88.
121 Provisional Agreement, Art. 21(1).
122 S. Saigal, n. 118, p. 56.
123 Appellate Body, Japan-Alcoholic Beverages II, pp. 19-21.
124 Ibid., p. 25.
125 GATT 1994, Art. III(2), Note "Ad Art. III".

pricing mechanism under the EU ETS would not be necessarily in violation of Article III(2) GATT, second sentence.[126]

2.2.2. Article III(4): the CBAM an "internal law, regulation or requirement"

As affirmed by the Appellate Body, a violation of Article III(4) must be determined under three conditions: (i) the imported and domestic products at issue are "like products"; (ii) the measure at issue is a "law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use"; and (iii) the imported products are accorded less favourable treatment than that accorded to like domestic products.[127]

Also in paragraph 4 the assessment of "likeness" shall be conducted following the criteria examined above.[128] Consequently, if the first requirement is assumed satisfied we can proceed with the analysis.

The terms "law" and "regulation" refer to "legally enforceable rules of conduct under the domestic legal system of the WTO Member concerned and do not include general objectives."[129] The meaning of the term "requirement" is outlined on the basis of two different situations, namely (i) obligations which an enterprise is legally bound to respect and (ii) those which an enterprise voluntary accepts in order to obtain an advantage from the government."[130] Since, the Regulation on the CBAM will be adopted according to Article 288 TFUE and, thus, it will consist in a legal act applying directly at the national level, it can be considered as a law in the meaning of Article III(4).

The term "affecting" has a broad scope and it refers to measures that concern imported goods. It covers not only measures that directly regulate or govern the sale of domestic and imported "like" products, but also any laws or regulations which might adversely modify the conditions of competition between domestic and imported products, including measures creating incentives or disincentives with respect to the sale, offering for sale, purchase, and use of an imported product.[131] The implementation of the CBAM is certainly going to affect the internal sale of the CBAM products as it will impose several obligations on exporters within the EU. In fact, in the event of non-compliance, CBAM declarants shall face criminal and administrative sanctions.[132]

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126 S. Saigal, n. 118, p. 60.

127 Appellate Body, WT/DS169/AB/R, *Korea-Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, 11.12.2000, [133].

128 Appellate Body, EC-Asbestos, [101-103].

129 Panel, WT/DS456/R, *India-Certain Measures Relating to Solar Cells and Solar Modules*, 24.02.2016, [7.310].

130 Panel, India-Autos, [7.190-7.191].

131 Panel, WT/DS142/R, *Canada-Certain Measures Affecting the Automotive Industry*, (Panel, Canada-Autos), 11.02.2000, [10.80, 10.84-10.85]; Panel, WT/DS472/R, *Brazil-Certain Measures Concerning Taxation and Charges*, 30.08.2017, [7.65-7.66]; Panel, WT/DS276/R, *Canada-Measures Relating to Exports of Wheat and Treatment of Imported Grain*, 06.04.2004, [6.267].

132 Provisional Agreement, Arts. 26, 27.

Lastly, the expression "less favourable treatment" conveys the general principle, set in Article III(1) that "internal regulations 'should not be applied […] so as to afford protection to domestic production'."[133] Adopting the CBAM while granting free allowances to EU producers under the EU ETS, for the same sectors,[134] may result in the adoption of a protectionist measure, in violation of Article III(4). "Treatment no less favourable" in paragraph 4 calls indeed for "*effective equality of opportunities* for imported products".[135] In this regard, to assess the consistency of a measure with Article III(4), one must not only examine whether the measure grants formally equal treatment to imported products and "like" domestic products. Rather, it must be examined whether the measure grants treatment to imported products that is no less favourable than that granted to "like" domestic products.[136]

Any free allowance in the ETS that has not been completely eliminated before the implementation of the CBAM would put the measure at odds with this obligation.[137] Furthermore, the fact that the CBAM prevents importers from trading unused CBAM certificates and from reselling to the competent authority of any EU Member a quantity exceeding one-third of the total amount of CBAM certificates purchased, reflects the environmental ambition of the measure.[138] As these restrictions are not present under the EU ETS, they could lead to the stockpiling of EU ETS certificates at favourable prices without a safeguard to support authorised declarants.[139] Even if the CBAM partially resolves this gap by reducing the total number of CBAM certificates surrendered by an authorised declarant to reflect the allocation of free EU ETS allowances to domestic producers in the transitional period, the different treatment accorded to domestic producers under the EU ETS between 2026 and 2034 may amount to discrimination within the meaning of Article III(4) GATT.

A second issue that arises under Article III(4) is when an authorised declarant fails to comply with the requirements related to the verification of the total

133 Appellate Body, EC-Asbestos, [100].

134 A full overlap between EU ETS and CBAM sectors is planned to be achieved by 2030, while full implementation of the CBAM and full phased-out of free allowances under EU ETS are expected in 2034.

