

# EXPORTING THE EUROPEAN GREEN DEAL: THE WTO COMPATIBILITY OF THE EU'S CARBON BORDER ADJUSTMENT MECHANISM

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## ABSTRACT

*While environmental protectionism and trade law are often thought to be in conflict, the EU's proposal for a climate border adjustment mechanism (CBAM) reflects a growing interest in using trade measures to combat climate change. Carbon border taxes, like CBAM, seek to address the issue of carbon leakage, which occurs when producers move to a third country with more lax emissions standards. With a planned rollout date of October 2023, CBAM would apply only to an initial five sectors and become a component of the Emissions Trading System (ETS), EU's domestic cap-and-trade scheme, which already sets a domestic price for carbon emissions. Producers would be able to deduct the cost of any carbon tax paid in the country of origin.*

*If implemented, CBAM would be the first measure of its kind, offering a novel opportunity to assess compatibility with WTO law and international environmental law. Concerns have been raised that the mechanism could violate World Trade Organization (WTO) law, specifically Articles I, III, and XX of the General Agreement on Tariffs and Trade of 1994 (GATT). In designing a mechanism that is WTO compliant, the EU must strike a balance and ensure that it is not in violation of environmental law obligations, such as the principle of common but differentiated responsibilities (CBDR).*

*While the EU can make changes to the proposal to ensure better compliance, it is the WTO that has meaningful authority to better align its policies with environmental obligations. As the developments at the 2021 United Nations Climate Change Conference (COP26) have shown, there is growing consensus on the need for global carbon markets. The future of trade and climate is inherently intertwined, and the WTO objective of sustainable development cannot be achieved without evolving to meet the current threat of climate change.*

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I. INTRODUCTION

As part of the European Green Deal, the European Commission has put forth a proposal for a carbon border adjustment mechanism (CBAM).<sup>1</sup> With a proposed rollout date of October 2023, CBAM seeks to prevent carbon leakage, which occurs when producers, due to stricter climate policies in their home country, emit in a third country by imposing a border adjustment on products in certain sectors based on their carbon emissions.<sup>2</sup> A challenge for the European Union (EU) is to design a mechanism that is compliant with World Trade Organization (WTO) law and in line with international environmental law obligations. Environmental protection and trade law are often

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1. This note was written in the fall of 2021 before the CBAM regulation was adopted. See *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, at 1, COM (2021) 564 final (July 14, 2021).

2. See *id.* at 2.

found to be in tension,<sup>3</sup> and while the EU can make small changes to ensure a better balance of its obligations, it is the WTO that should reconsider its relationship to environmental law in an effort to achieve its goal of promoting sustainable development.

This Note analyzes the compatibility of the EU's CBAM proposal with international trade and environmental law. Part II briefly summarizes various forms of carbon pricing mechanisms. Part III outlines the components of the EU's CBAM proposal. Part IV identifies possible compatibility issues that the proposal has with WTO law, specifically Articles I, III, and XX of the GATT. Part V examines CBAM's compatibility with the EU's relevant commitments under international environmental law. Part VI highlights possible changes that the EU could make to its proposal to better comply with both WTO law and international environmental obligations. Part VII discusses steps that the WTO can take to reduce conflict between WTO laws and environmental obligations that affects the general feasibility of carbon border taxes. Finally, Part VIII offers a brief conclusion on the necessity of designing WTO policies that are responsive to climate concerns.

## II. CARBON PRICING MECHANISMS

Carbon pricing, whether through a carbon tax or a cap-and-trade scheme, is increasingly recognized as an effective mechanism to incentivize carbon abatement.<sup>4</sup> Over 40 countries, including Canada, China, and South Africa, as well as various sub-national governments, have implemented a carbon pricing mechanism.<sup>5</sup> While there is a growing interest in domestic carbon pricing, carbon border taxes have proven to be more controversial, and though they have been discussed, no country has yet to implement one.<sup>6</sup>

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3. See generally Thomas J. Schoenbaum, *Free International Trade and Protection of the Environment: Irreconcilable Conflict?*, 86 AM. J. INT'L L. 700 (1992); John H. Jackson, *World Trade Rules and Environmental Policies: Congruence or Conflict*, 49 WASH. & LEE L. REV. 1227 (1992); David M. Driesen, *What is Free Trade—The Real Issue Lurking Behind the Trade and Environment Debate*, 41 VA. J. INT'L L. 279 (2001); Robin Eckersley, *The Big Chill: The WTO and Multilateral Environmental Agreements*, 4 GLO. ENV'T POL. 24 (2004); Mark Wu & James Salzman, *The Next Generation of Trade and Environment Conflicts: The Rise of Green Industrial Policy*, 108 NW. U. L. REV. 401 (2014).

4. See generally James K. Boyce, *Carbon Pricing: Effectiveness and Equity*, 150 ECOLOGICAL ECON. 52 (2018); Klaus Gugler et al., *Effectiveness of Climate Policies: Carbon Pricing vs. Subsidizing Renewables*, 106 J. ENV'T ECON. & MGMT. 102405 (2021); OECD, *EFFECTIVE CARBON RATES: PRICING CO<sub>2</sub> THROUGH TAXES AND EMISSIONS TRADING SYSTEMS* (2016).

5. See *Carbon Tax Basics*, CTR. FOR CLIMATE & ENERGY SOL. (Nov. 18, 2021), <https://www.c2es.org/content/carbon-tax-basics/>.

6. See Brad Plumer, *Europe is Proposing a Carbon Border Tax. What Is It and How Will It Work?*, N.Y. TIMES (July 14, 2021), <https://www.nytimes.com/2021/07/14/climate/carbon-border-tax.html>.

A. *Carbon Tax*

Carbon taxes are a way to reduce the rate of pollution by putting a specific price on carbon emissions and levying that tax on emitters.<sup>7</sup> It is a Pigovian tax, meaning that it taxes a negative market externality<sup>8</sup>—carbon emissions from the production process—thus making it less appealing to emit. Presumably, producers would then look for ways to reduce their emissions, such as utilizing cleaner technology, to reduce the amount they must pay under the tax.<sup>9</sup> While a carbon tax provides greater certainty about the set cost of emissions, there is less certainty about the resulting reduction in emissions.<sup>10</sup> Thus far, countries have set varying carbon tax rates from \$5 per tonne in Colombia to \$7 per tonne in South Africa.<sup>11</sup>

B. *Cap and Trade*

An alternative carbon pricing mechanism is a cap-and-trade scheme, also known in the EU as an emissions trading system (ETS).<sup>12</sup> An ETS establishes a cap on the total amount of emissions within a region and the government then issues allowances to account for that number of emissions.<sup>13</sup> Emitters must purchase the analogous allowances to account for their emissions.<sup>14</sup> Some percentage of allowances are often given for free and the rest are auctioned off.<sup>15</sup> Producers are allowed to buy, sell, and trade their allowances with other producers, thus creating a market with a fluctuating market price.<sup>16</sup> Typically, the cap, which is the total number of emissions allowed, is reduced over time, providing further incentive for producers to cut emissions.<sup>17</sup>

7. See *What You Need to Know About a Federal Carbon Tax in the United States*, COLUM. CTR. ON GLOB. ENERGY POL'Y (NOV. 8, 2021), <https://www.energypolicy.columbia.edu/what-you-need-know-about-federal-carbon-tax-united-states>.

8. See Ross Astoria, *Design of an International Trade Law Compliant Carbon Border Tax Adjustment*, 6 ARIZ. J. ENV'T L. & POL'Y 491, 493 (2015).

9. See *Carbon Tax Basics*, *supra* note 5.

10. See *Carbon Tax Basics*, *supra* note 5.

11. See *Carbon Pricing Dashboard*, WBG (NOV. 8, 2021), [https://carbonpricingdashboard.worldbank.org/map\\_data](https://carbonpricingdashboard.worldbank.org/map_data).

12. See *Pricing Carbon*, WBG (NOV. 8, 2021), <https://www.worldbank.org/en/programs/pricing-carbon>.

13. See *Cap and Trade Basics*, CTR. FOR CLIMATE & ENERGY SOL. (NOV. 8, 2021), <https://www.c2es.org/content/cap-and-trade-basics/>.

14. See *id.*

15. See *id.*

16. See *Pricing Carbon*, *supra* note 12.

17. See *How Cap and Trade Works*, ENV'T DEF. FUND (NOV. 8, 2021), <https://www.edf.org/climate/how-cap-and-trade-works>.

The EU implemented an ETS in 2005.<sup>18</sup> It was the first of its kind and remains the largest.<sup>19</sup> The EU ETS is now in phase four of implementation. The cap on total emissions and the number of free allowances continue to decrease each year.<sup>20</sup> In its current phase, about 43% of allowances are still provided for free.<sup>21</sup> The EU has estimated that between 2005 and 2019, installations covered by the ETS reduced emissions by 35%.<sup>22</sup> However, price volatility continues to be an issue. The cost of one tonne of carbon has almost doubled from €33 at the beginning of 2021 to a high of €88 in December 2021.<sup>23</sup>

### C. Border Tax

Carbon taxes and emission trading schemes are domestic tools that pose a significant risk of carbon leakage, a situation in which, given unequal climate commitments, domestic producers simply move production to a third country that has no carbon tax.<sup>24</sup> Thus, the country with the carbon pricing mechanism has simply transferred carbon emissions as opposed to reducing them.

