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Free Trade in the Age of Climate Change

The EU Carbon Border Adjustment Mechanism from an EU and WTO Legal Perspective

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Contents

Abstract

This thesis addresses the European Union (EU) *Carbon Border Adjustment Mechanism* (CBAM) by analysing whether recourse to Article 192(1) of the *Treaty on the Functioning of the European Union* (TFEU) is a sufficient legal basis for the instrument, as well as how the mechanism relates to Articles I, II, III, and XX of the *General Agreement on Tariffs and Trade* (GATT) in terms of possibilities for compliance. The purpose is to position the CBAM in the context of EU and World Trade Organization (WTO) law and to examine the nature of the CBAM in the light of criticisms of discrimination and protectionism that has been levelled against the EU in the context of the implementation of the instrument.

The analysis is carried out by reviewing the Treaty and Agreement Articles, discussing relevant rulings and reports by the Court of Justice of the European Union and the WTO Appellate Body, as well as referencing doctrine.

Based on an initial discussion, it appears that, in addition to 192(1), Articles 114 and 207 of the TFEU might be relevant for the CBAM in terms of the appropriate legal basis. The analysis indicates that while recourse to Article 207 would be difficult to justify, it is less clear that it would not be appropriate to use Article 114 in addition to 192(1). In terms of the GATT Articles, the analysis shows that there are several ambiguities and unclarities resulting from a lack of definition within a WTO context as well as the fact that the relation of the CBAM to the GATT largely depends on how the instrument will be implemented. If nothing else, the findings demonstrate that the relationship between trade and environmental measures is perhaps more relevant than ever.

Keywords: CBAM, TFEU, legal basis, GATT, border adjustment, non-discrimination, Article XX

Abbreviations

CBAM	Carbon Border Adjustment Mechanism
CCP	European Union Common Commercial Policy
CJEU	Court of Justice of the European Union
DSU	Dispute Settlement Understanding
EC	European Community
EEC	European Economic Community
ETS	Emissions Trading System
EU	European Union
GATT	General Agreement on Tariffs and Trade
MFN	Most-Favoured-Nation principle
NT	National Treatment principle
OSA	Open Strategic Autonomy
SCM	Agreement on Subsidies and Countervailing Measures
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
UN	United Nations
WTO	World Trade Organization

1 Introduction

1.1 Background – A New Policy Direction for the EU

The world that the European Union (EU) embodies and traditionally advocates is not self-evident. The growing importance of China, political developments in the United States, Brexit, increased authoritarianism and de-globalisation, the pandemic, Russia's invasion of Ukraine, and the impending climate crisis constitute a new geopolitical and geoeconomic reality to which the EU must adapt and position itself.[1] Ursula von der Leyen described her Commission as "geopolitical"[2] and developments in recent years have indicated such a direction: The ability of the EU to act and manage autonomously is not a new discussion. Nevertheless, the idea was not institutionalised until 2013 when "Strategic Autonomy" was mentioned for the first time in official EU documents.[3] Since 2016, the term has been used on a regular basis.[4] However, the protectionist connotation of the term was not uncontroversial, and Member States with interests in a different direction expressed the importance of ensuring the ability of the EU to act in its own interest while remaining a global player, promoting positive interdependence, and maintaining an open economy.[5] The result was the addition of "open" to the term, and the EU's February 2021 *Trade Policy Review* thus emphasises the importance of an "Open Strategic Autonomy" (OSA). The Review describes the term as a "policy choice" and "mind-set for decision makers".[6] Externally, OSA has been described as "economic statecraft", whereby economic and regulatory means are utilised for foreign policy.[7] OSA is thus a comprehensive policy approach comprising various legal instruments that strengthen the toolbox of the EU by linking different policy areas, from trade and economic stability, security and defence, to environmental and ethical considerations.[8]

A concrete manifestation of this approach and linking of policy areas is the *European Green Deal*. Through the Green Deal, the EU has the ambition of creating the first

[1] While a couple of years old, the following article offers a comprehensive review of the EU's position in this new reality: Isabelle Ioannides "What European Union in the "Age of Uncertainty"? Weathering the Geopolitical Storms in a World of Perpetual Crises" (2022) Vol. 57(6) *Intereconomics: Review of European Economic Policy* <www.intereconomics.eu/contents/year/2022/number/6/article/what-european-union-in-the-age-of-uncertainty-weathering-the-geopolitical-storms-in-a-world-of-perpetual-crises.html> accessed 21 May 2024

[2] Ursula von der Leyen "This is the geopolitical Commission that I have in mind, and that Europe urgently needs" in "Speech by President-elect von der Leyen in the European Parliament Plenary on the occasion of the presentation of her College of Commissioners and their programme" (SPEECH/19/6408) 27 November 2019 < https://ec.europa.eu/commission/presscorner/detail/en/speech_19_6408> accessed 12 April 2024.

[3] Mario Damen "EU strategic autonomy 2013-2023: From concept to capacity" (8 July 2022) European Parliamentary Research Service Briefing PE 733.589, p. 2.

[4] Ibid.

[5] "Spain-Netherlands non-paper on strategic autonomy while preserving an open economy" (25 March 2021)

[6] Commission, "Communication from the Commission to the European Parliament, the Council, The European Economic and Social Committee and the Committee of the Regions: Trade Policy Review - An Open, Sustainable and Assertive Trade Policy" (Communication) COM/2021/66 final, p. 4.

[7] Erika Szyszczak "Open Strategic Autonomy as EU Trade Policy" (2023) UK Trade Policy Observatory Briefing Paper 23 ISBN 978-1-912044-46-7, p. 1.

[8] Ibid pp. 2-3, 5.

climate-neutral continent by 2050.[9] While climate change lies at the heart of the Green Deal, the green transition is also considered closely related to pandemic-recovery, a resilient economic growth, increased European competitiveness, and decoupling from dependencies that might have negative security consequences, such as the energy relationship with Russia.[10] Environmental protection is also recognised as an important value for the EU, which it wishes to promote by, for example, including it in trade agreements.[11] At the same time, the EU sees itself as and aspires to be an international leader in climate action, and as such wants to set an example.[12] In addition, the policy area lends itself well to a "benevolent and value-driven world power", and legislating and taking the lead on environmental action can therefore be seen as a way for the EU to exercise power.[13] On this basis, it can thus be deduced that the Green Deal is about more than the need to address climate change and other environmental threats, it is about the political, economic, and security needs of a new reality and about ensuring an EU with independent capabilities.

Thus, the introduction of OSA and the implementation of the Green Deal as a climate and environmental policy with ties to other policy considerations, indicate a new direction in the EU's approach to external relations, whereby utilising its market power and transitioning to a green economy is considered intrinsically linked with creating political and economic security.[14] However, the nature of some of the instruments constituting this new direction has led to criticism being levelled at the EU for being protectionist and discriminatory.[15] Questions have been raised about the compatibility of some of these new measures with both EU primary law and international agreements to which the EU is a party, and about potential areas of conflict with EU and WTO law concerning primarily the risk of the undermining of open markets, multilateral cooperation, and the EU's obligations under international law.[16]

One of the recently introduced instruments under this new policy approach is the *Carbon Border Adjustment Mechanism* (CBAM). Through the CBAM, emissions related to the production of certain goods imported into the EU must be compensated through the purchase and surrendering of certificates to the Union.[17] The stated

[9] European Commission "The European Green Deal" <https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/story-von-der-leyen-commission/european-green-deal_en> accessed 15 April 2024.

[10] Ibid.

[11] European Council/Council of the European Union "Promoting EU values through trade" <www.consilium.europa.eu/en/policies/trade-policy/promoting-eu-values/> accessed 13 May 2024.

[12] European Council/Council of the European Union "Taking the lead on climate change", <www.consilium.europa.eu/en/eu-climate-change/> accessed 13 May 2024.

[13] Anu Bradford *The Brussels Effect: How the European Union Rules the World* (New York: Oxford University Press 2019) p. 210.

[14] For a comprehensive but clear overview of OSA and the various legal instruments that fall under OSA, Szyszczak, 2023 (n. 7) is recommended.

[15] Alice Hancock "EU's trading partners accuse bloc of protectionism over carbon tax plan" *Financial Times* (London, 17 December 2022) <https://www.ft.com/content/67c1ea12-7495-43ff-9718-7189cef48fd6> accessed 10 April 2024.

[16] Armin Steinbach "The EU's Turn to 'Strategic Autonomy': Leeway for Policy Action and Points of Conflict" (2023) Vol. 34(4) *The European Journal of International Law* 973, Gesa Kübek and Isabella Mancini "EU Trade Policy between Constitutional Openness and Strategic Autonomy" (2023) Vol. 19(3) *European Constitutional Law Review* 518, and "The European Green Deal, covering a number of trade initiatives, was mentioned in many interventions" in "Concluding remarks by the Chairperson" on the Trade Policy Review: European Union (Formerly EC) 5 and 7 June 2023 <https://www.wto.org/english/tratop_e/tpr_e/tp542_crc_e.htm> accessed 15 April 2024.

[17] Regulation (EU) 2023/956 of the European Parliament and of the Council of 10 May 2023 establishing a carbon border adjustment mechanism [2023] OJ L 130/52.

purpose is to address carbon leakage, whereby production is located in jurisdictions with less stringent environmental rules, and to incentivise greener production globally.[18] However, by addressing climate change through a measure that affects both external trade and the internal market,[19] the CBAM provides an interesting nexus where the question of the legal compatibility and context of the EU's new policy direction is made visible.

1.2 Purpose and Research Questions

The purpose of this thesis is to position the CBAM in an EU and WTO legal context. In light of the criticisms and questions that have been raised about the instrument and the EU's approach to OSA, the research questions are formulated to provide perspective on the nature of the CBAM as a policy tool. The questions are as follows:

Is Article 192(1) TFEU a sufficient legal basis for the Carbon Border Adjustment Mechanism?

How does the Carbon Border Adjustment Mechanism relate to Articles I, II, III, and XX of the General Agreement on Tariffs and Trade in terms of possible compliance?

1.3 Delimitations

In order to place the EU CBAM in the context of EU and WTO law, it is necessary to delimit the content and the legal aspects addressed. Both the EU and the WTO legal perspectives examined in the thesis are essentially linked to the criticism levelled at the CBAM in terms of what kind of instrument the CBAM is. While the EU emphasises that the CBAM is a "purely climate-oriented, environmental policy tool" which will be "applied in a non-discriminatory and even-handed manner in compliance with our international obligations",[20] the EU has been, as stated above, accused of protectionism and discrimination in relation to the adoption of the CBAM. The part of this thesis that is concerned with EU law therefore focuses on how the CBAM can be thematically placed in an EU legal context by examining the legal basis utilised. It also briefly touches on how EU primary law relates to issues arising from instruments under OSA, namely open markets, multilateralism, and the obligations of the EU under international law. The latter three aspects could certainly be developed much further than what is done in this thesis, but the aim is, as mentioned, primarily to place the CBAM in the context of EU law and to clarify how the criticisms levelled at the instrument can be understood with reference to the Treaties.

The discussion of compliance with WTO law is limited to the relationship between the CBAM and Articles I, II, III, and XX of the *General Agreement on Tariffs and Trade* (GATT). With regard to the first three Articles, this choice is partly because

[18] Ibid, art 1.

[19] Ibid.