135 Panel, WT/DS2/R, *United States-Standards for Reformulated and Conventional Gasoline*, 29.01.1996, [6.10]; Panel, WT/DS44/R, *Japan-Measures Affecting Consumer Photographic Film and Paper*, 31.03.1998, [10.379], (emphasis added).

136 Panel, WT/DS302/R, *Dominican Republic-Measures Affecting the Importation and Internal Sale of Cigarettes,* 26.11.2004, [7.182].

137 D. Smith, *The Legality of the European Union's Carbon Border Adjustment Mechanism and the Limitations of World Trade Organization Rules on Effective Climate Action*, in *eGrove* University of Mississippi, 04.2022, pp. 21, 56.

138 Provisional Agreement, Arts. 22-24.

139 L. Cheon-Kee, *EU CBAM: Legal Issues and Implications for Korea,* in *Korea Institute for International Economic Policy Opinions Paper*, 2021, p. 5.

embedded emissions contained in the CBAM declaration.[140] In that case, the number of CBAM certificates that have to be surrendered will be determined using "default values"[141] prescribed by Annex III of the proposed Regulation.[142] These will have to be set at the "average emission intensity of each exporting country"[143] for all CBAM products, except electricity. In addition, the values will have to be increased by a mark-up to account for the administrative burden of calculating emissions, except for electricity. Although this is not *per se* discriminatory, the issue arises when there is no reliable data for the exporting country. In this scenario, the "default values" would be set as the emissions corresponding to the "average emission intensity of the worst-performing X percent of EU installations for that type of good."[144] In this regard, a panel may consider this treatment as less favourably, since the default system is based on the principle of negative inference, which does not exist under the EU ETS.[145] Hence, the requirement for an importer to hold a quantity of CBAM certificates that corresponds to at least 80% of the embedded emissions based on the default values,[146] calculated by reference to the EU's worst technologies, may lead to non-trivial price differences between imported and domestic "like" products. This discrepancy may trigger downstream producers in the EU internal market to favour goods produced in the EU and subject to the EU ETS over those imported and subject to the CBAM from countries with unverifiable export data and therefore treat them less favourably.[147]

To conclude, CBAM products, when compared to the EU ETS products, will most probably be considered "like" or at least "directly competitive or substitutable" within the meaning of Article III of the GATT. Accordingly, the CBAM shall ensure compliance with the NT provision. However, in case of violation, the possibility of justifying a violation of Article III would remain available under Article XX.

2.3. Legal analysis according to Article I GATT

Article I(1) GATT relates to "[…] *customs duties and charges of any kind imposed on or in connection with importation or exportation* […] *, and with respect to all matters referred to in Article III(2) and (4),* […]."[148] Therefore, it covers both provisions as

140 Provisional Agreement, (45), Arts. 7(2)(3).
141 Ibid., Arts. 7(2)(3).
142 Ibid., Annex III (4.1)(4.2).
143 Ibid., Annex III (4)(1).
144 Ibid. In the Provisional Agreement the percentage is not indicated, whereas in the CBAM Proposal, it was set at 10%.
145 L. Cheon-Kee, n. 139, p. 5.
146 Provisional Agreement, Art. 22(2).
147 L. Cheon-Kee, n. 139, pp. 5-6.
148 Gatt 1994, Art. I, (emphasis added).

analysed in the previous sections. Article I is a "cornerstone of the GATT"[149] and it covers both *de jure* and *de facto* discrimination. It "protects expectations of equal competitive opportunities for 'like' imported products from all [WTO] Members."[150]

The Appellate Body singled out four elements that shall be proven to establish a violation of the MFN obligation. Notably, a breach requires that "(i) the measure at issue falls within the scope of application of Article I(1); (ii) the imported products at issue are 'like' products within the meaning of Article I(1); (iii) the measure at issue confers an 'advantage, favour, privilege, or immunity' on a product originating in the territory of any country; and (iv) the advantage so accorded is not extended 'immediately' and 'unconditionally' to 'like' products originating in the territory of all Members."[151]

That said, the investigation shall start from the scope of the measure. In this regard, reference is made to the examination conducted earlier, echoing that beyond its qualification the CBAM will be covered anyway by Article I. Indeed, would the CBAM be considered an "internal regulatory or fiscal measure"[152] rather than a custom duty or charge of any kind, the Appellate Body observed that the reference to "all matters referred to in paragraphs 2 and 4 of Article III" suggests "a broad coverage and consideration of trade effects."[153]

Moving to the requirement of "likeness", the determination of the latter is crucial because if products are "unlike" then the CBAM could, in principle, discriminate. On the contrary, if the "likeness" is established the CBAM shall comply with the non-discrimination obligations expressed in both Article I and III. The same considerations made with regard to Article III apply in this context, so that "likeness" has to be assessed on a case-by-case basis.[154] Having already extensively discussed "likeness" in sub-section 2.2.1. the scrutiny made above is recalled here.

