THE EU'S CBAM, COMPLYING WITH THE CBDR PRINCIPLE COULD ALSO MEAN COMPLIANCE WITH WTO LAW

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I. INTRODUCTION

As a response to the climate change crisis and to further the objectives of the Kyoto Protocol, the Paris Agreement, and the European Green Deal, the European Union ("EU") Commission has proposed a carbon border adjustment mechanism ("CBAM").[1] The accelerating climate crisis has generated growing support for carbon pricing, including a statement signed by twenty-seven Nobel Laureate economists identifying carbon taxes as "the most cost-effective lever to reduce carbon emissions at the scale and speed that is necessary."[2] If this policy is adopted, it will impact the world's trading relationship with the EU and thus the global economy. As for the United States ("US"), the EU and the US have a $5.6 trillion trade relationship.[3] US exports of goods and services to the EU in 2017 reached approximately $562 billion.[4] It is estimated that EU-US trading relationship generates more than 15 million jobs.[5] According to Eurostat, the EU accounts for 14% of global trade.[6] Any regulation that directly impacts this trading relationship will have significant

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1. Georg Zachmann & Ben McWilliams, *A European Carbon Border Tax: Much Pain, Little Gain*, BRUEGEL POLICY CONTRIBUTION, Mar. 2020, at 4, 10.

2. Matthew C. Porterfield, *Border Adjustments for Carbon Taxes, PPMS, and the WTO*, 41 U. PA. J. INT'L L. 1, 4 (2019).

3. Int'l Trade Admin., *European Union – Market Overview*, EXPORT.GOV (Aug. 2, 2019), https://www.export.gov/article?series=a0pt0000000PAtkAAG&type=Country_Commercial__kav.

4. *Id.*

5. *Id.*

6. *International Trade in Goods*, EUROSTAT (September 30, 2021, 3:00 PM), https://ec.europa.eu/eurostat/statistics-explained/index.php?title=International_trade_in_goods.

consequences on the global economy–a global economy already hit by the inflation caused by the COVID-19 pandemic and the Russian invasion of Ukraine.

Early critics have pointed out that a CBAM might be in contravention of the EU's obligations as part of the World Trade Organization ("WTO"). Further, critics argue that a CBAM might violate the international environmental principle of common but differentiated responsibilities because the CBAM may unfairly pass the cost of combating climate change to developing nations.[7]

This Article explores the compliance of the CBAM under both WTO law and the United Nations Framework Convention on Climate Change ("UNFCCC"). Part I will provide an insight into the EU's obligations as a member of the WTO and the UNFCCC. Further, Part I explains the details of the proposed CBAM and its mechanics. Part II analyzes whether the proposed CBAM complies with WTO and UNFCCC law. Considering the current crisis with WTO law enforcement and the fact that the international approach to combat climate change hinges on cooperation over coercive action, this Article argues that the CBAM's compliance with international law depends on the mechanics of the CBAM's recognition of carbon pricing in non-European countries and on the EU's disposition to both recognize non-European countries' environmental policies, and the EU's willingness to support developing nations on their efforts to curb carbon emissions.

II. BACKGROUND

A. THE CARBON BORDER ADJUSTMENT MECHANISM

The EU, under its international environmental responsibilities and the European Green Deal, has the objective of reducing emissions by 55 percent as compared to 1990 levels and to be climate-neutral by 2050.[8] In response to these objectives, the EU has implemented emission reduction policies. Among the most important of these is the European Emissions Trading System.[9] These policies have the effect

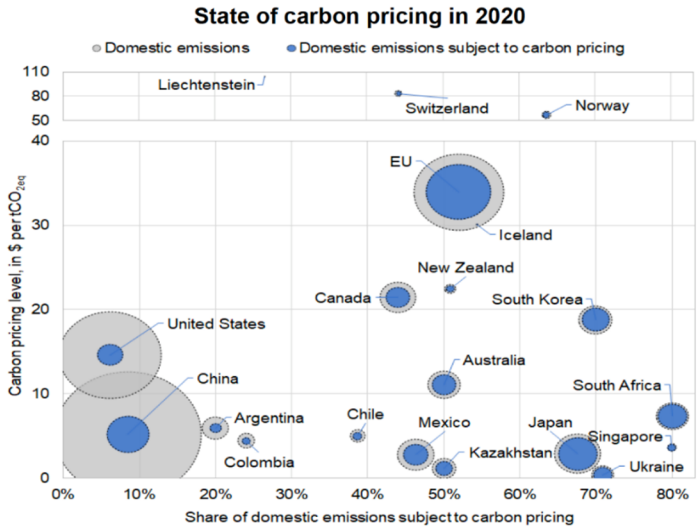
7. *Id.* at 6.

8. *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, at 1, COM (2021) 564 final (Jul. 14, 2021) [hereinafter CBAM Proposal].

9. European Commission Press Release QANDA/21/3661, Carbon Border Adjustment Mechanism: Questions and Answers, at 1–2 (July 14, 2021), https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_3661 [hereinafter CBAM Q&A]; *see also EU ETS Handbook*, at 4 (2015),

of making carbon-emitting industrial processes more expensive in the EU than in countries with more lax emissions regulations.[10] Industrial processes will tend to move from countries where emissions are more expensive to countries where emissions are cheaper. This pollution migration has two consequences: 1) it makes manufacturing in Europe less competitive; and 2) the global carbon emissions remain the same.[11] Basically, the EU's emissions policies only have the effect of moving from where the emissions come from instead of reducing them. This phenomenon is known as carbon leakage.[12] Figure 1 shows a comparison of the cost of carbon emissions among different countries as well as the portion of emissions that are subject to carbon pricing. The graphic illustrates how much more expensive it is to have emissions within the EU than in other countries.

Figure 1.[13]



https://ec.europa.eu/clima/document/download/8cabb4e7-19d7-45bd-8044-c0dcc1a64243_en [hereinafter ETS Handbook].

10. *See* CBAM Proposal, supra note 8, at 3.

11. *Id.* at 2; *see also* European Parliament, *Trade Related Aspects of a Carbon Border Adjustment Mechanism. A Legal Assessment*, PE 603.02, at 7 (Apr. 2020).

12. *See* Thomas Eichner & Rüdiger Pethig, *Carbon Leakage, the Green Paradox, and Perfect Future Markets*, 52 INT'L ECON. REV. 767, 767 (2011) (stating that "[a]ny national policy of curbing emissions is bound to raise domestic energy costs and thus enables firms in non-abating countries to expand. For that reason, the effort of abating countries will be offset to sine extent by increasing emission in non-abating countries.").

13. William L'Heudé et al., *A Carbon Border Adjustment Mechanism for the European Union*, TRÉSOR-ECONOMICS, Mar. 2021, at 1, https://www.tresor.

1. The European Emissions Trading System

The EU Emissions Trading Systems ("ETS") is a "cap and trade" system.[14] A "cap and trade" system caps the total volume of emissions from certain types of installations through the grant of limited emissions allowances, which are rights to emit emissions, and allows the trade of such allowances.[15]

Each year businesses covered by the ETS buy the allowances through auctions.[16] By the end of the year, these companies present a report of their actual emissions, then these emissions are compared to the allowances.[17] If a company had fewer emissions than the ones permitted by its allowances, then that company may trade its surplus allowances with other companies.[18] If a company surpassed its emissions allowances, then that company must acquire additional allowances either from companies that had spare allowances or at auction.[19] If a business fails to limit its emissions within its allowances it either has or acquires, the EU issues fines per carbon emission ton.[20] Every year the ETS decreases the quantity of emissions permitted by the allowances to gradually reduce the EU's emissions.[21] Put simply, the ETS functions as a prepaid credit card. The user deposits the amount of credit they want to have. If the user goes above that limit, they will need to get extra credit. If the user has credit to spare, they may trade on that extra credit.

It is important to note that currently, the ETS gives European companies a limited number of free carbon allowances.[22] These free allowances are given on a percentage basis and are being reduced in phases.[23] The EU implemented these free allowances as an effort to address the issue of carbon leakage.[24] The idea is that the free allowances may offset the impact of EU environmental law on EU

economie.gouv.fr/Articles/2021/03/23/a-carbon-border-adjustment-mechanism-for-the-european-union [hereinafter French Economic Ministry CBAM].

14. *See* ETS Handbook, *supra* note 9, at 16.

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.*

23. Free allowances started at 80% in 2013, and were reduced to 30% in 2020. *Id.* at 44.

24. Claudio Marcantonini, et al., *Free Allowance Allocation in the EU ETS*, 2017/02 ROBERT SCHUMAN CTR. FOR ADVANCED STUDIES POLICY BRIEF 1, 2 (2017).

companies, thus avoiding their migration outside of the EU. As it will be seen, these free allowances may be the source of an incompatibility issue between the CBAM and WTO law.