[20] Committee on Market Access, "Minutes of the Committee on Market Access 26 and 27 April 2023" (Minutes) G/MA/M/78, para 21.75.

they are central to the fundamental principle of non-discrimination in the WTO framework, and partly because a study of relevant doctrine generally identifies these three as important for analysing border adjustment in relation to WTO law.[21] The reason for analysing Article XX is that it deals with when measures may be exempt from the main provisions within the GATT on grounds including those related to environmental protection.[22] However, no other GATT articles or agreements under the WTO will be touched upon in the thesis. Likewise, it is worth noting that the CBAM will not be discussed in relation to either the possibility of it being covered by an *International Commodity Agreement* or whether it can be excluded from the Security Exceptions under GATT Article XXI, despite both potentially being relevant.[23] In the latter case, for example, there may be reasons to believe that carbon border adjustment mechanisms can be exempted if it can be successfully argued that climate change is a security threat.[24] The reason for concentrating the analysis of the relationship between the CBAM and the GATT exceptions to a discussion of Article XX is that this Article provides, as stated, for exceptions on environmental grounds. The possibilities for an exemption under Article XX are therefore partly related to the nature of the CBAM.

1.4 Method and Materials

The first part of this thesis concerns EU law. Thus, an EU legal method based on the principles of the EU legal system and its application is used. In this context, the basic principles of the EU as an organisation with legal effects are worth reiterating. As established by the landmark *Van Gend en Loos* ruling, the EU legal system represents a new form of governance.[25] In this new governance structure, the Treaties are the primary source of law while the *Charter of Fundamental Rights*, general principles of law, international agreements, and some secondary legislations are also binding legal instruments.[26] In addition, the case-law of the Court of Justice of the European Union (CJEU) has a central and binding role in the legal tradition of the EU.[27] Other sources of law, such as preparatory works, have an indicative function.[28] The hierarchy of these sources is mirrored in this thesis, in which the content of the relevant legal texts provides the basis, with the Treaties as the starting point for the analysis. In addition, as the subject matter of the thesis requires a discussion on issues that are not explicitly covered by the Treaties, such as how to choose the correct legal basis, and since the provisions of the Treaties can be vague,[29] interpretation by the

[21] See, for example, Joost Pauwelyn and David Kleimann "Trade Related Aspects of a Carbon Border Adjustment Mechanism. A Legal Assessment" (14 April 2020) European Parliament Think Tank Briefing PE 603.502 p. 6 and Matthew C. Porterfield "Carbon Import Fees and the WTO" (2023) Climate Leadership Council Center for Climate and Trade Report, p. 7.

[22] General Agreement on Tariffs and Trade (GATT) [1994] art. XX(b) and (g).

[23] For an overview of carbon border adjustment and its potential for justification under an International Commodity Agreement or Article XXI, see Porterfield 2023 (n. 21) pp. 14-18.

[24] Ibid, p. 18.

[25] Case C-26/62 *Van Gend en Loos v Nederlandse Administratie der Belastingen* [1963] ECLI:EU:C:1963:1, para II(B).

[26] Jörgen Hettne and Ida Otken Eriksson (eds) *EU-rättslig metod: Teori och genomslag i svensk rättstillämpning* (2nd ed. Stockholm: Norstedts Juridik 2011) p. 40.

[27] Ibid.

[28] Ibid.

[29] Ibid, pp. 158-159.

Court of Justice forms an important part of the analysis. Interpretation by the CJEU is based on a highly contextual and teleological reasoning whereby the purpose of the measure in question is given weight.[30] In addition, the principle of *effet utile*, i.e. the development of EU law, is a key aspect taken into account by the Court in its decisions.[31] In this context, it is worth noting that a dynamic and contextual reading of the Court's judgements should also be applied in relation to its other judgements. Thus, a case should not be studied in isolation, but should be understood in the context of its place as one piece of the puzzle among others in the Court's case-law.[32] Indicative preparatory documents are used sparingly and mainly to clarify and demonstrate when it may be desirable.

In the WTO Chapter, the international scope of the analysed object (in this context, "international" concerns aspects beyond the borders of the EU) means that the method utilised is one of international law.[33] More particularly, the focus is the WTO legal system. The main sources of law in the WTO are the multilateral agreements negotiated within the framework of the organisation, including the GATT, and, as established by the Appellate Body, an analysis should indeed commence with a textual reading.[34] Nevertheless, other sources may also be drawn upon, such as precedent within the WTO dispute settlement system, practice, teachings, and other international legal acts.[35] In the case of precedents, while previous rulings are not binding in the sense that they must be respected in subsequent ones, reports often refer to previous rulings, and interpretation and judgement in the latter are taken into account in new disputes.[36] This applies to the Appellate Body more than to the panels, as the Body has features more akin to a permanent court.[37]

As with EU law, then, the analysis of WTO law in this thesis takes as its starting point the wording of the relevant legal text, in this case the GATT Articles. Thereafter, the understanding of the Articles is developed by demonstrating how the Appellate Body has interpreted relevant aspects, while doctrine is used to provide context as regards issues related to carbon border adjustment and the CBAM specifically. In comparison to EU law, however, analysing the CBAM in relation to WTO law is not as clear. This is due to the fact that the legal text being analysed, the GATT, is itself somewhat unclear in relation to the issues being addressed, while, at the same time, there is a lack of relevant precedent[38], and hence interpretation, which could have had a clarifying effect. Contrary to the analysis of EU law, the discussion of WTO law is therefore more of a patchwork between Appellate Body rulings and doctrinal analyses of carbon border adjustment and the likelihood of such measures being in conflict with or compatible with the GATT. The discussion only refers to one panel report. Otherwise, decisions by the Appellate Body constitute the

[30] Ibid, p. 158.

[31] Ibid, p. 49.

[32] Ibid, p. 37.

[33] Rossana Deplano and Nicholas Tsagourias "Introduction" in Rossana Deplano - Nicholas Tsagourias (eds), *Research Methods in International Law* (Northampton: Edward Elgar Publishing 2021) p. 1.

[34] David Palmeter and Petros C. Mavroidis "The WTO Legal System: Sources of Law" (1998) Vol. 92(3) *The American Journal of International Law* 398, p. 398.

[35] Ibid, p. 399.

[36] Ibid, pp. 400-406.

[37] Ibid, pp. 405-406.

[38] Pauwelyn and Kleimann 2020 (n. 21) p. 5.

precedent-based part of the analysis. The reason for this is that the above-mentioned lack of clarity and precedent would not necessarily be improved by referring to more panel reports, which risks creating confusion and whose content has not been established by the Appellate Body. For the purpose of this thesis, it is therefore rather preferable to stick to the principles that have actually been clarified by the Appellate Body and that can therefore only contribute to an understanding of compliance.

It is also worth briefly summarising how the doctrine was selected. The starting point is that different sources have been used and compared to provide various perspectives and as wide a range of analysis as possible. The doctrine used in the EU law Chapter mainly concerns more general issues of OSA or perspectives on the work of the CJEU.[39] In terms of WTO law, it is worth bearing in mind that since the CBAM is a new instrument and an interpretation of its nature and many of its aspects is lacking in a WTO context,[40] analyses at this stage must be seen largely as a way of highlighting interesting aspects, in line with how the research question is worded, rather than giving a yes or no answer to whether the CBAM is compatible with WTO rules. Furthermore, compatibility largely depends on the application of the instrument, [41] implying that it is not until the CBAM has been implemented as intended, that things can be more readily established. The literature underpinning this thesis therefore touches on adjacent themes, such as border adjustment and climate action in relation to WTO law, as well as examines both proposals for the EU CBAM and how the regulation as it appears to be intended to operate might relate to WTO rules.[42] While it is certainly possible to build on this literature, it is worth bearing in mind that it does not always provide a detailed overview of the current state of the EU CBAM or predict how the CBAM may evolve in its application and therefore compliance in the future.

1.5 Outline

The outline of this thesis is as follows. The Chapter immediately following this, Chapter 2, explains the CBAM mechanism and how it relates to the EU *Emissions Trading System* (ETS). Understanding the design of the CBAM is essential for understanding the potential legal issues surrounding it. Chapter 3 is dedicated to EU law. The first section describes the legal foundations of the EU's environmental policy. The second section addresses the EU legal context in relation to some of the previously mentioned criticisms that have been levelled at the CBAM and the new EU policy direction. This is done in three sections. In section 3.2.2, the choice of legal basis is discussed to provide a perspective on the aim, content, and nature of the CBAM. In 3.2.3, the position of the Treaties and of the CJEU on the commitment of the EU regarding the principles of open markets and multilateral cooperation is described. Lastly, in 3.2.4, the relationship between EU law and international law is

[39] Kübek and Isabella Mancini 2023 (n. 16) and Jed Odermatt "The Court of Justice of the European Union: International or Domestic Court?" (2014) Vol. 3(3) Cambridge Journal of International and Comparative Law 696.

[40] Pauwelyn and Kleimann 2020 (n. 21) p. 5.

[41] André Sapir, "The European Union's carbon border mechanism and the WTO" (Bruegel Blog, 19 July 2021) <www.bruegel.org/blog-post/european-unions-carbon-border-mechanism-and-wto> accessed 3 May 2024.

[42] See, for example, Ibid, Porterfield 2023 (n. 21), and James Bacchus "Legal Issues with the European Carbon Border Adjustment Mechanism" (Cato Institute Briefing Paper 125, 9 August 2021) <www.cato.org/briefing-paper/legal-issues-european-carbon-border-adjustment-mechanism> accessed 19 May 2024.

explained in order to examine whether it is problematic from an EU law perspective if a potential departure from obligations under international law were to occur. While sections 3.2.3 and 3.2.4 are both concerned with EU law, they tie in to the second research question on the relationship and possible compliance of the CBAM with the GATT. Chapter 4 deals with WTO law, also in three parts following an introduction. Section 4.2 addresses the possibilities for border adjustment measures under the GATT, based on Articles II and III. Section 4.3 introduces the non-discrimination duo of Articles I and III and how the CBAM may conflict or be compatible with them. Section 4.4 discusses the general exceptions in Article XX of the GATT, together with a review of how the WTO Appellate Body has interpreted the Article to provide an understanding of the possibilities for the CBAM to be exempted if the instrument would be considered in breach of obligations under the GATT. Lastly, Chapter 5 summarises the discussions and offers conclusions.

2 The CBAM and its Relationship with the EU Emissions Trading System

Emitters in certain sectors located in the EU are subject to the EU ETS (Directive 2003/87/EC).[43] The ETS is a cap-and-trade system aimed at installations, whereby a cap on the quantity of emissions indicates how much entities covered are allowed to emit in total. To emit one tonne, an emitter must purchase one ETS allowance. The cap decreases annually to ensure that emissions are reduced, that the system retains its value, to promote foresight, and to incentivise the development of activities that require less emissions. If an emitter has bought more allowances than it needs, it can choose to keep them to cover future emissions or sell them to an emitter that needs more to cover its emissions.[44] Trading and allocation of allowances are mainly done through auctioning.[45] However, since EU emitters active internationally compete with producers that are not necessarily subject to costs related to or equivalent with the ETS, the EU allocates free allowances to level the playing field, reducing the risk of carbon leakage.[46]

The ETS is thus a carbon market reflecting the polluter pays principle.[47] However, it is not a perfect market or solution. The use of free allowances undermines the market function of the system and reduces the incentives to adopt greener production methods to avoid the costs associated with buying allowances.[48] To remedy the consequences of this, the CBAM Regulation was introduced in 2023 as a complement to coincide with the phasing out of the free allowances.[49] The CBAM *mechanism* involves offsetting the *carbon* emissions associated with the production of imported goods at the *border* of the internal market to *adjust* for the cost discrepancy between domestic and international production resulting from the ETS. Emissions from all covered products traded in the internal market are therefore compensated for through either the ETS or the CBAM.[50] This reduces the risk of carbon leakage in two ways. Firstly, it is not worthwhile for EU-based companies to move production to countries with less comprehensive environmental legislation to avoid paying a cost for their emissions as they will have to pay anyway if they want their product circulated on the EU market. Secondly, it levels the price between

[43] Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC [2003] OJ L 275/32.

