University of
Southern Denmark

A New Era of Climate Measures

A Legal Assessment of The European Union's Carbon Border Adjustment Mechanism

(En ny æra af miljøtiltag – en juridisk vurdering af den Europæiske Unions CO_2-grænsetilpasningsmekanisme)

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Abstract

Dette speciale undersøger, hvorvidt EU's CO_2-grænsetilpasningsmekanisme er forenelig med gældende international ret inden for Verdenshandelsorganisationen.

Specialet indledes ved at identificere de generelle kendetegn, der er ved grænsetilpasningsmekanismer, og hvad deres funktioner er inden for markedet. Dette ses både i lyset af de bagvedliggende miljømæssige hensyn, men også de protektionistiske undertoner, sådanne tiltag måtte have. Derefter identificerer specialet de specifikke designelementer, som findes i forslaget til grænsetilpasningsmekanismen, som Den Europæiske Kommission har fremlagt ved en forordning i 2021. Specialet finder, at der er flere elementer, som kan sættes spørgsmålstegn ved, herunder måden man udregner prisen, som skal betales ved import; sektor- og produktafgrænsningen inden for forordningens anvendelsesområde og den måde, hvorpå man kan opnå rabat eller kan undtage forordningen ved at et tredjeland har samme slags eller en lignende mekanisme, som EU har indført.

Herefter behandler specialet udvalgte materielle regler i GATT-aftalen, herunder GATT art I:1 og dele af GATT art III. Det undersøges om de brud, der findes på de materielle bestemmelser kan undtages ved GATT art XX. Specialet finder, at der sker et brud på GATT art I:1, idet grænsetilpasningsmekanismen tildeler nogle lande fordele, men at disse fordele ikke er udstrakt til alle lande, som eksporterer varer til EU, og på den måde er forordningen uforenelig med bestemmelsen. Derefter findes det, såfremt grænsetilpasningsmekanismen kan regnes for at være en skat efter GATT art III:2, at der sker der et brud på bestemmelsen, fordi forordningen beskatter importerede varer mere end nationalt producerede varer. Det undersøges yderligere, om der findes et brud på GATT art III:4, hvis det findes at forordningen er en regulering. Det konkluderes, at grænsetilpasningsmekanismen er forenelig med GATT art III:4, idet forordningen, om end tiltaget har diskriminerende kvaliteter, ikke er det på en måde, der er uforenelig med GATT art III:4, fordi beregningen af pris, som skal betales ved import, er baseret i faktiske udledninger af drivhusgasser. Desuden kan den evt. diskrimination forklares ved, at den er baseret på andre forhold end produktets oprindelse.

Tilslut findes det, at brudene på GATT bestemmelserne ikke kan undtages efter GATT art XX, selvom forordningen kan omfattes af undtagelsen i GATT art XX(g). Dette skyldes, at grænsetilpasningsmekanismen er for ufleksibel og dikterer, hvordan tredjelande skal gennemføre deres politikker på en måde, som ikke er forenelig med bestemmelsen. Desuden kan forordningen også tillægges et underliggende protektionistisk element, som ikke er foreneligt med GATT-aftalen.

Dele af EU's CO_2-grænsetilpasningsmekanisme er på denne måde ikke kompatibel med GATT-aftalen.

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1 Introduction

Climate change and climate protection have been on the agenda of international organizations since the adoption of the Paris Agreement in 2015 and even before then. The Paris Agreement sets out ambitious goals for climate change mitigation and is binding in nature. Although, it provides considerable leeway for states to determine which measures they consider necessary to implement, in order to support and achieve these goals, as outlined in art 3 of the Paris Agreement. However, someone must be the first to act with an ambitious climate action plan and pave the way for new climate policies that make a difference, but who is to determine, which way is the right way?

Ambition must be a keyword to meet the goals outlined in art 2 of the Paris Agreement from 2015. The provision sets forth a goal in its sub-paragraph (a) that the Paris Agreement aims to strengthen the response to climate change by holding the average temperature below 2 °C and pursuing to limit the temperature increase to 1.5 °C above pre-industrial levels. The European Union (EU) boasts of being the mainstay in combatting climate change mitigation. It is therefore no surprise that the EU has set forth a proposal for an ambitious climate action plan, The Green Deal. This deal is the main effort for the EU to become Greenhouse gas (GHG) i.e., carbon neutral by 2050.[1] Within the Green Deal, one will find the most questioned climate-related trade measure at the moment. This measure is a proposed carbon border adjustment mechanism (CBAM), which builds upon the current EU Emission Trading System (ETS). The main objective of the EU CBAM is to ensure and encourage a reduction in GHG emissions within emission-intensive sectors, while still protecting the competitiveness of the single markets.[2] CBAMs raise many questions within international trade, because they are of cross-border nature and thus reach beyond lawmakers' jurisdiction to still have coveted nationally produced products. The issue is especially prevalent for EU measures. The EU is a large trading partner to many countries; therefore, it is inevitable that measures of this kind will have a tangible effect beyond the borders of the single market.

[1] Europa.eu (2023). *Fit for 55*.
[2] European Commission - European Commission (2023). Press corner, Carbon Border Adjustment Mechanism: Questions and Answers

There are various issues relating to the EU CBAM and the general use of trade measures concerning climate change mitigation, which questions their legality within the multilateral trading system. In general, most measures are exempted due to their objective to protect the natural environment or the people within it. However, the extensive use of this exemption can also be seen as a cover for protectionist measures. The design of these measures must therefore be carefully considered and not just be analyzed in relation to mere statements by legislators. This gives rise to the following thesis statement:

1.2 Thesis Statement

This master's thesis examines in which way the design of CBAMs gives rise to trade concerns. Furthermore, it will investigate if the EU CBAM Proposal is in accordance with the law of the World Trade Organization (WTO) based on the design choices of the commission. Lastly, this master's thesis assesses if the EU CBAM Proposal can be exempted under WTO law.

2 Delimitation

CBAMs can be understood as an umbrella term for multiple border measures focusing on targeting GHG emissions with the main objective to mitigate climate change. However, this master's thesis is only concerned with the EU-proposed CBAM as found in document 52021PC0564, referenced as the EU CBAM. In the name of transparency, it must be noted that the Council adopted the EU CBAM Regulation on the 25th of April 2023. The methodical difficulties in relation to this will be discussed below in sec. 3. Due to space and time constraints of the master's thesis the assessment of the issue is based on the EU CBAM Proposal and not the EU CBAM Regulation.

The master's thesis opens with a paragraph on the structure of CBAMs in general, and how different design features constitute different issues. The master's thesis will have its main focus on the EU CBAM in the legal analysis concerning the rules of the General Agreement on Tariffs and Trade (GATT). The EU CBAM is highly related to the EU ETS system. However, this master's thesis will mainly focus on the elements of the EU CBAM and only include the EU ETS to the extent it is necessary within the legal

assessment. It will be briefly explained in which way they will co-exist and how they work together.

Some parts of the EU CBAM are highly scientific. This master's thesis does not question the scientific groundwork, it solely seeks to evaluate the legality of the proposed regulation. Scientific aspects of EU CBAM will only be included to the extent the legal analysis dictates so.

The EU CBAM gives rise to questions about compatibility with other WTO Agreements. This includes the Agreement on Subsidies and Countervailing Measures (SCM Agreement). The EU parliament has proposed the EU CBAM should include export rebates.[3] Scholars have discussed that export rebates are subsidies within the meaning of the SCM Agreement.[4] However, as the measure stands at the time of writing and the adopted version, the EU CBAM does not include such rebates. This discussion is therefore not included in this master's thesis.

It should be noted that an assessment of GATT art II would also be relevant in connection to the legal evaluation of the EU CBAM so far it can be established to be a border measure, however, due to space limitations according to the formalities of this master's thesis this assessment will not be included. This thesis will focus on the GATT art I, III:2, III:4, and XX.

Furthermore, it can be questioned if the Agreement on Technical Barriers to Trade (TBT Agreement) applies to the EU CBAM. On its preface, the EU CBAM falls outside the scope of the TBT agreement, as it will not be deemed a technical regulation within the meaning of annex 1.1 of the TBT agreement. This is mainly because the EU CBAM does not lay down product characteristics and therefore does not constitute a technical regulation within the meaning of annex 1.1 of the TBT agreement. To elaborate when assessing if a measure is a technical regulation, it is subject to a three-tier test as outlined in the Appellate Body (AB) report*, EC – Sardines,* para 176, with reference to the AB

[3] European Parliament (2022), Amendment 262 (Article 31, para 1b (new))
[4] Espa, et al. (2022), p. 14-15 and Leonelli (2023), entire text questions the issue

report, *EC – Asbestos,* para 66-70. The AB prescribes the test includes assessing if the measure (i) applies to an identifiable group of products, (ii) lays down one or more characteristics of the product, and (iii) ensures mandatory compliance.

The EU CBAM applies to emission-heavy industries, such as the production of steel and aluminum, electricity, and iron, and applies only to to goods from these industries. The scope of products is therefore carefully outlined and can be easily identified. The first step of the test is therefore fulfilled. The second step entails it laying down product characteristics. Examples of characteristics can be found in the text of annex 1.1 of the TBT agreement. This can for instance be labeling requirements, terminology, symbols, packaging, or marking. None of these statements are the case with the EU CBAM. The EU CBAM is a fiscal measure that imposes a charge on products that have not been subject to carbon pricing before. It has nothing to do with imposing or laying down product characteristics as seen in previous jurisprudence.[5]

3 Method

As a general method, this thesis uses the legal dogmatic method to answer the thesis statement. In the study of legal dogmatics, one explores a specific situation and sees if any legal norms apply, the outcome of this analysis is called subsumption. This method is used in both national and international law there is, however, there is a difference in the interpretation and type of rules of the different legal frameworks. This thesis operates within two different legal frameworks; public international law and EU law.

For transparency purposes, the EU CBAM has been adopted by the European Council on the 25 of April 2023.[6] It is yet to be published in the Official Journal of the EU.[7] The adopted regulation differs slightly from the EU CBAM. After careful consideration I found the proposal and the regulation to materially contain the same principles and obligations. The main differences are formalities and wording. Furthermore, the scope of

[5] For background knowledge see the cases: EC – Asbestos, EC – Sardines, EC – Seal Products, Australia – Tobacco Plain Packaging, US – Shrimp.
[6] Europa.eu (2023). *'Fit for 55': Council adopts key pieces of legislation delivering on 2030 climate targets*
[7] Taxation and Customs Union. (2022). *Carbon Border Adjustment Mechanism*.

which emissions are subject to the regulation has been extended to include a distinction between direct and indirect emissions[8] and limiting the calculation of emissions to solely be the direct ones on some goods listed in the EU CBAM regulation Annex II. The regulation is also slightly more flexible in relation to least developed countries (LDC) and other climate change mitigation policies,[9] which is mostly positive, as I have found this to be areas where the EU CBAM was lacking. It will come as no surprise that most of my analysis is based on the EU CBAM and not the Regulation, this is both due to timing and space limitations of the master's thesis.

3.1 Public International Law

This master's thesis is heavily based on sources of international law. This includes international agreements, treaties, jurisprudence, and relevant texts by scholars and researchers, this corresponds to the sources outlined in art 38 of the Statute of the International Court of Justice (the ICJ Statute). These can be divided into two groups of sources, primary and secondary. The primary sources are comprised of binding law that creates obligations and rights for the signing parties.[10] Secondary sources on the other hand, are used as a tool to find out what applicable law is.[11] Treaties, in this case WTO agreements, will be considered as a primary source as they are binding in nature. Therefore, the other sources are considered secondary.

3.1.1 Treaties

WTO agreements are in essence treaties. It is stated in art 3.2 of the Dispute Settlement Understanding (DSU), the interpretation of WTO rules is subject to customary rules and international public law. Therefore, the Vienna Convention on Law of Treaties (VCLT) applies to the interpretation of WTO agreements. This is also seen in case law. For instance, in AB*, US – Tuna II (Mexico),* para 371, the AB needed to determine the legal value of the TBT Committee Decision. In order to solve the issue art 31(3)(a) of the VCLT

[8] See art 3(21) for definition of direct emissions and art 3(34) for indirect emissions
[9] EU CBAM Regulation recital 71 and art 30(2)(f), special consideration when reporting, and by including more emissions in the calculation. However, the regulation is still fixated on carbon pricing and no other measures such as subsidies, see art 9 of the regulation, which is very much similar to art 9 of the proposal.
[10] Hamer & Schaumburg-Müller (2020), p. 232
[11] Ibid.

was included as an interpretative tool.[12] Within the VCLT, customary law on the interpretation of treaties is codified. Here art 31-33 are the most relevant. Art 31(1) of the VCLT provides the most central means of interpretation within treaties. Within the provision it is stated that treaties should be interpreted in good faith[13] in the context of the objective and meaning of the treaty, this is further emphasized in VCLT art 26, where it is reaffirmed that treaties are based on the principle of *pacta sun servanda*. To assist in the interpretation the annexes and preamble to a treaty should be used, cf. art 31(2) of the VCLT. This results in the most common rule of interpreting treaties which is the interpretation of the wording and interpretation of the purpose.[14] The different ways of interpreting law are intertwined and should be seen in consideration of each other.[15] An example of this can be seen in the AB case of *US – Shrimp*, para 129, where the AB states the term "*exhaustible natural resources*" should be considered in light of the preamble of the WTO agreement. In this thesis, the general interpretation of the WTO rules, therefore, adheres to the principles set out in the VCLT.

One does have access to preparatory work through the WTO website, however, this is not used in this master's thesis, as preparatory work within the framework of public international law carries limited legal value, because they are mainly documents relating to sovereign states discussing policy frameworks. They should only be used to confirm the meaning of a provision if it is not sufficiently clear or obscure.[16] This does not seem to be the case concerning the GATT provisions, which are the basis of the assessment of the EU CBAM in this master's thesis. Additionally, the fact that there is extensive case law relating to the issue, I have seen no need for the use of preparatory work during the writing process.

3.1.2 Case Law

Case law, meaning reports from the Dispute Settlement Body (DSB) within the WTO system, is considered a source of law under art 38 (1)(d) of the ICJ statute. They will be

[12] AB, US – Tuna II (Mexico), para. 371
[13] International Law Commission, p. 219
[14] Ibid., p. 218
[15] Hamer & Schaumburg-Müller (2020), p. 244
[16] International Law Commission, p. 223

perceived as secondary sources of law, as they are only binding to the parties of the dispute. Panel and AB Reports have a special status within the multilateral trading system. They automatically become binding to the parties after being adopted unless the parties decide that they will not be binding.[17] Therefore, one must be attentive to this fact when assessing case law. Furthermore, it has been heavily emphasized in case law that Panel and AB reports create legitimate expectations within the legal framework of the multilateral trading system. In AB, *US – Stainless Steel (Mexico)* the AB stated that Panel and AB reports become "*part and parcel of the aquis of the WTO dispute settlement system."*[18] They are therefore an important source of law within the system, and followingly also heavily relied upon in this thesis.