A carbon border tax is a mechanism intended to address the issue of carbon leakage.<sup>25</sup> It can take the form of an import tax, requiring a comparable amount to be paid for the emissions in imported products, or an export rebate so that domestic producers, who are required to pay a carbon tax, are not disadvantaged in other markets.<sup>26</sup> No carbon border taxes have been implemented thus far,<sup>27</sup> so the EU's newly

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18. See Council Directive 2003/87, 2003 O.J. (L 275), 32 (EC).

19. See *EU Emissions Trading System*, EUR. COMM'N (Nov. 8, 2021), [https://ec.europa.eu/clima/eu-action/eu-emissions-trading-system-eu-ets\\_en](https://ec.europa.eu/clima/eu-action/eu-emissions-trading-system-eu-ets_en).

20. See *Emissions Cap and Allowances*, EUR. COMM'N (Nov. 8, 2021), [https://ec.europa.eu/clima/eu-action/eu-emissions-trading-system-eu-ets/emissions-cap-and-allowances\\_en](https://ec.europa.eu/clima/eu-action/eu-emissions-trading-system-eu-ets/emissions-cap-and-allowances_en).

21. See *id.*

22. See *EU Emissions Trading System*, *supra* note 19.

23. See *Daily Carbon Prices*, EMBER (Dec. 27, 2021), <https://ember-climate.org/data/carbon-price-viewer/>.

24. See *Carbon Leakage*, EUR. COMM'N (Nov. 8, 2021), [https://ec.europa.eu/clima/eu-action/eu-emissions-trading-system-eu-ets/free-allocation/carbon-leakage\\_en](https://ec.europa.eu/clima/eu-action/eu-emissions-trading-system-eu-ets/free-allocation/carbon-leakage_en).

25. See *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, at 17, COM (2021) 564 final (July 14, 2021) ("the objective of the CBAM is to prevent the risk of carbon leakage").

26. See Susanne Droge & Carolyn Fischer, *Pricing Carbon at the Border: Key Questions for the EU*, 18 IFO DICE REP. 30, 30 (2018).

27. See Kate Abnett & Susanna Twidale, *EU Proposes World's First Carbon Border Tax for Some Imports*, REUTERS (July 14, 2021, 10:09 EDT), <https://www.reuters.com/business/sustainable-business/eu-proposes-worlds-first-carbon-border-tax-some-imports-2021-07-14/>.

announced carbon border adjustment mechanism proposal offers a novel chance to examine the potential legal issues.

### III. CARBON BORDER ADJUSTMENT MECHANISM

On July 14, 2021, the European Commission (EC) released its proposal for a CBAM as part of its “Fit for 55 Package,” which seeks to meet the EU target for 2030 of reducing greenhouse gas emissions by 55% compared to the levels in 1990.<sup>28</sup> The proposal was referred to the European Parliament Committee on the Environment, Public Health, and Food Safety in September 2021.<sup>29</sup> The European Council and European Parliament adopted the CBAM proposal on May 10, 2023 and it entered into force on May 17, 2023.<sup>30</sup> The mechanism is expected to enter a transitional phase on October 1, 2023.<sup>31</sup>

CBAM is tied to the EU’s existing ETS. EU importers will buy certificates that are equivalent to the allowances that would have been purchased if the imported good had been produced within the EU.<sup>32</sup> While the price of CBAM certificates is calculated by the average weekly value of the ETS,<sup>33</sup> CBAM does not establish any cap on imports.<sup>34</sup> Further, if the non-EU producer can show that they have already paid a carbon tax in their country of origin, they can request for the border adjustment to be deducted so that they are not double taxed for the same emissions.<sup>35</sup> The mechanism does require production facilities to calculate the amount of carbon produced in each product, but producers can provide an alternative default value, based

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28. See *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, at 1, COM (2021) 564 final (July 14, 2021).

29. This note was written in the fall of 2021 and does not reflect any changes made to the proposed legislation since then. See *Legislative Train Schedule: A European Green Deal*, EUR. PARLIAMENT, <https://www.europarl.europa.eu/legislative-train/theme-a-european-green-deal/file-carbon-border-adjustment-mechanism>.

30. See *Regulation (EU) 2023/956 of the European Parliament and of the Council of 10 May 2023 establishing a carbon border adjustment mechanism*, OJ L 130 (May 16, 2023).

31. See *id.*

32. See *Carbon Border Adjustment Mechanism: Questions and Answers*, EUR. COMM’N (July 14, 2021), [https://ec.europa.eu/commission/presscorner/detail/en/qanda\\_21\\_3661](https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_3661).

33. See *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, at 37, COM (2021) 564 final (July 14, 2021).

34. See *id.* at 18.

35. See *id.* at 32.

on a European production site, if they are unable to calculate the value themselves.<sup>36</sup>

The mechanism is intended to go into effect with a transition period from 2023 to 2025<sup>37</sup> and initially will apply to only five limited sectors: cement, iron and steel, aluminum, fertilizers, and electricity.<sup>38</sup> After the initial period, CBAM could be expanded to other sectors and to indirect emissions,<sup>39</sup> which would account for emissions consumed through the production of electricity, heating, and cooling.<sup>40</sup> Revenues generated by the mechanism will go into the EU budget, specifically to the NextGeneration EU recovery instrument.<sup>41</sup>

#### IV. WTO COMPATIBILITY

It remains unclear if CBAM, being the first measure of its kind, is compatible with WTO law, yet concerns have already been raised about possible non-compliance with Articles I, III, and XX of the General Agreement on Tariffs and Trade (GATT). The EU has certainly made efforts to ensure congruence with the proposal itself stating that CBAM “has been designed to comply with WTO rules.”<sup>42</sup> The Commission further emphasizes this point by outlining other measures that were considered and then rejected, precisely because they would conflict with WTO law.<sup>43</sup> However, over the years that carbon border taxes have been considered, concerns have been repeatedly raised about their potential to violate the following WTO principles: i) Most Favored Nation, ii) National Treatment, and iii) Article XX exceptions.

##### A. Article I—Most Favored Nation

CBAM threatens to violate Article I of the GATT because it uses domestic carbon taxes to differentiate between countries when applying CBAM to imported products. Article I of the GATT, a governing treaty of the WTO, establishes the most-favored-nation (MFN) status, ensuring that all countries that are parties to the WTO agree to grant

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36. See *Annexes to the Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, at 7, COM (2021) 564 final (July 14, 2021).

37. See *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, at 14, COM (2021) 564 final (July 14, 2021).

38. See *id.* at 20.

39. See *id.* at 18.

40. See *id.* at 29.

41. See *id.* at 11.

42. See *id.* at 3.

43. See *id.* at 8–10.

any advantage given to the product of one party to the like products<sup>44</sup> of all parties.<sup>45</sup> This ensures that there is no substantial discrimination between like products of WTO members, except in necessary circumstances.

There are concerns that CBAM would violate the MFN principle because it seeks to distinguish between countries that are already taking climate action and those that are not.<sup>46</sup> Article 9 of the proposed legislation allows a producer to claim “a reduction in the number of CBAM certificates to be surrendered in order for the carbon price paid in the country of origin for the declare embedded emissions to be taken into account.”<sup>47</sup> Thus, if producers have already paid a comparable carbon tax in their country of origin, CBAM will not apply to the imported goods. This ensures that producers from a third country are not penalized for climate action they have taken domestically, as that would be counterproductive to the legislation’s goal of climate change mitigation.<sup>48</sup>

While rewarding countries which are taking similar mitigation efforts incentivizes cleaner production, this benefit also distinguishes between countries and offers less favorable treatment, in this case the application of CBAM, to those that are not already implementing domestic carbon taxes. Furthermore, this exception is biased towards countries that are taking the same form of climate action—carbon taxing. Other comparative actions to reduce emissions or combat climate change, such as clean air acts or energy efficiency standards, do not negate application

44. In determining whether products are like, WTO case law has looked at i) the physical properties, ii) the extent to which the products can serve the same end-use, iii) whether consumers treat the products as alternatives to perform a particular function, and iv) international classification of the product for tariff purposes. *WTO rules and environmental policies: Key GATT disciplines*, WTO, [https://www.wto.org/english/tratop\\_e/envir\\_e/envt\\_rules\\_gatt\\_e.htm](https://www.wto.org/english/tratop_e/envir_e/envt_rules_gatt_e.htm).

45. GATT Article I: “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.” General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, art. I ¶ 1, 1867 U.N.T.S. 187, 33 I.L.M. 1153 (1994) [hereinafter GATT 1994].