Once concluded that the products are "like", it becomes necessary to establish whether any advantage, favour, privilege, or immunity is granted by the EU to any third country. In other terms, Article I prohibits discrimination "among like products originating in or destined for different countries."[155] In this re-

149 Appellate Body, WT/DS246/AB/R, *European Communities-Conditions for the Granting of Tariff Preferences to Developing Countries*, 07.04.2004, [101]; Appellate Body, WT/DS400/AB/R, *European Communities-Measures Prohibiting the Importation and Marketing of Seal Products*, (Appellate Body, EC-Seal Products), 22.05.2014, [5.86].

150 Ibid., [5.87].

151 Ibid., [5.86].

152 According to *1970 Border Tax Adjustments*, [4], fiscal measures are imposed on goods in the country (or customs union) of consumption at the point of import or export.

153 Appellate Body, China-Audiovisual Services, [305].

154 *1970 Border Tax Adjustments*, [18], as also recalled by the Appellate Body in Appellate Body, Japan-Alcoholic Beverages II; Appellate Body, Canada-Periodicals, pp. 20-21.

155 Appellate Body, Canada-Autos, [84];

gard, in EC-Bananas III the Panel considered that "advantages" in the sense of Article I(1) are those that create "more favourable import opportunities" or affect the commercial relationship between products of different origins.[156] The CBAM would exempt from the payment of the certificates and the administrative burdens only countries expressly listed in Annex II and this will result in an "advantage" for these latter in the meaning of Article I.

Article I(1) requires this advantage to "be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other Contracting Parties."[157] The term "immediately" shall be interpreted according to its ordinary meaning "without delay, at once, instantly."[158] Conversely, the expression "unconditionally" has been commonly defined as "without conditions" and was interpreted accordingly by WTO panels.[159] Given these premises, it is self-evident that the CBAM will not respect such requirements.

Nonetheless, the Appellate Body clarified that "Article I(1) permits regulatory distinctions to be drawn between like imported products, *provided that such distinctions do not result in a detrimental impact on the competitive opportunities for like imported products* from any Member."[160] Regrettably, the additional cost imposed on the products imported from some Members and not others would lead to a distortion of competition with a detrimental impact on competitive opportunities.

To sum up, if the CBAM will exempt some countries on a country-specific basis, it will apply "differential treatment" to "like" products and therefore operate a *de jure* discrimination. The proposed Regulation indeed will be more restrictive for "like products" produced in third countries employing explicit or implicit carbon pricing systems other than the EU ETS or not adopting any system at all, compared to those countries implementing the EU ETS or a system linked to the latter.[161]

It is interesting to notice that the EU could face allegations also for *de facto* discriminatory treatment due to the administrative and practical complexities that will arise from the implementation of the CBAM.[162] In this regard, the CBAM may violate the MFN principle when determining what constitutes a "carbon price" paid in a country of origin outside the EU.[163] At first glance, by exempting only countries with the same domestic carbon pricing scheme

156 Panel, WT/DS27/R, *European Communities-Regime for the Importation, Sale and Distribution of Bananas,* (EC-Bananas III), 22.05.1997, [7.239]; Panel, Canada-Autos, [10.16].

157 GATT 1994, Art. I(1); Appellate Body, EC-Seal Products, [5.86].

158 R. Wolfrum, (ed.), PT. Stoll, (ed.), HP. Hestermeyer, (ed.), *WTO – Trade in Goods*, in *Max Planck Commentaries on World Trade Law*, vol. 5, Martinus Nijhoff Publishers, 2011, p. 1265.

159 Ibid.

160 Appellate Body, EC-Seal Products, [5.88], (emphasis added).

161 E. Vranes, n. 113, p. 97.

162 See S. Saigal, n. 118, p. 67.

163 Provisional Agreement, Art. 3(23): carbon price is defined as "the monetary amount paid in a third country, under a carbon emissions reduction scheme, either in the form of a tax, levy,

or a linked ETS, the Regulation apparently will confer selective advantages to some third countries. It risks indeed failing in recognising other effective policy instruments or other direct emission regulations, which may have a regulatory effect comparable to the EU ETS.[164] However, this may not be entirely true. If we consider that the payment of certificates is based on the amount of direct and indirect embedded emissions of the products in question, then if countries are able to adopt other effective policies to reduce emissions, this would be reflected in the amount of embedded emissions and consequently, the total certificates to be surrendered would be lower or even equal to zero. In addition, the EU has expressed its readiness to enter into negotiations with interested WTO Members, across economic and policy sectors, to understand how their regulatory schemes contribute to achieving shared environmental policy goals.[165]

Once made such assessment, a panel theoretically could conclude for the CBAM violation of Article I. Nevertheless, it shall be recalled that, if this were the case, the possibility to justify the CBAM under Article XX GATT would remain open.[166]

2.4. The CBAM justifiability in light of Article XX GATT

Whether the CBAM will violate one of the examined provisions of the GATT, it would still be possible to justify it in light of Article XX GATT. Since the *chapeau* requires that measures provisionally justified under one of the specific heads in (a-j) be applied so as not to constitute a disguised restriction on international trade or arbitrary or unjustifiable discrimination, in the following sub-sections, we will conduct this two-tier assessment.