2. The Proposed CBAM in Detail

A border adjustment is a fiscal measure applied to imported products by imposing taxes or other charges, which correspond to those applied to the same products in the domestic market.[25] A border adjustment's objective is to level the field between domestic and foreign producers through the extension of domestic measures to imports.[26] The CBAM will mirror the ETS.[27] The system is based on requiring EU businesses to purchase carbon certificates that will account for the emissions of imported goods.[28] The price of the certificates will be calculated depending on the weekly average auction price of EU ETS allowances expressed in euros per ton of CO^2 emitted.[29] The CBAM will initially only apply to imports of five industries: cement, iron and steel, aluminum, fertilizers, and electricity.[30] The EU chose these sectors because of their high carbon emissions.[31]

The basic mechanics of the CBAM are the following. The importers of CBAM-covered products will register with their respective European member countries (e.g., an importer of aluminum in Germany will register in Germany) as registered importers.[32] The importers will then buy the CBAM certificates in advance of importing the covered goods.[33] Once registered and with certificates, the importer may proceed with the importation of the covered goods.[34] Later, on May 31 of each year, the registered importers must submit a declaration detailing the number of goods imported during the preceding year and their embedded emissions.[35] As with the ETS, if an importer's imported emissions surpass their CBAM certificate's allowances, the importer will have to acquire extra

25. KATERYNA HOLZER, CARBON-RELATED BORDER ADJUSTMENT AND WTO LAW: THE CASE OF TRADE IN GOODS 64 (2014).
26. *Id.*
27. CBAM Q&A, *supra* note 9, at 2.
28. *Id.*
29. *Id.*
30. *Id.* at 2–3.
31. *Id.* at 3.
32. CBAM Proposal, *supra* note 8, art. 5.
33. CBAM Q&A, *supra* note 9, at 2.
34. CBAM Proposal, *supra* note 8, art. 5(2).
35. CBAM Proposal, *supra* note 8, art. 6(1).

certificates or face fines.[36]

On the data that the importer must present at the border when importing the covered products, importers should get the embedded emission information from their non-EU supplier.[37] Embedded emissions are direct emissions released during the production of goods.[38] The CBAM will initially only apply to direct emissions but, upon further assessment, the EU Commission may expand to indirect emissions.[39] The Proposal defines direct emissions as the emissions from the production processes of goods *over which the producer has direct control*.[40] By contrast, indirect emissions are far more expansive, as they include the emissions from the production of electricity, heating and cooling consumed during the production processes of goods.[41] Embedded direct emissions are calculated by dividing the emissions caused by the production process during a reported period of time by the amount of the goods produced during such period.[42] Under the Proposal, exporters should provide to EU-importers the information to make the embedded direct emissions calculation.[43]

When this information is not available, values shall be set at the average emission intensity of each exporting country and for each of the covered goods except for electricity, increased by a mark-up, which the CBAM Proposal does not determines.[44] Emissions for the production of electricity will be calculated per country, group of countries or regions.[45] When reliable data for the exporting country cannot be applied for a type of goods, the default values shall be based on the average emission intensity of the 10% worst-performing EU installations for that type of goods.[46]

Further, an importer may claim in its CBAM declaration a reduction in the number of CBAM certificates to be surrendered to reflect the carbon price paid in the country of origin for the declared

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36. *Id.*
37. *See* CBAM Q&A, *supra* note 9, at 3.
38. CBAM Proposal, *supra* note 8, art. 3(16)..
39. CBAM Proposal, *supra* note 8, at 18.
40. CBAM Proposal, *supra* note 8, art. 3(15).
41. CBAM Proposal, *supra* note 8, art. 3(28).
42. CBAM Annex III(2). *Annexes to the Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, Annex III(2), at 5, COM (2021) 564 final (July 14, 2021) [hereinafter CBAM Annex].
43. *See* CBAM Q&A, *supra* note 9, at 3.
44. CBAM Annex III(4), *supra* note 42, at 6.
45. CBAM Annex III(4.2), *supra* note 42, at 7.
46. CBAM Annex III(4), *supra* note 42, at 6.

embedded emissions.[47] So, hypothetically, if carbon emissions for aluminum in Mexico are priced by the Mexican government at an equivalent of €30 and the CBAM certificate for aluminum prices carbon at €100, then the carbon pricing for Mexican aluminum would be effectively €70. Through this policy, the EU intends to consider the effort of non-Europeans to curb carbon emissions. As for the countries covered by the proposed CBAM, it will apply to imports from all non-European countries except for Iceland, Liechtenstein, Norway, and Switzerland.[48] Finally, because the EU intends to combat carbon leakage through the CBAM, the EU plans to phase out ETS free allowances.[49] The CBAM Proposal was approved by the European Commission on July 14, 2021, and referred to the European Parliament on September 2021.[50] A vote is expected by April 2022, so changes to the current Proposal may be expected.[51]

B. GATT, WTO, AND ITS ENFORCEMENT

1. Brief Background of GATT and WTO

The General Agreement on Tariffs and Trade ("GATT") is a multilateral treaty.[52] The original agreement over the GATT was reached in 1947 after the end of World War II to foster the recovery of the global economy through international trade.[53] The original membership was comprised by mostly European countries and the US.[54] The GATT implemented a set of rules that govern trade between its members and maintains reduced import tariffs amongst them.[55] In 1947, the GATT had twenty-three member countries; today the

47. CBAM Proposal, *supra* note 8, art. 9(1).

48. CBAM Annex II(1), *supra* note 42, at 4.

49. *See* CBAM Q&A, *supra* note 9, at 2.

50. Henrique Simões, *Carbon Border Adjustment Mechanism as Part of The European Green Deal*, EUROPEAN PARLIAMENT, https://www.europarl.europa.eu/legislative-train/theme-environment-public-health-and-food-safety-envi/file-carbon-border-adjustment-mechanism (Sept. 20, 2022).

51. *See* Yves Melin, et al., *The Lead Rapporteur at the European Parliament's Environment Committee Proposes Broader and Faster Implementation of CBAM*, REED SMITH (Jan. 7, 2022), https://viewpoints.reedsmith.com/post/102hfs2/the-lead-rapporteur-at-the-european-parliaments-environment-committee-proposes-b#page=1.

52. Meredith A. Crowley, *An Introduction to the WTO and GATT*, 27 ECON. PERSP. 42, 47 (2003).

53. *Id*. at 42.

54. *Id.*

55. *Id.*

WTO[56] has one hundred and sixty-four members which comprise over 97% of world trade.[57] The GATT is a series of treaties renegotiated through rounds.[58] These rounds update the GATT by reforming its provisions or adding new ones.

At its inception, the GATT treaty did not provide for a formal institution – all that existed was a small secretariat, headquartered in Geneva, with a limited institutional apparatus to administer various issues that arose among members.[59] Even though the GATT had success in the form of tariff reductions, its members felt that the GATT needed the creation of an enforcement institution.[60] To address this problem, a new round of trade negotiations—the Uruguay Round—was launched in 1986.[61] The treaty negotiated during the Uruguay Round, concluded with the Marrakesh Round, which established the WTO.[62] The WTO is the body in charge of enforcing the GATT between its members.[63]

2. GATT's Main Obligations and Border Adjustment Taxes

Broadly, the GATT establish two main obligations: (1) members will not discriminate between the trade of member parties, and (2) members will not discriminate in favor of their domestic production in detriment of imports from other members. These obligations are contained in the GATT's Articles I, II, and III.[64]

a. The Principle of Most Favored Nation

The GATT's obligation to not discriminate between members is exercised through the Most Favored Nation ("MFN") principle.[65]

56. *Id.*

57. *Id.*

58. WTO, *History of the Multilateral Trading System*, https://www.wto.org/english/thewto_e/history_e/history_e.htm (last visited Jan. 28, 2022).

59. *See* Crowley, *supra* note 52, at 43.

60. *Id.*

61. *Id.* at 44.

62. Kevin Kennedy, *GATT 1994*, *in* 1 THE WORLD TRADE ORGANIZATION: LEGAL, ECONOMIC AND POLITICAL ANALYSIS, 89, 95–96 (Patrick F. Macroy et al. eds., 2005).

63. Joost Pauwelyn, *Enforcement and Countermeasures in the WTO: Rules are Rules-Toward a More Collective Approach*, 94 AM. J. OF INT'L L. 335, 336 (2000).

