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# **THE EU'S CARBON BORDER ADJUSTMENT MECHANISM (CBAM): A LEGAL AND ECONOMIC ANALYSIS OF ITS COMPATIBILITY WITH WTO FREE TRADE PRINCIPLES**

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## **ABSTRACT**

The European Union's Carbon Border Adjustment Mechanism (CBAM) aims to tackle carbon leakage by imposing carbon tariffs on imported goods from regions with weaker environmental regulations. This policy aligns with the EU's Emissions Trading System (ETS) and seeks to maintain industrial competitiveness while promoting climate action. However, CBAM has sparked controversy due to concerns over its compatibility with World Trade Organization (WTO) rules, particularly in relation to the Most-Favoured-Nation (MFN) principle, National Treatment, and non-discrimination. This paper examines the legal implications of CBAM under WTO law, analyzing the potential conflicts with the General Agreement on Tariffs and Trade (GATT) provisions, especially Article XX (Environmental Exceptions), which permits trade restrictions for environmental protection purposes. Case studies from previous WTO disputes, including US-Shrimp/Turtle, EC-Asbestos, and Brazil-Tyres, are used to assess the viability of CBAM's legal standing. Additionally, this paper explores the economic and political repercussions of CBAM, particularly its impact on developing countries and the potential for trade retaliation from major trading partners like the US, China, and India. The paper concludes with policy recommendations to ensure CBAM's compliance with WTO rules while fostering global climate cooperation.

## Introduction

### Background and Importance of CBAM

The European Union's Carbon Border Adjustment Mechanism (CBAM) is an innovative climate policy designed to prevent carbon leakage while maintaining a competitive market for EU industries<sup>1</sup>. This policy is a central component of the European Green Deal, which seeks to make the EU climate-neutral by 2050<sup>2</sup>. The core principle of the CBAM is to impose a tariff on imported goods based on their carbon content, ensuring that foreign-produced goods face the same carbon pricing obligations as those produced within the EU under the Emissions Trading System (ETS).

Carbon leakage occurs when industries relocate to countries with laxer environmental regulations, thus undermining the effectiveness of climate policies<sup>3</sup>. As EU industries face higher carbon costs, they risk losing out to foreign competitors who do not face similar carbon pricing. To counteract this, CBAM aims to level the playing field by adjusting the price of imported goods to reflect the carbon costs associated with their production.

However, while the policy seeks to combat climate change, it has sparked significant debate regarding its potential conflict with the World Trade Organization (WTO) rules. Critics argue that CBAM may be seen as a protectionist measure that discriminates against non-EU nations, particularly developing countries that lack the infrastructure and financial capacity to implement comparable carbon pricing systems. Moreover, the imposition of tariffs on carbon-intensive imports could provoke retaliatory actions from major trade partners such as China, India, and the United States.

### Research Questions and Objectives

This paper aims to answer three critical research questions:

1. Does CBAM violate WTO's free trade principles?
2. Can CBAM be justified under GATT Article XX (Environmental Exceptions)?

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<sup>1</sup> European Commission, *Proposal for a Regulation Establishing a Carbon Border Adjustment Mechanism*, COM(2021) 564 final (July 14, 2021) <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021PC0564>

<sup>2</sup> European Commission, *The European Green Deal*, COM(2019) 640 final (Dec. 11, 2019) <https://commission.europa.eu/publications/communication-european-green-deal>

<sup>3</sup> OECD, *Carbon Leakage: Concept, Evidence and Policy Design*, ENV/WKP(2020)4 (2020) <https://globalclimateactionpartnership.org/>

3. What are the broader economic and political implications of CBAM, particularly for developing countries and global trade relations?

The thesis posits that while CBAM represents an ambitious and necessary climate initiative, its alignment with WTO principles remains uncertain. The paper explores potential legal challenges to CBAM, focusing on the compatibility of the policy with WTO provisions related to trade and the environment. In addition to the legal analysis, the economic impact of CBAM on global trade relations, especially between developed and developing countries, is examined. The ultimate objective is to assess whether CBAM can be crafted to meet climate objectives without violating international trade norms.

