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Trade Law and Border Carbon Adjustment Measures: Analyzing the EU CBAM within the WTO Framework

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Alla mia amata Mamma,

che mi ha insegnato a non aver paura di sbagliare un calcio di rigore.

Table of Contents

Introduction ***1***

Chapter I. The World Trade Organization: History and Legal Nature ***3***

1. The Nature of the WTO **3**

2. Historical Background and Rationale for the Establishment of the WTO **6**

2.1. Bretton Woods Conference and the GATT 1947 8

2.2. The Uruguay Round and the Birth of the WTO 11

3. Foundational Principles of the World Trade Organization **12**

3.1. Non-Discrimination Rules 13

3.2. Market Access Rules 14

3.3. Exceptions to Non-Discrimination and Market Access Rules 15

4. The Institutional structure of the World Trade Organization 17

5. Evolution and current Challenges faced by the World Trade Organization 20

Chapter II. The EU Carbon Border Adjustment Mechanism ***23***

1. The role of the European Union in the current Climate Crisis 23

2. Essential features of the Carbon Border Adjustment Mechanism 26

3. The aim of the Carbon Border Adjustment Mechanism: tackling the phenomenon of carbon leakage 28

4. The mechanisms of operation and field of applicability of the Carbon Border Adjustment Mechanism, ... 32

5. Conclusion 35

Chapter III. Comprehensive Analysis of the Carbon Border Adjustment Mechanism through the lens of the World Trade Organization ***37***

1. Introduction 37

2. The peculiar role of the European Union within the World Trade Organization 39

3. An Analysis on the CBAM's consistency with World Trade Organization's law 44

3.1. The Legal Characterization of the Carbon Border Adjustment Mechanism under the GATT 45

3.2. CBAM's consistency with National Treatment under the GATT 48

3.3. CBAM's consistency with Most Favoured Nation under the GATT 52

3.4. Admissibility of the CBAM under Article XX of the GATT 54

3.4.1. Qualification under Art. XX (b) 55

3.4.2. Qualification under Article XX(g) 57

3.4.3 Qualification under the Chapeau of article XX 58

4. Conclusion 60

Conclusion ***62***

Bibliography ***64***

Introduction

After the end of the Second World War, the world has witnessed an unparalleled transformation in global trade dynamics. The establishment of the General Agreement on Tariffs and Trade (GATT) in 1947, followed by the foundation of the more comprehensive World Trade Organization in 1995, has facilitated a significant increase in international trades. These multilateral trade agreements have enhanced economic integration among countries and industrial growth on a global scale, by enforcing free trade regulations and reducing custom duties. However, alongside the economic development brought by globalization, a severe environmental cost has emerged.

The expansion of industrial production and the consequent transportation of goods have caused a substantial rise in carbon emissions, identified as the main cause for global warming and environmental degradation. Despite the reiterated warnings form the scientific community on the devastating effects of global warming, national executives and policy makers undervalued the urgency of addressing climate change and often remained sceptical regarding the human involvement in such phenomenon. Moreover, potential measures to curb excessive carbon emissions were viewed as detrimental to economic and industrial development, which was considered the absolute priority.

The worsening of the effects of climate change in the last decades has highlighted the inability of international environmental governance to address the environmental crisis. However, certain countries and supranational organizations have decided to implement unilateral measures to contrast global warming and comply with their climate commitments. Inevitably, these measures affect industrial production and global trade dynamics, since those human activities are recognized as the primary contributors to carbon emissions. Consequently, numerous trade partner countries have raised concerns about the compatibility of such measures with the free trade principles enshrined in the WTO multilateral trade agreements.

In light of the above, this thesis aims to analyse the most prominent among these unilateral environmental measures, namely the Border Carbon Adjustments (BCAs), and their consistency with the obligations imposed by the World Trade Organization. To this end, it will be scrutinized the text of the regulation concerning the Carbon Border Adjustment Mechanism (CBAM), adopted by the European Union in October 2023. The CBAM is the first border carbon adjustment officially implemented by a public authority and, as such, has generated an

heated debate among scholars and government authorities on the effectiveness of such measure to tackle the environmental crisis and its alignment with WTO rules. The main objective of this project will be to understand the reasons which led to the establishment of such regulation, the potential effects on global carbon emissions and, primarily, if the EU authorities have designed the regulation as to be conforming with the requirements comprised in the WTO multilateral trade agreements.

The first chapterwill provide a comprehensive understanding of the WTO, focusing on its legal nature, the historical motives behind its establishment, the principles underlying the organization and the ad-hoc institutions which supervise on its proper functioning. Moreover, the last paragraph will discuss on the current challenges faced by the World Trade Organization and the institutional deadlocks which are endangering the role of the WTO in the international arena. Particular emphasis will be devoted to the non-discrimination principles and to the dispute settlement bodies proper of the organization, as these elements will be essential in the analysis of the conclusive chapter.

The second chapter, then, will be dedicated to the carbon regulation implemented by the European Union. The relevant analysis will commence with an examination of the design features which distinguish the EU mechanism. It will continue with an explanation on the phenomenon of carbon leakage, its economic and environmental impact on the EU territories and its role in the decision by EU institution to adopt a BCA.

Finally, the third chapter (which, forms the core of this thesis) is devoted to evaluating the consistency of the provisions contained in the CBAM with the rules and principles established by the WTO, building on the information provided in the previous chapters. The assessment will begin by outlining the role of the the role of the EU within the World Trade Organization and the motivations driving EU institutions to draft an environmental regulation that complies with WTO standards. It will continue by characterizing the CBAM under the law of the WTO and confronting the measures included in the regulation with the obligations laid down within the General Agreement on Tariffs and Trade (GATT), the relevant multilateral agreement in question.

Since an official opinion is yet to be published by an adjudicative body of the WTO, such evaluation will be based on personal opinions supported by the analysis of affirmed scholars and the content of previous case law, highlighting the most important issues and providing final remarks on the future development of the regulation evaluated.

Chapter I. The World Trade Organization: History and Legal Nature.

1. The Nature of the WTO

The World Trade Organization (WTO) is an international intergovernmental organization which became operational the 1st of January 1995, and it is headquartered in Geneva, Switzerland. The WTO Agreement, which is the constitutive charter of the organization, was signed in Marrakesh the 15th of April 1994 during the Uruguay Round[1], providing the legal basis for the establishment of the WTO. As it will be further analyzed in thenext paragraph, the Marrakesh Agreement effectively replaced the General Agreement on Tariffs and Trade of 1947[2], which was an international agreement aimed at promoting trade liberalization and reducing barriers, signed in the aftermath of the second world war. The original GATT, which had become outdated and unable to properly address the radically mutated global economy, was revised and broadened in scope, and subsequently named GATT1994.

The WTO Agreement is a rather short agreement, composed of 16 articles, but it is complemented by a series of Annexes, each devoted to a specific agreement. The first three Annexes[3], which incorporate all the multilateral trade agreements and the associated legal instruments[4], are binding on all the contracting parties to the WTO Agreement[5]; the last Annex[6] concerns the plurilateral agreements, binding only for those state parties which have ratified them. The majority of WTO 'substantive' law is encapsulated within Annex 1, consisting in three subsections which comprise the pillar agreements of the WTO: the GATT, along with twelve other multilateral trade in goods agreements, which is contained in Annex 1A; the General Agreement on Trade in Services[7], which is comprised in Annex 1B; the Agreement on Trade-Related Aspects of Intellectual Property[8], which belongs to Annex 1C.

[1] Marrakesh Agreement establishing the World Trade Organization, April 1,1994 (hereinafter WTO Agreement).
[2] General Agreement on Tariffs and Trade, Oct. 30, 1947, Geneva (hereinafter GATT 1947).
[3] Annexes 1, 2 and 3 to the Marrakesh Agreement.
[4] The instruments through which the WTO is able to enforce the multilateral trade agreements. They will be more thoroughly analyzed in the following paragraphs.
[5] Membership in the WTO automatically entails automatic and compulsory observation of these agreements.
[6] Annex 4 to the Marrakesh Agreement.
[7] General Agreement on Trade in Services, April 15, 1994, Marrakesh (hereinafter GATS).
[8] Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994 (hereinafter TRIPs)

The primary mandate of the WTO is to serve as an international forum for conducting trade negotiations and establishing multilateral trade agreements, such as those included in Annex 1, in the attempt to facilitate the exchange of goods and services between the Parties by reducing barriers to trade, promoting transparency, and establishing a rules- based multilateral trading system that safeguards the rights of all the participating parties. Annex 2 and Annex 3 of the WTO Agreement incorporate two distinct regulations, the Dispute Settlement Understanding (DSU)[9] and the Trade Policy Review Mechanism (TPRM). It is indeed a pivotal function of the WTO[10], the administration and the efficient and prompt execution of the dispute settlement system, in order to clarify and interpret the provisions contained in the agreements. The efficiency of the system designated for the resolution of legal controversies stemming from alleged violations of WTO agreements is essential for the credibility and reliance of the parties to the international organization. The DSU ensures the compliance of the members to the principles and procedures of the organization, which enhances stability in international trade relations and favor a sentiment of secureness and predictability in all the subjects involved in international trade. The dispute settlement system of the WTO is advanced compared to the dispute settlement mechanisms of other international organizations, as its jurisdiction is automatically compulsory for the member states and it concerns disputes arising out all the WTO agreements, except for plurilateral agreements, as the members have signed and ratified the WTO Agreement as a single undertaking[11]. As it will be explained in the next paragraph[12], the DSU was a major factor in the formation of the WTO, since the measures on dispute settlement contained in the GATT 1947 had become unsuitable and ineffective[13]. Developing countries, as well, campaigned towards a more comprehensive dispute settlement system, as they believed that their less influential position in the global context, without an established legal framework, would negatively impact them in conflict resolutions[14].

The differentiation between developed and developing countries is peculiar of the WTO, which reserves "special and differential[15]" treatment to countries belonging to the latter group.

[9] Dispute Settlement Rules: Understanding on Rules and Procedures Governing the Settlement of Disputes, Annex II to the WTO Agreement, 1994, Geneva.
[10] Art. III of the Marrakesh Agreement is subdivided in five paragraphs, each of which highlights one of the main functions of the WTO.
[11] World Trade Organization Secretariat. (2017). *A Handbook on the WTO Dispute Settlement System (2nd ed.)*. Cambridge: Cambridge University Press, pp. 1-20.
[12] Supra, pag. 4
[13] Davey, W. J. (1987). *Dispute settlement in Gatt, in Fordham International Law Journal*, 81-90.
[14] Ibid. 14.
[15] The WTO Agreements contain special provisions which grant developing countries special rights and allowother countries to treat them more favourably.

The inclusion of developing, - as well as least developed [16], countries in the multilateral trading system is vital for the effectiveness of the organization. Indeed, if excluded, those nations would most likely adopt protectionist policies towards the international market to survive the competition of developed nations. The WTO agreements contain special provisions dedicated to developing countries, such as extra time to fulfill their WTO commitments. The WTO does not provide a definition or criteria to be met to be recognized as a developing country; therefore, Members[17] can announce themselves as such when accessing the organization, benefitting of the status of developing countries[18].

Developing countries, which compose the majority of WTO members, are addressed in the Preamble of the WTO Agreement, which states the objectives of the organization[19]. It is outlined the importance of integrating developing countries in the world trading system, enhancing their economic development. Although being committed to the growth of income, the expansion of production and the attainment of full employment, the parties to the Marrakesh Agreement agreed to pursue these objectives in view of a sustainable development, both in terms of natural resources and labor social conditions[20].

Therefore, the WTO, contrary to the strictly economic nature of the GATT 1947, has a more comprehensive conception of the global trade dynamics, and the improvement of trades among countries becomes a mean to achieve improved living conditions and favor sustainable development. In this respect, the reduction of tariffs and other barriers to trade and the elimination of discriminatory treatment in international trade relations – both specified in the Preamble - are the fundamental means through which the WTO is determined to achieve the prefixed objectives[21].

Both provisions will be examined in the next paragraphs and throughout the entire thesis, as they constitute the essence of the WTO.

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[16] The Least Developed Countries (LDCs) are low-income countries confronting severe structural impediments to sustainable development. They are highly vulnerable to economic and environmental shocks and have low levels of human assets. ("General Assembly Resolution 26/2768, Identification of the least developed among the developing countries, A/RES/2768, November 18, 1971").

[17] Through the term "Members" it will always be intended, throughout the chapter, the signatories' parties of the WTO Agreement.

[18] Van den Bossche, P., & Zdouc, W. (2021). *The World Trade Organization. In The Law and Policy of the World Trade Organization: Text, Cases, and Materials*. Chapter 2, Cambridge: Cambridge University Press. pp. 84-172 [19] The Preamble to the WTO Agreement states: "Recognizing that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development"

[20] "*Preamble of the WTO Agreement*", 1994 Preamble - World Trade Organization.

[21] Ibid. references 20,21

2. Historical Background and Rationale for the Establishment of the WTO

While the WTO is considered a relatively recent international organization, established in 1995, the concept of promoting free trade among nations through the negotiation and stipulation of multilateral trade agreements dates further back in history. The two major economists which firstly outlined the potential economic benefits that nations could derive from liberalizing trade, thus not imposing tariffs or trade barriers, were Adam Smith and David Ricardo. Both believed that free trade was indispensable to foster the economic development of states, achieving greater efficiency in the production of goods, and increasing their wealth and welfare. Adam Smith developed his thesis on the benefits stemming from the liberalization of trade in his most important work, "The Wealth of Nations", published in 1776[22]. He argued that free trade of goods would create an international division of labour, where each nation would focus on developing its most efficient industries, making the production of certain goods faster and less costly than any other country. Each nation, possessing an absolute advantage in the production of those particular goods compared to other nations, would maximize its profit by engaging in free trade with other countries to sell their goods. Therefore, Smith affirmed that, as long as each nation holds an "absolute advantage[23]" over the production of at least one product, trades and exchanges of products could produce mutual gains for the countries involved and an overall increase in prosperity.

The English economist David Riccardo subsequently developed his own theory, presented in his most renowned work "On the Principles of Political Economy"[24], published in 1817. He built his reasoning on the foundations of Smith's theory, producing, however, significant modifications on the importance of absolute advantage. He affirmed the idea that free trade could be advantageous and should indeed occur even if not every country possesses an absolute advantage over one product. Ricardo defined the concept of "comparative advantage", explaining how even countries which compared to another country are lessefficient in the production of any good, can nevertheless obtain economic improvements through trade by exporting those products in which are comparatively more productive, and

[22] Smith, Adam. 1947 *The Wealth of Nation.* London: Dent. pp. 50-70

[23] In economics, Absolute advantage refers to the ability of a party to produce a certain good or service at a lower cost than another party. The first definition was given by Adam Smit, which introduced the term in its masterpiece "The Wealth of Nation". See Reference 22.

[24] Ricardo, David, 1772-1823. (1817). *On the principles of political economy and taxation*. London: John Murray.

import those commodities manufactured least effectively[25].

Even though Ricardo's argument might be considered as an improvement of the initial idea outlined by Smith, both theories aimed to discredit the mercantilist economic conception, which was predominant at the international level during those decades. This theory advocates for the government assiduous control over the economy, placing restrictions and trade barriers if needed, in order to ensure that exports exceed imports, creating the so called "trade surplus", the only truthful parameter when considering the wealth of a nation[26].This theory implied that not all nations could achieve such trade surplus, therefore distinguishing successful nations from those less prosperous, thus less powerful. Although the liberal theories of Smith and Ricardo gained international recognition since their publication, nations continued to act rather egoistically following the mercantilist principles, hence always pursuing their own economic interests, and improving their position to the detriment of others[27]. Even in the decades preceding the outbreak of World War I, when international trade flourished and many bilateral trade agreements were signed, nations were merely exploiting the favourable economic conditions of those years to enhance their prosperity, remaining prepared to

Indeed, the Great War brought a new wave of protectionism, shattering the treaty network and increasing the imposition of trade barriers between countries. However, the end of the 19th century, marked by great improvement in free trades among nations, demonstrated the effectiveness of reducing trade restrictions as well as the necessity of adhering to the unconditional Most-Favored-Nation (MFN) principle[28], a cornerstone of the WTO which will be analysed in detail in the next paragraph.

As mentioned above, the first World War and, more generally, the first half of the 20th century, was characterized by a mercantilist and protectionist approach, drastically reducing free trades and interdependence among States. During the "Interwar Period" any attempt to establish institutional mechanisms to address the issue of extensive trade barriers, such as the League of Nation's World Economic Conference of 1927, was extremely weak, and the widespread economic depression extinguished any illusion of reforms. The miserable economic performances of states during these decades of deep- rooted protectionism, and the

[25]*Chapter 3: Trade Agreements and Economic Theory | Wilson Center*. hhttps://www.wilsoncenter.org/chapter-3-trade-agreements-and-economic-theory. (2024, 15 March)

[26] Jackson&Sørensen, (2022). *International Political Economy. Introduction to International Relations: Theories and Approaches.*, Oxford University Press. 160-165.