46. See generally Reinhard Quick, *Carbon Border Adjustment: A Dissenting View on its Alleged GATT-Compatibility*, 23 ZEITSCHRIFT FÜR EUROPARECHTLICHE STUDIEN 549, 579 (2020); Kati Kulovesi, *Chapter 16 Climate Change and Trade: At the Intersection of Two International Legal Regimes*, in 21 IUS GENTIUM 149, 436 (Erkki J. Hollo et al., ed., 2013); Joachim Englisch & Tatian Falcao, *EU Border Adjustments and WTO Law, Part One*, 51 ENV’T L. REP. 10857, 10881 (2021).

47. *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, at 32, COM (2021) 564 final (July 14, 2021).

48. See *id.* at 17.

of CBAM.<sup>49</sup> Thus, only countries who are applying a similar domestic carbon tax as the EU will benefit from exemption.

In *EC-Seal Products*, which challenged the European Community's ban on importing seal products for animal welfare reasons (except for products from indigenous communities), the WTO Appellate Body rejected Norway's argument that an "aims and objectives" test should be applied to Article I.<sup>50</sup> The Appellate Body found that any measure that modified "the conditions of competition between like imported products to the detriment of the third-country imported products" was a violation of Article I, regardless of whether or not there was an exclusively "legitimate regulatory distinction" for the measure.<sup>51</sup> Thus, even a "legitimate regulatory distinction," such as differentiating between countries who have similar tax measures to mitigate climate change, is not a valid reason to violate Article I.<sup>52</sup>

Under existing jurisprudence, CBAM seems likely to violate Article I given the distinction it makes between the importation of like production based on domestic taxes. However, even if CBAM violates Article I, it can still be found valid under WTO law if it qualifies for an Article XX exception.

### B. Article III—National Treatment

Under Article III of the GATT, a party cannot impose an internal tax on another party that exceeds the taxes applied to its own domestic products.<sup>53</sup> This ensures that third party products receive the same national treatment as like domestic products. In its proposal, the EU has tried to comply with the national treatment requirement by deliberately tying CBAM to its domestic ETS.<sup>54</sup> Domestic producers in the EU already pay a carbon tax through the ETS and thus the implementation

49. See Stefan Koester et al., *Unworkable Solution: Carbon Border Adjustment Mechanisms and Global Climate Innovation*, INFO. TECH. & INNOVATION FOUND. 12 (Sept. 2021), <https://www2.itif.org/2021-cbam-unworkable-solution.pdf>.

50. Appellate Body Report, *European Communities—Measures Prohibiting the Importation and Marketing of Seal Products*, ¶ 2.50, WTO Doc. WT/DS400/AB/R, WT/DS401/AB/R (adopted June 18, 2014).

51. *Id.* ¶ 5.90.

52. See Englisch & Falcao, *supra* note 44, at 10881.

53. GATT, Article III: "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." GATT 1994, *supra* note 43, art. III.

54. See *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, at 20, COM (2021) 564 final (July 14, 2021).

of CBAM is an attempt to apply that same tax to imported products. Given the complexity of the ETS it is difficult to construct a mechanism that matches exactly. Under CBAM, the price that importers will pay for certificates corresponds to the price of carbon as set by the EU ETS.<sup>55</sup> While the ETS is a fluctuating market centered on daily pricing, the price for CBAM certificates will be based off an average of the closing prices of ETS allowances over the past week.<sup>56</sup> To accurately buy certificates, a third country producer must calculate the amount of carbon emissions that it produces.<sup>57</sup> If the producer is unable to calculate emissions, CBAM provides a default option for calculations.<sup>58</sup>

Despite closely tying CBAM to the ETS, the mechanism could still violate Article III because it differentiates products based on process and production methods (PPM). In defining “like products,” the WTO has historically used four criteria: i) physical properties, ii) the extent to which the products serve the same end use, iii) whether consumers perceive the products as being the same, and iv) international classification used for tariff purposes.<sup>59</sup> In its jurisprudence, the WTO Appellate Body has typically held that differentiation between production methods does not make products distinct if the four criteria are still met.<sup>60</sup> Thus, imposing a greater tax on an imported third party product with a more carbon intensive production process, even though it is otherwise considered a like product to one produced in the EU by a cleaner process, would appear to violate Article III. It would allow the EU to penalize countries that do not have access, or choose not to use, the same clean production methods as the EU, for importers would be taxed by CBAM while the domestic producer would not be taxed under the ETS.<sup>61</sup>

In limited circumstances, the WTO has shown a willingness to allow differing treatment based on PPMs. In *Shrimp-Turtle*, the Appellate Body found that the United States could discriminate between like

55. *See id.* at 38.

56. *See id.*

57. *See id.* at 31.

58. *See id.*

59. *See WTO rules and environmental policies: Key GATT disciplines, supra* note 42.

60. *See* Matthew C. Porterfield, *Border Adjustments for Carbon Taxes, PPMs, and the WTO*, 41 U. PA. J. INT'L L. 1, 29 (2019).

61. This reflects a concern identified in the *Tuna-Dolphin I* report that allowing for an extrajudicial interpretation of Article XX(g), as put forth by the United States, would permit one country to “unilaterally determine the conservation policies” of other countries. Panel Report, *United States-Restrictions on Imports of Tuna*, ¶ 5.32, WTO Doc. WT/DS21/R (adopted Sept. 3, 1991).

shrimp products, based on the mode used to harvest, to ensure conservation of an exhaustible natural resource, sea turtles.<sup>62</sup> However, this analysis was done under Article XX as opposed to Article III and thus required compliance with the Article XX chapeau, which is discussed below.<sup>63</sup>

There is a growing recognition that PPMs could play a role in addressing a variety of important issues including climate change,<sup>64</sup> health,<sup>65</sup> and human rights.<sup>66</sup> The *Shrimp-Turtle* case signaled that the ban on differentiation of like products based on PPMs is not absolute. While it remains to be seen if the WTO would be willing to broaden this reading to include carbon-heavy production methods, countries are moving forward unilaterally with initiatives to do so. For example, the recent Comprehensive Economic Partnership Agreement (CEPA), which entered into force in 2021, between the European Free Trade Association (EFTA) and Indonesia makes a distinction between conventional and sustainable production of palm oil.<sup>67</sup> Importers must show that their palm oil was made using sustainable production methods to benefit from tariff-reductions.<sup>68</sup> This type of sustainable production requirement remains controversial and limited.<sup>69</sup> It is possible that

62. See Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, ¶¶ 141–42, WTO Doc. WT/DS58/AB/R (adopted Oct. 12, 1998) [hereinafter *Shrimp-Turtle Appellate Body Report*].

63. However, the US measure was found to be noncompliant with WTO law because it failed to meet the chapeau of Article XX. See *id.* ¶ 187.

64. See Evdokia Moisé & Ronald Steenblik, *Trade-Related Measures Based on Processes and Production Methods in the Context of Climate-Change Mitigation*, 8–13 (OECD Trade and Environment Working Paper No. 4, 2011).

65. In *European Communities—Measures Affecting Asbestos and Asbestos Containing Products*, the Appellate Body found that the health risks associated with products that contained asbestos fibers could be taken into account when determining likeness. See Appellate Body Report, *European Communities—Measures Affecting Asbestos and Asbestos Containing Products*, ¶ 192, WTO Doc. WT/DS135/AB/R (adopted Mar. 12, 2001).

66. For example, discriminating between like-products when child labor was used in the production of the good. See Gabrielle Marceau, *WTO Dispute Settlement and Human Rights*, 13 EUR. J. INT'L L. 753, 807 (2002).

67. Charlotte Sieber-Gasser, *Is the Future of Preferential Trade in Sustainable Production Only?*, TRADE EXPERETTES (Mar. 16, 2021), <https://www.tradeexperettes.org/blog/articles/is-the-future-of-preferential-trade-in-sustainable-production-only>.

68. See *Fact Sheet: Comprehensive Economic Partnership Agreement (CEPA) Between the EFTA States and Indonesia*, SWISS CONFEDERATION 4 (Feb. 2020) (“If Swiss importers are to benefit from the partial tariff reductions for palm oil, they must ensure that the imported oil complies with the agreed sustainability principles.”).

69. In 2019, prior to ratification of the EFTA-Indonesia CEPA, Indonesia brought a claim before the WTO that the EU was violating Article III of the GATT by imposing sustainability

the EU could be found to not be in violation of Article III if the WTO undertook a flexible interpretation of differentiation products based on PPM.

