ARTICLES

EU CARBON BORDER ADJUSTMENTS AND WTO LAW, PART TWO

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SUMMARY

In July 2021, the European Commission published a proposal for a Carbon Border Adjustment Mechanism (CBAM), part of a wider package of laws aimed at implementing the European Union (EU) Green Deal. The exact design of the CBAM is in flux, and priorities will have to be set. The chief concern is the compatibility of a CBAM with the law of the World Trade Organization (WTO). This Article explores whether and how the various CBAM design options under consideration can be reconciled with WTO requirements, focusing on a possible import border adjustment scheme. Last issue's Part One described different instruments under consideration for the EU's proposal; this part assesses the validity of these measures against the public policy exceptions contained in Article XX of the General Agreement on Tariffs and Trade, and concludes. The measure will require careful design, and even then there is legal uncertainty in the WTO jurisprudence. In any event, the EU will be required to intensify its efforts to reach out to other jurisdictions to come to globally coordinated solutions.

This Article, which is published in two separate parts, explores whether, and if so how, the various Carbon Border Adjustment Mechanism (CBAM) design options presented by the European Commission[1] could be reconciled with World Trade Organization (WTO) law requirements.[2] In line with previous findings,[3] our main hypothesis is that a measure's effectiveness in addressing carbon leakage correlates with the risk of falling short of the WTO nondiscrimination requirements. To make this evident, we compare the CBAM instruments deliberated by the European Commission with the benchmark of a CBAM for a (carbon) excise tax levied on fossil fuels.

CBAM design options have long been the object of substantial economic and political debate, as well as legal analysis. Our research goes beyond the existing literature in that it offers an in-depth comparative analysis of the compatibility of the different CBAM design options (meaning a border adjustment to carbon pricing under different emissions trading system (ETS) pricing mechanisms or excise tax strategies) with WTO law. This approach includes interpretation of the legality of the carbon pricing system developed under an ETS framework, in respect of WTO law and its jurisprudence.

The Article further proposes certain design modifications for individual instruments so as to strike a better balance between the need to respect WTO law standards and the objective of effectively addressing carbon leakage. Due to its comprehensive nature, our findings are also applicable to the CBAM proposal recently proposed

Authors' Note: We are grateful for comments received from Alice Pirlot and others at the Monash University Tax Symposium 2021.

1. *See* European Commission, *The European Green Deal*, at 5, COM (2019) 640 final (Dec. 11, 2019); *see also Commission Work Programme 2021*, at 5, COM (2020) 690 final (Oct. 19, 2020). Meanwhile, the European Commission has tabled its CBAM proposal, *see Proposal for a Regulation Establishing a Carbon Border Adjustment Mechanism*, COM (2021) 564 final (July 14, 2021) [hereinafter *Proposal for a Regulation Establishing a CBAM*].
2. Editor's Note: Tatiana Falcão has provided inputs to the Coalition of Finance Ministers for Climate Action on the legality of employing a CBAM, and has spoken to the European Parliament's Subcommittee on Tax Matters concerning the mechanism.
3. *See* Aaron Cosbey et al., Designing Border Carbon Adjustments and Alternative Measures: An Overview 10 (2020).

by the Commission,[4] and for other jurisdictions contemplating similar measures. In particular, we suggest that the Commission proposal would probably not pass the general nondiscrimination tests under the General Agreement on Tariffs and Trade (GATT), and would require further efforts to meet the requirements of the public policy exception of GATT Article XX.

For context, last issue's Part One was subdivided into five sections. Section I described the different instruments that were under consideration for the October 2020 European Union (EU) CBAM proposal,[5] namely, (1) a carbon customs duty; (2) an extension of the existing emissions trading scheme; (3) a border tax adjustment (BTA) for a consumption-based excise tax (CET); and (4) a BTA for a tax on fossil fuels. In Section II, we analyzed the compatibility of each of these instruments with GATT, and to a lesser extent, with the Agreement on Subsidies and Countervailing Measures (ASCM), focusing on the most relevant GATT provisions, namely, Article I (Most Favored Nation Principle), Article II (Schedule of Concessions for Tariffs), Article III (National Treatment), and Article XI (Quantitative Restrictions).

In this issue's Part Two, we assess the validity of these measures against the public policy exceptions contained in GATT Article XX. In that context, we also consider some international political economic aspects of introducing a CBAM that are relevant in light of the chapeau of Article XX. In particular, we explore the need to take into account the practical circumstances of third states, and how bilateral or regional coordination or agreement might be necessary and could eventually lead to a multilateral approach. Part Two also summarizes our conclusions.

I. Admissible Exceptions Under GATT Article XX

Article XX of GATT contains public policy exceptions to the main provisions in Articles I, III, and XI. In a nutshell, in order for a charge on imports to pass scrutiny under the WTO and GATT, it must be consistent with the main provisions of GATT, namely, (1) the Most Favoured Nation clause (Article I), (2) National Treatment (Article III), and (3) Quantitative Restrictions (Article XI), or be justifiable under one of the Article XX exceptions.[6]

It follows that even if a particular policy or measure is inconsistent with one of the GATT main provisions, it could still be justified under one of the exceptions in GATT Article XX. In such cases, the Party arguing the exception has the burden of proving that the inconsistent measure falls within the scope of the exception.[7] GATT Article XX contains "limited exceptions from obligations under certain other provisions of the GATT 1994, not positive rules establishing obligations in themselves."[8] Article XX exceptions are thus affirmative defenses a Member may present if faced with a complaint of violation of a provision from another Party.

In the context of the CBAM, the exceptions contained in paragraphs (b) and (g) of GATT Article XX are of particular interest, due to their relevance for measures concerning the protection of the environment and attention to human health. These are measures (b) "necessary to protect human, animal or plant life or health," and (g) "relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption."[9]

In order for a justification under GATT Article XX to apply, a WTO Member must perform a two-tier analysis (or test) proving (1) that its measure falls within one of the exceptions mentioned above (here, paragraphs (b) and/or (g)), and (2) that the measure satisfies the requirements contained in the chapeau of GATT Article XX. The chapeau requires that the contested measure is not applied in a "manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade."[10] Both requirements have to be present in order for the measure to be justifiable under one of the general exceptions.[11]

The order in which the test takes place matters. That is what was established in *United States—Shrimp*, where the Appellate Body disagreed with the panel report, which reversed the order in which the test was to take place. The

4. *Proposal for a Regulation Establishing a CBAM*, *supra* note 1.
5. *Commission Work Programme 2021*, *supra* note 1.
6. Section partially based on Tatiana Falcão, *A Proposition for a Mutltilateral Carbon Tax Treaty*, ch. 8 (IBFD, Doctoral Series No. 47, 2019).
7. Panel Report, *United States—Standards for Reformulated and Conventional Gasoline*, paras. 6.31 and 6.35, WTO Doc. WT/DS2/R (adopted May 20, 1996).
8. Appellate Body Report, *United States—Measures Affecting Imports of Woven Wool Shirts and Blouses From India* 335, WTO Doc. WT/DS33/AB/R (adopted May 23, 1997).
9. The justifications under GATT Article XX(b) and (g) can be claimed interchangeably. A country may thus claim a justification under any of the two exceptions, or under both of them. A WTO Member is likely to use as many arguments as it can to try to justify a policy measure. In *United States—Shrimp*, for instance, the case was primarily justified under Article XX(g). The United States argued, in that case, that the defense posed with respect to Article XX(b) should only be taken into consideration by the Appellate Body in case the Appellate Body disagreed with the arguments presented under Article XX(g). Article XX(b) was thus invoked alternatively to Article XX(g). *See* Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, para. 125, WTO Doc. WT/DS58/AB/R (adopted Nov. 6, 1998).
10. See, in this respect, *id.*, para. 7.28, and Appellate Body Report, *United States—Standards for Reformulated and Conventional Gasoline*, para. 119, WTO Doc. WT/DS2/AB/R (adopted May 20, 1996). *See also* Panel Report, *European Communities—Measures Affecting Asbestos and Products Containing Asbestos*, para. 8.167, WTO Doc. WT/DS135/R (adopted Apr. 5, 2001).
11. This point was particularly reaffirmed by the WTO in the *United States—Gasoline* case:

> In order that the justifying protection of Article XX may be extended to it, the measure at issue must not only come under one or another of the particular exceptions—paragraphs (a) to (j)—listed under Article XX; it must also satisfy the requirements imposed by the opening clauses of Article XX. The analysis is, in other words, two-tiered: first, provisional justification by reason of characterization of the measure under XX(g); second, further appraisal of the same measure under the introductory clauses of Article XX.

