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THE EU'S PROPOSED CARBON BORDER ADJUSTMENT MECHANISM AND COMPATIBILITY WITH WTO LAW

ARWEL DAVIES*

The premise of carbon border adjustment mechanisms is that imported goods should be subject to the same carbon pricing as domestically-produced goods. Adjustments are imposed to mitigate carbon leakage, understood as the relocation of production in order to avoid domestic carbon pricing. The aspiration is that domestic carbon pricing, along with the adjustment for imports, begins to reduce overall emissions, rather than merely moving emissions from one country to another. The European Union (EU) is currently advancing towards the adoption of what will be the most ambitious adjustment mechanism of its kind. The European Parliament's support here is conditioned on the World Trade Organization (WTO) law compatibility, while the Commission's proposal offers assurances to this effect. This paper focuses on this question of compatibility. It finds that the Commission's assessment is overly optimistic at least if this is understood as indicating that the adjustment mechanism would not breach WTO law at all, rather than that the breaches would be capable of justification under the main exceptions provision.

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I. INTRODUCTION

For the foreseeable future, countries are likely to pursue climate action at differing speeds.[1] Paradoxically, the higher the level of ambition, the greater would be the potential for it to be undermined by carbon leakage. When domestic cap-and-trade systems such as the EU's Energy Trading System (ETS) begin to bite via the gradual phasing out of free allowances, producers naturally consider how they might reduce their exposure to carbon pricing. One option is to move production to a country with lower carbon pricing. When competitiveness is restored in this way, carbon pricing limited to domestic production will only shift the location of carbon emissions, rather than reduce the overall volume. This is the basic explanation for the EU's proposed Carbon Border Adjustment Mechanism (CBAM).[2] Imported energy-intensive and trade-sensitive goods[3] would be subject to the same carbon pricing as domestically produced goods, less any carbon price paid in the country of production. The incentive to move production is thereby reduced, as is the incentive for down-stream manufacturers to import the CBAM-covered goods they need, rather than source them from producers subject to the ETS.

If adopted,[4] the EU CBAM would be the most ambitious worldwide.[5] The reluctance of countries to extend carbon pricing outside their own territory is often

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* Associate Professor, Hillary Rodham Clinton School of Law, Swansea University. The author may be contacted at a.p.davies[at]swan.ac.uk.

[1] Article 4(3) of the Paris Agreement provides that each Party will gradually increase its "nationally determined contribution" to "reflect its highest possible ambition, reflecting its common but differentiated responsibilities and respective capabilities, in light of different national circumstances". *See* Paris Agreement to the United Nations Framework Convention on Climate Change, art. 4(3), Dec. 12, 2015, T.I.A.S. 16-1104.

[2] *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, COM (2021) 564 final (July 14, 2021) [hereinafter CBAM proposal]. The proposed CBAM is part of the 'Fit for 55' package under which the EU has set its 2030 climate ambition to cutting emissions by at least 55% by 2030. This is a stepping-stone to achieving climate neutrality by 2050 under the European Green Deal. For the overall coverage of the Fit for 55 package, see *Fit for 55*, EUR. COUNCIL & COUNCIL EUR. UNION, https://www.consilium.europa.eu/en/policies/green-deal/fit-for-55-the-eu-plan-for-a-green-transition/.

[3] Initial coverage is proposed to be limited to iron and steel, cement, fertiliser, aluminium and electricity generation. *See* CBAM proposal, *supra* note 2, Recitals 29-37.

[4] The CBAM proposal envisages a three-year transitional period from January 1, 2023 focused on collecting data and raising awareness. Financial adjustments are proposed to begin from January 1, 2026. At the time of writing, it has been reported that both the EU Parliament and Council have adopted their positions on the CBAM proposal with

explained with reference to WTO law compatibility problems. Indeed, the European Parliament's resolution in support of CBAM is conditioned on this compatibility.[6] This paper considers this compatibility based on the evolution of WTO law through the dispute settlement process, and its current content.

There are, of course, two ways to 'thread the needle' when it comes to WTO law compatibility. The relevant measures may not breach any provision of WTO law; termed here as the question of 'initial compatibility'. In contrast, when violations are confirmed, the measures may still ultimately be exonerated via an exceptions' provision; most obviously the General Agreement on Tariffs and Trade (GATT) Article XX in the trade in goods context.[7] For several reasons, this contribution is limited to the first enquiry.

First, there is considerable scope for discussion within the question of initial compatibility. It is sometimes a straightforward matter to identify which provisions apply to challenged measures. This is not the case for CBAM. Early reactions manifest a lack of nuance; for example, through the view that CBAM involves the payment of a charge triggered by importation and is, therefore, self-evidently an impermissible border measure. On the contrary, it is by no means clear whether CBAM is a border measure or an internal measure; whether it is a fiscal or charge-based measure, or regulatory in nature. The answer matters because it has implications for the ease with which a violation can be established. If CBAM is a

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proposed amendments. These institutions, and the Commission, will now enter the 'trilogue' negotiations. *See* James Killick et. al., *European Parliament and Council Adopt Positions on ETS and CBAM Proposals: Next Steps-Final Agreement & Formal Adoption*, WHITE & CASE (Jul. 6, 2002), https://www.whitecase.com/publications/alert/european-parliament-and-council-adopt-positions-ets-and-cbam-proposals-next.

[5] The Commission's web-page reports that California applies an adjustment to certain imports of electricity while Canada and Japan are planning similar initiatives. *See Carbon Border Adjustment Mechanism: Questions and Answers*, EUR. COMM'N (Jul. 14, 2021), https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_3661.

[6] Resolution of 10 March 2021 Towards a WTO-compatible EU Carbon Border Adjustment Mechanism, EUR. PARL. DOC. P9_TA 0071 (2021), https://www.europarl.europa.eu/doceo/document/TA-9-2021-0071_EN.html. There are two references to WTO obligations in this Resolution. The first is to GATT Article XX which perhaps gives the impression that compatibility is to be achieved via this exceptions provision. However, a subsequent statement gives the impression that the aim is to avoid any initial finding of discrimination:

> *Designing a WTO-compatible CBAM*
>
> 7. Supports the introduction of a CBAM, provided that it is compatible with WTO rules and EU free trade agreements (FTAs) by not being discriminatory or constituting a disguised restriction on international trade
>
> …

[7] General Agreement on Tariffs and Trade, art. XX, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT].

border measure covered by GATT Articles II or XI, a violation will be confirmed on a near automatic basis. Its WTO law compatibility would depend on the Article XX analysis. However, if CBAM is an internal measure covered by GATT Article III, this provision will only be breached if there is discrimination between like domestic and imported products.

The focus on initial compatibility is also motivated by the contrast between what is currently known, and not known. The CBAM proposal gives a strong indication of the broad shape of its operation. This is enough to offer a reasonably confident view on initial compatibility. In contrast, the finer details of how CBAM will operate in practice are currently unknown. For example, the proposal envisages the assessment of the carbon content of imported CBAM goods,[8] the gradual phasing in of obligations on importers as free allocation of allowances under the EU ETS are phased out,[9] and the recognition of any carbon price paid in the country of production.[10] In practice, these aspects could be administered in a wholly satisfactory manner,[11] or in a manner leading to the allegation of 'arbitrary or unjustifiable discrimination'. This language is from the chapeau of GATT Article XX which focuses on how measures are 'applied'. In sum, enough is already known to assess initial compatibility, whereas a GATT Article XX analysis would be at least somewhat more speculative at the current time.

On initial compatibility, the article defends the view that CBAM, if enacted, would be an 'internal regulatory measure' covered by the GATT Article III:4 national treatment provision, and the GATT Article I most favoured nation (MFN)

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[8] CBAM proposal, *supra* note 2, art. 7 & Annex III.

[9] *Id.* art. 31.

[10] *Id.* art. 9.

[11] See CBAM proposal, *supra* note 2, at 10, where a high value is attributed to the non-discriminatory operation of these aspects:

> A system based on actual emissions on imported goods ensures a fair and equal treatment of all imports and a close correlation to the EU ETS. The CBAM system will, however, need to be complemented by a possibility to base calculations on a set of default values to be used in situations when sufficient emission data will not be available. Moreover, during an initial transitional phase, where importers may not be able to produce yet the data required by system on actual emissions, a default value could also apply. This option will need to be designed to fully respect the EU's international commitments, in particular WTO rules, and therefore it will be necessary to ensure that if a default value applies, importers are in all cases given the opportunity to demonstrate that they perform better than such value based on their actual emissions. Moreover, with regard to the phase in of the CBAM and the corresponding phase out of the free allowances, it will need to be ensured that at no point in time over this period, imports are afforded less favourable treatment than domestic EU production.

treatment provision. These provisions address discrimination respectively between like domestic and imported products, and between like imported products from different origin. It is considered that many (but not necessarily all) WTO members would be able to establish violations of these provisions with the prospects of success increasing along with the carbon intensity of production in the member concerned.

The article proceeds as follows. Part II establishes the main features of the CBAM system and commences the analysis of the GATT provision/s that apply to the same. The initial question is whether it is possible to eliminate provisions (covering both border measures and internal measures) which cover taxes and/or charges. The answer here depends on a question of first impression for WTO law. Is it inherent to the concept of a tax or charge, payable to government, that the amount is known in advance or at least calculable? This question is answered in the affirmative with reference to case law from the Court of Justice of the EU (CJEU). Part III proceeds on the basis that CBAM is not a tax or charge based measure. This leaves two possible applicable provisions. The first is GATT Article XI. This is a border measure provision which prohibits quantitative restrictions. The second is GATT Article III:4 which prohibits discriminatory internal regulatory measures. The part offers a commentary on the distinction between border measures and internal measures. The most relevant GATT provision is considered, the Note Ad Article III, as well as the origin and current status of the product/process distinction. Part IV proceeds to apply GATT Article III:4, while Part V extends this analysis to the broadly drafted GATT Article I MFN obligation. Part VI concludes.