[27]Walter, A. (1996). *Adam Smith and the liberal tradition in international relations*. 29-34 https://eprints.lse.ac.uk/748/1/SMITHRIS.pdf (2024, 16 March)

[28] Wang, A. (2022). *The interpretation and application of the Most-Favored-Nation Clause in Investment Arbitration: History of the MFN clause in internal law*. https://doi.org/10.1163/9789004517899

fatal consequences provoked by the second major world conflict, convinced the United States and the United Kingdom of the indispensability of an international multilateral commercial agreement to reduce trade restrictions and favour free trade among countries[29].

2.1. Bretton Woods Conference and the GATT 1947

The foundations of the first multilateral trade agreement were laid between the Allies at the Bretton Woods Conference, held in July 1944. The conference focused on the conclusions of agreements establishing international financial and commercial organizations, deemed indispensable to revive the fortunes of a world brought to its knees by the Second World War. Even though the parties to the conference could find a compromise only on the creation of the International Monetary Fund and the World Bank, the necessity for a third institution focalized on matters concerning trade, which would have completed the new international financial system, was stressed. Indeed, in 1945 the US advocated for the establishment of the "International Trade Organization" (ITO) which would have reduced tariffs and disciplined the use of restrictive trade instruments, creating a legal framework which the parties of the organization must have accepted and respected. The negotiations, held in Havana at the United Nations Conference on Trade and Employment, produced the Havana Charter, which would have set out the rules and procedures regarding the ITO. However, the ITO did not obtain international relevance, since the US, which were the first proponent of the organization, decided not to ratify the Havana Charter, being concerned about the interference the organization could have had on its own internal economic affairs[30]. The unsuccessful attempt to establish the ITO is considered by some scholars a major setback in the process towards multilateral regulation of trade restriction, leaving a significant gap in the international economic and financial structure and demonstrating the dependence of the international community to the will of the US. According to Richard Toye, the ITO might have been a successful organization, since many post-colonial countries were interested in accession and were prepared to adhere to the principles outlined in the Havana Charter[31]. Instead, they adopted protectionist approaches in the next decades, pushed by the populations' desire to

[29] Irwin, D. A. (1995). *The GATT in Historical Perspective. The American Economic Review*, 85(2),pp. 323–328. http://www.jstor.org/stable/2117941
[30] Toye, R. (2003). *Developing Multilateralism: The Havana Charter and the Fight for the International Trade Organization*, 1947-1948. The International History Review, 25(2), pp. 282–305. http://www.jstor.org/stable/40109320
[31] Ibid.

enhance their economic conditions after centuries of exploitation and submission, and the fear to succumb in the international free market. Instead, other scholars, such as Douglas Irwin, sustained that the failure of the ITO might not be considered an impediment to the development of a freer international trade. The ITO, indeed, might have slowed down the international negotiations process, due the broadness of the agenda and the tendency to become overly bureaucratic, incapable of adjusting to changing economic conditions[32].

In the same period when the Havana Charter was adopted, representatives from 23 States reached an agreement in Geneva and signed the GATT in 1947. It was considered an *interim* measure, a provisional agreement intended to address the need for a legal framework governing the restriction of trade barriers until the establishment of the more comprehensive ITO. Due to its temporary nature, the GATT 1947 was limited in scope, and it mainly concerned the substantive reduction of tariff barriers to trade and the elimination of discriminatory treatment in the international commerce. However, the GATT was extremely successful because the parties to the agreement, which accounted for nearly 80% of world trade at that time, effectively reduced trade barriers based on the MFN principle.

As a matter of fact, despite its initial 'transient' character, the GATT filled the institutional gap left by the ITO: since countries started to turn to this multilateral agreement to solve issues linked to international trade, it became a *de facto* international organization governing trade relations[33]. The GATT had in the US its most important member, and initially it was considered a "rich-men club"[34], as the majority of the signatories were developed countries. However, the subsequent rounds of negotiations in the following decades expanded the membership of the GATT 1947, to the extent that the organization had grown to encompass 128-member countries[35].

The negotiation rounds conducted in the 1950s did not produce substantive diminutions on goods' tariff barriers, but they were essential to enlarge the reach of the agreement, as many developing countries decided to become signatories of the GATT. The two negotiation rounds which occurred in the 1960s and 1970s, namely the Kennedy Round and the Tokyo Round, were instead far more effective in shaping the international trading system. The Kennedy Round

[32] Ibid, reference 29

[33] Mavroidis, Petros C., *'From GATT 1947 to GATT 1994', Trade in Goods*: The GATT and the Other Agreements Regulating Trade in Goods (Oxford, 2008; online edn, Oxford Academic, 1 Jan. 2009),

[34] The term was coined to criticize the exclusivity of the organization, initially seen as a forum where developed countries could create ad-hoc trade policies to increase even more their wealth.

[35] WTO | GATT members by 1994. https://www.wto.org/english/thewto_e/gattmem_e.htm (2024, March 16)

(1964-67), which was the sixth round of GATT negotiations, concluded with a very substantial tariff reduction on a wide range of products[36]. The negotiations also addressed the issue of non-tariff barriers to trade, which were increasingly employed by countries and represented a serious danger to the integrity of the multilateral system. However, due to the limited institutional framework foreseen in the GATT and the complexity of addressing and categorizing non-tariff barriers, the Kennedy Round resulted incapable of solving efficaciously the issue at stake. All in all, the Kennedy Round of negotiations showed the limits of a multilateral agreement, devoid of autonomous power and lacking an international organization behind it capable of upholding the principles of the agreement. Indeed, the GATT could function properly as long as its members would be willing to make an effort to achieve certain objectives, but it lacked enforcement mechanisms to ensure compliance with its provisions. Moreover, the GATT proved to be unable to address the substantially mutated global economiccontext, though it had been nonetheless beneficial in the reduction of tariff barriers in trade in goods. The limited scope of the agreement did not consider the emergence of trades in services, which were expanding exponentially in the 20th century, especially in the telecommunicationsand financial services. Besides, it failed to address the protection of intellectual property rights, creating obstacles to the businesses operating in the knowledge- based industries. Finally, it could not effectively tackle non-tariff barriers to trade[37].

Conversely, the Tokyo Round (1973-79), primarily addressed non-tariffs barriers to trade, building upon the very scarce achievements obtained during the Kennedy Round[38]. Throughout the negotiations, a series of agreements dealing with non-tariff barriers were drafted, though only a few industrialized countries accepted to subscribe to these accords, showing an absence of consensus among the majority of contracting parties.

The narrow scope of the GATT, the incapability of the negotiators to find common grounds on matters which were heavily impacting the functioning of the trade system as well as the peripheral role covered by developing countries required a successive and more incisive negotiation round, which had to develop solutions through systematic and disciplined coordination.

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[36] Bhagwati, J. N., & Krishna, P. (1976). "Trade Liberalization Among Industrial Countries: Objectives and Achievements in the Kennedy Round" The Economic Journal, 86(343), pp. 470-485

[37] Smeets, M. (2017). The WTO Multilateral Trading System in a Globalizing World: Challenges and Opportunities. [Doctoral Thesis, Maastricht University]. Wolf Legal Publishers (WLP). pp.18-19.

[38] Director- General of the GATT, (1980). The Tokyo Round of Multilateral Trade Negotiations, Supplementary Report. pp 3-8.

2.2.The Uruguay Round and the Birth of the WTO

The Uruguay Round of negotiation, which is remembered as the last of the eight GATT negotiations rounds, was launched in September 1986. The parties had agreed not only to keep handling trade in goods, but, for the first time, to consider trade in services. The objectives of the negotiations were very comprehensive, since also non-tariff barriers, intellectual property and trade-related investment measures were included in the discussions[39].

The negotiations were obviously very lengthy and laborious, as every party[40] had its own interests to defend and its own goals to achieve. Developing countries, for instance, had reservations on the protection of intellectual property as they feared that it would have negate them the access to new technology indispensable for economic advancement[41]. The US, on the other hand, were very cautious about multilateral governance of trade in services, especially regarding banking and financial services.

The Uruguay round, indeed, lasted for eight years, but it managed to change dramatically the nature of the multilateral trading system. In 1990 Canada and the European Community submitted a proposal for the establishment of a "Multilateral Trade Organization", whose institutional and legal framework would have ensured the application of the accords achieved in the Uruguay Rounds. At the beginning of the Uruguay Round, the institution of an international organization to replace the GATT was not contemplated. Nonetheless, many parties, throughout the negotiations, acknowledged the necessity to create an institutional body, which could coordinate all the new agreements composing the revolutionized multilateral system, provide the means to settle disputes between the parties and supervise the application of common norms by the signatories. Many countries, included the US, initially obstructed the formation of such organization, concerned about the possible limitation of national sovereignty. However, after having witnessed the advantages which the GATT had brought to global commerce of goods, the more sceptic countries finally agreed to the foundation of the organization, and the US proposed the denomination "World Trade Organization"[42].

The Marrakesh Agreement, which established the World Trade Organization, was signed the 15th April 1994 and became operational the 1st of January 1995.

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[39] The negotiations had to address all the economic, technological, and financial development which had changed drastically the dynamics of the global economy.
[40] 107 countries participated to the Uruguay Rounds
[41] Khan, A. H., & Kazmi, A. A. (1994). *The Impact of the Uruguay Round on World Economy* [with Comments]. The Pakistan Development Review, 33(4), pp. 1197–1200. http://www.jstor.org/stable/41259821
[42] Ibid., p. 3, Reference 19

Besides, the Uruguay Round resulted in several other significant achievements for the global trading system[43]. Firstly, the GATS, concerning trade in services, was ratified and became integral part of the WTO. It aimed to create a legal framework to control and reduce barriers to trade in services, tackling a very substantial share of trades which had been left unregulated in the precedent decades. Secondly, an agreement on the regulation of intellectual property, the TRIPS, established a set of minimum standards to protect and enforce intellectual property rights, including adequate rewards stemming from copyrights and patents. Furthermore, an agreement on investment measure, the TRIMs, was drafted. It was deemed necessary to promote a more open and transparent investment environment, regulating and limiting those unnecessary trade barriers generated by investment policies.

Lastly, the dispute settlement mechanism provided for in the GATT - renominated "Dispute Settlement Understanding" - was strengthened and widened in scope. The broadness of the WTO legal framework required a more effective and well-defined regulation to solve the numerous disputes among the parties than the one provided in the GATT[44]. The DSU represents a legal basis for taking actions concerning the implementation of the agreements by providing dispute settlement procedures applicable to all multilateral agreements.

All these agreements were included in the legal framework of the newly formed WTO, and all of them were based on two fundamental principles, the MFN, and the National Treatment, which will be analysed in detail in the next paragraph.

3. Foundational Principles of the World Trade Organization

The multilateral trading system of the World Trade Organization (WTO) is governed by a set of rules that form the basis of all the agreements within the WTO's legal framework. These rules are designed to uphold the fundamental principles of the WTO, including the promotion of free and fair-trade competition, transparency in trade policies, predictability and stability of the system, and the integration and sustainable economic growth of developing countries. These basic rules can be distinguished as: rules on non- discrimination, rules on market accessand rules on unfair trade[45].

[43] Oxley, A. (1994). The Achievements of the GATT Uruguay Round. Agenda: A Journal of Policy Analysis and Reform, 1(1), pp.45–53. http://www.jstor.org/stable/43198662

[44] The rudimentary rules in Article XXIII:2 of GATT 1947 provided that the contracting parties themselves, acting jointly, had to deal with any dispute between individual contracting parties.

[45] Van den Bossche, P., & Zdouc, W. (2021). *The Law and Policy of the World Trade Organization: Text, Cases, and Materials (5th ed.).* Cambridge: Cambridge University Press. pp. 337-345.

However, the agreements provide for exceptions to such rules, which allow the Members to deviate, under specific circumstances, from their WTO's obligations. In the next subparagraphs firstly, it will be presented the rules which underlie the organization; then, attention will be devoted to the conditions under which exceptions might be applied.

3.1. Non-Discrimination Rules

The non-discrimination rules are the most significant provisions of the WTO's framework and aim at ensuring fair and equitable treatment among the Member countries[46]. In the absence of these rules the multilateral trading system could not exist, as discrimination among products and services of different countries would provoke unfair competition and resentment among trading partners, which might lead to trade wars and the application of retaliatory measures. The essentiality of impeding discrimination between countries within the WTO is also outlined in the Preamble of the WTO Agreement, which states that non-discrimination obligations are indispensable means through which attaining the objectives of the organization. These two key obligations are: the Most-Favored-Nation (MFN) and the National Treatment.

The MFN treatment obligation prohibits discrimination between and among trading partners, requiring that a country extends the same treatment, concessions or privileges granted to one trading partner to all other WTO Members. The same treatment among trading partners must be applied immediately and unconditionally. The MFN treatment obligation is included in all WTO multilateral agreements, as it is the most important condition to maintain the effectiveness of the multilateral trading system. Indeed, in the GATT 1994, the MFN treatment obligation is outlined in Art. I:1, while in the GATS it is encompassed in Art. II:1.

The National treatment obligation compels Members countries not to discriminate against the products or services produced in other countries, to favor its own products or services. The aim of such obligation is to impede national governments to enforce measures in order to protect domestic companies, affecting fair competition at the expense of the consumers. National governments, indeed, particularly during periods of economic downturns, often resort to the implementation of protectionist policies as a means to gain domestic consensus or to address the demands of influential interest groups. The National Treatment obligation is, similarly to the MFN obligation, included in the WTO agreements, specifically in Art.III

[46] WTO | Understanding the WTO - principles of the trading system. https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact2_e.htm

of the GATT 1994 and in Art. XVII of the GATS. Both obligations entail the assessment of "like products" in order to assess the conformity of national measures to such principles. "Like products"[47] denote the characteristics and functions of the products under scrutiny, which, if considered comparable, may be deemed to be competitive in the international market. These rules, not only prohibits de jure discrimination, but address de facto discrimination as well, which might arise when measures indirectly create discrimination between like products or services[48]. Both obligations, although relevant and clearly articulated in each agreement drafted within the WTO, have been shaped by the interpretations of the dispute settlement ad hoc bodies, which have particularly contributed to the formulation of the criteria to determine if the obligations have been respected.

3.2. Market Access Rules

Rules on market access represent the core of the WTO, as the openness of national markets is essential for the adequate functioning of the multilateral trading system. The restrictions on market access addressed by these rules are divided in two broad categories: tariff barriers, mostly in form of customs duties, and non-tariff barriers, such as quantitative restrictions, which affect both trade in goods and services[49].

Customs duties are financial charges in the form of taxes, mainly imposed on imported goods. Customs duties might be imposed relatively to the value of the product imported (Ad Valorem) or, in fewer cases, can be specific on a certain characteristic of the goods under scrutiny. Although the reduction of tariffs barriers has been at the base of each Round of Negotiations, customs duties are not prohibited under the GATT 1994. Customs duties might be applied, as long as they don't exceed the tariff concessions specified in the Member's Schedule of Concession, which is the commitment each member has taken not to impose customs duties above a certain level. However, in the application of customs duties, countries must respect the MFN treatment obligation.

Quantitative restrictions and other non-tariff barriers to trade are, differently from

[47] "Like products" are a subset of directly competitive or substitutable products: all like products are, by definition, directly competitive or substitutable products, whereas not all "directly competitive or substitutable" products are "like". The definition given by the Appellate Body in the Korean-Alcoholic Beverages case.
[48] Van den Bossche, P., & Prévost, D. (2021). *Essentials of WTO Law (2nd ed.)* Chapter 4. Cambridge: Cambridge University Press. pp. 54-80.
[49] Van den Bossche, P., & Prévost, D. (2021). *Essentials of WTO Law (2nd ed.)* Chapter 5. Cambridge: Cambridge University Press. pp. 83-103.

customs duties, prohibited under the GATT 1994 and the GATS.

Quantitative restrictions under the GATT can be applied both as prohibition to import certain goods or as quotas limiting the amount of importable goods. Even though the GATT specifies that, under specific circumstances, quantitative restrictions might be justified[50], the countries which impose them are periodically asked to notify the WTO, addressing the WTO provisions which would allow the introduction and maintenance of such measures. Many disputes within the WTO's legal framework concern the application of quantitative restrictions, principally regarding de facto quantitative restrictions and the broadness of the scope of such prohibition.

Differently from the GATT, the GATS, is mostly concerned with quantitative restrictions on service provisions, such as on the amount, value or people involved in the service supply. However, the prohibition under the GATS is less far reaching as many quantitative restrictions are the consequence of domestic measures implemented to govern sensible public policy areas. Under the GATS, countries can impose quantitative restrictions, or more generally market access barriers, in such a measure as they negotiate in their Member's Service Schedule[51], thus agreeing not to impose any restriction beyond that level. However, negotiations on reduction of market access barriers to trade in services are much less advanced than those regarding trade in goods, as the latter have been progressed since 1947 within the context of the precedent GATT, while the GATS is relatively new, and especially developing countries are not inclined to reduce those restrictions as they fear the competition of foreign developed countries.

3.3. Exceptions to Non-Discrimination and Market Access Rules

It might happen that national governments are obliged to adopt trade restrictive measures to protect societal values and national interests, such as public health or national security. The WTO legal framework provide specific rules to discipline such exceptions to both non-discrimination and market access rules. Among these various exceptions, three types will be analysed: general exceptions, exceptions for national and international security and exceptions for safeguard measures[52].