Appellate Body Report, *United States—Standards for Reformulated and Conventional Gasoline* 22, WTO Doc. WT/DS2/AB/R (adopted May 20, 1996).

Appellate Body concluded that reversing the order of the test would make the task of interpreting the chapeau of GATT Article XX very difficult, and even impossible, because of the broadness in the scope of the provision. It thus established that the correct approach would be to first verify the adequacy of applying a GATT Article XX exception, and then moving to the chapeau and analyzing it with respect to the exception to which it relates. This understanding was later confirmed in the *European Communities—Asbestos* case.

GATT does not provide any further explanation with respect to the scope and extent of these provisions' application. The interpretation of the above articles and their interrelation with one another can only be inferred from an analysis of GATT and WTO jurisprudence, in particular the relevant Appellate Body decisions. The WTO has dealt with a number of cases concerning the protection of environmental objectives, and has reaffirmed its Members' right to regulate and determine their own environmental objectives on several occasions. This section will look at specific cases in which environmental measures are classified either under exception (b) or (g) of GATT Article XX.

A. Measures Qualifying Under GATT Article XX(b)

GATT Article XX(b) provides an exception related to the protection of human, animal, or plant life or health. According to *United States—Gasoline*,[12] for a measure to be justified under GATT Article XX(b), the Party invoking GATT Article XX should demonstrate:

> (i) that the policy in respect of the measures for which the provision was invoked fell within the range of policies designed to protect human, animal or plant life or health; (ii) that the inconsistent measures for which the exception was being invoked were necessary to fulfill the policy objective; and (iii) that the measures were applied in conformity with the requirements of the introductory clause of GATT Article XX.

All of the above requirements should be satisfied, since they are cumulative.

The first stage of the test concerns the assessment of the strength of the link between the policy and the intended result, which is to protect human, animal, or plant life or health. There must be a direct correspondence between the action and the intended goal under GATT Article XX(b). In *United States—Gasoline*,[13] for example, the panel agreed with the United States' argument that about one-half of air pollution is caused by vehicle emissions that lead to particular ground-level ozone and toxic substances that present health risks to humans, animals, and plants. Since the disputed "Gasoline Rule"[14] reduced emissions, it was considered to be apt to fulfill the policy goal supported by GATT Article XX(b).

In *Brazil—Measures Affecting Imports of Retreaded Tyres*,[15] the Appellate Body clarified that the contribution toward preservation of the objectives pursued under Article XX(b) does not need to be immediately observable. With respect to the specific issue of global warming and climate change, the Appellate Body acknowledged that results obtained from certain measures can only be evaluated with the benefit of time. Therefore, in order to justify the policy objective under GATT Article XX(b), the contested measure need merely bring about a material contribution to the achievement of that objective.[16]

However, complying with the object of the exception is not enough to make the policy objective acceptable. The second stage gauges whether the measure is *necessary* for fulfilling the policy objective. This is currently referred to as the "least trade-restrictive test."[17] The question that ought to be asked here is whether there is no alternative measure more consistent with GATT that the country could employ to achieve the same health- or life-preserving objectives.[18] Therefore, part of the necessity test is to infer whether there was a less trade-restrictive way of achieving the same result under GATT.[19] According to WTO jurisprudence, this further includes a balancing test, meaning that a Party cannot justify a measure inconsistent with another GATT provision as "necessary" if there is an alternative measure that is not inconsistent with other GATT provisions and that it could be reasonably expected to employ.[20]

More recently, the level of importance of the health or life issue the policy measure seeks to preserve has also been taken into account. It has been argued that the more vital the interest in preserving certain health or life standards, the easier it is to justify the policy as being

12. Panel Report, *United States—Standards for Reformulated and Conventional Gasoline*, para. 6.20, WTO Doc. WT/DS2/R (adopted May 20, 1996).
13. *Id.* para. 6.21.
14. *Id.* paras. 6.1 and 6.21. The "Gasoline Rule" is the generic name conferred to the American Clean Air Act and its regulations under this case. It set standards for gasoline quality intended to reduce air pollution, including ozone, caused by motor vehicle emissions. It applied to refiners, blenders, and importers of gasoline.
15. Appellate Body Report, *Brazil—Measures Affecting Imports of Retreaded Tyres*, para. 151, WTO Doc. WT/DS332/AB/R (adopted Dec. 17, 2007).
16. This could be demonstrated, for example, based on empirical data.
17. Goran Dominioni, *WTO Law Compatibility of a "Feebate" Scheme on Imported Products*, *in* Designing Fiscal Instruments for Sustainable Forests 225 (Dirk Heine & Erin Hayde eds., World Bank Group 2021).
18. Panel Report, *Thailand—Customs and Fiscal Measures on Cigarettes From the Philippines*, para. 75, WTO Doc. WT/DS371/R (adopted July 15, 2011); Panel Report, *United States—Standards for Reformulated and Conventional Gasoline*, paras. 6.24, 6.25, and 6.28, WTO Doc. WT/DS2/R (adopted May 20, 1996).
19. In *Brazil—Tyres*, it was established that in order to determine whether a measure is necessary to protect human, animal, or plant life or health under Article XX(b), one has to go through a process of weighing and balancing factors. The Appellate Body thus looked at the contribution made by the environmental measure to the policy objective, the importance of common interests or values protected by the measure, and the impact of the measure on international trade. If the analysis of these issues leads one to believe that the measure is necessary, then the result must be confirmed by comparing it to other possible alternatives that might be less trade-restrictive, while achieving the same result pursued with the policy choice. Appellate Body Report, *Brazil—Measures Affecting Imports of Retreaded Tyres*, paras. 156-175, WTO Doc. WT/DS332/AB/R (adopted Dec. 17, 2007).
20. Panel Report, *United States—Standards for Reformulated and Conventional Gasoline*, para. 6.24, WTO Doc. WT/DS2/R (adopted May 20, 1996).

"necessary."[21] In *Brazil—Taxation*, the panel found that reduction of carbon dioxide (CO_2) emissions is an interest of high importance.[22]

In *United States—Gasoline*,[23] the panel noted the United States' uncontested arguments that air pollution, in particular ground-level ozone and toxic substances, presented health risks to humans, animals, and plants. The panel agreed with the Parties that a policy to reduce air pollution (caused by vehicle emissions) would fall within the exception in GATT Article XX(b).[24] However, it found that this was not the least restrictive means of achieving that result, and thus refused the application of the GATT Article XX(b) exception.

The third stage seeks to fit the measure into the chapeau of GATT Article XX, an issue that will be further examined in Section I.C.

B. Measures Qualifying Under GATT Article XX(g)

GATT Article XX(g) provides that a trade-restrictive measure may be justifiable if it relates to the conservation of exhaustible natural resources, provided it is made effective in conjunction with restrictions on domestic production or consumption.

In interpreting this provision, the Appellate Body in *United States—Shrimp* also established a four-part test: (1) the measure should be one "concerned with the conservation of 'exhaustible natural resources' within the meaning of GATT Article XX(g)"[25]; (2) the measure must *relate to* the conservation of exhaustible natural resources[26]; (3) the measure must be applied "in conjunction with restrictions on domestic production or consumption," a requirement also referred to as the evenhandedness principle[27]; and (4) the measure must be applied in conformity with the requirements of the introductory clause of GATT Article XX.