II. APPLICATION OF WTO PROVISIONS COVERING TAXES AND/OR CHARGES

CBAM potentially falls under provisions which apply to 'taxes' and/or 'charges'. It could be a 'border measure' falling under GATT Article II which applies to ordinary customs duties and (more pertinently) 'other duties or charges'.[12]

[12] See GATT, *supra* note 7, art. II:1(b), which states that:

> The products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties, shall, on their importation into the territory to which the Schedule relates, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those set forth and provided therein. Such products shall also be exempt from all other duties or charges of any kind imposed on or in connection with the importation in excess of those imposed on the date of this Agreement or those directly and mandatorily required to be imposed thereafter by legislation in force in the importing territory on that date.

Alternatively, if CBAM is an internal measure, it could fall under Article III:2 which covers 'internal taxes or other internal charges'.[13] Plainly, the correct characterisation of CBAM depends on whether it is a border measure or an internal measure. However, it is also possible to defer this question in favour of asking whether the provisions above can be eliminated. This depends on questions of first impression, at least in WTO law. Is it inherent to the concept of a government tax or charge, that the amount payable is fixed or calculable rather than fluctuating based on a market-based mechanism? Put differently, is it inconsistent with the concept of a tax or charge that there is freedom to decide when to make purchases, and how much to spend, in order to take advantage of price fluctuations? Are these questions of a determinative threshold nature, or those that can be balanced against other considerations?

These questions arise from the proposed operation of the CBAM system and its relationship with the ETS. While not explicitly identified as such, the central obligation appears to be for registered importers of CBAM goods to make an annual declaration.[14] This must specify the total number of CBAM certificates to be surrendered with each certificate representing a ton of embedded carbon. It is already noticeable that this central obligation is not framed as a tax or charge. The number of certificates must be specified, but there is no reference to certificate purchases or the timing of purchases. The purchase of certificates is therefore a precursor to the central obligation rather than itself being the central obligation.

The price of each certificate fluctuates on a weekly basis and is tethered to the ETS auction in which EU producers purchase allowances.[15] Importers have flexibility in relation to the timing and quantity of their purchases. It is not expressly envisaged that purchases will be made in relation to each importation, albeit there is nothing to prevent this practice. Payments are not therefore tethered to the event of importation.[16] In principle, certificates can be purchased at any time and in any quantity. This is subject only to the requirement to have purchased enough to cover the annual declaration, and an additional quarterly obligation for certificates on account to cover at least eighty per cent of embedded emissions.[17] It would be rational for importers to purchase certificates in bulk when the price is low and to err on the side of over-estimating the total number of certificates required. The

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[13] See *id.* art. III:2, which states that, "[t]he 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".

[14] CBAM proposal, *supra* note 2, art. 6.

[15] *Id.* art. 21.

[16] *See id.* Recital 38 (referring to importers not having to "fulfil their CBAM obligations … at the time of importation").

[17] *Id.* art. 22(2).

excess purchase allowance is generous,[18] and the certificates are re-purchased at the price of purchase. While importers do not participate in the ETS auction, the timing and volume of their purchases may well be influenced by the auction prices.

A final relevant aspect is the coordination with the free allocation of allowances under the ETS.[19] This means that the obligation to surrender certificates applies only to the extent that embedded carbon in imports exceeds free allowances for the emissions of domestic producers.

As indicated, WTO law does not answer the question of whether a measure can be properly classified as a tax or charge if the amount payable depends on a market-based mechanism. Guidance may be drawn from findings of the CJEU in *Air Transport Association of America and Others v. Secretary of State for Energy and Climate Change*.[20] The issue was whether the inclusion of aviation in the EU ETS contravened the obligation in the EU-US Open Skies Agreement to exempt the fuel load from taxes, duties, fees and charges.[21] The CJEU conceived of a tax, properly so called, as requiring the payment of a fixed, calculable, and definite amount. These features are absent in cap-and-trade systems in which the pecuniary burden ultimately depends on a market-based auction mechanism. The extent to which the following passage can be transposed to CBAM can be considered:

> [I]n contrast to the defining feature of obligatory levies on the possession and consumption of fuel, there is no direct and inseverable link between the quantity of fuel held or consumed by an aircraft and the pecuniary burden on the aircraft's operator in the context of the allowance trading scheme's operation. The actual cost for the operator, resulting from the number of allowances to be surrendered, a quantity which is calculated inter alia on the basis of fuel consumption, depends, inasmuch as a market-based measure is involved, not directly on the number of allowances that must be surrendered, but on the number of allowances initially allocated to the operator and their market price when the purchase of additional allowances proves necessary in order to cover the operator's emissions. Nor can it be ruled out that an aircraft operator, despite having held or consumed fuel, will bear no pecuniary burden resulting from its

[18] *Id.* art. 23(2) (discussing that re-purchases are limited to one third of the total CBAM certificates purchased in the previous year).
[19] *Id.* art. 31.
[20] Case C-366/10, Air Transp. Ass'n of America v. Sec'y of State for Energy & Climate Change, 2011 E.C.R. I-13833.
[21] Air Transport Agreement, U.S.-E.U., arts. 11(1) & 11(2)(c), May 25, 2007, 2007 O.J. (L 134) 4.

> participation in the allowance trading scheme, or will even make a profit by assigning its surplus allowances for consideration.[22]

The only statement here which does not apply equally to CBAM is the closing reference to the possibility of profit. At best, importers can break even when the CBAM authority re-purchases excess certificates at the original purchase price. Under CBAM, there is similarly 'no direct and inseverable link' between the quantity of embedded carbon in imported CBAM goods, and the pecuniary burden on the importer. The actual cost does not depend directly on the number of certificates to be surrendered as these have no fixed cost. Actual cost depends on the price of CBAM certificates when necessary to cover embedded carbon in excess of the coordination with the free allocation of allowances under the ETS.[23] Importers will bear no pecuniary burden if their imports are within the coordination level.

In sum, the CJEU considered that a system based on surrendering allowances whose price fluctuates based on a market-based mechanism was at odds with the very nature of a government tax or charge. This was a threshold matter, rather than one to be balanced against other considerations more consistent with the idea of a tax or charge.

In contrast to this position, some commentators rely on the sufficiency of auctioned allowances generating revenue to the State. Indeed, the revenues are substantial.[24] This makes it difficult to understand a further statement of the CJEU that the scheme was, "not intended to generate revenue for public authorities".[25] Javier de Cendra,[26] for example, views the criterion of revenue generation as satisfying the OECD definition of taxes, i.e., "compulsory, unrequited payments to

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[22] *Supra* note 20, ¶142.

[23] CBAM proposal, *supra* note 2, art. 31.

[24] The Commission's web-pages report that, "total revenues generated by Member States, the UK and EEA countries from the auctions between 2012 and 30 June 2020 exceeded EUR 57 billion". *See Auctioning*, EUR. COMM'N, https://ec.europa.eu/clima/eu-action/eu-emissions-trading-system-eu-ets/auctioning_en.

[25] *Supra* note 20, ¶143. This statement should perhaps be linked to the earlier identification of the 'ultimate objective' as being environmental protection. *See id.* ¶139. It is also possible that the CJEU had in mind the obligation in Article 10(3) of the EU ETS Directive, which provides that "at least 50% of the revenues generated from the auctioning of allowances … should be used" to combat climate change in the EU and third countries. *See* Directive 2003/87, of the European Parliament and of the Council of 13 October 2003 Establishing a System for Greenhouse Gas Emission Allowance Trading Within the Union and Amending Council Directive 96/61/EC, 2003 O.J. (L 275) 32.

[26] Javier de Cendra, *Can Emissions Trading Schemes Be Coupled with Border Tax Adjustments? An Analysis vis-à-vis WTO Law*, 15(2) REV. EUR., COMP. & INT'L ENVTL. L. 131, 135 (2006).

general government".[27] It is submitted that the notion of 'payments to general government' here carries with it the understanding that the amount of the payment is set by government (rather than by a market-based mechanism) and is calculable in advance. This may well have been the common understanding of the OECD Expert Group delegations, even though not expressly stated. An analogy might be drawn with the 'officious bystander test' well-known to English contract lawyers.[28]

Even if government revenue is accepted as sufficient, a further question is whether the payments for government auctioned allowances are 'unrequited'. This is defined by the OECD as, "benefits provided by government to taxpayers … not normally [being] in proportion to their payments".[29] Less generously, commentators have referred to taxpayers receiving 'nothing identifiable in return' for the compulsory contribution.[30] It has been argued that emissions allowances constitute tradeable property rights,[31] thereby undermining the notion that the payments are unrequited.

In favour of finding a tax, Meltzer moves the focus from the auctioned allowances to the requirement to pay €100 per ton of CO_2 when insufficient allowances have been purchased to cover emissions.[32] This is at least a definite pre-determined payment. However, the OECD definition provides that, "[the] term 'tax' does not include fines unrelated to tax offences".[33] It is clear that this payment is a penalty or fine within the ETS,[34] and the same is mirrored in the CBAM proposal.[35]

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[27] *Note on the Definition of Taxes by the Chairman of the Negotiating Group on the Multilateral Agreement on Investment (MAI)*, OECD, ¶1, DAFFE/MAI/EG2(96)3 (Apr. 19, 1996) [hereinafter OECD Note].

[28] See Shirlaw v. Southern Foundries [1939] 2 K.B. 206, 227, where MacKinnon LJ opined:

> Prima facie that which in any contract is left to be implied and need not be expressed is something so obvious that it goes without saying; so that, if, while the parties were making their bargain, an officious bystander were to suggest some express provision for it in their agreement, they would testily suppress him with a common 'Oh, of course!'.

