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**CROSS-BORDER TAXATION IN PURSUIT OF GLOBAL CLIMATE EQUITY –  
COMPATIBILITY WITH THE CONCEPT OF FREE TRADE**

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# CROSS-BORDER TAXATION IN PURSUIT OF GLOBAL CLIMATE EQUITY – COMPATIBILITY WITH THE CONCEPT OF FREE TRADE

Arunbaby Stephen\* & Ashima PA\*\*

*[Abstract: India has very recently criticised the carbon border measures being implemented by certain countries like the United States of America (USA) and the European Union (EU), terming them discriminatory and protectionist. The objectives stated in favour of such measures are securing fair competition for domestic products and incentivizing countries to cut emissions and hinder carbon leakage. After the European Union decided to implement the Carbon Border Adjustment Mechanism (CBAM), the Finance Minister, Nirmala Sitharaman, branded the step as a "climate tariff wall" because of the implications it has for Indian made goods in the EU. In a joint ministerial statement issued on November 15, 2022, BASIC countries, including India, China, South Africa, and Brazil, described the carbon border tax as a unilateral measure and discriminatory practise that can cause a trust deficit among parties.*

*India has committed to lower its emissions by 35% and China by 65% by 2030. The argument raised in the interests of such developing nations is that, in spite of such commitments, unilateral measures like CBAM impose an undue burden on them, who require financial and technological aid from developed countries to achieve sustainable development. It is also argued that measures like CBAM are violative of the notion of "common but differentiated responsibility," which is regarded as a legal obligation when interpreting WTO agreements. The objective of the paper is to analyse the validity of such carbon border measures in the light of the WTO's non-discrimination and other trade principles.]*

**Keywords:** carbon border measures, WTO, common but differentiated responsibility.

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# I

## Introduction

Warming has been measured on all components of the Earth's surface, including the geosphere, atmosphere, hydrosphere, and cryosphere.<sup>1</sup> The main cause of global warming is the increasing amount of Carbon dioxide (CO<sub>2</sub>) in the atmosphere. The Keeling Curve, which measures the presence of CO<sub>2</sub> in the atmosphere, signifies that this increase is not caused by any natural process but is a consequence of human actions, including burning fossil fuel, cement production, etc., broadly classified as anthropogenic emissions.<sup>2</sup> It was during the 1970s that scientists became aware of the dangers caused by the anthropogenic release of CO<sub>2</sub> and other greenhouse gases into the Earth's atmosphere, which led to the enactment of the 1985 Vienna Convention for the Protection of Ozone Layer and the 1987 Montreal Protocol on Substances that Deplete the Ozone Layer. Later, in the IPCC First Assessment report of 1990, it was conclusively stated that emissions resulting from human activities are substantially increasing greenhouse gases in the atmosphere, which will increase the greenhouse effect.<sup>3</sup> International Cooperation to tackle this common concern of all humanity took the form of UNFCCC, which the global community adopted in 1992 in Rio de Janeiro.<sup>4</sup> UNFCCC declared that the key goal of the convention, along with any legal instruments that the Conference of Parties (COP) may adopt, was to stabilize greenhouse gas amounts in the atmosphere at a point that would deter dangerous anthropogenic interference with the climate system.<sup>5</sup> UNFCCC required the industrialized countries (Annex I Countries) to implement national policies and corresponding strategies to address

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<sup>1</sup> Edmond A. Mathez, CLIMATE CHANGE: THE SCIENCE OF GLOBAL WARMING AND OUR ENERGY FUTURE 131 (2009).

<sup>2</sup> *Id.* at 58.

<sup>3</sup> WMO & UNEP, CLIMATE CHANGE: THE IPCC SCIENTIFIC ASSESSMENT, INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE 12 (1990) *available at* [https://www.ipcc.ch/site/assets/uploads/2018/03/ipcc\\_far\\_wg\\_I\\_full\\_report.pdf](https://www.ipcc.ch/site/assets/uploads/2018/03/ipcc_far_wg_I_full_report.pdf) (last visited Dec. 11, 2023).