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[50] Art. XI, WTO Agreement

[51] WTO | Services - Schedules of commitments and lists of Article II exemptions. https://www.wto.org/english/tratop_e/serv_e/serv_commitments_e.htm (2024, 20 March)

[52] Van den Bossche, P., & Prévost, D. (2021). *Essentials of WTO Law (2nd ed.)* Chapter 6. Cambridge: Cambridge University Press. pp 106-143.

The general exceptions are contained both in the GATT, under Art.XX, and in the GATS, under Art.XIV. Both articles, although the article under the GATT is broader in scope, provide a series of justification grounds under which it is possible to deviate from any agreement's obligations, adopting national measures which otherwise would be inconsistent with the principles of the WTO. Among the conditions included under the articles concerning general exceptions for justification of an inconsistent measure, the most relevant are the protection of public morals, the protection of life or health of humans, animals and plants, the conservation of exhaustible resources and the acquisition and distribution of products in short supply. As it regularly happens within the WTO legal framework, the general exceptions have been subject to the interpretations of the dispute settlement *ad hoc* bodies, which have tried, through their sentences and reports, to keep the balance between the societal values and national interest, while ensuring conformity with WTO rules.

The conditions outlined in *chapeau* of the articles mentioned above are highly relevant for the dispute settlement practice, as they aim to respect that balance between trade rules and national exigencies. The *chapeau* requires the provisionally justified measures to avoid the creation of arbitrary or unjustifiable discrimination between countries similar in conditions. Moreover, it must not constitute a disguised restriction of international trade, both in goods and services.

The security exceptions are included both in the GATT, under Art.XXI, and in the GATS, under Art.XIV*bis*, and they are specifically referred to situations in which national or international security is concerned. The provisions outlined in these articles enable Members to implement measures that would normally be considered inconsistent with WTO principles, if those measures are deemed to be indispensable for the protection of national security. The articles concerning security exceptions are indeed written as to allow a substantial amount of discretion to members, since national security is the crucial objective of any nation. However, for a measure to be justified under the security exception, it must be taken in time of armed conflict, or be in any case related to serious tensions involving the country in question.

The security exception provision had never been relied upon in the history of the WTO until recently when, following the increment in military hostilities and political frictions between countries, it has been repeatedly invoked before the dispute settlement bodies[53].

[53] An example is the dispute between Russia and Ukraine in Crimea. Russia imposed transit restrictions on goods moving from Ukraine to Kazakhstan, justifying this decision, evidently inconsistent with the GATT, with the national security exceptions, in light of the conflict between Russia and Ukraine.
Nevertheless, Ukraine challenged these measures before a WTO Panel, addressing the interpretation of the security exception. See *Russia – Traffic in Transit* (DS512).

Finally, the GATT Agreement, under Art.XIX, provides for economic exceptions, in particular regarding safeguard measures. This provision allows countries to impose otherwise GATT-inconsistent measure as trade remedies to protect domestic industries from an extreme flow of imported goods, which threatens the survival of those industries. However, these measures are permitted only if they fulfil certain criteria identified, through the resolution of disputes, by the Appellate Body.

A safeguard measure, to be considered as such, must suspend a GATT obligation in order to prevent the collapse of domestic industries involved in the production of specific goods, which are endangered by the heavy imports of those goods in the domestic market. The safeguard measures are temporary in nature, as they serve to industries and governments to adjust to new market development, and, in the meantime, the country might be required to compensate foreign importers for the foregone earnings.

4. The Institutional structure of the World Trade Organization

The expansive scope of the WTO's functions, the elevated number of parties involved in the organization and the complexity of the agreements governing the multilateral trading system, have necessitated, among many other reasons, the establishment and maintenance of a comprehensive and operational WTO's institutional structure[54].

Art. IV of the Marrakesh Agreement illustrates the main bodies composing the institutional framework of the WTO and specify the hierarchical relations among them. The most important and powerful body is the Ministerial Conference, which serves as a "supreme chamber" of the organization. It is composed by minister-level representative of each Member State and it detains the decision-making power on all aspects comprised under the WTO agreements. The Ministerial Conference exemplifies the nature of the WTO, which is a member-driven organization, as the members only decide on matters concerning the organization.

Decision-making in the WTO is chiefly exercised through negative consensus, which means that decisions are taken, unless a Member declares to be contrary to the decision. The idea behind this type of procedure is to promote only provisions which are more likely to be

[54] See also J. Jackson and S. Charnovitz, 'The Structure and Function of the World Trade Organization', in K.Heydon and S.Woolcock(eds.),The Ash gate Research Companion to International Trade Policy (Ashgate Publishing, 2012), pp. 387–403

implemented at the national level, since the first function of the WTO is to "facilitate the implementation of multilateral trade agreements"[55]. There are special occasions in which the treaties foresee the necessity to decide by simple or qualified majority, such as the accession in the organization. However, there always needs to be an attempt to reach a decision through consensus. That said, within WTO bodies the decisions taken through majority are not regarded as democratic (hence, legitimate) as the ones taken by *consesus*. However, the constant research for *consensus* might be detrimental to the functioning of the organization since it is very difficult to align the positions of all the Members concerning their own economic activities. Therefore, the consensus procedure has, and continues to, jeopardize the effectiveness of the organization to such an extent that it seems indispensable a reform of the decision-making process.

The Ministerial Conference, apart from the decision-making power, has many other competences, such as the appointment of the Director-General, which presides over the WTO Secretariat.

The Secretariat is the administrative body of the WTO, headquartered in Geneva and composed of nearly 625 functionaries, supported by civil servants and other staff. The Secretariat does not have any decisional competence or right of initiative, which is entirely exerted by the Members. The main role of the WTO Secretariat is to provide technical assistance to the Members, especially developing and least-developed countries, and WTO bodies as well.

Following the hierarchical institutional structure of the WTO, the General Council is subordinate to the Ministerial Conference. The former is composed of diplomats from each Member and shall perform the functions of the Ministerial Conference between the plenary sessions of the latter, since the Ministerial Conference gathers with biennal frequency.

The General Council can also be found under the denomination "Dispute Settlement Body" (DSB) and "Trade Policy Review Body" (TPRB), depending on the matter of discussion. The DSB is one of three bodies associated with the dispute settlement function of the WTO, as highlighted in the DSU. The DSB is the administrative body, responsible foroverseeing the dispute settlement process, and has the authority to establish panels and adoptreport both from panels and the Appellate Body. Indeed, the DSU envisages two levels ofjudgment concerning complaints brought by Members regarding alleged violations of WTO

[55] Art.III, WTO Agreement.

agreements perpetrated by other Members. The first is provided by the Panels, composed by independent trade law experts nominated by the DSB, which are *ad-hoc* bodies established solely with the purpose of solving a particular dispute. However, the reports of Panels, through which they assess their position on the alleged WTO inconsistent measure, are not legally binding. It is the DSB which can adopt the recommendation of the panel, transforming them into legally binding ruling. The second- instance judicial body is the Appellate Body, which is permanent, contrary to the Panels, and composed of seven members, nominated by the DSB. The Appellate Body serves to review the legal correctness of panel reports, ensuring consistency in the interpretation of WTO agreements. The decisions of the Appellate Body are binding on the parties to the dispute and the DSB must adopt Appellate Body's reports within a specified period of time[56].

The TPRB, on the other hand, supervises the TPRM, meeting regularly to discuss the reports provided by the Secretariat. Those reports are stipulated on each country undergoing a trade policy review. The Trade Policy Review Mechanism, established in 1995 as a direct result of the Uruguay Rounds of negotiations, is a mechanism which aims at achieving greater transparency of trade policies developed by the Members and enhances the adherence of the Members to WTO obligations. This mechanism is a peer review system of surveillance in which Members periodically examine trade measures conceived and adopted by other WTO members, in order to formulate opinions and provide recommendations regarding the policies under evaluation. It is important to highlight that the policy assessments do not impose legal obligations, since compliance with WTO rules is enforced exclusively through the Dispute settlement mechanism[57].

Article IV of the WTO Agreement establishes the formation of specialized councils and committees, which operate under the guidance of the General Council. These specialized councils and committees are subordinate to the General Council in the hierarchy of WTO governance and superintend the implementation and functioning of various trade agreements.

[56] Van den Bossche, P., & Zdouc, W. (2021). WTO Dispute Settlement. The Law and Policy of the World Trade Organization: Text, Cases, and Materials (5th ed.) Chapter 3. Cambridge: Cambridge University Press. pp. 176-190

57 Ibid.

5. Evolution and current Challenges faced by the World Trade Organization

The WTO, although relatively young as an international organization, has been confronted with the rapid evolution of global dynamics, particularly in the realm of trade, since its inception in 1995. These changes have occurred at an extraordinary pace, presenting challenges for the WTO in its efforts to adapt and remain relevant. Despite endeavors to keep pace with these shifts, the organization has not always been successful in doing so.

Firstly, the WTO has steadily expanded its membership, starting from 123 signatories in 1995 and growing to the current 164 Members, which account for the great majority of trade in goods and services, as well as of foreign investments. Emerging economies, such as China, India, Russia and Brazil, together with many developing, and least-developed countries have been integrated in the global trading system. In this respect, it is worth noting that the structure of the contemporary international market, characterized by complex value chains which intertwine the economies of developing and developed countries, requires as many countries as possible to be involved in the WTO, adhering to its principles and promoting the liberal market. However, the geopolitical dynamics and conflictual relations between certain countries, in particular the so called "superpowers", are endangering the effectiveness of the organization, undermining its principles in favour of their own interests[58].

For example, the access of China (which happened in 2001) radically changed the balance of power within the organization and triggered several criticisms from other members, most notably the US. Indeed, the question of accession was already a matter of great discussion, as China proclaimed itself a developing country in need of special and differential treatment, in order to be granted flexibility of commitments and longer transitional time periods to align with the requirements of the WTO. The US, on the contrary, sustained that China could not be granted the status of developing country, as its economic performances and enormous trade surplus were substantially different to any other developing country. However, since the status of one country is self-proclaimed, China has entered and still is considered a developing country in the framework of the WTO. The US has called numerous times for reforms involving the status of developed- developing country[59]. It advocated for changes in the criteria used to determine eligibility for such status, with the introduction of objective criteria such as GDP or trade

[58] World Trade Organization: Challenges and Opportunities. (March 2024). UK Parliament. https://researchbriefings.files.parliament.uk/documents/CBP-9942/CBP-9942.pdf (2024, 25 March).
[59] Ibid, p.18

volume, instead of self-proclamation. Moreover, the US, with the aim of tackling the continuance of preferential treatment for countries which have reached certain economic standards of development, proposed the adoption of a graduation mechanism, which automatically remove certain benefits and flexibilities distinctive of the developing status. However, as the proposals of the US should have been accepted through unanimity by the Ministerial Conference, China and many other developing countries have repeatedly denied their consensus to such provisions[60].

The decision-making mechanism of the WTO, based on general consensus, has been frequently criticized as well. Even though the consensus mechanism ensures the respect of equality among Members indistinctively of their economic weight, concurrently reveals many weaknesses, such as the paralysis of the organization in adopting regulations if divergent interests are involved[61]. The ineffectiveness of the actual WTO decision- making procedure has been evident throughout the last Round of Negotiations, launched in Doha in 2001. The main aim of the Doha Development Agenda[62] was to ensure the protection of the interests of developing countries for a sustainable economic growth, by facilitating and improving their access to the global market. The Doha Development Agenda experienced multiple deadlocks over more than a decade of negotiations, as divergent interests between developed and developing countries on how to effectively integrate development measures while maintaing competition rules madeit unfeasible to achieve consensus throughout Ministerial Conferences.

The Doha negotiation Round has been declared decayed in 2015, after years of negotiations *impasse.* Although some minor achievements have been accomplished, the Doha Negotiation Round has failed to deliver the results wished for, undermining the credibility of the WTO as a forum for multilateral trade negotiations.

Another major and contemporary issue of the WTO is the paralysis of the Appellate Body, which has degraded the efficacy of the Dispute Settlement Mechanism. The DSU has been considered as the most important attainment of the Uruguay Negotiations Round and, since its establishment in 1995, it has handled over 300 disputes brought by the members before the designated bodies[63].

60 KWA, Aileen; Lunenborg, Peter. Why the US proposals on development will affect all developing countries and undermine WTO. South Centre Policy Brief, 2019, 58: pp. 1-11.
61 Guan, W. (2014). Consensus yet not consented: A critique of the WTO decision-making by consensus. Journal of International Economic Law, 17(1), 77–104. https://doi.org/10.1093/jiel/jgu004
62 Verbiest, J.-P. A. (2002). The Doha Round: A Development Perspective. The Asian Development Bank. https://www.adb.org/publications/doha-round-development-perspective
63 Understanding the WTO - a unique contribution. WTO. (n.d.-a). https://www.wto.org/english/thewto_e/whatis_e/tif_e/disp1_e.htm

However, since 2019, the Appellate Body is unable to fulfil its duties as it lacks members. Indeed, since 2016 the US has opposed to the reappointment of judges, while the procedure requires the unanimity among Members of the WTO. The US has acted specifically to attain this paralysis situation, as to force the hand of the Ministerial Conference to assent to a reform of both the Dispute Settlement System and the functions of the Appellate Body, which is regarded as inefficient and detrimental by the American administration[64]. Such paralysis of the Appellate Body seriously endangers the global economic system, as countries could decide independently whether to abide to a panel report, which does not possess legally binding power. Forty-seven WTO Members, trying to tackle the situation, have agreed in 2020 to substitute the role of the Appellate Body through arbitration, by signing the Multi-Party Interim Arbitration Arrangement[65]. Obviously, adherence to such plurilateral agreement is voluntary, therefore countries can decide whether to commit to adopt the report formulated by the arbitrators.

In light of the above, one can conclude that the World Trade Organization is experiencing a transitional phase, which is undermining the relevance of this organization in the global context. The most powerful nations increasingly lost adherence with the principles and regulations of the WTO, enhancing their protectionist policies and implementing trade barriers, in order to strengthen their position at the detriment of their adversaries. The deadlock in decision-making and the paralysis of the Appellate Body are negatively influencing the positions of Members on the role of the WTO, as it is deemed to be ineffective to identify the issues in the global trading system, also providing, in short amount of time, solutions to tackle these problems.

However, if the Members will be capable of solving the structural defects and overcoming those negotiations deadlocks which have negatively affected the functioning of the organization, the WTO could still hold a crucial position in the international economic context, as it deals with sensitive matters strictly correlated with the economic welfare of countries.

[64] Bjil. (2021, October 10). The WTO Appellate Body Deadlock and the way ahead. BJIL. https://www.berkeleyjournalofinternationallaw.com/post/the-wto-appellate-body-deadlock-and-the-way-ahead [65] The multi-party Interim Appeal Arbitration Arrangement (MPIA) - WTO plurilaterals. WTO Plurilaterals - This site provides accessible and up to date information on plurilateral initiatives at the World Trade Organization. (2023, August 4). https://wtoplurilaterals.info/plural_initiative/the- mpia/

Chapter II. The EU Carbon Border Adjustment Mechanism.

1. The role of the European Union in the current Climate Crisis.

The climate crisis is the most urgent challenge the humankind must face in the contemporary world. The scientific community universally agrees on the human responsibility in the vast production of greenhouse gases that are provoking the rise of temperatures and the consequent global warming[66].

However, although it has been highlighted multiple times that higher temperatures are having devasting effects which will affect the life of every species living on earth, the clashing economic interests of nations are diminishing any attempt of the international community to deal with the issue. Indeed, the current globalized economic system, which has permitted to developed and developing countries to increase exponentially their industrial production and better their living conditions, is dependent on the energy produced through fossil fuels, which represent the main responsible for the current climate crisis[67].

Therefore, the entire chain of production should be drastically revolutionized through economic policies aiming at reducing the employment of fossil fuels and favouring the use of renewable energy resources[68]. Certainly, this revolution entails a high cost, especially in the short run, and the sacrifice of certain economic sectors, which the majority of countries consider essential for their economic prosperity or survival.

The international community has proven very reluctant in adopting consistent shared measures to tackle the climate crisis, due to the economic effects that measures aimed at… might provoke on their welfare.

Indeed, developed countries sustain that each measure aimed at contrasting global warming would be ineffectual if the entire global community does not share the same interest

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[66] IPCC, *Climate change widespread, rapid, and intensifying* (2021, August 9). IPCC Press Release. https://www.ipcc.ch/2021/08/09/ar6-wg1-20210809-pr/#:~:text=The%20report%20shows%20that%20emissions,1.5%C2%B0C%20of%20warming. (2024, 4 April)

[67] In 2013, the Intergovernmental Panel on Climate Change (IPCC), stated in its Fifth Assessment Report that "Climate change is real and human activities, largely the release of polluting gases from burning fossil fuel (coal, oil, gas), is the main cause". Stocker, T. F. (2013). *Climate change 2013 : the physical science basis : Working Group I contribution to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change*, pp. 17-18.

[68] Mitchell, G. R. (2017). Climate change and manufacturing. *Procedia Manufacturing, 12*, pp. 298–306.

in achieving such objective[69]. Developing countries, on the contrary, argue that wealthier countries have been polluting the world for decades to pursue their economic interests,therefore they do not have the right to impede to other countries to follow the same path[70]. Asa matter of fact, the truth rather lies in between, but this misalignment is rendering any international endeavour[71] almost devoid of any significance.