[44] European Commission "What is the EU ETS?" <https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets/what-eu-ets_en> accessed 16 April 2024.

[45] European Commission "Free allocation" <https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets/free-allocation_en> accessed 16 April 2024.

[46] European Commission "Carbon leakage" <https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets/free-allocation/carbon-leakage_en> accessed 22 May 2024.

[47] European Commission "Auctioning" <https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets/auctioning_en> accessed 13 May 2024.

[48] Reg (EU) 2023/956 (n. 17) recital 11.

[49] European Commission "Carbon Border Adjustment Mechanism" <https://taxation-customs.ec.europa.eu/carbon-border-adjustment-mechanism_en> accessed 16 April 2024.

[50] Ibid.

products with intra- and extra-EU origin, reducing the risk of replacing domestic goods with imports that might have a heavier carbon footprint. In addition, like the ETS, it incentivises greener production processes as less emissions mean less costs.[51]

In practice, the CBAM, just as the ETS, is based on the polluter pays principle. EU importers or a designated representative of the importer apply to be a CBAM declarant.[52] Upon authorisation, they can purchase CBAM certificates.[53] For harmonisation purposes, the price of the CBAM certificates is based on the weekly average auction price of ETS allowances.[54] Certificates corresponding to the emissions generated by imports for the year prior must be surrendered in the CBAM registry by the 31st of May.[55] If a price has already been paid for emissions in the country of origin and the importer provides adequate proof, it may surrender less certificates.[56] In this context, "price" is defined as "monetary amount paid in a third country, under a carbon emissions reduction scheme, in the form of a tax, levy or fee or in the form of 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."[57] If emissions cannot be calculated, a default value should be used.[58] If a declarant has bought more certificates than necessary to cover their emissions, excess certificates up to one third of the total number of certificates bought by that declarant in the preceding year can be repurchased.[59] Non-EU countries that participate in the ETS or have an equivalent carbon cost are excluded from the CBAM.[60] At a first stage, the CBAM is limited to sectors where the risk of carbon leakage is high: cement, iron and steel, aluminium, fertilisers, electricity, and hydrogen. When implemented fully, the CBAM is expected to cover more than half of the emissions in sectors subject to the ETS. During a transitional phase, 2023-2026, embedded emissions will only have to be reported, not paid for, after which the mechanism will be evaluated and then implemented to its full extent.[61]

75% of the revenues generated by the CBAM, by 2028 estimated to be 1.5 billion euros per year in 2018 prices, are planned to go to the EU budget. The remaining 25% are to be allocated to the Member States.[62] The discontinued use of the free allowances under the ETS and the potential future extension of the CBAM mean that the joint revenue from both instruments will probably increase.[63] Initially, the European Parliament proposed that the EU should provide an annual sum equivalent to that generated by the CBAM to help least developed countries with

[51] Ibid.
[52] Reg (EU) 2023/956 (n. 17) art 5.
[53] Ibid, art 20(4).
[54] Ibid, art 21.
[55] Ibid, art 22.
[56] Ibid, art 9.
[57] Ibid, art 3(29).
[58] Ibid, art 7(2).
[59] Ibid, art 23.
[60] Ibid, art 2(6).
[61] European Commission "Carbon Border Adjustment Mechanism" (n. 49) accessed 16 April 2024.
[62] European Commission "Questions and Answers: An adjusted package for the next generation of own resources" 20 June 2023 <https://ec.europa.eu/commission/presscorner/detail/en/qanda_23_3329> accessed 19 May 2024.
[63] Francesco Lombardi Stocchetti and Lina Strandvåg Nagell "How to Allocate Carbon Pricing Resources: Directing ETS and CBAM Revenues Towards Effective Climate Action" (2024) Bellona Europa Brief, p. 9.

decarbonisation measures.[64] Such a proposal was, however, not adopted in the final Regulation.[65]

[64] European Parliament, "Amendments adopted by the European Parliament on 22 June 2022 on the proposal for a regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism" (Amendments) T9-0248/2022, amendment 40.

[65] Emily Benson, Joseph Majkut, William Alan Reinsch, and Federico Steinberg, "Analyzing the European Union's Carbon Border Adjustment Mechanism" (Center for Strategic and International Studies, 17 February 2023) <https://www.csis.org/analysis/analyzing-european-unions-carbon-border-adjustment-mechanism> accessed 19 May 2024.

3 CBAM in an EU Law Context

3.1 Legal Context of the EU's Environmental Policy

Environmental policy is a shared competence, meaning that legislation may be adopted both by the EU and its Member States. The possibility for the latter to exercise their competence depends on whether this has been done at Union-level.[66] As with all EU action, the principle of proportionality applies, and as with all shared competences, the principle of subsidiarity must be respected, ensuring, respectively, that the action is proportionate to the objective and that action is taken at EU level only when preferable.[67] The legal bases for the EU's environmental action are Articles 11 and 191 to 193 of the TFEU. Article 11 states that environmental concerns should be part of the EU's policy while the latter three detail the Union's commitment in the field.[68] Article 191 emphasises that environmental policy should be based on the precautionary principle, preventive action, addressing the source of environmental damage, and on the polluter pays principle.[69] In addition, international climate action is one of the main objectives for the EU's environmental policy: "promoting measures at international level to deal with regional or worldwide environmental problems, and in particular combating climate change."[70]

The EU is subject to legally binding climate instruments both externally and internally. As provided for by Articles 47 of the TEU[71] and 216 of the TFEU[72] granting the EU legal personality and competence to conclude international agreements, the Union is a party to and bound by the Paris Agreement.[73] Furthermore, as part of the Green Deal, the *European Climate Law* was introduced in 2021. The Regulation, with Article 192(1) as its legal basis, binds the Union to achieve climate neutrality by 2050 in accordance with the provisions of the Paris Agreement.[74] The Regulation also demonstrates that the EU considers itself a leader in the fight against climate change and that it is prepared to "use all the tools at its disposal" to promote international climate action.[75] It is worth noting that the Climate Law is a Regulation, meaning that in addition to being binding and directly

[66] Consolidated Version of the Treaty on the Functioning of the European Union (TFEU) [2016] OJ C 202/48, arts 2 and 4.

[67] Consolidated Version of the Treaty on European Union (TEU) [2016] OJ C 202/1, art 5.

[68] TFEU (n. 66) arts 11, 191–193.

[69] Ibid, art 191.

[70] Ibid, art 191(1).

[71] TEU (n. 67) art 47.

[72] TFEU (n. 66) art 216.

[73] Council Decision (EU) 2016/1841 of 5 October 2016 on the conclusion, on behalf of the European Union, of the Paris Agreement adopted under the United Nations Framework Convention on Climate Change [2016] OJ L 282/1.

[74] Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law') [2021] OJ L 243/1, art 1.

[75] Ibid, recital 16.

applicable,[76] it has direct effect, granting rights on individuals who can invoke its provisions in national or EU courts.[77] In this respect, the EU and Member States could be challenged in court if the climate targets set out in the Climate Law are not met, thus adding another legal layer to the climate measures the EU is putting in place to reach climate neutrality by 2050.

3.2 A Climate Protector, Competition Tool, or Trade Policy Instrument?

3.2.1 Introduction

Article 1 of the CBAM Regulation indicates that the aim is to "address greenhouse gas emissions" embedded in certain imported goods with the view of avoiding carbon leakage and incentivise greener production, to establish similar carbon pricing rules for imports as for domestic goods, and to replace the free allowance system under the ETS.[78] In terms of means to achieve this aim, the CBAM thus introduces a system and rules for the purchase and surrendering of certificates corresponding to the emissions generated by the production of imports. By linking the price of the certificates to the auctioning price in the ETS, goods originating in third countries are equated with goods of domestic origin.[79] As can be deduced from this, apart from the environmental dimension there are thus at least two other considerations that are of importance for the CBAM. Firstly, as explained above, the CBAM works as a complement to the ETS to level out the playing field for EU companies that compete with imports from third countries. As such, the CBAM contributes to the smooth functioning of competition on the internal market. Secondly, the CBAM has a possible impact on EU trade with third countries, as the price to be paid for emissions represents an increased cost and thus a potential trade barrier for goods exported to the EU. Indeed, in the context of the CBAM, trading partners have accused the EU of protectionism and discrimination in violation of WTO-rules.[80] Developing countries have also expressed the view that the unilaterally imposed requirement to calculate emissions risks disadvantaging countries with fewer financial resources and a lack of systems for carrying out such calculations.[81]

Within an EU legal context, for the EU to be able to legislate in a certain area, there must be an article in the Treaties providing a legal basis authorising action, and as different areas are subject to different legislative processes, the legal basis also provides for the role of the different EU institutions when legislating a particular instrument.[82] The legal basis for the CBAM, like the Climate Law, is Article 192(1)

[76] TFEU (n. 66) art 288.

[77] Case 43/71 *Politi s.a.s. v Ministry for Finance of the Italian Republic* [1971] ECLI:EU:C:1971:122, para II(9).

[78] Reg (EU) 2023/956 (n. 17) art 1.

[79] Ibid, in particular paras 7, 21, 22.

[80] Committee on Market Access, "Minutes of the Committee on Market Access 16 and 17 October 2023" (Minutes) G/MA/M/79, in particular paras 22.5, 22.6, 22.7, 22.13.

[81] Hancock 2022 (n. 15) accessed 10 April 2024.

[82] Damian Chalmers, Gareth Davies, and Giorgio Monti *European Union Law* (4th ed. Cambridge: Cambridge University Press 2019) p. 119.

of the TFEU.[83] The Article is primarily of a referential nature, stating that the Parliament and the Council, in consultation with the Economic and Social Committee and the Committee of the Regions and through the ordinary legislative procedure, shall determine how to realise the aims set out in Article 191.[84] Article 191, in turn, provides a description and explanation of the EU's environmental policy and the principles that should guide it.[85] Legislation is, however, rarely straight forward enough to make the legal basis obvious,[86] and as alluded to above, the design of the CBAM touches upon aspects of both competition and trade in addition to the environment. In fact, for instruments falling under the umbrella of OSA, the two legal bases governing the internal market and external trade respectively are in a majority.[87] Firstly, Article 114 TFEU, which establishes the procedure for the harmonisation of laws for the proper functioning and an increasingly integrated internal market.[88] Secondly, Article 207 TFEU, stating the principles and legislative process underbuilding the EU's *Common Commercial Policy* (CCP).[89] In this context it may be interesting to note that two other proposed instruments under OSA that also touch upon environmental aspects, the Net-Zero Industry Act[90] and the Critical Raw Materials Act,[91] both rely on Article 114 and not Article 192.

Based on the discussion above, it is therefore worth examining whether the CBAM is mainly an environmental instrument and consequently whether the legal basis, 192(1) TFEU, appears adequate. In the light of the criticism levelled at the CBAM regarding discrimination and protectionism, the following section also includes a discussion of the position of EU primary law and the CJEU in relation to the imposition of unilateral measures that are contrary to fully open markets as well as the obligations of the EU under international law.

3.2.2 The Choice of Legal Basis

The Treaties themselves do not state how the legal basis should be chosen. However, case law from the CJEU has, in effect, resulted in a step-by-step process for determining the correct basis and whether more than one basis is required. As a rule, the basis should be founded on factors that can be objectively analysed in a court of law, such as the content and aim of the instrument in question.[92] In effect, this means that the purpose subjectively perceived by the institutions should not guide what the correct legal basis is.[93] Two additional considerations are that the legal basis should

[83] Reg (EU) 2023/956 (n. 17).

[84] TFEU (n. 66) art 191.

[85] Ibid, art 191.

[86] Chalmers et. al 2019 (n. 82) p. 119.

