

# THE GREEN DEAL THROUGH TRANSNATIONAL GOVERNANCE: THE CASE OF CBAM

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## *Abstract*

Through the application of the Carbon Border Adjustment Mechanisms – CBAM, adopted in 2023, the EU contributes to the Green Deal implementation, using a regional domestic regulatory measure with a transnational impact. This provides that producers importing goods into Europe will pay the same price for their carbon footprint as operators on the continent, with the elimination of the free allocation of permits within the emissions trading system. Besides its impact on decarbonization, as a tool towards climate neutrality, CBAM applies as a transnational trade regulatory measure, with a potential harmonizing effect, despite its unilateral origin inside the Global Arena. Trans-nationalization does not come out of cooperation or of the adoption of common rules (except for Member States inside the European area), but it should be the result of the potential capacity of the Union to condition global markets with a provision applying also to foreign operators. The article analyses CBAM, its rationale and functioning, and its transnational impact.

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## 1. Introduction

The Green Deal is not only a policy – or a strategy to translate into policies and measures for its actuation<sup>1</sup> – coming from the European Commission<sup>2</sup> and to be applied in the territories of the Member States. Indeed, in its several ways of development, it also has a reflection, and effects, in the Global Arena, through the application of measures with a transnational impact. This is the case of the Carbon Border Adjustment Mechanisms – CBAM, adopted by the EU in 2023<sup>3</sup>.

The proposal was born with the Commission's Communication "Fit for 55%"<sup>4</sup>, as a new regulatory tool for the implementation of the Green Deal. Then it became a binding norm, precisely Regulation (EU) 2023/956<sup>5</sup>. Art 1, par. 1 describes it as a mechanism "to address greenhouse gas emissions embedded in the goods listed in Annex I on their importation into the customs territory of the Union in order to prevent the risk of carbon leakage, thereby reducing global carbon emissions and supporting the goals of the Paris Agreement, also by creating incentives for the reduction of emissions by operators in third countries". In addition, it "complements the system for greenhouse gas emission allowance trading within the Union established under Directive 2003/87/EC (the 'EU ETS') by applying an equivalent set of rules to imports into the customs

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<sup>1</sup> See D. Bevilacqua & E. Chiti, *Green Deal. Come costruire una nuova Europa* (2024); D. Bevilacqua, *Il Green New Deal* (2024); E. Chevalier, *European Union law in times of climate crisis: change through continuity*, 1 French Y.B. Pub. Law 51 (2023); A. Bongardt & F. Torres, *The European Green Deal: More Than an Exit Strategy to the Pandemic Crisis, a Building Block of a Sustainable European Economic Model*, 60 JCMS 170 (2022).

<sup>2</sup> EU Commission, *Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of The Regions. The European Green Deal*, Bruxelles, 11 December 2019 COM(2019) 640 final.

<sup>3</sup> G. Dominionni & D.C. Esty, *Designing Effective Border-Carbon Adjustment Mechanisms: Aligning the Global Trade and Climate Change Regimes*, 65 Arizona L. R. 1 (2023).

<sup>4</sup> European Commission, Brussels, *Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. 'Fit for 55': delivering the EU's 2030 climate target on the way to climate neutrality*, 14 July 2021 COM(2021) 550 final.

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

territory of the Union of the goods referred to in Article 2 of this Regulation” (par. 2). The measure, which will be introduced gradually<sup>6</sup> and initially only for goods related to certain sectors, provides that producers importing goods into Europe will pay the same price for their carbon footprint as operators on the continent, with the elimination of the free allocation of permits within the emissions trading system<sup>7</sup>.

Through the described proposal, the EU actually imposes a tax on goods produced with a high carbon footprint, preparing for the gradual elimination of free quotas, in order to induce European and foreign industries to use production systems that, through innovation or other means, eliminate or reduce greenhouse gas emissions. Hence, particularly in the first phase of application of the new system and regardless of the place of origin, companies with lower emissions will reap greater competitive benefits, since they will not have to bear the increased costs, which will instead be borne by the producers who pollute more.

The measure is non-discriminatory and, *rebus sic stantibus*, compatible with the rules of the World Trade Organization (WTO). In addition, despite being compulsory for operators trading in European market, it merely applies as a cost to pay<sup>8</sup>:

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<sup>6</sup> The European Commission and the Council considered that technical and economic feasibility, including administrative constraints and the legitimate expectations of all economic operators, should be taken into account when moving from a carbon leakage scheme with free allowances to a carbon leakage scheme where this practice is addressed through a carbon border adjustment mechanism. So that operators can adapt to the new system and authorities can gain experience with regard to its operation.