Given that, among other countries, the EU has decided to take a leading role in the contrast against global warming. The European Green Deal[72], which has been launched in December 2019, is the proof of such willingness to reach effective results against global warming. This initiative places the climate crisis at the core of the EU policy framework, with the primary objective of aligning economic plans with environmental necessities. The main objective of the EU Green Deal is to achieve carbon neutrality within the EU borders before 2050, which means the elimination of net greenhouse gases emissions as well as maintaining the global average temperature increase below 2 Celsius degrees compared to preindustrial levels, in the attempt to comply with agreements reached at the COP21[73] held in Paris.

The EU's current primary objective is to reduce net greenhouse gas emissions by a minimum of 55% by the year 2030[74]. The Commission - lead by President Ursula Von der Leyen - has presented a package of legislation in 2021, nominated "Fit to 55"[75] which was directly aimed at achieving the above-mentioned reduction by 2030. Among the various measures, the Commission has presented a plan to enhance the EU Emission Trading System

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[69] Reid, W. V., & Goldenberg, J. (1998). Developing countries are combating climate change: Actions in developing countries that slow growth in carbon emissions. *Energy Policy*, *26*(3), pp. 233–237. https://doi.org/10.1016/S0301-4215(97)00137-7

[70] *'Inequality Crisis' Thwarting Least Developed Countries' Economic Progress, Ability to Achieve Middle- Income Status, Speakers Stress as Doha Conference Continues | Meetings Coverage and Press Releases*. 2023, March 6. https://press.un.org/en/2023/dev3449.doc.htm (2024, 8 April).

[71] The main international environmental law principle concerning the different interests of developed and developing countries is the "Common But Differentiated Responsibilities (CBDR)" principle. It entails that all states are responsible for addressing global warming, but not equally responsible due to their different industrial developments in the last century. The principle has been conceived to reconcile the different interests of developed and developing countries, in the hope to find common grounds to mature a unitary response towards the climate issue. However, the principle has not been assiduously followed by many countries in the international community. For a further analysis see: UN, United Nations Framework Convention on Climate Change, (1992, May 9, New York).

[72] EU Commission. The *European Green Deal* (COM(2019) 640 final). (2019, December 11, Brussels)..

[73] The 21st Conference of the Parties (COP21), also known as United Nations Climate Change Conference, was held in Paris in 2015. The main outcome of the negotiations was the drafting of the Paris Agreement, within which the attending parties agreed to limit global warming "well-below" 2°Celsius compared to preindustrial levels. For further information: UNFCCC, Adoption *of the Paris Agreement* (2015, December 12, France).

[74] EU Commission, Communication from The Commission To The European Parliament, The Council, The European Economic And Social Committee And The Committee of The Regions, Stepping *Up Europe's 2030 Climate Ambition Investing In A Climate-Neutral Future For The Benefit Of Our People*. COM (2020) 562 final. (2020, September 17, Brussels).

[75] EU Commission. "*Fit for 55": delivering the EU's 2030 Climate Target on the way to climate neutrality*. (2021, July 14, Brussels). In *EUR-Lex*.

(ETS)[76], imposing new and more consistent carbon taxes.

The EU ETS is an internal Union mechanism to control the emissions of greenhouse gases of energy-intensive industrial sectors. The mechanism works on a "Cap and Trade" principle, which implies the imposition of limits on the total amount of greenhouse gases that identified industries can emit in a year. These limits correspond to the amount of emission allowances which are allocated by the Union or purchased by the industries within the internal carbon market, since emission allowances can be traded among them. To meet the climate objectives, these caps are lowered each year. In theory[77], this means that total emissions are reduced accordingly. This system, which faces the issue of greenhouse gases emissions while assuring economic activities a gradual change in productivity conditions, is however undermined by the gas emissions associated with the manufacture of goods imported within the Union borders. This phenomenon, which will be analysed in detail in the following paragraphs, has been identified by the EU Commission as "Carbon Leakage"[78]. To tackle this detrimental trend, the Commission has included in the "Fit for 55" package the Carbon Border Adjustment Mechanism (CBAM)[79], which is expected to complement the regulatory framework provided by the EU ETS, extending EU climate policies to imported goods. In this chapter it will be provided an overview of the CBAM, outlining the essential features of this regulation, explaining the reasons which pushed European policy makers to intervene in this direction, and finally specifying the functioning and application field of the CBAM.

[76] The EU ETS represents the core of the EU's commitment to reduce its emissions of greenhouse gasses and reach effective results in its fight against climate change. For further information: EU Commission. (2016). *The EU Emissions Trading System (EU ETS).* EU Publications Office. https://climate.ec.europa.eu/system/files/2016-12/factsheet_ets_en.pdf (2024, 10 April).

[77] In the second paragraph of this chapter, it will be explained why this might not always represent the truth.

[10] The EU Commission has defined carbon leakage as "*the situation that may occur if, for reasons of costs related to climate policies, businesses were to transfer production to other countries with laxer emission constraint".* The concept will be examined throughout this chapter.

[79] EU Commission, *"Proposal for a regulation of the European parliament and of the council establishing a carbon border adjustment Mechanism*", COM 2021, 564 final. (14/7/2021, Bruselles).

2. Essential features of the Carbon Border Adjustment Mechanism.

The CBAM, which has entered into force the 1st of October 2023[80], is a mechanism that establishes a custom duty on specific imported products based on the amount of carbon emissions associated with their production. The text of the regulation is composed of 82 premises, 35 articles and 6 Annexes, which serve to clarify the scope of application and the functioning of the mechanism. As mentioned above[81], it complements the EU ETS policy framework and it aims at preventing the phenomenon of carbon leakage, while supporting the reduction of greenhouse gases emissions in non-EU countries, by encouraging third countries to focus on decarbonization and more sustainable industrial production. Carbon leakage refers to the movement, by energy intensive industries, of production, and the associated emissions, from countries with stricter carbon emissions regulation to nations with laxer environmental standard. Carbon leakage, as it will be illustrated in the next paragraph, does not only damage the EU commitments regarding environmental protection, but it also creates an unfair competition at the expense of European businesses which choose to maintain their manufacturing sites within the European territory and are subject to the ETS[82]. The CBAM aims to extend its internal carbon regulation on importations, aligning the carbon prices imposed upon imported products to those provided for EU products. The CBAM provides for two distinct phases to assure a smooth introduction and a gradual stabilization within the global market. The CBAM is currently in its transitional phase, which will end the 31st of December 2025. The transitional period has been established to allow third countries' businesses and authorities to get accustomed to the new rules provided for in the regulation and, in view of the requirements imposed by the CBAM, to start developing a less carbon-intensive line of production[83]. Moreover, the transitional phase will be essential for the EU Commission to collect data and individuate operational fallacies within the new system, which might not render the latter as effective as it is supposed to be[84].

The developing character of the CBAM is witnessed also in the limited scope of application, as the mechanism will initially apply only to certain goods and selected precursors,

[80] The document establishing the CBAM has been published the 10th of May 2023, under Regulation (EU) 2023/956of the European Parliament and of the Council.
[81] Cross reference p 21.
[82] D'Arcangelo, F. M., & Galeotti, M. (2022). Environmental Policy and Investment Location: The Risk of Carbon Leakage in the EU ETS, pp. 2-5.
[83] Reg. 2023/956, Premise 57
[84] Reg. 2023/956, Premise 44

recognized to be particularly carbon-intensive and already regulated under the ETS[85]. The goods initially covered by the CBAM are cement, electricity, fertilizers, iron and steel, aluminium, and chemicals[86]. However, the ultimate objective of the EU is to cover, under the CBAM, the same range of goods dealt by the EU ETS, to ensure consistency between the two regulative systems[87]. Distinctively from the other goods, the imports of electricity are singularly addressed within the scope of the CBAM, as this sector(which is already covered under the ETS) is responsible for a large share of greenhouse gas emissions in the Union. The inclusion of this specific sector within the CBAM, as a means to align the Union and foreign electricity markets, has been considered essential by EU institutions to avoid the risk of carbon leakage. Indeed, in the absence of a proportionate customs treatment for imported electricity, the existing connection between the Union's electricity grid and that of its neighbour countries[88] would push European producers to purchase less expensive electricity, mostly produced by fossil fuels-fired power plants in third countries. This is due to these countries not being bound by the stringent regulations of the Union .

Within the CBAM, electricity is not only addressed as an importing good. It is also analysed under the light of emissions caused by the use of energy, in the form of electricity, to power industrial production of goods which will later be imported within the EU territories[89]. Indeed, the text of the Regulation clearly states that not only direct emissions, calculated from the time of production until the imports of those goods within the EU customs territory, should be covered by the CBAM, but also indirect emissions, which are those generated through the utilization of electricity in the manufacture process, should be addressed by the mechanism[90]. The inclusion of indirect emissions within the scope of the CBAM is indispensable to maintain the effectiveness of the mechanism in addressing environmental issues and fighting global warming. However, indirect emissions, as they are more difficult to calculate and exceptions must be made for industries which favour the use of renewable sustainable energy in their production processes, will not be immediately imposed alongside direct emissions, in order to

[85] The goods covered by the CBAM are specified in Annex 1 of the Regulation, where there are also indicated the greenhouse gasses associated with the production of each of these goods.
[86] Under this denomination is included only the production of Hydrogen.
[87] *Carbon Border Adjustment Mechanism—European Commission*. (2021). https://taxation-customs.ec.europa.eu/carbon-border-adjustment-mechanism_en. (2024, 17 April)
[88] The union has pursued a policy of interconnectivity between electricity markets of third countries because it represents a fundamental factor for those nations to accelerate their transition to energy systems which contain considerable share of renewable energies.
[89] The energy required to power the production processes is a recognized source of greenhouse emissions, therefore it is addressed within the CBAM, as it can represent a cause for carbon leakage.
[90] EU Reg. 2023/956, Premise 19

allow the collection of useful data throughout the transitional phase and develop a specific methodology for their calculation[91].

The learning phase and all its specific provisions will be valid until the end of 2025, while at the beginning of 2026 the CBAM will effectively start to be fully applied by European authorities[92]. The CBAM will, however, maintain its developing character until 2034. Indeed, as it happens within the EU ETS system, at the beginning only a small share of embedded emissions will need to be offset by third countries importers. Then, the amount of greenhouse gases emissions to be paid through importing duties will progressively be elevated, in line with the European and global environmental commitments[93].

In order to guarantee a proper and constant supervision on the correct application of the mechanism, the Commission will occupy a central position in the CBAM framework, carrying out multiple functions. Firstly, it will fulfil a regulatory function, ensuring the enforcement of the provisions included in the regulation and reviewing the steps taken by involved businesses to adhere to the mechanism[94]. Secondly, as specified in the premises of the regulation, the Commission will support third countries whose trade relations to the Union will be heavily affected by the regulation, enhancing cooperation, and providing technical assistance[95]. Lastly, the Commission will detain the exclusive power to amend articles of the CBAM, in order to maintain the effectiveness of the regulation throughout the years.

3. The aim of the Carbon Border Adjustment Mechanism: tackling the phenomenon of carbon leakage.

The necessity to implement the EU ETS with the CBAM relates to the detrimental effects that a single unilateral domestic carbon regulation might have provoked on the possibilities of the EU to guide the international community towards a reduction in greenhouse emissions related to industrial production and, at the same time, on the competitiveness of European businesses in the global market. As mentioned above, the issue of global warming is mostly associated with the emissions embedded in the current industrial production, which

[91] Ibid.
[92] Reg. 2023/956, Chapter X, "Transitional Provisions".
[93] Accountancy Europe (2024), *Carbon Border Adjustment Mechanism (CBAM) Combatting carbon leakage in the EU Factsheet.* p.4.
[94] EU Reg. 2023/956, Ch. VIII, Art. 30.
[95] EU Reg. 2023/956, Premises 71, 73, 74.

is now widely recognized to be environmentally unsustainable[96]. As the global dimension of the problem requires comprehensive solutions, the international community has tried to set common goals to tackle the climate crisis which include, among others, the improvement of the environmental sustainability of the global industrial sector.[97]

Such efforts, however, have proved inadequate to effectively address the issue, as the international community did not develop any enforcement power to oblige countries to take appropriate policy actions towards the respect of such commitments[98].

The reluctance of national governments to adopt environmental policies that affect the country's economy stems from several factors: the consequent unpopularity of decisions impacting citizens' daily lives, concerns about potential economic recessions, and pressures from industrial lobbyist groups[99].

Against this backdrop, the EU has decided to take a leading role in the fight against climate change, as it possesses the resources, the power, and the independence necessary to implement suitable measures and influence third countries to act accordingly. The EU ETS and the successive European Green Deal proves the European Union's commitment to reform the industrial production processes towards a less carbon-intensive production, setting up a functioning system from which other countries could take inspiration[100].

However, the regulative framework produced controversial side effects, which risked undermining its effectiveness and reducing the willingness of the EU to continue acting against global warming. Indeed, unilaterally adopted environmental measures, which impact on the productivity of the domestic industrial sectors, can damage the competitiveness of domestic businesses in the global market[101].

As a matter of fact, the EU ETS has posed a price on the carbon emissions embedded in the regional industrial manufacture of specific products. The objective of the EU institutions was to reduce the total amount of carbon emissions within the EU territories in order to adhere

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[96] See, inter alia, Bocken, N. M. P., & Short, S. W. (2021). Unsustainable business models – Recognising and resolving institutionalised social and environmental harm. *Journal of Cleaner Production*, *312*, 127828. https://doi.org/10.1016/j.jclepro.2021.127828

[97] UN, The 2030 Agenda for Sustainable Development and its 17 Sustainable Development Goals (SDGs), (2015, September 25, New York).

[98] Samaan, A. W. (1994). Enforcement of International Environmental Treaties: At Analysis. *The Fordham Law Archive of Scholarship and History*, *5*(1), pp. 261–273

[99] Fredriksson, P. G., Neumayer, E., Damania, R., & Gates, S. (2005). Environmentalism, democracy, and pollution control. Journal of Environmental Economics and Management, 49(2),pp. 24-28

[100] Whitin the text of the CBAM is also specified the willingness of the EU to sign bilateral and multilateral treaties to help third countries deal successfully with the issue of climate change.

[101] Naegele, H., & Zaklan, A. (2019). Does the EU ETS cause carbon leakage in European manufacturing? *Journal of Environmental Economics and Management*, *93*, pp.125–147.

to international commitments[102], while pushing European businesses to invest on more advanced and sustainable technologies, so that producing less emissions would correspond to a better competitive position within the Union's market. However, the EU ETS, even though it has produced some beneficial effects, has been circumvented by some industries, which have delocalized their manufacture sites in third countries with laxer or null environmental policies related to the industrial production[103]. Those same businesses would later import their products within the Union's borders, and, having avoided the costs entailed by EU ETS, would result as more competitive than European businesses which have decided to remain in the EU and are subjected to rigorous environmental control.

This phenomenon, which is known as "carbon leakage", is deleterious both to the European environmental policies and to the European internal market[104]. As a matter of fact, the delocalization of carbon intensive businesses might generate deceptive data on the real effectiveness of the EU ETS in terms of reduction of carbon emissions. Indeed, even though EU data might suggest that the European actions are producing outstanding results in reducing carbon emissions, the total amount of global carbon emissions might not be effectively impacted, as these emissions are just relocated, not eliminated.

The EU ETS has unequivocally helped to regulate and curb the emissions within the European borders, but the risk of carbon leakage might render other countries, interested in adopting similar policies, doubtful on the overall effectiveness of an internal carbon regulatory framework. Moreover, due to the risk of carbon leakage for certain energy-intensive industries, the EU had to revise the initial ETS, introducing a system of free-allocation of emissions allowances to these economic sectors[105]. These free allocations have indeed posed a remedy to carbon leakage from energy-intensive industries. Nevertheless, the free allowances have exempted the most polluting European economic sectors from paying a major part of the emissions they produce and have reduced the economic incentives for these industries to invest into decarbonization technologies[106].

Even though the EU has planned to reduce annually these free allowances to achieve the objectives contained in the Green Deal, this is an example of how the risk of carbon leakage

[102] Ibid. references 9,11.
[103] Martin, R., Muûls, M., & Wagner, U. J. (2016). The Impact of the European Union Emissions Trading Scheme on Regulated Firms: What Is the Evidence after Ten Years? *Review of Environmental Economics and Policy*, *10*(1), pp. 129–148
[104] Acworth, W., Kardish, C., & Kellner, K. (2020). *Carbon Leakage and Deep Decarbonization.* International Carbon Action Partnership.
[105] European Union. EU ETS Handbook (2015). pp. 60-66.
[106] Greens/EFA in the European Parliament (2021). *Towards An Emission Trading Scheme That Delivers A Green And Just Transformation Of European Energy And Industry,* pp.4-6

might negatively influence the performance of European environmental policies[107].

