

# EP FORUM - Carbon Border Adjustment Mechanism: EU's climate ambition, carbon leakage and WTO compliance

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## *Legal insights*

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# Table of contents

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1. Preliminary considerations
2. Free allowances and CBAM at the same time can be WTO compatible
3. Export adjustments :
  - a) Why are they critically needed?
  - b) How to design them?
  - c) Why are they WTO compatible?

# 1 – Preliminary considerations

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- ❑ CBAM initiative faces negative dogmatic views on two key points:
  - Coexistence of free allocations and CBAM
  - Export adjustments to address the risks of carbon leakage associated with European exports
  
- ❑ Risks if those concerns are not addressed:
  - EU's objective of reducing global emissions are undermined
  - Progressive disappearance of EU industrial base

## 2 – WTO consistency of the coexistence of free allowances and a CBAM

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- ❑ There is no reason to phase out free allowances until :
  - the deployment of low carbon technologies to minimise the impact on downstream industries and users
  - CBAM has proven to be effective
- ❑ ETS free allowances and CBAM are complementary measures : both address carbon leakage → **Parallel existence does not amount to double protection**
- ❑ Design of CBAM is key to ensure WTO consistency (CBAM is part of the EU ETS regulatory regime)

## 2 – WTO consistency of the coexistence of free allowances and a CBAM

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- It is wrong to affirm that applying simultaneously the ETS free allowances and the CBAM would raise discrimination under WTO rules:
  - CBAM is characterized as a border adjustable internal measure under GATT Article III
  - CBAM consistent with GATT non-discrimination obligations (National Treatment and Most Favoured Nation) as long as EU products and imports face an **equivalent regulatory burden** applied on an even-handed basis (by aligning in strict synchrony the free allowances benchmark with the CBAM obligation )
  - Safety net: CBAM to fall within the General exceptions under GATT Article XX, provided that it would not discriminate or represent a disguised restriction on international trade
  - Free allowances are not a subsidy within the meaning of the WTO SCM Agreement (cf. European Commission's legal arguments in US anti-subsidy investigation on Forged Steel Fluid End Blocks)

# 3 – Export adjustments – why are they needed?

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- ❑ Risk of carbon leakage in relation to EU exports not addressed in the Commission's proposal → EU carbon-light products will be replaced on export markets by carbon-heavy goods from competing origins with low climate ambitions
- ❑ Undermines the EU's climate goals
- ❑ Solution: export adjustments for EU carbon-light products exported to third countries with lax or limited environmental obligations (also called 'allowance adjustments for exports')
- ❑ Goal: Export adjustments to simply calibrate the regulatory obligation and the net regulatory burden imposed in the Union under the EU ETS when these EU products are exported to third countries which have not yet limited or priced GHG emissions at the same levels as the EU

# 3 – Export adjustments – How to design them?

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- ❑ To be part of the CBAM : CBAM should not only cover imports into the EU: the export angle is an equal part of any border adjustment
- ❑ Export adjustments established as a component of the EU ETS (The EU Court of Justice ruled that the EU ETS system is not a tax system but a climate policy regime, thus representing an integrated regulatory regime)
- ❑ Export adjustments established to address carbon leakage and part of an overall decarbonization strategy: should remain in force independantly from the reduction commitments of free allowances under the EU ETS until other countries take equivalent and effective steps to impose carbon costs on competing production
- ❑ 2 options:
  - *De facto export adjustments*: Allocation of free allowances to EU production that is exported while making sure that the equilibrium and cap on emissions in the EU ETS is not affected. Emission allowances to be deducted from the amount of allowances above the product benchmark to be surrendered to the competent authority
  - *De jure export adjustments*: Refund/credit for allowance obligations on exports (i.e., for products consumed within the EU, the allowance obligation applicable to domestically produced products would correspond to the GHG emissions in excess of a product-specific benchmark, with the equivalent obligation imposed on imports consumed within the EU through application of the CBAM)

## 4 – Export adjustments: Why are they WTO compatible ?

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### □ Export adjustments are NOT export rebates or subsidies under Article 1.1. of the WTO SCM Agreement

Basic Approach: characterized as part of an integrated carbon limitation and reduction regulatory regime (not a fiscal or financial measure)

- No financial contribution by the EU (in the form of government revenue or any other form of financial contribution, because they do not involve any direct transfer of funds or any provision of goods or services)
- No benefit conferred (they are part of an integrated regulatory framework that imposes product-specific allowance obligations and are only used to implement this obligation) : simply calibrate the regulatory obligation and the net regulatory burden imposed
  - *Same reasoning as EU Commission's defence in a 2020 AS investigation initiated by the US on forged steel fluid end blocks from Italy involving the issue of free allowances : **Why EU Commission would take a different approach for export adjustments?***



## 4 – Export adjustments: Why are they WTO compatible ?

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### ❑ Export adjustments are NOT export rebates or a subsidy under Article 1.1. of the WTO SCM Agreement

Alternative Approach: Characterisation as a tax regime:

- Not a subsidy under footnote 1 of the SCM Agreement (it is not a subsidy to exempt an export product from duties borne when destined for domestic consumption) read in conjunction with Annex I of the SCM Agreement (which provides a list of export subsidies)
- Considered as “indirect taxes”: export adjustments equivalent to the obligation applicable above the product-specific benchmark = not in excess of the amount applied domestically