[29] OECD Note, *supra* note 27.

[30] Joost Pauwelyn, *Carbon Leakage Measures and Border Tax Adjustments under WTO Law*, *in* RESEARCH HANDBOOK ON ENVIRONMENT, HEALTH AND THE WTO 483 (Geert Van Calster & Denise Prévost eds., 2013).

[31] Lorand Bartels, *The Inclusion of Aviation in the EU ETS: WTO Law Considerations*, 6 ICTSD PROGRAMME ON TRADE & ENV. 9 (2012). This is, however, an unsettled question. *See* Javier de Cendra, *supra* note 26, at 136.

[32] Joshua Meltzer, *Climate Change and Trade – The EU Aviation Directive and the WTO*, 15 J. INT'L ECON. L. 111, 130 (2012).

[33] OECD Note, *supra* note 27, ¶2.

[34] *See* EUROPEAN COMM'N, EU ETS HANDBOOK 134 (2015), https://ec.europa.eu/clima/system/files/2017-03/ets_handbook_en.pdf. In phase 3 of the EU ETS, participants who fail to comply with their obligation to surrender allowances under the EU ETS are fined €100 per tCO2, adjusted with the EU inflation rate from 2013

Therefore, this payment can only itself be regarded as a tax if the obligation to purchase sufficient allowances for an indefinite price under a market-based mechanism is a tax. The view adopted here is that payments, even to government, are outside of the concepts of a tax or charge if their applicability and calculation depend on a market-based mechanism such as an auction. This is suggested as a universal and transferable idea, rather than one confined to instruments of aviation law.

Approached from another angle, it is difficult to see why a WTO panel would stretch the concept of a tax or charge in a manner unrecognised by any relevant body. Under WTO law, non-tax or charge based measures do not fall into a legal vacuum. Indeed, they may still be 'prohibited quantitative restrictions' under GATT Article XI. The other remaining alterative is Article III:4 which applies to internal regulatory measures.

III. GATT ARTICLE III:4 VERSUS GATT ARTICLE XI

It has been argued that the payments made by importers for CBAM certificates are not covered by provisions which refer to taxes and/or charges. This means that neither GATT Article II:1(b) nor Article III:2 — respectively, border measure and internal measure provisions — applies. The non-application of these provisions does not imply that the payments for certificates can be ignored in deciding on the application of other provisions. As noted, the purchase of certificates is a precursor obligation to meeting the annual declaration. Moreover, the required purchases would likely be the primary concern in any legal challenge. The question is therefore whether CBAM, which comprises of these obligations, is a 'quantitative restriction' under GATT Article XI, or an 'internal regulatory measure' under Article III:4. It is apt to set the scene by identifying how each provision could apply.

GATT Article XI is entitled General Elimination of Quantitative Restrictions:

> No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party …

CBAM could amount to "restrictions", "made effective through … other measures" on "importation". Based on how these terms have been interpreted, CBAM might have a 'limiting effect' on importation. It could limit the competitive opportunities available to imported products and be a disincentive to

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onwards, for which they fail to submit an allowance. This fine is imposed by the relevant Member State authority.

[35] CBAM proposal, *supra* note 2, art. 26(1).

importation.[36] The interference might be towards the lower end of the spectrum compared to some of the measures at issue in the cases,[37] but it is clear that the limiting effect of measures, "need not be demonstrated by quantifying the effect of the measures at issue".[38]

Article III:4 applies to measures, "affecting the internal sale, offering for sale, purchase, distribution or use" of products. The longstanding test here is whether the measure, "might adversely modify the conditions of competition between domestic and imported products on the internal market".[39] The question would be whether CBAM is more costly for imported products than the ETS is for like domestic products.

In broad terms, both provisions cover measures which affect the competitiveness of imports. The difference is that, under Article XI, the limitation on competitiveness stems from the proposition that only imports encounter border measure. Trade restrictive measures which only apply to imports self-evidently limit their competitiveness. In contrast, internal measures apply to both imported and domestic products. They may, or may not, limit the competitiveness of imports. This depends on whether internal regulation is discriminatory in the sense of disproportionately burdening imports. The contrasting incentives of the disputants can be detected from this explanation. If any aspect of a measure operates with reference to importation, the complainant's incentive is to argue for Article XI. It is then for the respondent to counter that there is an underlying internal measure which involves broadly equivalent regulation of domestic and imported products, and that it is convenient, or administratively efficient, for some aspects of this regulation to be applied to imports at the border. The respondent's argument will be framed with reference to Note Ad Article GATT Article III.

A. Interpreting and Applying Note Ad Article III

Any internal tax or other internal charge, or any law, regulation or requirement of the kind referred to in paragraph 1 which applies to an imported product

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[36] Panel Report, *Indonesia — Importation of Horticultural Products, Animals and Animal Products*, ¶7.46, WTO Doc. WT/DS477, 478/R (adopted Nov. 22, 2017).

[37] For example, one of the measures at issue in *Argentina — Import Measures* was a requirement for importers to offset the value of their imports with at least an equivalent value of exports. *See* Panel Report, *Argentina — Measures Affecting the Importation of Goods*, ¶¶6.166-6.177, WTO Doc. WT/DS438, 444, 445/R (adopted Jan. 26, 2015).

[38] Appellate Body Report, *Argentina — Measures Affecting the Importation of Goods*, ¶5.217, WTO Doc. WT/DS438, 444, 445/AB/R (adopted Jan. 26, 2015).

[39] Report of the Panel, *Italian Discrimination Against Imported Agricultural Machinery*, ¶12, L/833 (Oct. 23, 1958), GATT B.I.S.D. 7S/60 (1958). In relation to GATT Article III:4, this test was affirmed in Appellate Body Report, *Korea — Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, ¶137, WTO Doc. WT/DS161/169/AB/R (adopted Jan. 10, 2001).

and to the like domestic product and is collected or enforced in the case of the imported product at the time or point of importation, is nevertheless to be regarded as an internal tax or other internal charge, or a law, regulation or requirement of the kind referred to in paragraph 1, and is accordingly subject to the provisions of Article III.

The following discussion proposes a view of the 'true general test' under this provision. It should also be borne in mind that there is a difference between situations when the Note Ad is strictly relevant and is required to establish the internal nature of a measure, or other situations when the provision is not so required. Based on this, it is argued that CBAM's internal nature can be established independently of the Note Ad, albeit that the general test remains relevant. Moreover, and contrary to the general understanding, the Note Ad was not relevant in *China — Auto Parts*, and the Appellate Body did not establish a general test for its application.[40]

The Note Ad indicates that when there is a broadly equivalent regulation of domestic and imported products, the focus should be on this equivalence rather than on when and where the measure is applied to imports. When there is a measure, which applies to an imported product and to the like domestic product, the measure is internal in nature.

It may be objected that the proposed test of broad equivalence is at odds with the quoted text of the Note Ad which arguably envisages that the very same measures are applied to domestic and imported products. While CBAM mirrors the ETS, especially in relation to the weekly price of emissions certificates, the two schemes are not identical. The ETS applies to actual emissions in EU production facilities, whereas CBAM will apply to actual emissions embedded in imported products.[41]. A strong argument can be made that the Note Ad does not require identical treatment. First, for fiscal measures, the Note Ad effectively repeats GATT Article II:2(a). Under both provisions, internal taxes can be imposed on imported products at the border. Article II:2(a) uses the term 'equivalent' rather than requiring one identical measure for domestic products and imports. It therefore makes no sense to interpret the Note Ad as imposing a stricter standard for fiscal measures than Article II:2(a). It is also difficult to see why the Note Ad should impose a stricter standard for regulatory measures than fiscal measures. This is even more so bearing in mind that, when Article III:4 applies, the standard is 'treatment no less favourable'. It is well understood that this does not always require identical treatment; indeed, this may itself amount to less favourable

[40] Appellate Body Report, *China — Measures Affecting Imports of Automobile Parts*, WTO Doc. WT/DS342/AB/R (Dec. 15, 2008).

[41] CBAM Proposal, *supra* note 2, at 8.

treatment.[42] Finally, the case law supports the view that the Note Ad does not require identical treatment.[43]

It is therefore submitted that the essence of the Note Ad when distinguishing between border and internal measures is the test of broad equivalence of regulation. The CBAM clearly satisfies this test given that it mirrors the ETS.

A different question can now be posed. Notwithstanding that CBAM satisfies the general test for internal measures under the Note Ad, is this provision even required to establish its internal nature? The provision is required when imported products encounter regulation at the border. For example, an import ban would clearly be classified as a border measure without a successful argument from the respondent State based on the Note Ad. In contrast to an import ban, CBAM's features and operation are overwhelmingly internal in nature. The annual declaration and the surrender of certificates occur internally. Indeed, it is difficult to identify an aspect which is, "collected or enforced … at the time or point of importation". As noted, the purchase of certificates need not occur upon importation. In sum, CBAM is an internal measure because it operates internally, and because there is broadly equivalent regulation of domestic and imported products.

Is there any persuasive argument to the effect that the Note Ad does apply, and, moreover, that it is not satisfied? As noted, it is difficult to identify an aspect which is, "collected or enforced … at the time or point of importation". However, let it be conceded that there could be some flexibility in this language. It ought not to be interpreted in an overly literal manner. Based on the fact that CBAM is triggered by importation, and that the financial burden of purchasing certificates is at least connected with the volume of imports, it could be argued that the 'collected or enforced' language is satisfied. This would mean that Note Ad applies and must be satisfied to establish CBAM's internal nature. Of course, based on the analysis above, CBAM would still be classified as an internal measure since it satisfies the test of broad equivalence. But what if this test does not accurately reflect the essence of the Note Ad?

