Export Rebates and the EU Carbon Border Adjustment Mechanism: WTO Law and Environmental Objections

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The EU proposal for a carbon border adjustment mechanism ('CBAM') has triggered a lively academic and policy debate. In June 2022, the European Parliament put forward amendments regarding the potential introduction of export rebates under the EU Emission Trading System ('ETS') and the CBAM. This article focuses on this specific proposal, enquiring into the WTO law compatibility of ETS/CBAM export rebates. First, it enquires whether the 'pecuniary burden' associated with compliance with the CBAM would qualify as a 'charge' that is 'equivalent to an internal tax' and that is 'imposed consistently with Article III:2 GATT'. Second, it suggests that the 'pecuniary burden' associated with compliance with the ETS/CBAM is unlikely to qualify as an adjustable product tax; the analysis draws on a close examination of relevant provisions in the GATT 1994 and the Agreement on Subsidies and Countervailing Measures ('SCMA'). Finally, the article develops some brief considerations on the detrimental environmental effects of export rebates. As the article concludes, the regulatory design of the CBAM is not perfect; export rebates, however, would make this scheme considerably worse.

Keywords: Carbon Border Adjustment Mechanism; Carbon Border Measures; Export Rebates; Border Tax Adjustment; Tax; Charge; GATT 1994; Agreement on Subsidies and Countervailing Measures; Emission Trading System.

1. Introduction: The EU Proposal for a Carbon Border Adjustment Mechanism and the Controversy on Export Rebates

On the 14th of July 2021, the European Commission published its long awaited proposal for a Regulation establishing a carbon border adjustment mechanism ('CBAM').[1] Negotiations on the CBAM proposal are ongoing at the EU level. In early June 2022, the European Parliament voted down the draft proposal of its Committee on the Environment, Public Health and Food Safety. A couple of weeks later, the plenary reached an agreement on the reform of the EU Emission Trading System ('ETS') and on the CBAM; agreement in the Council followed suit, paving the way for inter-institutional negotiations.[2]

The CBAM pursues a set of interconnected environmental and economic goals. The central environmental justification for the adoption of this instrument is the attempt to prevent carbon leakage; this occurs when firms operating in carbon-intensive sectors relocate to

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[1] European Commission, Proposal for a Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism, COM(2021) 564 Final.

[2] European Parliament, Amendments adopted by the European Parliament on 22 June 2022 on the proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union, Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme, and Regulation (EU) 2015/757 (COM(2021)0551 – C9-0318/2021 – 2021/0211(COD)), P9_TA(2022)0246, Revision of the EU emission trading system; and European Parliament, Amendments adopted by the European Parliament on 22 June 2022 on the proposal for a Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism (COM(2021)0564 – C9-0328/2021 – 2021/0214(COD)), P9_TA(2022)0246, Carbon border adjustment mechanism.

jurisdictions with (more) lenient greenhouse gas ('GHG') emission reduction policies. The preconditions for carbon leakage to materialize are divergencies in the stringency of environmental protection standards, and trade intensity.[3] The former factor influences the regulatory compliance costs borne by market actors in carbon-intensive sectors. Trade intensity implies that 'green' (more expensive) products originating from 'virtuous' jurisdictions find themselves in competition with more polluting (cheaper) products originating from 'non-virtuous' countries.

The CBAM aims to prevent potential carbon leakage by ensuring that products imported in the EU 'bear' the same exact economic costs that are 'borne' by EU products due to the operation of the ETS cap-and trade system.[4] The economic playing field is levelled via the mandatory requirement for importers to annually purchase and surrender CBAM certificates. The price of CBAM certificates would be linked to the weekly auctioning price of ETS allowances, as further adjusted to take the distribution of free allowances to EU operators into account.[5] As regards the calculation of the carbon intensity of imported products, the Regulation provides for consideration of the verified GHG emissions embedded in the relevant goods.[6] Where this proves impossible, residual values apply; these include the average carbon intensity of the country of origin of the product, or the carbon intensity of the EU worst emitters.[7]

The regulatory design, structure and application of the scheme are far from perfect. The CBAM's failure to account for the effectiveness and stringency of *non-price-based* GHG emission reduction policies is perhaps the scheme's greatest weakness. Under the CBAM proposal, any 'explicit' carbon price already 'borne' by imported products in their country of origin will be taken into account in the calculation of the final number of CBAM certificates and 'waived'.[8] 'Explicit' carbon prices are associated with price-based GHG emission reduction policies; these include carbon taxes and cap-and-trade (emission trading) systems. 'Implicit' carbon prices, on the other hand, are not taken into account; these are associated with compliance with non-price-based (regulatory) standards. This fails to acknowledge one crucial point, which is often neglected in trade law and policy circles: 'explicit' carbon prices are *not additional* to 'implicit' carbon prices. The two should be rather characterized as different forms of regulatory compliance costs; price-based and non-price-based GHG emission reduction policies are alternative regulatory strategies to achieve the same goals.

This kind of regulatory design has two implications. First, the CBAM may result in the imposition of the EU 'explicit' carbon price on products originating from countries whose non-price-based policies are as effective and as stringent as the EU price-based ones. In these cases the CBAM would *not* serve any environmental purpose, as carbon leakage would *not*

[3] European Commission, Commission Staff Working Document, Impact Assessment Report Accompanying the Document Proposal for a Regulation Establishing a Carbon Border Adjustment Mechanism, SWD(2021) 643 final, part 2/2, Annex 11.
[4] Directive 2003/87/EC 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, OJ L 275, 25.10.2003.
[5] Arts 21(1) and 31 of the Commission proposal.
[6] Arts 6 and 8 and Annex III.
[7] Art. 7(2) and Annex III to the proposal.
[8] Arts 2(5) and 3(23).

materialize in these jurisdictions. Second, the CBAM fails to account for and waive the 'implicit' carbon prices borne by products originating from countries that have had recourse to non-price-based policies. This fails to treat 'environmentally equivalent' products in the same way. Both elements have specific implications in terms of WTO law compatibility.[9]

As this concise overview has demonstrated, the CBAM is not perfect. The recent proposal to provide ETS export rebates, however, would make it considerably worse. Carbon leakage risks have so far been managed at the EU level through the allocation of free ETS allowances; these have been distributed to firms operating in the sectors that are most exposed to carbon leakage. The abolition of free allowances has proven the main sticking point in the negotiations. Under the compromise reached in the European Parliament, free allowances are going to be gradually phased out between 2027 and 2032; however, agreement on the gradual abolition of free allowances has gone hand in hand with the first explicit proposals that *export rebates may be granted* under the ETS/CBAM.[10] The CBAM will ensure that domestic and imported products sold on the EU internal market 'bear' the same economic costs, thus levelling the economic playing field; nonetheless, it cannot redress the distortions of competition between *EU exported* products and *foreign* products sold on *foreign* markets. This lies at the heart of the export rebates controversy.