[87] Szyszczak 2023 (n. 7) p. 5.

[88] TFEU (n. 66) art 114.

[89] Ibid, art 207.

[90] Commission, "Proposal for a Regulation of the European Parliament and of the Council on establishing a framework of measures for strengthening Europe's net-zero technology products manufacturing ecosystem (Net Zero Industry Act)" (Proposal) COM/2023/161 final, p. 5.

[91] Commission, "Proposal for a Regulation of the European Parliament and of the Council establishing a framework for ensuring a secure and sustainable supply of critical raw materials and amending Regulations (EU) 168/2013, (EU) 2018/858, 2018/1724 and (EU) 2019/1020" (Proposal) COM/2023/160 final, p. 7.

[92] Case C-155/07 *European Parliament v Council of the European Union* [2008] ECLI:EU:C:2008:605, para 34.

[93] European Parliament, Committee on Legal Affairs, "Opinion on the legal basis of the Proposal for a Regulation of the European Parliament and of the Council concerning batteries and waste batteries, repealing Directive

not automatically be founded on the basis used for other similar instruments and that the most specific basis set out in the Treaties should be the one indicated.[94] If an instrument is determined to have more than one aim or element justifying more than one legal basis, the basis should be the one corresponding to the superior aim or element.[95] If such a hierarchy cannot be discerned, the instrument should be based on all relevant legal bases.[96] However, the use of several bases should only be seen as an exception when necessary, and cannot be applied if the bases relied upon are subject to procedures that make them incompatible with each other[97] or if the role of the Parliament risks being undermined by recourse to multiple bases.[98] Thus, the legal basis concerns where the centre of gravity of the legal instrument is located.[99] A discussion of the appropriate legal basis for the CBAM thus requires a consideration of the content and aim of the instrument, as well as a discussion of the relationship between Article 192(1) TFEU and the other possible legal bases, Articles 114 and 207 TFEU, and how to determine the boundaries between them. The remainder of section 3.2.2 therefore explains how the Court has dealt with issues regarding the appropriate legal basis between 192(1) and 114/207 respectively.

Firstly, it should be mentioned that Article 114 starts by stating "save where otherwise provided in the Treaties",[100] indicating that if another article is more specific, that is the appropriate basis.[101] A detailed review of the case law on how the Court has dealt with questions of legal basis shows that the distinction is not always straightforward. In C-300/89 (*Titanium Dioxide*) the dispute concerned whether it was correct for a directive aimed at "harmonising the programmes for the reduction and eventual elimination of pollution caused by waste from the titanium dioxide industry" to be based on what is now Article 192 instead of the current Article 114.[102] Since the Articles were subject to different legislative processes in the Treaty then in force, the *Treaty establishing the European Economic Community* (EEC Treaty), a dual legal basis was not possible.[103] The Court held that the correct basis was 114 by arguing, inter alia, that the content of the Directive sought to equalise production circumstances, which would improve the competitive situation since a lack of harmonisation of environmental rules can lead to distortion of competition as these rules can be burdensome for the companies to which they apply. Consequently, a measure aimed at harmonising these rules and improving the competition should be based on Article 114.[104] Furthermore, the Court considered that the wording now found in Article 114(3) stating that harmonisation measures

2006/66/EC and amending Regulation (EU) No 2019/1020 (COM(2020)0798 – C9 0400/2020 – 2020/0353(COD))" (Opinion) (6 March 2023) PE745.228v02-00, p. 5.

[94] Case C-155/07 (n. 92) para 34.

[95] Ibid, para 35.

[96] Ibid, para 36.

[97] Ibid, paras 36-37.

[98] Case C-178/03 *Commission of the European Communities v European Parliament and Council of the European Union* [2006] ECLI:EU:C:2006:4, para 57.

[99] Case C-376/98 *Federal Republic of Germany v European Parliament and Council of the European Union* [2000] ECLI:EU:C:2000:544, paras 32-35.

[100] TFEU (n. 66) art 114.

[101] Council of the European Union, Legal Service "Opinion on the Proposal for a Regulation concerning batteries and waste batteries – Legal basis" (Opinion) (7 July 2021) 10626/21, p. 5.

[102] Case C-300/89 *Commission of the European Communities v Council of the European Communities* [1991], ECLI:EU:C:1991:244, in particular paras 1 and 4.

[103] Ibid, para 21.

[104] Ibid, para 23.

shall consider a high level of environmental protection, means that the environmental aspect is not lost when using 114 as a legal basis.[105]

In C-155/91 and C-187/93, the Court argued differently. In the first case, the contested Directive concerned rules on waste management to be implemented by Member States.[106] The Court recognised that the Directive had an impact on the internal market but considered that the focus was not on the harmonisation of laws but rather on the environmental aspect of waste management.[107] Therefore, if the instrument only leads to increased harmonisation in the internal market "incidentally", it is not possible to rely on 114 and consequently, the Directive should be based on the Article corresponding to 192.[108] The substance of C-187/93 also concerned waste, this time its transport within, into and out of the Union. Again, the Court held that the fact that the internal market was affected did not mean that 114 should be listed as the legal basis.[109] Instead, the "conditions and procedures have all been adopted with a view to ensuring the protection of the environment, taking account of objectives falling within the scope of environmental policy...".[110]

In contrast to the previously mentioned EEC Treaty, both Articles 192(1) and 114 of the TFEU adhere to the ordinary legislative procedure.[111] As such, there is neither a procedural contradiction that would prevent the two from simultaneously being used as legal bases nor a risk of the Parliament being circumvented. Moreover, both the environment and the internal market are shared competences[112] and would therefore not at first glance imply a conflict between the EU and the Member States. Nevertheless, the Articles do provide for some differences in how Member States can act. With regard to Article 192, Article 193 provides that Member States may maintain and introduce more rigorous environmental protection measures than those adopted based on 192, as long as they are in line with the Treaties and have been communicated to the Commission.[113] Article 114 allows Member States to maintain or, if there is new scientific evidence relevant to the specific Member State, adopt environmental protection measures derogating from harmonisation. These measures must be approved by the Commission.[114] Consequently, Member States have more room to determine the level of environmental protection when a legal act refers to Article 192 than to Article 114, which, as emphasised in an Opinion by the Parliament's Committee on Legal Affairs on the legal basis of the subsequently adopted Proposal for a Regulation of the European Parliament and of the Council concerning batteries and waste batteries, leaves a potential legal unclarity if they are used as a dual legal basis.[115] In this case, it was considered that the aim and content of the measure was such that the Regulation should be based on both 192(1) and

[105] Ibid, art 24.

[106] Case C-155/91 *Commission of the European Communities v Council of the European Communities* [1993] ECLI:EU:C:1993:98, para 2.

[107] Ibid, paras 18, 20.

[108] Ibid, paras 19, 21.

[109] Case C-187/93 *European Parliament v Council of the European Union* [1994] ECLI:EU:C:1994:265, paras 24-26.

[110] Ibid, para 22.

[111] TFEU (n. 66) arts 114, 192.

[112] Ibid, art 4.

[113] Ibid, art 193.

[114] Ibid, art 114.

[115] PE745.228v02-00 (n. 93) p. 8.

114.[116] The solution was therefore to adopt the Regulation on 114 as the main basis, and to indicate which specific articles of the Regulation were adopted based on 192(1).[117] As pointed out in the Opinion, such a solution has not yet been tested by the CJEU, meaning that it is not necessarily problematic, while there are other legal acts, and thus precedents, utilising it.[118]

Similar to the relationship between Articles 192 and 114, the Court has held that Article 207 is not to be used if trade is merely an ancillary goal to the environment, emphasising that "A Community act falls within the exclusive competence in the field of the common commercial policy provided for in Article 133 EC only if it relates specifically to international trade in that it is essentially intended to promote, facilitate or govern trade and has direct and immediate effects on trade in the products concerned…".[119]

In cases C-94/03 and C-178/03, the Court held that it was appropriate to refer to the EC Treaty equivalent of both Article 192(1) and Article 207. Both cases concerned the *Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade* and whether the Council decision approving and the Regulation implementing the Convention were correct in omitting 207 in favour of 192(1).[120] In terms of the Regulation, the parties (Commission v. Parliament and Council) all agreed that the instrument included elements of both trade and the environment.[121] However, they disagreed on the centre of gravity, where the Commission held that the focus was to control trade in hazardous chemicals while the Parliament and Council argued that this was secondary to protecting health and the environment.[122] In its decisions, the Court took account of the actual text of both the Convention and the Regulation and held that the fact that the provisions included rules on trade meant that the commercial element could not be excluded, while ascertaining that these rules had a direct and immediate effect on trade.[123] The Court also noted that, although the prior informed consent procedure is part of the environmental legal framework, in this case this was based on rules governing trade and dealt exclusively with internationally traded hazardous chemicals, thus creating a direct connection between trade and environmental aspects.[124]

In C-411/06, the Court argued that the contested Regulation did not have a direct and immediate effect on trade.[125] The case concerned whether a regulation aimed, inter alia, at introducing the provisions of the *Basel Convention on the Control of*

[116] Ibid, pp. 8-9.

[117] Regulation (EU) 2023/1542 of the European Parliament and of the Council of 12 July 2023 concerning batteries and waste batteries, amending Directive 2008/98/EC and Regulation (EU) 2019/1020 and repealing Directive 2006/66/EC [2023] OJ L 191/1.

[118] PE745.228v02-00 (n. 93) p. 9.

[119] Case C-411/06 *Commission of the European Communities v European Parliament and Council of the European Union* [2009] ECLI:EU:C:2009:518, para 71 (207 TFEU).

[120] Case C-94/03 *Commission of the European Communities v Council of the European Union* [2006] ECLI:EU:C:2006:2, in particular paras 1, 21, 51, 56 and Case C-178/03 (n. 98) in particular paras 1, 28, 56, 60

[121] Case C-178/03 (n. 98) para 40.

[122] Ibid.

[123] Case C-94/03 (n. 120) para 42.

[124] Ibid, para 44.

[125] Case C-411/06 (n. 119) paras 71-72.

Transboundary Movements of Hazardous Wastes and their Disposal should be based solely on the Article corresponding to the current 192(1) or whether 207 should be added.[126] In addition to the preamble clearly describing the purpose as environmental in most of the recitals, the Court relied on the environmental policy nature of the method used, the prior written notification and consent procedure.[127] Furthermore, in a comparison to the rulings on the Rotterdam Convention, the court stated that the latter was "also aimed to promote shared responsibility and cooperative efforts in the international trade of certain hazardous chemicals and that it was through the adoption of measures of a commercial nature, relating to trade in certain hazardous chemicals or pesticides, that the parties to that convention sought to attain the objective of protecting human health and the environment",[128] but that a similar link did not exist in the Basel case. Thus, the Court concluded that the purpose was not mainly to control the conditions for the movement of waste but to ensure that this movement can be restricted so as not to have a negative environmental impact.[129]

As with 114 and 192, legislation based on 207 is adopted according to the ordinary legislative procedure[130] making it procedurally compatible with 192. It should, however, be noted that the environment and the CCP fall under the shared and exclusive competences respectively.[131] Thus, while the choice of one over the other determines whether legislation can be adopted on EU or Member State-level, the use of both could potentially create uncertainty regarding the division of legislative power. In C-94/03, the Court acknowledges that the CCP and the environment belong to different competences but does little more than state that this needs to be considered in the implementation process.[132] However, in light of the judgements in cases C-94/03 and C-178/03 (see above), it appears as though the Court finds no issue with Articles 192(1) and 207 being used together.