An argument to this effect could be made with reference to *China — Auto Parts*. The Appellate Body referred to the Note Ad as supporting the proposition that,

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[42] Report of the Panel, *United States — Section 337 of the Tariff Act of 1930*, ¶5.11 (Nov. 7, 1989), GATT B.I.S.D. 36S/345 (1989).

[43] See Panel Report, *European Communities — Measures Affecting Asbestos and Asbestos-Containing Products*, ¶8.98, WTO Doc. WT/DS135/R (adopted Apr. 5, 2001), wherein it was stated that, "… the wording of Note *Ad Article III* and practice in the GATT 1947 in this respect do not support Canada's approach that an *identical* measure must be applied to the domestic product and the like imported product if the measure applicable to the imported product is to fall under Article III". This point was not appealed.

"the time at which a charge is collected or paid is not decisive".[44] This statement is a direct interpretation of the Note Ad. In the same paragraph, however, it proceeded to note that, "[w]hat is important … is that the obligation to pay a charge must accrue due to an internal event, such as distribution, sale, use or transportation of the imported product". When satisfied, a charge imposed at the border is properly classified as an internal charge. The CBAM arguably satisfies this test if the internal event which triggers the payment for certificates is viewed as the annual declaration and surrender of certificates. In contrast, the test would not be satisfied if the payments are viewed as 'triggered by the act of importation'. This view is strengthened by noting that the obligation to purchase certificates does not depend in any way on what happens to the products after importation. The question, then, is whether the Appellate Body intended to establish a test of general application under the Note Ad for distinguishing between border measures and internal measures, or whether the test only applies to the circumstances at issue in the case. It is submitted that the second view is the better one.

The Note Ad applies when there is a measure, which applies to an imported product and the like domestic product. It is a much-overlooked point that *China — Auto Parts* was not such a case. The panel noted that, "as domestic products are not subject to the measures, they are also not therefore subject to any charge under the measures at all".[45] This is a sufficient basis to think of the Note Ad as lacking direct relevance in this case. The Appellate Body did not establish a generally applicable test under the Note Ad. It rather established a test for distinguishing between internal and border measures outside of the Note Ad in the situation when charges at the border are only encountered by imported products. Under this test, it is possible for such charges to be internal measures.

Explained from a different angle, *China — Auto Parts* effectively established a broad reach for Article III:2. This can be seen by starting from the proposition referred to above — that only imported products encounter border measures. The different question before the Appellate Body was whether all measures only encountered by imports are border measures. Its answer was that measures only encountered by imports, whose imposition turns on an internal event, are internal

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[44] Appellate Body Report, *China — Measures Affecting Imports of Automobile Parts*, ¶161, WTO Doc. WT/DS339, 340, 342/AB/R (adopted Jan. 12, 2009) [hereinafter *China — Auto Parts* (ABR)].

[45] *See* Panel Report, *China — Measures Affecting Imports of Automobile Parts*, ¶7.221, WTO Doc. WT/DS339, 340, 342/R (adopted Jan. 12, 2009) [hereinafter *China — Auto Parts* (Panel)]. The question was whether charges only encountered by imported auto parts were properly categorised as a border measure in the form of ordinary customs duties covered by GATT Article II, or internal charges subject to GATT Article III:2. China argued for the border measure interpretation, and further argued that the charges did not exceed the scheduled *ad valorem* tariff rates. The Complainants successfully argued that the charges were internal in nature and discriminatory under GATT III:2.

measures.[46] This expands Article III in the context of measures which apply only to imports. The test was used to classify something which looked very much like a border measure as an internal measure. It would be wrong to take from this expansion a contraction of Article III in the situation when there is broadly equivalent regulation of imported and domestic products. This equivalence should be enough to establish the internal nature of the measure.

Finally, there is the argument that CBAM might be redesigned to put its internal nature beyond doubt. The obligations to hold and relinquish certificates would clearly be internal in nature if they were applicable upon internal sale rather than being linked to importation. This argument, however, misses the whole point of the Note Ad which is to recognise that it could be administratively more efficient to impose internal measures on imports at the border. This gives WTO members much needed discretion in the design of their internal regulations. Indeed, CBAM could be more administratively burdensome if it operated with reference to internal sale. Importers are, plausibly, a smaller group than internal purchasers. It is easier to ensure that importers register with the CBAM authority.

In sum, the preferred view here is that the Note Ad is not required to establish the internal nature of CBAM. In this event, it remains possible to draw guidance from the Note Ad. Its essence is the test of broad equivalence of regulation as between like domestic and imported products. If the preferred view is that the Note Ad does apply, then this test is in any event satisfied. The Appellate Body did not reframe this essential test in *China — Auto Parts*.

B. The Product/Process Distinction

A further aspect of the boundary between GATT Articles XI and III is the product/process distinction. The idea here is that measures whose application focuses on how a product was produced, rather than on a physical characteristic of the product itself, fall outside of Article III and are remitted to Article XI. The possibility of the absence of an Article III violation is thereby removed and substituted with an automatic violation of Article XI based on the impediment to importation imposed by the extra burden of the process-based measure. The appraisal then shifts to Article XX if invoked by the respondent State.

The analysis below first considers whether this non-application of Article III ever gained the status of an accepted legal principle in the GATT era. It then considers whether any such principle, or a functionally equivalent one, is reflected in current understandings of WTO law. At the outset, however, it can be noted that the product/process distinction is conspicuous only by its absence in recent case law, both in terms of the arguments made (and not made) by States, and in terms of legal findings.

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[46] *China — Auto Parts* (ABR), *supra* note 44.

1. Product/Process in the GATT Era

The idea that Article III:4 does not apply to process-based measures originates from the *Tuna — Dolphin* reports.[47] These remain unadopted.[48] Access to the US tuna market was conditioned on the country of origin having a regulatory system comparable in effectiveness to that of the US regarding harm to marine mammals. Not having satisfied this requirement, tuna products from Mexico caught by setting on dolphins in the ETP were subject to an import ban.[49] Mexico argued that the import ban fell under Article XI, while the US argued that it was an enforcement at the border of the regulations applicable to fishing for domestic tuna. For the US, Article III:4 was therefore applicable via the Note Ad Article III. The panel noted that Article III and its Note Ad are concerned with imported and domestic 'products'. Article III therefore only covered 'measures affecting products as such'.[50] It considered that measures about fishing methods to reduce the incidental taking of dolphins 'could not be regarded as being applied to tuna products as such because they would not directly regulate the sale of tuna and could not possibly affect tuna as a product'.[51]

The panel was, of course, correct that the manner in which tuna is caught has no bearing on its physical characteristics; unlike, for example, whether a building material contains asbestos fibres. However, there is quite a leap between this acknowledgement and the position that the term 'product' requires process-based distinctions to be carved out from Article III. The language of Article III:4 refers

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[47] Report of the Panel, *United States — Restrictions on Imports of Tuna*, DS21/R (Sept. 3, 1991), GATT B.I.S.D. 39S/155 (1991) (unadopted) [hereinafter *Tuna/Dolphin I*]; Report of the Panel, *United States — Restrictions on Imports of Tuna*, DS29/R (June 16, 1994) (unadopted) [hereinafter *Tuna/Dolphin II*]. The main text details Tuna/Dolphin I; the second case added very little to the legal reasoning.

[48] *See* Appellate Body Report, *Japan — Taxes on Alcoholic Beverages*, at 14-15, WTO Doc. WT/DS8, 10, 11/AB/R (adopted Nov. 1, 1996) (stating that unadopted GATT and WTO panel reports have no legal status in the WTO).

[49] The fact that the import ban was country specific, rather than origin-neutral, is significant. Country specific import bans ignore how the product is produced. Tuna from Mexico was banned regardless of how it was produced because the US was not satisfied that Mexico's regulatory system was of comparable effectiveness to its own. It was therefore inconsequential in this case whether the embargo was held to be a breach of Article XI or Article III:4. Like the GATT Article XI breach, the GATT Article III:4 breach would also be established automatically. This would be *de jure* discrimination indisputable from the face of the measure. However, the panel did not make this point and its findings are clearly broad enough to apply to origin-neutral process-based measures. Here, the choice between the two provisions matters because origin-neutral measures covered by GATT Article III:4 must be found to be *de facto* discriminatory for a violation — an analytical process which is far removed from an automatic violation of Article XI.

[50] *Tuna/Dolphin I*, *supra* note 47, ¶5.11.

[51] *Id.* ¶5.14.

to measures, "affecting the internal sale … of products".[52] How a product is produced can just as much affect its internal sale as its physical composition. It can also be questioned why the panel's understanding results in the application of GATT Article XI, rather than its non-application. This provision also uses the term 'product' leading to the argument that quantitative restrictions are prohibited only to the extent that they apply to the product as such, rather than also when they are based on a production method which leaves no trace on the product. It follows that the term 'product' in these provisions tells us nothing about which one applies.

Reference should also be made to an analogy which influenced the *Tuna — Dolphin I* panel. The panel referred to the Report of the Working Party on Border Tax Adjustments. The Working Party had identified agreement, "to the effect that taxes directly levied or products were eligible for tax adjustment", while "… certain taxes not directly levied on products were not eligible for adjustment [such as] social security charges whether or employers or employees and payroll taxes". The panel considered that, "… it would be inconsistent to limit the application of [Note Ad Article III] to taxes that are borne by products while permitting its application to regulations not applied to the product as such".[53] As Howse and Regan point out, this claimed inconsistency is premised on the misconception of equating a tax borne directly by products, with a regulation applicable to products as such.[54] These are not the same concepts. An excise tax on cans of dolphin-unsafe tuna is just as much a direct product tax as a value added tax on all tuna. The fact that the first of these is process-based does not remove it from the application of Note Ad Article III and Article II:2(a). The inconsistency is therefore the opposite of that claimed by the panel. Based on a correct analogy with the type of taxes that are border-adjustable, process-based regulations should fall under the Note Ad Article III.