1. Exhaustible Natural Resources

The first step in defining whether a restrictive measure may be justified under GATT Article XX(g) is thus to define what is deemed to be an "exhaustible natural resource" under the WTO construct.

The Appellate Body has, on more than one occasion, declared that "exhaustible natural resources" include both living and nonliving resources,[28] among which are petroleum,[29] gasoline,[30] an assortment of living species,[31] and clean air.[32]

Regarding the admissibility of a border adjustment for a CET, or for an excise tax that is levied exclusively on fossil fuels, the first relevant decision is *United States—Gasoline*, where the panel discussed why a measure aiming to restrict the consumption of gasoline could be deemed to be a measure aimed at protecting human, animal, and plant life or health. The panel report adopted an inductive approach in answering the question as to whether the measure would fit into the exception rule in GATT Article XX, noting that gasoline is produced from petroleum, and petroleum is deemed to be an exhaustible natural resource.[33] Following this approach, all petroleum byproducts could automatically be considered exhaustible natural resources because of their finite condition.[34] Coal is not a byproduct of petroleum, but it would be fair to say that it could also be considered an exhaustible natural resource within the WTO framework, because it is derived from the same type of geological process that leads to the formation of petroleum basins.

However, the panel did not stop at this historic interpretation in *United States—Gasoline*. As subsequently highlighted in *United States—Shrimp*, the term "exhaustible natural resources" was actually crafted more than 50 years ago and must be read in light of contemporary concerns

21. Appellate Body Report, *European Communities—Measures Affecting Asbestos and Products Containing Asbestos*, para. 172, WTO Doc. WT/DS135/AB/R (adopted Apr. 5, 2001) (Appellate Body concluded that "[t]he more vital or important [the] common interests or values pursued, the easier it would be to accept as 'necessary' measures to achieve those ends").
22. Panel Report, *Brazil—Certain Measures Concerning Taxation and Charges*, paras. 7.914-7.916, WTO Doc. WT/DS472, 497/R (adopted Jan. 11, 2019). National Board of Trade Sweden, Border Carbon Adjustments: An Analysis of Trade Related Aspects and the Way Forward 54 (2020).
23. Panel Report, *United States—Standards for Reformulated and Conventional Gasoline*, para. 6.21, WTO Doc. WT/DS2/R (adopted May 20, 1996).
24. National Board of Trade Sweden, *supra* note 22, at 56.
25. Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, para. 127, WTO Doc. WT/DS58/AB/R (adopted Nov. 6, 1998).
26. *Id.* para. 135. The Appellate Body report mentions that "in making this determination, the treaty interpreter essentially looks into the relationship between the measure at stake and the legitimate policy of conserving exhaustible natural resources."
27. *Id.* paras. 143-145.
28. *Id.* paras. 128 and 131.
29. *Id.* para. 128.
30. GATT Panel Report, *United States—Taxes on Automobiles*, para. 5.57, DS31/R (unadopted, circulated Oct. 11, 1995).
31. Tuna (GATT Panel Report, *United States—Restrictions on Imports of Tuna*, para. 4.9, DS29/R (unadopted, circulated June 16, 1994)), salmon and herring (GATT Panel Report, *Canada—Measures Affecting Exports of Unprocessed Herring and Salmon*, para. 4.9, L/6268, GATT B.I.S.D. 35S/98 (adopted Mar. 22, 1988)), dolphins (GATT Panel Report, *United States—Restrictions on Imports of Tuna*, para. 5.13, DS29/R (unadopted, circulated June 16, 1994)), and sea turtles (Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, paras. 128 and 134, WTO Doc. WT/DS58/AB/R (adopted Nov. 6, 1998)).
32. Panel Report, *United States—Standards for Reformulated and Conventional Gasoline*, para. 6.37, WTO Doc. WT/DS2/R (adopted May 20, 1996). The panel concluded that clean air was a resource because it had value. It was natural, which means it could be depleted. The fact that the resource was renewable could not be an objection to its qualification within the meaning of GATT Article XX(g). The panel referenced two other cases, where it had previously asserted that the fact that something was renewable did not mean that it could not be exhaustible. In GATT Panel Report, *Canada—Measures Affecting Exports of Unprocessed Herring and Salmon*, para. 4.4, L/6268, GATT B.I.S.D. 35S/98 (adopted Mar. 22, 1988), and GATT Panel Report, *United States—Restrictions on Imports of Tuna*, para. 5.13, DS29/R (unadopted, circulated June 16, 1994), it concluded that renewable stocks of salmon and dolphins could, respectively, constitute an exhaustible natural resource.
33. The decision refers to the drafting history of GATT Article XX (g), and in particular to the mention of minerals such as manganese, in the context of arguments made that export restrictions should be permitted for the preservation of scarce natural resources. Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, para. 127, WTO Doc. WT/DS58/AB/R (adopted Nov. 6, 1998).
34. *Id.* para. 128.

with the protection and conservation of the environment.[35] The preamble of the WTO Agreement—which informs not only GATT 1994, but also the other covered agreements—explicitly acknowledges the objective of *sustainable development*.[36] *United States—Gasoline* further developed this rationale by clearly stating that "a policy to reduce air pollution resulting from the consumption of gasoline was a policy within the range of those concerning the protection of human, animal and plant life or health mentioned in Article XX(b)."[37] The rationale was then evolved to support that the object of conservation under Article XX(b) and (g) is not the fossil product as a natural resource, but clean air, as an exhaustible natural resource.[38]

This finding is relevant to all three forms of CBAM but particularly to an extension of the ETS to cover a border price (notional ETS) and to the CET, because it allows extending the protective levy to cases where there is no clear connection to the pollution potential of the measure in question.[39] Although the decision in question concerns the application of an excise tax at the border, it could likewise provide grounds to justify a border price, such as a notional ETS (the option ultimately adopted at the EU CBAM proposal of July 2021) as compatible with GATT. In *United States—Gasoline*, the panel agreed with the United States' assertion that clean air was an exhaustible natural resource,[40] because it could be exhausted by pollutants such as those emitted through the consumption of gasoline, and that for this reason it could also be considered justifiable under GATT Article XX(g).[41]

A question persists as to whether the incorporation of polluting materials (such as steel, pulp, iron) into a final product and the corresponding application of the border adjustment on the product (according to the presumed or actual carbon content of the polluting component) would also fit within the exception. In this case, the correlation between the material and the depletion of clean air would not be direct, or as obvious, as in the case of a charge directly imposed on the raw material or energy-intensive activity. However, considering that such a measure equally aims to reduce carbon-based emissions, which would contribute to the preservation of clean air, an exhaustible natural resource, it should be possible to maintain that such a measure could fit within the realm of GATT Article XX(b) and (g). This is all the more likely considering that WTO Members now strive to interpret trade obligations in light of their environmental commitments.[42]

The reduction of carbon-based emissions is therefore a purpose that has been shown to correspond both with the human, animal, and plant health in GATT Article XX(b) and with the preservation of natural resources in GATT Article XX(g). Nevertheless, to comply with GATT Article XX(g), a CBAM would still have to pass the remaining tests established by the Appellate Body for GATT Article XX(g), as indicated in the sections that follow.