2.4.1. The assessment under the specific heads

Article XX, entitled "General Exceptions", provides a justification for measures adopted by Members in order to protect a set of "valuable interests", other than commercial ones, that are at odds with the GATT.[167] Given the environmental protection purpose of the CBAM, letter b) and g) acquire particular relevance in our case. These provisions explicitly allow WTO Members to adopt measures, "necessary to protect human, animal or plant life or health" (letter b) and "relating to the conservation of exhaustible natural resources if

fee 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."

164 L. Cheon-Kee, n. 139, p. 4. Other effective policy instruments may be Renewable Portfolio Standards (RPS) and Feed-In Tariffs (FITs).

165 C. Galiffa, Ig. Bercero, *How WTO-consistent tools can ensure the decarbonization of emission-intensive industrial sectors*, in *American Journal of International Law*, vol. 116, 2022, pp. 196-201; I. Espa, n. 88.

166 See section 3.

167 Appellate Body, US-Gasoline, p. 24.

such measures are made effective in conjunction with restrictions on domestic production or consumption" (letter g).[168]

Yet, for the sake of conciseness, here the assessment of the measure will be conducted exclusively under letter g). Indeed, it is very likely that the EU will primarily invoke as justification the head outlined in letter g) because the establishment of the "relating to" requirement entails a much lower burden of proof rather than the "necessity" requirement imposed by letter b).[169]

The text of Article XX(g) suggests a "holistic assessment of its component elements."[170] First, it is essential to examine if the measure concerns "the conservation of exhaustible natural resources." The Appellate Body emphasized the need to interpret dynamically instead of statically the term "exhaustible", "in the light of contemporary concerns of the community of nations about the protection and conservation of the environment."[171] In our case, the objective of the measure is the preservation of the atmosphere, so that it becomes necessary to assess if the latter can be considered as an exhaustible natural resource.

Given the finding of the Panel in US-Gasoline (not appealed), clean air shall be considered an "exhaustible natural resource."[172] Consequently, *a fortiori*, the atmosphere can be considered an exhaustible natural resource.

The use of the wording "relating to" the conservation of exhaustible natural resources suggests that Article XX(g) covers a wider range of measures. However, to be considered as "relating to" conservation within the meaning of Article XX(g), the measure shall be "*primarily aimed at"* the conservation of an exhaustible natural resource.[173] There must be "a close and genuine relationship of ends and means between that measure and the policy of natural resource conservation of the Member maintaining the measure."[174] In this regard, in US-Shrimp, the Appellate Body focused on the design of the measure noticing that the legislation adopted by the United States (US) was not disproportionately wide in its scope and reached in relation to the policy objective of protection

168 It is interesting to notice that also letter a) which refers to measures "necessary to protect public morals" could be taken into account in justifying the CBAM under Art. XX. However, unlike letters b) and g), it makes no express mention of environmental protection and, therefore, could result in a "weaker" defence in the case at hand. Panel, WT/DS285/R, *United States-Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, 20.04.2005, [6.461, 6.465]; D. Smith, n. 137, p. 24.

169 Appellate Body, US-Gasoline, p. 16.

170 Appellate Body, WT/DS431/AB/R, *China-Measures Related to the Exportation of Rare Earths, Tungsten and Molybdenum*, (Appellate Body, China-Rare Earths), 07.08.2014, [5.94].

171 Appellate Body, WT/DS58/AB/R, *United States-Import Prohibition of Certain Shrimp and Shrimp Products, (*Appellate Body, US-Shrimp), 12.10.1998, [141-142].

172 Panel, WT/DS2/R, *United States-Standards for Reformulated and Conventional Gasoline*, (Panel, US-Gasoline), 29.01.1996, [6.37]; Appellate Body, US-Gasoline, p. 11.

173 Panel, L/6268, *Canada-Measures Affecting Exports of unprocessed Herring and Salmon,* 22.03.1988, [4.6]. Appellate Body, US-Gasoline, p. 18, (emphasis added).