It follows that there is no satisfactory legal rationale for the view that process-based measures fall under Article XI. This perhaps explains why this proposition is largely confined to the unadopted *Tuna — Dolphin* reports.[55] However, it would be incomplete to leave the analysis here because an equivalent idea did gain traction in

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[52] GATT, *supra* note 7, art. III:4.

[53] *Id.* ¶5.13.

[54] Robert Howse & Donald Regan, *The Product/Process Distinction – An Illusory Basis for Disciplining 'Unilateralism' in Trade Policy*, 11 EUR. J. INT. L. 249, 257-258 (2000).

[55] The only strong indications to the contrary are the panel and Appellate Body reports in the *Shrimp/Turtles* case. The United States did not contest the allegation that the process-based measure, prohibiting the import of shrimp caught in a manner harmful to sea turtles, breached Article XI, preferring to defend the measure under Article XX. The appeal was similarly based on Article XX. *See* Appellate Body Report, *United States — Import Prohibition of Certain Shrimp and Shrimp Products*, WTO Doc. WT/DS58/AB/R (adopted Nov. 6, 1998) [hereinafter *Shrimp/Turtles* (ABR)].

the case law. There are other cases which applied GATT Article III to process-based measures but found violations on the basis that it is not permissible to draw distinctions between products based on anything other than their physical characteristics. While Article III was applied in these cases, breaches were established in a near-automatic manner so that the choice between GATT Articles XI and III entailed no practical difference. In other words, this limitation on Article III was the functional equivalent of moving process-based measures to GATT Article XI.

The adopted panel report in *United States — Measures Affecting Alcoholic and Malt Beverages*[56] applied GATT Article III:2 to tax credits provided to small domestic breweries. For the most part, these tax credits were not available to imported beer. However, the panel noted disagreement between the parties on whether Minnesota's tax credits were available to imported beer from small breweries. The panel expressed no view on this disagreement. Even if Minnesota's system was origin-neutral in relation to beer from small breweries, it would not, in any event, be permissible to distinguish between domestic small brewery beer, and imported large brewery beer. These were like products as the size of the brewery (a process-based consideration) could not affect the nature of beer as a product.[57]

The last pre-WTO decision was the unadopted *United States — Taxes on Automobiles* report.[58] The panel considered that the activities covered by Article III:4, "relate to the product *as a product*, from its introduction into the market to its final consumption".[59] Distinctions "based on factors not directly relating to the product as such" were not permitted.[60] This idea survived into the WTO era. The panel in *United States — Standards for Reformulated and Conventional Gasoline*[61] cited the *Malt Beverages* case and found that, "Article III:4 … deals with the treatment to be accorded to like products; its wording does not allow less favourable treatment dependent on the characteristics of the producer and the nature of the data held by it".[62]

2. Product/Process: Current Status

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[56] Report of the Panel, *United States — Measures Affecting Alcoholic and Malt Beverages*, DS23/R (June 19, 1992), GATT B.I.S.D. 39S/206 (1992).
[57] *Id.* ¶5.19.
[58] Report of the Panel, *United States — Taxes on Automobiles*, DS31/R (Oct. 11, 1994) (unadopted).
[59] *Id.* ¶5.52.
[60] *Id.* ¶5.54. The findings were made in the context of fleet averaging fuel economy regulations whose operation depended on non-product related consideration such as the ownership and control of the manufacturer/importer.
[61] Panel Report, *United States — Standards for Reformulated and Conventional Gasoline*, WTO Doc. WT/DS2/R (adopted May 20, 1996).
[62] *Id.* ¶6.11.

The extent to which these ideas are still reflected in the case can now be considered. To be precise, the ideas are that process-based measures fall under and automatically violate Article XI, or, if they fall under Article III:4, also automatically violate this provision. These can be collapsed into the proposition that process-based regulatory distinctions must be justified under Article XX. The analysis first describes how this idea is conspicuously absent from the *US — Tuna II (Mexico)*[63] litigation. It then explains how it is inconsistent with the modern conception of likeness.

Mexico's concern in *US — Tuna II (Mexico)* was the non-eligibility of its tuna for the US dolphin-safe label. Under the US measures, the disqualifying process-based consideration was that Mexican tuna was commonly caught by 'setting on' dolphins in the ETP. Outside of the ETP, the requirements for use of the dolphin-safe label were less strict. Ineligible tuna was not subject to an import ban. Indeed, it could be marketed in the US, but not with the US dolphin-safe label, or any other dolphin-safe label. In practice, this drastically reduced the commercial viability of Mexican tuna compared to domestic tuna which predominantly complied with the eligibility criteria. Like the earlier cases, the US measures afforded different treatment to tuna depending on where and how it was caught, rather than the physical properties of the product itself. According to the first *Tuna — Dolphin* panel, GATT Article III:4 should therefore be inapplicable, and the process-based measure should be held to violate Article XI.

It is significant that Mexico did not invoke Article XI, preferring instead to invoke the GATT and Technical Barriers to Trade (TBT) non-discrimination obligations — both MFN and national treatment — as well as further TBT provisions. The panel proceeded on this basis, focusing on the TBT non-discrimination and further claims. It exercised judicial economy on the GATT claims erroneously as it turned out according to the Appellate Body.[64] However, at no point during this protracted litigation did any State claim, or adjudicator suggest that, GATT Article XI ought to have been applied in addition to, or to the exclusion of, other provisions.

The legal findings also indicate that the idea of not applying GATT Article III:4 to process-based measure is now anachronistic. The threshold issue under the TBT is whether the measure falls within the definition of a technical regulation:

> Document which lays down product characteristics or their related processes and production methods, including the

[63] Appellate Body Report, *United States — Measures Affecting the Importation, Marketing and Sale of Tuna and Tuna Products*, WTO Doc. WT/DS381/AB/R (adopted June 13, 2012) [hereinafter *US — Tuna (Mexico)* (ABR)].
[64] *Id.* ¶¶403-405.

> applicable administrative provisions, with which compliance is mandatory. It may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements as they apply to a product, process or production method.

It is possible to raise *Tuna — Dolphin I* based arguments in order to establish that this definition is not met. A production method, it might be argued, is not 'related' to the product if it leaves no trace on the product itself. Or, more simply, dolphin-safe labels are not about the product 'as such'. The US raised an argument along these lines before the panel, which was rejected.[65] Relying on earlier Appellate Body decisions, the panel found that the measures were 'labelling requirements' which applied to an identifiable product (tuna products). Moreover, 'labelling requirements' were a distinct example of the concept of 'product characteristics', so that the language 'related processes and production methods' was not relevant.[66] The US did not appeal the panel's findings on this point. Rather, it challenged the separate finding that the labelling requirements were 'mandatory'; a matter with no bearing on the product/process distinction.

Indirectly, this understanding of the term 'technical regulation' tells us something about the idea that GATT Article III:4 does not apply to process-based measures.

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[65] See Panel Report, *United States — Measures Affecting the Importation, Marketing and Sale of Tuna and Tuna Products*, ¶7.66, WTO Doc. WT/DS381/R (adopted June 13, 2012) [hereinafter *US — Tuna II (Mexico)* (Panel)], wherein it is stated that:

> The United States contends that the US dolphin-safe labelling provisions do not set out product characteristics for tuna products. Instead, they specify the conditions under which tuna products may be labelled dolphin-safe. Therefore, although the United States recognizes that the US dolphin-safe provisions 'set out requirements that must be met for tuna to be labeled dolphin-safe', it submits that the US dolphin-safe provisions do not specify the product characteristics that tuna products must meet (or not meet) to be sold on the United States' market.

[66] *Id.* ¶¶ 7.71-7.79. The idea that 'labelling requirements' under the second sentence are a distinct example of 'product characteristics' under the first sentence was explained by the Appellate Body as follows:

> … we note that the definition of a 'technical regulation' provides that such a regulation 'may also include or deal exclusively with terminology, symbols, packaging, marking or labelling requirements'. The use here of the word 'exclusively' and the disjunctive word 'or' indicates that a 'technical regulation' may be confined to laying down only one or a few 'product characteristics'.

See Appellate Body Report, *European Communities — Measures Affecting Asbestos and Asbestos-Containing Products*, ¶67, WTO Doc. WT/DS135/R (adopted Apr. 5, 2001) [hereinafter *EC — Asbestos* (ABR)].

Measures that provide for different treatment of products depending on how they were produced clearly do not automatically fall outside the definition. This is not to say that such measures will always or generally be within the definition. If there is a mandatory labelling requirement, this will be a technical regulation whether or not the label provides information about the physical characteristics of the product. The labelling requirement itself falls under 'product characteristics'. In contrast, when there is no labelling requirement (or something else falling under the second sentence), it is at least uncertain whether a production method which leaves no physical trace on the product, falls under 'product characteristics or their related processes or production methods' under the first sentence. The argument here is that 'product characteristics' could be limited to the physical characteristics of the products, and that production methods are not 'related' to 'product characteristics' if they leave no physical trace. Thus, a rule requiring that welding joints must be done by a robot rather than a person might leave a physical trace, while rules about fishing methods do not. The Appellate Body has certainly indicated that this is the correct understanding of the first sentence.[67] Once this threshold question is satisfied, the TBT national treatment provision is applicable. It then becomes difficult to argue that GATT Article III:4 does not also apply. This would give the GATT national treatment provision a narrower scope of operation than the TBT national treatment provision which is the reverse of the conventional understanding that the TBT Agreement is the narrower instrument — it only applies to technical regulations, standards, and conformity assessment procedures. It is also notable that Article III:4 was eventually applied in the compliance proceedings in *Tuna — Dolphin II* without any suggestion of non-application in favour of GATT Article XI.[68]

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[67] *See* Appellate Body Reports, *European Communities — Measures Prohibiting the Importation and Marketing of Seal Products*, ¶¶5.11-5.12, WTO Doc. WT/DS400, 401/AB/R (adopted June 18, 2014) [hereinafter *EC — Seal Products*]. Based on this understanding, there was, "… no basis in the text of Annex 1.1, or in prior Appellate Body reports, to suggest that the identity of the hunter, the type of hunt, or the purpose of the hunt could be viewed as product characteristics". *See id.* ¶5.45. This statement applies to the first sentence. It does not sit easily with the Appellate Body's own view of the relationship between the first and second sentences. Based on prior reports, if the case had involved a labelling requirement relating to the identity of the hunter, there would have been a product characteristic.