C. Article XX—General Exceptions

If CBAM was found to be in violation of either Articles I or III, the EU could still be in compliance with WTO law if it met one of the exceptions found in Article XX. To comply with Article XX, a measure that would otherwise not be justified must: i) fall under one of the listed categories and ii) meet the chapeau which ensures that the measure is not applied “in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade.”<sup>70</sup>

1. Article XX—Categories

Article XX lists ten categories of exceptions, two of which have applied in previous WTO cases on environmental issues: paragraph (b), which applies to measures “necessary to protect human, animal, or plant life or health” and paragraph (g), which applies to measures “relating to the conservation of exhaustible natural resources[,] if such measures are made effective in conjunction with restrictions on domestic production or consumption.”<sup>71</sup> Paragraph (g)’s “relating to” standard is easier to meet than paragraph b’s more stringent “necessary to protect” standard. As the WTO panel in *Thailand-Cigarettes* explained, a measure is not “necessary” in the context of GATT provisions “if an alternative measure which it could reasonably be expected to employ . . . is available to it.”<sup>72</sup> Thus, if a case on CBAM was brought before the WTO, and the EU claimed an Article XX(b) exception, it would have to demonstrate that there were no less restrictive measures than CBAM to achieve the relevant goal of protecting “human, animal, or plant life or health” that it could have reasonably employed.<sup>73</sup> Given the diversity of mechanisms to combat an issue as complex as climate change, this could be difficult.

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requirements on imported palm oil. See generally Request for Consultations by Indonesia, *European Union—Certain Measures Concerning Palm Oil and Oil Palm Crop-Based Biofuels*, WTO Doc. WT/DS593/1 (Dec. 16, 2019).

70. GATT 1994, *supra* note 43, art. XX.

71. *Id.*

72. *Article XX: General Exceptions*, WTO ANALYTICAL INDEX: GUIDE TO WTO LAW AND PRACTICE 566, [https://www.wto.org/english/res\\_e/booksp\\_e/gatt\\_ai\\_e/art20\\_e.pdf](https://www.wto.org/english/res_e/booksp_e/gatt_ai_e/art20_e.pdf).

73. See Joachim Englisch & Tatiana Falcão, *EU Carbon Border Adjustments and WTO Law, Part Two*, 51 ENV’T L. REP. 10935, 10937 (2021).

Alternatively, the EU could claim a paragraph (g) exception. In *Canada-Herring and Salmon*, the Panel defined “relating to” as primarily aimed at the conservation of that exhaustible natural resource.<sup>74</sup> While this standard is broader, it still requires the EU to demonstrate that CBAM is aimed specifically at the conservation of some exhaustible natural resource. Previous WTO panels have accepted living species, gasoline, and clean air as exhaustible natural resources within the definition of Article XX(g).<sup>75</sup> Within the context of CBAM, the EU would need to connect the legislation’s goal of reducing carbon emissions to an exhaustible natural resource that should be conserved. In *United State-Gasoline*, the Panel accepted that clean air was an exhaustible natural resource, which the United States was trying to protect by controlling air pollution caused by consumption of gasoline.<sup>76</sup> While carbon emissions are not an exhaustible natural resource that the EU is trying to conserve, a similar argument could be made by the EU that it is trying to protect an exhaustible natural resource, a stable climate, by reducing carbon emissions. However, there is no guarantee that a WTO panel would agree with that interpretation.

## 2. Article XX—Chapeau

Once a measure is determined to fall under one of the Article XX exception categories, the party invoking the exception still has the burden of proving that it complies with the chapeau, ensuring that it is neither arbitrary or unjustifiable discrimination nor a disguised restriction on trade.<sup>77</sup> To qualify as arbitrary or unjustifiable discrimination, three elements must be met: i) the result is discriminatory, ii) the measure is arbitrary or unjustifiable in character, and iii) the discrimination occurs between countries where the same conditions prevail.<sup>78</sup> When determining whether a measure is an unjustified restriction of trade, the WTO has previously looked at whether the measure has been publicly announced as a trade measure and whether its design and structure reflect any hidden, protectionist intentions.<sup>79</sup> The WTO has upheld other measures as justifiable when the implementing country has

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74. See Article XX: General Exceptions, *supra* note 70, at 584.

75. See Englisch & Falcão, *supra* note 71, at 10938.

76. See Panel Report, *United States—Standards for Reformulated and Conventional Gasoline*, ¶ 6.36, WTO Doc. WT/DS2/R (adopted Jan. 29, 1996) [hereinafter *Standards for Reformulated and Conventional Gasoline Panel Report*].

77. See Appellate Body Report, *United States—Standards for Reformulated and Conventional Gasoline*, 22–23, WTO Doc. WT/DS2/AB/R (adopted Apr. 29, 1996).

78. See *Shrimp-Turtle* Appellate Body Report, *supra* note 60, ¶ 150.

79. See Englisch & Falcão, *supra* note 71, at 10943.

designed the measures to be flexible and has attempted to conclude bilateral or multilateral agreements with affected countries.<sup>80</sup>

While the EU has announced CBAM publicly and made efforts to frame it as a trade mechanism intended for environmental preservation rather than as a protectionist trade restriction, it is unclear if other countries agree with that characterization.<sup>81</sup> Multiple statements have been made that reflect concerns. A statement from the meeting of BRICS environmental ministers expressed “grave concern” for “the proposals for introducing trade barriers, such as unilateral carbon border adjustment mechanism, that are discriminatory” and China has called the measure protectionist.<sup>82</sup> Analysis of the CBAM proposal argues that it fails the chapeau because it is unjustifiably discriminatory in that it coerces states to adopt the exact same means of decarbonization and offers little flexibility, regardless of what other measures they might have taken.<sup>83</sup> Further, the EU has few current negotiations for bilateral or multilateral agreements with affected states.<sup>84</sup> Thus, even if it falls within one of the two relevant categories for an Article XX exception, the chapeau remains a concern as the EU has not yet demonstrated that the measure is flexible or that it has attempted negotiations with affected countries.

80. See Englisch & Falcão, *supra* note 71 at 10943.

81. See *Carbon Border Adjustment Mechanism: Questions and Answers*, EUR. COMM’N (July 14, 2021), [https://ec.europa.eu/commission/presscorner/detail/en/qanda\\_21\\_3661](https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_3661) (“[T]he Carbon Border Adjustment Mechanism (CBAM) is a climate measure that should prevent the risk of carbon leakage and support the EU’s increased ambition on climate mitigation, while ensuring WTO compatibility.”).

82. See Matthew Townsend, *International Reaction to the EU’s Proposed CBAM*, ALLEN & OVERY (Oct. 8, 2021), <https://www.allenoverly.com/en-gb/global/blogs/countdown-to-cop/international-reaction-to-the-eu’s-proposed-cbam>.

83. See Timothy Meyer & Todd N. Tucker, *A Pragmatic Approach to Carbon Border Measures*, 21 *WORLD TRADE REV.* 109, 119 (2021).

84. The explanatory memo preceding the proposal mentions agreements with third parties as a possible alternative to the application in progress, but virtually no multilateral agreements are yet in place. See *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism, explanatory memo*, at 3, COM (2021) 564 final (July 14, 2021). The EU and Switzerland did previously agree link ETSs starting in 2020. See Council of the EU Press Release, *Linking of Switzerland to the EU Emissions Trading System – Entry Into Force on 1 January 2020* (Dec. 9, 2019). The EU and the US have also negotiated on steel and aluminum which could potentially allow US producers to be exempt from CBAM. See generally Chad P. Brown & Kathryn Russ, *Biden and Europe remove Trump’s steel and aluminum tariffs, but it’s not free trade*, PETERSON INST. FOR INT’L ECON. (Nov. 11, 2021), <https://www.piie.com/blogs/trade-and-investment-policy-watch/biden-and-europe-remove-trumps-steel-and-aluminum-tariffs>.

## V. COMPATIBILITY WITH INTERNATIONAL ENVIRONMENTAL LAW

In carefully constructing CBAM to comply with WTO obligations, the EU risks violating international environmental law obligations, including the principle of common but differentiated responsibilities and Principle 12 of the Rio Declaration. There is an obvious tension between international environmental legal regimes and international trade law. While the WTO has held negotiations on its relationship to multilateral environmental agreements<sup>85</sup> and various environmental treaties have relied on trade measures for implementation,<sup>86</sup> the WTO has also emphasized that it is not an environmental agency and does not seek to set environmental standards.<sup>87</sup> Furthermore, numerous cases involving environmental measures have been struck down by panels for violating WTO law.<sup>88</sup>

The CBAM proposal does invoke the EU's commitment to numerous environmental law principles. The very first paragraph of the proposal notes that the European Commission has a goal of better implementing the polluter pays principle, which places the responsibility of pollution on the party producing it.<sup>89</sup> The memo preceding the proposal explains that CBAM would further the principle of sustainable development,<sup>90</sup> which the WTO also recognizes as a fundamental principle.<sup>91</sup> An assessment impact report included after the proposal also mentions the need to respect the principle of common but differentiated responsibilities.<sup>92</sup> Yet, despite invocation of these important principles, it

85. See *Trade and Environment*, WTO, [https://www.wto.org/english/tratop\\_e/dda\\_e/status\\_e/envir\\_e.htm](https://www.wto.org/english/tratop_e/dda_e/status_e/envir_e.htm) (last visited Nov. 8, 2022).