3.2.3 The Commitment of the EU to Multilateral Cooperation and Open Markets

The EU's commitment to multilateral cooperation and open markets is clearly articulated in the Treaties. Article 21 of the TEU states that the EU externally should "promote multilateral solutions to common problems", and encourage multilateral cooperation, the gradual removal of trade barriers, and international efforts to care for the environment and achieve sustainable development.[133] Article 207 TFEU expresses that the CCP should be based on the principles that guide the EU's external action.[134] Furthermore, a general provision of the EU is that it should contribute to "free and fair trade".[135] A preference for a policy based on certain values can thus be inferred. Nevertheless, neither the adherence to multilateral cooperation nor the

[126] Ibid, paras 4, 30.
[127] Ibid, paras 51, 59.
[128] Case C-411/06 (n. 119) para 75.
[129] Ibid, 72, 75, 76.
[130] TFEU (n. 66) arts 192, 207(2).
[131] Ibid, arts 3-4.
[132] Case C-94/03 (n. 120) para 55.
[133] TEU (n. 67) art 21.
[134] TFEU (n. 66) art 207.
[135] TEU (n. 67) art 3.

promotion of open markets is absolute or unconditional.[136] In terms of the former, three aspects can be deduced that allow a limitation.[137] Firstly, the Treaties do not prohibit unilateral action and, in addition, the CCP includes measures, for example anti-dumping, which are inherently unilateral.[138] Secondly, the principles on which the EU's external action are based are all equal.[139] Pursuing multilateral cooperation therefore carries as much weight as, say, protecting the environment. Thus, an objective requiring unilateral action is not necessarily subordinate to multilateral if a conflict requiring one or the other exists. Thirdly, Article 21 states that the EU should cooperate with countries that shares its values, including democracy, the rule of law, and human rights,[140] which means that the scope of international cooperation is limited to where these values are considered to extend.[141]

In terms of open markets and free trade, the Treaties, while leaning towards certain values, also provide discretion for the legislators. Article 7 of the TFEU states that there should be consistency between the Union's policies, "taking all of its objectives into account".[142] Furthermore, Articles 205 and 207 stating that the CCP should be guided by the principles of the external action[143] indicates that there needs to be a balancing between those principles in the application of commercial measures, while Article 206 expressing that "…the Union shall contribute, *in the common interest,* to the harmonious development of world trade, the progressive abolition of restrictions on international trade and on foreign direct investment,…"[144] shows that Union interests are not unimportant. The Court has developed this understanding, stating that the Treaties requiring the EU to work towards the progressive abolition of international trade barriers does not mean that it cannot introduce measures affecting trade with third countries or refrain from introducing measures to liberalise trade if it conflicts with the interests of the EU.[145] The Court has also established that considering Articles 205 and 207 TFEU (the CCP being performed in line with the principles of the external action) together with Article 21(3) TEU (the external action of the EU should, as previously mentioned, be based on certain principles and objectives), means that sustainable development is a core aspect of the CCP.[146] While the liberalisation of trade might be the preference, the Treaties and Case Law thus indicate that introducing trade restrictive measures on the basis of other values and considerations, including environmental, is not prohibited.[147]

[136] Kübek and Mancini 2023 (n. 16) pp. 524-526.

[137] Kübek and Mancini 2023 (n. 16) identifies these three aspects on p. 524.

[138] Ibid.

[139] Ibid.

[140] TEU (n. 67) art 21.

[141] Kübek and Mancini 2023 (n. 16) p. 524.

[142] TFEU (n. 66) art 9.

[143] Ibid, arts 205, 207.

[144] Ibid, art 206 (emphasis added).

[145] Case C-150/94 *United Kingdom of Great Britain and Northern Ireland v Council of the European Union* [1998] ECLI:EU:C:1998:547, para 67.

[146] Opinion 2/15 *Opinion pursuant to Article 218(11) TFEU* [2017] ECLI:EU:C:2017:376, para 9.

[147] Kübek and Mancini 2023 (n. 16) pp. 526-527.

3.2.4 The Obligations of the EU under International Law

Firstly, it is worth reiterating that the EU legal system, as demonstrated by the *Van Gend en Loos* ruling,[148] is a novel and unique one whose standing in the international legal landscape is under ongoing development.[149] The previously mentioned Article 21 TEU states that the EU's action internationally should be conducted with "respect for the principles of the United Nations Charter and international law".[150] This sentiment is mirrored in Article 3(5) with the added emphasis that the Union should contribute "…to the strict observance and the development of international law…".[151] Article 216(2) TFEU further states that the EU institutions and Member States are bound by international agreements entered into by the EU.[152] The CJEU has also confirmed that the Union must consider international law "in its entirety" when introducing legislation.[153] Thus, there is a risk that not observing international law is not only in breach of said law, but of EU primary law.[154]

Nevertheless, the Court has demonstrated that the circumstances under which it accepts that international law is relied upon to successfully challenge EU legislation are limited. Before it determines the direct effect of an agreement, the Court needs to decide if the law being relied upon is a source of international law and if the EU is bound by it.[155] In cases involving treaties to which the EU is a party, the answer is generally in the affirmative.[156] This includes the WTO agreements.[157] Additionally, an international agreement can only be directly applicable and have direct effect if it is "unconditional and sufficiently precise"[158] and bestows rights that individuals can depend on.[159] Rulings such as the one in C-366/10 (*Air Transport Association of America*) however, means that, in principle, many multilateral agreements are by design too general to fulfil those criteria.[160]

This is even more so regarding the standing of the WTO agreements. The Court has clearly expressed that the WTO agreements do not have direct effect in the EU[161] with exception of in two circumstances. The first, the Fediol exception,[162] allows for the WTO agreements to be invoked if the contested legislation refers to a specific provision in them. The second, the Nakajima exception,[163] accepts direct effect if the

[148] Case C-26/62 (n. 25).

[149] Odermatt 2014 (n. 39) p. 704.

[150] TEU (n. 67) art 21.

[151] Ibid, art 3.

[152] TFEU (n. 66) art 216.

[153] Case C-366/10 *Air Transport Association of America and Others* [2011] ECLI:EU:C:2011:864, para 101.

[154] Kübek and Mancini 2023 (n. 16) pp. 528-529.

[155] Odermatt 2014 (n. 39), p. 704.

[156] Ibid, pp. 704–705.

[157] Wolfgang Igler "The European Union and the World Trade Organization" (European Parliament: Fact sheets on the European Union, October 2023) <https://www.europarl.europa.eu/factsheets/en/sheet/161/the-european-union-and-the-world-trade-organization> accessed 13 May 2024.

[158] Case C-366/10 (n. 153) para 74.

[159] Odermatt 2014 (n. 39) p. 710.

[160] Ibid.

[161] See, for example, Case C-21-24/72 *International Fruit Company NV and others v Produktschap voor Groenten en Fruit* [1972], ECLI:EU:C:1972:115, para 27 and Case C-149/96 *Portuguese Republic v. Council of the European Union* [1999] ECLI:EU:C:1999:574, para 47.

[162] Case C-70/87 *Fédération de l'industrie de l'huilerie de la CEE (Fediol) v Commission of the European Communities* [1989] ECLI:EU:C:1989:254.

[163] Case C-69/89 *Nakajima All Precision Co. Ltd v Council of the European Communities* [1990] ECLI:EU:C:1990:433.

purpose of the legislation is to implement a WTO measure. Additionally, in situations of ambiguity, the CJEU has applied consistent interpretation in cases concerning international law, including WTO agreements. Thus, if there is unclarity, a measure should be interpreted to the benefit of the international provision.[164] All in all, however, while the Treaties compel the EU to adhere to international law, the discussion above shows that the possibilities to invoke it in EU Courts are limited.

[164] Simon Lester, Bryan Mercurio, Arwel Davies *World Trade Law: Text, Materials and Commentary* (3rd ed. Oxford: Hart 2021) p. 136.

4 CBAM Compliance with the GATT

4.1 Introduction

The introduction of the CBAM has, as previously mentioned, sparked controversy among some EU trading partners who stipulate that the CBAM is protectionist and discriminatory and thus, that the EU violates WTO rules by implementing it.[165] Before reviewing potential legal issues of the CBAM in relation to the GATT, three things are worth noting. Firstly, the WTO dispute settlement mechanism allows for dispute settlement between states.[166] A potential dispute concerning a possible CBAM violation of WTO rules can therefore only be brought by a WTO Member State, not, say, an extra-EU based producer or EU importer that may have to bear the cost of the CBAM certificates. Secondly, carbon border adjustment is not a unique EU measure. Similarly to emissions trading, it is a tool. While the EU is currently the only region having introduced such a measure,[167] there are proposals for a CBAM in other countries, for example the USA.[168] Thirdly, the EU states that the CBAM is in compliance with WTO law.[169] Thus, in this context, it disagrees with the countries critiquing the CBAM on the application of WTO law. In truth, the actual implementation of the CBAM matters for its compliance with WTO rules.[170] As the CBAM is not yet in full force, it is therefore not possible to evaluate its exact implementation and to fully determine its compatibility. Furthermore, for many of the issues surrounding carbon border adjustment, there is no WTO precedent, and the relevant provisions of the agreements are unclear on the matter.[171] The following discussion is therefore intended to highlight the legal problems that may exist.

Three legal aspects are clarified and discussed in the three sections that follow. Firstly, under which circumstances it is possible for a party to introduce border adjustment measures. Secondly, whether the EU through the CBAM violates the non-discrimination principles of *Most-Favoured-Nation* (MFN) and *National Treatment* (NT). Thirdly, to what extent the CBAM is possibly covered by the exceptions under GATT Article XX.[172]

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[165] G/MA/M/79 (n. 80) in particular paras 22.5, 22.6, 22.7, 22.13.

[166] Dispute Settlement Understanding (DSU) [1994].

[167] International Carbon Action Partnership "EU Carbon Border Adjustment Mechanism (CBAM) takes effect with transitional phase" (1 October 2023) <https://icapcarbonaction.com/en/news/eu-carbon-border-adjustment-mechanism-cbam-takes-effect-transitional-phase> accessed 13 May 2024.

[168] Joint Economic Committee Democrats "What is a Carbon Border Adjustment Mechanism (CBAM) and what are some legislative proposals to make one?" (8 February 2024) <www.jec.senate.gov/public/index.cfm/democrats/2024/2/what-is-a-carbon-border-adjustment-mechanism-cbam-and-what-are-some-legislative-proposals-to-make-one> accessed 3 May 2024.

[169] European Commission "Carbon Border Adjustment Mechanism" (n. 49) accessed 16 April 2024.

[170] Sapir 2021 (n. 41) accessed 3 May 2024.

[171] Pauwelyn and Kleimann 2020 (n. 21) p. 5.

[172] For an explanation of how these three aspects have been chosen, see sections 1.3 "Delimitations" and 1.4 "Method and materials".

4.2 Border Adjustment

In accordance with Article II, each party to the GATT has its own Schedules of Concessions that describe the trade treatment, including tariff rates of different products, that the contracting parties should award other contracting parties.[173] As Article II(1)(b) GATT lays out, products should not be charged any additional costs than the rates in the Schedules.[174] In order to change the Schedules, Article XXVIII states that relevant contracting parties should negotiate on the amendments.[175] However, Article II(2) allows for some exceptions, including: "Nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product: (a) a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III* 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".[176] Article III(2) stipulates that imported products should not be subject to higher "internal taxes or other internal charges" than like domestic products.[177] The exemption under Article II thus allows for border adjustment as long as the charge is considered an adjustment of an internal carbon tax rather than an import duty, and as long as it fulfils the non-discrimination requirement of Article III.[178]

However, distinction has been made between direct and indirect taxes. Direct taxes, generally understood as taxes levied on producers, are not permissible for border adjustment, while indirect taxes, levied on products, are.[179] In a WTO context, the *Agreement on Subsidies and Countervailing Measures* (SCM) defines indirect taxes as "sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, border taxes and all taxes other than direct taxes and import charges", while direct taxes are presented as "taxes on wages, profits, interests, rents, royalties, and all other forms of income, and taxes on the ownership of real property."[180] Carbon taxes are generally understood to constitute "indirect taxes".[181]

It should be noted, however, that there is some unclarity as regards the CBAM specifically. Some doctrine note that the link between the CBAM and the EU ETS introduces an element of uncertainty to the compatibility of the CBAM with WTO rules[182] as there is a lack of legal clarity surrounding the relationship between WTO rules and emissions trading.[183] For example, the ETS being applied on facilities rather than products could complicate its potential definition as an indirect tax, if such a tax is understood as a cost on products rather than producers.[184] Similarly, the

[173] GATT (n. 22) art II.