When concerning oneself with case law from the DSB it is worth noting that the appointment of new AB adjudicators has been blocked by the US since 2016[19] and since December 10th 2019 there have not been enough adjudicators to establish an AB Panel.[20] This has left WTO members unable to appeal cases within the two-tier system, and leaves a legal void, as the interpretation of WTO rules is put on hold and therefore not able to be seen in the modern context that is needed to ensure a predictable and secure multilateral trading system, as provided by art 3.2 of the DSU. It has yet to be determined if this legal void which the lack of a two-tier system creates, when Panel reports are appealed, affects the legal value of Panel Reports. It seems unlikely, as adopted reports are binding for the parties involved and will continue to provide means of legal interpretation whereas unadopted reports will continue to have the same function within the system.

An alternative has been instated in the meantime to the AB called Multi-Party Interim Appeal Arbitration Arrangement (MPIA). At the time of writing 52 out of the 164 WTO-member states have joined the initiative.[21] The MPIA is put in place according to art 25 of the DSU to ensure that WTO member states still benefit from a fully functioning DSB.[22] The MPIA has recently issued its first report/award in the case of *Colombia* –

[17] Harhoff & Barten (2017), p. 327
[18] AB, US – Stainless Steel (Mexico), para. 160
[19] Galbraith (2019), p. 822
[20] Ibid.
[21] The Multi-Party Interim Appeal Arbitration Arrangement (MPIA) - WTO Plurilaterals (2021)
[22] Ibid.

Frozen Fries, which is an important step in getting back to a more normal procedure concerning the DSB. The arbitration award was circulated on the 21st of December 2022[23], at the time of writing there has been no further arbitration at the MPIA. It has yet to be determined what kind of legal value the disputes settled by this alternative appeal system provide the multilateral trading system with, it must, however, be emphasized that this is merely an interim arrangement and is only expected to fill the gap in a limited time until a fully functioning DSB is reinstated, as promised in the outcome of the 12th ministerial conference, cf. MC 12 outcome document, WT/MIN(22)/24 - WT/L/1135, para 4. In a previous DSU art 25 case it was stated that:

"The Arbitrators' recognition of their jurisdiction, in this case, is not a unilateral extension of WTO jurisdiction, since it is dependent on the agreement of the parties to a dispute to have recourse to Article 25 of the DSU."[24]

Such arbitration awards should therefore be seen in the light of the establishing agreement even though it may be similar to the DSU. Furthermore, the use of DSU art 25 arbitration is in line with the principles of the DSU, since it provides prompt dispute settlement in line with art 3.3 of the DSU, cf. Arbitration Award, *US — Section 110(5) Copyright Act*, para. 2.5, and is thus a legitimate means to resolving disputes. Additionally, it was solidified in the AB case, *United States – 1916 act (EC)*, that it is widely accepted that international tribunals can consider WTO-law issues at its initiative under its jurisdiction, which also applies to alternative means of arbitration.[25]

It should be noted that this thesis also makes use of dispute reports from before the establishment of the WTO. better known as the GATT system. The legal value of these disputes corresponds with the legal value of DSB reports and is still relevant to this day.[26] The older disputes relate to GATT 1947 and the newer disputes relate to GATT 1994. Several elements of GATT 1947 have become part of GATT 1994[27] and the older disputes should be carefully assessed and only be used in light of the relevant provisions.

[23] WTO Arbitrators Issue Award in EU-Colombia Frozen Fries Dispute, (2022)
[24] Arbitration Award, US — Section 110(5) Copyright Act, para. 2.7, footnote 30
[25] Ibid. Para. 2.1, referencing, AB, United States – 1916 act (EC) para. 54 footnote 30
[26] GATT disputes: 1948-1995, p. 7
[27] Wto.org (2023), GATT 1947

While there is extensive case law on the subject of environmental measures within the DSB, it does, however, not include CBAMs. Due to this lack of direct similarities this master's thesis relies extensively on analogy assessments. These kinds of assessments are a legitimate way of analyzing a legal issue and is used throughout different legal disciplines when assessing a new issue within an area of law also within the framework of international law.[28]

I have consulted the analytical indexes to get an overview of case law that may be relevant for the thesis. Analytical indexes are provided by the WTO secretariat and give an overview of what both Panel and AB reports have ruled on various legal issues within specific provisions. These vary in length and thoroughness, but, concerning GATT provisions, they are quite extensive and a great help to get started with assessing case law in the right way within the legal field.

Additionally, some cases used in the assessment of the thesis statement do not directly relate to the GATT provisions. Typically, they relate to provisions within the TBT agreement. This analogy assessment is legitimized since elements of the GATT provisions can be found throughout WTO agreements, the fact that the GATT expresses general principles. It should be noted that separate agreements impose different obligations and rights, something which should be taken into consideration when assessing case law.[29] Yet, it must be noted, that in a conflict between rules, the more specific agreement prevails, cf. Interpretive note to Annex 1a of the Marrakesh Agreement Establishing the World Trade Organization (WTO Agreement).

When citing cases I will be referencing their known short titles within the text and footnotes. Their long titles as well as case number can be found in the list of references.

[28] Bordin (2018), p. 29
[29] Notice the AB cases of: US – Tuna II (Mexico) (Article 21.5 – Mexico), para. 7.88, EC – Asbestos, para 80, US – Clove Cigarettes, para 111

3.1.3 Literature

This thesis also includes extensive use of literature to answer the thesis statement. Literature is considered a source of international law, cf. art 38(1)(d). Literature is non-binding, in a legal sense, therefore, it provides a means of interpretation, in this way it is a secondary source. Literature by well-known established scholars provides a legitimate source and is generally relied upon in an assessment of international law. However, it is still required to approach the sources with a critical thinking. One should remain skeptical and have a reasonable source of criticism.

3.2 EU-Law

This thesis also concerns EU law. The EU CBAM proposed regulation is centralized within the master's thesis and is used as part of a case study rather than a legal application. The EU CBAM and all other sources of EU law, including EU case law, are thusly considered facts within this master's thesis. However, the legal circumstances surrounding the proposal are explained through a thorough analysis of the legal design of the EU CBAM. This is done by assessing the preparatory work and statements by the Commission to establish the legal objective of the EU CBAM. This master's thesis does not question the legality of the EU CBAM within the Union's jurisdiction but rather assess it in accordance with international law.

3.2.1 Regulation, Directives, Preparatory Work, and Other Statements

Regulations and directives are in themselves secondary law within the EU regulatory framework. This is because they must have a legal basis in the Lisbon treaty, which includes the Treaty of the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU).[30] Their principles and objectives are derived from said treaties.[31] Regulations and directives are both binding legal documents, cf. art 288 of the TFEU, however, they differ in the nature in which they become binding.

[30] Hamer & Schaumburg-Müller (2020), p. 142
[31] Europa.eu (2023), EUR-lex, regulation

The EU CBAM is a proposed regulation. Regulations have general application, are binding in their entirety, and are directly applicable in all EU member states.[32] In this way no member state has to take any legal action for the regulation to be applicable within the state and it directly creates obligations and rights for the states and its legal entities.[33] This corresponds with its objective, as the measure seeks to regulate the carbon pricing of imports from third countries; therefore, it makes sense for it to be regulated as it must have a uniform application throughout the Single European Market.

EU legal acts are usually followed by an explanatory memorandum, as is the case for the EU CBAM. The explanatory memorandum is not binding in nature and should only be used as a means of interpretation.[34] There may be other preparatory work that is relevant, however, this is usually explained in the preamble to EU secondary law. The preambular recitals are also an important interpretative tool to look into when assessing EU law.[35] In this case the Commission has devised an Impact Assessment Report, which thoroughly explains the considerations reflected when designing the EU CBAM. These considerations include not only environmental impact, but also budgetary impact and statements by stakeholders. This is a valued document that contribute extensively to the assessment of the objective and the deliberations behind the regulation, which is needed when assessing the EU CBAM as a measure under the GATT provisions. It is, however, not legally binding.

Turning to statements by the Commission. The Commission statements in themselves are not legally binding and therefore they cannot be considered legal acts.[36] However, they can be seen to express a significant political and legal intent, and one should take note of them when addressing the legal objectives within the EU legal framework.

Within this master's thesis EU law is used as facts in the legal assessment of WTO rules. They bear no legal value in the arguments but should be considered facts as part of a case study.

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[32] Ibid.
[33] Hamer & Schaumburg-Müller (2020), p. 142
[34] Ibid., p. 147
[35] Ibid., p. 148
[36] Bacchus (2021), p. 4 and Espa, et al. (2022), p. 11

I have included the amendments to the EU CBAM by the European Parliament under the subparagraph of literature within the bibliography. This is because I have not assessed the amendments as a source of law, but as a point under the delimitation as well as briefly discussed under section 5.2.7. of this master's thesis. The EU CBAM does not include these amendments. Furthermore, the amendments have not been included in the EU CBAM Regulation, therefore they do not carry any legal value.

4 Structure

This master's thesis will begin by explaining the structure of CBAMs and the policy objectives they are trying to achieve. This will focus firstly on the different design choices that can influence the effectiveness and trade restrictiveness of CBAMs. This is followed by an assessment of how the EU CBAM fits within these different categories and a general explanation of the trade-restrictive qualities the EU CBAM may possess, and which elements must be assessed in relation to the GATT provisions.

This leads to the second section which focuses on the potential breaches of the GATT. Firstly, I will focus on art I of the GATT, which relates to the Most-Favored-Nation (MFN) principle and assess if the EU CBAM breaches this provision. Secondly, I will address the compatibility of the EU CBAM with GATT art III:2 and III:4. Lastly, I will assess art XX of the GATT to address if the potential breaches of the EU CBAM can be exempted. I will focus on the exemptions relating to environmental measures, hereinunder litra b and g.

5 The Nature of CBAMs

There are many ways to structure and design CBAMs. However, generally speaking, they have the same objective; to incentivize a lower GHG emission in the production of products in a way that stretches beyond the policymaker's borders.[37] This section seeks to highlight the issues connected to CBAMs. It is divided into two where the first part

[37] Dominioni & Esty (2023), p. 6

maps out which trade effects these may cause, in which it operates, and the second part investigates in what way the design choices of CBAMs affect this. This will also include a broader discussion of policy objectives.

Lastly, this section will include a comment and evaluation of the EU CBAM concerning the legal design of the measure and how this corresponds with the EU narrative.

5.1 CBAMs as measures

CBAMs seek to adjust the prices of trans-border goods in cases where these have not been subject to carbon prices. This is a way to ensure that nationally produced goods, which have been subject to carbon pricing, are still competitive within its domestic market concerning price compared to imported goods, which have not been subject to a carbon pricing scheme.[38] These measures are seen as environmental trade measures and seek to ensure that producers in nations that have an ambitious climate policy agenda do not suffer in the market, where products from less ambitious nations can be sold much cheaper since they are not subject to the same policy framework.[39] It is done through a special tax, tariff, or charge that may be established based on the differences or stringency of climate policies.[40] Therefore, this is also an issue of leveling the playing field between domestic and foreign products in the absence of a standardized pricing instrument.[41]

Policymakers have found different grounds for the need of CBAMs to be explained or justified. One explanation is closely related to the previous-mentioned level playing field. Under this, policymakers justify CBAMs because they seek to mitigate unfair competition in the sense that they unilaterally establish carbon pricing in the absence of a multilateral carbon pricing scheme.[42] CBAMs, therefore, try to seek trade neutrality to realize the goal of reducing climate change.[43] CBAMs are designed in a way they can easily be leveled up by increasing the price for importers without harming domestic producers concerning

[38] Espa, et al. (2022), p. 5
[39] van Asselt & Brewer (2010), p. 42
[40] Dominioni & Esty (2023), p. 6
[41] Espa, et al. (2022), p. 5
[42] Pirlot (2022), p. 28
[43] Espa, et al. (2022), p. 6

carbon pricing.[44] In this way, countries with ambitious carbon pricing can keep increasing the price without losing competitiveness with foreign producers and intrinsically put political pressure on others to adopt similar carbon pricing.[45] This has however been criticized by other countries where CBAMs have been described as green protectionism because they protect domestic producers from the negative economic consequences of their own policies.[46] This is therefore argued to create an obstacle to trade, which can be assessed under WTO law.

The second way policymakers look into the justification of CBAMs is by legitimizing them in relation to the Paris Agreement. In this agreement one of the objectives is to:

"Hold the increase in global average temperature to well below 2 C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5 C above pre-industrial levels", cf. art 2 of the Paris Agreement.

The principal way of doing this is through minimizing GHG emissions, which is now known as the biggest catalyst for the increase in temperatures globally.[47] Nations imposing CBAMs seek to incentivize and increase climate ambitions abroad,[48] but, this connection between CBAMs and the Paris Agreement has been criticized. This relates to the fact that CBAMs seek to level the carbon pricing between ambitious and less ambitious states whereas the Paris Agreement permits differences in levels of carbon pricing, as it mentions that the objective in art 2 should be achieved through national determined contribution, normally abbreviated NDC. Nevertheless, CBAMs may still be permittable under this agreement, as they justify the climate policy of a nation.

A third element is CBAMs budgetary story.[49] In many ways, since CBAMs impose a monetary barrier on goods before they enter into a market, they can generate revenue.

[44] Ibid.
[45] Ibid.
[46] Pirlot (2022), p. 31 and Espa, et al. (2022), p. 6
[47] IPCC 2022, 6th assessment Report
[48] Dominioni & Esty (2023), p. 14 and 15
[49] Pirlot (2022), p. 37

This revenue may be used in various areas, and it would be beneficial to spend the monetary gains on developing greener options for the policymaker.

There are two other explanations highlighted in Alice Pirlot's text '*Carbon Border Adjustment Measures: A Straightforward Multi-Purpose Climate Change Instrument?'*, herein the climate leadership story, which highly corresponds to the two previously mentioned policy considerations and consumption-based story. This thesis will rely heavily on the climate explanation of CBAMs as measures as this is important for the legal assessment.

CBAMs can look very different and impose border adjustments in diverse forms. In the article '*Designing Effective Border Carbon Adjustment Mechanisms: Aligning the Global Trade and Climate Trade Regimes'* by Goran Dominioni and Daniel Esty it is argued that there are two kinds of CBAMs worth taking into consideration when designing measures of this kind; effective and explicit adjustment mechanisms.

Explicit CBAMs only seek to accredit policies that explicitly put a price on GHG emissions of the exporting nation.[50] For instance if the exporting country already have an ETS in place it will not have to pay such a charge at the border of the country which has a CBAM in place. CBAMs that are explicit in nature are easier from an administrative standpoint, as they can quickly determine if there is a need for border adjustment in cases where a good is yet to be subject to carbon pricing. However, they lack a way of catching nuances in policy measures. Some environmental pricing measures can quickly turn into implicit carbon pricing, such as the Inflation Reduction Act (IRA) which is a subsidy measure enacted by the United States (US). As noted in the previously mentioned article:

"(the) debate over what policies can be translated into implicit GHG pricing is likely to intensify in the wake of the 2022 Inflation Reduction Act in the United States."[51] Parentheses added by author

[50] Dominioni & Esty (2023), p. 10
[51] Ibid., p. 11

Therefore, in this time of climate measures, it may be more policy-sound to move to effective carbon pricing.