## **CBAM: Mechanism and Implementation**

### **Overview of CBAM's Functionality**

The European Union's Carbon Border Adjustment Mechanism (CBAM) is designed to address the issue of carbon leakage by imposing tariffs on imports that fail to meet the same carbon pricing standards as those in the EU. This is necessary to level the playing field for EU businesses that operate under the EU Emissions Trading System (ETS), a cap-and-trade mechanism that puts a price on carbon emissions.<sup>4</sup> Under CBAM, importers of goods from non-EU countries must purchase certificates equivalent to the carbon costs that would have been incurred if the goods were produced in the EU.

For example, if an EU steel producer is subject to a carbon price of €50 per tonne of CO<sub>2</sub> emissions, an importer of steel from a non-EU country with no carbon pricing will have to purchase CBAM certificates that reflect the €50 cost. This mechanism ensures that imported goods face the same costs as domestically produced goods, thereby preventing carbon leakage and ensuring fair competition for EU industries.

The CBAM will initially cover a limited number of industries, including steel, cement, aluminum, fertilizers, electricity, and hydrogen<sup>5</sup>. These sectors are particularly vulnerable to carbon leakage due to their high carbon intensity and the competitiveness of industries in countries with lower environmental standards. Over time, the scope of CBAM is expected to expand to include other products, such as plastics, polymers, and downstream products.

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<sup>4</sup> European Commission, EU Emissions Trading System (EU ETS), [https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets\\_en](https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets_en).

<sup>5</sup> Regulation (EU) 2023/956 of the European Parliament and of the Council of 10 May 2023 Establishing a Carbon Border Adjustment Mechanism, 2023 O.J. (L 130) 52.

## Phased Implementation and Reporting Requirements

The phased implementation of CBAM is intended to give both importers and exporting countries time to adapt to the new system. The first phase of CBAM, which began in 2023<sup>6</sup>, requires importers to report the carbon emissions embedded in the goods they are importing. However, no financial penalties or tariffs are imposed during this phase, giving industries time to gather the necessary data and adjust to the system. The reporting requirement is designed to ensure transparency in carbon emissions associated with production processes, allowing both EU authorities and trading partners to assess the carbon footprint of imported goods.

Starting in 2026, financial penalties will be introduced, and importers will be required to purchase CBAM certificates to cover the carbon content of their imports. The cost of these certificates will depend on the price of carbon in the EU ETS and the carbon content of the imported goods. This approach provides a financial incentive for exporters from non-EU countries to adopt carbon pricing mechanisms and improve the environmental performance of their industries.

## Revenue Generation and Allocation

Revenue generated from CBAM is projected to reach approximately €1 billion annually between 2026 and 2030<sup>7</sup>. These funds will be used to support the EU's climate initiatives and green technologies. However, there are concerns regarding the allocation of these revenues. Critics argue that CBAM could exacerbate inequalities between developed and developing countries, with the latter potentially facing significant challenges in meeting the new carbon standards.

One potential solution is to direct a portion of CBAM revenues towards supporting green technology adoption in developing countries<sup>8</sup>. This would help to ensure that CBAM does not disproportionately disadvantage these nations and encourage global cooperation on climate change mitigation. Additionally, the EU could consider offering financial assistance or technology transfers to help developing countries implement carbon pricing systems and transition to low-carbon economies.

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<sup>6</sup> European Commission, Carbon Border Adjustment Mechanism: Transitional Phase Reporting Obligations, [https://taxation-customs.ec.europa.eu/carbon-border-adjustment-mechanism\\_en](https://taxation-customs.ec.europa.eu/carbon-border-adjustment-mechanism_en).

<sup>7</sup> European Commission, *Impact Assessment Report Accompanying the CBAM Proposal*, SWD(2021) 643 final.

<sup>8</sup> OECD, *Making Climate Finance Work for Developing Countries*, OECD Environment Working Papers No. 155 (2020), <https://www.oecd.org/environment/making-climate-finance-work.pdf>.

## Challenges in Implementation

While CBAM's design is ambitious, it faces several challenges in terms of implementation. One of the primary issues is the accurate measurement of embedded carbon in imported goods. Different countries have varying approaches to carbon accounting<sup>9</sup>, and the absence of a global standard for measuring carbon emissions could lead to discrepancies in the data reported by importers. Moreover, the calculation of embedded emissions in goods that are produced through complex, multi-stage processes poses another challenge. The EU will need to work closely with trading partners to establish standardized methodologies for calculating carbon content to ensure fairness in the application of CBAM.