86. See generally Convention on International Trade in Endangered Species of Wild Fauna and Flora, Mar. 3, 1973, 27 U.S.T. 1087, 993 U.N.T.S. 243 [hereinafter CITES]; Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, Mar. 22, 1989, 28 I.L.M. 657, 1673 U.N.T.S. 125 [hereinafter Basel Convention]; Montreal Protocol on Substances that Deplete the Ozone Layer, Sept. 16 1987, 26 I.L.M. 1541 [hereinafter Montreal Protocol].

87. See *The environment: a specific concern*, WTO, [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/bey2e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/bey2e.htm).

88. See generally Shrimp-Turtle Appellate Body Report, *supra* note 60; Standards for Reformulated and Conventional Gasoline Panel Report, *supra* note 74.

89. See *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism, explanatory memo*, at 2, COM (2021) 564 final (July 14, 2021).

90. See *id.* at 11.

91. See *Sustainable development*, WTO, [https://www.wto.org/english/tratop\\_e/envir\\_e/sust\\_dev\\_e.htm](https://www.wto.org/english/tratop_e/envir_e/sust_dev_e.htm).

92. See *Commission Staff Working Document Impact Assessment Report Accompanying the Document, Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism pt. 1/2*, at 8, COM (2021) 564 final (July 14, 2021).

remains unclear if the EU has taken sufficient steps within the proposal to comply with its environmental obligations.

A. *Common but Differentiated Responsibilities*

The principle of “common but differentiated responsibilities” (CBDR), as found in the UN Framework Convention on Climate Change (UNFCCC) and the Paris Agreement, recognizes that while all states have a common responsibility to address climate change, those responsibilities are differentiated and contextualized for each individual state.<sup>93</sup> Industrialized states, which have histories of both greater means and emissions, given higher rates of industrialization, should bear greater responsibility for responding to, and alleviating, the effects of climate change. Though no WTO-covered agreement explicitly incorporates the principle of CBDR, there are multiple WTO provisions on special and differential (S&D) treatment. While CBDR provides an overarching approach to international environmental law that encompasses inter- and intra-generational equity,<sup>94</sup> the principle of S&D is more limited and serves as an exception rather than a rule in trade law.<sup>95</sup> The WTO has S&D provisions which allow for, but do not grant a right to, more favorable treatment of developing countries by developed countries.<sup>96</sup> This can encompass transition time periods, technical assistance, and flexibility of commitments.<sup>97</sup>

The CBAM proposal mentions the principle of CBDR in reference to obligations stemming from the Paris Agreement, but fails to specify

93. See United Nations Framework Convention on Climate Change, art. 3, May 9, 1992, S. Treaty Doc No. 102-38, 1771 U.N.T.S. 107; Paris Agreement to the United Nations Framework Convention on Climate Change, art. 4, Dec. 12, 2015, T.I.A.S. No. 16-1104 [hereinafter Paris Agreement].

94. See *Special and differential treatment provisions*, WTO, [https://www.wto.org/english/tratop\\_e/devel\\_e/dev\\_special\\_differential\\_provisions\\_e.htm](https://www.wto.org/english/tratop_e/devel_e/dev_special_differential_provisions_e.htm) (last visited Jan. 25, 2023). Inter-generational equity refers to equitable use of resources between generations past, present, and future while intra-generational equity refers to equitable use of resources within the present generation. See G. F. Maggio, *Inter/Intra-Generational Equity: Current Applications Under International Law for Promoting the Sustainable Development of Natural Resources*, 4 BUFF. ENV'T L.J. 161, 163–64 (1997).

95. See Anastasios Gourgourinis, *Common but Differentiated Responsibilities in Transnational Climate Change Governance and the WTO: A Tale of Two ‘Interconnected Worlds’ or a Tale of Two ‘Crossing Swords’?*, in RSCH. HANDBOOK ON CLIMATE CHANGE & TRADE L. 31, 40 (Panagiotis Delimatsis ed., 2016).

96. See *Special and differential treatment provisions*, *supra* note 92.

97. See Comm. on Trade and Dev., *Note by the Secretariat: Special and Differential Treatment Provisions in WTO Agreements and Decisions*, at 4, WTO Doc. WT/COMTD/W/258 (Mar. 2, 2021).

how it might comply with this principle.<sup>98</sup> The Commission does state in the preamble of the proposed CBAM legislation that it will engage with third countries “to explore possibilities for dialogue and cooperation with regard to the implementation of specific elements of the Mechanism.”<sup>99</sup> Additionally, the EU commits to working “with low and middle-income countries towards the de-carbonisation of their manufacturing industries” and supporting “less developed countries with the necessary technical assistance in order to facilitate their adaptation to the new obligations.”<sup>100</sup> While providing assistance to low-income countries would certainly be permissible under S&D provisions in WTO law, these remain as vague commitments solely focused on technical assistance with no mention of transitional time periods or more flexible commitments for LDCs.

In response to discussion of the EU’s proposal, ministers from Brazil, South Africa, India, and China released a joint statement claiming that a unilateral carbon border adjustment mechanism is explicitly counter to the principle of CBDR.<sup>101</sup> If these countries wanted to bring a claim against the EU for violating CBDR, they would need to either go through a dispute settlement mechanism of an existing multilateral environmental agreement (MEA) that contains a CBDR provision<sup>102</sup> or ask a WTO Panel to consider the relevant MEA provision on CBDR when interpreting whether CBAM is WTO compliant.<sup>103</sup> While it is unlikely that the WTO would interpret CBDR to change the meaning of Article I of the GATT, which requires parties to treat all exporting countries the same, the EU could still be brought before an alternative dispute settlement mechanism and found to be in violation of the Paris Agreement and the UNFCCC.<sup>104</sup>

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98. *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism, explanatory memorandum*, at 2, COM (2021) 564 final (July 14, 2021).

99. *Id.* at 3.

100. *Id.* at 23.

101. See Joe Lo, *Emerging economies share ‘grave concern’ over EU plans for a carbon border levy*, EURACTIV (Apr. 12, 2021), <https://www.euractiv.com/section/energy-environment/news/emerging-economies-share-grave-concern-over-eu-plans-for-a-carbon-border-levy/>.

102. See Anastasios Gourgourinis, *supra* note 93, at 41.

103. *Id.*

104. See Pananya Larbprasertporn, *The Interaction Between WTO Law and the Principle of Common but Differentiated Responsibilities in the Case of Climate-Related Border Tax Adjustments*, 6 GOETTINGEN J. INT’L L. 145, 162–63 (2014).

B. *Principle 12, Rio Declaration*

Principle 12 of the 1992 Rio Declaration on the Environment and Development addresses the contentious relationship between trade and the environment. It calls on states to avoid “unilateral actions to deal with environmental challenges outside the jurisdiction of the importing country” and instead to pursue environmental measures that are “based on an international consensus.”<sup>105</sup> While the Rio Declaration is not binding on states, it is soft law that indicates a general consensus among parties.<sup>106</sup> The WTO has taken a complementary approach and included Principle 12 almost verbatim in its Decision on Trade and Environment.<sup>107</sup> The Appellate Body applied Principle 12 in *Shrimp-Turtle* where it took issue with the United States’ decision to impose an import ban with the goal of conserving sea turtles without looking to international mechanisms or pursuing negotiations first.<sup>108</sup> Thus, this principle has been used not only as a guiding principle of international environmental law, but as a relevant principle to the interpretation of the Article XX chapeau. While CBAM is a unilateral action, in the sense that it is EU-specific legislation that imposes obligation on third parties, the EU could point to the recent developments at COP26 to demonstrate growing international consensus on the need for global carbon markets.<sup>109</sup>

VI. EU COMPLIANCE WITH WTO AND ENVIRONMENTAL LAW OBLIGATIONS

The EU could make changes to better comply with both its WTO and environmental law obligations by i) providing exemptions to Least Developed Countries (LDCs), ii) pursuing negotiations for bilateral and multilateral agreements on carbon markets, and iii) clearly communicating the benefits of the mechanism to other countries that might otherwise consider bringing a case before the WTO.

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105. U.N. Conference on Environment and Development, *Rio Declaration on Environment and Development*, Principle 12, U.N. Doc. A/CONF.151/26/Rev.1 (Vol. I), annex I (Aug. 12, 1992).

106. See Foo Kim Boon, *The Rio Declaration and its Influence on International Environmental Law*, 1992 SING. J. LEGAL STUD. 347, 351 (1992).

107. See *Decision on trade and environment*, WTO (Apr. 15, 1994), [https://www.wto.org/english/docs\\_e/legal\\_e/56-dtenv.pdf](https://www.wto.org/english/docs_e/legal_e/56-dtenv.pdf).

108. See *Shrimp-Turtle Appellate Body Report*, *supra* note 60, ¶¶ 171–72.

109. See generally Charles E. Di Leva & Scott Vaughan, *The Paris Agreement’s New Article 6 Rules*, INT’L INST. FOR SUSTAINABLE DEV. (Dec. 13, 2021), <https://www.iisd.org/articles/paris-agreement-article-6-rules>.