64. General Agreement on Tariffs and Trade, *opened for signature* Oct. 30, 1947, T.I.A.S. 1700, 55 U.N.T.S. 187, art. I–III [hereinafter GATT]

65. *Principles of the trading system*, World Trade Org. [WTO], https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm (last visited Dec. 2, 2022); GATT art. I.

Article I states that "[w]ith respect to customs duties and charges of any kind imposed on or in connection with importation or exportation [of goods] . . . any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties."[66] Put simply, the GATT's MFN obligation means that WTO members must automatically grant to products originating in or destined to any WTO Member any trade advantage that they have granted to a like product originating in another nation, *regardless* of whether the latter is a WTO member.[67]

b. Border Adjustment Taxes

Generally, the WTO considers border adjustments as an acceptable practice.[68] The GATT's Articles II and III recognize that WTO Member countries have the right to develop internal regulations and that such regulations may be imposed on imports.[69] Article II establishes that a GATT Member may impose a charge on the importation of any product equivalent to an internal tax imposed on a like product.[70] In somewhat the same line as Article II, Article III recognizes the GATT Member's right to have internal taxes and other internal charges and to have regulations and requirements affecting the internal sale, offer, purchase, transportation, distribution, or use of products. It also recognizes that such internal regulations may be imposed on imported goods.

However, under the GATT, a member's right to impose internal regulations on imported goods is limited by the obligation to not discriminate against foreign goods in favor of domestic goods. Article III.1 establishes the principle that the application of a Member's internal regulations should not be applied to the imported products from another Member in a manner that affords protection to domestic production.[71] This means that a Member's implementation of internal regulation to foreign products should be limited to the compliance of such regulation without applying the internal laws in a disparate way that causes better treatment to national products in detriment of foreign products. For restraints on a Member's right to implement

66. GATT art. I.
67. *See id.*
68. HOLZER, *supra* note 25, at 63.
69. *Id.* at 68.
70. *Id.* at 64.
71. GATT, *supra* note 66, art. III.1.

equivalent taxes to imports, Article II points to Article III paragraph 2.[72] Article III.2 states that "[t]he products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind *in excess* of those applied, directly or indirectly, to like domestic products."[73]

Mexico's Value Added Tax ("VAT") may be used as an example to illustrate the application of Articles II and III. Mexico's Federal Government imposes a 16% VAT to, *inter alia*, the sale of goods.[74] This is an internal measure of Mexico's government. Under Articles II and III of the GATT, Mexico is entitled to enforce a 16% VAT on the importation of goods.[75] Further, these imported goods will be subject to a 16% VAT on their subsequent sales after importation. This benefit exists so Mexico's domestic goods and services are not put at a disadvantage against foreign products. The GATT balances this right by limiting the charge to not be exclusively applied to imported goods and to not be in *excess* of 16%. This is so to not afford Mexico's domestic commerce protection against foreign products avoiding the discrimination of foreign commerce.

c. Border Adjustment Taxes, subject to GATT's Article II or III?

Under the GATT, Articles II.2 and III regulate border adjustment taxes. The applicability of Article II or Article III depends on the nature of the event that triggers the charge.[76] As mentioned before, Article II.2(a) states that a contracting party may impose on the importation of a product a charge *equivalent* to an internal tax imposed consistently in respect of the like domestic product.[77] The key term in Article II.2(a) is *equivalent*. The charge is not an extension of the inner tax but an equivalency of it. Article III states that the GATT members may impose internal taxes, charges, laws, and regulations on imports.

The difference between Article II.2 and Article III is that the former applies to *border charges* equivalent to an inner charge while

72. GATT, *supra* note 66, art. II.2(a).

73. GATT, *supra* note 66, art. III.2. (Emphasis added).

74. Ley del Impuesto al Valor Agregado [LIVA] [Added Value Tax Law] art. 1 (Mex.).

75. In effect, Mexico does charge a 16% VAT to the import of goods and services, *see id.*

76. *See* Joachim Englisch & Tatiana Falcao, *EU Carbon Border Adjustments and WTO Law, Part One*, 51 ENVTL. L. REP. 10857, 10865 (2021) [hereinafter Englisch Part One].

77. GATT, *supra* note 66, art. II.

the latter does not apply an equivalency but applies the actual *inner charge*. A border charge is a charge where the liability is born from the mere importation of a product.[78] In contrast, the obligation to pay *internal charges* does not accrue because of the importation of the product at the very moment it enters the territory of another Member but because of internal factors such as the internal re-sale of the product or because the product was used internally.[79] The triggering events occur once the product has been imported into the territory of another member.[80] Referring to the VAT Mexico example, the VAT accrued at import is a border charge while the VAT accrued for the subsequent sales of an already imported product is an inner charge.

WTO jurisprudence has delved into the issue of defining a charge as a border charge or an inner charge. In *China–Autoparts*, the WTO appellate body held that the obligation to pay a border charge is linked to the product at the moment it enters the territory of another Member.[81] It is at this moment, and this moment only, that the obligation to pay such charge accrues. It is based on the condition of the good at this moment that any contemporaneous or subsequent act by the importing country to enforce, assess or reassess, impose, or collect ordinary customs duties should be carried out.[82]

As mentioned before, Article II.2(a) requires that any border adjustment of an *equivalent* internal tax must be consistent with the provision of paragraph 2 of the GATT's Article III.[83] This seems to make the differentiation between internal charge and border charge irrelevant because compliance with Article III is still required. But internal charges have to *only* comply with Article III whereas border charges have to comply with *both* Article III.2 and Article II.2(a). This has caused scholars to consider that the WTO is less stringent with inner charges than with border charges.[84]

Further, the term "equivalent" in Article II limits the mechanics of a border adjustment tax. The Legal Drafting Committee of Article II agreed that the term "equivalent" in Article II.2 means that if a duty is imposed on an article because a duty is imposed on part of the content of this article, then the duty should only be imposed regarding the

78. Panel Report, *China–Measures Affecting Imports of Automobile Parts*, ¶ 4.100 WTO Doc. WT/DS339/R (July 18, 2008) [hereinafter China–Automobile Parts].

79. *Id.*

80. *Id.*

81. *Id.* at ¶ 4.324.

82. *Id.*

83. GATT, *supra* note 66, art. II.2(a).

84. *See* Jennifer A. Hillman, *Changing Climate for Carbon Taxes: Who's Afraid of the WTO?*, GEO. UNIV. L. CTR., July 2013, at 5.

particular content of this article.[85] For example, if a duty is imposed on perfume because it contains alcohol, the duty to be imposed must take into consideration the value of the alcohol and not the value of the perfume; that is to say, the value of the content and not the value of the whole. In theory, this limitation would not apply to an inner charge type of border adjustment.

d. Likeness

Another important issue for the imposition of border adjustment taxes is the likeness between the products that are subject to the policy. Article III.2 requires that border adjustments should not be made in excess of the tax imposed on *like* domestic products. In *Mexico–Tax Measures on Soft Drinks and Other Beverages* ("*Soft Drinks*"), the WTO's appellate body held that "like" products don't have to be identical and the dispositive factor is if the products would compete for the same market and are substitutes of each other.[86]

In *Soft Drinks*, Mexico imposed a tax on beverages sweetened with high fructose corn syrup ("HFCS") and extended the tax's application through a border adjustment tax to imported soft drinks sweetened with HFCS.[87] The tax did not apply to sugar-sweetened products either domestic or imported. At the time, most of Mexico's domestic soft drinks were sweetened with cane sugar, an industry that was in a financial crisis. Mexico argued that the tax was not discriminatory because it applied to *like* domestic products such as domestic HFCS-sweetened products but that sugar-sweetened products were not *like* products and thus the fact that sugar products were not taxed was not in violation of Article III. The WTO held that Mexico was in violation because even though HFSC-sweetened products and sugar-sweetened products are not identical, they were substitutes for each other and would compete for the same market, falling under the "like" definition of Article III.[88] So, for a BAT to be compliant with the GATT, it must be applied equally to foreign and domestic products that are substitutes of each other and that compete for the same market.

85. Englisch Part One, *supra* note 76, at 10869.

86. Panel Report, *Mexico-Tax Measures on Soft Drinks and Other Beverages*, ¶¶ 4.58, 4.8, WTO Doc. WT/DS308/R (adopted Oct. 7, 2005) [hereinafter Mexico-Beverages].

87. *Id.* ¶¶ 2.2–2.3.