[68] Both the panel and the Appellate Body applied GATT Article III:4 in the first round of compliance proceedings. In the second round, this was limited to the panel. *See* Panel Report, *US Tuna II (Mexico) Recourse to Article 21.5 of the DSU by Mexico*, WTO Doc. WT/DS381/RW (adopted Dec. 3, 2015); Appellate Body Report, *US Tuna II (Mexico) Recourse to Article 21.5 of the DSU by Mexico*, WTO Doc. WT/DS381/AB/RW (adopted Dec. 3, 2015); Panel Reports, *US Tuna II (Mexico) Recourse to Article 21.5 of the DSU by the United States/Second Recourse to Article 21.5 of the DSU by Mexico*, WTO Doc. WT/DS381/RW/USA, WT/DS381/RW/2 (adopted Jan. 11, 2019); Appellate Body Reports, *US Tuna II (Mexico) Recourse to Article 21.5 of the DSU by the United States/Second*

If this is not enough to persuade the reader that Article III:4 applies to process-based measures, the matter can be approached from another angle. According to the Appellate Body:

> [A] determination of "likeness" under Article III:4 is, fundamentally, a determination about the nature and extent of a competitive relationship between and among products.[69]

The same position applies to tax-based measures under Article III:2;[70] to the national treatment and MFN provision of the TBT agreement,[71] and to 'services and services suppliers' under the General Agreement on Trade in Services (GATS) national treatment and MFN provisions.[72] Given this position, it is axiomatic that process-based considerations could be intensely relevant to likeness.[73] This

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Recourse to Article 21.5 of the DSU by Mexico, WTO Doc. WT/DS381/AB/RW/USA, WT/DS381/AB/RW/2 (adopted Jan. 11, 2019).

[69] *EC — Asbestos* (ABR), *supra* note 66, ¶99.

[70] Appellate Body Report, *Philippines — Taxes on Distilled Spirits*, ¶170, WTO Doc. WT/DS396, 403/AB/R (adopted Jan. 20, 2012).

[71] Appellate Body Report, *United States — Measures Affecting the Production and Sale of Clove Cigarettes*, ¶111, WTO Doc. WT/DS406/AB/R (adopted Apr. 24, 2012) [hereinafter *US — Clove Cigarettes* (ABR)].

[72] Appellate Body Report, *Argentina — Measures Relating to Trade in Goods and Services*, ¶6.25, WTO Doc. WT/DS453/AB/R (adopted May 9, 2016).

[73] See, e.g., *US — Tuna II (Mexico)* (Panel), *supra* note 65, ¶¶7.249, 7.250, wherein this position comes close to acknowledgement:

> The information presented to the Panel does suggest that US consumers have certain preferences with respect to tuna products, based on their dolphin-safe status, and we do not exclude that such preferences may be relevant to an assessment of likeness. To the extent that consumer preferences, including preferences relating to the manner in which the product has been obtained, may have an impact on the competitive relationship between these products, we consider it a priori relevant to take them into consideration in an assessment of the likeness.

Despite this acknowledgement, the panel proceeded to dismiss the relevance of consumer preferences:

> 7.249 … we are not persuaded that, in the circumstances of this case, a consideration of US consumer preferences relating to the dolphin-safe status of tuna products should lead us to modify our conclusion with respect to the likeness of US and Mexican tuna products and tuna products originating in any other country.
>
> 7.250 The basis for our analysis is a comparison between Mexican tuna products and tuna products of US origin and tuna products originating in any other country, not between dolphin-safe and not dolphin-safe tuna. *A comparison on the basis of dolphin-safe status would imply that Mexican tuna products are assumed not to be dolphin-safe while US tuna products and tuna products*

depends on whether consumers are aware of differences in how products are produced, whether they care about these differences, and, ultimately, whether this affects their purchasing habits.[74]

This is not the same as considering regulatory context in the likeness analysis — an approach rejected by the Appellate Body.[75] The question is not directly whether there is a compelling non-protectionist reason for the regulator to view the

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> *originating in any other country would be assumed to be dolphin-safe.* [emphasis added]

The emphasised passage here is incorrect. It does not provide a basis for dismissing consumer preferences. A finding that cans of tuna are unlike based on their dolphin-safe status makes no assumption about the proportion of dolphin-safe tuna from different countries, yet alone assuming that all tuna from Mexico is not dolphin-safe. A finding of unlikeness simply removes all dolphin unsafe tuna from the comparison regardless of its origin. The question is then whether there is discrimination between domestic and imported dolphin-safe tuna, and between imported dolphin-safe tuna from different countries. The panel's findings around likeness were not appealed to the Appellate Body.

[74] See *id.* ¶7.166, wherein a part of the panel's discussion was whether the measure was a technical regulation rather than the likeness analysis. However, it is a stark illustration of how consumers can view physically identical products very differently based on a process-based difference:

> 7.166 Mexico alternatively argues that the labelling scheme established by the US dolphin-safe provisions is de facto mandatory 'because the market conditions in the United States are such that it is impossible to effectively market and sell tuna products without a dolphin-safe designation'. In this respect, … Mexico has observed that the US distribution and retail networks for tuna products are acutely aware of the dolphin safe issue and the fact that they will encounter actions such as boycotts, promoted by NGOs, if they carry tuna that is not labelled as dolphin safe. Mexico argues that large US grocery chains have indicated that they will be unable to carry any Mexican tuna products unless they bear a US government-approved dolphin safe label. Mexico has also noted that the three major tuna processors in the United States refuse to purchase tuna caught in the ETP including Mexican tuna because tuna products containing such tuna cannot be labelled as dolphin safe. [notes omitted]

[75] *See US — Clove Cigarettes* (ABR), *supra* note 71, ¶119. The panel declined to transpose the competition approach to likeness under GATT Article III:4 to Article 2.1 of the TBT Agreement. Its analysis of the likeness of domestic menthol and imported clove cigarettes was informed by the legitimate objective of the technical regulation before it; this being to regulate cigarettes with characterising flavours to reduce youth smoking. Based on this objective, there was no compelling reason to treat cloves and menthols differently. The two products were therefore 'like'. In contrast, the Appellate Body considered that regulatory concerns could only be relevant to the likeness analysis, "to the extent they have an impact on the competitive relationship between and among the products concerned". This different approach did not, in this case, affect the overall finding of likeness.

products as unlike. Such a test would operate independently of competition in the marketplace because the focus would be on what the regulator reasonably thinks, rather than on the manifestation of consumer preferences in purchasing decisions. Using the 'competitive relationship test', consumers could, at the extreme, perceive that, two physically identical products (differing only in a process-based aspect) belong in segmented markets with different price ranges. Conversely, consumers might be oblivious to the process-based difference or might not care about it enough to pay a premium for one product over the other. In both situations, the concerns of consumers and regulators might be aligned. For example, there are sound reasons to treat building materials containing asbestos differently from those which do not (a product-based difference), and this reason may well be of equal and contemporaneous concern to consumers and regulators. The likeness analysis would then reach the same conclusion, whether based on competition or regulatory context. However, the two approaches might not be aligned — for example, when the regulator is minded towards paternalism in relation to health risks, when even well-informed consumers are content to run the gauntlet.

Given that likeness is about considerations which have a bearing on competition, it makes no sense to claim that the 'tastes and habits of consumers' are only relevant if they pertain to the product 'as such', rather than also to process-based considerations. Contrary to the Appellate Body's insistence, likeness would then be about something other than the nature and extent of the competitive relationship.

In sum, it is difficult to detect the product/process distinction in WTO law as it currently stands. The non-application of Article III in favour of Article XI only remains to the extent that a respondent State might concede this point and decline to argue that the treatment of imports at the border amounts to the enforcement of an internal measure.[76] The functionally equivalent idea that Article III applies but does not permit regulatory distinctions between physically identical product gained at least some traction. However, this depends upon a strong focus on the physical properties of products in the likeness analysis. This focus pre-dates the conception of likeness as competition,[77] under which physical properties, along with the tastes and habits of consumers (and other considerations), reveal the nature and extent of the competitive relationship. The conclusion is therefore that CBAM is an internal regulatory measure covered by Article III:4.

IV. APPLYING GATT ARTICLE III:4

[76] *See e.g.*, *Shrimp/Turtles* (ABR), *supra* note 55. The US declined to invoke the Note Ad to establish that its import ban was an internal regulation, preferring instead to defend the import ban under GATT Article XX. Therefore, neither the panel nor the Appellate Body had any need to consider the boundary between GATT Articles XI and III:4.
[77] *EC — Asbestos* (ABR), *supra* note 66, ¶99.

The two tests under GATT Article III:4 are likeness and treatment no less favourable (TNLF). The provision is breached if domestic and imported CBAM products are like, and if the CBAM involves less favourable treatment of imported products than the ETS does for domestic products. It would be unproblematic for a complainant to establish likeness. In contrast, for TNLF, the correct application is less definite.