This article focuses on the WTO law compatibility of ETS/CBAM export rebates, engaging in the lively academic and policy debate on the CBAM and its regulatory design.[11] The aim of the article is to identify all arguments against ETS/CBAM export rebates, emphasizing their likely WTO law incompatibility and environmental pitfalls. The second section introduces the relevant WTO law provisions. The third and fourth sections discuss different aspects of potential WTO law incompatibility; the analysis cuts across relevant provisions under the GATT 1994 and the Agreement on Subsidies and Countervailing Measures ('SCMA'). The final section draws all relevant conclusions. Further, it emphasizes that export rebates would undermine the environmental integrity of the CBAM and the credibility of the EU environmental protection agenda.

2. WTO Law Objections to Export Rebates: an Introduction

[9] For a detailed analysis of these points, *see* Giulia Claudia Leonelli, *Carbon Border Measures, Environmental Effectiveness and WTO Law Compatibility: Is There a Way Forward for the Steel and Aluminium Climate Club?*, World Trade Review, 1 (2022); and Giulia Claudia Leonelli, *Practical Obstacles and Structural Legal Constraints in the Adoption of 'Defensive' Policies: Comparing the EU Carbon Border Adjustment Mechanism and the US Proposal for a Border Carbon Adjustment*, Legal Studies, 1 (2022).

[10] European Parliament, P9_TA(2022)0246, Revision of the EU emission trading system, *supra* n. 2, amendment 679; and European Parliament, P9_TA(2022)0246, Carbon border adjustment mechanism, *supra* n. 2, amendment 262. The proposed amendments refer to the continued allocation of free allowances to 'products … produced for export to third countries without carbon pricing mechanisms similar to the EU ETS', and to the potential adoption of 'export adjustment mechanisms for installations belonging to the 10% most efficient installations as laid down in Article 10a of Directive 2003/87/EC'. Both mechanisms would be tantamount to ETS/CBAM rebates for EU exports.

[11] Ingo Venzke and Geraldo Vidigal, *Are Trade Measures to Tackle the Climate Crisis the End of Differentiated Responsibilities? The Case of the EU CBAM*, Amsterdam Law School Research Paper 2022-02; and Aaron Cosbey, Alexandra Maratou, Andrei Marcu and Michael Mehling, *Border Carbon Adjustment in the EU: Treatment of Exports in the CBAM*, European Roundtable on Climate Change and Sustainable Transition (2022).

An interesting argument surrounding the distinction between 'fiscal' and 'non-fiscal' components of the CBAM has been recently put forward.[12] This framing of the CBAM's constituent dimensions has specific implications as regards the nature and WTO law compatibility of export rebates. For this reason, this argument deserves a close look.

Under this construction, the CBAM establishes a complex regime that includes 'fiscal' and 'non-fiscal' (i.e. regulatory) elements. The purchase of CBAM certificates to offset the GHG emissions embedded in imported products would qualify as the 'fiscal' element of the scheme.[13] The obligation for EU firms to purchase and surrender allowances under the ETS, with a view to covering their GHG emissions, would be the corresponding 'fiscal' component at the domestic (EU) level. The destination principle, according to which products shall be taxed in the country where they are consumed, plays a key role in this context.[14] Identifying a corresponding/equivalent 'fiscal' element within the CBAM and ETS arrangements would result in the categorization of the pecuniary component of the former instrument as a *border tax adjustment* ('BTA'); further, it would allow for *WTO law compatible export rebates*.[15] These are two sides of the same coin.

Article II:1 of the 1994 General Agreement on Tariffs and Trade ('GATT') regulates ordinary customs duties and the residual category of 'all other duties or charges of any kind' imposed on or in connection with importation. Article II:2(a), however, stipulates that nothing in Article II shall prevent the contracting Parties from imposing at any time on the importation of a product '*a charge equivalent to an internal tax* imposed *consistently with the provisions of paragraph 2 of Article III* in respect of the *like domestic product or in respect of an article* from which the imported product has been manufactured or produced in whole or in part' (emphasis added). This Article regulates internal taxes that are levied on both imported products and the 'like' domestic products and adjusted at the border. Excises and value added taxes are perhaps the most famous examples; in accordance with the destination principle, these taxes are levied in the country where the goods are consumed.

As specified in Article II:2(a), adjustable taxes must be imposed consistently with Article III:2 ('National Treatment on Internal Taxation'). The first sentence of this Article provides that imported products 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.[16] Further, in accordance with the second sentence of Article III:2 and the note *ad* Article III, the taxed product and directly competitive or substitutable products must be similarly taxed.[17] Importantly, the note *ad* Article III clarifies that any internal tax or other

[12] Venzke and Vidigal, *supra* n. 11.
[13] *Ibid*.
[14] *Report of the Working Party on Border Tax Adjustments*, L/3464 (20 November 1970).
[15] As suggested in Venzke and Vidigal, *supra* n. 11.
[16] Under the two-tiered test applied by the dispute settlement organs, two elements are necessary for a finding of a violation of Article III:2, first sentence. First, it must be determined that the domestic and imported products are 'like' products. Second, it must be established that imported products are taxed in excess of the domestic products. *See* WTO Appellate Body Report, *Canada – Certain Measures Concerning Periodicals* [*Canada – Periodicals*], WT/DS31/AB/R, adopted 30 July 1997, pp 22 and 23.
[17] As the AB reiterated in *Korea – Alcoholic Beverages*, 'Like products are a subset of directly competitive or substitutable products … The notion of like products must be construed narrowly but the category of directly competitive or substitutable products is broader. While perfectly substitutable products fall within Article III:2, first sentence, imperfectly substitutable products can be assessed under Article III:2, second sentence'. *See* WTO

internal charge which applies to an imported product and to the 'like' domestic product and which is collected in the case of the imported product at the time or point of importation is nevertheless to be regarded as an internal (adjustable) tax or charge under Article III. The moment and context in which the tax or charge is collected or paid by the imported products is irrelevant; as reiterated by the dispute settlement organs, the distinction between duties or charges regulated under Article II:1 and internal taxes/charges and BTAs under Articles III:2 and II:2(a) is based on different elements. The obligation to pay ordinary customs duties or 'other duties or charges' is linked to the importation of the product and accrues because of the importation of the product, regardless of the moment when the charge is collected or paid.[18] Conversely, the payment of adjustable taxes or charges accrues to an internal event, such as the distribution, sale, use or transportation of a product.[19]

Under the 'fiscal' element scenario, the pecuniary component of the CBAM can be categorized as a BTA *in so far as* it qualifies as a *charge equivalent to an internal tax* imposed *consistently with Article III:2* on imported as well as domestic *products*. Categorizing the CBAM as a BTA does not have very significant implications as regards defending the scheme's compatibility with the substantive obligations of the GATT; the CBAM is extremely likely to violate the Most Favoured Nation ('MFN') principle.[20] Nonetheless, this construction would allow for WTO law compatible export rebates. Pursuant to the note *ad* Article XVI GATT, 'the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy'. The same provision is enshrined in footnote 1 to Article 1 of the SCMA, which cross-references both Article XVI GATT and Annexes I to III of the SCMA.[21] Yet again, the destination principle comes into play. If the 'fiscal' component of the ETS and CBAM respectively applies to domestic and imported products destined for consumption on the EU internal market, exported EU products can be legitimately exempted from the ETS 'fiscal' component via export rebates.