174 Appellate Body, US-Shrimp, [129, 140, 141].

and conservation of the exhaustible natural resource. It then held that the means were, in principle, reasonably related to the ends.[175] Following the same reasoning, if we focus on the structure of the CBAM, even though the measure pursues two different goals, namely the economic object of maintaining the competitiveness of European companies and the environmental aim to counteract carbon leakage, the latter does not appear disproportionate in scope to the political objective of protecting and preserving the atmosphere. Therefore, we can conclude for the existence of "a close and genuine relationship of ends and means."[176]

Turning to conservation, it stands for "the preservation of the environment, especially of natural resources."[177] In its general design and structure, the CBAM specifically imposes an equivalent cost on foreign exporters in order to counteract carbon leakage and limit GHGs emissions. Thus, it can be considered to ensure the conservation of the atmosphere.

Concerning the "made effective in conjunction with" condition, the latter is described as a "requirement of even-handedness in the imposition of restrictions."[178] The meaning of "'made effective' when used in connection with a measure – a governmental act or regulation – may be seen to refer to such measure being 'operative', as 'in force', or as having 'come into effect'. Similarly, the phrase 'in conjunction with' may be read quite plainly as 'together with' or 'jointly with'."[179] In this regard, the existence of a domestic measure, namely the EU ETS acquires relevance. When international trade is restricted, effective restrictions must be imposed equally on domestic production or consumption.[180] Notice, however, that the requirement of "even-handedness" embodied in Article XX(g) does not amount to a requirement of "identity of treatment."[181]

Given the premises made in section 1.2.2. by mirroring the EU ETS,[182] the CBAM can be considered to be made effective in conjunction with the EU ETS in the meaning of letter g). Accordingly, we might conclude that the CBAM can be provisionally justified under the head of the letter g).

2.4.2. The assessment under the chapeau

As already mentioned, to be considered justified, the measure shall also comply with the conditions set by the *chapeau* of Article XX.[183] Namely, the measure

175 Ibid.

176 Appellate Body, China-Rare Earths, [5.90].

177 Appellate Body, WT/DS398/AB/R, *China-Measures Related to the Exportation of Various Raw Materials*, 30.01.2012, [355].

178 Appellate Body, US-Gasoline, p. 20.

179 Ibid.

180 Appellate Body, China-Rare Earths, [5.132].

181 Appellate Body, US-Gasoline, p. 21.

182 Provisional Agreement, [17].

183 Appellate Body, US-Gasoline, p. 22, [11, ff.]; Appellate Body, US-Shrimp, [119-120].

shall not be adopted nor applied in a manner that would constitute a "means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail", or a "disguised restriction on international trade". Before entering into the substance of the matter, a preliminary remark is necessary. The Appellate Body found that the *chapeau* of Article XX embodies "the need to maintain a balance of rights and obligations between the right of a Member to invoke one or another of the exceptions of Article XX […] and the substantive rights of the other Members under the GATT 1994."[184] Accordingly, a line of "equilibrium" between Article XX GATT as a defence and the right of other WTO Members to market access or non-discrimination must be established.[185]

Concerning the first sentence of the *chapeau*, three elements must be verified: "(i) the application of the measure that must result in 'discrimination', thus, the difference in treatment concerning the application of a national measure;[186] (ii) the discrimination must be 'arbitrary or unjustifiable' in character; (iii) the discrimination must occur 'between countries where the same conditions prevail'."[187]

Regarding the application of the measure that must result in "discrimination", the issue concerning the relationship between the non-discrimination standard as enshrined in the *chapeau* and the non-discrimination obligations provided in Articles I and III arises. As pointed out by the Appellate Body, the principle of effective interpretation of treaties would require that the notion of non-discrimination under *chapeau* not to overlap with the notion of non-discrimination under GATT substantive provisions.[188] Nonetheless, the Appellate Body held that this does not imply that the "circumstances that bring about the discrimination that is to be examined under the *chapeau* cannot be the same as those that led to the finding of a violation of a substantive provision of the

184 Appellate Body, WT/DS2/AB/R, *United States-Standards for Reformulated and Conventional Gasoline*, (Appellate Body, US-Gasoline), 29.04.1996, [9]; Appellate Body, US-Shrimp, [156].

185 Appellate Body, US-Shrimp, [159]. For a more detailed analysis see G. Adinolfi, *Art. XX GATT-General Exceptions [Chapeau],* in COMMENTARIES ON WORLD TRADE LAW, 4, 2023, pp.139-156. Some scholars claim that this line is drawn by Art. XX as a whole, by both the *chapeau* and paragraphs (a-j). See L. Bartels, *The chapeau of the general exceptions in the WTO GATT and GATS agreements: a reconstruction*, in *American Journal of International Law 109*, no. 1, 2015, pp. 95-125.

186 Appellate Body, US-Gasoline, p. 23, the word "discrimination" in the *chapeau* covers both discrimination between products from different supplier countries and discrimination between domestic and imported products.

187 Appellate Body, US-Gasoline, pp. 28-29, this latter element has to be considered together with "arbitrary" and "unjustifiable". In this context the discrimination is different from discrimination in the treatment of products according to Art. I or III.