Effective carbon pricing is characterized as CBAMS that are extended to measures that generally increase the marginal cost of emitting GHGs, therefore both explicit and implicit carbon pricing.[52] They are more likely to catch all environmental measures of fiscal nature and may be more even-handed compared to explicit CBAMs. Though the immense administrative burden allocated to this kind of measure might not be sound policymaking to have such a broad measure.

It is debatable to which extent CBAMs contribute to policy objectives. It is made very clear that they seek to build a higher climate ambition, and which is the main objective of these kinds of measures. Do they however increase their ambition? When dealing with explicit CBAMs only similar policy measures can be accounted for. The reality is that policy choices vary greatly form region and reflect regulatory tradition, tax practices, etc.[53] and who is to determine if carbon pricing is the right way to go? For the time being, only a few Western economies have emission trading systems or carbon pricing in place. This type of policy framework does not exist in Africa, South America, and Southeast Asia[54] and the warping of carbon pricing should consequently be kept in mind when addressing carbon pricing schemes, no matter what shape they take.

There are evident contradictions between the climate and financial narratives surrounding CBAMs. A way to reconcile this is by considering the two main objectives of CBAMs; leveling the playing field and political leverage, as the central functions to mitigate GHG emissions.[55] The ultimate test to ensure that the CBAMs contribute to the stated goals, is if they succeed in lowering emissions.[56] This depends on the actual design of the measure in question. These differences when addressing objectives and the differences in design choices should be kept in mind in the following section when addressing the EU CBAM and its different building blocks.

[52] Ibid., p. 10
[53] Dominioni & Esty (2023), p. 21
[54] Ibid, p. 20, figure 1 in EU Impact Assessment Report, p. 4
[55] Espa, et al. (2022), p. 7
[56] Ibid.

5.2 The EU CBAM

This section will first describe what policy objectives are connected to the EU CBAM based on what the Commission has explained as the reasons for the measure.

To determine the design choices of the EU CBAM and how these design choices seem to work with the real world and what influence they may have on the objective within the EU CBAM. I have chosen to focus on several issues; (i), I look into how the pricing of the EU CBAM work including the continuing of the free allowance scheme of the EU ETS, (ii), I will focus on what sectors and to which goods the EU CBAM applies, (iii) I asses which emissions are calculated within the measure and how it works with other policies in other countries. (iv), I will look into the way revenue from the EU CBAM is used, (v) I will assess the geographical scope of the EU CBAM, and (vi) I will briefly consider the question of not including export rebates in the measure.

This is done by looking into the specific provisions within the EU CBAM as well as assessing the Impact assessment report by the Commission. This is further elaborated in the previous section on the method.

5.2.1 Identification of the Policy Objective

The EU CBAM is a part of the Green Deal recently proposed by the EU. It is one of the measures which targets the Commission's fit for 55 Strategy[57], a strategy that seeks to lower the EU's emissions by 55% by 2030.[58] In Ursula von der Leyen's Union address from 2020, she emphasized the EU's leadership within the green transition and pinpointed that:

> *"(the) EU will move forward - alone or with partners that want to join*."[59]

[57] EU CBAM preambular recital 9, p. 17
[58] Europa.eu (2023)
[59] European Commission - European Commission (2023), State of the Union Address by President von der Leyen at the European Parliament Plenary

This was a segue into addressing the EU CBAM. The EU CBAM seeks to give incentives to more ambitious climate measures and for third parties wanting to continue to import to the EU to up the ante concerning mitigation measures. This is made clear when von der Leyen emphasizes that the EU CBAM should motivate producers to reduce carbon emissions.[60] Furthermore, von der Leyen quite strikingly says:

"*Carbon must have its price – because nature cannot pay the price anymore*."[61]

This quote summarizes the need and objective behind the EU CBAM which seems to be overarchingly rooted in environmental protection. However, on occasions, the Commission has admitted that more specific objectives are also in play concerning the EU CBAM including leveling the playing field.[62] This is mainly about equalizing carbon pricing and strengthening the EU ETS.[63]

Trade and environmental sustainability are two policy areas which intersects. This is partly due to the fact that the expansion of international trade and growth of the economy increase production and hence pollution.[64] On the other hand the international trading scheme can be a tool to establish environmental standards and make the trading of environmentally sustainable goods and services more accessible.[65] Furthermore, the general growth of wealth within a jurisdiction can also contribute to a country's ability of addressing climate change more sustainably.[66] There has been a considerable increase in environmental clauses within trade agreements both on a bilateral and regional level.[67] This trend highlights the connectedness of the two policy areas. However, there is a lack of standardization when it comes to environmental measures unilaterally. The Organization for Economic Co-operation and Development (OECD) and the WTO have both expressed worry in relation to this and calls for multilateral action.[68] The OECD has

[60] Ibid.
[61] Ibid.
[62] Espa, et al. (2022), p. 10
[63] Ibid.
[64] Oecd.org (2023)
[65] World Trade Report (2022), p. 118
[66] Ibid. P, 34
[67] Morin et al. (2018), p. 128, figure 2
[68] World Trade Report (2022), p. 39 and OECD Work on Trade (2021)

highlighted that there needs to be co-operation about environmental policies on emissions to not create pollution havens.[69] The EU is doing this by basing the application of the EU CBAM on imports. However, unilateral environmental measures may be a way to cover protectionist measures. This can be the case when environmental measures call for higher environmental standards in a country and by this reduces the competitiveness of the products of this country.[70]

In this way trade related environmental measures are two sided and should be carefully considered. This area of conflict will be further elaborated upon in section 7 of the master's thesis under the assessment of the exemption found in GATT art XX.

5.2.2 The Pricing Scheme and Free Allowances

The EU CBAM is very closely connected to the EU ETS as the Commission has also argued in the proposal from 2021.[71] The EU CBAM mirrors the pricing as seen under the EU ETS, as closely as possible, and seeks to ensure a level playing field between EU producers and foreign producers.[72] The measures, therefore, work together. However, the EU CBAM is transboundary and affects producers from third countries and thus not EU member states. The EU member states will still be subject to the EU ETS.[73] The intertwined nature of the two measures is also made clear in art 1(2) of the EU CBAM.[74] On top of this The EU ETS directive[75] is referred to throughout the proposal. This must be kept in mind when assessing the EU CBAM.

To understand the EU CBAM and its policy background we have to look at the history and the explanations of the considerations the Commission has brought forward. Industries have since 2005 been covered by the EU ETS, which is a flagship environmental measure in ensuring climate change mitigation.[76] The EU ETS is a cap-

[69] Oecd.org (2023)
[70] Morin et al. (2018), p. 130
[71] EU CBAM, COM/2021/564, p. 3
[72] European Commission - European Commission (2023), Press corner, Carbon Border Adjustment Mechanism: Questions and Answers
[73] EU CBAM, COM/2021/564, art 2
[74] Ibid., p. 25
[75] Directive 2003/87/EC
[76] Bacchus (2021), p. 2 and ibid.

and-trade system that allows a maximum of GHG emissions.[77] This cap will, over the years, decrease in size giving incentive to lower carbon emissions.[78] The EU CBAM will become an alternative to the EU ETS within its sectors and the emission caps will gradually be phased out by 2026 and are indented to be fully out phased by 2035.[79] In this interim period the EU CBAM will only apply to the emissions not covered by the free allowances under the EU ETS.[80]

The Commission has assessed several different options on how the EU CBAM should take form. Ultimately, the fourth option was chosen, as it was deemed to be the most effective in relation to keeping emissions at bay, giving the incentive to be more ambitious abroad and creating the most level playing field.[81] Option 4 is explained as:

"A Carbon Border Adjustment Mechanism on selected sectors in the form of import certificates based on actual emissions with the parallel continuation of free EU ETS allowances for a transitional period."[82]

One should take notice of the fact that the EU CBAM and the EU ETS work side by side for an extended time – essentially until 2032 when free allowances are completely phased out.[83] In this period the free allowances within the EU ETS will serve as double protection for domestically produced goods.[84] This is because some goods would partially be exempted from cost, following the EU ETS, while still benefitting from competition with imported goods on the EU market that have been subject to the EU CBAM pricing scheme that imposes a cost on emissions.[85] The transitional phase has been argued to ensure a more predictable transition for EU businesses.[86] Within the EU CBAM the potential

[77] Ibid. p. 1
[78] Ibid.
[79] (European Commission - European Commission, 2023), Press corner, Carbon Border Adjustment Mechanism: Questions and Answers and EU CBAM, COM/2021/564, p. 25, art 1(3)
[80] Ibid.
[81] EU Impact Assessment Report, p. 86
[82] Ibid.
[83] Espa, et al. (2022), p. 16
[84] Ibid.
[85] Ibid.
[86] EU CBAM, COM/2021/564, p. 10-11

unjust double protection has been taken into account. When looking at the EU CBAM, art 31(1), it is noted that:

"*The CBAM certificates to be surrendered […] shall be adjusted to reflect the extent to which EU ETS allowances are allocated free of charge".*[87]

However, the actual methodology is being left for implementation acts, cf. EU CBAM art 31(2) and is therefore far from being established. This raises questions concerning WTO compatibility.

The EU CBAM is groundbreaking in the sense that it is the first carbon pricing scheme that is extended to imports.[88] The pricing is based on the weekly average of the EU ETS pricing, cf. EU CBAM art 21 and preambular recital nr. 43. This allows for a different level of pricing, as the calculated weekly average may differ from ETS pricing, as these flows are determined daily by auction.[89] The difference in pricing levels between imported and regionally produced goods may be questioned under WTO law. It should be acknowledged that this difference in pricing may also benefit importers as it may be cheaper than the EU ETS pricing. Nevertheless, the different pricing levels may lead to less favorable treatment. There is yet to be seen how the EU CBAM pricing level differs in general from the EU ETS as there is a lack of data. As time passes it will be easier to assess the difference in pricing levels through comparable pricing curves. The Commission has argued that daily pricing will become too unclear and excessively burdensome on importers, cf. EU CBAM preambular recital nr. 43.

The direct mirroring of the EU ETS system was also considered in the impact assessment of the EU CBAM by the Commission.[90] However, this was disregarded as it was deemed less effective in comparison to the other options in the loop.

[87] Ibid. art 31(1)
[88] Joachim Monkelbaan, Figures and World Economic Forum (2022)
[89] EU Impact Assessment Report, p. 26
[90] EU CBAM, COM/2021/564, p. 8

It must also be noted that the Commission did include the possibility of creating the CBAM as a tax in its impact assessment report, but a carbon tax was deemed less effective in protecting against carbon leakage.[91] It can also be argued that taxes do not create the same incentive as CBAMs because they do not rely on the comparison to the policy choices in the country of origin.

5.2.3 The Scope of Products and Sectors

The fact that the EU CBAM is applicable to all imports of a small number of goods; steel, iron, aluminum, fertilizers, cement, and electricity, cf. annex 1 to the EU CBAM, makes it limited in scope. This rather stringent design choice may affect the legal objective of the EU CBAM and may influence its effectiveness in relation to minimizing GHG leakage. This is the case because emissions happen in all sectors of production, this results in The EU CBAM will not being able to catch all emissions, which raises questions about its effectiveness.

The Commission has assessed this issue in the Impact Report. Here it is stated that the specification of sectors is essential to its implementation.[92] The scope is limited to the most emission-intensive sectors according to the present EU ETS and may be further expanded in the future. Moreover, the sectors have been chosen due to three criteria:

"(i) terms of emissions, namely whether the sector is one of the largest aggregate emitters of GHG emissions; (ii) the sector's exposure to a significant risk of carbon leakage, as defined according to the EU ETS Directive and (iii) the balancing broad coverage in terms of GHG emissions while limiting complexity and administrative effort".[93] parentheses added by author for readability.

It is further explained that the sectors have been chosen with technical feasibility and enforceability in mind.[94] As seen in Annex I of the EU CBAM the products and materials to which the EU CBAM is applicable are very clearly defined with combined

[91] Ibid., pp. 8 and 9, for further background see pp. 31-32,EU Impact Assessment Report
[92] EU Impact Assessment Report, p. 20
[93] Wording taken from EU Impact Assessment Report, p. 21
[94] EU Impact Assessment Report, p. 21

nomenclature, normally abbreviated CN codes, which is a specific EU system comprised of further subdivisions to the harmonized system, normally abbreviated HS.[95] The products/materials in question upon importation can easily be identified to keep the administrative burden to a minimum. Furthermore, it has been considered that it should be possible to calculate the emissions within the sector. This calculation must be determined with reasonable robustness and credibility within the sector.[96] It is easier, or more feasible, to define the actual emissions in the production when it has only been through one facility.[97] Therefore, the EU CBAM only applies to basic materials and products and consequently not manufactured end products that include a blend of materials, i.e. Railway tracks, aluminum foil, and structures of iron and steel, see annex I of the EU CBAM. In this way, the most emission-intensive sectors with which the EU experiences the most trade have been selected to be the first limited scope of material and products to which the EU CBAM applies.[98] The Commission may further extend the EU CBAM to other goods and indirect emissions, but in the first implementation period, it will be more limited compared to the EU ETS, cf. EU CBAM preambular recital nr. 17. This may also be an administrative consideration due to the complexity of the measure. It has been found in various studies that:

"*a majority of leakage reduction benefits can already be obtained when a [CBAM] is applied to major energy-intensive and trade-exposed sectors.*"[99]

The fact that a low number of major emitters is targeted, is proven to be economically and administratively sound to target the most emissions, and in this way combat leakage in the most efficient way.[100]

5.2.4 Calculation of Emissions and Crediting the Policies of Third Countries

Looking at the calculation of emissions within the EU CBAM and which emissions may be included in the regulation. This is also an important component of the design of

[95] Europa.eu (2023), CN codes.
[96] EU Impact Assessment Report annex 7, p. 67
[97] Ibid.
[98] Espa, et al. (2022), p.12
[99] Ibid.
[100] Ibid.