A. Likeness

Under the competition-based approach to likeness described above, all relevant indicators, including the perceptions of consumers, would very likely point towards positive findings for any particular CBAM/ETS covered imported and domestic product. The physical properties would likely be indistinguishable. In addition, it is reasonably clear that consumers currently do not differentiate between products based on production emissions or embedded carbon content. Physically identical CBAM products compete intensely based on price rather than also based on environmental considerations. Consumers are not currently prepared to pay higher prices based on how the product was made. Were the position otherwise, there would be less need for an adjustment mechanism; the market position would be that identical products which differ significantly in their carbon content belong in segmented markets rather than in the same market with intense price competition. It is possible to question who the relevant consumer is here. While the direct answer is the commercial entities such as manufacturers which purchase CBAM products, the Appellate Body has also stated that such entities cannot, "ignore the preferences of the ultimate consumer of its products".[78] However, this does not change the analysis. The carbon content of the steel and cement in a washing machine does not currently influence the purchasing decisions of the manufacturer or the ultimate consumer. Likeness is therefore a low hurdle.

B. Treatment no Less Favourable

If the domestic and imported products are like, the TNLF standard will be breached if imports encounter a detrimental effect compared to domestic products. The questions here are how this detrimental effect is established, and whether this is enough to confirm a violation, or whether regulatory context can influence the outcome.

The ease or difficulty of establishing detrimental effect is sometimes identified via the concepts of 'best treatment' versus 'group comparison'.[79] The best treatment approach is a low threshold for identifying detrimental effect. It is a matter of

[78] *Id.* ¶122.

[79] Arwel Davies, *Group Comparison Versus Best Treatment in International Economic Law Non-Discrimination Analysis*, *in* YEARBOOK ON INTERNATIONAL INVESTMENT LAW & POLICY 111-176 (Andrea K. Bjorklund ed., 2014-2015).

identifying the best treatment afforded to domestic products. In the current context, this will be the ETS charge for the product whose production resulted in the least emissions. For the TNLF analysis, this will be taken as the ceiling for the equivalent CBAM charge. There will the detrimental effect on every occasion when an imported product encounters a higher CBAM charge than the lowest ETS charge on like domestic products. Detrimental effect is established here almost automatically. There will always be some imports treated less favourably than the like domestic products receiving the best treatment.

The group comparison is a higher threshold. It compares the overall treatment of the group of domestic products with that of the group of like imported products. Within both groups, a range of ETS and CBAM charges will be present. The question is whether the group of imports have been subject to higher charges overall, or disproportionately, than the group of domestic products. It is now well-settled that the TNLF standard requires a group comparison:

> [T]he national treatment obligation … calls for a comparison of treatment accorded to, on the one hand, the group of products imported from the complaining Member and, on the other hand, the treatment accorded to the group of like domestic products. … [T]he treatment accorded to all like products imported from the complaining Member must be compared to that accorded to all like domestic products. The 'treatment no less favourable' standard … does not prohibit regulatory distinctions between products found to be like, provided that the group of like products imported from the complaining Member is treated no less favourably than the group of domestic like products.[80]

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[80] *US — Clove Cigarettes* (ABR), *supra* note 71, ¶194. The Appellate Body was interpreting the national treatment obligation in Article 2.1 of the TBT Agreement. However, the quotation clearly recalls the original statement to this effect in *EC — Asbestos* (ABR), *supra* note 66, ¶100, which concerned GATT Article III:4:

> … even if two products are 'like', that does not mean that a measure is inconsistent with Article III:4. A complaining Member must still establish that the measure accords to the group of 'like' imported products 'less favourable treatment' than it accords to the group of 'like' domestic products … [A] Member may draw distinctions between products which have been found to be 'like', without, for this reason alone, according to the group of 'like' imported products 'less favourable treatment' than that accorded to the group of 'like' domestic products.

The more recent quotation is provided because it provides the additional clarification that the group of imported products comprises only of those originating from the complaining member, as opposed to imports as a whole.

Along with clearly endorsing the group comparison, this passage clarifies that the group of imported products comprises only of those originating from the complaining member, as opposed to imports as a whole. This means that the ability of some WTO members to establish detrimental effect does not imply that all WTO members will be able to do so, with the prospects of success increasing along with the carbon intensity of production in the complainant State.

The remaining question is whether detrimental effect based on the group comparison concludes the TNLF analysis, or whether there is a further stage involving regulatory context. Can the respondent State argue within GATT Article III:4 that the detrimental effect is an incidental consequence of a legitimate non-protectionist objective, or must this consideration be deferred to GATT Article XX? An aspect of the Article III:4 case law provides one possible opening here, while the other is a call for an alignment of the GATT and TBT TNLF standards.

The Article III:4 line of argument has its origin in *Dominican Republic — Cigarettes*.[81] Among the challenged measures here was a bond requirement imposed on domestic producers and importers to guarantee compliance with tax liabilities. Honduras argued that the fixed amount of the bond resulted in less favourable treatment on the basis that the cost of the bond per cigarette sold would be higher for Honduran than domestic cigarettes. This calculation was based on the relatively low market share of Honduran-produced cigarettes compared to two domestic manufacturers. Within its dismissal of this argument, the Appellate Body noted:

> … [T]he existence of a detrimental effect on a given imported product resulting from a measure does not necessarily imply that this measure accords less favourable treatment to imports if the detrimental effect is explained by factors or circumstances unrelated to the foreign origin of the product, such as the market share of the importer in this case.[82]

This passage can be understood as permitting arguments based on regulatory context in the TNLF analysis. The detrimental effect might be unrelated to foreign origin if it results incidentally from the pursuit of non-protectionist objectives including those referred to in GATT Article XX. In subsequent cases, however, the Appellate Body has strongly de-emphasised the possible general test of whether the detrimental impact is 'unrelated to foreign origin'.[83] Emphasis has

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[81] Appellate Body Report, *Dominican Republic — Measures Affecting the Importation and Internal Sale of Cigarettes,* WTO Doc. WT/DS302/AB/R (adopted May 19, 2005).
[82] *Id.* ¶96.
[83] See Appellate Body Report, *United States — Certain Country of Origin Labelling (COOL) Requirements, Recourse to Article 21.5 of the DSU by Canada and Mexico*, ¶5.358, WTO Doc. WT/DS384,386/AB/RW (adopted May 29, 2015) [hereinafter *US — Cool* (ABR)], where the Appellate Body noted that:

instead been placed on a narrower causation based point; that, "there must be … a genuine relationship between the measure at issue and its adverse impact on competitive opportunities…".[84] In *Dominican Republic — Cigarettes*, the nexus between the fixed bond and the detrimental impact was insufficiently close, with the more proximate cause being the market share.[85]

It is submitted that there is a meaningful distinction between the two possible bases for exonerating the bond requirement. The causation basis precedes, and is distinct from, any consideration of regulatory context. Causation is about what caused the detrimental effect which may, or may not, be the measure at hand. Regulatory context becomes relevant only if it is established that the detrimental effect was caused by the measure. The question is whether this detrimental effect can be sufficiently explained with reference to a non-protectionist objective. An affirmative answer results in the exoneration of the measure, but this does not undo the earlier finding that the measure caused the detrimental impact. In other words, it would seem to be quite manageable and natural to first ask what caused a particular outcome, and then, if necessary, proceed to ask whether there are any mitigating or exonerating explanations. In the cases which followed *Dominican Republic — Cigarettes*, the clear message from the Appellate Body is that only the first question is considered within Article III:4.

Looking at the causation test itself, this is a low hurdle for complainant States and *Dominican Republic — Cigarettes* is a rare example of its non-satisfaction. It is clear that the measure itself will be to blame for the detrimental effect notwithstanding the fact that foreign producers could change and adapt their production to avoid the disbenefit of the measure.[86] The focus is therefore on production as it is, rather

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> [T]he United States' argument is based on the proposition that the analysis of less favourable treatment under Article III:4 should include an inquiry into whether the detrimental impact of a measure on imports is unrelated to foreign origin, and can be explained by other factors that do not reflect discrimination, in this case, the fact that the amended COOL measure pursues consumer information objectives. However, we note that this argument is based upon a proposition that was expressly rejected by the Appellate Body in *US — Clove Cigarettes*.

[84] Appellate Body Report, *Thailand — Customs and Fiscal Measures on Cigarettes from the Philippines*, ¶134, WTO Doc. WT/DS371/AB/R (adopted July 15, 2011).

[85] This reasoning is robust provided the market share is not itself impacted by the fixed bond requirement. This would seem to be unlikely bearing in mind that the panel had identified the effective cost of the bond for the importer as approximately US$1,873 or two cents per thousand cigarettes. *See* Panel Report, *Dominican Republic — Measures Affecting the Importation and Internal Sale of Cigarettes*, ¶7.299, WTO Doc. WT/DS302/R (adopted May 19, 2005).

[86] See *US — Tuna II Mexico* (Panel), *supra* note 65, ¶¶7.291, 7.344, where an argument to the contrary succeeded before the panel. For the panel, the question was whether Mexican

than on how it hypothetically could be. For CBAM, it will not be possible to argue that the detrimental effect is attributable to the failure of foreign producers to invest in cleaner production technologies, rather than the measure itself.

Regardless of the exact parameters of the causation test, it is the distinction between causation and explanation, which means that *Dominican Republic — Cigarettes* can no longer be understood as opening the possibility of considering regulatory context within Article III:4. As indicated, the other possible opening here is an alignment of Article III:4, and TBT Article 2.1 TNLF standards. Under the latter, there is a further stage in the analysis having established likeness and detrimental effect. There will be no violation if the detrimental effect, "stems exclusively from a legitimate regulatory distinction".[87] Although the Appellate Body has not directly said so, the reason for this additional test is clearly that the TBT agreement does not contain a general exceptions provision like GATT Article XX.[88] The additional test therefore reflects the imperative of having to consider regulatory context somewhere within the overall appraisal of the measure. For GATT Article III:4 in contrast, it is clear that the Appellate Body does not wish to bring forward consideration of regulatory context into Article III:4,[89] preferring to defer this to Article XX.