88. *Id.* ¶¶ 4.18–88.

e. Border Adjustments, Direct and Indirect Taxes, and Taxes Occultes

Another important factor for the compliance of BATs under the GATT is if the tax is understood as a direct or indirect tax. Taxes can be distinguished by those levied on a product, often called indirect taxes, and taxes on producers known as direct taxes.[89] "In its examination of [border tax adjustments], the 1970 GATT Working Party indicated that [indirect taxes] . . . were eligible for border adjustment, while certain taxes that were not levied on products (i.e. direct taxes such as taxes on property or income) were normally not eligible for adjustment."[90] So, for a tax to be eligible for border adjustment, it cannot be understood as being imposed *directly* on the foreign producer of an imported good but on the product that is crossing the border.

Another relevant issue for BATs under the GATT is the physical presence of the object that causes the tax on the imported good at its time of crossing the border. Under the GATT, taxes on elements that are not physically incorporated into the final product are known as "*Taxes Occultes*."[91] The literal interpretation of the GATT Article II.2(a) has caused an extensive debate on whether energy inputs and fossil fuels used in the production of a good could be considered to be "articles from which the imported product has been manufactured or produced in whole or in part."[92] It has been suggested by some experts that the wording of Article II.2(a) may restrict their application to inputs physically incorporated into, or part of, the final product, excluding the possibility to adjust taxes on the energy of fossil fuels used during the production of goods.[93] This would limit environmental border adjustment taxes to those levied on inputs that are physically incorporated into the final product.[94]

On the other hand, the *United States–Superfund* case lends support for the possibility of implementing border adjustment taxes in compliance with the GATT to inputs that do not become part of a final product.[95] In *Superfund*, an American law that taxed the use of

89. Ludivine Tamiotti et al., *Trade and Climate Change, WTO-UNEP Report*, at 103 (2009), https://www.wto.org/english/res_e/booksp_e/trade_climate_change_e.pdf, [hereinafter WTO-UNEP Report].

90. *Id.*

91. Englisch Part One, *supra* note 76, at 10868.

92. *Id.* at 10869; GATT, *supra* note 66, art. II.2(a).

93. Hillman, *supra* note 84, at 9.

94. *Id.*

95. *See* Panel Report, *United States-Taxes on Petroleum and Certain Imported Substances*, ¶¶ 2.1–2.6, WTO Doc. L/6175-34S/136 (adopted June 17, 1987)

certain chemicals in the manufacture of petroleum derivative products–even if the chemicals were not part of the final product–was challenged for violating the GATT.[96] The dispute panel found that a US tax on substances used as inputs in the production process of certain goods imposed directly on the final products could be eligible for border adjustment.[97] It has been argued that this case confirms that under the GATT, border adjustments concerning internal taxes on certain inputs used in the production process but not physically attached to an imported product could be allowed.[98]

f. Article XX Exceptions

Even if a BAT violates the obligations established by the GATT's Articles I, II, and III, the policy may remain compliant under one of GATT's exceptions. GATT's "Article XX lays out a number of specific instances in which WTO members may be exempted from GATT rules."[99] For a justification under the GATT's Article XX to apply, a WTO Member must perform a two-tier test proving that (1) its measure falls within one of the Article XX exceptions, and (2) the measure satisfies the requirements contained in Article XX's chapeau.[100]

Article XX allows WTO members to adopt enforcement measures for different national interests.[101] Article XX's paragraph (b) states that a member may adopt measures that are "necessary to protect human, animal or plant life or health."[102] Further, paragraph (g) states that a member may adopt measures that relate "to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption."[103] Scholars have agreed that the exceptions from paragraphs (b) and (g) are the most relevant for the implementation of a carbon border adjustment mechanism.[104]

[hereinafter United States–Superfund].

96. *Id.*

97. *Id*. ¶ 5.2.7.

98. Hillman, *supra* note 84, at 9.

99. *Id.*

100. Appellate Body Report, *Brazil-Measures Affecting Imports of Retreaded Tyres*, ¶ 139, WTO Doc. WT/DS332/AB/R (adopted Dec. 3, 2007) [hereinafter Brazil-Tyres].

101. GATT, *supra* note 66, art. XX.

102. GATT, *supra* note 66, art. XX(b).

103. GATT, *supra* note 66, art. XX(g).

104. Hillman, *supra* note 84, at 9; Joachim Englisch & Tatiana Falcão, *EU Carbon Border Adjustments and WTO Law, Part Two*, 51 ENV'T L. REP. 10935, 10936 (2021) [hereinafter Englisch Part Two].

WTO jurisprudence suggests that for a measure to fit under Article XX exceptions, the policy has to 1) fall within the exception's language; and 2) the exempted measure must be necessary to fulfill the policy's objective.[105] In regards to "necessity," for a measure to be exempted through Article XX, the policy is subject to the "least trade-restrictive test."[106] This last assessment is a balancing test to determine if the measure is the least restrictive alternative.[107]

In addition to any requirement that a particular Article XX exception has, for a policy to be exempted from the GATT rules, the policy has to additionally comply with the Article's Chapeau.[108] In general terms, the Chapeau requires that the contested measure is not applied in a "manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade."[109] Both requirements have to be present for the challenged measure to be excused by one of Article XX exceptions.[110]

The Chapeau is animated by the principle that while the exceptions of Article XX may be invoked as a matter of legal right, they should not be so applied as to frustrate or defeat the legal obligations of the holder of the right under the substantive rules of the GATT's General Agreement.[111] The objective of the Chapeau is to achieve a balance between the right of a member to invoke an exception under Article XX and the duty of that same member to respect the treaty rights of the other members.[112] There are three specific standards contained in the Chapeau: 1) arbitrary discrimination between countries where the same conditions prevail; 2) unjustifiable discrimination between countries where the same conditions prevail; and 3) a disguised restriction on international trade.[113]

The WTO applies the chapeau through a two-part test: 1)

105. WTO Comm. on Trade and Env't, *Note by the Secretariat: GATT/WTO Dispute Settlement Practice Relating to GATT Article XX, Paragraphs (b), (d) and (g)*, ¶ 9, WTO Doc. WT/CTE/W/203 (adopted Mar. 8, 2002) [hereinafter GATT/WTO Dispute Settlement Practice].

106. *Id.* ¶ 36.

107. *Id.* ¶ 38.

108. *Id.* ¶ 57.

109. *Id.*

110. Englisch Part Two, *supra* note 104, at 10942.

111. Appellate Body Report, *United States–Standards for Reformulated and Conventional Gasoline*, at 22, WTO Doc. WT/DS2/AB/R (adopted Apr. 29, 1996) [hereinafter *United States–Gasoline*].

112. Appellate Body Report, *United States–Import Prohibition of Certain Shrimp and Shrimp Products*, ¶ 156, WTO Doc. WT/DS58/AB/R (adopted Oct. 12, 1998) [hereinafter *United States–Shrimp*].

113. GATT/WTO Dispute Settlement Practice, ¶ 63.

determining whether the measure would be the means for arbitrary or unjustifiable discrimination among other member countries; and 2) determining whether the challenged policy would impose a disguised restriction on international trade with respect to some products, to the detriment of others.[114] To determine whether the discrimination was arbitrary or unjustifiable, WTO's Appellate Body will look into the detailed operating provisions of the measure and how the measure is applied.[115] An unjustifiable discrimination is one that is "foreseen" and not "merely inadvertent or unavoidable."[116]

WTO's Appellate Body has identified two criteria for the unjustifiable discrimination determination. First, a serious effort by the responding Member to negotiate with other Member countries with the objective of concluding bilateral and multilateral agreements for the achievement of a certain policy goal, and second, the flexibility of the challenged measure.[117]

The WTO Appellate Body looks into the challenged Member's efforts to negotiate with other members treaties that would address the policy objective the Member intends to achieve before enforcing the challenged measure.[118] A WTO's finding of a disparate intent to negotiate (i.e., trying to negotiate with some countries without trying with other countries) supports an unjustifiable discrimination determination.[119] In *United States–Shrimp,* the Appellate Body held that the showing of intent to negotiate is limited to only an intent to enter into a treaty not the actual completion of a treaty.[120]

The WTO's Appellate Body has held that the lack of flexibility by the country imposing the restrictions in considering the different circumstances of the countries with which it trades constituted an inflexible measure.[121] In *United States–Shrimp,* the US required a certification process to avoid a shrimp importation ban.[122] The certification process established by the US was stringent and did not take into consideration the different economic or sociopolitical

114. Englisch Part Two, *supra* note 104, at 10943.

115. GATT/WTO Dispute Settlement Practice, ¶ 63 (citing *United States–Shrimp*, *supra* note 112, ¶ 160).

116. *Id.* ¶ 67.