CBAMs. As stated in annex 1 of the EU CBAM, the EU CBAM will apply to carbon dioxide (CO_2), nitrous oxide, and perfluorocarbons. The EU CBAM only applies to direct emissions during the production of the goods, except concerning electricity where indirect emissions are subject to calculation. Direct emissions are defined as:

"*Emissions taking place as part of a production process on which the producer has direct control. These include emissions from heating and cooling*."[101]

Transportation is not included in the calculation except for airfare within the EU.[102] The scope of emissions is primarily based on what one sees in the EU ETS. This is understandable as the EU CBAM seeks to establish a 'like' measure for imported products similar to the EU ETS, which only applies to domestically produced products, and they should therefore be similar to what pricing is calculated based on. However, the fact that the CBAM does not apply to transportation is questionable in the sense that the transportation sector stands for 33% of emissions within international trade.[103]

The fact that the measure only applies to direct emissions makes the EU CBAM an explicit CBAM. As further emphasized in Daniel Esty and Goran Dominioni's text explicit CBAMs give a direct incentive for exporting countries to introduce more stringent carbon pricing, though, it does not leave much leeway to determine which kind of measure would be best suited for the legal scheme already in place in the specific country.[104] This is especially prevalent within the EU CBAM because, for the imported goods not to be subject to the EU CBAM, it has to have been subject to carbon pricing similar to the EU ETS, cf. EU CBAM art 9, see art 3(23) of the EU CBAM for the definition of carbon pricing. It may be problematic to determine if the carbon pricing of a third country is equal to the EU ETS and may lead to unpleasant relations with trading partners as their climate policies are scrutinized.[105] The EU CBAM is thusly only designed to co-work with other measures relating to carbon pricing but does not take account of other types of measures promoting sustainability or mitigating climate change

[101] EU Impact Assessment Report p. 17
[102] Ibid., p. 18
[103] World Trade report (2022), p. 103
[104] Dominioni & Esty (2023), p. 14
[105] Pirlot (2022), p. 41 – indication of same problem

in other ways. The modeling on the EU ETS is justified based on the objective to ensure that regionally produced goods are not to be treated disadvantageously in comparison to imported goods, or vice versa.[106] Though it does make sense in relation to avoiding double pricing the carbon leakage on imported goods that have already been subject to a form of carbon pricing.[107]

The Commission has argued that the EU CBAM is only based on direct emissions as this is the easiest and most transparent way to calculate emissions and is the less burdensome way to assess emissions for importers.[108] This design choice is based on the consideration of trading partners. Embedded emissions are not included as this would be too burdensome a calculation. There are no specific standards concerning embedded emissions, furthermore, there are no standards in relation to carbon pricing.[109] This lack of standardization in the area brings the transparency and legitimacy of lawmaking into question. At present, it is for the first movers within carbon pricing to determine, what the cost of carbon emissions should be. This can be more or less based on scientific material but is not diplomatically negotiated. The lack of negotiation leaves some countries out of having a say in policies that can be especially burdensome and questionable within international trade. This should be kept in mind when assessing measures relating to carbon pricing.

When there is no information on directly emitted carbon during the production of goods the EU CBAM pricing scheme relies on default values.[110] The default values are determined on the basis of the emissions of 10% of the most emitting producers, meaning the companies producing products, within the EU.[111]

The whole basis of calculation is still to be tested since the EU CBAM is yet to be implemented. However, it seems the administrative burden of the measure has been heavily considered to ensure the calculation and price as transparent as possible.

[106] EU Impact Assessment Report, p. 18
[107] Espa, et al. (2022), p. 25
[108] EU Impact Assessment Report, p. 19
[109] World Trade report (2022), pp. 93-94
[110] EU CBAM, COM/2021/564, art 7(2)
[111] Ibid., annex III, para 4.1

The new regulation includes indirect emissions in the calculation of indirect emissions, which is defined as:

"Emissions from the production of electricity which is consumed during the production processes of goods, irrespective of the location of the production of the consumed electricity."[112]

This is not a big difference, but it does include a broader spectrum of emissions in its adopted version vs. the proposal. This speaks in favor of the EU CBAM Regulation having an environmental objective compares to the EU CBAM as proposed.

5.2.5 Use of Revenue

Turning to the use of revenue from the sale of CBAM certificates. Revenue from the purchase of EU CBAM certificates is considered an ancillary effect, and the revenue generated is not considered at the heart of the measure.[113] The revenue will be allocated as an EU-own resource and will become a part of the EU budget.[114] It is yet to be determined where the revenue will be spent, though, some options would be more in line with the green transition that the EU is furthering, for instance, the Green Climate Fund set up by the United Nations Framework Convention on Climate Change, normally abbreviated UNFCCC.[115]

The question then becomes if the EU CBAM as it is will be effective in contributing to the goal set out by the Commission; to alleviate climate change and lower emissions. This will be considered further under the element of contribution concerning the assessment of GATT art XX.

[112] EU CBAM Regulation, art 3(34)
[113] EU Impact Assessment Report, p. 15
[114] Ibid., p. 79
[115] See: Green Climate Fund

Within the newly adopted regulation the use of revenue has become clearer. In the preambular recital nr. 74 it is stated that the Union should contribute to the development and support to especially LDCs within the framework of the regulation.

5.2.6 Geographical Scope

Turning to the geographic scope of the EU CBAM. Under the EU CBAM's annex II, the proposal specifies that it does not apply to the European Economic Area including Switzerland, Norway, Iceland, and Lichtenstein. This is because they are linked to the EU ETS and are therefore subject to carbon pricing, in the same way, EU member states are. The proposal includes another type of exemption to the EU CBAM provided by art 2(7):

"*If a third country has an electricity market which has been integrated with the Union internal market […], and has not been possible to find a technical solution for the application of the CBAM to the importation of electricity."*

In the following subparagraphs, there are conditions listed for the exemption to apply, this includes that the third country must have agreed with the EU, that the third country implements EU electricity market legislation, etc. cf. EU CBAM art 2(7) (a-f). Any country is yet to be expected to fulfill these rather stringent criteria.[116]

This exemption of countries and lack thereof raises questions in relation to WTO compatibility and will be assessed further under section 6 of this master's thesis.

5.2.7 Export Rebates

It should be noted that the EU CBAM only applies to imports coming to the EU and consequently not to exports, cf. EU CBAM art 2.1 and annex 1. During the development of the proposal, the Commission was asked by stakeholders to include export rebates in the system.[117] It has been argued that the extension of the CBAM to include exports would not be compatible with the objectives of the EU CBAM and would undermine the target of having strict environmental regulation and the EU being the frontrunner concerning

[116] Espa, et al. (2022), p. 18
[117] Ibid., p. 13

leakage prevention. The EU CBAM as it stands at the time of writing does not include export rebates. However, the European Parliament has proposed an amendment that suggests that:

"*CBAM-covered products produced in the EU 'for export in third countries without carbon pricing mechanisms similar to the EU ETS' will continue to receive free allowances*"[118]

The amendment further includes the possibility to include an export adjustment mechanism that takes account of the possibility to create green export rebates.[119]

The whole question of export rebates is rather problematic; while an adjustment on exports may result in domestic producers exporting carbon-intensive products and thus undermine the green transition in the domestic sectors, not including exports may lead to domestic products being replaced by less environmentally friendly foreign products, because this may reduce the EU CBAM's power to offset carbon leakage.[120]

6 General Agreement on Tariffs and Trade

While the earlier sections concerned the issues within the EU CBAM, this section will focus on how the EU CBAM will be assessed under the GATT framework. As the EU CBAM is yet to be implemented, there is no current case law that deals explicitly with the measure. As no case law regarding similar measures, meaning other CBAMs exists, the problem is dealt with through an analogy assessment of how the DSB normally deals with cases regarding art I:1, III:2 and III:4 in keeping with their principles and usual practice.

The structure of the assessment corresponds with the elements of interpretation that can be found in the case law or through an interpretation of the wording in accordance with the VCLT.

[118] Ibid.
[119] Ibid.
[120] Ibid

To easily get an overview of case law, I started by consulted the analytical indexes, which is a tool administered by the secretariat of the WTO. The Analytical indexes indicate where to find the most relevant paragraphs in case law and are a guiding hand within the WTO jurisprudence. I will not be referring to the analytical indexes directly but to the cases most relevant to the issue at hand.

During the assessment of the GATT provisions, I encounter four major difficulties where the DSB reports are either ambiguous, unclear, or have left substantial room for interpretation in future cases. This is firstly regarding the likeness assessment in general, where the DSB has yet to add jurisprudence about environmental measures which differentiate on the grounds of GHG emissions, secondly, the assessment of unconditional, thirdly, the question of the EU CBAM is a border or internal measure, and lastly, if the EU CBAM must be considered a tax.

I have reconciled these issues with the subject at hand through analogy assessments and legal discussion based on the ambiguities in order to contribute with a thought-through prediction of the legality of the EU CBAM.

6.1 GATT art. I – General Most-Favored-Nation Treatment

GATT art I is the legal basis for the MFN principle within WTO law. The object and purpose of the provision have been firmly established in case law. In the AB case of *Canada – Autos,* para. 84 it was explained that art I prohibit:

"[…] discrimination among like products originating in or destined for different countries."

One must therefore make sure to treat products equally no matter where the products originate from. This corresponds with the fact that WTO member states are required to treat trading partners equally, which can also be read out of the provision at hand.

The MFN principle is said to be one of the pillars of the multilateral trading system and is a fundamental non-discrimination obligation under the GATT.[121]

The principle in itself is critical to upholding a fair and predictable trading system and is a cornerstone in the legal framework of the WTO. The framework emphasizes the importance of creating policies in keeping with this legal principle, which should be kept in mind during the assessment. The MFN obligation is specifically found in GATT art I:1.

6.1.1 GATT art I:1

To establish inconsistency with GATT art I:1 the following elements must be demonstrated: (i) the measure at issue falls within the scope of application of the provision, (ii) the imported products at issue are like products within the meaning of GATT art I:1, (iii) the measure at issue must confer an advantage, favor, privilege, or immunity on a product originating in the territory of a country; and (iv) the advantage so accorded is not extended immediately and unconditionally to like products originating in the territory of all members.[122]

These four steps will be the basis for assessing the EU CBAM, which is consistent with the MFN obligation found in GATT art I:1.

6.1.1.1 the Scope of Art. I:1

The first step of the assessment relates to the scope of GATT art I:1. Within the wording of the provision it can be found that the provision applies to:

"*Customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and concerning the method of levying such duties and charges, and with respect*

[121] AB report, EC – Seal Products, para 5.86
[122] Ibid., para. 5.86, and the text of GATT art I:1

to all rules and formalities in connection with importation and exportation and with respect to all matters referred to in paragraphs 2 and 4 of Article III […]"[123]

It can be deduced from the citation that GATT art I:1 is broad in its scope and applies to many different kinds of measures. Concerning the measure at hand, the EU CBAM, the most relevant part of the provision to determine the scope would be to assess if the EU CBAM constitutes a rule. The Panel in *EC – Banana III* said that the phrase has been interpreted broadly and can cover both rules related to tariff quota allocations and import licensing procedures.[124] Furthermore, in *Colombia – Ports of Entry* a measure that prescribing a special advance import declaration requirement for imports of products originating from elsewhere, besides Panama, were considered rules and formalities in connection with importation.[125] A much broader interpretation of the wording was found in the Panel case of *US – Poultry (China)* where it was concluded that:

"in connection with importation […] not only encompasses measured which directly relate to the process of importation but could also include measures […] which relate to other aspects of the importation of product or have an impact on actual importation."[126]

This very broad assessment of the scope was however counteracted in the Panel report of *Argentina – Financial Services* where the Panel stated that the scope did not extend to any measure that is hypothetically or remotely connected to importation or exportation.[127]

To determine if the EU CBAM falls within the scope of GATT art I:1 one, therefore, has to establish a connection between the measure at hand and the importation that foregoes. The EU CBAM is de facto an importation measure that establishes a cost in the sense that importers have to purchase CBAM certificates corresponding to the emissions that occurred during the production of the products that wish to be imported. This adds a

[123] GATT art I:1
[124] Panel Report, EC – Bananas III, para 7.107 and 7.189
[125] Panel Report Colombia – Ports of Entry, para 7.342
[126] Panel Report, US – Poultry, para 7.410
[127] Panel Report, Argentina – Financial services, paras 7.995

charge, within its meaning of asking for a price and being an expense,[128] at the time of importation. This can also be connected to the first part of the provision:

"[…] Charges of any kind on or in connection with importation […]", cf. GATT art I:1.

However, some may argue that the EU CBAM is an internal regulation and not a border measure.[129] In relation to GATT art I:1 this is not an issue, because of its broad scope that also extends to:

"*All matters referred to in paragraphs 2 and 4 of art III"*, cf. wording of GATT art I:1.

GATT art I:1, therefore, catches all measures imposed by the Member States, both border and internal measures. For a more in debt discussion on what kind of measure the EU CBAM is look to section 6.2 of the master's thesis.

Art I:1 of the GATT is therefore applicable to the EU CBAM both concerning it being a rule in connection with importation and it is a charge on importation.

6.1.1.2 Likeness

The like products assessment is essential when assessing if there is any differential treatment between products that may constitute discrimination in some way that is not compatible with the MFN principle. The likeness assessment is found in various GATT articles including art III which will be assessed later in this thesis. The AB evoked the image of an accordion to explain how the likeness assessment can vary in the different GATT provisions.[130]

One assessment of the likeness of products may therefore be more stringent compared to another. This also takes the measure at issue into account. In *Colombia – Ports of Entry*

[128] n. Charge, OED
[129] Bacchus (2021), p. 3
[130] AB report, Japan – Alcoholic Beverages (II), p. 21

the Panel found that it was not necessary to determine if the products to which the measure was applicable, were in fact like due to the nature of the measure at hand.[131] This was specifically because the ports of entry measure applied to any textiles, apparel, or footwear imported from elsewhere besides Panama and explicitly discriminated.[132]

However, a more traditional assessment of like products has been thoroughly tried by the AB in various cases. Here the likeness assessment is to be discussed based on:

"(i) the properties, nature, and quality of the products; (ii) the end-uses of the products; (iii) consumers' tastes and habits […] in respect of the products; and (iv) the tariff classification of the products."[133]

For reference, the likeness assessment is used as an indicator to establish a competitive relationship between products.[134] It should be noted that the AB in the case of *EC – Asbestos* criticized the Panel for not following the very well-established criteria within the likeness assessment.[135] In the Panel Report, the Panel concluded based only on two criteria that the products were like, but the AB noted that the Panel needed to assess all criteria as they have equal gravity on the conclusion of likeness.[136] However, this was concerning the assessment of like products under art III:4 of the GATT, which may need a more stringent assessment of likeness compared to the one under art I:1 of the GATT. In the Panel Report of *Indonesia – Autos* the Panel found that the discussion of like products under GATT art III:2 justified the products to also be considered like under GATT art I:1.[137] Therefore the assessments overlap and justify the use of GATT art III jurisprudence under this assessment. However, the likeness assessment of GATT art III:2 is especially narrow as emphasized in AB Report *Japan – Alcoholic Beverages (II),* p. 21.

[131] Panel report, Colombia – Ports of Entry, para 7.355
[132] Ibid.
[133] Panel Report, US – Poultry (China), para 7.425, AB Report, EC – Asbestos, para. 101, AB Report, Canada – Periodicals, pp. 21-22 and more
[134] AB Report, Canada – Feed-In Tariff Program, para 5.63
[135] AB Report EC – Asbestos, para. 109
[136] Ibid. Para. 120
[137] Panel Report, Indonesia – Autos, para. 14.141

Turning to the measure at hand, the EU CBAM. The EU CBAM applies to a narrow well-defined group of products categorized on the basis of the CN system, cf. EU CBAM annex II. Furthermore, the EU CBAM only applies to imported products, which may indicate that it is explicitly discriminatory, as seen in *Colombia – Ports of Entry.* The only difference that may occur is the pollution that comes with the production of said products. This is also defined as Non product related process and production methods (NPR-PPM). On its face, the products may seem to be like within the meaning of the assessment. This is because one may see the defined products as like, considering the products are primary in nature including aluminum, steel, iron, and cement. Turning to the other criteria of the likeness assessment it can be established rather quickly that the products within the categories of aluminum, steel, iron, and cement are like, because different steel products, for instance tube and pipe fittings, bear the same qualities as they are made of steel, have the same end-use, because they are all capable of connecting pipes and assist in transporting a liquid. They are within the same tariff classification, which is also a criterion of the likeness assessment. This criterion does not bear the same weight as the other, as this is primarily a classification question left for the importing member state that to determine. In general, the products to which the EU CBAM applies are primary in nature and serve purposes within the building industry. The likeness of products should be determined on a case-by-case basis, however, because the products are predominantly simple and only made up of one material, this being a kind of metal, speaks in favor of the products being like. The case may be different with electricity and fertilizers, as they are more complex products by nature.