[174] Ibid, art II(1)(b).

[175] Ibid, art XXVIII.

[176] Ibid, art II(2)(a).

[177] Ibid, art III(2).

[178] Porterfield 2023 (n. 21) p. 7.

[179] Working Party on Border Tax Adjustments, "Report by the Working Party on Border Tax Adjustments" (Report) (2 December 1970) L/3464, para 14.

[180] Agreement on Subsidies and Countervailing Measures (SCM) [1994], footnote 58.

[181] See, for example, Pauwelyn and Kleimann 2020 (n. 21) p. 8.

[182] Porterfield 2023 (n. 21) pp. 4, 9, 19.

[183] Ian Parry, Simon Black, and Karlygash Zhunussova "Carbon Taxes or Emissions Trading Systems? Instrument Choice and Design" (2022) International Monetary Fund IMF Staff Climate Note 2022/006, pp. 11-12.

[184] Porterfield 2023 (n. 21) pp. 4, 9.

categorisation of a tax based on production method rather than the product itself is unclear in a WTO-context.[185]

In addition, the emission allowance element of the ETS could be considered an internal regulation in the context of GATT Article III rather than a tax subject to Article II.[186] Article III(4) states that "The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use."[187] The exception in GATT Article II(2) mentioned above allows for border adjustment of an internal tax, but not for the adjustment of an internal regulation through a border tax. An internal regulation can be adjusted at the border only through an equivalent regulation, for example if also imports are subject to emission allowances.[188] It should be noted that in the previously mentioned *Air Transport Association of America* case (see above p. 25), the CJEU affirmed that the EU ETS is a "market-based measure and not a duty, tax, fee or charge."[189] In this context, it could therefore be important that the CBAM is also based on the purchase of allowances.[190] It is relevant to note, though, that a measure might have a different designation within the context of WTO law than it does in EU law.[191]

Finally, it is worth noting that the Appellate Body has stated that the difference between what constitutes an import duty under Article II(1)(b), which cannot be adjusted without violating the Schedules of Concessions, and an "internal charge" under Article III, which could be adjusted, is what triggers the requirement to pay. If it is the import itself that triggers the charge, it is a non-adjustable border measure. If, on the other hand, it is an internal factor that leads to the payment requirement, such as the distribution or sale, the measure is an internal matter.[192] It is not impossible, and perhaps even likely, that this distinction would cover internal regulations as well. That is, if the ETS is considered a regulation and the EU argues that the CBAM is an extension of the ETS, and if it is considered that it is the importation, rather than an internal factor, that is the activity requiring the purchase of an, in this case, emissions certificate under the CBAM, it is possible that the CBAM could be considered a non-adjustable border measure.[193]

[185] Kateryna Holzer "Proposals on Carbon-related Border Adjustments: Prospects for WTO Compliance" (2010) Vol. 4(1) *Carbon & Climate Law Review* 51, p. 58.

[186] Pauwelyn and Kleimann 2020 (n. 21) p. 9.

[187] GATT (n. 22) art III(4).

[188] Pauwelyn and Kleimann 2020 (n. 21) p. 9.

[189] Case C-366/10 (n. 153) para 147.

[190] Hervé Jouanjean, Stephan Orava, Marie-Sophie Dibling, Bernard O'Connor "Consistency of an EU Carbon Border Adjustment Mecanism ("CBAM" with World Trade Organization ("WTO") Rules" (3 June 2021) Aegis Europe Legal Analysis Executive Summary, p. 1.

[191] Pauwelyn and Kleimann 2020 (n. 21) p. 5.

[192] Appellate Body Reports, *China – Measures Affecting Imports of Automobile Parts*, WT/DS339/AB/R / WT/DS340/AB/R / WT/DS342/AB/R, adopted 12 January 2009, paras 158-162.

[193] In the case referenced in note 192, the Appellate Body makes the distinction between "customs duty" and "internal charge". However, former Appellate Body member James Bacchus has referenced this distinction in regards to "internal regulation" as well: Bacchus 2021 (n. 42) accessed 19 May 2024.

4.3 Non-discrimination

If the CBAM is considered a permissible border adjustment instrument, it must still be non-discriminatory under Article I (MFN)[194] and Article III (NT)[195] of the GATT. The latter is already, as demonstrated by the discussion in the section prior, relevant to whether the CBAM constitutes a border-adjustable measure, but there are other aspects to consider.

GATT Article III states that measures should not be construed to favour domestic production and that imports should not be treated less favourably than like domestic goods.[196] The Article can be understood as products of domestic and foreign origin being subject to the same or equivalent "regulatory burden".[197] GATT Article I stipulates that as a basis, like goods should be awarded the same treatment regardless of origin.[198]

The definition of a "like" product is not absolute. The WTO Appellate Body has established that it should be narrowly defined but also that "the concept of "likeness" is a relative one that evokes the image of an accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the WTO Agreement are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term "like" is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply."[199] However, the Appellate Body has also stated that like products are "directly competitive or substitutable",[200] indicating an economic and utilisation equivalence. From an environmental point of view, it is worth noting that in an appreciation of likeness, there is no definite answer as to what concerns differences in the production process. Two products can still be "like" in a WTO-context despite one having been produced in a less sustainable way.[201] While certain criteria pertaining to the characteristics, end-use, and tariff categorisation of the products, as well as consumer behaviour, have generally been used to ascertain "likeness", an analysis must therefore, as the Appellate Body has emphasised, be carried out in each individual case.[202]

Keeping in mind the caveat that an individual analysis is necessary, the design of the CBAM creates conditions for Article III compliance in at least two ways. Firstly, the price of CBAM certificates being based on the average auction price of ETS allowances creates a direct link between the price on domestic and foreign like goods.[203] Secondly, the proportionality between the CBAM certificates to be

[194] GATT (n. 22) art I.

[195] Ibid, art III.

[196] Ibid.

[197] Jouanjean et. al 2021 (n. 190) p. 2.

[198] GATT (n. 22) art I.

[199] Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 21.

[200] Appellate Body Report, *Korea – Taxes on Alcoholic Beverages*, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999, para 118.

[201] World Trade Organization "WTO rules and environmental policies: key GATT disciplines" < www.wto.org/english/tratop_e/envir_e/envt_rules_gatt_e.htm> accessed 7 May 2024.

[202] Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, paras 101-102.

[203] Sapir 2021 (n. 41) accessed 3 May 2024.

surrendered and emissions means that it is possible to demonstrate that the emissions from imports are lower, leading to a lower price to be paid and therefore, in principle, that imports could be treated in a more advantageously manner than like domestic goods.[204] However, WTO Members have expressed concern about the free allowances of the ETS leading to domestic goods being subject to lower costs than foreign ones and that there is no clear plan for their phasing out.[205] The continued use of the allowances parallel to the CBAM, also considering that the free allowances will only be phased out over time would, as one former Appellate Body member noted, "unquestionably be a violation of the national treatment rule",[206] demonstrating that the phasing out of these allowances are of the utmost importance for compliance with the NT-principle. Moreover, in their current format, these free allowances may already be in breach of WTO subsidy rules, further indicating that the balancing of the costs of domestic and imported products that the CBAM is meant to bring about, is important if one wishes to be in line with WTO rules.[207]

In terms of the MFN principle, compatibility is less straightforward. Countries are exempt from the CBAM if they are integrated into the ETS or have a carbon pricing system that is sufficiently linked to the ETS. So far, only Iceland, Lichtenstein, Norway, and Switzerland fulfil the criteria.[208] For products originating in other countries, it may be allowed to surrender fewer CBAM certificates if a carbon cost has been paid in that country.[209] From an MFN perspective, this gives rise to ambiguities. One such is whether it is discriminatory that a country is not excluded from the CBAM if it has an emissions trading scheme or other type of carbon pricing that is not considered sufficiently similar to the ETS.[210]

The CBAM applying universally also means that it does not account for differences in development status.[211] As mentioned earlier, developing countries have argued that the CBAM is discriminatory because countries differ in terms of whether they can calculate carbon emissions in production.[212] The CBAM recourse to default values in cases where emissions cannot be properly calculated[213] could thus make the CBAM discriminatory de facto. Furthermore, countries have questioned the CBAM in the context of the principle of *Common but Differentiated Responsibilities and Respective Capabilities*.[214] The principle is enshrined in the Paris Agreement and therefore a core part of the international environmental framework.[215] In general, exempting developing countries from the CBAM is in breach of the MFN-principle in so far as it discriminates on account of origin.[216] Nevertheless, the so called

[204] For a general and exemplified discussion on the National Treatment principle and carbon border adjustment, see Pauwelyn and Kleimann 2020 (n. 21) pp. 9-10.

[205] G/MA/M/79 (n. 80) para 22.13.

[206] Bacchus 2021 (n. 42) accessed 19 May 2024.

[207] Ibid.

[208] Reg (EU) 2023/956 (n. 17) art 2(6) and Annex 1.

[209] Ibid art 9.

[210] Sapir 2021 (n. 41) accessed 3 May 2024.

[211] Ibid.

[212] Hancock 2022 (n. 15) accessed 10 April 2024.

[213] Reg (EU) 2023/956 (n. 17) art 7(2).

[214] G/MA/M/79 (n. 80) para 22.18.

[215] Paris Agreement to the United Nations Framework Convention on Climate Change (Paris Agreement) [2015] art 2(2).

[216] Pauwelyn and Kleimann 2020 (n. 21) p. 10.

"enabling clause" of the WTO justifies preferential trade treatment for developing countries.[217] It is, however, not certain that exempting developing countries from a carbon border adjustment instrument would be permissible under the enabling clause, since it appears as though it would be dependent on the CBAM being deemed a tariff or that the instrument is a multilateral GATT agreement.[218] With the rise of carbon border adjustment as a climate tool and considering that other countries are contemplating introducing one,[219] a multilateral approach and understanding in the context of the WTO, including the possibilities for a waiver for developing countries, could clarify issues of compliance.[220]

4.4 Exceptions under GATT Article XX

Notwithstanding the above, the CBAM can be exempt from the obligations under the GATT pursuant to the GATT exceptions. Article XX states: "Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures: […] (b) necessary to protect human, animal or plant life or health; […] (g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;".[221] Despite the order of words in the Article, the Appellate Body has emphasised that an analysis of compliance should start by recognising whether the measure in question falls under one of the specific exemptions (a-j), followed by a review of its relationship to the chapeau.[222]

Firstly, it could be noted that the Appellate Body has emphasised that it is for each Member to decide on their environmental legislation and objectives as well as the relationship between such policy and trade, in so far as the obligations under the WTO Agreements are respected.[223] As stated above, in terms of Article XX(b), a measure must be considered "necessary". In addition to exception (b), the word is also found in the same sense in exceptions (a) and (d).[224] Interpreting the concept in the context of exception (d), the Appellate Body in *Korea – Various Measures on Beef* held that "necessary" does not necessarily mean "indispensable", "of absolute necessity", or "inevitable". Instead, the term can mean anything from the concepts mentioned above to "making a contribution to". However, the Appellate Body also stated that they understood it as being closer to the meaning of "indispensability"

[217] Contracting Parties, "Differential and more favourable treatment reciprocity and fuller participation of developing countries" (Decision) (28 November 1979) L/4903.