117. *Id.* ¶ 68.

118. *Id.* ¶ 69.

119. *Id.* ¶ 70.

120. *Id.*

121. *Id.* ¶ 71.

122. *Id.* ¶ 72 (citing Appellate Body Report and Panel Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products, Recourse to Article 21.5 by Malaysia*, ¶ 46, WTO Doc. WT/DS58/AB/RW (adopted on Nov. 21, 2001) [hereinafter *US–Shrimp (Article 21.5)*].).

circumstances of US's trading partners.[123] In the WTO's eyes, this lack of flexibility meant that the US's shrimp ban constituted both an unjustifiable discrimination and an inflexible policy.[124] Further, the WTO Appellate Body found that the application of the measure required the exporting party to implement a system equal to the regulatory system implemented in the US.[125] The WTO concluded that an importing country's imposition on an exporting country for the latter to implement a system in use in the former strongly implies the violation of the unjustifiable discrimination principle in the Chapeau.[126]

Under the GATT, a measure constitutes arbitrary discrimination when the measure's application is capricious, unpredictable, or inconsistent.[127] The WTO Appellate Body held that, in a similar way as with unjustifiable discrimination, "rigidity and inflexibility may be construed as arbitrary discrimination within the meaning of the Chapeau."[128] On the other hand, processes that are too vague or opaque are also construed as arbitrary.[129]

The second part of the Chapeau test tries to deduce whether the challenged measure would be taken as a "disguised restriction to international trade."[130] The controlling issue on disguise restriction to international trade is not the restriction *per se* but the concealment of the restriction's real objective—the "disguise."[131] Hence, if a member country attempts to enforce a trade restriction that on paper should be exempted by paragraphs (b) and (g) of Article XX but that in reality has the objective of protecting domestic industry against certain exporters, such restriction violates Article XX's Chapeau and hence in violation of the GATT. Three criteria have been introduced by both the WTO Panels and its Appellate Body to determine whether a measure is a disguised restriction on international trade: "1) the publicity test; 2) the consideration of whether the application of a measure also amounts to arbitrary or unjustifiable discriminations; and 3) the examination of the 'design, architecture and revealing the structure of the measure' at issue."[132]

123. *Id.* ¶ 72 (citing *US–Shrimp (Article 21.5)*, ¶ 46).
124. *Id.*
125. *Id.* ¶ 73 (citing *US–Shrimp (Article 21.5)*, ¶ 5.46).
126. *US – Shrimp (Article 21.5)*, ¶ 144.
127. GATT/WTO Dispute Settlement Practice, *supra* note 105, ¶ 75.
128. *United States–Shrimp (Article 21.5)*, *supra* note 112, ¶ 178.
129. *See United States–Shrimp*, *supra* note 112, ¶ 119.
130. Englisch Part Two, *supra* note 104, at 10943.
131. GATT/WTO Dispute Settlement Practice, *supra* note 105, ¶ 78.
132. *Id.* ¶ 79.

The publicity test requires the enforcing party to announce the policy in a public way in accordance with the country's procedures to announce trade policies.[133] Although, the failure of a restriction to abide by this requirement on its own is not enough to consider a restriction as a disguised restriction of trade.[134] As for the second criterion—that the application of the policy amounts to arbitrary or unjustifiable discrimination—this analysis is a redo of the first prompt of the Chapeau test.[135] So a policy that fails the first part of the Chapeau test will also fail the second one.

Finally, as for the third criterion, the WTO panel or Appellate Body will try to discern from the application of the restrictive measure if it has an intent to protect domestic industry to the detriment of imports.[136] An illuminating example of the application of this last criterion may be seen in *Soft Drinks*. As mentioned above, in this case, Mexico intended to exempt a restriction on soft drinks sweetened by HFCS under paragraph (d) of Article XX (necessary to secure compliance with domestic laws or regulations) while openly accepting that the actual intent was to protect Mexican sugar cane producers from foreign competitors.[137] This "disguised" intent caused the restriction to violate Article XX's Chapeau.[138]

3. The EU and WTO

The EU, as a community, has been a WTO member since January 1, 1995.[139] Additionally, each of the EU's member states is a WTO member in its own right.[140] Thus, WTO law applies to the EU's foreign trade policies. However, the European Court of Justice has held that, even though WTO law rises to the level of an international obligation for the EU, WTO agreements do not have a direct effect on EU law—that is, WTO law cannot invalidate EU law.[141] This means that EU members or residents cannot invoke WTO law to European courts in an effort to invalidate EU law.

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133. *Id.* ¶ 80.
134. *Id.* ¶ 82.
135. *Id.* ¶ 82.
136. *Id.* ¶ 84.
137. *Mexico–Beverages*, *supra* note 86, ¶ 4.286.
138. *Id.* ¶ 4.288.
139. World Trade Organization, *The European Union and the WTO*, https://www.wto.org/english/thewto_e/countries_e/european_communities_e.htm (last visited Jan. 21, 2022).
140. *Id.*
141. John Errico, *The WTO in the EU: Unwinding the Knot*, 44 CORNELL INT'L L. J. 179, 185 (2011).

4. WTO enforcement and its current crisis

Currently, the WTO's enforcement body is unable to implement GATT law on its members. The WTO enforces the GATT through a dispute settlement body ("DSB").[142] The dispute settlement system consists of panels of three or five members.[143] When the dispute resolution body reaches a resolution, the parties in dispute can appeal such decision to WTO's Appellate Body.[144] When the Appellate Body reaches a decision this verdict is conclusive, and these decisions are known as final reports.[145] Similar to the DSBs, the Appellate Body consist of a collegiate panel. For the Appellate Body to issue its final reports it requires a quorum.[146]

Arguing concerns about the WTO's dispute settlement mechanism, both the Obama and Trump Administrations blocked the appointment of members to the WTO's Appellate Body, resulting in a lack of quorum necessary to decide appeals and issue final reports.[147] The Biden Administration has continued this approach, leaving the WTO dispute settlement process in crisis and unable to enforce the GATT.[148] This is because whenever a dispute arises and the DSB issues a resolution, a party dissatisfied with such decision may appeal it—leaving the DSB resolution as unenforceable until the Appellate Body resolves it. But because the Appellate Body does not have its required quorum to function, no final report can be issued, leaving the dispute in limbo.[149] Because of this, WTO law is currently unilaterally implemented by its members.

C. UNFCCC AND THE COMMON BUT DIFFERENTIATED RESPONSIBILITIES PRINCIPLE

The EU and its members agreed that the combat against climate change should be conducted under the Common but Differentiated Responsibilities Principle ("CBDR"). This principle entails the consideration of the capacities of developing nations in the combat of

142. Pauwelyn, *supra* note 63, at 336.
143. *Id.*
144. *Id.*
145. *Id*.
146. Nina M. Hart & BRANDON J. MURRILL, CONG. RSCH. SERV., R46852, THE WORLD TRADE ORGANIZATION'S (WTO'S) APPELLATE BODY: KEY DISPUTES AND CONTROVERSIES, Report: R46852 SUMMARY(2021).
147. *See Id.*
148. *Id.*
149. *Id.*

climate change as well as their responsibility for creating the current climate change crisis. The CBDR principle is described succinctly in Principle 7 of the Rio Declaration on Environment and Development:

> States shall cooperate in a spirit of global partnership to conserve, protect and restore the health and integrity of the Earth's ecosystem. In view of the different contributions to global environmental degradation, States have common but differentiated responsibilities. The developed countries acknowledge the responsibility that they bear in the international pursuit of sustainable development in view of the pressures their societies place on the global environment and of the technologies and financial resources they command.[150]

The basic idea behind the CBDR principle is that industrialized countries have a larger contribution to the global historical emissions of greenhouse gases ("GHG") and thus should carry a larger responsibility in the battle to curb GHG emissions.[151] Conversely, developing nations have historically had a smaller contribution to GHG emissions. Moreover, developing nations have fewer resources to combat climate change.[152]

The CBDR principle has been one of the core tenets behind international environmental law. In 1992, the United Nations Framework Convention on Climate Change ("UNFCCC") was agreed upon by 197 countries.[153] The UNFCCC is the first multilateral agreement that sets out basic principles, institutions, and procedures for reporting GHG emissions between member states.[154] The '92 UNFCCC incorporated the CBDR principle in its Article 3:

> "The Parties should protect the climate system for the benefit of present and future generation of humankind, on the basis of equity and in accordance with their common but

150. U.N. Conference on Environment and Development, *Rio Declaration on Environment and Development*, U.N. Doc. A/CONF.151/26/Rev.1 (Vol. I), annex I (Aug. 12, 1992) [hereinafter Rio Declaration].