Additionally, there are concerns about the potential for disputes over the recognition of carbon pricing systems in non-EU countries. While the EU has indicated that it will provide exemptions for countries with equivalent carbon pricing systems, the criteria for determining equivalence remain unclear<sup>10</sup>. This could lead to challenges from exporting countries that feel unfairly treated or excluded from the exemption process.

## WTO Law and CBAM Compliance

The legality of the EU's Carbon Border Adjustment Mechanism (CBAM) under the World Trade Organization (WTO) law is a critical aspect of its implementation and potential global implications. This section delves into the main WTO provisions that are at the heart of the debate: the Most-Favoured-Nation (MFN) principle, National Treatment, non-discrimination, and environmental exceptions under GATT Article XX. By evaluating these principles in relation to CBAM, the paper will explore whether the mechanism aligns with WTO rules or risks violating core trade commitments.

### A. The Most-Favoured-Nation (MFN) Principle

Under Article I of the General Agreement on Tariffs and Trade (GATT), the MFN principle requires that WTO members treat all other members equally in terms of trade<sup>11</sup>. Any trade restriction or tariff imposed by one member on another must apply universally, without discrimination. This rule ensures that trade preferences given to one member must be extended to all WTO members.

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<sup>9</sup> World Bank, *State and Trends of Carbon Pricing 2022*  
<https://openknowledge.worldbank.org/handle/10986/37455>

<sup>10</sup> European Commission, *CBAM: Implementation Details and FAQ*

<sup>11</sup> General Agreement on Tariffs and Trade art. I, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194.

CBAM, however, presents a challenge to the MFN principle. By imposing a tariff on imports based on their carbon content, CBAM effectively differentiates between goods produced in the EU (subject to carbon pricing) and those imported from non-EU countries (which may or may not have carbon pricing mechanisms in place). This could be viewed as discriminatory, as it places a higher cost burden on goods from countries that do not have equivalent carbon pricing systems, potentially violating the MFN principle.

The EU argues that the CBAM is not discriminatory because it aims to prevent carbon leakage, a form of environmental protection that is legitimate under international trade law. However, this argument depends on the mechanism's implementation being consistent across all WTO members, ensuring that no country is unfairly disadvantaged by the carbon tariff.

### **B. National Treatment Principle**

The National Treatment principle, enshrined in Article III of GATT<sup>12</sup>, requires that once goods have entered the domestic market, they must receive the same treatment as similar domestic products. This rule is designed to ensure that foreign goods are not discriminated against once they have been cleared through customs. CBAM's implementation could face challenges under this principle because it treats imported goods differently based on their carbon content, even after they have entered the EU market. Imported goods from countries without carbon pricing systems would be subject to higher tariffs, while domestic products produced under the EU ETS would not.

The EU might argue that the carbon tariff is an indirect measure designed to create a level playing field, and thus it does not violate National Treatment. However, WTO jurisprudence has established that any measure which directly or indirectly disadvantages imported goods can be challenged under Article III. If CBAM's tariffs are deemed to disproportionately affect non-EU goods, the mechanism could be considered a violation of this principle.

### **C. Non-Discrimination and Transparency**

A related issue is whether CBAM is consistent with the general non-discrimination and transparency principles within the WTO framework. Non-discrimination requires that trade measures do not have the effect of unjustifiably discriminating against foreign goods.

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<sup>12</sup> General Agreement on Tariffs and Trade art. III, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194.

Transparency, on the other hand, mandates that trade regulations be clear and publicly available, so that all trading partners can understand the rules and comply with them.

CBAM's approach to carbon tariffs raises concerns in both these areas. If the carbon tariff system is opaque or too complex, it could lead to disputes regarding its fairness and implementation. Furthermore, if developing countries feel that their exports are unfairly disadvantaged by the mechanism, they might argue that CBAM violates the non-discrimination principle.