<sup>4</sup> United Nations Framework Convention on Climate Change was adopted on 9<sup>th</sup> May 1992 at New York.

<sup>5</sup> UNFCCC, 1994, Art. 2.

climate change by limiting greenhouse gas emission.<sup>6</sup> However, it did not establish a detailed and legally enforceable obligation for the states that are part of it. The regulatory framework of UNFCCC was supplemented by the Kyoto Protocol of 1997.<sup>7</sup> Kyoto Protocol made a legally binding commitment on Annex I countries to make sure that their anthropogenic carbon dioxide equivalent of greenhouse gas emissions do not exceed the assigned limits. It also required them to minimise greenhouse gas emissions to an average of 5.2% below 1990 emissions by 2012.<sup>8</sup> After the United States decided not to ratify the treaty, the protocol's existence depended on the European Union's efforts. EU took a leap of faith and ratified the treaty, and convinced Russia, Japan, and Australia to ratify the treaty, which ensured that Kyoto Protocol came into effect.<sup>9</sup> Similarly, the EU and each of its constituent nations have agreed to make the EU the first climate-neutral economy and society by 2050. Following the terms of the Paris agreement, the EU has resolved to lessen emissions by at least 55% by 2030.<sup>10</sup> The Emission Trading System of EU plays a crucial role in achieving these lofty goals.

## II

### **Emission Trading System of the European Union**

The Emission Trading System was established through a directive of European Parliament and the Council on October 13, 2003, and began operating on January 1, 2005. The European Union Emission Trading System operates based on the 'cap and trade' principle, which means every installation covered by the system can only release a specific quantity of greenhouse gases. Under the cap, installations can buy or receive emission allowances that are tradable among themselves as

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<sup>6</sup> UNFCCC, 1994, Art. 4.2.

<sup>7</sup> Kyoto Protocol to the United Nations Framework Convention on Climate Change was adopted on 11 December 1997 and came into effect on 16 February 2005.

<sup>8</sup> Kyoto Protocol to UNFCCC, 2005, Art. 3.1.

<sup>9</sup> Cinnamon Pinon Carlarne, CLIMATE CHANGE LAW AND POLICY EU AND US APPROACHES 9 (2010).

<sup>10</sup> EUROPEAN COUNCIL *available at* <https://www.consilium.europa.eu/en/policies/climate-change/paris-agreement/> (Last visited 29 Nov., 2023).

required. Each allowance gives the holder to release either one metric ton of carbon dioxide (CO<sub>2</sub>) or a comparable quantity of other powerful greenhouse gases like nitrous oxide (N<sub>2</sub>O) and perfluorocarbons (PFCs).<sup>11</sup> From 2005 to 2015, the total emissions covered by the ETS directive were reduced by 0.7%<sup>12</sup>, and by 2030 the EU aims to attain a 55% reduction in its emission of greenhouse gases.<sup>13</sup> However, despite all these milestones achieved and goals set out by the ETS, concerns remain about 'carbon leakage.' The concern arises because a strict carbon emission allowance regime might expose certain sectors of the economy to competition from foreign products, which can produce in more competitive environments because they are not under any obligation to buy GHG allowances. This, in turn, can cause more investments to flee to countries without cap and trade schemes, which is described as carbon leakage.<sup>14</sup> Carbon leakage can also be described as a scenario where emissions in a territory reduce because of the shift in industrial activities to other regions where they do not face carbon constraints.<sup>15</sup> To tackle this problem EU has heavily depended on the allocation of emission units at no cost. The rationale behind the free distribution of allowances is to lessen carbon costs faced by sectors that compete at an international level, and thus, it has constituted the principle allocation methodology in Phase I and Phase II of EU ETS.<sup>16</sup> Gratis allocation will continue in phase 4 (2021-2030) of the EU ETS however, free allocation rules have been revised for this phase. Specific sectors are given 100% of their allocation at no cost, taking into account their exposure to competition, and in certain

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<sup>11</sup> EUROPEAN COMMISSION available at [https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets/emissions-cap-and-allowances\\_en](https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets/emissions-cap-and-allowances_en) (Last visited 29 Nov., 2023).