## A. LDC Exceptions

The EU can better align with the principle of CBDR by making firm commitments within the CBAM legislation to provide funding and technology sharing to LDCs. Thus far, the EU has shown a hesitancy towards providing any exemptions from CBAM. In an Impact Assessment Report, Commission Staff expressed concern that exempting LDCs from the border adjustment mechanism would encourage increased emissions from those countries.<sup>110</sup> Yet it is first worth noting that most LDCs have already made binding commitments to reduce emissions, through international agreements like the Paris Agreement, and have their own domestic interests, separate from the EU's concerns of carbon leakage, to reduce carbon dependency.<sup>111</sup> Further, many LDCs are not responsible for a large percentage of carbon emissions<sup>112</sup> and LDCs account for less than 0.1% of the relevant imports of Iron and Steel, Fertilisers, and Cement that are covered by CBAM.<sup>113</sup> Thus, exempting LDCs would not have a large impact on the proposal's goal of reducing current emission leakage in targeted sectors.<sup>114</sup>

Instead of blanket exemptions, the Impact Assessment Report recommends “technical assistance, technology transfer, extensive capacity building and financial support,” noting that a failure to include any of these mechanisms could lead to LDCs alleging a violation of CBDR.<sup>115</sup> However, the current CBAM proposal only makes one mention of “providing the necessary technical assistance” to LDCs in the preamble of the proposal.<sup>116</sup> The preamble is indicative of the drafters' intent, but it is not binding and there is no further mention in the proposal of

110. See *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism pt. 1/2*, at 30, COM (2021) 564 final (July 14, 2021).

111. See generally Mohammad Feisal Rahman et al., *Low-Carbon Futures in Least Developed Countries*, WORLD RES. INST., <https://www.wri.org/climate/expert-perspective/low-carbon-futures-least-developed-countries>.

112. See Press Release, U.N. Conf. on Trade and Dev., LDC – The Least Developed Countries Report 2017: Facts and Figures, U.N. Press Release UNCTAD/Press/IN/2017/011 (Nov. 22, 2017) (“less than 1 percent of historical anthropogenic greenhouse gas emissions are accounted for by the least developed countries.”).

113. See *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism pt. 1/2*, at 19, COM (2021) 564 final (July 14, 2021).

114. *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism pt. 1/2*, at 30, COM (2021) 564 final (July 14, 2021) (“LDCs currently account for a minimal share of EU-external trade in the commodities that could be covered by a CBAM”).

115. *Id.*

116. *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, at 23, COM (2021) 564 final (July 14, 2021).

commitments to provide capacity building or financial support to LDCs.<sup>117</sup> One non-binding reference to technical assistance does not demonstrate a substantial commitment to CBDR.

There is existing precedent within both WTO and EU law for differential treatment towards LDCs. Under the GATT, an enabling clause allows for more favorable treatment of LDCs, including preferential tariff and non-tariff measures, and recognizes the “need for increased access” to markets for products of export interest to LDCs.<sup>118</sup> Under EU trade law, the Generalized Scheme of Preferences Plus (GSP+) allows for zero duties for LDCs that ratify conventions on sustainable development and human rights and the Everything but Arms (EBA) initiative gives 48 LDCs duty-free and quota-free access to the EU for everything except arms and ammunitions.<sup>119</sup> The EU also contributes significant funding to Aid for Trade, which supports the trading capacity of developing countries, including support to develop low-carbon and climate resilient economies.<sup>120</sup> The EU can develop a similar program for carbon emissions by tying any benefits to conditions, such as ratification of the Paris Agreement, or access to monitoring information. Many of the countries that would be covered by CBAM exceptions are likely already covered by the GSP+ or EBA and thus already engage on similar issues with the EU.

If the EU is unwilling to provide blanket exemptions to LDCs, it should add specific guarantees within the proposal’s existing structure of funding, technical assistance, and delayed timetables for LDCs. The EU must provide adequate assistance to ensure that LDCs have the capabilities to comply with the mechanism without undue burden. Such exceptions would be permissible under the principle of S&D and show a stronger commitment by the EU to the principle of CBDR. Relatedly, increasing the clean production capacity of LDCs would further align the EU with its overarching goal of leading “global action to tackle climate change” that still ensures “fairness and environmental integrity.”<sup>121</sup>

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117. *See generally id.*

118. *See* Decision on Differential and More Favourable Treatment Reciprocity and Fuller Participation of Developing Countries, WTO Doc. L/4903 (Nov. 28, 1979).

119. *See* Mario Damen & Wolfgang Iglar, *Trade Regimes Applicable to Developing Countries*, EUR. PARLIAMENT 3 (Oct. 2021), [https://www.europarl.europa.eu/ftu/pdf/en/FTU\\_5.2.3.pdf](https://www.europarl.europa.eu/ftu/pdf/en/FTU_5.2.3.pdf).

120. *See* European Commission Press Release IP/21/5641, Aid for Trade: European Union Remains the World’s Leading Provider with 17.9 billion (Oct. 29, 2021).

121. *See Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, at 4, COM (2021) 564 final (July 14, 2021).

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### B. Pursue Negotiations

The EU could simultaneously pursue negotiations on carbon pricing and emission reduction to demonstrate a commitment to building international consensus and considering other alternative, less restrictive, options to CBAM. As held by the Appellate Body in *Shrimp-Turtle*, a lack of consensus-driven negotiations results in unilateral decision-making, which can be unjustifiably discriminatory and thus violate the Article XX chapeau as well as Principle 12 of the Rio Declaration.<sup>122</sup> While the negotiations have to be done in good faith, there is no requirement of conclusion of a negotiation to comply with Article XX.<sup>123</sup> The explanatory memo to the CBAM proposal mentions that agreements with third countries could be an alternative to the application of CBAM so commencing broad negotiations of those agreements prior to the implementation of CBAM would be more in line with the WTO's interpretation of article XX.<sup>124</sup>

Recent agreements, both bilateral and multilateral, offer various potential starting places. In October 2021, the United States and the EU reached a “carbon-based sectoral agreement” to negotiate the removal of tariffs and incentivization of low-carbon steel production.<sup>125</sup> The EU could open negotiations with other countries for similar arrangements that seek to prioritize low-carbon production, thus achieving a similar result to the application of CBAM.

At the 2021 UN Climate Change Conference (COP26), parties made significant progress on a rulebook for Article 6 of the Paris Agreement,<sup>126</sup> a legally binding treaty to which the EU is party.<sup>127</sup>

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122. See *Shrimp-Turtle* Appellate Body Report, *supra* note 60, ¶ 172.

123. See Article 21.5 DSU Appellate Body Report, *United States—Import Prohibition of Certain Shrimp and Shrimp Products*, ¶ 123, WTO Doc. WT/DS58/AB/RW (adopted Oct. 22, 2001).

124. See *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, at 3–4, COM (2021) 564 final (July 14, 2021).

125. See *Fact Sheet: The United States and European Union to Negotiate World's First Carbon-Based Sectoral Arrangement on Steel and Aluminum Trade*, WHITE HOUSE (Oct. 31, 2021), <https://www.whitehouse.gov/briefing-room/statements-releases/2021/10/31/fact-sheet-the-united-states-and-european-union-to-negotiate-worlds-first-carbon-based-sectoral-arrangement-on-steel-and-aluminum-trade/>.

126. See generally Conference of the Parties on its Twenty-Sixth Session, *Guidance on Cooperative Approaches Referred to in Article 6, Paragraph 2, of the Paris Agreement*, FCCC/PA/CMA/2021/L.18 (Nov 13, 2021) [hereinafter *Guidance on Paris Agreement*]; Conference of the Parties on its Twenty-Sixth Session, *Rules, Modalities, and Procedures for the Mechanism Established by Article 6, Paragraph 4, of the Paris Agreement*, FCCC/PA/CMA/2021/L.19 (Nov 13, 2021) [hereinafter *Rules, Modalities, and Procedures of the Paris Agreement*].

127. See Chapter XXVII 7d, UNITED NATIONS TREATY COLLECTION, [https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg\\_no=XXVII-7-d&chapter=27&clang=\\_en#EndDec](https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=XXVII-7-d&chapter=27&clang=_en#EndDec).

Though Article 6 does not explicitly mention carbon markets, it has been widely interpreted to reflect a market-based approach to combating climate change.<sup>128</sup> The latest agreement provides a broad framework for international cooperation between parties as they work towards meeting their nationally determined contributions to reduce greenhouse gas emissions.<sup>129</sup> It sets out relevant guidance for voluntary, consensus-based cooperation, including the exclusion of double counting for carbon credits, sharing proceeds with developing countries for markets linked to the multilateral mechanism, and creating a common accounting framework, which would be helpful in integrating various distinct markets.<sup>130</sup> Efforts by the EU to show continued negotiations on a global carbon market could also demonstrate further international consensus.

Finally, the EU could open negotiations to create some form of climate club, in which participating countries would set the same carbon price, regardless of what type of mechanism they are using.<sup>131</sup> This would allow the EU to coordinate prices with other countries that are already employing a domestic mechanism, which is in line with its commitment in the CBAM proposal to not double tax countries that are already employing similar taxes domestically.<sup>132</sup> These potential negotiations offer options for starting places for the EU to make good faith efforts in negotiating for similar policy ends before resorting to a border tax.