#### **D. Environmental Exceptions under GATT Article XX**

GATT Article XX<sup>13</sup> allows for exceptions to trade rules when the measure in question is designed to achieve legitimate policy goals, such as the protection of human, animal, or plant life and health or the conservation of natural resources. CBAM may find justification under the exceptions provided in Article XX, particularly the environmental exceptions outlined in Article XX(b) and XX(g).<sup>14</sup>

- **Article XX(b)** permits measures necessary to protect human, animal, or plant life or health. The EU could argue that CBAM is necessary to protect the global environment by preventing carbon leakage, which could undermine the effectiveness of the EU's climate policies. By imposing carbon tariffs, the EU aims to ensure that its climate goals are not thwarted by industries relocating to countries with weaker environmental standards.
- **Article XX(g)** permits measures related to the conservation of natural resources. CBAM could also be justified under this exception because carbon emissions contribute to environmental degradation and the depletion of natural resources. The EU may argue that the carbon tariff is a necessary tool to conserve global environmental resources, aligning with international efforts to combat climate change.

However, for CBAM to qualify under Article XX exceptions, it must meet the chapeau test, which ensures that the measure is not applied in a manner that would constitute arbitrary or unjustifiable discrimination between countries where the same conditions prevail. The WTO has historically applied this test strictly, and if CBAM is perceived as discriminatory in its

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<sup>13</sup> General Agreement on Tariffs and Trade art. XX, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194.

<sup>14</sup> General Agreement on Tariffs and Trade, art. XX(b), (g), Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194.

implementation, it may not satisfy this requirement.<sup>15</sup>

### **Case Studies: WTO Disputes on Trade & Environment**

To assess how CBAM might be treated under WTO law, it is useful to examine relevant past cases where environmental measures were scrutinized under WTO rules. The following case studies provide insight into the potential challenges that CBAM might face.

#### **A. US - Shrimp/Turtle (1998)**

In the landmark US - Shrimp/Turtle case, the WTO ruled on the legality of the United States' ban on shrimp imports from countries that did not use turtle-excluder devices (TEDs) in their fishing nets. The US argued that the ban was necessary to protect endangered sea turtles, which were being caught unintentionally in shrimp nets.

While the WTO acknowledged the legitimacy of the environmental goal (protecting turtles), it found that the US measure was applied in a discriminatory manner. The US did not provide sufficient flexibility for countries to meet the requirement or adopt alternative measures. The WTO emphasized that trade measures aimed at protecting the environment must be applied fairly and consistently.

This case is particularly relevant for CBAM because the EU's carbon tariff could be challenged on similar grounds. While the environmental objective of reducing carbon emissions is legitimate, CBAM must be applied in a non-discriminatory manner to avoid facing the same fate as the US measure. If CBAM disproportionately impacts certain countries, it could be ruled as unjustifiably discriminatory.

#### **B. EC - Asbestos (2001)**

In EC - Asbestos, the European Union banned the import of asbestos due to its severe health risks. The WTO upheld the ban under GATT Article XX(b)<sup>16</sup>, recognizing that the EU was protecting human health, which is a legitimate policy goal. This case highlights that the WTO allows trade restrictions when they are deemed necessary to protect human or animal health, provided that the measure is proportionate and does not unfairly discriminate against foreign goods.

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<sup>15</sup> Appellate Body Report, *US – Shrimp*, WT/DS58/AB/R (Oct. 12, 1998) [“Chapeau” interpretation of Art. XX]. <https://www.wto.org/>

<sup>16</sup> Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R (Mar. 12, 2001). <https://www.wto.org/>



The EC - Asbestos case supports the argument that CBAM could be justified under Article XX(b) for environmental protection purposes, as long as the tariff is proportionate and not discriminatory. However, like the US - Shrimp/Turtle case, the WTO would likely examine the fairness of CBAM's application, particularly in terms of how it impacts developing countries.

### **C. Brazil - Tyres (2007)**

In the Brazil - Tyres case, the WTO allowed Brazil to restrict the import of used tyres due to environmental and health concerns. The WTO ruled that the measure was consistent with GATT Article XX(g)<sup>17</sup>, as it was aimed at conserving natural resources and preventing environmental harm. The case underscores the WTO's acceptance of trade restrictions designed to address environmental and health risks.

The Brazil - Tyres case strengthens the argument that CBAM could withstand WTO scrutiny if it is framed as a measure to conserve natural resources (i.e., the global environment). As with the other cases, the key issue will be ensuring that CBAM is applied in a way that is not discriminatory or arbitrary.