This begs the question whether the 'fiscal' component construction can be justified from a WTO law perspective. The following sections explore these questions in detail.

3. Can the CBAM or its 'Fiscal' Component Qualify as a *Charge Equivalent to an Internal Tax* Imposed *Consistently with Article III:2*?

This section focuses on three different yet interconnected points. First, it enquires whether the 'fiscal' component of the CBAM and ETS could qualify as a *tax or charge* under Articles II:2(a) and III:2 GATT. Assuming that the answer to the first question is positive, it enquires

Appellate Body Report, *Korea – Taxes on Alcoholic Beverages* [*Korea – Alcoholic Beverages*] WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 Feb. 1999, para. 118.

[18] WTO Appellate Body Report, *China – Measures Affecting Imports of Automobile Parts* [*China – Auto Parts*], WT/DS339/AB/R, WT/DS340/AB/R, WT/DS342/AB/R, adopted 12 Jan. 2009, para. 158.

[19] WTO Appellate Body Report, *China – Auto Parts*, para. 162.

[20] The exemption for products originating from countries whose emission trading systems are fully linked to the EU and the provision that any 'explicit' carbon price already 'borne' in the country of origin of the product shall be waived violate the MFN principle. *See* Leonelli, *supra* n. 9.

[21] For a detailed analysis of the text of the footnote and of the Annexes, *see* section 4 *infra*.

whether the pecuniary component of the CBAM is *equivalent* in nature to the pecuniary component of the ETS; this is a further precondition for the existence of a BTA and the application of Article III:2. Third, assuming again that this is the case, it turns to the question whether the pecuniary component of the ETS/CBAM is imposed *consistently with Article III:2 GATT*. The analysis suggests that all of these questions may be answered in the negative. As explained in greater detail below, this would make export rebates WTO law incompatible.

The identification of a corresponding (adjustable) 'fiscal' component under the ETS and the CBAM draws on the broad construction of the notion of a 'charge' by the dispute settlement organs. In *Argentina – Hides and Leather*, the Panel emphasized that the term 'charge' denotes a 'pecuniary burden' and a 'liability to pay money';[22] these findings have been relied on to support the argument that the 'fiscal' component of the ETS/CBAM would fall for analysis under Article III:2.[23]

As rightly noted, the pecuniary burden imposed under the CBAM could easily qualify as a tax or charge. Whether the same would apply to the pecuniary burden imposed under the ETS, however, is far more controversial; this has been indirectly acknowledged by the supporters of the 'fiscal' component construction.[24] While this argument is not impossible to defend, several reasons militate against it. EU law and the findings of the European Court of Justice ('ECJ') have no value under WTO law; regardless, the ECJ's case law highlights some structural difficulties in the categorization of cap-and-trade systems (emission trading schemes) as taxes or charges. In Case C-366/10, the ECJ was called upon to deliver a preliminary ruling on the validity of Directive 2008/101 on the inclusion of aviation activities within the EU ETS.[25] The claimants and interveners contended among other things that the ETS amounted to a tax or charge prohibited by international agreements.[26] In her Opinion to the ECJ, Advocate General ('AG') Kokott drew a distinction between taxes or charges, on the one hand, and emission trading schemes, on the other.

First, she noted that taxes or charges are levied by public authorities.[27] In the case of the EU ETS, however, emission allowances are simply surrendered to the relevant public authorities. Allowances are tradeable; for this reason, any 'excess' allowances can be kept by market actors and be sold to other actors who need them to offset their GHG emissions.[28] Second, taxes or charges are set unilaterally by a public body.[29] In the case of cap-and-trade systems, however, 'no provision is made for fees or charges for the acquisition of emission

[22] WTO Panel Report, *Argentina – Measures Affecting the Export of Bovine Hides and the Import of Finished Leather* [*Argentina – Hides and Leather*], WT/DS155/R and Corr.1, adopted 16 Feb. 2001, para. 11.143. The Panel also noted that Article III:2 refers to 'internal taxes or other internal charges of any kind'.
[23] Venzke and Vidigal, *supra* n. 11, pp. 10 et seq.
[24] *Ibid.*
[25] Case C-366/10, *Air Transport Association America and Others*, 21.12.2011, ECLI:EU:C:2011:864.
[26] Opinion of AG Kokott in Case C-366/10, *Air Transport Association America and Others*, 06.10.2011, ECLI:EU:C:2011:637, paras 42, 104, 161 and 207; and Case C-366/10, *Air Transport Association America and Others*, para. 136.
[27] Opinion of AG Kokott in Case C-366/10, *Air Transport Association America and Others*, para. 214.
[28] *Ibid.*, para. 215.
[29] *Ibid.*, para. 214.

allowances'.[30] To the contrary, as the AG remarked, a number of ETS allowances have been (and still are) allocated free of charge by public authorities.[31]

Third, in the case of taxes and charges, the amount that is due can be predetermined in advance according to specific criteria, such as the tax rate and basis of assessment.[32] In the case of emission trading schemes, by contrast, the price of emission allowances is 'governed solely by supply and demand' on the market.[33] Drawing on these findings, and after emphasizing that different international bodies have drawn similar distinctions between cap-and-trade systems and taxes or charges, the AG concluded that the ETS should qualify as a 'market-based measure'.[34] On these grounds the 'purchase price' paid for an emission allowance, i.e. the *pecuniary burden* associated with the ETS, could *not* qualify as a *tax* or *charge* under *EU law*.[35] The ECJ adhered to the Opinion.[36]

The findings of the ECJ resonate with the traditional environmental law distinction between carbon taxes and cap-and-trade systems.[37] Both instruments set carbon pricing mechanisms in place and involve the adoption of price-based policies. However, the amount of carbon tax levied by public authorities is 'fixed' and can be predetermined in advance by the relevant stakeholders. In the case of cap-and-trade systems, by contrast, the price of emission allowances fluctuates; once the 'cap' has been established, the overall levels of GHG emissions of installations and 'trade' in emission allowances will determine the latter's price. According to the advocates of emission trading, the tradability of emission allowances results in a more economically efficient system; in other words, it enables market actors to achieve GHG emission reductions at the lowest possible economic cost.[38] Low polluting firms can sell their 'excess' emission allowances to high polluting firms; the relevant economic profit can then be employed to make further investments in decarbonization. The differentiation between carbon pricing mechanisms under environmental law again militates in favour of drawing a distinction between taxes or charges, on the one hand, and the purchase price for emission allowances, on the other.