2. Relating to the Conservation of Exhaustible Natural Resources

To meet the second requirement (i.e., "relate" to the conservation of an exhaustible natural resource), the contested measure does not have to be necessary or essential for the conservation of an exhaustible natural resource. It merely needs to be "primarily aimed at" its conservation.[43] To this effect, the measure should have a "substantial relationship" with the conservation of an exhaustible natural resource and not merely be "incidentally or inadvertently" aimed at this objective.[44]

The Appellate Body in *United States—Gasoline* examined whether the United States' baseline establishment rules were appropriately regarded as "primarily aimed at" the conservation of natural resources within the meaning of GATT Article XX(g). It concluded that the rules were primarily aimed at conservation of natural resources because the "baseline establishment rules, taken as a whole (that is, the provisions relating to establishment of baselines for domestic refiners, along with the provisions relating to baselines for blenders and importers of gasoline), [were] . . . related to the 'nondegradation'

35. *Id.* para. 129.
36. National Board of Trade Sweden, *supra* note 22, at 53, 54; International Institute for Sustainable Development & United Nations Environment Programme, Trade and Green Economy: A Handbook 36, 103-04 (3d ed. 2014).
37. Panel Report, *United States—Standards for Reformulated and Conventional Gasoline*, para. 6.21, WTO Doc. WT/DS2/R (adopted May 20, 1996).
38. *Id.* para. 6.37.
39. *See* Stéphanie Monjon & Philippe Quirion, *How to Design a Border Adjustment for the European Union Emissions Trading System?*, 38 Energy Pol'y 5199, 5201 (2010).
40. Jochem Wiers extends this finding, arguing that "air not 'depleted' by excessive greenhouse gas concentration caused by human-induced CO_2 emissions may also qualify as an exhaustible natural resource." The loss of biodiversity due to climate change may also qualify as an exhaustible natural resource. See, in this respect, Jochem Wiers, *French Ideas on Climate and Trade Policies*, 2 Carbon & Climate L. Rev. 18-32 (2008), and Madison Condon & Ada Ignaciuk, *Border Carbon Adjustment and International Trade: A Literature Review* 21 (OECD Trade and Environment, Working Paper No. 2013/06, 2013), https://www.oecd-ilibrary.org/docserver/5k3xn25b386c-en.pdf.
41. Panel Report, *United States—Standards for Reformulated and Conventional Gasoline*, para. 6.37, WTO Doc. WT/DS2/R (adopted May 20, 1996).
42. The objectives of (1) sustainable development, (2) environmental preservation and protection, and (3) optimal use and consumption of natural resources are recognized in the preamble of the Marrakesh Agreement, which is the agreement establishing the WTO. The inclusion of an environmental objective in the Marrakesh Agreement implies that all multilateral and plurilateral agreements operating within the WTO framework (amongst them GATT, the General Agreement on Trade in Services, and the ASCM) are to be interpreted in light of that environmental object and purpose.
43. GATT Panel Report, *Canada—Measures Affecting Exports of Unprocessed Herring and Salmon*, para. 4.6, L/6268, GATT B.I.S.D. 35S/98 (adopted Mar. 22, 1988). Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, paras. 141-145, WTO Doc. WT/DS58/AB/R (adopted Nov. 6, 1998), used the language "reasonably related to the ends pursued" (in this case, the conservation of natural resources). Meaning that the general structure and design of the measure ought to be narrowly focused, and not just a "blanket prohibition" (in this case, on the importation of shrimp). WTO, Understanding the WTO 66, 67 (2011).
44. *See* Appellate Body Report, *United States—Standards for Reformulated and Conventional Gasoline* 19, WTO Doc. WT/DS2/AB/R (adopted May 20, 1996). See also, in a similar vein, Appellate Body Report, *China—Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum*, para. 5.90, WTO Doc. WT/DS431, 432, 433/AB/R (adopted Aug. 29, 2014), where the Appellate Body further specified that a "close and genuine relationship of ends and means" was required.

requirements set out elsewhere in the Gasoline Rule." The Appellate Body thus undertook a holistic approach to analyzing the suitability of the instrument and the standard imposed by the measure.

Over the years, the Dispute Settlement Body (DSB) jurisprudence has come to establish some other parameters to substantiate the above criteria.[45] To qualify under GATT Article XX(g), a trade-restrictive measure must not (1) be based on unpredictable conditions[46]; (2) force other countries to change their policies with respect to a certain issue, and only lift the trade limitation once such countries have implemented the policy change[47]; or (3) fail to further the objectives of conserving the natural resource it aims to protect.[48]

Further explanation is required with respect to (2). When the panel referred to "measures taken so as to force other countries to change their policies with respect to persons or things within their own jurisdictions, and requiring such changes in order to be effective,"[49] it was assessing an embargo imposed on the import of any tuna product, regardless of the environmental damage caused by the respective harvesting practice and policy, as long as the latter was not comparable to the policies pursued by the United States.

The measure was thus not deemed to be primarily aimed at the conservation of the envisaged natural resource, because even if the importing country harvested a product in a way designed to achieve the desired environmental objective, its product might still be subject to the embargo if the harvesting methods had not been applied in the same way.[50] From this, it can be inferred that in view of the panel deciding *United States—Tuna I*, a trade-restrictive measure cannot be justified under GATT Article XX(g) if it does not take into account measures adopted by the country of origin of an imported product with similar objectives and equivalent effect.

The case of applying a BTA (under any of the three modalities) ought to be distinguished, because nothing would happen to the country of origin (the trade partner from which the chargeable raw material or product derives), were it to fail to employ a domestic carbon tax or price itself. Although the administration of a BTA could act as an incentive for third countries (trading partners) to introduce their own domestic legislation aiming to tax carbon, as will be further discussed under the requirements of the chapeau, it does not require trading partners to introduce a corresponding domestic carbon tax or price in order to trade with the EU. Failing to do so will be to the detriment of the country of origin to the extent it will in a way waive its right to tax the product domestically, and hence accumulate the revenues associated with the tax, but it will not limit trade between the two nations.

As a result, countries may ultimately exercise their sovereign right not to tax carbon content upon production or extraction. What would be required, however, is to take into account any eventual carbon pricing, carbon taxation, or equivalent emission reduction efforts of the respective country of origin for the purpose of calculating the amount of the carbon border adjustment. It is our understanding that this flexibility would be built into the CBAM rebate upon certification of a better-than-benchmark carbon content of the imported product, as envisaged in the inception impact assessment.

3. Applied in Conjunction With Domestic Restrictions

Finally, the evenhandedness requirement implies that a measure imposing restrictions on imported products should also be applied on domestically produced products so that (1) there is no distortion of competition between like products, and (2) foreign and domestic products compete on equal terms when accessing a foreign or domestic market.[51]

This requirement does not in itself limit the imposition of a border tax but conditions it to the imposition of a similar domestic tax. This means that the tax or price applied at the border would be disallowed if applied only with respect to foreign-derived products. The conditions for application of the tax must be substantially similar for domestic and foreign products.[52]

Further, the Appellate Body in *China—Rare Earths* held that to comply with the "made effective" clause in GATT Article XX(g), the Member concerned must impose a

45. WTO, *GATT/WTO Dispute Settlement Practice Relating to GATT Articles XX, Paragraphs (b), (d) and (g)—Note by the Secretariat* 16, 17, WTO Doc. WT/CTE/W/203 (Mar. 8, 2002). Worthy of note is the fact that the following criteria are derived from unadopted panel reports and therefore have no formal legal status in the GATT or WTO system. Unadopted panel reports can nevertheless provide useful guidance to a panel or the Appellate Body in a subsequent case dealing with the same legal question, as has been the case with the issue dealt with in these cases.
46. GATT Panel Report, *United States—Restrictions on Imports of Tuna*, para. 5.33, DS21/R-39S/155 (unadopted, circulated Sept. 3, 1991). The unpredictability here referred to a regulatory measure that linked the Mexican conservation obligation to American trading standards. The assessment of the Mexican conservation measures according to American conservation standards brought upon Mexico a high degree of unpredictability, making the trade limitation caused by that regulatory measure unjustifiable under GATT Article XX(g).
47. For example, by conditioning the admissibility of a product to the adoption of an extraneous environmental regulation that is in line with the environmental regulation of the importing country. See, in this respect, GATT Panel Report, *United States—Restrictions on Imports of Tuna*, paras. 5.24 to 5.27, DS29/R (unadopted, circulated June 16, 1994).
48. GATT Panel Report, *United States—Taxes on Automobiles*, para. 5.60, DS31/R (unadopted, circulated Oct. 11, 1995).
49. GATT Panel Report, *United States—Restrictions on Imports of Tuna*, para. 5.25, DS29/R (unadopted, circulated June 16, 1994).
50. *Id.* para. 5.24. See also Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, para. 141, WTO Doc. WT/DS58/AB/R (adopted Nov. 6, 1998), on measures *not* constituting a simple blanket prohibition, aimed at influencing another country's policy.
51. Appellate Body Report, *United States—Standards for Reformulated and Conventional Gasoline* 20, 21, WTO Doc. WT/DS2/AB/R (adopted May 20, 1996). The Appellate Body acknowledges, however, that there is no textual basis for requiring identical treatment of domestic and imported products. This notwithstanding, placing limitations on imported products *alone* would "simply be a naked discrimination for protecting locally-produced goods."
52. Tatiana Falcão, *Ensuring an EU Carbon Tax Complies With WTO Rules*, Tax Notes Int'l, Jan. 4, 2021, at 41.