188 Appellate Body, US-Gasoline, p. 23.

GATT 1994."[189] For this reason, the considerations made in sub-section 2.2.2. on the different treatment accorded to domestic products are echoed here.

Turning to the "arbitrariness and unjustifiability" of such discrimination, in most cases, the two situations have been applied together by the WTO dispute settlement organs and no general criteria have been set out to differentiate them.[190] According to the Appellate Body, the analysis of whether discrimination is arbitrary or unjustifiable "must focus on the cause of the discrimination, or the rationale put forward to explain its existence and should be made in the light of the objective of the measure."[191] Accordingly, discrimination can be considered arbitrary or unjustifiable when the reasons given for the discrimination "bear no rational connection to the objective" or "would go against that objective."[192] In this specific case, the discrimination occurring between the three group of third countries, namely those adopting regulatory tools in order to limit GHGs emissions; those adopting market-based mechanisms which are not the EU ETS and, in any case, are not linked to the EU ETS; and those that are covered by the EU ETS, could be considered as "arbitrary or unjustifiable" since it does not bear any rational connection to the reduction of GHGs emissions.

Another problematic aspect arising under the profile of discrimination is that WTO Members may deem the CBAM as an attempt to force all WTO Members to adopt the same comprehensive regulatory regime as the one adopted by the EU and as a protectionist measure.[193] A similar discrimination was detected in US-Shrimp, by Appellate Body while analysing the justifiability of the ban adopted by the US on importation of shrimp and shrimp products under the introductory part of Article XX.[194] The aforementioned ban was adopted for the conservation of turtles and it applied to all shrimp and shrimp products fished with nets not approved by the US because they lacked sea turtle protection devices. In that case, the complaining countries where all developing countries with limited technical and technological capacity. It was in fact on this basis that the Appellate Body, while observing that the "intended and actual

189 Appellate Body, US-Gasoline, pp. 28-29; Appellate Body, EC-Seal Products, [5.298, 5.318]. For a detailed analysis of the *chapeau* of Art. XX see G. Adinolfi, n. 185.

190 G. Adinolfi, n. 185.

191 Appellate Body, WT/DS/332/AB/R, *Brazil-Measures Affecting Imports of Retreaded Tyres*, 03.12.2007, [226, 227, 246]; Appellate Body, WT/DS381/AB/RW, *United States-Measures Concerning the Importation, Marketing and Sale of Tuna and Tuna Products,* 20.11.2015, [7.316];

192 Ibid.

193 *Brexit, EU's carbon border adjustment mechanism take centre stage at Market Access Committee*, in *WTO news*, 2020.

194 Appellate Body, US-Shrimp, [164-165], the Appellate Body found discrimination in the fact that the import of shrimps was prohibited only because they had been caught in waters of countries that were not certified by the US, although these countries used methods identical to those employed by the US.

coercive effect [of the measure] on other governments" to "adopt essentially the same policy", held that such a uniform standard cannot be permissible in international trade relations.

As a matter of fact, in US-Shrimp, the Appellate Body recognized the legitimacy of adopting measures that produce extraterritorial effects, to the extent that the specific characteristics of third states are taken into account. It affirmed indeed that discrimination in the meaning of Article XX exists, inter alia, "when the application of the measure at issue does not allow for any inquiry into the appropriateness of the regulatory programme for the conditions prevailing in those exporting countries."[195] Transposed in the case at stake, essentially the CBAM seems to require all other Members to adopt the same standard enforced domestically by the EU, namely the EU ETS. Moreover, the cost of CBAM certificates will be based on that of the EU ETS certificates and will therefore reflect EU-specific supply and demand conditions. Nonetheless, one may argue that it is not totally accurate to the extent that the price of CBAM certificates would be paid in respect of the emissions embedded, so that if a country adopts other measures to fight GHGs emissions, equally effective, it would consequently reduce or eliminate the emissions and obtain similar or the same results as countries adopting an ETS EU-based. On this basis, this case can be considered very different from the one of US-Shrimp.

In addition, the administrative complexity associated with the measure would be too burdensome and may give rise to unjustifiable discrimination, amounting to a disguised restriction on international trade, as it will be outlined later.[196] In this context, a clarification of the use of the CBAM revenues to support the climate policies of developing countries is paramount in providing decisive evidence of the measure's climate, and not protectionist, objective.[197] Interestingly, while in the EU Explanatory Memorandum the Commission indicated that the plan was to allocate most of these additional resources to the EU budget, including financing its COVID-recovery instrument "Next Generation EU", in the 2022 Provisional Agreement, the EU Council and the European Parliament agreed that besides providing developing countries and Least Developed Countries (LDCs) with technical assistance, in order to support the de-carbonisation of their manufacturing industries, the EU will introduce "a new own resource based on the revenues generated by the sale of CBAM." [198]

In relation to the wording "between countries where the same conditions prevail", the Appellate Body held that "in determining which 'conditions'