This concise overview has highlighted the difficulties associated with the categorization of the 'fiscal' component of the ETS as a tax or charge; however, the broad WTO law definition of the notion of a 'charge' may still result in such categorization. The ensuing question is whether the 'charge' imposed under the CBAM can be characterized as *equivalent* to the 'charge' imposed under the ETS. This is the second precondition for the existence of a BTA.

[30] *Ibid*., para. 215.
[31] *Ibid*., para. 215.
[32] *Ibid*., para. 214. For a mention of some of the points raised by the AG, *see* also Venzke and Vidigal, *supra* n. 11.
[33] *Ibid*., para. 215.
[34] *Ibid*., paras 218-220.
[35] *Ibid*., para. 216.
[36] Case C-366/10, *Air Transport Association America and Others*, paras 143 et seq.
[37] For a detailed overview, *see inter alia* Javier de Cendra de Larragán, *Emission Trading Schemes and WTO Law: A Typology of Interactions*, 636-668 (Geert Van Calster and Denise Prévost eds, Edward Elgar 2013).
[38] *Ibid*.

It is well known that an internal tax or regulatory measure and its corresponding adjustment at the border need not be identical.[39] The relevant question for the purposes of the present analysis is rather *to what extent* they may differ in their design, structure and application. In the controversial case of the ETS/CBAM, we are navigating uncharted waters.

In *Argentina – Hides and Leather*, the Panel analysed two sets of tax measures that respectively applied to domestic and imported products. RG3543 established a system for the collection of income tax with respect to transactions on imported products. RG2784 established a withholding regime in respect of the income tax applicable to transactions on domestic products. The Panel found that the two systems were equivalent in nature, despite the application of different methods of taxation; RG3543 thus provided for the collection of the internal tax at the border.[40] The case of the ETS/CBAM, however, is different in many respects.

To begin with, the ETS targets the GHG emission *output* of *installations*. The CBAM, by contrast, targets the GHG emissions *embedded* in *products*. The case of the ETS/CBAM is thus structurally different from the one under analysis in *Argentina – Hides and Leather*; both RG3543 and RG2784 applied in respect of transactions on specific *products*. Second, the ETS applies in respect of all reported GHG emission outputs. In a different vein, the CBAM provides for consideration of the verified emissions embedded in products *or* recourse to default values. Third, for the purposes of the ETS application, 'explicit' carbon prices are determined in auctions. Firms may also make use of allowances that they purchased at a prior stage and kept; further, in sectors at risk, allowances have so far been allocated free of charge. In the case of the CBAM, the prices of certificates are determined by reference to average weekly auctioning prices. Fourth, 'excess' ETS allowances can be sold by EU firms to make a profit. By contrast, CBAM certificates are neither tradable nor part of the overall ETS 'cap'.

This may suggest that the 'fiscal' components of the two instruments are too different in nature for the CBAM 'charge' to be characterized as *equivalent* to the ETS 'charge'.[41] Alternatively, these differences may be relevant to an assessment of the third component of Article II:2(a): whether the 'charge' that is 'equivalent to an internal tax' is imposed *consistently with Article III:2*.

An analysis of the first sentence of the Article will suffice for the purposes of the present enquiry. Article III:2 protects the equality of competitive opportunities of imported and 'like' domestic products;[42] any 'excess' will automatically result in a violation of the first sentence of the Article, and *de minimis* rules do not apply.[43] An analysis under Article III:2 involves a

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[39] As regards adjustable regulations under Article III:4 and their domestic counterparts, *see* Panel Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/R, adopted 5 April 2001, paras 8.94 et seq.
[40] WTO Panel Report, *Argentina – Hides and Leather*, paras 11.150 et seq.
[41] Under an alternative construction, the CBAM could instead be regarded as a *regulatory* border adjustment. This construction may be easier to reconcile with the differences between the two instruments. *See* Leonelli, *supra* n. 9. Alternatively, the CBAM would fall for analysis under the residual category of 'all other duties or charges of any kind imposed on or in connection with importation', enshrined in Article II:1(b).
[42] *See* WTO Panel Report, *Argentina – Hides and Leather*, para. 11.182, and the disputes cited therein.
[43] Appellate Body Report, *Japan – Taxes on Alcoholic Beverages* [*Japan – Alcoholic Beverages II*], WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, pp. 18 and 23.

holistic assessment of actual tax burdens and includes consideration of tax rates, taxation methods and tax collection rules.[44]

The differences in the application of the ETS scheme and CBAM reveal potential breaches of Article III:2, first sentence.[45] Referring to the *average* weekly auctioning price of ETS allowances could easily result in a heavier tax burden for imported products vis-à-vis EU installations; reference to the lowest weekly auctioning price of ETS allowances may be the only way to prevent such a finding. The problems regarding default values for the calculation of GHG emissions under the CBAM would be more difficult to remedy; yet, recourse to these values may result in a breach of Article III:2.[46] Finally, the possibility for EU actors to 'keep' ETS allowances and sell them and the different ways in which this affects and potentially reduces the pecuniary burdens 'borne' by EU installations may also result in a violation of the National Treatment obligations.

As suggested so far, the pecuniary burden associated with the ETS/CBAM may not qualify as a 'charge'. The 'fiscal' component of the CBAM may also not be considered 'equivalent' to the 'fiscal' component of the ETS, particularly in so far as the latter applies to installations rather than to products. Further, as explained above, the ETS/CBAM is likely to violate Article III:2. If the CBAM were categorized as a 'charge' 'equivalent to an internal tax or charge', any potential breach of Article III:2 could still be justified under Article XX GATT. The CBAM's justification under Article XX would 'save' the BTA and would also 'save' export rebates; these would still be covered by the note *ad* Article XVI GATT and by footnote 1 to Article 1 SCMA.[47]

A finding that the CBAM does *not* qualify as a 'charge' 'equivalent to an internal tax or charge', by contrast, would have important implications in respect of export rebates. These would *not* be covered by the express exemptions of the note *ad* Article XVI GATT and footnote 1 to Article 1 SCMA. Were these exemptions not to apply, export rebates under the ETS would automatically fall for analysis under Article 3.1 SCMA.[48] Article 3.1(a) sets out a prohibition on '*subsidies contingent*, in law or in fact, whether solely or as one of several other conditions, *upon export performance*, including those illustrated in Annex I' (emphasis added).[49]

The final question is then whether export rebates under the ETS would qualify as 'subsidies'. Regardless of their specific design, it is legitimate to suggest that they would. Article 1 SCMA stipulates that a subsidy shall be deemed to exist for the purposes of the Agreement if there is a *financial contribution* by a government or any public body within the