"real" restriction on domestic production or consumption that reinforces and complements the restriction on international trade. "The Appellate Body has described a 'restriction' as '[a] thing which restricts someone or something, a limitation on action, a limiting condition or regulation.'" Therefore, the domestic regulation must equally impose a restriction on domestic production that is roughly equivalent to that imposed on imports.[53]

This requirement carries different implications depending on the policy design:

1. Under the notional ETS option, the border levy would apply to selected imported commodities in sectors with a high risk of carbon leakage. The notional permits needed could be determined either based on actual emissions, or by relying on certain stylized estimates of actual emissions under a benchmark production method. According to the Commission proposal that was tabled in July 2021, actual emissions would be prioritized, with default values as a back-up.

   Since the notional ETS seeks to mirror the actual ETS cost incurred by domestic producers, the CBAM price applied to the carbon benchmark should be set according to the cost of acquisition of ETS allowances needed by the domestic benchmark producer of the respective commodity. Therefore, the price employed at the border could either (1) correspond to the average price of the auctioned allowances under the domestic ETS, or (2) correspond to the average spot price paid by ETS sectors for allowances in the emissions trading market, determined for the relevant period, respectively. The decision made under the EU proposal for a CBAM was for the CBAM to mirror the ETS by calculating the price of certificates needed for imports on the basis of the weekly average auction price of EU ETS allowances expressed in euro (€) per ton of CO_2 emitted, therefore more aligned with option (1).

   Meeting the evenhandedness requirement under this option would require accounting for the free allocation of allowances.[54] That is because only 57% of allowances are currently auctioned under Phase 4 of the ETS program.[55] That would mean that for the CBAM to be roughly proportionate to the ETS price, and thus be compatible with WTO rules, the price for notional certificates would have to correspond to approximately 57% of the carbon-polluting capacity of the products imported into the EU for the select sectors and industries to which it applies.[56] If the aim were to impose a price on the full carbon-producing potential of the imported products, WTO law might require the expansion of the coverage of the domestic ETS and the auction of the totality of domestic emissions.[57]

   The CBAM proposal of the Commission accounts for the free distribution of allowances, by determining that the CBAM will apply only to the proportion of emissions that does not benefit from free allowances under the EU ETS until free allowances are completely phased out in 2035. Such a provision thus ensures that importers are treated in an evenhanded way compared to EU producers. Indeed, the EU Green Deal also envisions the revision of the Emissions Trading System Directive.[58]

   If the price applied to the carbon benchmark for the purposes of the notional ETS were to correspond to the spot price practiced under the Emission Trading Market (ETM), it is less obvious that a rebate for eventual free allowances would be required under the evenhandedness criterion. It could then be argued that the CBAM should also reflect the opportunity cost that domestic producers incur by not trading free allowances.[59] Moreover, even though the domestic commodities with which the imported products compete in the market will usually not have borne the exact price applied at the border, because they might well have been produced earlier at a different (opportunity) cost for emission permits, the evenhandedness requirement would arguably still be fulfilled, since it does merely call for roughly equivalent burdens imposed on domestic and imported products.[60]

   Finally, an additional option could consist in the development of a hybrid system, based on options (1) and (2)—a combination of auctioned price and spot price—which would probably also involve a high level of complexity but would probably better reflect the carbon price employed regionally within the EU.[61] Regardless of the choice of method to compute the carbon price'

53. Appellate Body Report, *China—Measures Related to the Exportation of Rare Earths, Tungsten, and Molybdenum*, para. 141, WTO Doc. WT/DS431, 432, 433/AB/R (adopted Aug. 29, 2014).
54. There is extensive literature indicating that free allocation of emissions under the EU ETS is exaggerated and may have led to domestic overproduction, *see* William L'Heudé et al., Trésor-Economics, A Carbon Border Adjustment Mechanism for the European Union 8 (2021), https://www.tresor.economie.gouv.fr/Articles/2021/03/23/a-carbon-border-adjustment-mechanism-for-the-european-union.
55. *See supra* Section I.B in Part One.
56. This is also the understanding expressed by the National Board of Trade Sweden, that any free allowances should ultimately be computed in determining the CBAM price. National Board of Trade Sweden, *supra* note 22, at 76. Free allowance allocation dampens the effectiveness of the carbon price faced by producers and consumers in the value chain, as per Karsten Neuhoff et al., Climate Strategies, Inclusion of Consumption of Carbon Intensive Materials in Emissions Trading—An Option for Carbon Pricing Post-2020, at 5 (2016).
57. On the factors for identification of carbon leakage under the EU ETS, and a convincing explanation over why free allocations under the EU ETS can be excluded, see Claudio Marcantonini et al., Free Allowance Allocation in the EU ETS (Florence School of Regulation, Policy Brief No. 2017/02, 2017), http://hdl.handle.net/1814/46048; *see also* Antoine Dechezleprêtre et al., Searching for Carbon Leaks in Multinational Companies (Centre for Climate Change Economics and Policy, Working Paper No. 187, Grantham Research Institute on Climate Change and the Environment, Working Paper No. 165, 2014).
58. *Commission Proposal for a Regulation of the European Parliament and of the Council Establishing the Framework for Achieving Climate Neutrality and Amending Regulation (EU) 2018/1999 (European Climate Law)*, COM (2020) 80 final (Mar. 4, 2020) [hereinafter Legislative Proposal for European Climate Law].
59. *See supra* Section I.B in Part One.
60. WTO, Short Answers to Big Questions on the WTO and the Environment 7, 8 (2020).
61. There might also be national considerations to take into account in pricing, as Member States receive different allocations of allowances and trade separately under the ETM.

the crucial aspect is for the conditions for importers to be roughly the same as the conditions for producers within the EU.[62] The CBAM proposal tabled for consideration seems to have been able to achieve that threshold, and therefore it would not be expected for there to be any third-country opposition from the perspective of the application of the evenhandedness requirement.

In practice, however, the implementation of a WTO-compatible notional levy could prove to be administratively costly. It is unclear what the cost would be to promote the complex system of price adjustments at the border, based on weekly average prices of auctioned emissions in the internal market. An impact assessment report would be needed to assess that cost, from an implementation and administrative perspective.[63] Since the CBAM proposal tabled for consideration is still, after all, a proposal, it is worth mentioning that the administrative cost could prove to be particularly challenging if highly volatile spot market prices were chosen as the reference system.

2. Under the CET, the taxable amount would be determined per unit of taxable product. This taxable amount would apply irrespective of the actual carbon content of the product, and regardless of the origin of the product. The CBAM would thus impose the exact same tax on each unit of an imported product as is borne per unit of a like domestic product upon its release for consumption. As a consequence, the evenhandedness requirement is easily fulfilled.