### **D. Lessons for CBAM**

These case studies provide valuable insights for assessing CBAM's potential under WTO law. While CBAM's environmental goals align with the WTO's recognition of trade measures for environmental protection, its application must be non-discriminatory and fair. The US - Shrimp/Turtle case highlights the importance of flexibility and the need for consistent application of the measure across all trading partners. The EC - Asbestos and Brazil - Tyres cases suggest that CBAM's environmental rationale could be upheld, but only if it meets the proportionality and non-discrimination requirements.

### **Economic and Political Implications of CBAM**

The economic and political implications of the Carbon Border Adjustment Mechanism (CBAM) extend far beyond legal considerations. While the mechanism has the potential to promote climate goals by leveling the playing field for industries in the European Union (EU) operating under stringent carbon pricing regulations, it also introduces significant economic challenges and geopolitical risks. This section explores how CBAM could impact both

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<sup>17</sup> Appellate Body Report, *Brazil – Measures Affecting Imports of Retreaded Tyres*, WT/DS332/AB/R (Dec. 3, 2007). <https://www.wto.org/>

developed and developing countries, the risks of trade retaliation, and its broader implications for global economic stability.

### A. Economic Impacts on Developing Countries

One of the most contentious aspects of CBAM is its potential economic impact on developing countries. Many of these countries have less stringent climate regulations and, as a result, may face higher costs for their exports when entering the EU market<sup>18</sup>. The additional burden of purchasing CBAM certificates, reflecting the carbon gap between the EU and the exporting country, could disproportionately affect low-income nations that rely heavily on exports of carbon-intensive goods.

1. **Higher Costs for Exporters:** Developing countries are often dependent on industries such as steel, cement, and aluminum, which are energy-intensive and produce significant carbon emissions. These countries may struggle to comply with the carbon pricing imposed by CBAM, especially if they lack the infrastructure or financial capacity to implement their own carbon pricing mechanisms. The added cost could reduce their competitiveness in the EU market, as EU manufacturers, which are subject to the EU Emissions Trading System (ETS), would not face the same tariff burden.
2. **Limited Carbon Pricing Systems in Developing Countries:** While some developed nations have already implemented carbon pricing systems, many developing countries still lack such mechanisms. For these countries, the CBAM may function as a barrier to trade, as they could be forced to pay for carbon emissions they have not previously accounted for. This could exacerbate existing trade imbalances, particularly for countries heavily dependent on exports of carbon-intensive goods.
3. **Risk of Climate Inequity:** The CBAM could also contribute to climate inequity between the global North and South<sup>19</sup>. Developing nations may argue that CBAM exacerbates existing inequalities by imposing additional costs on them without offering the necessary support or technological resources to transition to low-carbon economies.

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<sup>18</sup> UNCTAD, *The EU Carbon Border Adjustment Mechanism: Implications for Developing Countries*, UNCTAD/DITC/TAB/INF/2021/3 (July 2021), [https://unctad.org/webflyer/eu-carbon-border-adjustment-mechanism:contentReference\[oaicite:2\]{index=2}](https://unctad.org/webflyer/eu-carbon-border-adjustment-mechanism:contentReference[oaicite:2]{index=2}).

<sup>19</sup> Michael Mehling et al., *Designing Border Carbon Adjustments for Enhanced Climate Action*, 113 AJIL Unbound 432 (2019)

This could undermine efforts to promote climate justice and global cooperation, especially if the mechanism is perceived as a form of "green protectionism."

4. **Impact on Trade Balance:** The increased costs of exports could further strain the trade balance in developing countries. These countries could be forced to either raise the prices of their exports to absorb the cost of the carbon tariff, which could reduce their competitiveness, or lower their prices, which could hurt their domestic industries and overall economic growth.

## B. Potential for Trade Retaliation

One of the most significant risks associated with the implementation of CBAM is the potential for trade retaliation. Several major economies, including China, India, and the United States, have expressed concerns about the mechanism and could retaliate by imposing their own tariffs or trade restrictions on EU goods.<sup>20</sup>