In sum, the ability of a WTO member to establish that CBAM charges violate the GATT Article III:4 national treatment obligation focuses on the outcome of the group comparison. Complainant States will need to establish that their production

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tuna products were, "effectively denied access to the advantage provided by the [dolphin-safe] label". The panel thought not as setting on dolphins could be practiced or not practiced by vessels of all nationalities. Therefore, any disadvantage encountered through non-eligibility for the label resulted from the choices of the Mexican fleet as opposed to the measure itself. For the Appellate Body, enquiring into whether, "imported products could somehow gain access to the advantage, for example, by complying with all applicable conditions" was not relevant to detecting less favourable treatment. The panel's reasoning was, "difficult to reconcile with the fact that a measure may be *de facto* inconsistent with Article 2.1 even when it is origin neutral on its face". *See US — Tuna (Mexico)* (ABR), *supra* note 63, ¶¶211, 225.

[87] *US — Clove Cigarettes* (ABR), *supra* note 71, ¶182.

[88] *Id.* ¶¶169-173. Without referring to GATT Article XX, the Appellate Body has drawn attention to the context in which TBT 2.1 appears. The immediate context is Article 2.2. This is an additional stand-alone provision rather than an exceptions provision. It nevertheless draws significantly on the language of GATT Article XX, as does the sixth recital of the TBT Agreement preamble to a lesser extent.

[89] See, e.g., *US — Cool* (ABR), *supra* note 83, ¶5.358, where the Appellate Body referred to its previous decision in *EC — Seal Products*: "the analysis of whether a measure causes detrimental impact on competitive opportunities for like imported products under Article III:4, 'does not involve an assessment of whether such detrimental impact stems exclusively from a legitimate regulatory distinction'".

of the CBAM product in question is, on the whole, more carbon-intensive than the production of the same product in the EU. WTO members who are unable to establish this might turn to the GATT Article I most-favoured-treatment (MFN) obligation.

V. APPLYING GATT ARTICLE I

A possible breach of GATT Article III can, in addition, or alternatively, be pleaded as a possible breach of Article I.[90] The difference of course is the origin of the products whose treatment is compared. MFN focuses on the treatment of imported products from the complainant State and one or more other States identified by the complainant. To establish the MFN violation, the incentive will be to identify CBAM products from countries with the least carbon-intensive production. If recourse to GATT Article I reflects the difficulty of establishing an Article III:4 violation, the complainant will need to identify a country with less carbon-intensive production than the EU. In other words, a complainant unable to establish that its production is more carbon-intensive than that of the EU (national treatment), may nevertheless be able to establish that its production is more carbon-intensive than that of another country whose CBAM products are imported into the EU (MFN).

While the likeness analysis is uniform across WTO law, including within national treatment and MFN, the TNLF standard does not appear in GATT Article I. Instead, this provision requires that, "… any advantage, favour, privilege or immunity [in relation to matters covered by Article III:4] granted by any contracting party to any product originating in … any other country shall be accorded immediately and unconditionally to the like product originating in … the territories of all other contracting parties". The uses here of, 'any advantage' and 'product' rather than the plural, raises the question of whether the group comparison also applies under GATT Article I, or whether these terms imply the use of the best treatment standard.

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[90] GATT, *supra* note 7, art. I states:

> General Most-Favoured-Nation Treatment: With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, 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.

It is reasonable to claim that the group comparison in the MFN context has been all but confirmed by the Appellate Body, both in the context of TBT Article 2.1[91] and GATT Article I[92]. Indeed, it is inconceivable that a best treatment approach applies to MFN claims. This is because almost any national treatment claim can be presented instead as an MFN claim. As noted above, this is simply a matter of

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[91] It is reasonably clear that the Appellate Body envisages a group comparison for the MFN component of TBT Article 2.1. In *US — Clove Cigarettes* (ABR), *supra* note 71, ¶192, the Appellate Body considered it the duty of panels, "under Article 2.1 to identify the products of domestic and other origins that are like the products imported from the complaining Member". If a group comparison did not apply, there would be no point in instructing panels to identify the range of imported products from other than the complaining member which are like the products imported from the complaining member. In other words, if best treatment applied under the MFN component, it would be sufficient for panels to merely assess the complainant's view that a particular imported product is like a product from the complainant).

[92] The Appellate Body interpreted GATT Article I as follows in *EC — Seal Products*, *supra* note 67, ¶5.88:

> [Under Article I:1] … any advantage granted by a Member to imported products must be made available 'unconditionally', or without conditions, to like imported products from all Members. However, as Article I:1 is concerned, fundamentally, with protecting expectations of equal competitive opportunities for like imported products from all Members, it does not follow that Article I:1 prohibits a Member from attaching any conditions to the granting of an 'advantage' within the meaning of Article I:1. Instead, it prohibits those conditions that have a detrimental impact on the competitive opportunities for like imported products from any Member. Conversely, Article I:1 permits regulatory distinctions to be drawn between like imported products, provided that those distinctions do not result in a detrimental impact on the competitive opportunities for like imported products from any Member.

This passage clearly evokes from *EC — Asbestos* (ABR), *supra* note 66, ¶100, which established the group comparison for GATT Article III:4 national treatment claims. It differs from ¶100 in that the term 'group' is not used. However, there are repeated references to 'imported products' in the plural even when paraphrasing GATT Article I which refers to 'any product'. The implication that a group comparison is required is reinforced by focusing on the closing sentence of the passage. Suppose that the regulatory distinction is based on carbon intensity with some imports from State X subject to the lowest CBAM charge. This is the relevant 'advantage' under GATT Article I which State Y claims entitlement to even though some of its products have a higher carbon intensity. The different CBAM charges are permitted provided they 'do not result in a detrimental impact of the competitive opportunities' afforded to products from State Y. But how can the absence of detrimental impact here be established? The only obvious answer is that there will be no detrimental impact when the overall group of like imported products from State Y is not disadvantaged compared to the overall group of like imported products from State X.

changing the comparator country from the respondent State to an exporting country of the product(s) concerned other than the claimant. If best treatment were to apply for MFN claims, this would spell the end of national treatment claims because of the relative difficulty in satisfying the group comparison.

Even though the group comparison under MFN has a higher threshold than best treatment, this will not close off the possibility of successful claims. The effect will be more to potentially limit the pool of comparator States referred to by the complainant State. As noted above, the incentive will be to identify CBAM products from countries with the least carbon-intensive production. It will need to be established that overall, or disproportionately, products from this country are subject to a lower CBAM charge than the same products from the complainant State.

VI. CONCLUSION

The CBAM proposal gives a strong impression that CBAM will operate entirely compatibly with WTO law. The impression created is that it will operate in a non-discriminatory manner, rather than that it will involve discrimination nevertheless justifiable under GATT Article XX.[93]

This paper has established a disjunction between the messaging in the CBAM proposal and the content of WTO legal obligations, in particular the national treatment and MFN non-discrimination norms. The premise in the proposal is that if CBAM mirrors the ETS in its design and operation in practice, it will treat the imports from different sources equally and will not therefore breach WTO law. This is a misconception. On the contrary, many WTO members will be able to establish breaches of GATT Article III:4 and/or GATT Article I even if the proposed mirroring is fully realised. This will be possible whenever imports from the complainant are, overall, more carbon-intensive than EU production (national

[93] *See* CBAM proposal, *supra* note 2, at 10. A system based on actual emissions on imported goods ensures a fair and equal treatment of all imports and a close correlation to the EU ETS. The CBAM system will, however, need to be complemented by a possibility to base calculations on a set of default values to be used in situations when sufficient emission data will not be available. Moreover, during an initial transitional phase, where importers may not be able to produce yet the data required by system on actual emissions, a default value could also apply. This option will need to be designed to fully respect the EU's international commitments, in particular WTO rules, and therefore it will be necessary to ensure that if a default value applies, importers are in all cases given the opportunity to demonstrate that they perform better than such value based on their actual emissions. Moreover, regarding the phase in of the CBAM and the corresponding phase out of the free allowances, it will need to be ensured that at no point in time over this period, imports are afforded less favourable treatment than domestic EU production.

treatment), or the production of a third country (MFN). The discrimination lies in the relatively high cost of CBAM certificates encountered by goods from the complainant, compared to the cost of ETS allowances for EU producers, or CBAM certificates for goods from a third country. If the proposed mirroring is fully realised, there will be no further violations. However, if it is not fully realised, this will result in further violations of national treatment and MFN norms depending on whether any favourable treatment here is given to EU products, or those of a third country. It is likely that mirroring problems will be addressed under the chapeau of GATT Article XX if they pertain to how the CBAM is 'applied' in practice.

This disjunction should not remotely lead to the condemnation of the CBAM proposal as being irredeemably at odds with WTO law. It is now a hallmark of the GATT national treatment and MFN obligations that determinations are made without considering regulatory context. The CBAM's declared objective of preventing carbon leakage and possible increases in global greenhouse gas emissions is simply not relevant to whether it breaches these norms, any more than whether it is a necessary and proportionate instrument in this regard. The Appellate Body has insisted on deferring such questions to GATT Article XX. This compartmentalised approach is unobjectionable provided it is understood that findings on initial compatibility carry little normative weight or moral opprobrium. This is reflected in the central finding of this paper — that the prospects of establishing a breach increase along with the carbon intensity of production in the member concerned. Rather than the terms 'breach' or 'violation' here, the more neutral connotations of 'initial compatibility' should be preferred. It cannot meaningfully be reported that a WTO member has breached its obligations until arguments to the effect that there might be a good reason for the measure have been considered.