

Part 1 – Border Carbon Adjustments and the WTO



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Famously, the legal philosopher HLA Hart described the system of international law as ‘primitive’,^[1] given its distinct lack of secondary rules: the rules which dictate how primary rules (those imposing obligations) are identified, changed and adjudicated upon.^[2]

This state of affairs renders the effect of primary rules obscure, leaving room for derogation from the obligations they impose.

This theory appears to have turned to practical reality in the current state of WTO (World Trade Organisation) law. Founded in 1995, pursuant to the 1994 [Marrakesh Agreement](#), the WTO [intends to facilitate trade in goods and services](#) by aiming to reduce, or eliminate, trade restrictions, such as tariffs or quotas. However, in the global competition to transition to sustainable energy in the wake of the climate crisis, states have increasingly adopted protectionist, industrial measures to ensure that their domestic production is shielded from counter-vailing market forces. Such policies run expressly contrary to the free-trade principles central to the WTO’s establishment in 1995.

No better example exists than the [US Inflation Reduction Act](#) of August 2022, which introduces heavy subsidies for companies wishing to build products such as cars and batteries in the US, generally known as ‘Local Content Requirements’ (LCRs). These LCRs have been [explicitly criticised by other states as breaching the WTO](#).

However, the US is not the only country to have adopted such measures. The EU has [recently adopted a Carbon Border Adjustment Mechanism \(CBAM\)](#) to complement its pre-existing Emissions Trading Scheme (ETS) for domestic companies. The transition period for CBAM began on 1 October 2023 and has caused significant controversy amongst the WTO’s signatories regarding the schemes’ compliance.

This is the first in a series of posts that will address the legal questions regarding the CBAM’s compliance with WTO law. This post sets out, broadly, the relevant WTO law and its relationship with Border Carbon Adjustments (BCAs), the category of taxation in which the CBAM sits. The second will address the EU ETS

and CBAM, specific aspects of the CBAM which have drawn criticism and the potential for disputes arising at the WTO panel.

BCAs

The term BCA generally refers to the range of trade measures designed to equalise the costs incurred by domestic industries as a result of national carbon pricing policies with the costs incurred by producers in countries with less stringent or non-existent climate policies.^[3]

Three broad purposes can be drawn from the introduction of BCAs.^[4]

The first is the preservation of the competitiveness of domestic industries. National firms will necessarily incur increased costs as a result of domestic carbon reduction measures, thereby driving up the price of their goods. International actors not subject to the same regulation will therefore be able to access a great market share. BCAs equalize this imbalance by placing an equivalent cost on international firms seeking to operate in the domestic market.

The second purpose is the prevention of carbon leakage. Carbon leakage refers to an increase in emissions outside a region as a direct result of an emissions reduction scheme within the region.^[5] This can occur for two reasons:

- a. The increased market share gained by international firms subject to weaker or no carbon reduction regime as a result of domestic measures.
- b. The offshoring of domestic companies to countries abroad with less stringent emissions reduction regimes.

BCAs prevent carbon leakage by leveraging the same cost on imported goods as domestic industries. Therefore, firms seeking to avoid the emission reduction requirements by producing goods offshore and then importing them into the market will still be caught under the same regulatory umbrella. The third purpose is leverage. By eliminating the advantage gained from not possessing an equivalent emission reduction program, BCAs may induce foreign countries seeking to import goods to adopt more rigorous climate policies.

General Agreement on Tariffs and Trade (GATT)

One of the core principles of WTO law is that of non-discrimination. This is embodied in the [1994 General Agreement on Tariffs and Trade](#), specifically two of the key Articles. Article I addresses “general most favoured nation treatment” and Article III covers “national treatment on internal taxation and regulation.”

Article I:1 states:

“any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.”

Article II:1 specifically addresses the possibility of BCAs. It bans custom duties and “all other duties or charges of any kind” imposed on imported goods. However, Article II:2(a) contains an exception: nothing in Article II can stop the contracting party from imposing “a charge equivalent to an internal tax” consistent with Article III:2, where the charge applies to a “*like domestic product* or in respect of an article from which the imported product has been manufactured or produced in whole or in part.”