195 Appellate Body, US-Shrimp, [161, 164].

196 D. Sifonios, n. 118, p. 216.

197 Provisional Agreement, [54, 54b, 55].

198 CBAM Proposal, Explanatory Memorandum to (COM(2021)564), 15.07.2021, pp. 10-11. CBAM Proposal, Preamble, [47], where the Commission was silent about the destination of the CBAM's revenue, which was estimated to reach above EUR 2.1 billion by 2030.

prevailing in different countries are relevant in the context of the *chapeau*, the sub-paragraphs of Article XX, and in particular the sub-paragraph under which a measure has been provisionally justified, provide pertinent context and the substantive obligations under the GATT 1994 with which a violation has been found."[199] This being crucial to allow the *chapeau* to maintain the equilibrium between the obligations under the GATT 1994 and the exceptions provided under each paragraph of Article XX.[200]

This aspect shall be applied when assessing the discrimination occurring in respect of third countries on the three levels. Firstly, there is discrimination between third countries adopting policies limiting GHGs emissions other than explicit carbon pricing mechanisms, in particular the EU ETS, and those adopting the EU ETS or linked to it. Secondly, discrimination emerges also between third countries adopting an ETS that is not linked to the EU ETS and those embracing by the EU ETS. In these contexts, if the environmental policies are different but equally aimed at reducing GHGs emissions we can conclude for the existence of "the same conditions". Then, the discrimination shall be considered arbitral and unjustified between countries where the same conditions prevail.

On a third level, the analysis applies differently when discrimination is ascertained between third countries that do not adopt any environmental policy aimed at limiting GHGs emissions and those adopting the EU ETS or linked to it. In this case, it would be hard to argue that the "same conditions" are established and, thus, discrimination could be legitimate. Nonetheless, it shall be recalled that the Appellate Body clarified that discrimination under the *chapeau* can occur not only when countries, where the same conditions prevail, are treated differently but also when the same measure is applied to different countries despite the diversity in the conditions prevailing within each of them.[201] Notice that usually the countries not adopting such sophisticated environmental policies are developed countries and LDCs, which not by chance, are also granted a differentiated treatment under the international environmental system in light of their "different national circumstances".[202]

In our case, the obligation to calculate and verify the embedded GHGs emissions according to the Regulation, inter alia, will have unintended, geographically

199 Appellate Body, EC-Seal Products, [5.299-5.301]. Appellate Body, WT/DS477/AB/R, *Indonesia-Importation of Horticultural Products, Animals and Animal Products*, 09.11.2017, [5.99].

200 Ibid.

201 Appellate Body, US-Shrimp, [165].

202 See Paris Agreement 2015, Art. 2(2). These considerations will entail further analysis also under the Paris Agreement, however, this will not take place in this paper. For more information see L. Rajamani, *Differentiation in a 2015 Climate Agreement*, in *Center for Climate and Energy Solutions*, 2015, pp. 606-623; S. Maljean-Dubois, *The Paris Agreement: A New Step in the Gradual Evolution of Differential Treatment in the Climate Regime?*, in *Review of European, Comparative & International Environmental Law*, 2016, pp. 151-160.

disparate effects in developing countries compared to advanced economies. Indeed, developing countries that will not have the technical expertise to calculate and verify the carbon content of their export products will be adversely affected by the pejorative application of "default values".[203] Hence, to counter such discrimination, it will be paramount for the EU to provide support to these countries.[204]

Finally, regarding "disguised restriction", it shall be recalled that concealed restrictions do not exhaust the term "disguised restrictions."[205] The Appellate Body held that it "may properly be read as embracing restrictions amounting to arbitrary or unjustifiable discrimination in international trade taken under the guise of a measure formally within the terms of an exception listed in Article XX." Hence, the very same considerations relevant in deciding whether the application of a particular measure amounts to "arbitrary or unjustifiable discrimination" can be taken into account also in determining the presence of a "disguised restriction" on international trade. This reflects the purpose and object of avoiding abuse or illegitimate use of the exceptions to substantive rules available in Article XX.[206]

Moreover, it shall be recalled that in US-Shrimp, the Appellate Body interpreted the *chapeau* as to impose a duty to undertake cooperation activities and negotiate before the unilateral measure, having significant extraterritorial effects, is implemented at the international level.[207] If, by analogy, a panel were to find such an obligation also in the case of the CBAM, notice that the EU has manifested in several occasions, beyond the Regulation on the CBAM,[208] its interest and willingness to enter into negotiations with other WTO Members on strategies and programs that the latter can adopt to mitigate the administrative costs and burdens associated with verifying the embedded GHGs emissions in products covered by the Regulation.[209] Despite, the fulfilment of this requirement will depend on how negotiations and discussions will be conducted,[210] it

203 See sub-section 2.3.2.

204 Trade and Climate Change Information Brief No.6, *What Yardstick for Net-Zero? How WTO TBT Disciplines Can Contribute To Effective Policies on Carbon Emission Standards and Climate Change Mitigation,* in *WTO Publications*, 2022, p. 3.