1. **China's Position:** China is the world's largest emitter of carbon dioxide and a major exporter to the EU. Given that China lacks a national carbon pricing system comparable to the EU's ETS, Chinese goods would likely face substantial tariffs under CBAM. China has already voiced its opposition to the mechanism, arguing that it unfairly targets developing countries and violates WTO rules<sup>21</sup>. In response, China could impose retaliatory tariffs on EU exports, especially in areas such as technology, machinery, and luxury goods. This could escalate into a broader trade war, further complicating the global trading system and disrupting the EU's economic relations with China.
2. **India's Concerns:** India, another major exporter to the EU, also faces significant challenges under CBAM. The country's industrial base is heavily reliant on coal and other fossil fuels, making it particularly vulnerable to carbon tariffs. India could view CBAM as an unjust trade barrier and may retaliate with its own tariffs or restrictions on EU goods. Additionally, India could challenge CBAM at the WTO, arguing that it violates the principle of Most-Favoured-Nation (MFN) treatment and discriminates against developing nations.<sup>22</sup>

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<sup>20</sup> OECD, *The Climate and Trade Nexus: Towards a Multilateral Approach*, OECD Trade and Environment Working Paper 2022/01, <https://www.oecd.org/environment/the-climate-and-trade-nexus.htm>

<sup>21</sup> Ministry of Ecology and Environment of the People's Republic of China, Press Statement on CBAM as cited in Li Zhou, *China Slams EU's Carbon Border Tax as Trade Barrier*, Politico (Apr. 2021) <https://www.politico.eu/article/chinas-xi-slams-eu-carbon-border-levy/>

<sup>22</sup> Manoj Kumar and Neha Arora "India plans to challenge EU carbon tax at WTO"

3. **US Opposition:** The United States has long been a critic of carbon tariffs, especially given that it lacks a federal carbon pricing system. While individual states such as California have implemented their own carbon pricing mechanisms, the lack of a unified national approach could make it difficult for the US to comply with CBAM. The US may argue that the EU's carbon tariff unfairly targets American industries<sup>23</sup> and could retaliate by imposing tariffs on EU goods. The risk of a transatlantic trade conflict could further undermine international trade relations and delay global efforts to combat climate change.
4. **Retaliatory Measures and Escalation:** If major trading partners like China, India, and the US retaliate against the EU's CBAM, this could lead to a series of tit-for-tat tariffs and trade restrictions, disrupting global trade flows and economic growth. The potential for an escalating trade war could undermine the EU's objectives of both reducing carbon emissions and promoting fair trade practices. Additionally, trade retaliation could exacerbate tensions between major economies, further complicating international climate negotiations.

### C. Geopolitical Implications and Global Economic Stability

In addition to the direct economic impact of CBAM on individual countries, the mechanism could have broader geopolitical and economic consequences. Trade tensions arising from CBAM could lead to a fragmentation of the global trading system, with countries either aligning themselves with or against the EU's carbon tariff. This could further polarize the global community, particularly between the developed world, which has the resources to implement carbon pricing mechanisms, and developing countries, which may struggle to do so.

1. **Shift in Trade Alliances:** Countries that are negatively affected by CBAM may seek to form new trade alliances to counterbalance the EU's economic power. This could lead to the formation of alternative trade blocs focused on protecting developing nations' interests and reducing the influence of Western economies. The growing divide between global North and South could lead to increased protectionism and reduced international

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(May 16, 2023) <https://www.reuters.com/world/india/india-plans-challenge-eu-carbon-tax-wto-sources-2023-05-16>

<sup>23</sup> David Kleimann, *The EU Carbon Border Adjustment Mechanism: Key Legal and Design Considerations*, Bruegel Policy Brief (2021) <https://op.europa.eu/en/publication-detail>

cooperation, both in terms of trade and climate action.

2. **Impact on Global Supply Chains:** CBAM could disrupt global supply chains, especially for industries reliant on carbon-intensive products. Companies that produce goods in countries without robust carbon pricing systems may face higher costs when exporting to the EU, leading to adjustments in global supply chains. Firms may seek to relocate production to countries with more favorable climate policies, further reshaping global trade dynamics.
3. **Potential for Trade Wars:** The introduction of CBAM could contribute to the rise of trade wars, with countries challenging each other's trade policies at the WTO and imposing retaliatory tariffs. A prolonged trade conflict could undermine economic growth, delay the implementation of climate policies, and disrupt the global economy. The risk of escalating trade disputes over CBAM highlights the need for a more coordinated and cooperative approach to international climate policy.

#### **D. Influence on Future Climate Agreements**

CBAM could play a significant role in shaping future international climate agreements. If the mechanism proves successful in encouraging countries to adopt carbon pricing systems, it could create a domino effect, with more countries implementing similar measures to avoid trade disadvantages. This could pave the way for a more unified global approach to climate change, where carbon pricing is seen as a standard tool for achieving emission reductions.