   If the taxable amount for the consumption excise tax were fixed based on a (political) appraisal of the externalities caused by the carbon content of the taxable commodities, no further complexity should arise from the administration of the levy, either. However, since it is the stated intention of the European Commission to make an eventual excise tax commensurate with the ETS carbon price, the amount of tax would have to be periodically adjusted to the average cost of acquisition of the ETS allowances.[64] Regarding the administrative costs of such a system, the above comments regarding the notional levy would therefore also apply to the CET, in principle. However, it should be noted that the adjustment intervals would likely be much longer (i.e., the connection to the ETS price would be only relatively loose as compared to a notional ETS), which should somewhat reduce the administrative challenges of this system.

3. Finally, a tax on fossil fuels would require the application of an excise tax both domestically and at the border. This is perhaps the easiest option to administer, because a fossil fuel's carbon content does not vary according to origin. Rather, it varies according to the quality of the fossil fuel and the type of byproduct. Therefore, provided that the tax works so as to be levied on the built-in carbon content of the fossil product, it would automatically achieve a similar benchmark price both domestically and at the border

   The biggest impediment under this option lies in the fact that the EU does not have an EU-wide policy to tax carbon consistently, across the board. Some Member States administer carbon taxes, whereas others do not, and the ones that do, do so at varying rates. Success in administering an equivalent tax at the border would probably require the passing of an EU-wide carbon tax law determining a carbon tax schedule or range that could be roughly employed at the border to account for similar burden levels toward foreign and nationally derived products. This option would require unanimous agreement from all Member States (an EU internal requirement)—a difficult benchmark to meet. However, the EU Green Deal also considers a revision of the EU Energy Directive, to include a carbon component. This option will perhaps only become viable should the European Commission succeed in revising the Energy Directive and establishing an EU-wide carbon tax as part of that framework.

C. *The Chapeau*

Following the WTO case law, the final test would be to determine whether the proposed carbon tax would meet the requirements of the chapeau of GATT Article XX. As previously asserted, once it is proven that an environmental measure corresponds to one of the appropriate paragraphs in GATT Article XX (paragraphs (b) or (g)), it should then pass the test under the chapeau of GATT Article XX. For this to be the case, the measure must not be "applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade."[65]

It cannot be automatically assumed that because the measure falls within the terms of GATT Article XX(b) or (g), it necessarily complies with the requirements of the chapeau.[66] The chapeau is meant to prevent an abusive application of the exceptions to GATT Article XX.[67]

62. National Board of Trade Sweden, *supra* note 22, at 77.
63. The French proposal of 2019 advocates for the price of the importers' allowances to be based on the price of a domestic allowance the day before the import took place. See, in this respect, Elodie Lamer, *France Outlines ETS-Based Border Adjustment Approach*, Tax Notes Int'l, Mar. 2021, at 1716.
64. A consumption-based BTA can be based both on carbon content built-in emissions potential or on the commercial carbon price employed upon trading carbon permits. Both options are considered in literature. See on the commercial option Neuhoff et al., *supra* note 56, at 12.
65. *Marrakesh Agreement, Appendix, General Agreement on Tariffs and Trade 1947, Article XX GATT, in* The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations 455 (1999).
66. Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, para. 149, WTO Doc. WT/DS58/AB/R (adopted Nov. 6, 1998).
67. Appellate Body Report, *United States—Standards for Reformulated and Conventional Gasoline* 23, WTO Doc. WT/DS2/AB/R (adopted May 20, 1996); Appellate Body Report, *United States—Import Prohibition of Certain*

1. The Relevant Criteria

The chapeau provides a two-part test. The first part determines whether the measure would be discriminatory (with respect to other countries), and the second part whether it would impose a disguised restriction to international trade (in respect to some products, to the detriment of others using different types of technology in the manufacturing process, for example).[68] In other words, the first part concerns discrimination with respect to different subjects and the second part concerns market access restriction with respect to the object of the tax.

Relevant under this provision is whether (1) a border tax or price proposing different tax rates (or tax burdens) for different countries of origin of a given imported product, depending on the technology employed for its production (in the case of the notional ETS or the carbon excise tax), would pass the test proposed by the chapeau of GATT Article XX and not result in arbitrary discrimination between countries where the same conditions prevail; and (2) a border tax or price providing for different tax rates (or tax burdens) based on carbon content would impose a disguised restriction to international trade with respect to some products and not others depending on provenance, use of technology, production methods, and other criteria.

In the first part of the test, one should observe how the detailed provisions of the restrictive measure operate, and how they actually apply, meaning that both "substantive and procedural requirements" count.[69] A country might have the right to impose a certain environmental requirement even if they are discriminatory (and in most cases where an exception applies, it will be discriminatory—an exception is needed to justify such discrimination). But if the means by which a standard is imposed are arbitrary or unjustifiable, and thus discriminate between countries where the same conditions prevail, then the measure is incompatible with the GATT structural framework and will be rejected.[70]

The key expression for assessing whether different tax rates or tax burdens per country would be unjustifiably discriminatory is "discrimination between countries where the same conditions prevail." It follows from this expression that in order for the discrimination to be arbitrary, countries subject to a provision must share the same circumstances. Therefore, provided the tax rate or tax burden employed at the border is the same or substantially similar toward all countries using the same technology and production standards (in the case of the notional levy or the carbon excise tax), then a tax rate differentiation between countries would arguably not be considered arbitrary discrimination with respect to one or a set of countries.

That leads to the question of what is arbitrary and what is unjustifiable discrimination. According to the Appellate Body, an arbitrary measure is one that is "capricious, unpredictable, [or] inconsistent," depending on the context of the measure applied with reference to the chapeau of GATT Article XX.[71] The lack of flexibility in the norm is emphasized in interpreting the measure according to its arbitrariness. The measure must aim at the achievement of certain environmental objectives and not at the application of certain methods or standards. Allowing other WTO Members the opportunity to prove (or demonstrate) that they run a comparable program (aimed at fulfilling the same environmental objectives) is a sign of such flexibility and allows them to demonstrate that the measure is not arbitrary on its face.[72]

A measure will be deemed justifiable if the country imposing it is shown to have put considerable effort into concluding bilateral and multilateral agreements to achieve the envisaged policy goals and if the measure is flexible.[73] An unjustifiable act of discrimination is one that is "foreseen" and not "merely inadvertent or unavoidable."[74]

The second part of the test tries to infer whether the measure would be a disguised restriction to international trade. The Appellate Body and panels have on different occasions argued that a measure will not be deemed a disguised restriction to international trade if it (1) has been publicly announced as a trade measure[75]; (2) is not an arbitrary or unjustifiable act of discrimination with respect to international trade—a disguised restriction must thus also be read as a form of disguised discrimination with respect to international trade[76]; and (3) its design, architecture, and structure do not reveal any protectionist and

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Shrimp and Shrimp Products, para. 157, WTO Doc. WT/DS58/AB/R (adopted Nov. 6, 1998), which states:

> [P]aragraphs (a) to (j) of Article XX is a *limited and conditional* exception from the substantive obligations contained in the other provisions of the GATT 1994, that is to say, the ultimate availability of the exception is subject to the compliance by the invoking Member with the requirements of the chapeau.

This interpretation was said to be cohesive with the negotiating history of GATT Article XX.