Moreover, carbon leakage and relocation heavily affect the competitiveness of European businesses, as the costs of production for industries under carbon regulated jurisdictions are substantially, and unfairly, higher than those under unregulated jurisdictions. This disadvantage in competitiveness might provoke changes in market share, as foreign manufacturers would be able to offer the same products at lower costs, enhancing their appeal in the international market at the expense of European producers. To avoid such revenue diminishing trend, European producers would be prone to relocate in countries, also known as "pollution havens"[108], where such unilateral carbon regulations are absent or less stringent than the EU ETS. Relocation also negatively impacts on the domestic population since it causes unemployment and economic disruption for satellite activities in the communities reliant on the delocalizing industries. Therefore, carbon leakage might indirectly generate a significant social cost for the affected population in the European Union.

This would provoke a general resentment against the EU ETS and the European climate objectives since the latter would be considered the reason for the deterioration of living conditions for a portion of the domestic population.

On the other hand, carbon leakage might incentivize less developed countries to become "pollution havens", as it would attract European businesses to relocate their manufacture sites in their territories, in the attempt to reinvigorate the domestic economy. These States and their populations, indeed, deem the possibility of improving their living conditions in a short period as much more attractive than the implementation of policies to contrast global warming and environmental. Moreover, the unilateral carbon regulation adopted by the EU might provoke a higher demand for fossil fuels in these countries, due to the energy -intensive nature of the relocated businesses. Indeed, if a large market such as the European one reduces substantially the demand for fossil fuels to diminish the carbon emissions in its own production processes, the price of these commodities would drop, making it very appealing for low-income countries. This phenomenon is defined as "indirect carbon leakage"[109].

For all these reasons, the EU institutions have decided to complement the domestic EU ETS with the CBAM. The CBAM is, indeed, a complex and innovative regulative system, conceived by the EU institutions, not only to support and enhance the effectiveness of the

[107] European Parliament. (2020). Economic assessment of carbon leakage and carbon border adjustment, p.5
[108] Dechezleprêtre, A., Nachtigall, D., & Venmans, F. (2023). The joint impact of the European Union emissions trading system on carbon emissions and economic performance. Journal of Environmental Economics and Management, 118, 102758.
[109] Ibidem (reference 35)

Union's internal environmental policies, but also to address issues related to the competitivity and production capability of European business in the global market. The EU, through this mechanism, also aims to induce a "technological spill over"[110], which means that thirdcountries industries, incentivized by the tax imposed according to the amount of emissions embedded in imported products, would develop, and adopt, more advanced technologies to reduce their carbon emissions and enhance their competitiveness in European market. Moreover, the adoption of such a far-reaching measure confirms the leading role of the EU in the fight against climate change and might inspire other countries subject to carbon leakage to incorporate similar mechanisms in their domestic legal framework.

4. The mechanisms of operation and field of applicability of the Carbon Border Adjustment Mechanism,

The mechanism ideated by the EU institutions to protect the Union's environmental policies, while tackling the phenomenon of carbon leakage, generally reflects the functioning of the EU ETS, as it requires importers to purchase CBAM certificates on a common central platform, in numbers corresponding to the total embedded emissions of the goods imported within the Union's borders. However, the CBAM presents some peculiarities which differ from the provisions of the Union's internal carbon regulation, as it must deal with businesses located in third countries, which act in a different legal context. The mechanism is based on a declarative system, which means that businesses, or indirect European customs representative in case of companies not established within the territory of any EU Member State, must apply for the status of CBAM declarant, if they are willing to continue importing inside the EU borders goods covered under the CBAM[111].

The application for authorization must include precise information about the nature of the enterprise, with particular reference to the amount of goods imported within the EU. The applications, which are submitted through an *ad hoc* electronic database called CBAM registry[112], are evaluated by the National Competent Authorities, designated by each EU Member State to perform the functions contained within the regulation and overview on the correctness of the process. The competent authorities will assess the application presented by

[110] Mörsdorf, G. (2022). A simple fix for carbon leakage? Assessing the environmental effectiveness of the EU carbon border adjustment. *Energy Policy*, *161*, 112596
[111] EU Reg. 2023/956, Ch. II, Art. 5.
[112] EU Reg. 2023/956, Ch. III, Art. 14.

the businesses or customs representatives relying on the legal records in matters concerning custom regulations, the compliance with the registration requirements and the financial capacity to fulfil the obligations under the CBAM[113]. The acceptance of applications and the consequent grant of status of CBAM declarants are fundamental for businesses which intend to import goods included in the regulation within the EU borders. Indeed, starting from 2026, only CBAM authorized declarants will be permitted to import the goods concerned by the mechanism within the customs territory of the Union.

Indeed, as mentioned above, the CBAM is currently in its informative and learning phase, as the Union, the competent authorities and the businesses involved needs to enhance familiarity with the new system. In this initial period, CBAM authorized declarants are not under any financial obligation, as they are not yet required to purchase or surrender any CBAM certificate to import. However, since this initial transitional phase serves mainly to gather information and collect data, importers must submit detailed quarterly reports on the emissions embedded in the imported goods to the Commission[114], which needs such reports to adjust the procedural mechanism of the system and avoid inefficiencies.

The definitive phase of the CBAM, which will begin in 2026, will entail the full application of the regulation. Only CBAM authorized declarants will be allowed to import the goods included in Annex I of the regulation, surrendering a number of CBAM certificates which correspond to the embedded, direct, and indirect, emissions of the products[115]. Member States are responsible for the selling of CBAM certificates, which must be purchased through a common central platform by CBAM authorized declarants established in that member state or which are interested in importing in that particular country. As the CBAM is primarily concerned with the alignment of environmental taxes imposed on European and third countries' carbon intensive goods, the price of CBAM certificates will be determined on the basis of the average of closing prices of EU ETS allowances, which are subject to daily auctions, calculated on a weekly basis[116].

However, differently from the EU ETS, CBAM certificates cannot be exchanged between businesses, as this situation would have distanced the price of ETS allowances to that of CBAM certificates and could have created different prices for operators from different third

[113] EU Reg. 2023/956, Ch. III, Art. 11.
[114] Ibidem (Reference 25).
[115] In Annex II of the regulation, it is thoroughly explained the modalities through which embedded emeissions are calculated.
[116] EU Reg. 2023/956, Ch. IV, Art. 21.

countries, failing to achieve one of the objectives of the regulation[117]. Nevertheless, the CBAM, as to allow importers to recover costs sustained due to the purchase of CBAM certificates, provides for the establishment of a system which consent to the importers to resell to Member States the CBAM certificates in excess, through the common central platform and at the same price paid at the time of acquisition[118].

Besides, another difference with ETS allowances lies in the number of certificates purchasable by importers. Indeed, the regulation does not impose any upper limit on the quantity of certificates that businesses can acquire, while the EU ETS works on a cap-and-trade principle, posing a ceiling on the purchasable quantity. The absence of such a limit is justified by the willingness of the European Union not to affect excessively existing trade flows, always considering the obligations imposed by the WTO. The remained CBAM certificates are cancelled at the end of each year, as authorized businesses will be required to buy new CBAM certificates in correspondence to the embedded emissions of the following year.

As stated above, the CBAM has been devised as declarative system, where authorized importers are required to communicate to the customs authorities of the Member State precise information on the amount of goods imported and the direct and indirect carbon emissions caused by their production and their transportation. These documents, which must be transmitted annually through the CBAM registry, are called CBAM declarations[119], and they will substitute in the definitive phase the current CBAM reports.

Through their declarations, the importers, or their representatives, have the right to claim for a reduction of certificates to be surrendered if they already incur carbon-relative costs in their country of origin for the production of the concerned goods. However, the carbon price paid in the country of origin must be well documented and, in order to ascertain its truthfulness, certified by a third party, independent from the authorized declarants and their businesses.

This provision witnesses the efforts of the European Union, and of the Commission in particular, to promote policies tackling carbon intensive production also in third countries, while at the same time not penalizing those businesses which respect higher environmental standards and are committed to the common objective of containing global warming.

To ensure compliance with such regulation, the Commission has authorized competent Member States authorities to impose penalties upon CBAM declarants who fail to surrender

[117] Indeed, the price of CBAM certificates in this situation would have not been controlled by the European authorities, but it would have followed the market dynamics.
[118] Eu Reg. 2023/956, Ch. IV, Art. 23
[119] Eu Reg. 2023/956, Ch. II, Art. 6.

the correct number of CBAM certificates relatively to the embedded emissions of their goods. Moreover, not authorized importers which try to introduce goods covered by the CBAM within the EU custom borders, must be financially punished by the competent authorities, proportionally to the amount of goods they were trying to import, but consistently, as these punitive measures must be dissuasive in nature, to tackle similar behaviours which undermine the effectiveness of the mechanism[120]. The Commission, nonetheless, must be also particularly careful to identify and detect practices aimed at circumventing the mechanism. These practices, such as slightly modifying the composition of a good without altering its core characteristics to import them as goods not covered by the CBAM, are not illegal per se, therefore are tougherto face for the European authorities. The Commission is empowered by the regulation to investigate on these practices, whose only aim is to avoid the measures included in the regulation following a complaint by an affected party or Member State, and, in case the evidences confirm the establishment of a common pattern to circumvent CBAM obligations in one or more Member States, has the faculty to amend the regulation in order to limit the possibilities for these actions[121].

5. Conclusion

The CBAM is certainly a pioneering environmental policy, as it is the first time that a carbon border adjustment is implemented within the legal framework of an internal market. It requires careful supervision and an efficient bureaucratic structure, as it must deal with products originating from the entire globe.

In order to favour a gradual and well-executed implementation in the global market dynamics, European institutions have chosen to initially apply the CBAM only to a limited number of goods, even if the objective is to fully align the scope of the CBAM to that of the EU ETS. The CBAM could significantly aid the fight against climate change by providing economic incentives for energy-intensive industries in non-EU Countries to adopt new technologies and adjust their production processes towards greater environmental sustainability.

However, as it is a unilateral measure which impacts on third countries businesses, the

[120] Eu Reg. 2023/956, Ch.VI, Art. 26.
[121] Pietras, J. (2023). Navigating the Carbon Border Adjustment Mechanism: The Dangers of Non-Compliance and Circumvention. *European View, 22*(1), pp. 24-28.

CBAM has been subjected to numerous critics. Indeed, the EU's single market and the extensive network of trade agreements signed by its Member States make the EU a major trading partner for numerous countries around the globe. These countries are concerned about the effects that the regulation might provoke on their trade flow towards the Union's territories. Moreover, they accused the EU of having a protectionist aim in the implementation of the CBAM, rather than addressing the fight against global warming. These countries' governments, backed by the lobbyist groups which represent the interested businesses, argue that the CBAM will discriminate foreign products, treating them differently from the domestically manufactured goods.

Such a consequence would be in contradiction with the obligations established by the WTO[122], which the EU must respect as one of its members. Nevertheless, the EU has expressed, within the text of the CBAM, its willingness to comply with the international trade principles of the WTO and provide support to developing and least-developed countries which might be excessively affected by the carbon duty imposed on their products[123]. Indeed, the premises, in the text of the CBAM, clearly states the readiness of the EU to engage in cooperative dialogues with third countries which production and export capabilities might be affected by the customs duties imposed through the new mechanism. Moreover, the Union is keen to reinvest financial resources, acquired through the imposition of CBAM certificates, to support economically and logistically low and middle income third countries in the process towards the decarbonization of their industrial production.

The debate is still in place, as the CBAM will effectively become operative in 2026. In the next chapter of this thesis the international debate around this innovative measure will be presented more in detail; additionally, the provisions included in the CBAM will be analysed in light of the WTO obligations, trying to assess if the regulation constitutes a breach of international trade principles.

[122] In the previous chapter of this thesis, it has been provided a thorough analysis of these obligations.
[123] Eu Reg. 2023/956, Premise 15

Chapter III. Comprehensive Analysis of the Carbon Border Adjustment Mechanism through the lens of the World Trade Organization.

1. Introduction

The interconnection between industrial production and climate change is nowadays a scientific truth. Global warming is heavily influenced by the carbon emissions associated with the manufacture and trade of goods in the global market. All the international conferences on climate change have highlighted the necessity to modify the industrial sector production processes towards a reduction of greenhouse gas emissions[124]. Even though the climate crisis is already happening rather than just representing an upcoming menace, the national economic interests at stake prevail over the willingness to find a common harmonized solution. It is true, nonetheless, that some countries are trying to address the issue, by setting up domestic regulative systems to reduce their carbon emissions[125]. As explained in the previous chapter, these systems might affect the competitiveness of domestic businesses and lack environmental effectiveness, if not properly implemented[126]. For this reason, national executives have started to develop measures to adjust their internal carbon regulations on imported products coming from third countries. These measures are known as Border Carbon Adjustments (BCAs) and are deemed as one of the most efficacious policy instruments to recombine environmental measures with economic efficiency. At the same time, numerous criticisms have arisen regarding the impact of these BCAs on trade flows; in particular, such criticisms concern the protectionist objective which might be hidden behind these environmental measures, and the disrespect of WTO multilateral trade principles.

The EU, recognized as the frontrunner institution in the fight against climate change, has

[124] Among them, particular prominence must be given to the UN Climate Change Conferences (Also known as Conferences of the Parties) in the framework of the United Nations Framework Convention on Climate Change (UNFCCC).
[125] In the previous chapter it was addressed the EU ETS regulatory system, but also countries such as Australia or the UK require their domestic producers to report the carbon emissions associated with their manufacture processes.
[126] See Section 2, Chapter 2.

been the first to officially adopt a regulation of this kind. The CBAM, extensively analysed in the previous chapter, aims at complementing the domestic carbon system, namely the EU ETS. EU's trading partners have not positively responded to such decision, promising to present complaints before the WTO dispute settlement bodies to demonstrate the illegality of the CBAM[127]. Indeed, the EU's trade regulations must comply with WTO principles, as the EU is an active member of the organization.

To date, however, no formal proceedings have been brought before the WTO dispute settlement bodies concerning the CBAM. The reasons lie in the current crisis experienced by the DSB and in the temporary character of the current CBAM. This means that the WTO bodies have yet to rule on the compliance of BCAs, and in particular of the CBAM, with trade principles.

Nevertheless, it is possible to provide reasonable arguments concerning the admissibility of certain design features of the CBAM under free trade rules, such as non-discrimination or general exceptions. The analysis will be mainly based on previous WTO case law about measures which resembled the design of the CBAM, as well as on research works carried out by WTO experts and scholars.

The chapter will be organized as follows. The first paragraph will be dedicated to the relation between the WTO and the EU, focusing on the role of the EU within the organization and the effects that a WTO inconsistent measure might provoke on European trade diplomacy. The second paragraph, then, will develop the analysis on the compliance of the CBAM with multilateral trade agreements. Particular attention will be provided to the interpretation of the CBAM legal character under the WTO, to the observance of non-discrimination principles and the eventual justification under the General Exceptions. Lastly, the third paragraph will focus on the reactions of main EU's trading partner regarding the implementation of such an innovative measure.

[127] See, *inter alia*, the declarations of WTO members States regarding the implementation of the CBAM. WTO Trade Concerns Database, *Council for Trade in Goods*-Formal Meeting of November 2023. https://tradeconcerns.wto.org/en/stcs/details?imsId=148&domainId=CTGo. (2024, 4 May).

[128] Directorate- General for Trade, "*the EU and the WTO",* EU Commission Website. https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/eu-and-wto_en (2024, 4 May).

2. The peculiar role of the European Union within the World Trade Organization

The European Union, taken as a single market and a single custom union, is among the largest economies in the world. It represents a crucial trading partner for many developed and developing countries, as it is one of the largest importers of manufactured goods[128]. Moreover, due to its transparent and secure legal investment framework, it ranks first in inbound and outbound international investments. The influence of the EU in the global trading dynamics and its peculiar legal character pushed the international community to include the EU as a single undertaking within the WTO. The EU is, indeed, a contracting party to the WTO Agreement, operating as a single actor in the WTO framework. Concurrently, also the EU Member States are parties to the organization[129]. This unique "mixed" membership witnesses the willingness of the EU to intervene and supersede upon the global multilateral trading system, exercising its power to better the trading position of both the Union and the Member States.

However, the relationship between the European supranational organization and the multilateral trading system dates back to the ratification of the GATT 1947[130]. Initially, the European Economic Community (EEC or EC) was not a contracting party to the trade agreement, while EC member states were. However, throughout the years, the EC substantially acquired the status of a contracting party, as it practically exercised all rights and obligations of the EC Member States under the GATT framework[131]. Since the 1970, it unofficially replaced the EC member states, since it started negotiating and signing trade agreements under the GATT framework, bypassing the formal approval of each EC Member State.

The establishment of the WTO was a turning point for the EC, because it was formally accepted as a contracting party to the new international organization, alongside all the other Members States which were already parties to the GATT 1947[132]. In practice, however, due to the fundamental and almost exclusive role the EC had covered throughout the decades concerning trade policy development and implementation, formal membership was a

[129] For a more careful analysis on the WTO Agreement see Section1, Chapter 1 of this thesis.
[130] Bazerkoska, J. B. (2011). The European Union and the World Trade Organisation: Problems and Challenges. *Croatian Yearbook of European Law & Policy*, *7*(7).
[131] Ibidem.
[132] Art. XI:1 of the WTO Agreement states: "The contracting parties to GATT 1947 as of the date of entry into force of this Agreement, and the European Communities, which accept this Agreement and the Multilateral Trade Agreements and for which Schedules of Concessions and Commitments are annexed to GATT 1994 and for which Schedules of Specific Commitments are annexed to GATS shall become original Members of the WTO".

continuation to the de facto central role covered under the GATT 1947[133].