<sup>12</sup> EEA Report No 24/2016 (2016), TRENDS AND PROJECTIONS IN THE EU ETS IN 2016 8 (2016).

<sup>13</sup> EUROPEAN COMMISSION available at [https://climate.ec.europa.eu/eu-action/european-green-deal/2030-climate-target-plan\\_en](https://climate.ec.europa.eu/eu-action/european-green-deal/2030-climate-target-plan_en) (Last visited 29 Nov., 2023).

<sup>14</sup> Olivier De Schutter, *Linking trade and climate change* in CLIMATE CHANGE AND HUMAN RIGHTS: AN INTERNATIONAL AND COMPARATIVE LAW PERSPECTIVE 213 (Ottavio Quirico *et. al.*, eds. 2016).

<sup>15</sup> Susanne Droge & Simone Cooper, *Tackling Leakage in a World of Unequal Carbon Prices: A Study for the Greens/EFA Group*, 5 (2010) available at <https://climatestrategies.org/wp-content/uploads/2014/11/cs-greens-group-final-160610.pdf> (Last visited 29 Nov., 2023).

<sup>16</sup> *Id.* at 33.

sectors, free allocation is to be periodically phased out.<sup>17</sup> Along with these measures, the European Parliament and Council of Europe have agreed on a provisional Carbon Border Adjustment Mechanism (CBAM), which would come into effect once the Parliament and the Council of Europe formally approve it.

### III

#### **Carbon Border Adjustment Mechanism (CBAM)**

By way of the Paris Agreement,<sup>18</sup> each party has to submit a 'Nationally Determined Contribution' which consists of a pledge to reduce emission levels of greenhouse gases.<sup>19</sup> Paris Agreement calls upon parties to revise their NDCs every five years. Every NDC involves strategies to achieve the target and financial aspects for the same. Each party's successive NDC represents a progression beyond the party's current NDC and reflects its highest goal.<sup>20</sup> However, the economic costs that the countries will incur in achieving these goals would vary. The concern among the EU policymakers is that differing climate policies can cause the domestic price of goods to increase more than the prices of similar goods manufactured abroad, which can cause a shifting of economic activities to countries with less rigorous climate policies.<sup>21</sup> The EU is developing a CBAM framework to address these adverse effects to equalize competition conditions between goods produced in different countries having distinct tax systems.<sup>22</sup> A non-EU producer of a good covered under CBAM will have to purchase carbon certificates that would need to be paid had the goods been produced in the EU. If the producer has already paid the price for carbon used in producing goods, the cost will be fully deducted for the non-EU

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<sup>17</sup> EUROPEAN COMMISSION available at [https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets/free-allocation/allocation-industrial-installations\\_en](https://climate.ec.europa.eu/eu-action/eu-emissions-trading-system-eu-ets/free-allocation/allocation-industrial-installations_en) (Last visited 29 Nov., 2023).

<sup>18</sup> Paris Agreement came into effect on 4 November 2016.

<sup>19</sup> Paris Agreement, 2016, Art. 4.2.

<sup>20</sup> Paris Agreement, 2016, Art. 4.3.

<sup>21</sup> Jonathan L. Ramseur *et. al.*, *Border Carbon Adjustments: Background and developments in the European Union*, R47167 (2023) available at <https://crsreports.congress.gov/product/pdf/R/R47167> (last visited 29 Nov., 2023).

<sup>22</sup> EUROPEAN COMMISSION available at [https://taxation-customs.ec.europa.eu/green-taxation-0/carbon-border-adjustment-mechanism\\_en](https://taxation-customs.ec.europa.eu/green-taxation-0/carbon-border-adjustment-mechanism_en) (Last visited 29 Nov., 2023).