There is a reason to believe that products with different levels of GHG emissions are not like. For instance, in the AB Report of *EC – Asbestos* the AB found that types of cement containing actual and synthetic asbestos were not like.[138] The cement products in question were otherwise identical, but the fact that there was an immediate health hazard, concerning the asbestos content of the cement, had such an impact on consumer preferences according to the AB that they should not be considered like products within the meaning of GATT art III:4.

[138] AB Report, EC – Asbestos, para 147-148

GHG emissions are not an immediate health risk and are not physically incorporated into the product, which may also influence the like assessment. Therefore, the assessment within the meaning of the EU CBAM is different from the one seen in the AB Report of *EC – Asbestos.* However, it should be noted that consumer preferences are important in the likeness assessment, as case law establishes. The sustainability of products is very much discussed, especially within the more recent years, and many consumers do in fact have preferences between more sustainable and less sustainable products. They have become more aware of the environmental impacts more dirty products may have, at least in relation to cars.[139] It is also indicated in some economic literature that the sustainability awareness is a tendency among European consumers,[140] however, this is still unclear when it comes to producers buying goods they need for their production, which are the ones to be considered the consumers within the scope of the EU CBAM. Even though there is an indication of a preference towards sustainable products, it is still unclear whether all consumers share this preference. It indicates that the different levels of emissions during production may result in products not being like, allowing governments to treat them differently. However, this seems unlikely as GHG emissions are not an intrinsic part of the products at hand and the products to which the EU CBAM applies, are tailored to producers and manufacturers needing the products as an input, and do, as mentioned before, not constitute an immediate health risk.

The products at hand fulfill the criteria of being like, contrary to what was found in the AB Report of *EC – Asbestos.*

Another case that may suggest that products, with different levels of GHG emission, are not like is the AB Report of *Canada – Feed-In Tariff Program.* In this dispute, the AB noted that:

"What constitutes a competitive relationship between products may require consideration of inputs and processes of production used to produce the product."[141]

[139] Armenio, et al. (2022), p. 6
[140] Moser (2016), p. 392-393
[141] AB Report, Canada Feed-In Tariff Program, para. 5.63

Therefore, embedded emissions during production may result in the products at hand not being like in accordance with the GATT provisions. However, this case mainly relates to an SCM issue. The likeness assessment is an intrinsic part of the WTO system and is streamlined which means the GATT criteria are also the subject of assessment in likeness both within the TBT Agreement[142] and the SCM Agreement.[143] Furthermore, it is still relevant within the EU CBAM context because expresses clearly how to assess the likeness of electricity. In this case, only electricity producers of renewable energy received government benefits and not while the energy powered by fossil fuels this was legitimate according to the AB.[144] This suggests that renewable energy is not like energy produced with fossil fuels.[145]

It should be noted that these notions of distinguishing products by GHG emissions have been criticized by scholars mostly in relation to the AB report regarding electricity.[146] There is also no clear indication if the likeness assessment is extended to NPR-PPMs. For instance, in the AB case of *EC – Bananas III* is stated that:

" The essence of the non-discrimination obligations is that like products should be treated equally, irrespective of their origins […] the nondiscrimination provisions apply to all imports of bananas, irrespective of whether and how a Member categorizes or subdivides these imports […]."[147]

This indicates that products are like irrespective of any administrative indications, like the difference in emissions. Furthermore, in the AB case of *EC – Seal Products* the AB stated that an EU measure was inconsistent with art I:1 of the GATT since like products were not treated equally, even though there were major differences in the hunting operations.[148] There are other examples of these connotations in the likeness assessment concerning NPR-PPMs.

[142] AB Report, US – Clove Cigarettes, para. 111
[143] Panel Report, Indonesia – Autos, para. 14.174
[144] Dominioni & Esty (2023), p. 33
[145] Ibid., pp. 33-34
[146] Ibid.
[147] AB Report, EC – Bananas III, para 190
[148] Maggio (2017), p. 91

For the time being, it seems like the likeness of products under GATT art I:1 only relates to the criteria as set forth by the AB in various cases. Therefore, NPR-PPMs do not indicate that products may not be like for the time being, even though the inclusion of consumers' tastes and habits is a step in this direction.[149] However, I find the tendency of including NPR-PPMs in the form of GHG emissions worrisome within the multilateral trading system, because more often than not, the products that may be considered like when only looking at the classic criteria, have a dirtier production and stems from poorer countries. This is because LDCs rely on the export of emission-heavy goods, here especially primary products.[150] The fact that emissions may be included in the likeness assessment and result in products not being like, allows for, in my opinion, double discrimination and creates a catch-all exemption within environmental regulations. However, this may change as environmental measures related to sustainable production become more normal and widespread, for instance through CBAMs, and the area will become clearer on whether NPR-PPMs will be the basis of a distinction between products.

It is therefore concluded that the products at hand will be considered like and is followingly subject to the MFN principle and should be treated equally.

6.1.1.3 Conferring an Advantage, Favor, Privilege, or Immunity

The term '*advantages'* is considered to cover all situations that create more favorable import opportunities or affect commercial relationships between products of different origins.[151] The broad notion of art I:1 of the GATT applying to *any* advantage given to *any* product originating from *all other* member states was reiterated in the AB Report of *Canada – Autos,* para. 79. The provision, therefore, covers any advantages that may be applied to products depending on their origin. The term is extended to expectations of equal opportunities for like products to prove, there are advantages conferred. This assessment does not have to be dependent on actual trade effects of the measure at issue.[152] According to the AB report in the case of *EC – Seal Products* market access is a

[149] Ibid., p. 92
[150] UNCTAD (2022)
[151] Panel Report, EC – Bananas III, para 7.239
[152] AB Report, EC – Seal Products, para. 5.87

form of advantage.[153] Therefore, a difference in import requirements may be considered to confer a benefit to those importers that have easier market access, compared to those that are subject to more stringent market access upon importation.

The design elements of the EU CBAM, create different requirements for different like products. This is the case concerning the fact that the measure credits third countries' climate policies, cf. EU CBAM art 9, and there are actual exemptions in relation to the EU ETS linkage, cf. art 2(2), 2(5) and Annex II, a.

The EU CBAM, therefore, confers an advantage within the meaning of GATT art. I:1, because it de jure discriminates on the basis of origin and creates easier market access for some WTO members compared to others.

6.1.1.4 Advantage Accorded Not Extended to all WTO Member States

The extension of the advantage must be '*immediate'* and '*unconditional'* according to the wording of art I:1 of the GATT itself. This is further emphasized in the AB Report of *EC – Seal Products,* additionally, the AB modified the 'unconditional' standard. The AB noted that:

"[…] any advantage granted by a member to imported products must be made available 'unconditionally', or without conditions, to like imported products from all members. […] However, […] it does not follow that article I:1 prohibits a member from attaching any conditions to the granting of an advantage."[154]

The AB further clarified, in the same paragraph, that the provision prohibits conditions that have a detrimental impact on competitive opportunities.[155] However, in the Panel Report of *Indonesia – Autos,* the Panel found that a measure was incompatible with GATT art I:1 because it introduced various conditions and criteria for the importation of cars.[156] In general the interpretation of '*unconditional'* lacks clarity. This is especially obvious in

[153] Ibid. Para. 5.96
[154] Ibid., para. 5.88
[155] Ibid.
[156] Panel Report, Indonesia – Autos, para. 14.147

the Reports *Canada – Autos* and *EC – Tariff Preferences*. In the case involving Canada, the Panel put forward similar to the AB ruling in *EC – Seal Products*, that not all conditions are considered to be subject to the unconditional notion within the provision, in the sense that not all conditions are prohibited.[157] Only conditions that are discriminatory will be incompatible with art I:1 of the GATT.[158] In the *EC – Tariff Preferences* case the Panel found that 'unconditionally' should be awarded its ordinary meaning; that no advantage should be subject to any conditions.[159] However, on its face, and following the wording of the provision, it seems to cover the notion of the advantage conferred has to be extended to all members without any other conditions.[160] Furthermore, this is the meaning of the word '*unconditional'* in the Oxford English Dictionary.[161] This is the understanding applied within this master's thesis.

Several elements of the EU CBAM seem to grant advantages to certain member states that are not conferred to all WTO members. This includes (i) the fact that the EU CBAM credits policies similar to the EU ETS, cf. EU CBAM art 9, and (ii) the actual exemption found based on the linkage to the EU ETS, cf. EU CBAM art 2(2), 2(5) and Annex II, a.

Turning to the first matter at issue regarding the fact that the EU CBAM credits climate policies in third countries. As explained in the previous section, one can get a discount on CBAM certificates if the product one wishes to be imported to EU territory has been subject to carbon pricing beforehand in its country of origin.

The fact that the EU CBAM distinguishes between third countries' climate policies gives rise to concern in relation to art I:1 of the GATT. This is because it explicitly runs counter to the MFN principle to distinguish market access for the importation of goods on the basis of different policies and whether or not the country in question has adopted carbon pricing.[162] Furthermore, in the GATT Panel Report of *Belgium – Family Allowances* adopted in 1952, there is an indication that suggests that crediting policies of third

[157] Panel Report, Canada – Autos, para. 10.29
[158] Ibid.
[159] Panel Report, EC – Tariff Preferences, para. 7.59 – obs. Not appealed to the AB
[160] Maggio (2017), p. 93
[161] unconditional, adj. OED
[162] Espa, et al. (2022), p. 25

countries are not compatible with GATT art I:1.[163] This is further emphasized because WTO members are self-judging in nature, including in the extent and way they create and implement climate policies.[164] Ergo, picking and choosing between what climate policies should be credited and, in this way, buying fewer CBAM certificates results in discrimination of like products based on origin and is therefore incompatible with GATT art I:1.

Focusing on the second issue; the actual exemption of countries linked to the EU ETS. The exemption is largely comparable to the crediting of third countries' policies because the crediting is based on similar carbon pricing, and since the countries mentioned in EU CBAM Annex II, a, is subject to 'similar' carbon pricing, meaning the same carbon pricing in this case, it all adds up. In essence, any country-based exemption is incompatible with GATT art I:1.[165] Therefore, one can easily conclude the exemption is illegal within the meaning of GATT art I:1 due to the explicit exemption based on origin.

6.1.1.5 Exemption for GATT art I:1 – Enabling Clause

Under GATT art I:1 it is possible to exempt differential and more favorable treatment to developing countries.[166] This is based on the general WTO system that seeks to open up free trade in all regions and between all members of the organization.[167] Both developing and LDCs are granted many flexibilities according to other WTO agreements.[168] Therefore, intuitively, such flexibilities for the benefit of developing countries, should not be 'illegal' within the multilateral trading system.

The EU CBAM contains no such given flexibilities that could be exempted under the enabling clause. This is not problematic in a legal sense, it should, however, be noted that developing LDCs may be unproportionally affected by the measure. A very tangible example of this is how the EU CBAM will affect the economy in Mozambique, which is

[163] GATT Panel Report, Belgium – Family Allowances, para. 3 and 8
[164] Bacchus (2021), p. 3
[165] Espa, et al. (2022), p. 19
[166] AB Report, EC – Tariff Preferences, para. 90
[167] Wto.org (2023), WTO | Understanding the WTO - principles of the trading system.
[168] See for instance TBT Agreement art 11 and 12.5 and DSU art 24.1 and 24.2

an LDC.[169] It is predicted that the EU CBAM will result in a decrease of 60% of Mozambique's export of aluminum, which will result in a 2.5% decrease in their gross domestic production, normally abbreviated to GDP.[170]

The lack of flexibility will therefore have a huge impact on less developed economies, that mainly export mining and other goods related to production.

6.2 GATT art III – National Treatment on Internal Taxation and Regulation

GATT art III encompasses the national treatment (NT) principle within the framework of the multilateral trading system. It is solidly rooted in case law that the NT principle entails:

"[…] Members of the WTO (are obliged) to provide equality of competitive conditions for imported products in relation to domestic products."[171] Rephrased to fit by author

This provision is intended to ensure the right of equal treatment between domestic and imported goods once they have passed customs.[172] The provision is generally known as an anti-protectionism clause, which requires equality of competitive conditions and protects expectations of equal competitive relationships.[173] The NT principle, like the MFN principle, is one of the cornerstones of the WTO.

Before diving into the more specific parts of the provision it is relevant to establish if the measure at hand, the EU CBAM, falls within the scope of art III. GATT art III applies to internal regulation, cf. the wording of the provision. The EU CBAM can be seen as a border measure. This can be discussed in relation to another GATT provision, namely GATT art II. Even though the assessment relates to a different provision than the one being assessed at hand, it is still relevant to keep in mind, what the AB would consider as

[169] Wto.org (2023), WTO | Understanding the WTO - least-developed countries
[170] Njenga Hakeenah (2022), also Impact assessment report, annex 3, p. 21 – export of aluminium constitutes 7% of GDP
[171] AB Report, Japan – Alcoholic Beverages II, p. 16; also notice AB report, Korea – Alcoholic Beverages, para 119; AB report, EC – Asbestos, para. 97 and more
[172] AB Report, Japan – Alcoholic Beverages II, p. 16
[173] AB Report, Korea – Alcoholic Beverages, para. 120; AB Report, Canada – Periodicals, p. 18

being an importation/border measure. The issue relates to establishing if a measure is enacted '*on importation'*, which refers to the time of importation, cf. GATT art II:b. The AB ruled in *China – Auto Parts* that what triggers a measure to be a measure of importation is the obligation to pay.[174] The obligation to pay according to the EU CBAM occurs the moment the good enters the customs territory, because of this the EU CBAM is an importation measure and very closely connected to importation. Therefore, on its face, the EU CBAM may be accounted as a border measure.