Nevertheless, doubts arose regarding the proper functioning of the dual membership. Firstly, the European Court of Justice (ECJ) was called to clarify the distinction between EC competences and national competences under the WTO framework[134]. The Opinion 1/94 of the Court[135], which was aimed to respond to such enquiry, concerned the scope of powers of the Union for the conclusion of the WTO Agreement and the multilateral agreements included in its annexes. In particular, the Court stated that all agreements concerning trade in goods were to be exclusively dealt by the EC under the Common Commercial Policy (CCP), while those concerning trade in services and intellectual property came within the shared competence of the EC and the Member States[136]. These (complicated) arrangements of competences were dealt by the Nice Treaty[137] and the Lisbon Treaty[138], which clarified the exclusive powers of theEU institutions in the ratification of international trade agreements. Secondly, States parties tothe WTO other than EU member States were concerned about the double weight of votes withinthe WTO decision making process. Indeed, since both the Union and the Member States are represented at the WTO level, EU interests might carry undue influence[139].

However, the issue has been promptly addressed by the WTO Agreement, whichspecifies that the total number of votes casted cannot exceed the number of EU Member States[140]. Moreover, as specified in the first chapter of this thesis[141], decision making within theWTO in most cases involves the reach of consensus by the parties.

Even though the Maastricht Treaty establishing the European Union was signed in 1992, it was only after the entrance into force of the Treaty of Lisbon in 2007 that the EC was eventually replaced by the EU as a member of the WTO. Moreover, as mentioned above, the

[133] Igler, W. (2023). The European Union and the World Trade Organization.Fact sheet on the European Union, European Parliament Website. p.4.
[134] Bourgeois, J. H. J. (2001). The European Court of Justice and the WTO: Problems and challenges. In *Oxford University Press eBooks* (pp. 83–90).
[135] Opinion 1/94, Community Competence to conclude certain international agreements. 1994 ECR I-5276, 1 C.M.I.R. 205. European Court of Justice, November 15, 1994.
[136] Ivi. p. 3
[137] European Union, Treaty of Nice, Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Official Journal C 80 of 10 March 2001; 2001/C 80/01, 11 December 2000.
[138] Conference of the Representatives of the Governments of the Member States, Treaty of Lisbon Amending the Treaty on European Union and the Treaty Establishing the European Community, 2007/C 306/01, European Union, 13 December 2007.
[139] Ibid. ref. 7
[140] Article IX of the WTO Agreement states: "The number of votes of the European Communities and their member States shall in no case exceed the number of the member States of the European Communities".
[141] See p.19, Section 4, Chapter 1.

Lisbon Treaty expanded the scope of the CCP[142], providing exclusive power to the Union regarding international trade agreements and eliminating the shared competences defined by the previous Court's opinion. The multilateral trade agreements under the WTO framework are, therefore, primarily dealt by the EU. While the European Commission represents the Unionin Geneva, it is the Directorate General for External Trade that, collaborating with EU parliament's international trade committees, is responsible for the pursue of the EU trade diplomacy. The Commission, however, must follow the policy guidelines presented by the EU Council, therefore by Member States ministers. It is, indeed, the EU Council, cooperatively with the EU Parliament, which authorises the Commission to ratify international trade agreements on behalf of the EU. The competent authorities of the Union have developed, throughout the years, a solid knowledge of the WTO legal framework and expertise on the functioning of its internal dynamics[143]. This entails that the EU representatives most speak and negotiate on behalf of the EU Member States[144].

The EU trade offices are also particularly experienced in WTO dispute settlements. Indeed, it is always the EU that presents complaints before the Dispute Settlement Bodies, even in the (rather infrequent) case that the trade-related controversy affects only a single Member State[145]. The same occurs for passive litigation, namely when the Union or Member States are the recipients of complaints.

Since the establishment of the WTO, the European Union has been among the most active participants in its dispute resolution mechanism. From 1995 to 2022, the EU engaged in 203 dispute cases, acting as a complainant in 110 instances and as a defendant in 95. Additionally, in 217 cases, it sought third-party status, enabling it to observe disputes involving other parties[146]. The EU has frequently pursued enhancements and clarifications of WTO agreements by seeking rulings from panels and the Appellate Body.

The EU is a major supporter of the WTO, deeming fundamental the presence of an impartial body capable of setting common trade obligations and solving related disputes. It has

[142] Consolidated Version of The Treaty On The Functioning Of The European Union, Part Five - The Union's External Action, Title II - Common Commercial Policy, Article 207, 202 OJ C (2016). http://data.europa.eu/eli/treaty/tfeu_2016/art_207/oj/eng

[143] Van Well, L., & Reardon, M. (2011). The WTO and the EU: leadership versus power in international image. *Hal: Open Science.*, 3–8. https://halshs.archives-ouvertes.fr/halshs-00648761

[144] Ibidem.

[145] Duran, G.M. (2017). The EU and its Member States in WTO Dispute Settlement: A 'Competence Model' or a Case Apart for Managing International Responsibility? In *Hart Publishing eBooks*. pp.2-9

[146] Igler, W. (2023). The European Union and the World Trade Organization. Fact sheet on the European Union, European Parliament Website. p.2.

advocated repeatedly the need to reform the WTO, in light of the evolving global trade dynamics and internal crisis which are affecting the effectiveness of the organization[147].

Due to its fundamental role within the WTO, the European Union has tried to shape the common agenda in the direction of enhanced labour conditions and environmental protection in the productive and trading processes. However, the majority of WTO parties (especially developing countries) has demonstrated hostility towards such proposals, considering them an attempt by the EU to establish a moral and green protectionist regime[148], rather than improving the scope of multilateral trade agreements.

The adoption by the EU of unilateral measures, aimed at addressing the aforementioned social and environmental problems concerning trades, has strained trade relations with other WTO countries. The latters have harshly criticized the decisions taken by the EU, claiming that those unilateral policies are inconsistent with WTO obligations and detrimental for international free trade[149]. For such reasons, legal proceedings might be advanced in the future against such unilateral regulations, before the WTO dispute settlement bodies.

However, incoherently with the importance it has attributed to the WTO obligations to regulate the international trading system, the EU has not implemented the WTO Agreement into its legal order, and the ECJ has repeatedly refused to grant direct effect to WTO rules within Community law[150].

This means that individuals are unable to challenge EU measures before the ECJ relying solely on the content of the WTO agreement, because the latter is not a component of the European's Courts legality review. Therefore, even in the case an EU regulation is found in breach of WTO obligations by the DSB, the Union is not obliged to comply with the judgement of the WTO Panels or Appellate Body.

The DSU allows injured States, which represent their citizens at the WTO level, to apply retaliation measures against the breaching country until the regulation in question has not been withdrew or amended to comply with WTO law[151]. However, the EU, negating direct

[147] See, inter alia, EU Parliament, *Multilateralism in international trade: Reforming the WTO* (2019) https://www.europarl.europa.eu/RegData/etudes/BRIE/2017/603919/EPRS_BRI(2017)603919_EN.pdf; and EU Commission, *EU concept paper on WTO reform*, (2018). https://www.wita.org/atp-research/eu-concept-paper-on-wto-reform/

[148]Lottici, M. V., Galperín, C., & Hoppstock, J. (2014). «Green Trade Protectionism»: An Analysis of Three New Issues that Affect Developing Countries. *Chinese Journal of Urban and Environmental Studies*, *02*(02), 13–15. https://doi.org/10.1142/S234574811450016X,

[149] Ibid. ref.4.

[150] Živičnjak, I. (2012). Effect of WTO law in the EU and individual's right to damages caused by a breach of WTO law. *Croatian Yearbook of European Law and Policy*, *8*, 531–560.

[151] Article XXII, Dispute Settlement Understanding, Annex II to the WTO agreement.

effect[152], can decide whether to comply with WTO obligations or accept retaliatory measures depending on what better safeguard its interests. This line of reasoning might be applied regarding the regulation taken under analysis through this thesis, the CBAM. If found inconsistent with WTO law, the EU might still keep applying the measures included in the regulation, accepting eventual retaliatory acts. Moreover, in light of the current crisis which has rendered the WTO Appellate Body ineffective, in case a Panel were to provide a legal opinion in favour of the inconsistency argument, the EU would have the right to apply for a judgement by the Appellate Body. Such legitimate request would mean posing a blockage to the entire process.

Nevertheless, it is essential that the EU develops its policies as to be consistent with WTO rules. Firstly, the retaliatory measures against the EU would affect Member States' nationals, which would blame the supranational institution for the consequences suffered. Secondly, the EU has always declared itself as the main advocate of the WTO, arguing for the inclusion of its principles in all the bilateral, plurilateral and multilateral trade agreements signed throughout the decades. The intentional enforcement of a measure declared to be in contradiction with the rules of the WTO agreement would undermine the position of the EU within the organization in the eye of the other Members. Moreover, it would confirm the accusation of developing countries that the EU hides behind social and environmental commitments its attempt to set protectionist policies to provide a competitive advantage to its businesses. Lastly, it would compromise the ability of the EU to reach the objectives for whichthe CBAM has been elaborated. Indeed, the nature of the CBAM requires collaboration between national authorities to be effectively applied, as it is a measure which affect third country businesses not under the direct supervision of the Union. In the absence of such collaboration, the CBAM would nor be able to function properly, neither exerting any influenceon carbon emissions associated with manufacture. Tarnished trade diplomatic relations with third countries would, therefore, be politically fatal for the EU leading ambitions concerning climate change. The need to respect WTO rules is, for all these reasons, clearly acknowledgedby all the EU institutions involved in the drafting and ratification of the CBAM. Such prerogative has been repeatedly formulated by Union's authorities throughout conferences and

[152] Direct effect means that EU Law endangers obligations for EU Members and rights for the individuals. The concept was defined in a benchmark ECJ judgement *Ven Gend en Loos v. Netherlands.* Judgment of 5 February 1963, NV Algemene Transport- en Expeditie Onderneming van Gend en Loos v Netherlands Inland Revenue Administration, C-26/62, ECLI:EU:C:1963:1.

international dialogues about the application of a carbon border mechanism[153]. It has also been included in the premises of the approved CBAM regulation[154]. Nonetheless, many trading partners of the EU argued that the commitment of the EU to respect WTO principles in the application of the CBAM is just theoretical, while practically the adopted regulation impact on the global free trade dynamics. In the next paragraph, possible inconsistencies of the CBAM will be analysed in order to comprehend the admissibility of such regulation.

3. An Analysis on the CBAM's consistency with World Trade Organization's law

As previously highlighted, the CBAM is the first attempt by a governing institution to impose a Border Carbon Adjustment (BCA). It is the result of the cooperative effort between the EU Commission, the EU Parliament and the Council, to meet the international and domestic climate obligations. These EU bodies, throughout the entire process which has brought to the enactment of the CBAM, have repeatedly acknowledged the necessity to construct the CBAM as to be compatible with WTO law. It is indeed recognised that such measure could negatively influence international trade dynamics and, consequently, compromise global cooperation sought by the EU to tackle the climate crisis. However, although considerable effort has been put to reconcile the regulation with WTO law requirements, the CBAM presents certain design features which might be in contradiction with multilateral trade principles. The aim of this paragraph is to evaluate such features, in the endeavour to individuate possible WTO inconsistencies that might compromise the effective implementation of this mechanism.

[153] An example is: Mission letter, https://ec.europa.eu/commission/sites/beta-political/files/mission-letter-phil-hogan-2019_en.pdf. In this mission letter adressed to the EU representative at the WTO Phil Hoghan, EU Commission president Ursula Von Layen stated: ''I would like you to contribute to the design and introduction of the Carbon Border Tax [which] should be fully compliant with WTO rules'. (2019)
[154] See premise 15 to the CBAM Regulation

3.1. The Legal Characterization of the Carbon Border Adjustment Mechanism under the GATT

The first issue concerning the design of the CBAM regards its legal characterization under WTO law. Border Carbon Adjustments are defined as the climate related equivalent of Border Tax Adjustments (BTAs)[155]. The concept of BTA has been developed within the framework of the WTO to tackle the issue created by the absence of harmonized international taxation on products. Indeed, such fiscal measures, through the extension of domestic levies on imported goods, aim at levelling the playing field of competition between domestic and foreign production. Nonetheless, it is essential that such BTAs respect the principle of even-handednes and are strictly intended to preserve the competitive equality between domestic and foreign products. Under the GATT, BTAs on importation are regulated under Article II:2(a)[156]. This article allows the imposition of a "charge equivalent to an internal tax" to the imported products, conditionally to the respect of the National Treatment obligation provided for in Article III:2. Therefore, according to these provisions, imposing a cost equivalent to the domestic tax on imports does not constitute a breach of WTO law.

The GATT, nonetheless, grant the possibility of border adjustment also to non-fiscal measures related to the importation of products, such as domestic regulations or internal legal requirements[157]. These provisions, must comply with the relative National Treatment obligation, included in Article III:4 of the GATT. Therefore, were the CBAM considered a border adjustment of a domestic tax or domestic regulation compliant with the principle of National Treatment, it could be justified under WTO law.

Against this backdrop, one shall investigate the recognition of the CBAM as a BTA. Indeed, the CBAM might be qualified under WTO law as a strictly fiscal border measure applying a duty on imported products[158]. In this situation, the CBAM would contravene Article II:1 (b), because it would impose upon imported products a charge in excess to those indicated

[155] Espa, I., & Francois, J. (2022). The EU Proposal for a Carbon Border Adjustment Mechanism (CBAM): An Analysis under WTO and Climate Change Law. *Oil, Gas & Energy Law.* pp 5-8.
[156] Article II:2(a) of the GATT states: "Nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product:
(a) a charge equivalent to an internal tax imposed consistently with the provisions of paragraph 2 of Article III* in respect of the like domestic product or in respect of an article from which the imported product has been manufactured or produced in whole or in part."
[157] Kateryna Holzer. (2022). *The EU CBAM Proposal and WTO Law*, Annex I pp. 5-6.
[158] Englisch, J., & Falcao, T. (2021). *EU Carbon Border Adjustments for Imported Products and WTO Law*. 15-20 [SSRN Scholarly Paper]. https://doi.org/10.2139/ssrn.3863038

in its Schedule of Concessions. The arguments in favour of this interpretation refer principally to the fact that the CBAM requirement to buy an emission certificate is activated by the sole action of importing a product, and not by internal activities like distributing, selling, using, or as a carbon tariff on imports, as the latter would oblige them to modify their schedule of transporting the imported product[159]. In contradiction to such argument, however, it has been outlined that the obligation to surrender CBAM certificates is heavily correlated with the internal measure of the EU ETS[160]. Moreover, the amount to be paid to acquire CBAM certificates would not be fixed, but it would correspond to the average price of European allowances, strengthening the correlation between the internal carbon regulation and the CBAM[161]. The EU has stated in multiple circumstances that the CBAM would not be designed concessions and free trade agreements. Based on WTO case law, the nature of the CBAM as a border measure or as an internal measure would be determined by ascertaining whether the obligation to buy the CBAM certificates is triggered by an 'internal' factor, that is, something that takes place within the EU territory or by an 'external' factor, that is, something that occurs outside the EU territory[162]. According to the latter view, the CBAM would be triggered by an external factor, namely the emissions produced in fabricating the covered products in third countries. Consequently, the CBAM should not be considered as the border adjustment of an internal measure, but as a border measure itself.

However, the lack of a well-established case law within the WTO legal framework on BCAs makes the presented arguments more predictive than substantial. The CBAM is a pioneering carbon policy instrument, with no precedents in WTO history. Therefore, the WTO interpretation will be based exclusively on the text of the argument and the consequences these provisions will have on the performance of international trades.

The CBAM, on the contrary, might be regarded as a border regulation, which impose quantitative restrictions on the amount of imported products through the use of *de facto* importing licenses (CBAM certificates)[163]. If interpreted as such by a WTO dispute settlement body, the CBAM would be inconsistent with Article XI:1[164]. It would be a decision based on established WTO jurisprudence, as the issue of quantitative restriction, in all its meanings, has been faced repeatedly throughout the decades.

[159] Such argument has been dealt by the Appelate Body in *China – Autoparts.* For a further analysis see Wauters, J., & Vandenbussche, H. (2010). China – Measures Affecting Imports of Automobile Parts. *World Trade Review, 9*(1), 201–238. doi:10.1017/S1474745609990334

[160] R Quick, 'Carbon Border Adjustment: A Dissenting View on its Alleged GATT-compatibility' (2020) 4 Zeus,p. 567.

[161] This provision has been analyzed in Section IV, chapter II of this thesis.

[162] *China – Auto Parts*, Appellate Body report, paras159-164

[163] Ibid.33

It seems therefore evident that, in case the CBAM would be deemed as a border measure unrelated to the EU internal carbon regulatory system (EU ETS), it would most likely be found in contradiction with the WTO principles contained within the GATT.