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[44] *See* GATT Panel Report, *Japan – Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages* [*Japan – Alcoholic Beverages I*], L/6216, adopted 10 November 1987, para. 5.8.
[45] For this view, *see* also Gary Hufbauer et al, *Can EU Carbon Border Adjustment Measures Propel WTO Climate Talks?*, PIEE Policy Brief (2021).
[46] WTO Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline* [*US – Gasoline*], WT/DS2/AB/R, adopted 20 May 1996.
[47] However, another precondition would have to be met in order for the CBAM to qualify as a BTA; this aspect is analysed in the next section. In any case, the CBAM is unlikely to meet the conditions of the Chapeau of Article XX; on these grounds, justification under Article XX is also unlikely. *See* Leonelli, *supra* n. 9.
[48] As noted by Cosbey et al, *supra* n. 11.
[49] As noted by the AB, Article 3.1(a) of the SCMA, read in conjunction with Article 1.1, enshrines a blanket prohibition against any subsidy that is contingent upon export performance. This marks a considerable difference with the provisions of Article XVI:4 GATT. WTO Appellate Body Report, *United States – Tax Treatment for 'Foreign Sales Corporations'* [*US – FSC*], WT/DS108/AB/R, adopted 20 March 2000, para. 115.

territory of a Member, and a *benefit* is thereby conferred. The Appellate Body (AB) has specified that these are '[…] two separate legal elements […] which together determine whether a subsidy exists'.[50] Export rebates would certainly confer a 'benefit'.[51] As regards the scope of 'a financial contribution by a government or any public body', Article 1.1(a)(1) includes two specific scenarios: these are (i) government practices involving a direct transfer of funds or a direct potential transfer of funds or liabilities, and the case where (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits).

Regardless of their specific design, export rebates would qualify as measures whereby 'government revenue that is otherwise due is foregone or not collected'.[52] In *US – FSC*, the AB noted that the word 'foregone' in Article 1.1(a)(1)(ii) 'suggests that the government has given up an entitlement to raise revenue that it could otherwise have raised'.[53] Evaluating whether this 'otherwise due' government revenue has been foregone or has not been collected involves a very close focus on the specific tax rules of the Member. As the AB clarified in *US – FC (Article 21.5 – EC)*, this evaluation will be more straightforward in cases where the measure under challenge is an exception to a general rule of taxation.[54] In other cases, Panels should instead evaluate 'the fiscal treatment of comparable income, in the hands of taxpayers in similar situations'.[55] ETS export rebates fall in the first group of measures.

On these grounds, ETS export rebates would qualify as subsidies and would be automatically prohibited under the SCMA; as seen above, subsidies contingent upon export performance are the object of a blanket prohibition under Article 3.1(1). This is the first potential reason for the incompatibility of ETS export rebates with WTO law.

4. Can the ETS/CBAM or their 'Fiscal' Component Qualify as an *Adjustable Product Tax or Charge*?

This section analyses the final condition for the 'fiscal' component of the CBAM to qualify as a BTA; as already explained, this categorization is necessary to ensure that export rebates are WTO law compatible. If we assume that the CBAM is regarded as a 'charge' that is 'equivalent to an internal tax or charge' and 'imposed consistently with Article III:2', it will still *only* qualify as a BTA *if* the ETS/CBAM and their 'fiscal' components can be categorized as *adjustable product taxes or charges*. The final question thus relates to the *specific nature* of the 'fiscal' component of the ETS and CBAM.

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[50] WTO Appellate Body Report, *Brazil – Export Financing Programme for Aircraft* [*Brazil – Aircraft*], WT/DS46/AB/R, adopted 20 Aug. 1999, para. 157.
[51] The AB has found that a benefit is conferred if the relevant financial contribution has made the recipient of the subsidy better off than it would have been in the absence of the contribution. WTO Appellate Body Report, *United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)* [*US – Large Civil Aircraft* (*2nd Complaint*)], WT/DS353/AB/R, adopted 23 March 2012, paras 635 and 636.
[52] As also acknowledged in Cosbey et al., *supra* n. 11, 10.
[53] WTO Appellate Body Report, *US – FSC*, para. 90.
[54] WTO Appellate Body Report, *United States – Tax Treatment for 'Foreign Sales Corporations' – Recourse to Article 21.5 of the DSU by the European Communities* [*US – FSC* (*Article 21.5 – EC*)], WT/DS108/AB/RW, adopted 29 Jan. 2002, para. 91.
[55] *Ibid.*, paras 91 and 98.

As briefly explained above, Article II:2(a) refers to charges imposed 'in respect of *the like domestic product* or in respect of *an article* from which the imported product has been manufactured or produced in whole or in part' (emphasis added). The internal tax must be levied on a 'product' or in respect of a specific 'article'.

The wording of Article III:2 is slightly different from the one of Article II:2. The first sentence of Article III:2 stipulates that imported products shall 'not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products'. The reference to internal taxes or internal charges applied *directly or indirectly* to *imported products* and the *like domestic products* has triggered a discussion on the nature of carbon taxes and their adjustability at the border. This question has been extensively debated in the past years.

On the one hand, the wording of Article II:2(a) and of the note *ad* Article III support the argument that producer taxes do *not* qualify for border adjustment. As already emphasized, Article II:2(a) refers to taxes or charges imposed in respect of a 'product' or an 'article from which the product is manufactured or produced'; the note *ad* Article III refers to taxes, charges, laws, regulations or requirements which apply to imported products and to the 'like' domestic products. Further, the 1970 Report of the Working Party on Border Tax Adjustments militates against the inclusion of producer taxes within the scope of Article II:2(a).[56]

On the other hand, considerable ambiguity persists on the treatment of so-called *taxes occultes*.[57] The specific wording of Article III:2 ('directly or indirectly') may also underpin a broader interpretation of BTAs.[58] Further, the Panel Report in *US – Superfund* has been relied on to advance the argument that carbon taxes targeting the GHG emissions embedded in a product may be subject to border adjustment.[59] The US Superfund Act imposed a tax on certain imported substances; the tax applied when specific chemicals constituted more than 50% of the weight or more than 50% of the value of the materials used to produce the imported substances.[60] The complainants argued that this tax targeted polluting processes occurring in the country of production of the substances, and that it should be categorized as a producer tax; on these grounds, they also claimed that it could not be the object of border adjustment.[61] The Panel, by contrast, found that the tax was imposed on a 'product' and equalled 'in principle the amount of the tax which would have been imposed … on the chemicals used as materials in the manufacture or production of the imported substance if these chemicals had been sold in the US'.[62]