68. *See* Jason E. Bordoff, *International Trade Law and the Economics of Climate Policy: Evaluating the Legality and Effectiveness of Proposals to Address Competitiveness and Leakage Concerns*, *in* Brookings Trade Forum 2008/2009: Climate Change, Trade, and Competitiveness: Is a Collision Inevitable? 51-52 (Lael Brainard & Isaac Sorkin eds., Brookings Institution Press 2009).
69. Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, para. 160, WTO Doc. WT/DS58/AB/R (adopted Nov. 6, 1998).
70. *Id*. para. 186; Panel Report, *European Communities—Measures Affecting Asbestos and Products Containing Asbestos*, para. 8.226, WTO Doc. WT/DS135/R (adopted Apr. 5, 2001).
71. Panel Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, *Recourse to Article 21.5 by Malaysia*, para. 5.124, WTO Doc. WT/DS58/RW (adopted Nov. 21, 2001).
72. *Id*. (with respect to the application of turtle excluder devices (TEDs)).
73. Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, para. 166, WTO Doc. WT/DS58/AB/R (adopted Nov. 6, 1998); Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, *Recourse to Article 21.5 by Malaysia*, para. 134, WTO Doc. WT/DS58/AB/RW (adopted Nov. 21, 2001).
74. Appellate Body Report, *United States—Standards for Reformulated and Conventional Gasoline* 27, WTO Doc. WT/DS2/AB/R (adopted May 20, 1996).
75. See the references cited in Panel Report, *European Communities—Measures Affecting Asbestos and Products Containing Asbestos*, para. 8.233, WTO Doc. WT/DS135/R (adopted Apr. 5, 2001).
76. Appellate Body Report, *United States—Standards for Reformulated and Conventional Gasoline* 23, WTO Doc. WT/DS2/AB/R (adopted May 20, 1996).

trade-restrictive objectives disguised behind the stated legislative intent.[77]

2. Implications for the CBAM Project

Therefore, the envisioned border adjustment policy options would probably pass the WTO test, provided the respective CBAM is publicly announced, is applied using the same parameters for domestic and foreign counterparts, and its stated policy objective is reflected in its design and structure. The latter two criteria are inherent to the policy options put forward by the European Commission so far, or could at least be achieved through careful design of the measure. The necessary publicity of the CBAM, once adopted, can be expected to be ensured by the Commission, too.

The chapeau of GATT Article XX moreover requires that the CBAM should be advanced through a bilateral or multilateral approach.[78] If not through a multilateral or bilateral instrument, the country imposing the restriction should demonstrate that it made substantial efforts to engage in a bilateral or multilateral approach. This test would currently not be met by the EU, considering that the bloc has so far not attempted to engage in bilateral or multilateral negotiations—however, it should not prove to be insurmountable.

Concerning regional coordinated approaches, under plurilateral agreements, the EU could strive to achieve an agreement involving countries that currently already impose carbon prices. For example, carbon tax systems are widespread in Latin America. Countries could work on forming blocs of regional geographic or economic cooperation (also known as climate clubs).[79] Argentina, Mexico, Colombia, and Chile all apply taxes on carbon. Argentina applies a carbon tax at $6.25 per metric ton of CO_2 equivalent (tCO_2e), Mexico at $5.70 per tCO_2e, Colombia at $5.50 per tCO_2e, and Chile at $5 per tCO_2e. Taken as a group, these countries are already administering carbon tax rates of roughly $5.50 per tCO_2e. Therefore, if the countries were interested in forming a regional coalition and in linking the different regional climate clubs, it would be easy to permit the free flow of fossil fuels, combustible products, or select carbon-intensive products that have already been subjected to a domestic carbon tax or price in one of the other countries.

In the current example, the EU would devise a policy to take into account the price previously employed by its trading partners in Latin America toward the energy-intensive products covered under the EU CBAM. There could be a plurilateral agreement under the terms of the WTO to support this approach, where the terms of the relationship between the two blocs could be established, and several regional blocs could be formed and linked, providing the basis to initiate a wider network where the need to impose a CBAM price is either removed or reduced, considering third-country considerations.[80]

The principle of common but differentiated responsibilities (CBDR) could be addressed through bilateral equivalence agreements between the EU and its trading partners, or the establishment of an independent supervisory body that engages experts from third countries in identifying a benchmark price that is admissible both for the EU and the partner State.[81] One such initiative would meet the requirement of the chapeau and also allow for a more transparent and cooperative approach between the EU and its trading partners. Some studies go as far as to suggest that although the focus of the measure should be on products from selected sectors irrespective of the country of origin, living up to the principle of CBDR would mean exempting least developed countries from the measure.[82] It is unclear from the current jurisprudence whether this would be an essential requirement to meet the commitments of the Paris Agreement.

Besides making efforts to engage in bilateral and multilateral negotiations, as previously asserted, a country imposing a border adjustment mechanism might be required to waive (or substantively reduce the amount of) the border tax or charge in circumstances where a foreign country is able to demonstrate that it applies a similar tax or charge, with similar environmental-protection objectives, through a parallel taxing or pricing scheme. That would mean, for example, that even absent a bilateral or multilateral agreement to recognize a regional bloc such as a climate club, the EU would need to provide compensatory measures toward countries already employing a domestic carbon price.

In practice, this means providing a rebate, exemption, or credit when the country of origin has employed a carbon price. Using the example of Chile, where the carbon tax is $5, if the EU were to apply a CBAM of $40 per relevant unit of measurement, that would mean that in practice, Chilean products would be entitled to a reduction of $5, resulting in a border tax of $35, because of already being subjected to the tax in the state of origin.[83] The similarity

77. Panel Report, *European Communities—Measures Affecting Asbestos and Products Containing Asbestos*, para. 8.236, WTO Doc. WT/DS135/R (adopted Apr. 5, 2001).
78. National Board of Trade Sweden, *supra* note 22, at 60.
79. William Nordhaus, *Climate Clubs: Overcoming Free-Riding in International Climate Policy*, 105 Am. Econ. Rev. 1339 (2015).
80. There are currently several proposals for a multilateral approach to the pricing of carbon, the most notable of which is the one put forward by the International Monetary Fund (IMF) on the establishment of an international carbon tax floor for China, the EU, and the United States (potentially also India), in a true climate club fashion. In 2019, Tatiana Falcão proposed the need for agreement on a multilateral carbon tax treaty. This is as of yet still in the realm of theoretical debate, but it is certainly gaining momentum by the day. See, in this respect, Ian Parry, *Implementing the United States' Domestic and International Climate Mitigation Goals: A Supportive Fiscal Policy Approach* 26 (IMF, Working Paper No. WP/21/57, 2021), and Falcão, *supra* note 6.
81. L'Heudé et al., *supra* note 54.
82. National Board of Trade Sweden, *supra* note 22, at 66.
83. It is unclear whether the EU would also need to take into account implicit carbon prices such as energy taxes, excises on fossil fuels, and other regulatory measures that might implicitly price carbon domestically. It is likewise unclear whether reductions, exemptions, and subsidies incident on fossil fuels and carbon-intensive products should be taken into account in accounting for compensatory measures from third countries. Further investigation would be required on this point. National Board of Trade Sweden, *supra* note 22, at 100.

between taxes in this case would be left for the country of origin to decide together with the EU or, in case of conflict, the DSB.[84]

Allowing Members the opportunity to prove (or demonstrate) that they run a comparable program (aimed at fulfilling the same environmental objectives) and provide a credit or exemption that is proportionate to the tax or price previously employed in the country of origin, would allow the EU to demonstrate its interest in adopting a flexible and nonarbitrary measure,[85] and at the same time provide an incentive for third countries to impose equivalent taxes in their own jurisdictions, thus allowing them to source the proceeds of a carbon tax to their own jurisdictions and to use the revenue to meet their own budgetary targets. Such a measure, besides being required to live up to the requirements of the chapeau of GATT Article XX, would also be consistent with the EU Green Deal proposal, which projects the EU as a global leader in the field of environmental protection through "example setting and green deal diplomacy."[86]

Despite the many benefits that such a policy could bring to the wider global commons, in inciting countries to adopt a higher level of environmental protection through the adoption of an explicit carbon price,[87] such an approach is already subject to heavy criticism on the part of low- and middle-income countries,[88] because it would be pressuring them to (1) adopt measures that could go beyond the voluntary nationally determined contributions they agreed to under the Paris Agreement; and (2) it would in fact mean that, to some degree, third countries (there including high-income countries who have not yet adopted an explicit carbon price) would be in practice financing the European ambitions for a just transition to sustainable practices, to the extent that they waive their sovereign right to tax, on behalf of the EU.[89]

This is a debate that has only just started, that brings together both political and legal issues into the realm of international tax, trade, and public law. The future is yet unknown, but it is clear that there is a larger political will to make the ends justify the means. The main issue now will be to make the means one that is just for all countries despite their level of economic development.