### C. Messaging

Given that only WTO member governments can bring a claim for dispute settlement, the EU should take efforts to communicate the benefits of linked carbon markets and the limited effects of CBAM on key geopolitical states.<sup>133</sup> It is in the EU's best interest to communicate the benefits of linked carbon markets to encourage countries to develop their own mechanisms as opposed to protesting the EU's mechanism. Implementing a domestic carbon tax is a clear way for other countries

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128. See Michael A. Mehling, *Governing Cooperative Approaches Under the Paris Agreement*, 46 *ECOLOGICAL Q.* 765, 766 (2019).

129. See Paris Agreement, *supra* note 91, art. 6.

130. See generally Di Leva & Vaughan, *supra* note 107.

131. See William Nordhaus, *Climate Clubs: Overcoming Free-riding in International Climate Policy*, 105 *AM. ECON. REV.* 1339, 1341 (2015).

132. *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, at 32, COM (2021) 564 final (July 14, 2021).

133. See *Introduction to the WTO dispute settlement system*, WTO, [https://www.wto.org/english/tratop\\_e/dispu\\_e/dispu\\_settlement\\_cbt\\_e/c1s4p1\\_e.htm](https://www.wto.org/english/tratop_e/dispu_e/dispu_settlement_cbt_e/c1s4p1_e.htm) (last visited Jan. 12, 2023).

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to cancel out the effects of CBAM, as the EU has carved out exceptions for existing taxes so that a producer is not double taxed. Implementing a domestic tax is also a necessary first step for a country before it implements a border tax because it establishes a price for carbon emissions.<sup>134</sup> Countries that opt out of any carbon pricing could face a long-term threat of competitive disadvantage as compared to countries that implement carbon border taxes, which incentivize cleaner production.<sup>135</sup>

The United States government, in contrast to a number of countries, has yet to implement any form of carbon tax or emissions trading scheme on a federal level.<sup>136</sup> Numerous carbon tax proposals have been introduced in Congress in the past year, but none have been brought to a vote.<sup>137</sup> Given the lack of federal action, the implementation of carbon taxes in the United States has been applied through piecemeal approaches by states and cities.<sup>138</sup> With a decentralized approach, the federal government is wasting an opportunity to standardize and to take strong climate action. Further, passing some form of carbon tax would be in line with the United States' binding commitment under the Paris Agreement to reduce its emissions 50 percent by 2030.<sup>139</sup> CBAM offers an opportunity for the EU to encourage the United States specifically to pursue carbon taxing. As the recent agreement between the United States and EU on low-carbon steel production demonstrates, it is better for the United States to be a part of a

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134. Thornton Matheson, *Border Carbon Adjustments without Carbon Pricing Makes Little Sense*, TAX POLICY CTR. (Aug. 9, 2021), <https://www.taxpolicycenter.org/taxvox/border-carbon-adjustment-without-carbon-pricing-makes-little-sense>.

135. See *What is the Impact of Carbon Pricing on Competitiveness*, CARBON PRICING LEADERSHIP COAL. (June 2016), <https://thedocs.worldbank.org/en/doc/759561467228928508-0020022016/original/CPLCCompetitivenessprint2.pdf>.

136. See *Carbon Tax Basics*, *supra* note 5.

137. See Jason Ye, *Carbon Pricing Proposals in the 117<sup>th</sup> Congress*, CTR. FOR CLIMATE & ENERGY SOL. (June 2021), <https://www.c2es.org/wp-content/uploads/2021/06/carbon-pricing-proposals-in-the-117th-congress.pdf>.

138. Currently, twelve states have cap and trade programs for some type of emission including California and eleven northeastern states that make up the Regional Greenhouse Gas Initiative (RGGI). Pennsylvania is planning to join the RGGI in 2022 and Washington state has passed cap-and invest legislation which will go into effect in 2023. See Jason Ye, *U.S. State Carbon Pricing Policies*, CTR. FOR CLIMATE & ENERGY SOL. (May 2021), <https://www.c2es.org/document/us-state-carbon-pricing-policies/>; *Regional Greenhouse Gas Initiative (RGGI)*, CTR. FOR CLIMATE & ENERGY SOL., <https://www.c2es.org/content/regional-greenhouse-gas-initiative-rggi/>.

139. See *Fact Sheet: President Biden Sets 2030 Greenhouse Gas Pollution Reduction Target Aimed at Creating Good-Paying Union Jobs and Securing U.S. Leadership on Clean Energy Technologies*, WHITE HOUSE (Apr. 22, 2021), <https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/22/fact-sheet-president-biden-sets-2030-greenhouse-gas-pollution-reduction-target-aimed-at-creating-good-paying-union-jobs-and-securing-u-s-leadership-on-clean-energy-technologies/>.

mutual framework for a greener economy instead of starting a retaliatory trade war with the EU.<sup>140</sup> There are also geopolitical concerns for the United States given that the EU has already helped China to implement its own emission trading scheme.<sup>141</sup>

Other effective messaging for the EU is to highlight the limited effect of the initial set of CBAM categories on its key trading partners. Among the six major trading partners with the EU, the United States would be the least affected and in fact the fees on United States would be “almost negligible.”<sup>142</sup> U.S. steel and aluminum products that are covered by CBAM account for only 0.6% of total U.S. sales to the EU.<sup>143</sup> CBAM would also have a limited effect on China, affecting less than 2% percent of exports to the EU.<sup>144</sup> Instead, it is likely that the cost of CBAM will be primarily borne by European consumers as opposed to importers.<sup>145</sup> Thus, while CBAM is an effective tool to target industries in the EU that receive substantial free allowances, the percentage of affected imported goods for major trading partners remains limited.

## VII. THE FUTURE OF THE WTO’S RELATIONSHIP WITH CLIMATE CHANGE

While the adjustments above could certainly help the EU further its efforts to balance WTO law and international environmental obligations, it is the WTO that should consider updating its current environmental framework to prevent blocking the implementation of carbon border taxes and better reflect its commitment to sustainable development. The preamble of the WTO Agreement recognizes that the world’s resources should be utilized “in accordance with the objective of sustainable development, seeking both to protect and preserve the

140. See Bentley Allen & Todd Tucker, *The E.U.-U.S. steel deal could transform the fight against climate change*, WASH. POST (Oct. 31, 2021, 9:12 PM), <https://www.washingtonpost.com/politics/2021/10/31/eu-us-steel-deal-could-transform-fight-against-climate-change/>.

141. See Barbara Pongratz, *EU-China climate policy – balancing cooperation and pressure*, MERICS (July 30, 2021), <https://merics.org/en/short-analysis/eu-china-climate-policy-balancing-cooperation-and-pressure>.

142. See Press Release, E3G, *New study shows limited trade impacts of EU CBAM* (Aug. 31, 2021), <https://www.e3g.org/news/new-study-shows-limited-trade-impacts-of-european-carbon-border-adjustment-mechanism/>.

143. See Gary Clyde Hufbauer et al., *EU’s proposed CBAM would cover a small share of its imports but leave exports open to retaliation*, PETERSON INST. FOR INT’L ECON. (Nov. 3, 2021), <https://www.piie.com/research/piie-charts/eus-proposed-cbam-would-cover-small-share-its-imports-leave-exports-open>.

144. See Sandbag, *‘CBAM’ carbon levy will only hit a fraction of Chinese exports to the EU*, CHINA DIALOGUE (Sept. 23, 2021), <https://chinadialogue.net/en/climate/cbam-carbon-levy-will-only-hit-a-fraction-of-chinese-exports-to-eu/>.

145. See *New study shows limited trade impacts of EU CBAM*, *supra* note 140.

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.”<sup>146</sup> Instead of acting as a possible hindrance to the EU’s bold proposal on reducing carbon emissions, the WTO should seek to adapt its relationship to the environment by i) broadening its judicial interpretation of environmental exceptions to include climate change, ii) working towards the setting of a global carbon price, and iii) restarting negotiations on trade and the environment. While the WTO’s role is not to create environmental law, it also should not stand in the way of its progress.

A. *Judicial Interpretation*

The WTO should broaden its Article XX exceptions to explicitly cover climate change or reinterpret jurisprudence to cover climate-related measures under its environmental exceptions. The WTO could encourage a party to suggest a climate-related amendment to Article XX which, once accepted by two-thirds of the contracting parties, would go into effect,<sup>147</sup> though amendments are typically only binding on parties who ratify them.<sup>148</sup> This amendment could propose either an entirely new category for Article XX or amend one of the two existing environmental paragraphs. A new exception specific to climate change could still utilize either the “necessary to” or “relating to” tests of the two exceptions that have been applied to environmental cases, depending on how narrow the parties want the exception to be. Alternatively, the amendment could propose an addendum to paragraph (b) to explicitly include “necessary to protect a stable climate.” This would allow for a more direct interpretation of climate-related measures under paragraph (b) as opposed to forcing a party to indirectly connect the categories of human, animal, plant life or health to a measure intended to reduce emissions and protect the climate.