However, one can also argue the EU CBAM to be an internal measure within the meaning of the present provision. This is due to the inherent reason for the measure has an internal effect, in this case, the EU ETS.[175] Even though the obligation is rooted to a specific time, namely upon importation, the EU CBAM is intertwined deeply and is related to the EU ETS, that it becomes an internal regulation that is applied at the border.[176]

It has yet to be determined what kind of measure the EU CBAM is, however, *prima facie* the EU CBAM is more closely connected to the point of importation, due to the argument of what triggers the payment, which is the point in the legal relationship that is most burdensome for the actors and should be considered a border measure. This is argued based on the '*center-of-gravity test'* that was implied by the AB in the report *China – Auto Parts,* para 171. This test entails that the center of gravity of the measure is the catalyst for the measure either being a border measure or an internal one. If one applies the center of gravity test to the EU CBAM it becomes evident, as beforehand, that the obligation that is laid upon the importer, stems from the act of importation, albeit a border measure. It should contrarily be noted that the Commission does not intend for the EU CBAM to be a border measure and has argued against this being the nature of the EU CBAM.[177] Furthermore, the background of the EU CBAM also relates to building a stronger EU ETS, and as previously mentioned also under the assessment under section 5.2, it is intended to build upon the EU ETS. Therefore, one may also argue that the center of gravity stems from within the EU itself as the EU CBAM is so closely related to the

[174] Bacchus (2021), p. 3 and AB report, China – Auto Parts, para 158
[175] Quick (2020), p. 567
[176] Ibid., p. 569, with reference to the same jurisprudence as Bacchus
[177] EU Impact Assessment Report p. 42

EU ETS both in relation to pricing point and design. It should be noted that the Commission's statements have no legal value within the WTO system and DSB jurisprudence does not normally take account of preparatory considerations but mainly takes the legal design into account.[178]

However, in the Panel Report, *Argentina – Hides and Leather,* and in the AB report of *EC – Bananas III,* the relationship between a measure both having internal and border qualities was questioned. The Panel assessed if the prepayment of a value-added tax applied on importation could be considered an internal measure based on the Note Ad to art III.[179] This note explains that measures applied to importation are internal measures if they are also applied to like domestic products. In the dispute the Panel found that the Argentinian taxation measure on imports is equivalent to the mechanism seen in an internal measure because the import measure is seen to '*adjust for the adverse competitive effects'* of the internal measure.[180] GATT art III:2 was therefore applicable to measure that on its face was considered a border measure.

In the AB report of *EC – Bananas III* an import licensing system was questioned under GATT art III:4. The AB ascertained against the claim of the European Communities and held that the import licensing system was in fact an internal measure within the meaning of GATT art III:4 because the system generally affected the *´internal sale, offering for sale and purchase'* of bananas within the market.[181] This explains that there is a need to assess the border measures implications on the market under the ad note to GATT art III.

Turning to the EU CBAM. The measure is a border adjustment mechanism and therefore bears some of the same qualities as the measure questioned in the Panel Report *Argentina – Hides and Leather*. Even though the EU CBAM is not centralized around adjusting competitive conditions, rather it has a climate perspective, at least this is a central objective of the measure, the adjustment is an ancillary effect based on the design of the EU CBAM. Furthermore, as previously established the EU CBAM is designed to mirror

[178] AB Report, Japan – Alcoholic Beverages II, p. 29; Panel Report, Argentina – Hides and Leather, paras. 11.168-11.170 and AB Report, Canada – Periodicals, p. 32.
[179] Panel Report, Argentina – Hides and Leather, para. 11.145
[180] Ibid., para. 11.150 and 11.154
[181] AB Report, EC – Bananas III, para 211

the EU ETS, which is inherently an internal measure, that connects them very closely. Additionally, the EU CBAM will inevitably affect the trade of the goods subjected to the measure due to a price change and therefore has an impact on the competitive conditions in the market. In this way, the EU CBAM will affect the sale and purchase of goods within the meaning of the AB Report of *EC – Bananas III.* It should be noted that trade effects in general are irrelevant to the assessment of GATT art III because it protects expectations and does not import volumes or market shares.[182]

Thus, the EU CBAM as a measure falls within the scope of GATT art III based on previous jurisprudence and the above discussions, even if it should be established that it is a border measure because the EU CBAM has characteristics of being an internal measure applied at the border.

6.2.1 GATT art III:2

The provision as outlined in GATT art III:2 relates to internal taxes and charges that apply to imported products. The provision can be divided into two sentences, which propose two different obligations. This master's thesis assesses these separately.

As previously established the EU CBAM is subject to art III of the GATT, however, it is relevant to assess if the EU CBAM is a charge or tax within the meaning of this specific provision. In the Panel Report *Argentina – Hides and Leather* it was found that the provision applies to charges of any kind and was interpreted broadly:

"The term 'charge' denotes, inter alia, a 'pecuniary burden' and a 'liability to pay money laid on a person."[183]

Naturally, the EU CBAM constitutes a charge, as it sets forth an obligation to pay in order to enter the market. Therefore, it falls within the scope of GATT art III:2.

[182] AB Report, Japan – Alcoholic Beverages II, p. 16
[183] Panel Report, Argentina – Hides and Leather, para. 11.143

Turning to the issue of tax. The EU CBAM has been associated with a carbon tariff or tax in various articles.[184] A tariff is defined as a custom duty or tax levied on the import of merchandise and goods, tariffs raise revenue for governments and are known to raise the price of imported products.[185] A tariff can both take the form of a price based on a percentage of the value of the goods or a specific tariff, [186] like the one seen in the EU CBAM where one pays a price for a number of certificates relating to GHG emissions during production. A Tariff relates to border measures. In light of the EU CBAM being an internal measure, it is argued that the EU CBAM is a tax within the meaning of GATT art III:2. A tax is defined as a compulsory contribution to the government levied on something, mostly calculated proportionally.[187] A carbon tax is levied on the burning of fossil fuels and is there to incentivize less GHG emissions.[188] Both these definitions seem to fit within the objective of the EU CBAM. The EU CBAM, therefore, constitutes a tax within the meaning of GATT art III:2.

However, the EU is not keen on the EU CBAM constituting a tax, this is argued based on internal EU practices. Should the EU CBAM constitute a tax it would be required to be adopted unanimously according to EU procedural rules.[189] Furthermore, the EU ETS, which the EU CBAM is closely related to and is supposed to mirror, is not a tax or other charge because the price of the certificates is determined on a market that relates to the auctioning system of the EU ETS.[190] The question now is whether the EU CBAM is closely enough linked to the EU ETS in order to also not be considered a tax. The EU CBAM price is determined on a weekly basis of the average price on EU ETS certificates, cf. EU CBAM art 23. The fact that the price is not fixed but rather linked to this market-determined notion speaks in favor of the EU CBAM not being a tax. It should be noted that this is pursuant to EU law and not WTO law.

[184] Taxation and Customs Union (2022) – in the subsection green taxation, Joachim Monkelbaan, Figures and World Economic Forum (2022) – mentions tariff
[185] Europa.eu (2023) tariff
[186] Ibid.
[187] Tax OED
[188] Carbon Tax OED
[189] TFEU art 192(2) and Espa, et al. (2022), footnote 163, p. 22
[190] ECJ case C-366/10, para 142-143

These facts do not take away from the notion that the EU CBAM could constitute a tax or charge within the meaning of WTO law.

6.2.1.1 First Sentence

The DSB has, in various cases, established a two-tiered test under the first sentence of art III:2 of the GATT. This includes assessing if the products at hand are like and addressing if the imported products are taxed in excess of like domestic products.[191] This assessment is also the one applied in this master's thesis.

6.2.1.1.1 Like Products

The notion of the products within the scope of the EU CBAM being like, has been assessed under section 6.1.1.2. Under the assessment of likeness in the present provision, the same criteria for likeness apply.[192] In the previous section it was found that products may be considered like as long as the notion that NPR-PPMs concerning different levels of GHG emissions are not included. However, it should be noted that the likeness assessment within the first sentence of GATT art III:2 is particularly narrow as established in the AB report of *Japan – Alcoholic Beverages II*, p. 19-21.

One report that may be the most relevant concerning the likeness assessment of GATT art III:2 is the GATT case of *US – Superfunds.* The case claims that a tax, on inputs not incorporated in imported products, is permittable under WTO law.[193] This is because the Panel in the present case made no distinction based on whether the taxable chemical was physically included in the imported products, but relied more generally on the fact that there were volatile chemicals used in the production of the feedstocks.[194] Furthermore, the measure was contested because the chemicals used in the production did not cause pollution in the US, and therefore should not be subjected to the border tax.[195] The Panel did not agree with this position, as there is a notion within border adjustment taxes that

[191] AB report, Japan – Alcoholic Beverages II, p. 18 and AB report, Canada – Periodicals, pp- 22-23
[192] AB report, Canada – Periodicals, pp. 21-22, and AB Report, Japan – Alcoholic Beverages II, p. 20, and others.
[193] Dominioni & Esty (2023), p. 32
[194] Ibid. and GATT report, US – Superfunds, para. 3.2.11 and 2.6
[195] US – Superfunds,. para. 5.2.3

payment follows the polluter.[196] In the present case it was found to be in accordance with WTO law to establish a tax when the pollution did not harm the country of importation, why it also makes that to allow for taxation on GHG emissions that do harm the importing country.[197]

The discussion based on case law from the DSB does not seem to allow for such distinctions, since the adjudicators have centered their discussion around the competitive relationship of products[198] and not policy objectives or intent of the legislators, as appears to be the case in the *US – Superfunds* report. Therefore, the products to which the EU CBAM applies, are nevertheless like within the meaning of GATT art III:2, as there is not sufficient evidence for the assumption of unlikeness based on the prior discussion.

6.2.1.1.2 Taxed in Excess

The AB has established a very strict standard in relation to the assessment of 'taxed in excess'. In the AB report *Japan – Alcoholic Beverages II* it was stated:

"Even the smallest amount of 'excess' is too much. The prohibition of discriminatory taxes […] is not conditional on a "trade effects test" nor is it qualified by a de minimis standard."[199]

At this time, this is only speculative but may nevertheless constitute a breach of the provision since it also protects expectations.[200]

When assessing this, one should look at actual tax burdens and not nominal tax burdens.[201] Because the EU CBAM price of certificates is based on a weekly average of the EU ETS price it may result in a price difference, meaning that imported products may be taxed in excess compared to nationally produced like products. This indicates that the EU CBAM may result in a higher burden on imported products.

[196] Ibid. para. 5.2.5
[197] Dominioni & Esty (2023), p. 32
[198] Espa, et al. (2022), p. 21
[199] AB report, Japan – Alcoholic Beverages II, p. 23
[200] AB Report, Japan – Alcoholic Beverages II, p. 16, AB Report, Korea – Alcoholic Beverages, para. 119
[201] Panel Report, Argentina – Hides and Leather, para. 11.260

Therefore, the EU CBAM breaches GATT art III:2 first sentence. Because there is a breach of the first sentence, there is no need to assess the measure under the second sentence of the provision.[202] This will therefore not be included.

6.2.2 GATT art III:4

Should the EU CBAM not be considered a tax or charge it may nevertheless be considered a regulation pursuant to GATT art III:4, which implies a similar notion of the NT principle. GATT art III:4 issues a three-tier test in order to show a breach of the provision. This test is established in case law and will be the roadmap for the assessment under this provision. The test is as follows:

"(i) the imported and domestic products at issue are 'like products'; (ii) the measure at issue is a 'law, regulation, or requirement affecting their internal sale, offering for sale, purchase, transportation, distribution, or use'; and (iii) the imported products are accorded 'less favorable' treatment than that accorded to like domestic products."[203] parentheses were added for a readability.

6.2.2.1 Like Products

It is thoroughly established in case law that if the products at hand are considered like under GATT art III:2, they will also be considered like under GATT art III:4, as the latter encompasses a broader notion of likeness compared to the first.[204] Based on earlier discussions, the products to which the EU CBAM applies should therefore also be considered like within the meaning of art III:4 of the GATT.

6.2.2.2 Measure at Issue is a 'Law, Regulation or Requirement Affecting Internal Sale, Distribution, etc.'

Preliminarily, it must be stated that the EU CBAM can be considered a regulation within the meaning of GATT art III:4 if it is not considered a tax within the meaning of the

[202] Method introduced by the AB in Canada – Periodicals, pp. 22-23
[203] AB Report, Korea – Various Measures on Beef, para. 133
[204] AB Report, EC – Asbestos, paras. 98-99, supported by the accordion analogy in AB Report, Japan – Alcoholic beverages II, p. 21

second subsection of the provision. Previous DSB reports have indicated that the terms law, regulation, and requirement, invoke a broad interpretation to cover a plethora of measures.[205]

The Panel has in various cases explained that a regulation or law is:

"[…]'laws' and 'regulations' refer to 'rules'. We note that in Mexico – Taxes on Soft Drinks, the Appellate Body concluded that 'the terms 'laws or regulations' refer to rules that form part of the domestic legal system of a WTO Member' […]. We consider that interpreting 'laws or regulations' to mean rules governing conduct is consistent with the immediate context in which these terms appear."[206]

The EU CBAM imposes conduct in the sense that an importer must submit CBAM certificates in order for the products to enter the market. In other words, the EU CBAM imposes an obligation to act in a certain way to gain market access, which means that the EU CBAM is a rule governing conduct imposed by a secular lawmaker, the EU. The EU CBAM should therefore be considered a law or regulation according to art III:4 of the GATT.

Turning to the other part under this assessment, if the regulation is affecting the internal sale, distribution, or anything else relating to the trade internally of the products afflicted by the measure.

Looking at the assessment of whether the measure is affecting the internal sale, distribution, or purchase. The scope of 'affecting' has been defined in case law. The idea of 'affecting' is that it covers not only measures that directly relate to, or govern the sale of products but also measures that create incentives.[207] During the assessment one should consider if the measure at hand has an impact on the conditions of competition between domestic and imported like products, but not to the extent that one needs to assess if there

[205] Panel Report, India – Solar Cells, para. 7.310, Panel Report, India - Autos, para. 7.174, with reference to other cases and Panel Report, Argentina – Import Measures, para. 6.280
[206] Panel Report, India – Solar Cells, para. 7.310
[207] Panel Report, EC – Bananas III, para. 7.175

is a de facto impact on purchases at the moment.[208] Furthermore, the de minimis standard in this regard is very low, and only a minimal impact on purchasing decisions of private firms is not enough to rebut *prima facie* showing that the measure has affected the competitive relationship.[209] This ties into the notion that trade effects do not account for any weight in the legal arguments within the WTO system,[210] as previously mentioned. The 'affecting' ability is naturally tied to the assessment of less favorable treatment. First of all, it must be stated that due to the nature of the EU CBAM, it will have the ability to affect the internal sale of the products to which it applies. Since the importers have to obtain certificates for a price in order for their products to enter the market this may affect the pricing of products and therefore also the ability to sell.

This will be discussed further in the following subsection.

6.2.2.3 Imported Products Accorded Less Favorable Treatment

It is firmly established by the AB in the report of *Korea – Various Measures on Beef,* that the assessment of less favorable treatment revolves around assessing if the measure modifies the conditions of competition to the detriment of the imported products.[211] Based on previous case law it can be argued that the EU CBAM in fact does not impose less favorable treatment on imported products.