205 Appellate Body, US-Gasoline, p. 24.

206 Appellate Body, US-Gasoline, p. 25.

207 United Nations Environment Programme and the World Trade Organisation (UNEP-WTO), *Trade and Climate Change*, in *WTO Publications*, 2009, p. 109; T. Cottier, T. Payosova, n. 113, p. 28.

208 Provisional Agreement, [53].

209 Ibid., Recital [54a] providing that: "The establishment of the CBAM calls for the development of bilateral, multilateral and international cooperation with third countries. For this purpose, a forum of countries *with carbon pricing instruments or other comparable instruments* ('Climate Club') should be set up, in order to promote the implementation of ambitious climate policies in all countries and pave the way for global carbon pricing framework. […]" (emphasis added).

210 Appellate Body, US-Shrimp, [172-173].

is certain that a failure to cooperate will establish the existence of unjustified discrimination.[211]

In conclusion, based on the pre-existing case law, the main problems in justifying the CBAM according to Article XX would arise with respect to the *chapeau* test. However, there is still open the possibility that a panel will depart from the precedents discussed in the paper and will consider the CBAM justified under Article XX.

3. Conclusive remarks

The analysis conducted so far has provided an overview of some of the legal issues that will arise with the adoption of the CBAM under the GATT. What will actually happen will depend on the details of the CBAM once fully implemented. Yet, one fact is that, as it stands, the measure will prompt several WTO Members to complain to a panel about alleged GATT violations[212] and, at that point, only the established Panel will be able to provide a definitive answer.

The increasing adoption of trade measures by WTO Members in order to achieve environmental targets seems to side with the effectiveness of the EU CBAM. Although the EU CBAM is the first major trade measure of this kind that will apparently come into force, similar border measures are being developed in other countries and more will come in the future as countries seek to reduce GHGs emissions. While an unsuccessful defence of the CBAM might discourage other WTO Members from adopting similar measures, a successful defence of the CBAM will not guarantee that other measures will be equally WTO-compliant, since, again, it all depends on the specifics of the measure. However, it has to be kept in mind that the stalemate of the Appellate Body and the long timeframe for dispute decisions could disproportionately extend the time frame of the decision.[213]

In order to conclude our assessment under GATT, following are some of the scenarios that could happen if a dispute were carried out before the WTO dispute settlement system. If the established Panel will conclude for the inconsistency of the CBAM with the GATT, pursuant to Article 19(1) DSU, the EU will have to bring its measure into conformity with WTO law.[214] Yet, the EU may decide alternatively (i) not to comply, as it has previously done in other

211 D. Smith, n. 137, p. 39.

212 D. Bergin et al., *Perception of the Planned EU Carbon Border Adjustment Mechanism in Asia Pacific-An Expert Survey*, Regional Project Energy Security and Climate Change Asia-Pacific (RECAP) 2021, pp. 15-21.

213 In the functioning WTO dispute settlement system major cases often took three years or more to pass through the system's various stages.

214 DSU, Arts. 19, 21, 22.

cases where it acted as defendant[215] and, therefore, bear the costs of "countermeasures" enacted by the complaining Members.[216] If the claimants before the Panel are parties in the Multi-Party Interim Appeal Arbitration Arrangement (MPIA),[217] (ii) the EU could resort to MPIA.[218] In this latter scenario, if the MPIA would also conclude for the violation of the GATT of the CBAM, again the EU will have in principle to bring the measure into conformity or bear countermeasures.[219]

In any case, hopefully soon enough, we will be able to see concretely what the practical consequences of the adoption of such a complex and elaborate trade measure as the CBAM will be.

215 Decision by the Arbitrator, WT/DS26/ARB, *European Communities-Measures Concerning Meat and Meat Products*, (EC-Hormones), Original Complaint by the United States – Recourse to Arbitration by the European Communities under Art. 22(6) of the DSU, 12.07.1999.

216 DSU, Arts. 3(7), 21(6), 22(1).

217 See R. Wolfe, P. C. Mavroidis, *WTO dispute settlement and the Appellate Body: Insider perceptions and Members' revealed preferences*, in *Journal of world trade 54*, no. 5, 2020.

218 DSU, Art. 25. At the time of writing, Australia, Colombia, Iceland, Nicaragua, Ukraine, Benin, Costa Rica, Japan, Norway, Uruguay, Brazil, Ecuador, Macao, China, Pakistan, Canada, the European Union, Mexico, Peru, China, Guatemala, Montenegro, Singapore, Chile, Hong Kong, China, New Zealand and Switzerland are part of the MPIA.

219 DSU, Arts. 21, 22, 25(3, 4).