Given the high bar required for an amendment to go into force, the WTO could also seek to reinterpret its existing jurisprudence of paragraph b and paragraph (g). As mentioned above, this could be done by finding that a reduction of carbon emissions is “necessary to protect

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146. Marrakesh Agreement Establishing the World Trade Organization, pmbl., Apr. 15, 1994, 1867 U.N.T.S. 154, 33 I.L.M. 1144 (1994).

147. GATT 1994, *supra* note 43, art. XXX.

148. See Katsuri Das et al., *Making the International Trade System Work for Climate Change: Assessing the Options*, CLIMATE STRATEGIES 17 (2018), [https://climatestrategies.org/wp-content/uploads/2018/07/CS-Report\\_Trade-WP4.pdf](https://climatestrategies.org/wp-content/uploads/2018/07/CS-Report_Trade-WP4.pdf).

human, animal, plant life or health” or that a stable climate is an exhaustible natural resource that needs to be conserved.<sup>149</sup>

If a relevant case was commenced, the WTO could also explicitly recognize carbon production as a valid reason to discriminate under Article III based on PPMs. There are some precedents for flexible interpretations such as the finding by the Appellate Body in *Shrimp-Turtle* that the United States’ decision to discriminate between products based on the process used to catch shrimp was valid.<sup>150</sup> A similar decision could be made that the production of carbon emissions is relevant so long as it meets the chapeau of Article XX, and as such does not attempt to limit all producers to the exact same measures but instead allows for flexibility on how manufacturers achieve emissions reductions.<sup>151</sup>

### B. Global Carbon Price

The WTO should commit to working with other international institutions to produce an agreement on a global carbon price. Members of the WTO leadership have already endorsed the idea of a global carbon price. Director-General Ngozi Okonjo-Iweala has argued that doing so would combat protectionism,<sup>152</sup> and Deputy Director-General Angella Ellard has pointed to the need for standardization given the great variation by country in type of carbon pricing scheme, the price of carbon, and even the existence of a scheme at all.<sup>153</sup> While the WTO cannot accomplish this unilaterally, it can take the lead in pushing for a global price. Though climate change is not explicitly an issue for the WTO, it is relevant to the WTO’s fundamental goal of sustainable development and carbon prices, specifically, are a distinct trade issue. The existing, disparate market with varying prices has limited effect on reducing emissions and threatens free trade. Further, in line with the WTO’s commitment to international consensus, there is growing evidence of a progression towards a greater consensus on the need for a global carbon market. As the agreement at COP26 on Article 6 of the Paris Agreement has shown, there is progression towards a framework that

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149. GATT 1994, *supra* note 43, art. XX.

150. See *Shrimp-Turtle* Appellate Body Report, *supra* note 60, ¶¶ 141–42.

151. See Porterfield, *supra* note 58, at 39.

152. See *DG Okonjo-Iweala: Climate-related trade policies must focus on needs of most vulnerable*, WTO (Feb. 14, 2022), [https://www.wto.org/english/news\\_e/spno\\_e/spno22\\_e.htm](https://www.wto.org/english/news_e/spno_e/spno22_e.htm).

153. See “Trade plays an important role in climate change adaption and mitigation.” – DDG Ellard, WTO (Oct. 26, 2021), [https://www.wto.org/english/news\\_e/news21\\_e/ddgae\\_26oct21\\_e.htm](https://www.wto.org/english/news_e/news21_e/ddgae_26oct21_e.htm).

an integrated carbon market could operate within.<sup>154</sup> The WTO should take the lead in further progressing that framework to include a single price.

C. *Restart Trade and Environment Negotiations*

More generally, the WTO should push to restart and expand the failed trade and environment negotiations from the 2001 Doha Round. The 1994 Uruguay Round established the WTO Committee on Trade and Environment (CTE) with the goal of making “international trade and environmental policies mutually supportive.”<sup>155</sup> In 2001, Doha Round’s Trade and Environment Negotiation focused on the relationship between WTO rules and MEAs, collaboration between the WTO and MEA secretariats, and the elimination of tariff and non-tariff barriers on environmental goods and services.<sup>156</sup> Since the Doha Round, the Paris Agreement, another MEA, has come into force, and continues to shape existing climate policy, making it even more crucial to successfully negotiate the relationship between the WTO and MEAs.

A new round of negotiations should focus more explicitly on the challenge of climate change in relation to trade. While various issues have been raised in other meetings, such as the CTE discussing carbon border taxes<sup>157</sup> and the Goods Council discussing the EU’s impending CBAM proposal, there has been a lack of sustained, formal negotiations about WTO’s future role and relationship to climate change efforts.<sup>158</sup> In the face of continued discussion about the possible value of carbon markets, a trade-based measure, to combat climate change, it is crucial that the WTO prioritizes the relevant dialogue among parties.

VIII. CONCLUSION

The EU’s proposal for a carbon border adjustment mechanism offers the first opportunity to evaluate the feasibility of a carbon border tax. Though the EU has made a concerted effort to ensure that CBAM

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154. See generally *Guidance on Paris Agreement*, *supra* note 124; *Rules, Modalities, and Procedures of the Paris Agreement*, *supra* note 124.

155. See *Decision on trade and environment*, *supra* note 105.

156. See *Negotiations on trade and environment*, WTO, [https://www.wto.org/english/tratop\\_e/envir\\_e/envir\\_negotiations\\_e.htm](https://www.wto.org/english/tratop_e/envir_e/envir_negotiations_e.htm) (last visited Jan. 12, 2023).

157. See *WTO CTE Considers Carbon Border Adjustment and Carbon Footprint Schemes*, INT’L INST. FOR SUSTAINABLE DEV. (July 7, 2011), <http://sdg.iisd.org/news/wto-cte-consideres-carbon-border-adjustments-and-carbon-footprint-schemes/>.

158. See *Goods Council considers EU plans for carbon taxes on certain imports*, WTO (June 11, 2020), [https://www.wto.org/english/news\\_e/news20\\_e/good\\_11jun20\\_e.htm](https://www.wto.org/english/news_e/news20_e/good_11jun20_e.htm).

complies with WTO law, it still risks violating Articles I and III of the GATT because it distinguishes both between countries that are taking different forms of climate action and between cleaner methods of production. Though CBAM could still fall under an Article XX exception, it would need to show that the mechanism is flexible and the EU is not taking unilateral action. Simultaneously, the EU has obligations under international environmental law to respect the principle of common but differentiated responsibilities and Principle 12 of the Rio Declaration, which it could violate by making the unilateral decision to apply the mechanism to all countries regardless of level of development.

The EU can make changes to ensure a greater likelihood that it would not be in violation of either set of obligations. By providing exemption to LDCs, which are permitted under the enabling clause of WTO law, the EU would better align with the principle of CBDR. Opening negotiations and allowing for more flexibility beyond limited exemptions for countries with similar taxes would put the EU in compliance with Principle 12 and better comply with the requirements to meet the chapeau of Article XX. Despite these alterations, there is no guarantee that CBAM will be found in compliance with WTO law. The WTO has struck down numerous environmental measures in the past.<sup>159</sup>

However, the WTO is experiencing a crisis of legitimacy. To act as an impediment to crucial progress towards reducing carbon emissions would further discredit its ostensible commitment to achieving shared climate goals.<sup>160</sup> The WTO must be agile and embrace evolving attitudes on measures, such as carbon border taxes, that are crucial to achieving planned emissions reductions. The WTO can take meaningful steps to update its environmental framework such as broadening its interpretation of Article XX exceptions, working to produce an agreement on a global climate price, and restarting negotiations on trade and the environment. Regardless of any future rulings by the WTO, the

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159. See generally Shrimp-Turtle Appellate Body Report, *supra* note 60 (noting the policy's lack of flexibility); Standards for Reformulated and Conventional Gasoline Panel Report, *supra* note 74 (finding that the US had other options for alternative actions that were not discriminatory).

160. The Appellate Body is currently non-operational and thus cases are in limbo after being appealed from a panel decision. See Geraldo Vidigal, *Living Without the Appellate Body: Multilateral, Bilateral, and Plurilateral Solutions to the WTO Settlement Dispute Crisis*, 20 J. WORLD INV. & TRADE 862, 70 (2019).

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announcement of the CBAM proposal has already had meaningful effects and spurred extensive discussion on the future of carbon markets.<sup>161</sup> The implementation of a carbon border tax is not a matter of if but when, and thus it would serve the WTO to adapt its relationship to climate change to the current, pressing reality.

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161. Turkey's envoy pointed to CBAM as influential to its decision to finally ratify the Paris Agreement. See Zia Weise, *EU's looming carbon tax nudged Turkey towards Paris climate accord, envoy says*, POLITICO (Nov. 6, 2021, 5:38 PM), <https://www.politico.eu/article/eu-carbon-border-adjustment-mechanism-turkey-paris-accord-climate-change/>.