151. Paul G. Harris, *Common but Differentiated Responsibility: The Kyoto Protocol and United States Policy*, 7 N.Y.U. ENV'T L. J. 27, 28 (1999).

152. *Id.*

153. *About the* Secretariat, United Nations Framework Convention on Climate Change (UNFCCC), https://unfccc.int/about-us/about-the-secretariat (last visited Jan. 28, 2022).

154. Jacob Werksman, *Remarks on the International Legal Character of the Paris Agreement*, 34 MD. J. INT'L L. 343, 346 (2019).

> differentiated responsibilities and respective capacities . . . [D]eveloped country Parties should take the lead in combating climate change and the adverse effect thereof."[155]

The UNFCCC created the Conference of the Parties, commonly known as the COP, which serves as the governing body of the UNFCCC.[156]

Later in 1997, the Kyoto Protocol was adopted.[157] In contrast to the UNFCCC, the Kyoto Protocol contains legally binding emissions cuts with target deadlines between 2008 and 2012, and a compliance system authorized to impose binding sanctions.[158] These substantive obligations only apply to industrialized countries that agreed to such constraints—primarily the EU and its members.[159] As a result of the Kyoto Protocol, the EU accepted a reduction of 8% of its GHG emissions.[160] Along the same line as the UNFCCC, Article 10 of the Kyoto Protocol adopts the CBDR principle stating that all parties are responsible for pursuing the treaty's objectives, but this responsibility is differentiated among countries depending both on their culpability on the current global GHG emissions circumstances and their respective capabilities.[161]

Eighteen years after the Kyoto Protocol, at COP 21, the Paris Agreement was adopted by 196 signatory countries.[162] The Paris Agreement aims to hold the global average temperature rise to below 2 degrees Celsius and to pursue efforts to limit this rise to 1.5 degrees Celsius.[163] Further, the Agreement calls for continued financial and technical support to poor and vulnerable countries, both to cut their emissions, as well as to prepare for the impacts of climate change.[164] The EU and its Member States are among the countries that adopted and ratified the Paris Agreement.[165]

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155. United Nations Framework Convention on Climate Change art. 3, May 9, 1992. 1771 U.N.T.S. 107 [hereinafter UNFCCC].

156. *See* Werksman, *supra* note 155154.

157. *What is the Kyoto Protocol?*, UNFCCC , https://unfccc.int/kyoto_protocol (last visited Jan. 28, 2022).

158. *See* Werksman, *supra* note 154 at 347.

159. *See id.* at 346–47.

160. Laurent L. Viguier et al., *The Costs of the Kyoto Protocol in the European Union*, 32 ENERGY POL'Y 459, 459 (2003).

161. Kyoto Protocol to the United Nations Framework Convention on Climate Change art. 10, Nov. 12, 1997, 2303 U.N.T.S. 162 [hereinafter Kyoto Protocol].

162. *The Paris Agreement*, UNFCCC, https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement (last visited Jan. 28, 2022).

163. *See* Werksman, *supra* note 154, at 345.

164. *Id.* at 346.

165. *Paris Agreement*, EUR. COMM'N, https://ec.europa.eu/clima/eu-

In concert with the UNFCCC and the Kyoto Protocol, the Paris Agreement incorporates the CBDR principle. Article 2 paragraph 2 of the Paris Agreement states: "This Agreement will be implemented to reflect equity and the principle of common but differentiated responsibilities and respective capabilities, in the light of different national circumstances."[166] Similar to the UNFCCC and the Kyoto Protocol, the Paris agreement is legally binding for its signatories, *but* there is no enforcement body to impose penalties for violations.[167] The enforcement of the Paris Agreement depends on the goodwill and moral responsibility of its signatories.

The EU and its members, being Parties to the UNFCCC, Kyoto Protocol, and Paris Agreement, have accepted the responsibility under international law, as developed nations, to significantly contribute to the reduction of global emissions. More importantly, the EU and its members agreed to carry out their combat against climate change in compliance with the CBDR principle, respecting the capacities of developing nations, accepting their responsibility for the current environmental crisis, and under the Paris Agreement, agreeing to support these nation's efforts to curb emissions.

III. ANALYSIS

The GATT imposes obligations on its member countries. Among these obligations, members have the obligation to not discriminate through tariffs or similar charges between GATT members and to treat exporting manufacturers in the same way the importing country treats its industry of like products. The EU and its members are parties to the GATT. Because a CBAM is to be applied to imports, it must comply with the GATT obligations. Because of WTO's crisis, although the finding of a violation would not result in the invalidation of the CBAM legislation, it could give rise to retaliation by other WTO members with the imposition of tariffs, giving rise to a trade war. Further, the CBAM may be in violation of the "common but differentiated responsibilities and respective capabilities" principle agreed to by the EU under the UNFCCC. The compliance of the CBAM with both WTO and UNFCCC law may depend on the EU's willingness to recognize foreign countries' policies to curb emissions and the EU's

action/international-action-climate-change/climate-negotiations/paris-agreement_en, (last visited on Jan. 28, 2022).

166. Paris Agreement art. 2, Dec. 12, 2015, Registration Number 54113 [hereinafter Paris Agreement].

167. Noah M. Sachs, *The Paris Agreement in the 2020s: Breakdown or Breakup*, 46 ECOLOGY L.Q. 865, 872–73 (2019).

involvement in supporting developing nations' efforts to combat climate change.

A. THE CBAM AND THE EU'S GATT OBLIGATIONS

1. Article II or Article III, is the CBAM an Inside Charge or a Border Charge?

To determine if the CBAM complies with WTO rules, it is necessary to first understand the nature of the CBAM and determine what type of charge it is, then define what rules apply to that type of charge, and finally determine if the CBAM complies with those rules. Even though the CBAM mirrors the ETS, it is not part of the ETS.[168] The CBAM is a different policy designed to address carbon emissions outside of Europe.[169] The CBAM is designed to compensate for the fact that foreign production processes are not included in the EU ETS and have not been subjected to equivalent charges outside the EU.[170] Thus, the triggering event is the importation of the taxed goods, not any inner event that accrues after the importation of the goods. It is upon the import that EU customs authorities would determine, based on the product's production process emissions, the tax owed through the carbon allowances.[171] These facts make the CBAM more akin to a border charge than an inner charge and thus, subject to Article II.2's obligations.[172]

Under Article II.2, the CBAM must be implemented equally to like products. An issue here is that there are products that under GATT are "like" products but are produced by different methods with different emissions. Examples of like products are aluminum and low-carbon aluminum.[173] These two types of aluminum are substitutes for each other and are likely to compete for the same market. However, the manufacturing process of low-carbon aluminum generates far fewer carbon emissions than regular aluminum. Under the CBAM, the low carbon aluminum would receive preferential treatment as compared to regular aluminum, and since they are like products, it would be construed as illegal discrimination against regular aluminum.

As for the requirements that foreign products be treated equally

168. *See* CBAM Q&A, *supra* note 9.
169. *Id.*
170. *See generally* CBAM Proposal, *supra* note 8, at 50.
171. *See* CBAM Q&A, *supra* note 9.
172. *See* Englisch Part One, *supra* note 76, at 10865.
173. Hillman, *supra* note 84, at 8.

to domestic products, the current structure of the ETS—which grants European manufacturers a limited number of free allowances of carbon certificates—presents an issue. As mentioned above, these free allowances are designed to counter the effect of imported products that were not subject to carbon regulations as stringent as European regulations (the issue the CBAM is aimed to resolve). The free allowances could be grounds to consider that domestic producers are being treated differently as compared to foreign producers because the allowances would reduce the carbon tax paid by domestic producers. The EU Commission has said that the free allowances will be phased out during the CBAM's implementation process and by the point that the CBAM will begin to be levied the allowances would be completely out. The mechanics of phasing out the free allowances are elemental to determine if the CBAM complies with the non-discrimination of foreign products policy of the GATT.

a. The CBAM, a Direct or Indirect Tax?

As mentioned in the background, there is a presumption that BATs are only allowed under the GATT if they are executed against products and not to producers. Thus, the CBAM needs to be construed as an indirect tax levied directly on the imported products and not on the product's manufacturers to comply with the GATT law.

The issue here is the process by which the product's emissions would be calculated. Against interpreting the CBAM as an indirect tax, it may be argued that the tax is applied to producers and not their products because the tax is based on the producers' emissions while manufacturing the good not on the actual emissions that the production of a specific good caused. To avoid this issue, the CBAM states that it, at least initially, is to be applied to the product's actual process and not to the plant's emissions or energy consumption. Because of this, at least on paper, the CBAM may be considered an indirect tax eligible for border adjustment under the GATT.

b. Taxes Occultes.