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[56] GATT Report, *Report of the Working Party on Border Tax Adjustments*, L/3464, 20 November 1970, para. 14.
[57] For different views, *see inter alia* Joost Pauwelyn, *US Federal Climate Policy and Competitiveness Concerns: The Limits and Options of International Trade Law*, Duke University Working Paper (2007); Robert Howse, *Non-Tariff Barriers and Climate Policy* (Christoph Herrmann, Markus Krajevski and Jörg P Terhecte eds, Springer 2015); Gabrielle Marceau, *The Interface between Trade Rules and Climate Change Actions* (Deok-Young Park ed, Springer 2016); Joel P Trachtman, *WTO Law Constraints on Border Tax Adjustment and Tax Credit Mechanisms to Reduce the Competitive Effects of Carbon Taxes*, Resources for the Future (2016).
[58] Pauwelyn, *US Federal Climate Policy and Competitiveness Concerns*, *supra* n. 57, 20.
[59] *Ibid.*
[60] GATT Panel Report, *United States – Taxes on Petroleum and Certain Imported Substances* [*US – Superfund*], L/6175, adopted 17 June 1987, para. 2.4.
[61] *Ibid.*, para. 3.2.7.
[62] *Ibid.*, para. 5.2.8.

Some scholars have noted that GHG emissions are an 'output' rather than an 'input' of production processes; this may justify a difference in the treatment of carbon taxes, vis-à-vis taxes on input materials.[63] Indeed, the latter taxes qualify as taxes or charges imposed in respect of an 'article from which the product is manufactured or produced' under Article II:2(a). Other commentators, by contrast, have laid emphasis on the absence of any specification by the Panel as to whether the chemical substances which were the object of taxation in *US – Superfund* 'still had to be physically present in the imported product'.[64] This may strengthen the argument that a carbon tax covering the GHG emissions 'embedded' – but not incorporated – in a product is adjustable.

Overall, the question whether carbon taxes may qualify for border adjustment is very controversial.[65] An analysis of the corresponding provisions in the SCMA makes this question even more controversial; these provisions are key to establish the boundaries of the notion of *adjustable product taxes* and ascertain the WTO law compatibility of *export rebates*. Footnote 1 to Article 1 SCMA stipulates that 'in accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy'. In *India – Export Related Measures*, the Panel clarified the difference between the two scenarios. Under the former (exemption) scenario, liability for the relevant duty or tax does not arise; under the latter (remission), the liability arises but is remitted at a later stage.[66] In its Report, the Panel also identified the four constituent elements of the measures covered by footnote 1. These are respectively (i) an exemption or remission; (ii) of duties or taxes; (iii) on an exported product; (iv) not in excess of the duties or taxes that have accrued.[67]

As the AB emphasized in *US – FSC*, 'the tax measures identified in footnote 1 as not constituting a subsidy involve the exemption of exported *products* from *product-based consumption taxes*' (emphasis added).[68] Further, footnote 1 makes express reference to Annexes I to III of the Agreement; on these grounds, the text of the footnote must be read *in the light of* and *in accordance with* the provisions of the Annexes.[69] The three Annexes respectively include an illustrative list of export subsidies, guidelines on the consumption of inputs in the production process, and guidelines on the determination of substitution drawback systems as export subsidies. As the Panel noted in *India – Export Related Measures*, 'a measure

[63] Patrick Low, Gabrielle Marceau and Julia Reinaud, *The Interface Between the Trade and Climate Change Regimes: Scoping the Issues*, WTO Staff Working Paper ERSD-2011-1 (2011); and Marceau, *supra* n. 57, 7.

[64] *See* Pauwelyn, *US Federal Climate Policy and Competitiveness Concerns*, *supra* n. 57, 20; Howse, *supra* n. 57, 6.

[65] For a broad interpretation of the potential scope of application of Articles II:2(a) and III:2, *see* WTO Panel Report, *Argentina – Hides and Leather*, paras 11.159 et seq. The Panel acknowledged that RG3543 (an income tax) would not normally be the object of a BTA; however, it also found that in this case it fell within the scope of Article III:2 in so far as both RG3543 and RG2784 were levied on imported and domestic *products*. The *Argentina – Hides and Leather* scenario is still different from the one of the ETS/CBAM. As already noted, the CBAM is levied on products. The ETS, however, is not; it applies to installations and targets GHG emission outputs.

[66] WTO Panel Report, *India – Export Related Measures* [*India – Export Related Measures*], WT/DS541/7, circulated 31 Oct. 2019, para. 7.169.

[67] WTO Panel Report, *India – Export Related Measures*, para. 7.170.

[68] WTO Appellate Body Report, *US – FSC*, para. 93.

[69] WTO Panel Report, *India – Export Related Measures*, para. 7.171.

falling within the definition of any items … [included in the illustrative list of Annex I] would *not benefit* from the shelter of *footnote 1*' (emphasis added).[70] For the purposes of the present analysis, this has crucial implications. The provisions of Annexes I and II provide *fundamental interpretative guidance and context* to evaluate whether the 'fiscal' component of the ETS/CBAM could fall within the scope of Footnote 1 to Article 1 SCMA; this aspect has been largely overlooked.

Paragraphs (g), (h) and (i) of Annex I are the key provisions in this respect. Paragraph (g) includes the 'exemption or remission, in respect of the production and distribution of exported products, of indirect taxes in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption'. The exemption or remission of indirect taxes *in excess of* those levied in respect of 'like' products sold for domestic consumption is bound to qualify as a prohibited export subsidy. Symmetrically, the exemption or remission of indirect taxes will normally fall within the scope of footnote 1.

Would the 'fiscal' component of the ETS qualify as an *indirect tax* levied in respect of *the production and distribution of products*? This is far from clear. According to footnote 58 to the SCMA Agreement, 'indirect taxes' shall mean 'sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, border taxes and all taxes other than direct taxes and import charges'. Under the same footnote, 'import charges' are 'tariffs, duties, and other fiscal charges not elsewhere enumerated in this note that are levied on imports'. This somehow brings us back to square one: can carbon taxes be adjusted at the border ('indirect tax'/border tax scenario), or would they qualify as other duties or charges imposed on or in connection with importation ('import charge' scenario)?