However, if CBAM leads to trade retaliation and economic disruption, it could have the opposite effect, discouraging countries from adopting carbon pricing mechanisms and delaying global efforts to address climate change. To avoid this scenario, it is essential for the EU to engage in diplomatic negotiations with affected countries and work towards a global carbon pricing framework that is fair, transparent, and inclusive of all nations.

#### **Policy Recommendations & The Future of CBAM**

To ensure that CBAM aligns with WTO rules while promoting global climate cooperation, a set of policy recommendations can be proposed. These recommendations focus on improving the mechanism's design to address concerns about discrimination, ensuring that it does not disproportionately harm developing countries, and fostering international collaboration on climate action.

## A. Non-Discriminatory Implementation

CBAM's effectiveness in achieving its climate goals will depend largely on its implementation. To avoid challenges under WTO law, the EU must ensure that the mechanism is applied consistently and transparently, with clear criteria for determining which countries are subject to carbon tariffs. The EU should adopt a flexible approach, providing developing countries with transition periods and technical assistance to help them implement their own carbon pricing systems.<sup>24</sup>

1. **Differentiated Treatment for Developing Countries:** The EU should provide special treatment for developing countries, recognizing their unique economic and technological challenges. This could include allowing these countries to gradually implement carbon pricing or providing them with financial assistance to support their transition to low-carbon economies. Such an approach would help to alleviate the economic burden of CBAM on developing countries while encouraging them to adopt sustainable practices.
2. **Avoiding Green Protectionism:** To prevent CBAM from being perceived as a form of green protectionism, the EU should ensure that its carbon tariff system is transparent and applied equitably across all trading partners. The EU should also avoid using CBAM as a tool to protect domestic industries, as this could undermine the credibility of the mechanism and provoke retaliation from trading partners.

## B. Promoting Global Carbon Pricing Cooperation

Rather than relying on unilateral measures like CBAM, the EU should work towards establishing a global carbon pricing framework under the auspices of the WTO or other international bodies. This would provide a consistent and transparent approach to carbon pricing, reducing the risk of trade distortion and fostering greater cooperation among nations.

1. **International Climate Agreements:** The EU should advocate for the inclusion of carbon pricing mechanisms in future international climate agreements, such as the Paris Agreement. By promoting a global carbon pricing system, the EU can help create a level playing field for all countries, ensuring that no nation is unfairly disadvantaged

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<sup>24</sup> United Nations Framework Convention on Climate Change (UNFCCC), *Common But Differentiated Responsibilities and Respective Capabilities (CBDR-RC)* principle, Art. 3.1, May 9, 1992, 1771 U.N.T.S. 107.

by carbon tariffs.<sup>25</sup>

2. **Bilateral and Multilateral Negotiations:** In addition to working through international organizations, the EU should engage in bilateral and multilateral negotiations with other major emitters, such as China, India, and the US, to align carbon pricing systems and avoid trade conflicts. This could include providing financial assistance and technological support to developing countries to help them adopt carbon pricing systems.

## Conclusion

The EU's Carbon Border Adjustment Mechanism (CBAM) represents a bold initiative in the fight against climate change, but its compliance with WTO law remains uncertain. While the mechanism has the potential to promote climate goals and level the playing field for EU industries, it risks violating key trade principles, particularly the Most-Favoured-Nation (MFN) principle, National Treatment, and non-discrimination.

CBAM could also have significant economic and political consequences, particularly for developing countries that lack carbon pricing systems. The additional cost burden imposed by CBAM could reduce the competitiveness of their exports, exacerbate existing trade imbalances, and potentially lead to trade retaliation from major economies like China, India, and the US. The risk of a global trade war further complicates the discourse surrounding CBAM and its potential to foster international cooperation on climate change.

To ensure the success of CBAM and its alignment with WTO principles, the EU must adopt a non-discriminatory and transparent approach, providing flexibility for developing countries and encouraging global cooperation on carbon pricing. By working towards a global carbon pricing framework, the EU can help create a fairer and more sustainable international trading system that promotes both environmental and economic goals.

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<sup>25</sup> Paris Agreement, Dec. 12, 2015, T.I.A.S. No. 16-1104.