D. Interim Conclusions on GATT Article XX

Based on the above, we conclude that a border tax could be admissible under the framework of the WTO, provided certain conditions are met. Although a border tax considered broadly might fail some of the tests contained in the nondiscrimination rules in GATT Articles III (national treatment) and XI (quantitative restrictions), it would probably be a measure that is considered to be justified under the general exceptions contained in GATT Article XX(b) and (g).

Importantly, the tone of the decisions reached by panels and the Appellate Body provides that a distinction must be made with respect to the degree of acceptability of unilateral measures, on the one hand, and multilateral measures on the other. It seems very clear that WTO jurisprudence would privilege multilateral approaches with an environmental objective more than unilateral measures that seek to impose an environmental standard. In fact, a mechanism substantially similar to a CBAM was applied during the enforcement phase of the Montreal Protocol.[90] The Montreal Protocol relied on a number of features for its successful operation: (1) broad membership; (2) the imposition of trade-restrictive measures on Parties and non-Parties in order to lure more countries into reducing or eliminating the production and consumption of ozone-depleting substances; and (3) the employment of a multilateral instrument for the protection of environmental commons.[91]

This means that, from a practical perspective, a trade-restrictive measure meant to encourage countries to adhere to a multilateral initiative aimed at the protection of a global common (clean air, the environment) has been successfully imposed before.[92] The case for a CBAM is, of course, to be distinguished, because the European institutions currently propose a unilateral measure (as opposed to a multilateral agreement) that most likely will restrict trade with the objective of safeguarding human and animal health and preserving exhaustible natural resources. However, the above findings do not imply that unilateral measures are

84. Tatiana Falcão, *Toward Carbon Tax Internationalism: The EU Border Carbon Adjustment Proposal*, Tax Notes Int'l, June 1, 2020, at 1047.

85. Panel Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, *Recourse to Article 21.5 by Malaysia*, para. 5.124, WTO Doc. WT/DS58/RW (adopted Nov. 21, 2001) (with respect to the application of TEDs). *See also* Monjon & Quirion, *supra* note 39, at 5204.

86. Legislative Proposal for European Climate Law, *supra* note 58.

87. *See* Roland Ismer et al., *Border Carbon Adjustments and Alternative Measures for the EU ETS: An Evaluation* 13 (DIW Berlin, Discussion Paper No. 1855, 2020) (weighing positive and negative impacts on third countries).

88. As well put by Alice Pirlot, Environmental Border Tax Adjustments and International Trade Law 97 (2017):

> BTAs should in principle be applied to compensate for the effects of national tax policies and not for the effects of (the absence of) third countries' policies on international trade. Consequently, differences related to how countries internalise externalities should not serve as a basis for the adoption of BTAs *against* countries that are assumed to have "lower" levels of internalisation of environmental costs.

89. Tero Kuusi et al., Finland's Prime Minister's Office, Carbon Border Adjustment Mechanisms and Their Economic Impact on Finland and the EU 113 (2020).

90. The Montreal Protocol, finalized in 1987, is a global agreement to protect the stratospheric ozone layer by phasing out the production and consumption of ozone-depleting substances, such as hydrofluorocarbons (HFCs).

91. Annick Emmenegger Brunner, *Conflicts Between International Trade and Multilateral Environmental Agreements*, 4 Ann. Surv. Int'l & Comp. L. 77, 78 (1997). According to Annick Brunner, the application of a trade-restrictive measure (a ban on chlorofluorocarbons (CFCs) in the case of the Montreal Protocol) was decisive in persuading CFC-producing and -consuming countries to adhere to the global framework.

92. According to the WTO's own assertion:

> [T]he vast majority of environmental measures affecting trade do not raise any disagreement in the WTO—only around 10 disputes involving environmental measures have been decided at the WTO. In all such cases, the validity of environmental objectives pursued by the measures was never put into question by the decisions rendered, but rather certain incoherent elements of such measures. Not disputing a measure that is centered around an environmental motivation is in itself a measure of success and denotes the WTO's commitment to preserving the environment while preserving Member States' trade obligations. WTO, *supra* note 60, at 8.

always inadmissible. They probably merely meet a higher level of scrutiny in order not to hinder free trade.

Moreover, whereas the Montreal Protocol imposed a ban on the production and consumption of goods containing ozone-depleting substances, the CBAM would either price or impose a tax on select carbon-intensive products and/or fuels. A restriction on trade in the form of a price or a tax (meaning an additional cost to the polluting substance) seems to be an achievable objective within the framework of the WTO and GATT jurisprudence.

II. Conclusion

Based on all of our analysis, we conclude that it will not be possible to impose a border levy in function of the actual carbon content of imported products without infringing the relevant GATT nondiscrimination provisions. A notional ETS for imported products would therefore most likely have to be justified by invoking the environmental exceptions of GATT Article XX. Moreover, country-specific differentiations that would have to be avoided so as to pass the GATT nondiscrimination test may precisely be necessary in order to meet the justification standards under the chapeau of GATT Article XX.

Thus, certain CBAM design elements that may be acceptable or required in one context may be harmful in the other. Developing the preferred CBAM option therefore requires a clear vision of what should be achieved by this instrument, an understanding of the WTO law constraints and implications corresponding to the relevant trade offs, and consistency of the design with the stated objective.

The European Commission and Parliament apparently have a preference for a notional ETS as an instrument that potentially targets carbon leakage accurately. To this effect, the amount of border adjustment would be determined according to the same (or substantially similar) parameters as the carbon price for domestically produced like commodities, relying on certain benchmark technology standards and the possibility to demonstrate a lower carbon content. Such application of differentiated carbon-related charges for like domestic and foreign chargeable materials in function of their respective carbon content would not necessarily be incompatible with WTO law requirements of free and nondiscriminatory access to the EU internal market. Provided that substantially similar parameters are used for the computation of the border adjustment—in the case of the notional ETS, including a similar price for emission allowances—a justification could be possible on the grounds of the aim to advance a common environmental objective (climate protection).

The WTO jurisprudence is clearer with respect to the admissibility of a border carbon tax aiming to conserve clean air, but it is still unclear whether the rationale currently presented by the DSB could be extended to a carbon price under the ETS framework. There are strong arguments to sustain that the rationale could be extended toward an ETS, seeing as both carbon tax and market-based approaches pursue the same objective, and may ultimately signal an explicit carbon price signal; however, a formal confirmation of this rationale can only be obtained if the issue is brought forward for consideration of the DSB under a dispute-settling procedure.

In any case, there is precedent—for example under the Montreal Protocol—to support the admissibility of a measure that would theoretically be trade-restrictive,[93] based on its environmental grounds. The Montreal Protocol was never questioned or brought to dispute under the DSB. Further, the introduction of the new preamble to the Marrakesh Agreement, which included an environmental objective, implies that all multilateral and plurilateral agreements operating within the WTO framework (amongst them GATT, the General Agreement on Trade in Services, and the ASCM) are to be interpreted in light of the environmental object and purpose included therein.

That is especially true if the measure is proposed on a multilateral basis, or if substantial efforts have been made to engage with other countries on a bilateral or multilateral basis. Although the EU has to date not made any efforts to this effect, such actions are foreseen in the work plan of the EU Green Deal. Further, the political context of the negotiations currently occurring under the framework of the WTO are promising, and seem to favor an interpretation of GATT and of the wider WTO regulations that would facilitate the introduction of environmental measures. This would imply that a CBAM-type approach would, in principle, be feasible if appropriately designed.

Over time, one option to meet the multilateral or bilateral engagement requirement could clearly be the establishment of climate clubs. They would constitute groups of close cooperation where more favorable rules would apply, and potentially even "CBAM free trade" rules could be employed toward countries with similar levels of environmental protection.

93. The Montreal Protocol actually demanded a ban on the trade of certain products containing HFCs.