As already seen, the ETS cap-and-trade-system applies to EU *installations* and their overall GHG outputs. There is no link between the monetary burden associated with compliance with the ETS, on the one hand, and specific 'products' or specific 'articles' from which the products have been manufactured or produced, on the other. On these grounds, is it possible to regard the ETS's 'fiscal' component as a duty or tax that is *borne* by *domestic products* and *remitted* to *exported products*?[71]

Further, would ETS export rebates involve the exemption of exported products from *product-based consumption taxes*?[72] As pointed out in the literature, footnote 1 has always applied to 'indirect taxes imposed on products where the tax incidence rests with the final consumer'.[73] Nonetheless, the extent to which the carbon price 'borne' by goods is passed through in the final consumer price is both controversial and very difficult to measure.[74]

An analysis of paragraphs (h) and (i) of Annex II triggers further considerations. Paragraph (h) defines as a (prohibited) export subsidy the exemption, remission or deferral of prior-stage cumulative indirect taxes on goods or services used in the production of exported products *in excess of* the exemption, remission or deferral of like prior-stage cumulative indirect taxes on goods or services used in the production of 'like' products when sold for

[70] WTO Panel Report, *India – Export Related Measures*, para. 7.173.
[71] Again, the wording of Footnote 1 expressly refers to the exemption or remission of duties or taxes *borne by the like product* when destined for domestic consumption. *See supra* in this section.
[72] WTO Appellate Body Report, *US – FSC*, para. 93.
[73] Cosbey et al, *supra* n. 11, 13.
[74] *Ibid*., 10.

domestic consumption. Prior-stage cumulative indirect taxes may be exempted, remitted or deferred on exported products *even when* this treatment is *not accorded* to the 'like' domestic products, *provided that* these prior-stage cumulative indirect taxes are levied on *inputs that are consumed in the production of the exported products*.[75] Footnote 58 defines 'prior-stage' indirect taxes as 'those levied on goods or services used *directly or indirectly* in making the product' (emphasis added). 'Cumulative' indirect taxes, on the other hand, are defined as multi-staged taxes levied where there is no mechanism for subsequent crediting of the tax if the goods or services are used in a succeeding stage of production.

Paragraph (i) enshrines the last relevant provisions. It includes within the list of export subsidies the remission or drawback of import charges *in excess of* those levied on *imported inputs that are consumed in the production of the exported products*.[76] This paragraph shall be interpreted in accordance with the guidelines of Annex II.

Again, paragraphs (h) and (i) lay out the specific conditions under which the exemption, remission, deferral or drawback of prior-stage cumulative indirect taxes levied on inputs or import charges levied on imported inputs will qualify as export subsidies. This provides *further interpretative guidance* to evaluate the potential treatment of ETS rebates; it provides *crucial indications* regarding the specific taxes that could be adjusted at the border and be the object of WTO law compatible export rebates.

Footnote 61 to Annex II (guidelines on consumption of inputs in the production process) stipulates that *inputs consumed in the production process* as per paragraphs (h) and (i) are *inputs physically incorporated*, *energy*, *fuels* and *oil* used in the production process and *catalysts* which are consumed in the course of their use to obtain the exported product. Crucially, the dispute settlement organs have found that this is an *exhaustive* rather than an illustrative list.[77] Part II of Annex II reiterates that inputs should be regarded 'as *physically incorporated* if such *inputs are used in the production process* and are *physically present in the product exported*' (emphasis added). Nonetheless, an input need not be present in the final product in the same form in which it entered the production process.

These provisions came under analysis in *India – Export Related Measures*. India claimed that capital goods, whose importation was exempt from customs duties under the Indian schemes, were inputs consumed in the production process of the relevant exported products. It also argued that capital goods qualified as inputs in so far as they contributed to the final cost of the exported products. The Panel rejected both arguments, emphasizing that capital goods were neither physically incorporated in the relevant goods, nor included in the exhaustive list provided for in footnote 61.[78]

With their reference to *inputs that are consumed in the production* of the exported products, paragraphs (h) and (i) of Annex I and the provisions of Annex II delimit the analytical

[75] This para. clarifies that normal allowance shall be made for waste, and that the provisions shall be interpreted in accordance with Annex II.
[76] This para. clarifies that normal allowance shall be made for waste, that the provisions shall be interpreted in accordance with Annexes II and III, and that further caveats may apply.
[77] WTO Panel Report, *India – Export Related Measures*, para. 7.211.
[78] WTO Panel Report, *India – Export Related Measures*, paras 7.202 to 7.208. On the requirement of physical incorporation and physical presence, *see* also WTO Panel Report, *India – Measures Concerning Sugar and Sugarcane* [*India – Sugar and Sugarcane* (*Australia*)], WT/DS579/R, WT/DS580/R, WT/DS581/R, circulated on 14 Dec. 2021, para. 7.288.

scope of the notion of *taxes occultes* to a considerable extent; further, as mentioned above, the dispute settlement organs have found that the list in footnote 61 is exhaustive in nature.[79] As already seen, GHG emissions are an 'output' rather than an 'input' that is consumed in the production of the exported products. This suggests that the 'fiscal' component of the ETS could not be the object of WTO law compatible export rebates.

The attempt could be made to draw a connection between GHG emissions, on the one hand, and *energy, fuels and oil* used in the production process, on the other.[80] Alternatively, a broad interpretation of the notion of *inputs that are physically incorporated* could be put forward; this could interpretatively broaden the exhaustive list of footnote 61. Nonetheless, both arguments would be unlikely to succeed.

The first argument was put forward in Case C-366/10; the ECJ was called upon to rule *inter alia* on the question whether the ETS introduced a (prohibited) excise duty on fuel. In her Opinion, AG Kokott noted that fuel consumption *per se* did not permit any direct inferences as to the resulting GHG emissions; rather, due consideration had to be given to the specific fuel employed. On these grounds, she argued that the ETS was not characterized by a 'direct and inseverable link' between the quantity of fuel consumed by aircrafts, on the one hand, and the pecuniary burden on operators, on the other. Consequently, the ETS did not introduce an excise duty on fuel.[81]

Turning to the second argument, a 'direct and inseverable link' exists between the quantity of energy, fuels and oil employed in production processes, and the pecuniary burdens associated with *taxes occultes* on energy, fuels and oil. The same 'direct and inseverable link', however, does not exist in the much more complex case of GHG emissions. Under the CBAM, as already seen, consideration of the verified GHG emissions embedded in imported products is only one of the potentially applicable criteria. The application of residual criteria undermines the 'direct and inseverable link' between *GHG emission outputs*, on the one hand, and *pecuniary burdens*, on the other. This sheds further light on the structural differences between the ETS/CBAM and the structure, design and application of prior-stage cumulative indirect taxes.

As the analysis in this section has endeavoured to demonstrate, several reasons militate *against* the WTO law compatibility of export rebates and the argument that the ETS/CBAM 'charge' may qualify as an adjustable product tax.[82] The final points regard the specificities of carbon taxes or charges, if compared to 'traditional' BTAs. Adjustable product taxes such as excises can be adopted and levied on domestic and imported products by any country. Symmetrically, in these cases, any country is entitled to provide export rebates. The case of carbon taxes and cap-and-trade systems, however, is structurally different.