producer.<sup>23</sup> CBAM is meant to make sure that there is a level playing field between EU and non-EU businesses and will ensure that there is an incentive to invest in greener technologies. The implementation of CBAM is proposed to be in a phased manner, and till 2035, when free allowances are phased out, CBAM will apply only to the proportion of emission that does not benefit from free allowance under EU ETS.<sup>24</sup> The products covered under the proposed CBAM include iron and steel, cement, aluminum, fertilizers, electricity generation, and some downstream articles like screws and bolts.<sup>25</sup> During the transition period (2023 October – 2026), the commission will decide whether to include goods like organic chemicals and polymers.<sup>26</sup> In short, CBAM would cover the goods produced in all non-EU countries except those with an emission trading system linked to the Union, like Switzerland. Countries like India, Brazil, China, and South Africa have already raised concern against planned measures and described them as violating the tenets of equity and Common but Differentiated Responsibilities.<sup>27</sup> Similarly, Ministers of the BASIC group met at the UNFCCC COP 27 in Sharm el-Sheikh, Egypt, where similar sentiments were shared. A joint statement described carbon border taxes as a unilateral and discriminatory practice which may lead to market distortion and aggravate trust deficit between parties.<sup>28</sup> Considering the level of exports into the EU in sectors that are expected to be included in CBAM, the developing countries most probable to be

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<sup>23</sup> EUROPEAN COMMISSION *available at* [https://ec.europa.eu/commission/presscorner/detail/en/qanda\\_21\\_3661](https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_3661) (last visited 29 Nov., 2023).

<sup>24</sup> *Id.*

<sup>25</sup> EUROPEAN PARLIAMENT *available at* <https://www.europarl.europa.eu/news/en/press-room/20221212IPR64509/deal-reached-on-new-carbon-leakage-instrument-to-raise-global-climate-ambition> (last visited 29 Nov., 2023).

<sup>26</sup> *Id.*

<sup>27</sup> JOINT STATEMENT ISSUED AT THE CONCLUSION OF THE 30TH BASIC MINISTERIAL MEETING ON CLIMATE CHANGE HOSTED BY INDIA ON 8TH APRIL 2021 *available at* <https://www.gov.za/speeches/joint-statement-issued-conclusion-30th-basic-ministerial-meeting-climate-change-hosted> (Last visited 29 Nov., 2023).

<sup>28</sup> BASIC MINISTERIAL JOINT STATEMENT AT THE UNFCCC'S SHARM EL-SHEIKH CLIMATE CHANGE CONFERENCE (COP27/CMP17/CMA4) *available at* [https://www.dffe.gov.za/mediarelease/basicministerialmeeting\\_cop27egypt2022](https://www.dffe.gov.za/mediarelease/basicministerialmeeting_cop27egypt2022) (Last visited 29 Nov., 2023).



affected are India, Brazil, and South Africa<sup>29</sup> which explains the adverse reaction to the proposal from the BASIC group. In its submission to World Trade Organization, India has raised issues of discrimination and protectionism concerning the implementation of CBAM.<sup>30</sup> The next section of the paper attempts to study whether the proposed EU-CBAM complies with the rules of the World Trade Organization.

## IV

### WTO and CBAM

World Trade Organization became operational on January 1, 1995, with multiple objectives like 1) increase in the quality of life, 2) attainment of full employment, 3) rise of real income and effective demand, and 4) the extension of production of and trade in goods and services.<sup>31</sup> The primary tools to accomplish these goals are 1) the lowering of tariff barriers and other trade obstacles and 2) the eradication of discriminatory practices in international trade relations.<sup>32</sup> The General Agreement on Tariffs and Trade 1994 sets out the basic rules for trade in goods. It contains the two basic rules of non-discrimination in WTO jurisprudence. Article I of GATT 1994 discusses the most-favored-nation treatment obligation. It requires a WTO member that provides specific favorable treatment to any given country to extend the same treatment to all other WTO members, which means WTO members are precluded from showing discrimination among their trading partners.<sup>33</sup> Article III of GATT discusses the national treatment obligation. It requires a WTO member to treat foreign products, services, and service suppliers no less favorably than it treats like

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<sup>29</sup> United Nations Conference on Trade and Development, *A European Union Carbon Border Adjustment Mechanism: Implications for Developing Countries*, 9, UNCTAD/OSG/INF/2021/2 (July 14, 2021).