As mentioned above, the CBAM would likely fall within Article II.2. This Article allows BTAs on "article[s] from which the imported product has been manufactured or produced in whole or in part."[174] The issue here is that a tax on carbon emissions is a tax on a discharge of the production process and not on something physically attached

174. GATT art. II.2(a).

to the product.

The problem for the CBAM is that it is not clear that emissions would equal inputs. In *Superfund*, one of the only WTO cases where a policy similar to the CBAM was challenged, the particular issue of the physical presence of the forbidden chemicals in the imported product was not examined by the GATT panel. Even if a border adjustment can be used against an input not physically present in the imported good, it is hard to argue that carbon emissions are inputs used to manufacture a good and not only a consequence of a manufacturing process. Hence, it remains to be decided if border adjustments are available under the GATT for elements that both are not physically present at the final product being imported *and* are only a consequence of the product's manufacturing process.

2. Article XX Exceptions

As seen above, it is not entirely clear that the CBAM complies with the GATT's Articles I, II, and III. This does not mean that the CBAM, as presented in the EU's Proposal, is incompatible with the GATT. The CBAM could be exempted from the GATT's main obligations if it fits within Article XX's exceptions and Chapeau. The likely exceptions that may apply to the CBAM are exceptions (b) and (g).

a. CBAM and Article XX(b)

Article XX(b) refers to measures "*necessary* to protect human, animal or plant life or health."[175] The objectives of the policies for which the provision was implemented have to fall within the range of policies designed to protect human, animal or plant life or health.[176] According to WTO Jurisprudence, the term "necessary" is not equal to indispensable.[177] Further, the policy's contribution to the attainment of the objective does not need to be immediately observable.[178] For WTO's appellate body, the term "necessary" refers to a continuum of degrees of necessity, with one end being indispensable and at the other end as "making a contribution to."[179]

United States–Gasoline lends support to the argument that the CBAM is sufficiently linked to Article XX(b) intended policy results. In

175. GATT art. XX(b).
176. United States–Gasoline, *supra* note 111, at 16.
177. Brazil–Tyres, *supra* note 100, ¶ 141.
178. *Id.*
179. *Id.*

United States–Gasoline, WTO members challenged U.S.' American Clean Act which set standards for imported gasoline quality intended to reduce air pollution caused by motor vehicle emissions.[180] The Panel agreed with the U.S. that air pollution caused by vehicle emissions presents health risks to humans, animals, and plants meaning that policies aimed at reducing emissions are considered by the WTO as apt to fulfill the policy goals supported by the GATT's Article XX(b).[181] Further, there is scientific consensus about the health benefits of curbing carbon emissions and the risks that GHG contribute to human life.[182] It is likely that an argument that the CBAM is within the "necessity" continuum of Article XX(b) would be persuasive for the WTO.

Further, the *Brazil–Tyres* decision is enlightening in regards to the "least trade-restrictive test." In *Brazil–Tyres*, Brazil implemented a retreated tires importation ban.[183] Brazil contended that retreated tires were a relevant source of pollution and were particularly hard to dispose of them.[184] The EU challenged Brazil's ban necessity by proposing several alternatives to the ban.[185] Among the alternatives, the EU proposed landfilling, stockpiling, co-incineration of waste tires, and material recycling techniques that could be effective at combating the pollution that results from the importation of the retreated tires.[186] The Panel held that these measures, while effective, were remedial in nature of the pollution issue. In contrast, Brazil's ban was a non-generation measure that strived for a different effect than that of remedial solutions.[187]

Similarly, the CBAM Proposal may be challenged with remedial alternatives, but the EU could argue that the policy's objective is not a remedy to carbon pollution but a net reduction of such emissions. Additionally, as noted before, the CBAM was not the only alternative that the EU considered as an option, a carbon tariff was also contemplated but these alternatives were deemed more restrictive on trade than the CBAM.[188] On the issue of "alternatives", the greatest risk of the CBAM will depend on the policy's mechanics to measure the carbon emissions of exporters and the EU's recognition of foreign

180. United States–Gasoline, *supra* note 111, at 2, 4–5.
181. *Id.* at 16.
182. *See* Anthony J. McMichael, Rosalie E. Woodruff & Simon Hales, *Climate Change and Human Health: Present and Future Risks*, 367 LANCET 859 (2006).
183. Brazil–Tyres, *supra* note 100, ¶ 6.
184. *Id.*
185. *Id.* ¶ 211.
186. *Id.*
187. *Id.*
188. *See* CBAM Proposal, *supra* note 8, at 8–11.

environmental policies. Complaining members may argue for different mechanics to solve this issue, in a less trade-restrictive way, that still may reach the same objectives as the CBAM.

b. CBAM and Article XX(g)

The exception in paragraph (g) of Article XX relates to measures that: "rela[te] to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption."[189] In *United States–Shrimp* the WTO's Appellate Body broke the XX(g) relation test into three parts: 1) if the resource protected by the policy is an exhaustible natural resource; 2) if the policy relates to the conservation of such resources; and 3) if the "measures are made effective in conjunction with restrictions on domestic production or consumption."[190]

In *Shrimp*, the Panel held that, under the GATT, "exhaustible natural resources" must be read in "the light of contemporary concerns of the community of nations about the protection and conservation of the environment."[191] According to the Panel, "the generic term 'natural resources' in Article XX(g) is not 'static' in its content or reference but is rather 'by definition, evolutionary'", so the meaning is not tied to what the framers of the GATT originally intended.[192] Currently, the definition of natural resources under the GATT conforms with modern international conventions and declarations that hold natural resources as embracing both living and non-living resources.[193] Further, in *United State–Gasoline*, the Panel explicitly agreed with the US' argument that clean air could be considered an exhaustible natural resource.[194] Thus, for the CBAM, a resource such as the environment, clean air, or the protection of human and animal life will fall within the GATT's definition of natural resource affording Article XX(g) protection to the CBAM.

Article XX(g) requires the measure to be justified as one that "relates to" the conservation of exhaustible natural resources. In *United States–Shrimp*, the Panel held that to comply with the "relates to" requirement, the means (the measure) must, "in principle, [be] reasonably related to the ends" ("the legitimate policy of conserving

189. GATT art. XX(g).
190. *United States–Shrimp*, *supra* note 105, ¶¶ 126–43.
191. *Id.* ¶ 129.
192. *Id.* ¶ 130.
193. *See id.* ¶ 131.
194. United States–Gasoline, *supra* note 111, at 8.

an exhaustible" resource).[195] For the *United States–Shrimp* Panel, the contested measure does not have to be necessary or essential for the conservation of an exhaustible natural resource. It merely needs to be "primarily aimed at" its conservation.[196] This means that the measure should have a "substantial relationship" with the conservation of an exhaustible natural resource and not merely be "incidentally or inadvertently aimed at" this objective.[197]

WTO's DSB has complemented the "primarily aimed at" interpretation by introducing additional elements to be considered when determining whether a measure was related to the conservation of exhaustible natural resources. In *United States–Tuna (Mexico)*, the Panel found that for a measure to be primarily aimed at the Article XX(g) objectives, the measure cannot be based on "unpredictable conditions."[198] In *United States–Tuna (EEC)*, the Panel concluded that "measures taken so as to force other countries to change their policies, and that were effective only if such changes occurred, could not be primarily aimed at either the conservation of an exhaustible natural resource, or at rendering effective restrictions on domestic production or consumption, in the meaning of Article XX(g)."[199]

Applying these principles to the CBAM, it is easy to see how this measure relates to the conservation of the environment in general. The CBAM's objective is to reduce carbon emissions. The CBAM would have a harder time complying with Article XX(g) on the "primarily aimed at" elements considered by the WTO. First, because the mechanics to calculate the carbon emission of foreign producers are still vague and set emission values may not be available for every exporter, the WTO may consider that the proposed CBAM contains "unpredictable conditions." Second, the WTO may construe the CBAM as forcing the EU's trading partners to change their environmental policies—especially if the EU's application of the CBAM fails to recognize the carbon reduction policies of non-European countries. Nevertheless, the EU may argue that the CBAM is mostly aimed at European importers, the exporters are only considered as a baseline to calculate the use of carbon allowances, and changes in foreign legislation are not the main objective of the CBAM but an incidental result.