Article II therefore regulates internal taxation levied on both imported products and “like” domestic

products. In theory, a BCA applied in conjunction with an ETS would fit this description, being designed to equalise the taxation levied on the carbon produced in the formation of domestic products with that produced by imported equivalents.

However, the charge must be consistent with Article III:2. Article III:2 provides that an import “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.”

The key proviso here is “in excess.” Article III:2 is therefore aimed at preventing discrimination against imported products in comparison to like domestic products. This does not require that the two systems be identical: in *Argentina – Hides and Leather*, the WTO Panel found that the question is to what extent the two taxes differ in their design, structure and application.^[6]

Further, in order to achieve non-discrimination, there must be an assessment of what constitutes “like products” (as detailed in Articles II and III).

Following GATT/WTO jurisprudence in *EC–Asbestos*, the following criteria may be taken into account when determining ‘like’ products, on a case-by-case basis :

- a. The products’ properties, nature and quality, i.e. the physical features of the products;
- b. The products’ end uses in a given market, i.e. the extent to which they are capable of serving the same or similar end-uses;
- c. Consumers tastes and habits, i.e. the extent to which consumers perceive and treat the products as alternative means of performing the same functions in order to satisfy a particular want or demand; and
- d. The international classification of the products for tariff purposes.

Any determination of ‘like’ products should ideally take into account all the criteria on a case by case basis, even if they provide ‘conflicting indications.’^[8] However, the criteria should not be considered exhaustive.^[9]

Therefore, a BCA would need to account for the above considerations in its application. Importantly, if products are not considered alike, then they are subject to the general ban on import taxation in Article II. Further, if there is any differentiation in the application of the BCA to goods originating from certain countries, this would be in breach of the “most favoured nation principle” in Article I.

The Article XX exception

Even if the BCA were found to be in breach of the most favoured nation and national treatment principles in Articles I and III, it may still fall under the exceptions detailed in Article XX GATT.

Article XX states:

“Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:”

...

(b) necessary to protect human, animal or plant life or health;

...

(g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;

...

Article XX(b) raises an interesting question, given the recent surge in litigation related to climate change impacts on health, such as the judgment in [KlimaSeniorinnen v Switzerland](#) recently handed down by the European Court of Human Rights. However, exception (g) is arguably more relevant and imposes a lower threshold, only requiring that the measure be “related” to conservation, rather than “necessary” to protect health as in (b).

As highlighted in the underlined text above, the BCA would also need to meet the requirements of the introductory chapeau to Article XX; namely that the measure does not constitute arbitrary or unjustifiable discrimination, nor a disguised restriction on international trade. The second proviso raises important questions regarding the fundamental purpose of the BCA (discussed above). Specifically, if the measure is in fact largely designed to protect the competitiveness of domestic industries, then it may arguably be a restriction on international trade.

Conclusion

There are therefore many hurdles (including those not addressed in this post) that a BCA must meet to be compliant with WTO law. This is why the EU’s sui generis CBAM has generated so much controversy. Importantly, this blog addresses BCAs in their barest form; there are many issues that arise specifically in the case of the EU’s CBAM, perhaps most fundamentally whether the adjoining EU Emissions Trading System (ETS) constitutes a charge or tax at all and the question of export rebates. Such questions will be addressed in the next blog.

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[1] HLA Hart, “The Concept of Law” (1994, 2nd Edn) 214

[2] Ibid, 94

[3] Sarah Davidson Ladly, “Border carbon adjustments, WTO-law and the principle of common but differentiated responsibilities,” Int Environ Agreements (2012) 12, 64

[4] ibid 66-7

[5] ibid

[6] Report of the Panel, Argentina – Measures Affecting the Export of Bovine Hides and the Import of Finished Leather, para 11.150, WT/DS155/R (Dec 19, 2000)

[7] Appellate Body Report, European Communities—Measures Affecting Asbestos and Asbestos-Containing Products, para. 101, WT/DS135/AB/R (Apr 5, 2001)

[8] ibid paras 109, 120

[9] ibid para 102