<sup>30</sup> Kirtika Suneja, *Carbon border rules protectionist and discriminatory: India to WTO*, *Economic Times*, (Feb. 15, 2023) available at <https://economictimes.indiatimes.com/news/economy/foreign-trade/carbon-border-rules-protectionist-and-discriminatory-india-to-wto/articleshow/97958613.cms> (Last visited 29 Nov., 2023).

<sup>31</sup> WTO Agreement, Preamble.

<sup>32</sup> *Id.*

<sup>33</sup> General Agreement on Tariffs and Trade, 1994, Art. I:1.

domestic products, services and service suppliers, which implies a WTO member is not allowed to discriminate against foreign products, services, and service suppliers.<sup>34</sup> A challenge to CBAM could be made for violation of these two basic rules.

In *EC-Bananas III*<sup>35</sup>, it was held that irrespective of their origin, products should be treated equally. Also, Article I:1 applies not only to origin-based measures but also to measures that seem impartial but are, in fact, discriminatory. The panel noted in *Canada – Pharmaceutical Patents*<sup>36</sup> that defacto discrimination occurs when an ostensibly neutral measure imposes differentially disadvantageous consequences on certain parties, and they are found to be unjustifiable. CBAM could result in like products being taxed at a different rate depending on their carbon content and the emission control norms in the country of origin, which could violate the most favoured nation treatment obligation. In *Spain – Unroasted Coffee*<sup>37</sup>, the panel had to determine the scope of *like products* within the meaning of Article I:1. To ascertain whether various types of unroasted coffee were like products panel applied 1) physical characteristics of the products, 2) their end-use and 3) tariff regimes of other members. In the case of a product proposed to be covered by CBAM, like cement, every variety is likely to be considered like products irrespective of differences in carbon content. Even though the WTO panels could take other criteria into consideration in determining the likeness of products, it remains improbable that they are not classified as like products.

Article III:2 of GATT mandates that a country cannot impose an internal tax on a product from a different country more than the tax applied to domestic products. Depending on the details of CBAM, a country may claim that the tax imposed is higher than the domestic tax. For example, a product imported from a non –EU country without an ETS would attract provisions of CBAM. However, the same product

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<sup>34</sup> General Agreement on Tariffs and Trade, 1994, Art. III:2.

<sup>35</sup> Appellate Body Report, EUROPEAN COMMUNITIES- REGIME FOR THE IMPORTATION, SALE AND DISTRIBUTION OF BANANAS, WT/DS27/AB/R, ADOPTED 25 SEPT. 1997, DSR 1997: II, 597.

<sup>36</sup> Panel Report, CANADA – PHARMACEUTICAL PATENTS, WT/DS114/R, ADOPTED 7 APRIL (2000), DSR 2000: V, 2289.

<sup>37</sup> GATT Panel Report, SPAIN – TARIFF TREATMENT OF UNROASTED COFFEE, L/5135, ADOPTED 11 JUNE 1981, BISD 28S, 102.

might be manufactured in the EU with minimum carbon emission. This would result in the imported product being taxed higher when compared to the domestic product. Also, WTO jurisprudence is against distinguishing between products based on the production method. According to the panel in the *US – Tuna (Mexico)* 1991, processes and production methods which do not affect the characteristics or properties of products concerned (NPR –PPMs) are not relevant in determining the likeness of the products.<sup>38</sup> Even though this panel report was never adopted, it is doubtful whether CBAM, which proposes classifying products based on production methods, would conform to this WTO rule.

## V

### General Exceptions and CBAM

Article XX of the GATT 1994 is titled General Exceptions. These exceptions allow member countries to adopt and maintain legislation and measures that promote or protect other important societal values and interests. They allow members under specific conditions to prioritize certain societal values and interests over trade liberalization, market access, and non-discrimination rules provided the conditions in chapeau are met.<sup>39</sup> Article XX becomes relevant only when a measure is inconsistent with another GATT provision. Out of the exceptions discussed in (a) to (j), the exceptions under the headings (b) and (g) allow for environment-related trade measures that are otherwise in conflict with the provisions of GATT.<sup>40</sup>

Article XX (b) provides that a GATT inconsistent measure is justified if it is imperative to protect human, animal, or plant life or health.<sup>41</sup> It covers public health policy measures and also environmental policy measures. To determine whether a measure is required within the

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<sup>38</sup> GATT Panel Report, UNITED STATES –RESTRICTIONS ON IMPORT OF TUNA (MEXICO), DS21/R, 3 SEPTEMBER 1991, unadopted, BISD 39S, ¶ 5.15.