On the other hand, the CBAM might be judged as the border adjustment of an internal measure. In this case, the distinction between the fiscal and non-fiscal nature of the CBAM would be fundamental to apply the adequate articles. Indeed, as stated above, border adjustments of a domestic tax and border adjustment of a domestic regulation are covered by different GATT articles. Such determination entirely relies on the definition of the EU ETS[165] as an internal tax or internal regulation. It seems improbable that the EU ETS would be classified as an internal tax, as it does not possess the features of a charge of this kind. In this respect, the ECJ itself has intervened on the matter, stating that the EU ETS cannot be considered as an internal tax because the costs of emission allowances are not fixed, but depend on the market price of an allowance[166]. Moreover, an EU producer could be exempted or very lightly affected by the costs allowances if its associated carbon emissions are low[167].

In addition, the EU Commission has presented the CBAM as a border adjustment regulation, which would reflect the internal system of allowances related to carbon emissions. CBAM certificates' prices would be based on the average price of European allowances and the CBAM will be imposed only upon industrial sectors which are already regulated under the EU ETS. The EU Commission was aware that the implementation of the CBAM would have triggered third countries' complaints about the consistency of the regulation with WTO law. Therefore, it has attempted to design the CBAM as the border adjustment of an internal regulation, because it would have had a higher probability to be considered WTO consistent under Article III:4[168].

However, certain unique characteristics of the CBAM, deemed necessary to assure practical feasibility to the regulation, might contradict the arguments of the EU Commission on the nature of the CBAM.

The main difference between the EU ETS and the CBAM concerns the calculation of emissions to determine the number of allowances or certificates to be purchased. Indeed, the former covers the emissions strictly related to the production process within European

[164] Article XI:1 of the GATT, on General Elimination of Quantitative Restrictions states that: No prohibitions or restrictions other than duties…shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party…".

[165] The EU ETS is contemplated as the internal measure which triggers the border adjustment.

[166] ECJ Case C-366/10, Air Transport Association of America and others v. Secretary of State for Energy and Climate Change [2011], paras 142-144.

[167] Ibid.34

[168] Bellora, C., & Fontagné, L. (2022). EU in Search of a Wto-Compatible Carbon Border Adjustment Mechanism. pp. 3-8 *SSRN Electronic Journal*. https://doi.org/10.2139/ssrn.4168049

installations, while the latter relies on the emissions embedded in the imported products from third countries. The reason for this misalignment lies in the impossibility of Europeanauthorities to efficaciously calculate the emissions of manufacture sites located in foreigncountries[169]. However, this critical difference might push WTO adjudicative bodies to considerthe CBAM as border measure on imported products.

The issue of legal characterization of the CBAM under the WTO is very controversial, as different interpretations for each measure included in the regulation might influence the decision of the WTO dispute settlement bodies. Therefore, even though it might be inferred from the declarations of the European Commission and the general construction of the regulation that the CBAM will be considered a border adjustment to an internal measure and not of an internal tax, the final qualification is to be made by a WTO adjudicative body.

3.2. CBAM's consistency with National Treatment under the GATT

Assuming that the CBAM will be qualified as an internal measure, it is essential that the CBAM design features respect the principle of National Treatment included in Article III of the GATT. As explained above[170], the CBAM as an internal tax would fall under Article III:2, while the CBAM as a regulation would fall under Article III:4. The former is more stringent, as requires the exact same tax rate applied to imported and domestic products[171]. The latter instead is less stringent, as it refers to "no less favourable treatment" and not "identical treatment"[172]. Therefore, if considered as the border adjustment of a domestic regulation, the CBAM might be consistent to the National Treatment principle even if different conditions for practical feasibility are applied[173].

In either case, the National Treatment obligation prohibits the establishment of internal taxes or regulations which "afford protection to domestic production" at the detriment of imported products. As outlined in the first chapter, the national treatment obligation is applicable only to products considered to be "like". The determination of likeness is often central in WTO dispute, and it is often a WTO adjudicative body which, on a case by case, set

[169] Anatole Boute. (2023). Accounting for Carbon Pricing in Third Countries Under the EU Carbon Border Adjustment Mechanism. *World Trade review 2024*. pp. 172-174. See p.46.
[171] Article III:2 of the GATT states: "The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products".
[172] This interpretation was given by the Appellate Body within the case *EC-Asbestos,* para 100. (2000)
[173] Kateryna Holzer. (2022). *The EU CBAM Proposal and WTO Law*, Annex I, pp 13-18.

the conditions for likeness[174].

Regarding the CBAM, the identification of likeness between domestic and imported products relies on their carbon footprints. Indeed, it might be argued that the production methods of imported, and EU domestic products are different. This differentiation will be mirrored in the classification of the goods in question as carbon intensive or low carbon goods. Therefore, the different level carbon intensity would represent a distinctive feature, determining the unlikeness between imported and domestic products[175]. It is, however, very improbable that this argument would be accepted before a WTO adjudicative body. The first

reason involves the characteristics which determine the dissimilarity between products. It is indeed a characteristic which does not affect the physical traits of the goods and it does not change their final end-use[176]. Moreover, in the determination of likeness, it must also be considered the degree of direct competition between the products involved. The WTO jurisprudence establishes that directly competitive and substitutable products, even if they differ in some physical features, must be treated as like products[177]. Therefore, based on WTO case law which has set the conditions of likeness, it might be inferred that imported commodities covered by the CBAM will be reputed as like to domestic commodities.

The EU efforts to design the CBAM as the border adjustment of an internal regulation were also aimed at increasing the chances to comply with the National treatment obligation. Indeed, ascertained the likeness of products, the stringent conditions under article III:2 ("no taxes in excess of") would not be met by the CBAM. Alternatively, Article III:4 imposes less rigorous requirements, and it might allow some variations in the treatment of like imported products, if the objective is strictly practical feasibility of the regulation.

A difference between EU ETS and the CBAM which might be covered by this interpretation of article III:4 is the mode of calculation of the number of certificates to be purchased by the importers. Indeed, the EU has contemplated the possibility to use default

[174] Howse, R., & Tuerk, E. (2009). *The WTO Impact on Internal Regulations—A Case Study of the Canada–EC Asbestos Dispute*. 291–296.

[175] Mehling, M. A., Asselt, H. van, Das, K., Droege, S., & Verkuijl, C. (2019). Designing Border Carbon Adjustments for Enhanced Climate Action. *American Journal of International Law*, *113*(3), 460–461. https://doi.org/10.1017/ajil.2019.22[176] Pauwelyn, J. and Kleimann D., Trade *Related Aspects of a Carbon Border Adjustment Mechanism. A Legal Assessment*. Briefing requested by the European Parliament's Committee on International Trade (April 2020). pp 9-10.

[177] On the criteria for the determination of likeness see, *inter alia*, : WTO…*Japan- Alcoholic Beverages II* (1996), *Canada-Periodicals* (1997) and *Philippines-Distilled Spirits* (2012). Inserire tutti I dettagli dei casi (bene il riferimento almeno a due!)

values if the actual carbon declarations of importers are insufficient to determine the relevant data[178]. Default values might, however, overcharge certain third country businesses and determine differential treatment in relation to domestic businesses, which are charged only in view of their actual emissions[179]. The measure, however, has been justified by the EU in light of the practical issues that might arise in the gathering of precise information about installations around the world[180]. Moreover, to comply with the principle of national treatment, the default values will be based on the values of ETS allowances[181], in order to mirror the prices imposed upon domestic businesses.

The enhanced possibilities for a border adjustment to a domestic regulation under Article III:4 is also demonstrated by WTO case law. Indeed, in the "*Dominican Republic-Import and Sale of Cigarettes*"[182] dispute, it was outlined that less favourable treatment would not automatically occur if negative effects on imports could be attributed to factors unrelated to the product's foreign origin, such as the importer's market share[183].

Regarding the EU CBAM, this suggests that if imported products are less competitive than similar domestic products due to their higher carbon footprint, and not simply because they are foreign, this wouldn't violate the National Treatment rule under GATT Article III.4. The carbon footprints of products, within the scope of emission reduction policies, might be considered as circumstances unrelated to the product's foreign origin. Therefore, a carbon tax or charge could meet the requirements of Article III:4, even if similar products with varying levels of carbon intensity are classified as alike.

Regardless of the legal characterization of the CBAM, specific design features of the regulation risk to be inconsistent with the National Treatment principle[184]. The first provision under analysis is the inclusion of indirect emissions in the calculation of certificates to be surrendered by importers. The CBAM has been implemented as to cover only direct emissions, similarly to the EU ETS. However, within the text of the regulation, it is outlined the

[178] Regulation (EU) 2023/956, Article 7.
[179] Arwel D. (2022). *The Eu's Proposed Carbon Border Adjustment Mechanism and Compatibility with WTOLaw.* Trade, Law and Development., pp. 118–120.
[180] Even though these default values have been subjected to numerous criticisms, the European Parliament's ENVI Committee has clarified that default values were chosen not to overcharge foreign producers but to avoidthat those values would be 'lower than the likely embedded emissions', which would result in the exporter benefitting from the failure to provide reliable data on actual emissions and from the use of default values. EP ENVI Committee (n 63) Compromise Amendment 6, Annex III, point 4.
[181] The CBAM proposal envisages that, in the absence of reliable data for the exporting country, the default value will be based on the average emission intensity of the 10 percent worst performing EU installations forthat type of good. See Regulation (EU), 2023/956, Annex IV.
[182] Appellate Body Report, *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes*, WT/DS302/AB/R, adopted 19 May 2005.
[183] Van Calster, Prevost. (2013). *Research Handbook on Environment, Health and the WTO*. pp. 491-492. https://www.e-elgar.com/shop/gbp/research-handbook-on-environment-health-and-the-wto-9781782544821.html
[184] Ibid. 31

willingness to require certificates also in light of the indirect emissions embedded in imported goods. Leaving aside the doubts concerning the real capability of the EU to correctly calculate such emissions, the measure would be in clear violation of the principle of National Treatment if the same treatment would not be applied to domestic producers. In fact, to date, indirect emissions are not taken in consideration by the EU ETS, which requires the acquisition of allowances only relatively to direct emissions.

The different nature of CBAM certificates and ETS allowances might also represent a measure inconsistent with the National Treatment principle. As described in the previous chapter, ETS allowances can be traded among European businesses, as to allow industries with a low-carbon impact to make revenues on allowances which would otherwise represent a loss. CBAM certificates, on the other hand, are not tradable, but they can only be partiallyreimbursed if the importers had previously purchased too many certificates[185]. Therefore, eventhough the two instruments are conceptually interchangeable, the aforementioned feature couldprovide an advantage to domestic producers in relation to foreign importers.

In light of the above, it might be argued that the measure does not directly affect the products; however, the profits gained from the sale of allowances could be reinvested in production processes and more advanced technologies, which would have an influence also on the final product. This means that, due to the different concessions envisaged under the two systems, domestic producer might indirectly obtain a more favourable treatment than foreign importers. The EU has justified this differentiation as a measure necessary to equip the CBAM with practical feasibility, as it would be difficult to control the price of CBAM certificates if the possibility to exchange them between CBAM declarants was granted.

However, the attention regarding CBAM compatibility with the National Treatment obligation has been mainly posed on the free allocation of allowances provided for under the EU ETS[186]. It was explained in the previous chapter that the free allocation of emission allowances was the most important tool to tackle carbon leakage under the ETS. Free allowances have been provided to a significant number of carbon intensive domestic businesses, especially in those sectors where the risk of carbon leakage was higher. The CBAM has been developed as the alternative policy instrument to address the issue of carbon leakage.

[185] Regulation (EU), 2023/956, Article 23.
[186] Pirlot, A. (2022). Carbon Border Adjustment Measures: A Straightforward Multi-Purpose Climate Change Instrument? *Journal of Environmental Law*, *34*(1), 25–52. https://doi.org/10.1093/jel/eqab028; Bacchus J. (2021). Legal Issues with the European Carbon Border Adjustment Mechanism. *Cato Briefing paper*, *125*, 3–5.

Nonetheless, the free allocation of allowances under the EU ETS has not ceased alongside the adoption of the CBAM. The EU Commission has envisaged a period of ten years, through which the free allowances would be phased out, while the CBAM certificates would be phased in. While the EU argues that this gradual approach serves to "ensure a prudent and predictable transition for businesses and authorities"[187], it is very likely that it would provide preferential treatment to domestic producers. Indeed, it would create a situation of double protection for EU producers. On one side, they would not incur in costs associated with their emissions under EU ETS; on the other, their direct foreign competitors would be charged a price associated with the emissions embedded in their products[188]. It is evident that this double protection wouldbe in clear contradiction with the National Treatment principle of the GATT.

The EU has declared that, until free allowances under the EU ETS are entirely phased out, CBAM declarants will be requested to surrender a number of certificates proportionate to the free allowances granted to EU producers. However, the methods on how to effectively calculate such amount are far from clear, and it seems probable that it will result in discriminatory treatment for foreign producers.

3.3. CBAM's consistency with Most Favoured Nation under the GATT

The CBAM has been conceived to regulate the relation between foreign and EU domestic products, in light of the carbon emissions associated with their production. It is therefore quite understandable why most of the criticism concerning the CBAM compliance with WTO obligations refer to the National Treatment principle. Nevertheless, specific provisions incorporated in the CBAM have raised concerns about the regulation alignment with the Most Favoured Nation (MFN) principle, contained in Article I of the GATT. The MFN, as explained above, requires WTO members to grant the same advantages "immediately and unconditionally" to the all the "like" products originating from every contracting party[189]. Applied to the CBAM, it theoretically obliges the EU not to make any distinction between any foreign importer when it requires carbon certificates to transport their products within the EU borders. There are, however, some exceptions encompassed by the text of the CBAM. These

[187] Commission, 'Proposal for a Regulation of the European Parliament and of the Council Establishing Carbon Border Adjustment Mechanism (EU CBAM proposal)' COM (2021) 564 final, Explanatory Memorandum 10–11.
[188] Assous, A., Burns, T., Tsang, B., Vangenechten, D., & Schäpe, B. (2021). *A Storm In A Teacup Impacts And Geopolitical Risks of The European Carbon Border Adjustment Mechanism*. pp. 21–24. https://sandbag.be/wp-content/uploads/E3G-Sandbag-CBAM-Paper.pdf
[189] Article I of the GATT, Annex 1 to the WTO Agreement.

exceptions will be analysed in this section in order to understand if they can be justified under Article I of the GATT.

In light of the declared objectives of the CBAM[190] , the EU commission has envisaged the possibility for importers to deduct from the EU carbon costs the price already paid in the country of origin[191]. At first glance, it seems fair both from an environmental and an economic point of view. Indeed, the foreign producers and importers would be economically disadvantaged if they had to surrender the full amount of CBAM certificates irrespective of the carbon duties already paid in their country of origin, as it would represent a double charge on the same characteristic of the product. At the same time, the absence of such provision would undermine the global environmental objectives of the EU through the CBAM, as countries with well-established carbon regulation would be penalized. However, the EU has included in this crediting mechanism only direct and explicit carbon measures, which impose pecuniary amount on carbon emissions. It lacks to recognize the efforts of those countries which have implemented different regulatory approaches, which rely on indirect carbon pricing, differently from the system established by the EU. Such distinction has been justified by the EU pointing out the methodological obstacles to assess the carbon-price equivalence of these policies. Nevertheless, it is largely shared among scholars and WTO experts that this limited provision will determine a differential treatment to "like" imported products manufactured in different foreign countries[192]. This would entail the recognition of the discriminatory nature of the CBAM crediting system and the consequent inconsistency with the MFN obligation.

Another CBAM provision likely to be in tension with the requirements of the MFN obligation is the exclusion of certain countries from the CBAM scope of application. These countries, namely Lichtenstein, Norway, Iceland and Switzerland[193], have been exempted from the CBAM importing obligations because they are already integrated or linked to the EU ETS system. Therefore, it would be unjust to charge those countries' producers with an importing duty if they are already under the EU ETS system. From an environmental point of view, there is no risk of carbon leakage in these countries because they are subjected to the same regulatory system applied to domestic producers. However, it is still unclear if such exception can be

[190] The EU has specified within the text of the regulation concerning the establishment of the CBAM that among the main objectives are the reduction of carbon leakage and enhancement of restrictive carbon emissions measures.
[191] Ibid 44
[192] See, inter alia, Edward J Balistreri, Daniel T Kaffine, and Hidemichi Yonezawa (2019) 'Optimal Environmental Border Adjustments Under the General Agreement on Tariffs and Trade' Environmental and Resource Economic; and Andrei Marcu, Michael Mehling and Aaron Cosbey (2020), 'Border Carbon Adjustments in the EU: Issues and Options', Roundtable on Climate Change and Sustainable Transition. https://ercst.org/wp-content/uploads/2021/08/20200929-CBAM-Issues-and-Options-Paper-F-2.pdf. (2024, 18 May).
[193] Annex III of the CBAM define the countries which are outside of the scope of the Regulation.

justified under the MFN obligation. Referring to the argument presented above on the inappropriate crediting system constructed by the EU Commission, it might be argued that the products of these exempted countries are receiving a more favourable treatment than other third countries. Indeed, their interconnection with the EU ETS system is recognized and valued by the EU Commission, while implicit carbon restrictive policies of third countries, which might be equivalent in practice to the EU ETS system, are overlooked.