[218] Sunayana Sasmal, Dongzhe Zhang, Emily Lydgate, and L. Alan Winters "Exempting Least Developed Countries from border carbon adjustments: A legal and economic analysis" (4 October 2023) Centre for Inclusive Trade Policy Briefing Paper 5, pp. 6-7.

[219] Joint Economic Committee Democrats 2024 (n. 168) accessed 3 May 2024.

[220] Sapir 2021 (n. 41) accessed 3 May 2024.

[221] GATT (n. 22) art XX.

[222] Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted 6 November 1998, paras 118-119.

[223] Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, p. 30.

[224] GATT (n. 22) art XX.

than "making a contribution to".[225] Following this line of reasoning, the Appellate Body in *Brazil-Retreaded Tyres* stated: "in order to determine whether a measure is "necessary" within the meaning of Article XX(b) of the GATT 1994, a panel must consider the relevant factors, particularly the importance of the interests or values at stake, the extent of the contribution to the achievement of the measure's objective, and its trade restrictiveness. If this analysis yields a preliminary conclusion that the measure is necessary, this result must be confirmed by comparing the measure with possible alternatives, which may be less trade restrictive while providing an equivalent contribution to the achievement of the objective. This comparison should be carried out in the light of the importance of the interests or values at stake."[226] It thus appears that the Appellate Body prescribes an initial analysis that includes what interests and values the measure is intended to address and the importance of these, how the measure contributes to its aims, as well as its effect on trade. A potential subsequent analysis should examine whether there are alternative measures that have a more favourable impact on trade while maintaining the desired level of protection.

In *Korea-Various Measures on Beef*, the Appellate Body indicated that it may be suitable to consider the "relative importance" of interests or values and that a measure is more likely to be deemed necessary if the interests and values it is intended to address weigh heavily.[227] In this context, the Body in *Brazil-Retreaded Tyres* noted that the protection of human life and health as well as the environment should be considered important values.[228] In this latter case, in which the contested measure was an import ban and the issue at question whether it was permissible under Article XX(b), the Appellate Body found that the measure had to provide "a material contribution to the achievement of its objective" to be approved under Article XX(b).[229] It further noted that some measures relating to, for example, climate change cannot be assessed until sufficient time has passed for the measure to take effect but ascertained that this is not a problem with regard to Article XX(b). Consequently, trade restrictive measures need not have immediate identifiable effects to be approved on the basis of XX(b).[230] In terms of effects on trade, the Body agreed with the Panel's conclusion that considering the values concerned (including the protection of human life and health and the environment), the achievement of its aims were superior to the trade restrictive nature of the measure.[231]

If the measure is initially considered necessary in accordance with the above, an analysis should be made of alternatives. Under the procedure of such an analysis, it is for the Member challenging the measure to propose alternatives that allow the Member whose measure is challenged to retain the protection level it wishes.[232] The challenged Member may then show why these options are not reasonable, because they either do not fulfil the desired objectives, because the Member is not in a

[225] Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001, para 161.

[226] Appellate Body Report, *Brazil – Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R, adopted 17 December 2007, para 178.

[227] *Korea – Various Measures on Beef* (n. 225) para 162.

[228] *Brazil-Retreaded Tyres* (n. 226) para 179.

[229] Ibid, para 151.

[230] Ibid.

[231] Ibid, para 179.

[232] Ibid, para 156.

position to implement the measure, or because it would involve an unreasonable burden.[233] If an alternative is deemed to fall under the above, the original measure should be considered necessary.[234] When analysing the alternatives, the Appellate Body has taken into account the potential risks of such alternatives as well as their effectiveness in relation to the original measure in achieving the desired objectives.[235]

In terms of the CBAM, it must thus be proven that its means (border adjustment) is justified for its ends (addressing carbon leakage and consequently climate change). In the context of border carbon measures, it has been suggested in doctrine that while there are alternatives, such as the free allowances already in force, they are not as effective as a carbon cost in terms of environmental protection.[236] Furthermore, border adjustment restricts, but does not prohibit, trade, thus constituting a comparatively trade-friendly option.[237] On the other hand, it has also been noted that a carbon tax would arguably provide the same level of environmental protection while at the same time being compliant with WTO rules and not as potentially trade restrictive as the CBAM, making it unlikely that the CBAM could be considered "necessary".[238] Referencing the discussion in section 4.2, this latter point is of course relevant if the CBAM is not considered to be a tax.

It is worth noting that a Panel has concluded that measures aimed at reducing CO_2 emissions can fall under Article XX(b).[239] However, doctrine has noted that it might be possible for carbon border measures to be more easily justified on the basis of Article XX(g), since the term "relating to" is more easily fulfilled than "necessary to".[240] Referencing the wording of the Article as stated above, an analysis of XX(g), must thus consider the term "relating to", what constitutes exhaustible natural resources, as well as whether the measure has a domestic counterpart.

In terms of "relating to", the Appellate Body has indicated that there should be a clear link between the measure and conservation. In *US-Gasoline*, the Body agreed with the notion that a measure should be "primarily aimed at" its goal to be considered "relating to" in the context of Article XX(g). However, it also underlined that "primarily aimed at" is not a test to be passed.[241] In *US-Shrimp*, the Appellate Body considered the layout of the measure, and argued that since it was not introduced without regard to its effects and that "the means are, in principle, reasonably related to the ends", it fulfilled the criterion of "relating to".[242] In terms of "exhaustible natural resources", the Appellate Body has applied the concept broadly to include mineral, non-living, and living resources and stated that "we do not believe that "exhaustible" natural resources and "renewable" natural resources

[233] Ibid.
[234] Ibid.
[235] Ibid, paras 174-175.
[236] Pauwelyn and Kleimann 2020 (n. 21) p. 11.
[237] Ibid.
[238] Bacchus 2021 (n. 42) accessed 19 May 2024.
[239] Reports of the Panel, *Brazil – Certain Measures Concerning Taxation and Charges*, WT/DS472/R, WT/DS497/R, 30 August 2017, para 7.880.
[240] Porterfield 2023 (n. 21) p. 11.
[241] *US-Gasoline* (n. 223) pp. 18-19.
[242] *US-Shrimp* (n. 222) para 141.

are mutually exclusive.[243] The Body in *US-Gasoline* indicated that clean air can be classified as an exhaustible natural resource.[244] In an appreciation of potential exhaustibility, the Appellate Body has referenced the description of the resource in question in international conventions.[245] Furthermore, the Body has emphasised that the concept is dynamic and should be considered in relation to the environmental circumstances prevailing when the concept is interpreted.[246] Given its effects, it is thus reasonable to believe that climate change might fall under the concept "exhaustible natural resources" in the context of XX(g).[247] In the case of domestic restrictions, the Appellate Body has noted that there is no need for identical treatment between domestic and foreign products. If the same restrictions apply, a need to rely on the exception in Article XX is not necessary.[248] However, if no restrictions are put on domestic like products, the goal of the measure cannot be considered solely environmental.[249] The Body has instead considered "even-handedness"[250] and compared the features of measures affecting domestic goods with those affecting imported ones.[251] It has been suggested that a CBAM based on a domestic price on carbon would equate products of domestic origin and imports so as to meet this condition.[252]

If a measure is considered to fall under one of the exceptions in XX, it should thus be analysed whether it is also allowed in light of the chapeau. In reference to Article XX, the measure cannot "constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail" or be "a disguised restriction on international trade".[253] The Appellate Body has noted that the chapeau is primarily concerned with the application of a measure rather than the contents of it. Importantly, it is meant to prevent abuse of the exceptions and ensure that the general provisions of the GATT still apply.[254] Furthermore, "arbitrary or unjustifiable discrimination" and "disguised restrictions" are not mutually isolated terms but may be analysed in connection to each other. Disguised restrictions, for example, contain an aspect of discrimination.[255] In addition, compliance with the chapeau is inherently dependent on the individual circumstances in each case: "The task of interpreting and applying the chapeau is, hence, essentially the delicate one of locating and marking out a line of equilibrium between the right of a Member to invoke an exception under Article XX and the rights of the other Members under varying substantive provisions […] so that neither of the competing rights will cancel out the other […]. The location of the line of equilibrium, as expressed in the chapeau, is not fixed and unchanging; the line moves as the kind and the shape of

[243] Ibid, para 128.
[244] *US-Gasoline* (n. 223) pp. 14-19.
[245] *US-Shrimp* (n. 222) para 132.
[246] Ibid, para 129.
[247] Porterfield 2023 (n. 21) p. 11.
[248] *US-Gasoline* (n. 223) p. 21.
[249] Ibid.
[250] Ibid, pp. 20-21.
[251] *US-Shrimp* (n. 222) para 144.
[252] Porterfield 2023 (n. 21) p. 11.
[253] GATT (n. 22) art XX.
[254] *US-Gasoline* (n. 223) p. 22.
[255] Ibid p. 25.

the measures at stake vary and as the facts making up specific cases differ."[256] Among the cases mentioned above, the contested measures in both *Brazil-Retreaded Tyres*[257] and *US-Gasoline*[258] were considered to fall under Article XX(b) and (g) respectively but were not considered to fulfil the requirements of the chapeau and were therefore not approved for exemption.

In *US-Shrimp*, the measure was also initially considered not to be exempt under the chapeau. While noting that unilateral measures imposed by an importing Member requiring that exporting Members complies with or adopts certain policies are not necessarily unjustified, the Appellate Body argued, inter alia, that the particular measure in question lacked flexibility and required, in practice, that other countries adopted "essentially the same" legislation as the US without accounting for different conditions prevailing in different countries.[259] This, the Body decided, constituted "unjustified discrimination" and was therefore not exempt.[260] However, due to Malaysia's concerns that the United States had not modified its measures in accordance with the Appellate Body ruling, the case was considered anew by recourse to Article 21.5 of the *Dispute Settlement Understanding* (DSU).[261] The US claimed that it had addressed the concerns raised by the previous ruling, by, among other things, addressing the lack of flexibility and entering into negotiations on an agreement with the countries concerned.[262] This was confirmed in the panel report and the subsequent Appellate Body decision. In its decision, the Appellate Body agreed with the panel in that in the revised measure, the US did not require a system that was "essentially the same" as its own, but rather one that was "comparable in effectiveness".[263] This increase in the level of flexibility meant, inter alia, that the actions of the USA were no longer in violation of the chapeau.[264] In addition, and with reference to the line of reasoning in *US-Shrimp*, the Body in *Brazil-Retreaded Tyres* stated that "the assessment of whether discrimination is arbitrary or unjustifiable should be made in the light of the objective of the measure."[265] Consequently, discrimination cannot be justified in light of the chapeau on a basis unrelated to the one used to approve the measure as falling under one of the specific exceptions (a-j) of Article XX.[266]

The Appellate Body's decisions on the chapeau have possible implications for the evaluation of carbon border adjustment instruments. While unilateral measures conditioning access to a market are thus not prohibited, such measures must provide a certain level of flexibility and not require the exporting country to introduce measures that are more or less identical to the ones utilised by the importing Member: "The Appellate Body's jurisprudence in the Shrimp-Turtle dispute