The fact that the EU CBAM is established on, and favors, a calculation based on the actual emissions, is grounded in the notion found in the Panel Report of *US – Gasoline,* where it was found that a default baseline, which applied to imported gasoline, was considered to imply less favorable treatment compared to domestic products which were subject to an individual baseline.[212]

Additionally, it can be argued that the default baseline, which is based on an average of emissions by the 10% worst performing emitters within the same product category, [213]

[208] Panel Report, US – Renewable Energy, para. 7.161
[209] Ibid., para. 7.160-7.161, with reference to Panel Report, Canada – Autos, para 10.83
[210] AB Report, Japan – Alcoholic Beverages II, p. 16
[211] AB Report, Korea – Various Measures on Beef, para. 137
[212] Panel Report, US – Gasoline, para 6.16 and as Espa, et al. (2022), p. 22
[213] EU CBAM, COM/2021/564, annex III

may also be permittable in the sense that the overall group of imported products is not treated less favorably compared to the same group of imported products.[214]

Lastly, the fact that the EU CBAM general narrative is based on GHG emissions may support the conformity of the measure in relation to GATT art III:4. In the AB report of *Dominican Republic – Import and Sale of Cigarettes* it was found that:

"[…] the existence of a detrimental effect on a given imported product resulting from a measure does not necessarily imply that this measure accords less favourable treatment to imports if the detrimental effect is explained by factors or circumstances unrelated to the foreign origin of the product, […]"[215]

The EU CBAM is origin neutral, but does contain exemptions in relation to countries that are connected to the EU ETS, cf. Annex II of the EU CBAM. The exemption is mainly related to the carbon footprint during the production of products, therefore the less favorable treatment that may result from the different pricing levels based on GHG emissions stems from something unrelated to the products' origin and may therefore be compatible with art III:4 of the GATT.[216]

However, it should be noted that the administrative burden may be too severe for small and medium enterprises and even for larger companies to demonstrate actual emissions, and therefore they may opt for the default value based on the average emissions of the 10% highest GHG emitting companies. Compliance with the EU CBAM is substantial, which is also indicated by the EU's own Impact assessment report.[217] Followingly, the good intentions on which the EU CBAM is based, might be counterintuitive, as businesses may not exert the option of using the actual emissions, something which in turn might result in de facto disadvantageous treatment. Furthermore, during the period where both the free allowances under the EU ETS and the EU CBAM are overlapping, there is a problem in relation to differential treatment since importers do not enjoy the

[214] AB Report, EC – Asbestos, para 100 and as Espa, et al. (2022), p. 22
[215] AB report, Dominican Republic – Import and Sale of Cigarettes, para. 96, and Panel Report, US – Clove Cigarettes, para. 7.268
[216] Espa, et al. (2022), p. 23
[217] EU Impact Assessment Report, annex 6, p. 83 and Espa, et al. (2022), p. 24

same free pass. The Commission has emphasized that the number of EU CBAM certificates will correspond with the number of free allowances, but, as emphasized in the text by Ilaria Espa et al., p. 17, the mechanism is far from settled and may very well result in discriminatory conduct not compatible with GATT art III:4.

Nevertheless, taking the previous rulings into account the EU CBAM may be permissible under GATT art III:4.

6.3 Partial Conclusion

Based on the above discussion it was found that the EU CBAM breaches the MFN-Principle embodied in GATT art I:1. This was because the EU CBAM creates advantages based on origin that are not extended to all members. The distinction is based on whether foreign policies are relates closely enough to the EU ETS and if the countries are already linked to the EU ETS. This distinction is not in accordance with GATT art I:1.

Furthermore, it was found that the EU CBAM breaches art III:2 of the GATT. This is because the EU CBAM constitutes an internal tax. Should this be the case then the measure taxes imported products in excess, due to the way calculations of the EU CBAM certificates are carried out. Lastly, it was found that the EU CBAM may be in accordance with GATT art III:4 if the measure is found to be an internal regulation. This is because the pricing mechanisms found in the EU CBAM have been permissible in principle under previous DSB jurisprudence, for instance, the *US – Gasoline* case. However, the measure is still problematic concerning the free allowances that are only applied to domestic products under the EU ETS.

7 Exemption – GATT art XX

The breaches found in the above section can be exempted through GATT art XX.[218] The subject of this section is the breaches found in the most important task within the assessment of the provision is trying to find the equilibrium between a member's right to

[218] AB Report, US – Gasoline, p. 24

invoke an exemption to protect a legitimate policy goal, and the same member's obligations within treaty law.[219]

It is established in case law, and by a reading of the provision itself, that the provision entails a two-tier test. First one must establish that a measure is justified under one of the subsections listed in litra a to j, secondly, one must examine if the measure satisfies the requirements of the chapeau to GATT art XX, both elements must be met in order to claim the exemption.[220] This master's thesis will follow the same approach.

7.1 Particular Exemptions

There is no specific sub-section relating to environmental protection, which the EU CBAM revolves around. The most fitting one is litra b, which justifies measures '*necessary to protect human, animal or plant life or health*', as well as litra g which relates to '*conservation of exhaustible natural resources'*. These two subsections have been the grounds for an assessment of exemptions of environmental measures in various case law.[221] Furthermore, it was noted in the AB report of *US – Gasoline* that protection of the environment is an important state interest and that it is critical to coordinate environmental and trade policies.[222] It further noted, that member states have a large degree of autonomy to determine environmental measures that are only circumscribed by the obligations within WTO law.[223] It is widely acknowledged that trade is an effective tool in the mitigation of climate change, this is emphasized in the World Trade Report of 2022 and the fact that the WTO established a Committee on Trade and Environment in 1994 that has continuously worked to unite trade policy objective with environmental objectives and create an open forum to discuss this.[224]

Measures that serve environmental protection can therefore be exempted within GATT art XX even though it is not explicitly mentioned. Though, the DSB has yet to assess a

[219] AB Report, US – Shrimp, para 156
[220] AB Report, Brazil – Retreaded Tyres, para. 139, AB Report, US – Gasoline, p. 22, and AB Report, US – Shrimp, para. 119-120
[221] Notice Brazil – Retreahed Tyres, US – Shrimp, US – Gasoline etc.
[222] AB Report, US – Gasoline, p. 30-31
[223] Ibid.
[224] Wto.org (2023) CTE work

measure like the EU CBAM that revolves around mitigating climate change and has its focal point on GHG emissions. This section therefore heavily relies on an analogy assessment of DSB jurisprudence to assess if the EU CBAM in fact can be exempted.

7.1.1 Litra B

In order to establish an exemption based on '*health'* under litra B of the provision, there must be established a nexus between the mitigation of climate change and the protection of *'human, animal or plant life or health*'. It has been questioned by scholars if there are some extraterritorial constraints within this exemption.[225] It was suggested that GATT XX(b) should only apply to policies related to internal concerns, whereas GATT XX(g) should apply to policies related to global and transboundary concerns.[226] The concern, or nexus, can be determined through a '*proximity-of-interest test'*, which was proposed by the OECD.[227]

Applying the '*proximity-of-interest'* to the issue at hand, the EU CBAM, it seems more likely that the EU CBAM would be exempted through GATT XX(g), due to the global environmental concerns, that appear to be the policy base of the measure.[228] This will be further discussed below. However, air pollution based on GHG emissions can both be interpreted as an internal concern as well as a transboundary concern.[229] This depends, on which grounds the measure at issue is enacted. If the measure relates to an internal concern in relation to air pollution it can be exempted under GATT art XX(b), if it relates to a transboundary concern, it can be exempted under GATT art XX(g).

When assessing case law in this regard, it becomes evident that when a member state aims to protect a transboundary resource with a unilateral measure, it can be exempted through GATT art XX(g). This is a notion found by the AB in the case of *US – Shrimp,* because migrating sea turtles were found in waters within US jurisdiction at some point in their then the measure was able to be exempted under GATT art XX(g).[230] The AB did refrain

[225] Condon (2004), p. 147 (and in general) and Kaufmann & Weber (2011), pp. 512-513
[226] Condon (2004), p. 156-161 for discussion.
[227] Ibid. p. 140
[228] notion in Kaufmann & Weber (2011), pp. 512-513
[229] Ibid. P. 159
[230] AB Report, US – Shrimp, para. 120

from finding a clear jurisdictional limit. Furthermore, the jurisdictional limits of GATT art XX(b) and (g) were contradicted in the case of *US – Gasoline*, where it was found that a measure dealing with the protection against air pollution internally was to be assessed under GATT art XX(g).[231] This shows that there are clear ambiguities regarding the jurisdictional limits of the two provisions. However, when addressing GATT art XX(b) it is clear from caselaw that this provision deals with internal measures.[232]

The '*proximity-of-interest test'* seems to be the way forward when figuring out which exemption to apply, as the provisions apply to different kinds of measures.[233]

Based on this assessment it must be concluded that the EU CBAM cannot be exempted through GATT art XX(b), because it is extraterritorial in nature. This is based on the fact that the EU CBAM relates to the GHG emissions during production outside the EU and the fact that the Commission has been very adamant about the climate crisis being a transnational issue.[234] It should be noted that the Commission's statements have no legal value. However, it is prevalent from the assessment of CBAMs that they are mainly related to extraterritorial activities. Therefore, GATT art XX(g) will be the exemption that applies.

7.1.2 Litra G

To establish that the EU CBAM can be exempted under GATT art XX(g), it must fulfill the requirements within the provision. In the AB report of *China – Rare Earths*, it was found that:

"In sum, Article XX(g) permits the adoption or enforcement of trade measures that have 'a close and genuine relationship of ends and means' to the conservation of exhaustible natural resources, when such trade measures are brought into operation,

[231] AB Report, US – Gasoline, p. 19
[232] EC – Asbestos on protection of human health internally
[233] Condon (2004), p. 160-161
[234] Notice section 5.2 of the master thesis

adopted, or applied and 'work together with restrictions on domestic production or consumption, which operate so as to conserve an exhaustible natural resource'."[235]

From a reading of the provision itself and the moments of interpretation in the AB's findings, the assessment of the provision will be based on the following steps: assessment of (i) the measure at hand relates to the conservation of exhaustible resources, (ii) the measure is made effective in conjunction with a domestic measure.

7.1.2.1 relates to the conservation of exhaustible resources.

Based on previous DSB jurisprudence, it becomes evident that measures seeking to mitigate climate change, this meaning the surety of clean air or protection of biodiversity, fulfill this particular requirement within the provision.[236] The standard of relating to what more lenient than the concept of necessity found in GATT art XX(b).[237] Therefore, the provision encapsulates more measures to be exempted. When focusing on EU CBAM, the question becomes whether the objective is actually related to this conversation.

The '*relating to'* concept has been established in case law to embody something to be '*primarily aimed at*' conserving exhaustible natural resources,[238] and there must be a genuine relationship between the means and ends of the measure and the objective to conserve[239], in this case, clean air, the ozone layer, and biodiversity. A stable climate is in general considered an exhaustible natural resource within the meaning of GATT art XX(g), this is based on the climate being an international concern.[240] This indicates a proportionality test where the means, the measure itself, is balanced against the ends, the objective, here mitigation of climate change.

The objective of the measure should be found in the legal design and not in the lawmaker's statements as these bear no legal value.[241] The commission itself has been

[235] AB Report, China – Rare Earths, para. 5.94
[236] Panel Report, US – Gasoline, para. 6.37, and AB report, US – Shrimp, para. 128
[237] Condon (2004), p. 147 referring to US – Gasoline
[238] AB Report, US – Gasoline, p. 18
[239] AB report, China – Rare Earths, para. 5.90
[240] Dominioni & Esty (2023), p. 37
[241] Bacchus (2021), p. 4

very careful, as previously stated, in explaining that the EU CBAM is based on the overarching objective which is to address GHG emissions in the EU and globally, in order to fight climate change.[242] However, this also entails an equalization of carbon pricing to ensure fair competition.[243] Furthermore, The Commission envisions the EU CBAM to be a climate tool which can positively impact mitigation strategies in third countries.[244] This is political leverage in order to fulfill the goal of the Paris Agreement.[245] These are all political statements that firmly establishes a climate objective. Looking further into the design elements this climate objective is strengthened through the EU CBAM having sectoral exemptions. It has been found in economic studies that a significant leakage reduction can already be detected when a CBAM is applied to major emitting and trade-heavy industries.[246] This exemption is therefore environmentally sound in order to deliver the highest environmental impact at a low administrative cost.[247]

The fact that the EU ETS continues its scheme of free allowances during an interim time with the EU CBAM, argues the environmental objective of the measure. It has been found that free allowances have resulted in industrial emissions remaining at the same level for a decade.[248] Furthermore, the double protection that domestic producers find under both the EU ETS and EU CBAM may result in a reduced incentive to decarbonize their production.[249] This double protection, even for a limited time, also seems protectionist and may result in the EU CBAM not being exempted through GATT art XX(g). Even though there is this slight contradiction within the measure, it must be concluded that the overarching objective of the measure is to mitigate climate change by lowering emissions. Moreover, it should be noted that the general principle of CBAMs is to level the playing field for domestic and imported products in relation to carbon prices internally and externally.[250] It is difficult to say to which extent this will surmount to protectionism and

[242] EU CBAM, COM/2021/564, p. 15 and art 1
[243] Ibid, p. 21
[244] Ibid. 12th recital
[245] Espa, et al. (2022) p. 11
[246] Ibid., p. 12
[247] EU CBAM, COM/2021/564, p. 5 and recital 29
[248] Espa, et al. (2022), footnote 128, p. 18
[249] Ibid., p. 18
[250] See section 5

an economical objective compared to the environmental objective set forth *prima facie* in the EU CBAM.

As stated above, the EU CBAM must be accepted to have the objective to mitigate climate change, and therefore it also must be accepted that the measure is primarily aimed at conserving exhaustible natural resources in the sense of still having clean air, and ozone layer etc. Turning to the contribution factor within this legal standard, the actual effectiveness of the EU CBAM can be questioned. This is especially true in relation to the EU CBAM being an explicit CBAM. Explicit CBAMs give incentives to solely reduce GHG emissions, whereas effective CBAMs incentivize a cross-cutting sustainable strategy.[251] However, explicit CBAMs such as the EU CBAM are still closely tied to the conservation of resources since it is a climate mitigation measure.

Turning to the proportionality test, the way forward will first be, to first indicate the severity of the problem/interest which is the objective the lawmaker is conserving through the measure. It is made very clear through the latest IPCC reports[252] that there are grave and adverse risks connected to human-induced climate change, including but not limited to human health, conserving ecosystems, biodiversity, and food security. The IPCC calls for action now and has been for several years. An increase has been seen in adaptation measures, but there are still gaps regionally and they call for a more streamlined adaption strategy.[253] The severity of the climate change crisis is echoed throughout the international system by agreeing to the Paris Agreement, the Kyoto Protocol, the Copenhagen Accord, and the Cancun agreements.[254] The need for action is evident.