<sup>39</sup> Peter Van den Bossche & Werner Sdouc, *THE LAW AND POLICY OF THE WORLD TRADE ORGANIZATION* 545 (2013).

<sup>40</sup> Kasturi Das, *Can Border Carbon Adjustments Be WTO-Legal*, VII MANCHESTER J. INT'L. ECO. L. 65, 85 (2011).

<sup>41</sup> General Agreement on Tariffs and Trade, 1994, Art. XX (b)

meaning of Article XX(b), various factors are taken into account, like the importance of interests or values at stake, the extent of contribution to the realization of the measure's objective, and its trade restrictiveness.<sup>42</sup> The necessity of a measure is decided after weighing and balancing every relevant factor, and every variable will have to be considered before reaching a judgment. In *EC –Asbestos* (2001)<sup>43</sup>, the issue was a French ban imposed on asbestos and asbestos products. Canada, the complainant claimed that the controlled use of asbestos and asbestos products was a reasonable measure that could achieve the same goal. However, the Appellate Body ruled that France could not be expected to employ any alternative action since it would involve continuing the risk that the Decrees sought to halt.<sup>44</sup> The Appellate Body clarified that it is for each member state to choose level of protection of health or environment and others can only argue that a measure adopted is not essential to achieve that objective. However, it is to be emphasised that CBAM is a measure that can be criticized as an extra-territorial trade measure. It means a measure though enacted and imported within the importing country's territory, has an extra-territorial motivation.<sup>45</sup> The Appellate Body in *Shrimp – Turtle II*<sup>46</sup> has opined that if there is a rational nexus between the implementing country and the purpose of the measure, such measures can be adopted. Hence, though CBAM has considerable extra-territorial motivation considering the nature and gravity of the issue of climate change, CBAM could very well be defended under Article XX(b).

Article XX(g) of GATT permits a departure from GATT rules if it is meant for the conservation of exhaustible natural resources.<sup>47</sup> It also requires the measures to be made effective in concert with restrictions

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<sup>42</sup> Appellate Body Report, BRAZIL – MEASURES AFFECTING IMPORTS OF RETREADED TYRES, WT/DS332R, ADOPTED 17 DECEMBER 2007, DSR 2007: IV, 1527, 178.

<sup>43</sup> Appellate Body Report, EUROPEAN COMMUNITIES – MEASURES AFFECTING ASBESTOS AND ASBESTOS CONTAINING PRODUCTS, WT/DS135/AB/R, ADOPTED 5 APRIL 2001: VII, 3243.

<sup>44</sup> *Id.* ¶174.

<sup>45</sup> *Supra* note 40, Kasturi Das, at 85.

<sup>46</sup> Appellate Body Report, UNITED STATES – IMPORT PROHIBITION OF CERTAIN SHRIMP AND SHRIMP PRODUCTS- RECOURSE TO ARTICLE 21.5 OF THE DSU BY MALAYSIA, WT/DS58/AB/RW, adopted 21 November 2001, DSR 2001: XIII, 6481.