[256] *US-Shrimp* (n. 222) para 159.
[257] *Brazil-Retreaded Tyres* (n. 226) para 258.
[258] *US-Gasoline* (n. 223) p. 29.
[259] *US-Shrimp* (n. 222) paras 121, 161, 164-165.
[260] Ibid, paras 161, 187.
[261] Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia*, WT/DS58/AB/RW, adopted 21 November 2001, para 2.
[262] Ibid, paras 31, 39.
[263] Ibid, para 144.
[264] Ibid, paras 135, 144, 153.
[265] *Brazil-Retreaded Tyres* (n. 226) para 227.
[266] Ibid, paras 227, 232.

suggests that carbon import fees that are contingent on whether an exporting country adopts a particular policy approach rather than on meeting a certain emissions goal could be deemed to be impermissibly coercive and therefore constitute arbitrary or unjustifiable discrimination."[267] To develop this line of reasoning, the ambiguities being raised in relation to the NT and MFN-principles could also be an issue in relation to the chapeau. It is perceivable, for example, that it may be problematic from an arbitrary-or-unjustifiable-discrimination point of view that the EU has the discretion to determine what constitutes adequate climate action in another WTO Member State and thus whether its producers can benefit from deductions in terms of CBAM certificates.[268] Similarly, the simultaneous use of the CBAM and free allowances would possibly be considered "a disguised restriction on international trade".[269]

It has also been noted, however, that a tax on imports to the EU based on emissions does not necessarily require the exporting country to implement a certain policy.[270] In addition, despite the fact that adjusting the cost depending on what has already been paid in the country of origin and possibly exempting developing or least developed countries from the CBAM could be considered discriminatory (see discussion under section 4.3), it could be motivated under Article XX if it is clear enough that the CBAM is an environmental measure. In this way, discriminatory measures can be seen as a way to internalise a negative externality (carbon emissions) or to take into account the *Common but Differentiated Responsibilities and Respective Capabilities* principle.[271] Moreover, there is a possibility that these countries would be considered to have different conditions, in which case, with reference to the chapeau, there is no discrimination to start with.[272] To really emphasise that the CBAM is intended as a genuine environmental instrument that can be exempted under Article XX, it has been suggested that instead of income from the CBAM going to the EU budget, it should be earmarked for environmental policies.[273]

[267] Porterfield 2023 (n. 21) p. 13.
[268] Bacchus 2021 (n. 42) accessed 19 May 2024.
[269] Ibid.
[270] Pauwelyn and Kleimann 2020 (n. 21) p. 11.
[271] Ibid.
[272] Ibid.
[273] Benson et. al 2023 (n. 65) accessed 19 May 2024.

5 Summary and Conclusions

5.1 Research Questions

The research questions in this thesis are:

Is Article 192(1) TFEU a sufficient legal basis for the Carbon Border Adjustment Mechanism?

How does the Carbon Border Adjustment Mechanism relate to Articles I, II, III, and XX of the General Agreement on Tariffs and Trade in terms of possible compliance?

Based on the analysis above, these are discussed in turn below.

5.2 Legal Basis

Based on the discussion in section 3.2.2, in assessing what constitutes the appropriate legal basis, the CJEU has thus made it clear that it is the basis that reflects the main purpose and content of the instrument that should govern the choice of basis. An instrument in which an alternative object and purpose can be identified should be based only on the principal legal basis. Purposes and objectives that are merely "incidental" should thus not be determinative. If the purpose and content correspond to two or more legal bases without it being possible to establish a hierarchy between them, all of them should be indicated (pp. 19-20 above). Considering the fact that the CBAM has features indicating that either Article 114 or 207 could also be appropriate legal bases, the question is therefore whether it can be established that the centre of gravity in the CBAM is the environment, competition on the internal market, foreign trade, or whether these aims or some of them carry equal weight.

Firstly, it can be stated that there is undoubtedly an environmental aspect to the CBAM in so far as the measure is introduced because of climate change. This is reflected in the way in which the CBAM is described in the Regulation itself (p. 18 above), which is something that the Court has considered in its judgements (p. 22). As explained above in section 3.2.1, however, the Regulation states that the purpose of the CBAM is not only to manage emissions but also to ensure that goods of non-EU origin are subject to similar rules and equivalent costs as goods of domestic origin, which would potentially justify recourse to Article 114. One can imagine that in isolation from the prevailing context, the implementation of legislation aimed at equalising the relationship of domestic goods to imports need not be related to climate at all. At the same time, however, the environmental aspect is central to why it is considered important that goods of different origins have the same rules, and such isolation of elements is not possible in an analysis of a complex issue, not least if one is to follow, as one should, the circumstance-based interpretation generally applied by the CJEU (see section 1.4).

In line with the Court's reasoning in previous cases, the question is thus whether the impact on the internal market is a consequence of introducing measures to address the climate crisis. On the one hand, the problem, carbon leakage, is considered to be remedied by improving the competitive relationship, and in a sense, it thus appears as though the harmonisation of rules for goods with an origin outside and inside the EU is the means used for the environmental aim of the instrument. As such, the main focus is on how to improve the environmental situation rather than on harmonising rules, with reference to how the CJEU argued in C-155/91 and C-187/93 (see p. 21). On the other hand, is it correct to say that the impact on the internal market is only "incidental" when the measure is aimed at ensuring that the corresponding rules apply to everyone, thus improving the competitive situation that may be the result of differing environmental rules, similarly to what the Court held in *Titanium Dioxide* (pp. 20-21)?

In accordance with the opinion of the CJEU, there must be a direct link between the instrument and an impact on trade for recourse to Article 207 TFEU (see p. 22). It is undeniably the case that the CBAM has a potential impact on trade to the extent that it will cost more to import a product into the EU. Moreover, the CBAM only affects products subject to international trade, recalling the CJEU ruling in favour of the use of both Articles 192 and 207 in C-94/03 and C-178/03 (p. 22). Having said that, the question is if it is possible to establish that the CBAM will "directly and immediately" affect trade. The impact can perhaps only be considered potential as imports are still allowed as long as certificates are bought and surrendered according to the rules. In this sense, and with a comparison to the arguments of the Court in C-411/06 (pp. 22-23), the focus is rather on ensuring that the environmental aspect is considered in trade, rather than regulating trade itself.

As pointed out earlier, the CBAM has an element of environment, competition, and trade (pp. 18-19 above). When analysing how the legal basis should and has been applied by the Court in previous cases, it can be concluded that the use of 192(1) is at least not erroneous. Furthermore, it is difficult to see how the CBAM would pass the de facto test set by the Court for the appropriateness of using Article 207. However, it is a little more difficult to say with certainty that the CBAM does not have an objective and content corresponding to Article 114. Perhaps the question is whether the statement in the Article itself, that it is to be used only if there is no other more precise article (p. 20), suggests that only Article 192(1) is appropriate. On the other hand, as can be deducted from this discussion, it is not necessarily self-evident that the improvement of the competitive situation on the internal market is not intrinsically linked to the environmental aspects of the CBAM. The solution offered in another case, to utilise both 192(1) and 114 as legal bases but clarify if there are certain provisions that are based on a certain article (pp. 21-22 above), would perhaps be a possibility.

To answer the research question, the above discussion shows that while the use of Article 192(1) is not necessarily wrong, a case could be made that it is not sufficient.

5.3 The CBAM and the GATT

Firstly, drawn from the discussions in sections 3.2.3 and 3.2.4, there is discretion on the part of the EU under EU primary law to introduce international measures that are unilateral and potentially trade restrictive. Furthermore, while the EU is bound to follow its obligations under international law, invoking provisions of international law to challenge an EU measure in an EU court is difficult, not least in terms of the agreements under the WTO. On this basis, although the CBAM may conflict with GATT rules, it is important not to equate WTO rules with EU rules. If the CBAM leads to a dispute in the WTO, it needs to be resolved within the framework of that process. However, to return to the discussion in section 1.1 on the EU's new policy orientation, it is important to remember that the CBAM, although OSA may be a new type of behaviour by the EU, is not necessarily at odds with what the EU is "allowed" to do under its own rules.

Regarding the relationship between the CBAM and the GATT Articles, there are ambiguities, not least because the actual implementation matters for compliance. Firstly, there is a need to define the CBAM and the ETS in the context of WTO law. As follows from the discussion in section 4.2, Articles II and III regulate and affect the ability of the CBAM to, in compatibility with WTO law, be a measure that can be introduced or applied on imported goods. Import duties in excess of the rates specified in each party's Schedules of Concessions are not permissible under the GATT. However, charges that are considered internal taxes, rather than tariffs, may be imposed also on imported products, as long as they are indirect rather than direct taxes. The general view is that carbon taxes constitute an indirect and not a direct tax. A key aspect seems to be that there is no discrimination, which the ETS could ensure in the case of the CBAM. However, there is a possibility that the ETS may not be considered an internal tax but rather an internal regulation. If so, the CBAM must also be defined as an extending regulation to be authorised for adjustment. Nevertheless, it is important to note that the Appellate Body has indicated that an internal measure can only be considered as such if the requirement to pay is triggered by an internal event such as the distribution or sale of the goods in question, not if the condition for paying is the act of importation.

Assuming that the CBAM is deemed an internal measure, the following should apply based on the analysis in section 4.2: If both the ETS and the CBAM are considered indirect taxes (as is usually the case for carbon taxes), border adjustment should in principle be permissible. If they are considered direct taxes, border adjustment is not allowed. If, on the other hand, the ETS is considered an internal regulation while the CBAM is considered a tax, the GATT does not allow for such an adjustment. If they are considered as connected internal regulations, the adjustment should be compatible with the relevant GATT articles.

Regarding the non-discrimination principles in Articles I and III, it is clearer how the CBAM fulfils the NT principle in Article III. It appears that the CBAM is compatible if the free allowances are phased out. However, problems may arise during the phasing-out period if goods originating in the EU gain an advantage. In terms of the MFN principle, there are ambiguities regarding what applies to countries with a carbon offset scheme that is not considered sufficiently similar to that of the

EU, the use of default values, and how the status of developing countries should be taken into account (pp. 31-32 above). There are thus several potential pitfalls for the CBAM in an MFN analysis in a dispute procedure. Regardless of whether the CBAM is judged to violate the MFN principle, this shows the desirability of dealing with these issues multilaterally in the WTO, not least in view of the fact that the introduction of a CBAM has also been discussed in other countries and may therefore become an increasingly common instrument (p. 32).

Finally, the CBAM can be exempted from the rules discussed above under Article XX if it fulfils the requirements of the Article of falling under one of the specific exceptions and being compliant with the chapeau (p. 32). As the discussion shows, there are several aspects that need to be clarified and defined in an analysis. What can be concluded, however, is that based on the judgement of the Appellate Body in previous disputes, the unilateral nature of the CBAM and the conditions included are not issues as long as there is a level of flexibility for trading partners (see pp. 36-37). Furthermore, an important aspect seems to be that the measure is clearly environmentally oriented. As it appears from the analysis in section 4.4, a measure should not include rules that cause discrimination or barriers to trade that are unjustified in relation to the intended and desired environmental protection that the measure is meant to bring about. Based on the discussion, however, it does not seem inconceivable that the CBAM could be exempt according to Article XX.

It is also interesting to highlight the fact that the EU believes that the CBAM is in line with WTO rules while at the same time emphasising that the CBAM is entirely an environmental instrument. However, based on the discussion in sections 4.2 and 4.3 above, it appears that for the CBAM to be compatible with the GATT it must have a competition element to it, i.e. that the CBAM is introduced to correspond to the ETS. If the environmental consideration governs, there is a need instead to rely on the exceptions in Article XX. Regardless of how the CBAM would be judged in a dispute, the EU CBAM is a clear example that the relationship between trade and the environment and their respective international legal frameworks is perhaps more relevant than ever.

To answer the research question, the relationship between the CBAM and the GATT Articles is ambiguous, and in order to determine the possibilities for compliance, aspects of the CBAM would have to be further defined within the context of WTO law, possibly as part of a dispute procedure.

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