195. United States–Shrimp, *supra* note 112, ¶¶ 141–42.
196. GATT/WTO Dispute Settlement Practice, *supra* note 105, ¶ 44.
197. *Id.* ¶ 50.
198. *Id.* ¶ 46.
199. *Id.* ¶ 47.

c. CBAM and Article XX's Chapeau

For the CBAM to comply with Article XX's Chapeau, it must pass WTO's two-part test. As mentioned in the background, this test has the objective of determining whether a trade policy is a means for arbitrary or unjustifiable discrimination and if the policy would impose a disguised restriction to international trade by protecting European industry to the detriment of the non-European industry.

First, it must be determined if the CBAM could be considered unjustifiable discrimination. To do so we must evaluate if the EU has conducted serious efforts to negotiate with non-European nations to reach its objective of reducing carbon emissions. Additionally, we need to evaluate the flexibility of the CBAM's implementation.

In the case of the CBAM, the EU could argue that by entering into the Kyoto Protocol and the Paris Agreement, the EU has successfully negotiated treaties to curb carbon emissions. Further, the EU could contend that such treaties have proven insufficient to avoid the carbon leakage issue and hence, has decided to implement the CBAM. Nonetheless, challenging members could point out that although the treaties negotiated by the EU concern emission reductions, the issue that third countries have with the CBAM is not its objective but how the policy is being implemented. Specifically, the issues of accounting for carbon emission reduction efforts in non-European countries and the methodology of calculating emissions in these countries are of concern. The challenging members could argue that no treaty regarding these specific issues has been proposed. Because the effort to negotiate requirements is limited to an intent to diplomatically achieve the objectives of the challenged policy, it is likely that the EU's leadership in the negotiation and creation of international environmental law would prove that the EU complies with this requirement.

WTO law considers an inflexible measure as one that unjustifiably discriminates. To avoid this issue, the CBAM must be flexible in its implementation. This means that the CBAM has to consider the different circumstances of its different trading partners when applying the CBAM and avoid a one-size-fits-all approach.

In the case of the CBAM, as for arbitrary discrimination, the issue is again with the specific implementation of the CBAM. The EU has to strike a balance between treating countries with varying conditions differently and treating countries with the same conditions in an equal way. As the CBAM's implementation process hasn't started, the EU should attempt to enter treaty negotiations with different countries through bilateral or multilateral agreements. These agreements could

address the implementation of the CBAM to adapt its functionality to the particular circumstances of the EU's different trading partners; in particular with regards to common methods to account for carbon emissions at the exporters' manufacturing centers and the different approaches to regulate and price carbon.

Applying the three disguised restrictions to international trade criteria to the CBAM, it is not clear if this policy passes the "disguised" restrictions test. The publication of the CBAM, videos explaining its functionality, Q&A documents, and other resources have been broadly publicized by the EU's Council in multiple channels in numerous languages, making it compliant with the publicity requirement. But the evaluation of the criteria regarding the arbitrary or unjustifiable discrimination and the protective nature of the design, architecture, and structure of the CBAM is debatable.

The CBAM could be considered arbitrary or discriminatory by some countries because of its mechanics and its inherent discrimination against the economic capacity of Europe's different trading partners. Additionally, there are no clear efforts from the EU to negotiate alternative measures to reach its carbon reduction policy. Further, the CBAM's Proposal explicitly states that one of its specific objectives is "ensuring that domestic production and imports are subject to [a] similar level of carbon pricing."[200] This objective could be interpreted as a measure intended to protect the EU's domestic industry. As seen above, a solution to these issues could come in the form of agreements between the EU and its trading partners that consider the exporting country's efforts to combat carbon and its "carbon pricing." Additionally, the solution could grant some sort of support in the form of technology transfer, resources, and capacitation for the least capable partners to level the application of the CBAM and make its impacts more flexible to each partner. Although, because of the current crisis in the WTO's dispute resolution body, a short-term challenge thorough the WTO of the CBAM is unlikely.[201] Nevertheless, it is important to consider that even though enforcement through the WTO may not happen, a blatant disregard of WTO law could cause a trade war—particularly between the EU and exporting nations such as China, India, and Brazil, which have already voiced disapproval of the CBAM Proposal.[202]

200. CBAM Proposal, *supra* note 8, at 47.

201. *See* Hart & Murrill, *supra* note 146.

202. *See* Muyu Xu & David Stanway, *China Says EU's Planned Carbon Border Tax Violates Trade Principles*, REUTERS, (July 26, 2021, 12:02 AM), https://www.reuters.com/business/sustainable-business/china-says-ecs-carbon-border-tax-is-expanding-climate-issues-trade-2021-07-26/; Vishwa Mohan, *BASIC*

B. THE CBAM AND THE EU'S OBLIGATIONS UNDER THE UNFCCC

To comply with the EU's international environmental obligations, the CBAM must be applied in line with this CBDR commitment and "not pre-empt climate targets that third countries are free to set for themselves."[203] EU members have acknowledged that "taking account of third country climate policies, in particular their carbon pricing, and their levels of development will be key within the multilateral climate framework of the Paris Agreement."[204] Though, it is important to note that the international obligations created by the UNFCCC and its progeny are not enforceable through penalties or other types of remedies. The EU cannot be fined or otherwise punished for having a CBAM that is not compliant with the CBDR principle. But, even if no penalty can be imposed against the EU at the international level, the EU's moral leadership in combatting climate change would be badly hurt if the EU ignores its international environmental obligations and implements a CBAM that does not respect the CBDR principle. Additionally, unilateral action by the EU may end up hurting the international cooperation that combatting climate change requires.

After analyzing both WTO law and the CBDR principle, it is clear that there is great commonality between the obligations these two impose on the EU. Thus, it may be argued that implementation of a CBAM in compliance with CBDR guidelines would also comply with GATT Article XX's Chapeau. The flexible application of the CBAM in consideration of each trading partner's circumstance ensures that the policy is not arbitrary. The entry into negotiations and treaties will support the EU against an unjustified discrimination accusation. Further, avoiding turning the CBAM into a policy that requires third countries to adopt EU tailored environmental policies will help ensure that the CBAM is exempted under the GATT and is not seen as a policy that effectively passes the expenses of combating climate change to developing nations. Additionally, if the EU successfully negotiates agreements with developing nations that ensure technology transfers that further these nation's emissions reduction efforts, the EU would be both in compliance with its obligations under the Paris Agreement and would make it harder for WTO members to challenge the CBAM under the pretense that its application is arbitrary. Thus, the EU, by allowing broad participation of its trading partners and supporting

Nations Oppose EU's Plan to Impose a 'Carbon Border Tax', TIMES INDIA, (Apr. 10, 2021, 4:57 AM), https://timesofindia.indiatimes.com/india/basic-nations-oppose-eus-plan-to-impose-a-carbon-border-tax/articleshow/81998314.cms.

203. French Economic Ministry CBAM, *supra* note 13, at 10.

204. *Id.*

developing nations' efforts to curb emissions, may ensure that the CBAM does not start a trade war and would further the EU's effort to combat climate change.

IV. CONCLUSION

As the CBAM Proposal declares, global warming is an existential threat against humankind. Efforts to combat global warming must be conducted by the international community in concert. This requires cooperation amongst nations. Because of the difference in regulations and resources among countries and regions around the world, different efforts will be taken. Efforts to curb emissions like the EU's cap and trade ETS system show potential to combat climate change, but because of the globalized economy that the WTO fostered, these efforts are hampered by carbon leakage in the form of the migration of industry from where emitting carbon is expensive to where it is not. Carbon leakage results in global emissions remaining the same while industries, like Europe's, will face somewhat unfair competition against nations with lenient environmental policies. A CBAM, which extends the ETS system to imports, may prove to be an effective tool to level the competition between EU industry and non-EU industry, reduce global emissions, and foster the adoption of environmental policies in exporting nations. The problem is that a CBAM may be construed both as a violation of the WTO trade principles, causing a trade war because of the current crisis in the WTO's dispute resolution body, and unilateral action that passes the cost of combating climate change to developing nations, hampering the cooperation that combatting global warming requires.

But these unwanted consequences are avoidable. The CBAM Proposal was elaborated with WTO compliance in mind. The CBAM may be excused by the GATT's Article XX exceptions as a policy that advances the protection of humankind and the environment. But the devil is in the details. The actual implementation of the CBAM must be done by taking into consideration the efforts of non-European countries to curb emissions and their impact on carbon pricing. Further, the CBAM should eliminate any anti-carbon leakage concessions made to EU industry, like the free ETS allowances, to ensure fair trade. Finally, the EU should negotiate agreements with developing nations that produce know-how, technology transfers, and similar means of support to help these nations achieve sustainable emission reductions while keeping the EU in compliance with its CBDR obligations.