<sup>47</sup> General Agreement on Tariffs and Trade, 1994, Art. XX(g)

on domestic production or consumption.<sup>48</sup> Notably, the Appellate Body in *US- Gasoline* (1996)<sup>49</sup> held that exhaustible natural resource includes clean air. Also, the Appellate Body explained the phrase 'made effective in conjunction with' as a requirement of 'even-handedness' in imposing limitations on imported and domestic products. In *China – Raw Materials* (2012)<sup>50</sup>, it was held that 'made effective in conjunction with' means that the measure at issue works jointly with limitations on domestic production or consumption, which operate to conserve an exhaustible natural resource.<sup>51</sup> CBAM could fit within the exception under XX(g) because, similar to the measures undertaken by the US in the case of gasoline, CBAM is also intended to reduce carbon-based emissions for the preservation of clean air, which has been recognized as an exhaustible resource. The criteria of even-handedness could be met if CBAM accounts for the free allowances given to various installations. While determining the CBAM price, it should be roughly proportionate to the ETS price after accounting for the free allowances given to each installation.<sup>52</sup>

In the *US- Gasoline* (1996)<sup>53</sup>, it was ruled by the Appellate Body that to validate a measure under Article XX, it must satisfy two conditions 1) the measure must come under one of the exceptions in para (a) to (j) under Article XX and 2) it must satisfy the requirements under opening clauses of Article XX.<sup>54</sup> The chapeau of Article XX states that the measures discussed shall not be employed in a manner that would result in arbitrary or unjustifiable discrimination between countries where the same conditions prevail.<sup>55</sup> It should not be used as a disguised restriction on international trade. In the *US –shrimp* (1998), the Appellate Body held that the ultimate availability of the exception

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<sup>48</sup> *Id.*

<sup>49</sup> Appellate Body Report, UNITED STATES- STANDARDS FOR REFORMULATED AND CONVENTIONAL GASOLINE, WT/DS2/AB/R, adopted on 20 May 1996.

<sup>50</sup> Appellate Body Report, CHINA – MEASURES RELATED TO THE EXPORTATION OF VARIOUS RAW MATERIALS, WT/DS394/AB/R/WT/DS395/AB/R/WT/DS398/AB/R, ADOPTED 22 FEBRUARY 2012.

<sup>51</sup> *Id.*

<sup>52</sup> Joachim Englisch & Tatiana Falcao, *EU Carbon Border Adjustments and WTO Law, Part Two*, 51 ELR 10935, 10941 (2021).

<sup>53</sup> *Supra* note 49.

<sup>54</sup> *Id.* at 22.

<sup>55</sup> *Id.* at 23.

is subject to compliance by the invoking member with the requirement of chapeau.<sup>56</sup>

The chapeau does not prohibit discrimination per se but only seeks to prohibit arbitrary or unjustifiable discrimination. The Appellate Body in *US-Shrimp* (1998) explained what constitutes arbitrary discrimination. It was held that,

*"It is not acceptable in international trade relations, for one WTO member to use an economic embargo to require other members to adopt essentially the comprehensive regulatory problem, to achieve a certain policy goal, as that force in Member's territory without taking into consideration different conditions which may occur in the territories of those other members."*<sup>57</sup>

This implies that when a measure is imposed without considering the differences in conditions across the countries without any flexibility, it might constitute arbitrary discrimination within the ambit of the chapeau of Article XX. If CBAM is implemented without sufficient flexibility, without considering the particular circumstances prevailing in any exporting country, it could very well be challenged as arbitrary discrimination. As to whether a measure is a disguised restriction on international trade, it was held in the *US – Gasoline* (1996) that it includes restrictions amounting to arbitrary or unjustifiable restriction taken under the guise of a measure formally within exceptions to Article XX.<sup>58</sup>

## VI

### Conclusion

Even if found violative of the non-discrimination rules in GATT, the Carbon Border Adjustment Mechanism could be justified under the environmental exceptions of the GATT. However, much would depend on the details of the mechanism, which involves complex calculations. It remains to be seen how reconciliation is possible

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<sup>56</sup> Appellate Body Report, UNITED STATES – IMPORT PROHIBITION OF CERTAIN SHRIMP AND SHRIMP PRODUCTS, WT/DS58/AB/R adopted 6 November 1998, DSR 1998: VII,2755, 157.

<sup>57</sup> *Id.* ¶165.

<sup>58</sup> *Supra* note 49 at 25.

between the difference in treatment which is demanded under chapeau, with the non-discrimination test of GATT. If more countries adopt emission reduction mechanisms, most of the concerns surrounding CBAM can be addressed.