Concerning the proportionality of the measure the AB has developed a test that seeks to show there are no other less trade restrictive measures available to achieve the same policy goal.[255] This has mainly been used in cases revolving around the necessity test of GATT art XX (b) and has never been applied to an assessment under GATT art XX(g).[256]

[251] Dominioni & Esty (2023), p. 38
[252] IPCC 2022: 6th assessment Report, and IPCC 2023: Synthesis Report to the 6th assessment
[253] IPCC 2022: 6th assessment Report p. 20
[254] Kaufmann & Weber (2011), p. 515
[255] Ibid. p. 514
[256] Daniel (2004), p. 444

However, It is believed to be an efficient way of assessing WTO law compatibility, since the system is concerned with trade, and not policy objectives[257] and gives an indication of whether the means fit the ends when balancing the relationship of the two. Furthermore, in the Panel case of *China – Rare Earths* the Panel also looked into less trade-restrictive measures as a part of their analysis based on AB jurisprudence.[258] As indicated in section 6 the EU CBAM can be identified as both an internal and border measure depending on the outcome of the '*center-of-gravity test'*. Generally, internal measures are considered less trade-restrictive compared to border measures based on economic theory.[259] This is made evident in the way the GATT is structured. Art III, where internal measures are regulated, indicates that internal measures are allowed as long as they are not discriminatory, a standard which varies in the different subparagraphs.[260] Turning to the border measure, specifically the issues relating to tariffs, these are not banned as such, but seem to be stronger regulated, thus indicating that they are more trade restrictive.[261] This master's thesis found the EU CBAM to be an internal measure applied at the border, which does make it less trade restrictive. Turning to the current policy space and looking to, how other nations design environmental measures, a CBAM seems to be the less trade-restrictive alternative, i.e. the US has recently enacted the IRA, which is primarily a subsidy mechanism to support a green transition in the US for American businesses.[262] Production subsidies are considered more trade restrictive than internal measures, but are accepted within the GATT, though they are subject to a notification requirement and can be discussed upon request.[263]

Based on these discussions it must be accepted that the EU CBAM relates to the conservation of exhaustible natural resources, as the measure passes the relationship test outlined in the sub-paragraph and must be accepted as the least trade-restrictive measure one can set forward.

[257] Kaufmann & Weber (2011), pp. 513-514
[258] Panel Report, China – Rare Earths, para. 7.664
[259] Daniel (2004), pp.74-80
[260] Ibid., p. 75
[261] Ibid., p. 77
[262] The White House (2023)
[263] Daniel (2004), p. 76

7.1.2.2 made effective in conjunction with a domestic measure.

The second step in the assessment under GATT art XX(g) revolves around contemplating if the measure is made effective in conjunction with a domestic measure. In the AB case of *US – Gasoline* this has been described as *´a requirement for even-handedness in the imposition of restrictions´*.[264] The same notion was applied in the AB case of *US – Shrimp.*[265] This does not mean that imported and domestic products need to be treated identically.[266] Another standard was invoked in the AB report of *China – Raw Materials*. In this case, the AB noted that the second step would be fulfilled if the restrictions on domestic production worked together with restrictions applied to imported products.[267] The same notion was reiterated in the AB report of *China – Rare Earths,* which added that the domestic restriction were 'real' restrictions.[268] The same case noted that the contribution did not have to be evenly distributed between foreign and domestic producers.[269]

This element seems easily fulfilled by the EU CBAM since it mimics and is closely connected to the EU ETS that is applied to domestic production. The even-handedness is ensured through a similar pricing scheme and similar products to which the two measures are applicable. Since the standard is not particularly strict based on the findings in the AB report of *US – Gasoline*, where there is no need for identical treatment, these similarities seem to suffice the standard.

7.2 GATT XX Chapeau

The Chapeau of GATT art XX does not question the specific content of the measure, rather it questions its application.[270] The objective of the chapeau is to prevent abuse of the subparagraphs and has, in literature, been referenced as the gatekeeper for the exemptions.[271] The assessment under the chapeau is the same regardless of the

[264] AB Report, US – Gasoline, p. 20
[265] AB Report, US – Shrimp, paras. 144-145
[266] AB Report, US – Gasoline,. P. 21
[267] AB Report, China – Raw Materials, para. 360
[268] AB Report, China – Rare Earths, paras 5.132
[269] Ibid. Para. 5.136
[270] AB Report, US – Gasoline, p. 22
[271] Wells (2014), p. 228

subparagraph that has been invoked beforehand[272] and entails a balancing of the rights of members on the one hand and the obligations on the other.[273] This balancing act is linked to the principle of good faith, that is embedded in public international law as well as treaty interpretation.[274] The assessment is therefore quite delicate where one seeks to strike an equilibrium between the rights and obligations of member states.

Based on caselaw and by reading the provision itself, the assessment of the chapeau consists of three elements: (i) the application of the measure must result in discrimination, (ii) the discrimination must be arbitrary or unjustifiable in character, and (iii) the discrimination must occur between countries where the same conditions prevail.[275]

The assessment of the concept of discrimination under the chapeau differs from the concept of discrimination in the substantive rules, here particularly GATT art III:4.[276] This idea has been reiterated in case law.[277] However, in the AB Report of *EC – Seal Products* it was found that discrimination under GATT art I:1 was the same as those found under the chapeau.[278]

Based on earlier discussions concerning an infringement of GATT art I:1 it was found that the EU CBAM does in fact breach this provision, which results in a breach of the MFN obligation. Therefore, the application of the measure does result in discrimination.

Turning to the assessment of the discrimination is arbitrary or unjustifiable. The idea in relation to this element, is that there is a rational connection between the reasons for discrimination and the objectives mentioned in the sub-paragraph of GATT art XX.[279] To better understand this, it would be interesting to investigate measures that have been found to be arbitrary or unjustifiable by the Panel and AB.

[272] AB report, US – Shrimp, para 159-160.
[273] Ibid. 156
[274] Ibid., para 158.
[275] Ibid., para. 150
[276] AB Report, US – Gasoline, p. 23
[277] First found in AB report, US – Gasoline, reiterated in AB report, US – Shrimp, para. 150, AB Report, EC – Seal Products, para 5.298
[278] AB Report, EC – Seal Products, para. 5.318
[279] Kaufmann & Weber (2011), p. 517, based in findings from AB Report, Brazil – Retreaded Tyres, p. 227

In the AB report of *US – Shrimp* the AB assessed an import ban on shrimp and shrimp products from countries that did not use a certain net to catch shrimp. The AB found the measure to be arbitrary and unjustifiable discriminative based on two key findings. (i) the nature of the certification process, this being rigid and inflexible with a certain lack of transparency and procedural fairness in the administrative certification procedure. (ii) the measure had that intended and coercive effects on other member states' policy decisions.[280]

In another AB report, *Brazil – Retreaded Tyres*, the AB assessed a measure that imposed an import ban on retreaded tyres, which included an exemption for Mercado Común del Sur (MERCOSUR) countries under court conjunctions. The AB found the chapeau of GATT art XX to not be fulfilled because the blanket exemption of MERCOSUR countries resulted in arbitrary discrimination, and because the import ban did not have a rational connection to the objective.[281]

To sum up, paradoxically the AB will accept measures that are applied fairly, accepting due process, that allows flexibility for member states to assess their own policymaking[282] where there is a close connection to the objective outlined in the measure.

Turning to the measure at issue, the EU CBAM raises three questions under the chapeau. Firstly, concerning the rational connection to the objective, as it has been discussed earlier, that there are very clear climate-related objectives adhered to by the EU CBAM, see section 7.1.2. However, it must not be forgotten that the EU CBAM is solely a fiscal measure, with the intention to apply a financial burden on the importer, that should have the ancillary effect to make them change their production to a greener alternative in order to more easily and cheaper import to the EU. The EU CBAM in itself does not have a direct impact on emissions, and therefore, it relies heavily on the willingness of producers to reorganize their production. This speaks to the EU CBAMs economic objective to level the playing field between nationally produced goods in emission-intensive sectors and

[280] WTO: One page summaries, p. 29, US – Shrimp,
[281] Ibid., p. 138, Brazil – Retreaded Tyres
[282] Dominioni & Esty (2023), p. 39-40, and on the basis of what was found in the AB reports.

imported goods from the same sector. This objective is protectionist in character and cannot be exempted through GATT art XX.

Secondly, the EU CBAM can be categorized as an explicit CBAM, which means it only takes account of other carbon pricing schemes. More specifically one can only get a rebate on CBAM certificates if the goods have been subject to a closely related pricing scheme, cf. art 2 of EU CBAM. Even though this does not mandate a specific policy in another member state, it nevertheless creates a strong incentive for governments to engage in similar carbon pricing, and clearly indicates how the EU expect importing countries to meet their standards. This questions the ability of the EU CBAM to be exempted under GATT art XX based on the findings from the AB report, *US – Shrimp.*

Lastly, the exemption of countries connected to the EU ETS and the calculation methods of EU CBAM certificates must be assessed, in relation to the exemption of countries. The exemption is based on environmental grounds. The fact that these products have already been subject to the EU ETS pricing scheme or a like scheme, it can be argued that this does not amount to arbitrary or unjustifiable discrimination.[283] The calculation method of the EU CBAM also disproves the measure being arbitrary or unjustifiable discrimination. The Calculation method indicates that the objective of mitigating climate change is rationally connected to the EU CBAM, as it is based on actual emissions. Furthermore, the calculation method of the EU CBAM also strengthens the fact that the measure is applied in a non-discriminatory way to countries where the same conditions prevail, which is the last element to be assessed.

The last element has been clearly described in the AB report of *US – Shrimp.* It entails that there must be a degree of flexibility in relation to how the measure is applied.[284] The importing country cannot require exporting countries to adopt a specific policy, however, the importing country can require the exporting country to implement a regulatory program, that is comparably effective and suitable for conditions in the exporting countries' territory.[285] To meet this requirement a CBAM must take account of a country's

[283] Espa, et al. (2022), p. 19
[284] AB report, US – Shrimp (article 21.5), para. 164
[285] Dominioni & Esty (2023), p. 39, referencing AB report US – Shrimp (article 21.5), para. 149

development and the climate change mitigation policies the country has already implemented.[286]

This discussion takes us back to the second question discussed just above in relation to if the EU CBAM is flexible enough to meet the requirements of the chapeau of GATT art XX. The EU CBAM does not credit other climate mitigation policy tools besides a carbon pricing scheme. Thus, it puts a de facto limitation on policy measures that exporting countries can implement while still avoid charges upon importation. Especially in developing countries a carbon pricing scheme may not be suitable due to the level of development and administrative burden, whereas other environmental measures such as reforms on fossil fuel subsidies and energy taxes are easier to implement.[287]

The EU CBAM is on its face not compatible with the chapeau because it amounts to unjustifiable or arbitrary discrimination between countries where the same conditions prevail.

7.3 Partial Conclusion

Based on the discussion above, it must be concluded that the EU CBAM can be exempted based on GATT art XX(g) because it passes the relationship test outlined in the provision. As the EU CBAM relates to the conservation of exhaustible natural resources, this being clean air and a stable environment, and is applied in an evenhanded manner between imported and domestic products.

However, the EU CBAM constitutes arbitrary or unjustifiable discrimination between countries where the same conditions prevail, due to the inflexibilities of the measure and the fact that there is a limited rational connection between the objective of the EU CBAM, climate change mitigation, and the application of it.

The EU CBAM can therefore not be exempted through GATT art XX and is therefore found to be incompatible with the GATT more specifically GATT art I:1 and art III:2.

[286] Ibid.
[287] Ibid. p. 20

8 Conclusion

Based on an extensive assessment of the EU CBAM this master's thesis finds that the EU CBAM gives rise to a plethora of trade concerns especially in relation to the crediting of third countries' climate change, the calculations of emissions that cause an extensive burden on companies seeking to import to the EU, the free allowances scheme that will continue to work in an interim period creating double protection for EU companies and the limited possibilities to be exempted from the EU CBAM.

The measure inevitably breached the MFN principle found in art I:1 of the GATT, because the EU CBAM establishes advantages based on the origin that is not extended to all members. The distinction in the crediting of third countries policies and if the countries are closely related to the EU ETS.

In relation to GATT art III, it was discussed if the EU CBAM was a border or an internal measure. It was found that the EU CBAM bears qualities of both kinds of measures but could nevertheless be examined under GATT art III as it could also be identified as an internal measure applied at the border. Following what I ran into in relation to this assessment was whether the EU CBAM could be qualified as a tax. It was found that the EU CBAM can be qualified as a tax because it is a compulsory contribution to the government levied on goods, primarily calculated in a proportional manner, should this be too farfetched and not the case the EU CBAM should be considered a charge to which GATT art III:2 is applicable. It was found that the EU CBAM breaches art III:2, first sentence, due to the EU CBAM charging imported goods in excess compared to domestic products. The measure was further examined under GATT art III:4, to assess the EU CBAM should it be a regulation. The EU CBAM was found to be compatible with GATT art III:4 because the pricing mechanisms found in the EU CBAM have been permissible in principle under previous DSB jurisprudence, for instance, the *US – Gasoline* case. However, there are still issues concerning the EU CBAM under this provision.

Lastly, it was assessed if the EU CBAM could be exempted under GATT art XX. This was not found to be the case, because the EU CBAM amounts to arbitrary and

unjustifiable discrimination within the meaning of the chapeau of GATT art XX. This was mainly due to the inflexibilities of the EU CBAM concerning crediting the policies of third countries.

This master's thesis, therefore, finds that elements of the EU CBAM are incompatible with and illegal according to WTO law.

List of Abbreviations

AB	Appellate Body
Art	Article
CBAM	Carbon Border Adjustment Mechanism
CN	Combined Nomenclature
CO_2	Carbon Dioxide
DSB	Dispute Settlement Body
DSU	Dispute Settlement Understanding
ECJ	European Court of Justice
ETS	Emissions Trading System
EU	European Union
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic production
GHG	Greenhouse gas
HS	Harmonized system
ICJ	international court of justice
IRA	Inflation Reduction Act
LDC	Least developed countries
MC	Ministerial Conference
MERCOSUR	Mercado Común del Sur
MFN	Most-Favored-Nation
MPIA	Multi-Party Interim Appeal Arbitration Arrangement
NDC	National determined contribution
NPR-PPMs	Non product related process and production methods
NT	National Treatment

OECD	Organization for Economic Co-operation and Development
SCM	Subsidies and Countervailing Measures
TBT	Technical Barriers to Trade
TEU	Treaty on the European Union
TFEU	Treaty on the Functioning of the European Union
UNFCCC	United Nations Framework Convention on Climate Change
US	United States
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organization

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GATT: General Agreement on Tariffs and Trade 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1867 UNTS 190.

ICJ Statute: Statute of the International Court of Justice, United Nations, 1946, 33 UNTS 993

Kyoto Protocol: Kyoto Protocol to the United Nations Framework Convention on Climate Change, Dec. 10, 1997, 2303 U.N.T.S. 162

Paris Agreement: Paris Agreement to the United Nations Framework Convention on Climate Change, Dec. 12, 2015, T.I.A.S. No. 16-1104

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TBT Agreement: Agreement on Technical Barriers to Trade 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, 1868 UNTS 120.

TEU: Document 12012M/TXT, Consolidated version of the Treaty on European Union, Official Journal of the European Union, C 326/13, 26 November 2012

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VCTL: Vienna Convention on Law of Treaties, United Nations, 1969, 1155 U.N.T.S. 331

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