It seems therefore unlikely that the current crediting system predisposed by the European Commission will be considered consistent with the MFN obligation contained in Article I of the GATT.

3.4. Admissibility of the CBAM under Article XX of the GATT

From the analysis of the CBAM's compliance with non-discrimination principles, it can be inferred that certain provisions of the regulation are unlikely to be found consistent with the GATT obligations by a WTO adjudicative body. The EU Commission could, however, claim the justification of the regulation under the General Exceptions contained in Article XX of the GATT. Indeed, as illustrated in the first chapter, even if a measure is inconsistent with the WTO obligations, it can still be maintained if meets the requirements of at least one of the exceptions included in Article XX[194].

Concerning the CBAM, the two exceptions which might be claimed to justify the regulation are exception (b)[195], which states that a measure must be "necessary to protect human, life or plant health", and exception (g)[196], which regards measures "relating to the conservation of exhaustible natural resources". The latter, however, imposes that the contested measures are "made effective in conjunction with restriction on domestic production or production". To be justified under these paragraphs of Article XX, the WTO inconsistent measures must comply with specific requirements which have been determined by the WTO jurisprudence and are now denominated "two-tier tests"[197]. Moreover, irrespectively of the exemption under analysis, the measures must satisfy the conditions delineated in the *chapeau*

[194] See section 3.3, Chapter 1 of this thesis.
[195] Paragraph (b) Article XX of the GATT. [196]
Paragraph (g) Article XX of the GATT.
[197] The most important WTO case concerning this matter is: "*EC – Measures Prohibiting the Importation and Marketing of Seal Products*, WT/DS 401/AB/R (22 May 2014) para 5.167.

of Article XX. The *chapeau* imposes that such measures "are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where thesame conditions prevail" or are designed as "disguised restriction on international trade". In the absence of consistency with these requirements, no measures could be justified under any of the exceptions included in Article XX[198]. In this section, it will be provided an evaluation on the chances of the CBAM to be justified under Article XX of the GATT, determining its consistencywith the afore mentioned requirements.

3.4.1. Qualification under Art. XX (b)

The two-tier test under the Article XX(b) requires that the measure in question has been designed to pursue the "protection of human, animal and plant life" and that it is necessary to fulfil the policy objective[199]. Therefore, to be justified under exception (b), the CBAM should be promoted as exclusively designed for environmental protection purposes, without any trade-related goals. The CBAM, indeed, has been explicitly presented as a measure necessary to tackle the detrimental phenomenon of carbon leakage. The latter, in fact, causes an increase in global carbon emissions and determine an enhancement of the catastrophic effects associated with climate change. These effects can be considered as dangerous for the "human animal and plant life and health". Considering the first condition of the test, it can be sustained that the CBAM, tackling carbon leakage, is indeed an environmental measure which aims at preserving the survival of living species on earth. However, as it was explained in the previous chapter, the CBAM also has trade-related objectives, as it aims to level the playing field between domestic and foreign producers to maintain a just degree of competitiveness. It can be argued, nonetheless, that the trade-related objectives are strictly linked with the environmental objectives. Indeed, the CBAM aims to provide the economic incentives to build a global response against the environmental crisis. In light of its multi-purpose character, to be justified under exception (b), the CBAM must be presented before a WTO adjudicative body as a purely environmental measure, detaching the economic rationale from it. Moreover, in accordance with the second condition of the compliance test, the CBAM must be necessary to attain its policy objective. Therefore, it needs to be demonstrated that the CBAM is effective in tackling

[198] In *Us-Shrimp,* the Appellate Body established that the correct approach would be to first verify the adequacy of applying an Article XX GATT exception, and then moving to the chapeau and analysing it with respect to the exception to which it relates.
[199] The conditions have been set by Panel Report, United States — Standards for Reformulated and Conventional Gasoline, WT/DS2/R, adopted 20 May 1996, paras., para. 6.20.

carbon leakage. To date, it is still impossible to determine the efficacy of the CBAM in addressing its objectives. The WTO Appellate Body, however, has stated that measures concerning climate change must be given the right amount of time to evaluate their validity[200]. Due to its current transitional phase, it is still early to determine if the CBAM will be compliant with the conditions imposed to be justified under exception (b). The most prominentissue lies in the trade-related aspect inevitably influenced by the CBAM. However, if themeasure will result as essential to reduce the phenomenon of carbon leakage and, therefore,described as an effective environmental measure, the CBAM might have good chances to be legitimized under Article XX(b).

3.4.2. Qualification under Article XX(g)

The CBAM could be justified under Article XX (g) of the GATT, which states that trade restrictive measure can still be valid if they are concerned with the conservation of exhaustible natural resources. As it was outlined for Article XX(b), this exception requires the compliance with specific conditions, established through WTO jurisprudence[201]. The first is the protection of exhaustible natural resources. In light of the current interpretation given by the WTO adjudicative bodies, the CBAM can be considered as a measure aimed at preserving exhaustible natural resources. Indeed, in the attempt to reduce the impact of climate change, the CBAM is trying to protect the right of living species to breath clean air, benefit from drinkable water and, more in general, safeguard those natural resources indispensable for the survival on earth[202]. The most important condition, however, relates to the obligation to apply the measure in conjunction with "restriction on domestic production". This implies that the CBAM must be considered as comparable to the effects of the EU ETS. The EU Commission has developed its regulation also in view of the possibility to claim justification under Article XX(g), therefore it has clearly stated the interconnection between the European internal carbon system and the CBAM. There are, however, certain provisions which could endanger the possibility for the

[200] Appellate Body Report, Brazil — Measures Affecting Imports of Retreaded Tyres, WT/DS332/AB/R, adopted 17 Dec. 2007, para. 15.
[201] In *US-Shrimp*, the Appellate Body established the conditions for a measure to be justifies under this provision. [202] In US-Gasoline, the panel agreed with the United States' assertion that clean air was an exhaustible natural resource 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 Article XX(g). See Panel Report, United States — Standards for Reformulated and Conventional Gasoline, WT/DS2/R, adopted 20 May 1996, para. 6.37.

regulation to be justified under this exemption. Among them, the most critical is the concession of free trade allowances to domestic producers. Indeed, providing free allowances to carbon-intensive European businesses would undermine the EU commitment to domestically restrict carbon emission while imposing a similar measure on third country producers. Moreover, if the EU will not be able to effectively phase in CBAM certificates while concurrently phaseoutETS allowances, it could be argued that the measure does not relate to the protection of exhaustible natural resources because it furnishes incentives to domestic producers to maintain carbon-intensive line of production. In fact, European businesses would have a competitive advantage over foreign businesses if it could maintain polluting manufacturing and avoiding the consequent charges. Nevertheless, if the EU representatives could demonstrate, before a WTO adjudicative body, that the measure is an extension of the domestic EU ETS and that it is designed to restrict both internal and external production to preserve the conservation of exhaustible natural resources, the CBAM can be justified under Article XX (g).

3.4.3 Qualification under the Chapeau of article XX

In addition to the compliance with the specific tests under each different general exception, the CBAM, to be justified under Article XX, must align with the requirements outlined in the *chapeau* of that concerned. The first requisite under the *Chapeau* regards the prohibition to unjustifiably discriminate between countries where "the same condition prevails". This means that the CBAM should provide for design differentiation between countries where the same conditions are not in place. For example, the provision which exempts the exports from countries included in Annex III from the scope of the CBAM meet the requirements of the chapeau. Indeed, as those countries are already integrated in the EU ETS, they can be considered differently from all the other countries concerned, therefore discrimination is justified. In assessing the compliance with the chapeau, it must always be considered the objective of the regulation. In relation to the climate objective of the CBAM, discrimination between countries possessing a carbon restrictive regulation and those which lack such measures is justifiable because it aims at inducing third countries to implement such policies in their domestic legal framework. At the same time, the crediting system for third countries domestic carbon charges designed by the EU might be in contradiction with the chapeau prerequisite. Indeed, it might lack to recognize implicit carbon policies, equivalent in value to explicit pecuniary carbon measures.

While, in theory, those nations should be considered as "countries where the same conditions prevail", the EU does not recognize them as such, and impose a discriminatory measure in favour of those countries which apply explicit domestic carbon charges.

On the other hand, the European Commission has not included within the CBAM any measure to provide aid to developing and least developed countries. This decision was justified by stating that exemptive provisions for those nations would have endangered the global objective of the CBAM and would have undermined the incentives for those nations to reduce their carbon emissions. However, under WTO law, those countries should be accorded "special ad differential treatment", thus assuring more time to implement the trade obligations and supply more efficient technologies to enhance their possibilities to comply with the regulation. Therefore, the inclusion of ad-hoc provisions aimed at assisting third world countries would have been in accordance with the chapeau considering the different conditions existingin those countries. At the same time, it would have enhanced the CBAM's effectiveness regarding the reduction of carbon leakage. From a general perspective, the CBAM would be compliant with the first prerequisite of chapeau, because it does not evidently discriminate between countries. However, the crediting system and explicit assistance provisions for least developed countries could be interpreted should be improved within the text of the CBAM toenhance the possibilities of justification and pursue the environmental objective.

The second prerequisite for a trade restrictive measure to be compliant with the chapeau of Article XX is the prohibition to create "disguised restriction on international trade". This condition focuses on the objective and design features of the measure in question. Therefore, were the CBAM found to be constructed as a purely trade restrictive measure lacking any environmental benefit, it would be inconsistent with the Chapeau. The CBAM must be designed to address the stated legislative objective of reducing carbon leakage, and not as a protectionist measure to safeguard domestic producers from foreign competition. The Appellate Body has set standards for a measure to avoid being considered a disguisedrestriction to trade. Firstly, the measure must be publicly announced and explained in detail. The EU Commission has been very precise in communicating its intent and, after the adoptionof the measure, has predisposed numerous meetings to clarify any doubts to foreign importersand authorities. Secondly, the measure should be advanced through multilateral agreements developed through the WTO forum. The CBAM, on the contrary, is a unilateral agreement exclusively designed by the EU institutions. Even though the European Commission has expressed its willingness to engage in multilateral cooperation (as highlighted in the text of the

regulation)[203], it is yet to start any discussion on the CBAM with foreign countries. However, due to the importance of the objective pursued, the EU might argue that unilateral measures represent the sole solution to impose such measures effectively. Therefore, the need to unliterally implement the CBAM would be directly connected with the aim of the regulation.

The free ETS allowances provided to domestic producers could, however, endanger the possibility of the CBAM to respect the prerequisites of the Chapeau. Indeed, if the free allowances were to be maintained or not correctly phased out, the CBAM would provide double protection to domestic producers without incentivizing them to reduce carbon emissions. Hence, the CBAM would not address the issue of carbon leakage, but it would unjustifiably discriminate against foreign products. This situation would certainly be considered as "disguise restriction of international trade", and the CBAM would consequently be declared inconsistent with the GATT, as a discriminatory protective measure.

Nevertheless, it can be inferred that the CBAM is likely to be justified under Article XX of the GATT. Indeed, the measure has scarce possibilities to be found consistent with the non-discrimination principles contained in article I and III of the GATT. However, due to its stated environmental objective and its general design, the CBAM could be justified under the General Exceptions mentioned above. It is, however, foreseeable that the WTO adjudicative body would ask the European Commission to revise certain provisions of the CBAM, in order to render the CBAM less restrictive on global trade flows while maintaining its effectiveness.

4. Conclusion

Border Carbon Adjustments (BCAs) have been under the careful attention of policy makers in the last decades. The potential within these measures lies in their capacity to tackle the environmental crisis while enhancing competitiveness between countries. Their influence on international market dynamics, however, has pushed scholars and expert to assess the real capacity of these measures to be beneficial in the fight against climate change in relation to the restrictive effects that they might have on international trade. The decision by the European Commission to be the first to officially adopt a BCA, under the name of Carbon Border Adjustment Mechanism (CBAM), has increased the discussions on the implementation of this kind of measures. In this chapter, the primary focus has been provided to the characterization

[203] Regulation EU, 2023/956, Premise 72.

and compatibility of the CBAM with the WTO multilateral trade agreement concerning goods, namely the GATT.

The WTO legal framework lacks specific provisions on the regulation of BCAs, mainly because of the only recent development of such policy instruments. However, the EU has declared its endeavour to design the CBAM as fully compatible with WTO law, in line with the EU's role within the organization. On the other hand, numerous trading partners have expressed concerns on the effects of the regulation on trades, highlighting the hidden protectionist aim of the EU. Such assertions are very likely to be followed by legal proceedings before WTO adjudicative bodies, which would be called to express their judgement on the CBAM's consistency with WTO rules. Such legal opinions would also create precedents within the WTO legal framework, providing specific answers on BCAs.

In light of the high probability that the CBAM will challenge before a WTO Dispute Settlement Body, this chapter has attempted to provide an assessment on the CBAM's design features which might represent a breach of WTO rules. The analysis has pointed out the uncertainty regarding the legal definition of the CBAM under WTO standards. Depending on the legal characterization attributed to the regulation, namely border or internal measure, the CBAM would be covered by different articles of the GATT, each with its specific provisions. Nevertheless, it has been argued that the CBAM would most likely be in contradiction with the non-discrimination principles of National Treatment and Most Favoured Nation, which would make the measure inconsistent with WTO law.

The analysis has been concluded evaluating the CBAM under Article XX, which contain General Exception for trade-restrictive measures. Such evaluation has underlined the probable justification of the CBAM under specific general exceptions associated with health and environmental protection.

A future legal opinion provided by the WTO Dispute Settlement mechanism will verify the accuracy of the arguments presented in this analysis.

Conclusions

It is undisputable that the EU, adopting the CBAM, has has revived the debate on the compatibility between effective environmental measures and global productive and trade dynamics. On one hand, the EU has presented its innovative measure as a decisive step towards the fight against global warming and the achievement of its international environmental commitments. The focus has been posed primarily on the causes and effects of carbon leakage, the global reduction of carbon emissions and the necessity to find common grounds to impede environmental degradation.

On the other hand, EU's trading partners have raised numerous concerns on the CBAM, claiming that the EU has implemented a protectionist unilateral measure, disguising its economic purposes behind "green" objectives. These countries argue that the CBAM is in contradiction with the obligations included in the WTO multilateral trade agreements, and for this reason, it should be annulled by a WTO adjudicative body.

The present analysis sought to understand the consistency of the CBAM, based on its design features and trade implications, with WTO standards.

The overview of the WTO and its annexed agreements has served to contextualize the legal framework under analysis and to illustrate the fundamental principles upon which international trade has been established for decades. The same globalized trade dynamics which have been identified as one of the major polluters in terms of carbon emissions. It is fair to say that the WTO, due to its current crisis, has not been able to function as an international forum to revise the multilateral agreements to include appropriate provisions to tackle carbon emissions associated with trades. Moreover, as the Appellate Body of the WTO is in deadlock, the competent adjudicative body of the organization has not provided any interpretation under WTO law of unilateral measures aimed at reducing carbon emissions.

Despite the evident lack of effectiveness of the contemporary WTO, the EU has attempted to design its regulation as to be in line with the principles of the international organization. The application outside of EU borders and the mechanism of operation of the CBAM renders essential the cooperation with third country authorities. If the CBAM were to be considered as unjust and trade restrictive, foreign countries would not be willing to provide the EU institutions with the necessary information to effectively apply the carbon measure. Moreover, they could apply retaliatory provisions at the detriment of the EU, which not only

would undermine the leading role of the EU in the fight against global warming, but it would also economically penalize European businesses. Consistency with international obligation is the key to legitimize such unilateral measure and demonstrate the primacy of the environmental objectives over claimed economic benefits.

Nevertheless, through the analysis conducted in the last part of this thesis, it was showed that the CBAM will be most likely found to be inconsistent with the fundamental WTO principles of non-discrimination. However, it can be justified under the General Exceptions as a strictly environmental measure necessary for the protection of huma lives and the conservation of natural resources.

It is true that the CBAM would not be entirely legitimized under these exceptions, but it would only be justified, which might still not be enough for certain third countries to provide fair assistance to the EU. However, such opinion would possess a fundamental value, producing a precedent on Border Carbon Adjustment measures and their relationship with the WTO. Indeed, while many EU's trading partners, in particular developing countries, have been condemning the regulation since its inception, there are countries, such as the UK or the USA, which are evaluating the possibility to introduce similar provisions. However, since the CBAM is still in its transitional phase, it is still uncertain whether the measure adopted by the EU will be environmental effective and aligned with the obligations of WTO multilateral trade agreements. In the case the CBAM would result as an efficient and legitimized mechanism, third countries would be willing to adopt similar measures, and the EU would have achieved its objective of involving third countries in the global reduction of carbon emissions.

The long-term aspiration of the EU would be to complement, and progressively substitute, the CBAM with a so-called "Climate Club", creating a coalition of countries with high environmental standards and restrictive policies on carbon leakage. Such solution would reduce the need for complex carbon adjustments and would represent a significate step towards a common solution for the reduction of carbon emissions.

The CBAM, therefore, must be recognized by third countries as an environmental measure lacking any protectionist aim. The following years will be decisive to understand if the CBAM, and Border Adjustment Measures in general, could represent a valuable policy tool to address the most critical crisis for humanity in the current world.

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