Price-based policies are *one potential* decarbonization strategy; nonetheless, countries may have recourse to non-price-based policies or partial-price-based policies to achieve the

[79] This is apparent from a comparison of these provisions with the text of footnote 58; the latter defines 'prior-stage' indirect taxes as 'those levied on goods or services used *directly or indirectly* in making the product' (emphasis added). Paras (h) and (i) and Annex II thus restrict the scope of permissible export rebates considerably.
[80] In this respect, *see* also the reference in Cosbey et al., *supra* n. 11, 13.
[81] Opinion of AG Kokott in Case C-366/10, *Air Transport Association America*, para. 233.
[82] Even if the CBAM/ETS were regarded as adjustable taxes or charges, as explained in the previous sections, the CBAM is unlikely to comply with Art III:2 and unlikely to meet the conditions of the Chapeau of Article XX. On these grounds, again, the BTA would not be 'saved' and export rebates would not be WTO law compatible.

same GHG emission reduction goals. Qualifying carbon taxes or cap-and-trade systems as adjustable product taxes or charges is thus associated with a range of implications. As noted in the first section, the CBAM does not take the effectiveness and stringency of non-price-based policies in force in different jurisdictions into account; as a result, the CBAM may be levied on products originating from countries where carbon leakage would not materialize and afford protection to domestic (EU) products, levelling the economic rather than the environmental playing field. For the purposes of the present analysis, the difference between price-based GHG emission reduction policies and 'traditional' adjustable product taxes weakens the arguments surrounding export rebates.

Further, countries that have adopted carbon taxes or set emission trading systems in place may decide not to levy their 'explicit' carbon price on imported products; in a similar vein, they may decide not to provide export rebates. Again, this points to a structural difference with 'traditional' product taxes. Indeed, the CBAM takes into account the 'explicit' carbon prices 'borne' by imported products in their country of origin and 'waives' them. This would be unnecessary if the CBAM qualified as an adjustable product tax. *On the contrary*, from that perspective, the 'explicit' carbon prices borne by imported products in their country of origin would have to be the object of export rebates. This peculiarity again militates against granting export rebates to EU products. If the CBAM takes foreign 'explicit' carbon prices into account and 'waives' them, the same should occur for EU exports on foreign markets.

To conclude, it is worth emphasizing that export rebates are bound to have several environmentally detrimental effects at the external (foreign market) level. Granting export rebates distorts competition between products on foreign markets. Exported EU products that have benefited from the rebate may be in competition on foreign markets with domestic products that have 'borne' high 'implicit' carbon costs. Under another scenario, EU products may be exported to countries that have had recourse to stringent carbon pricing policies but do not have any carbon border measures in place. In this case, exported EU products that have benefited from the rebate would be in competition on foreign markets with domestic products that have 'borne' high 'explicit' carbon costs. Regardless of the specific policies of the importing country, exported EU products that have benefited from the rebate may be in competition with other foreign products imported in that country; yet again, these products may have 'borne' high 'implicit' or 'explicit' carbon costs in their country of origin.

Granting export rebates under these scenarios would produce two effects. First, by distorting competition between products on foreign markets, it could have environmentally detrimental effects vis-à-vis third countries and promote carbon leakage at the transnational level. Second, it would afford *economic protection to EU products* in the *absence of any risks of export-related carbon leakage*. This testifies to the *economic rather than environmental* rationale of export rebates.[83]

The point has been made that export solutions should not be applied to high ambition countries.[84] This might be beneficial. However, this exclusion mechanism would be associated with several difficulties; the obstacles connected to the establishment of environmental

[83] Leonelli, *supra* n. 9.
[84] Cosbey et al., *supra* n. 11, 18.

equivalence would come into play in this context.[85] Further, a high ambition country exclusion mechanism would not be resolutive. There is no way to account for competition between EU exports and other imported products on foreign markets. High ambition countries where cheap and polluting imports are sold may be excluded; conversely, low ambition countries where green and expensive imported products are sold may not be excluded.

Finally, but crucially, the perverse effects that export rebates would have in low ambition countries should not be underestimated. Granting rebates to EU products exported to low ambition countries would place 'green' products sold on these markets at a competitive disadvantage; for this reason, it would *reinforce the competitive position of more polluting (cheaper) products* and *discourage low ambition countries* from enacting more stringent environmental regulations. Levelling the economic playing field would thus trigger a vicious circle, entrenching low environmental standards in low ambition countries.

5. Conclusions: The CBAM is Not Perfect. Export Rebates Would Make it Worse

This article has focused on the recent proposal for the inclusion of ETS/CBAM export rebates, enquiring into their WTO law compatibility. As illustrated throughout sections 2 to 4, export rebates are very likely to be WTO law incompatible. Further, from an environmental protection perspective, they create more problems than they solve.

The question whether export rebates have any *environmental* justification is highly controversial. Data suggests that the absence of export rebates could affect the economic competitiveness of EU products.[86] Whether this actually results in carbon leakage, however, will depend on different factors: these include the level of trade intensity on foreign markets, the carbon intensity of foreign or imported products vis-à-vis EU exports, and the ('explicit' or 'implicit') carbon prices 'borne' by foreign or imported products sold on foreign markets. The Commission's 2021 impact assessment suggests that export-related carbon leakage risks are very limited; as a result, the option of granting export rebates was rejected by the Commission.[87]

Further, invoking the carbon leakage hypothesis to defend economic measures is bound to undermine the environmental integrity of the CBAM and the credibility of the EU environmental protection agenda. Export rebates would stretch the carbon leakage hypothesis too far. *Imposing* the EU 'explicit' carbon price on *imported products* aims to *extend* the transnational scope of carbon pricing. This can achieve environmental goals indirectly. *Waiving* the EU 'explicit' carbon price to benefit *EU exported products reduces* the transnational scope of carbon pricing. This exemption can hardly achieve any environmental goals; this is all the more true in the absence of conclusive evidence of export-related carbon leakage. Requiring foreign products to 'bear' the EU carbon price while waiving that price for EU exported products short-circuits the environmental rationale of the entire ETS/CBAM

[85] For a detailed analysis, *see* Leonelli, *supra* n. 9.
[86] Cosbey et al., *supra* n. 11.
[87] Impact Assessment Report, *supra* n. 3, part 2/2, 65 et seq. and 187 et seq.

framework. This is expressly acknowledged in the Commission's impact assessment,[88] and is bound to have far-reaching effects.

As argued since the introductory section, the CBAM is not perfect. Several aspects in its regulatory design and operation have been and will be the object of criticism. Export rebates, however, would make it considerably worse. Considerations surrounding WTO law compatibility and environmental integrity militate against their inclusion in the final CBAM Regulation.

[88] Impact Assessment Report, *supra* n. 3, part 2/2, 42: 'A CBAM combining an import tax or import certificates with a refund for exports would not be in line with the overarching climate objective of the mechanism, which is to reduce GHG emissions in the EU and globally. The inclusion of refunds of a carbon price paid in the EU would undermine the global credibility of EU's raised climate ambitions and further risk to create frictions with major trade partners due to concerns regarding compatibility with WTO obligations'.