<sup>7</sup> “The EU emissions trading system (ETS), established in 2005, puts a cap on greenhouse gas (GHG) emissions, and divides these into emission allowances that permit the emission of one tonne of carbon dioxide (CO<sub>2</sub>) or CO<sub>2</sub>-equivalent (CO<sub>2</sub>e) [...]. Through market-based determination of prices, the system encourages emissions reductions. The European Commission gives the rest of the allowances for free to sectors at risk of 'carbon leakage', whereby companies offshore production to jurisdictions with laxer environmental regulations. [...] The aim of the CBAM is to equalise the carbon price between domestic and foreign products, thereby limiting carbon leakage; the measure could also encourage partner countries to adopt carbon pricing that tests the prediction of a Brussels effect”, European Parliament, *Briefing. EU carbon border adjustment mechanism. Implications for climate and competitiveness*, PE 698.889, June 2023.

<sup>8</sup> Arts. 4-10 describe an authorization procedure that includes a mandatory declaration by the authorized entity (Art 6) and a system for calculating and

companies are free to continue with their methods of production, but they face an economic disincentive to pollute; in addition, by paying for their carbon footprint they provide extra funding to be used by the public powers dealing with environmental objectives.

Besides its impact on decarbonization, as a regulatory tool towards climate neutrality, CBAM applies as a transnational measure, with a potential harmonizing effect, despite its unilateral origin inside the Global Arena. In this respect, transnationalization does not come out of cooperation or of the adoption of common rules (except for Member States inside the European area), but it should be the result of the potential capacity of the Union to condition global markets with a provision applying also to foreign operators.

## **2. The Green Deal and global markets: bending free-trade to ecologic transition**

The Carbon border adjustment mechanism reinforces the regulatory paradigm of public powers limiting and disciplining global markets to protect general goods. Such approach differentiates from the previous one, consequent to the orientation established by the WTO and based on a deferential and recessionary trade governance. The features stressing the differences of the measure at stake with the regulatory approach used in recent decades, particularly on a global scale, are at least four, as follows.

First, CBAM alters free trade, influencing the production choices – and the related costs – of operators, in contrast to the idea of facilitating low-cost production.

Secondly, it provides for a tariff, which, thanks to a mirror tax aimed at domestic producers, does not violate the WTO's rules of formal equality (Articles I and III, GATT 1947), but increases transaction costs, with potentially negative effects on “comparative advantages”<sup>9</sup>.

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verifying the emissions produced by the same (Arts 7 and 8). It allows the import of the products and calculate the tariff applied, which may be reduced by taking into account the carbon price paid in the country of origin for the declared embedded emissions (Art 9).

<sup>9</sup> The theory of comparative advantages, developed by D. Ricardo (*On the Principles of Political Economy and Taxation* (1 ed., 1817)) and other economic scholars, is the foundation of the international free market, and therefore also of

The third character concerns the ability of CBAM to affect production methods and not final products; so that goods that are theoretically equivalent (“like products”)<sup>10</sup> receive different treatment based on their carbon footprint.

Finally, it works as a taxation system extended to the entire European area, which, as far as operators pay for their carbon footprint, gives the Union significant revenues for environmental policies.

Nonetheless, CBAM does not deny or contradict the spirit of global free trade as the border imposition explicitly rely on the convenience to exploit the European market, although respecting certain public-related conditions – identical for all the operators – in order to protect the environment. The perspective we use changes the judgment of such provision: not a new burden for foreign companies, but an equal cost every party must share.

In order to understand the *rationale* of the measure at stake, it is useful to compare it with a draft reform of the WTO’s Agreement on Subsidies and Countervailing Measures (ASCM)<sup>11</sup>, put forward by the United States in 2020<sup>12</sup>. This presents analogy and coherence with the Carbon Border Adjustment Mechanism, since it proposes to consider the application of excessively lax environmental and ecological standards as “actionable subsidies”. Meaning indirect – unlawful – aid to domestic producers, in violation of WTO law<sup>13</sup>. Therefore, if a member is actually

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the World Trade Organization and the European Union, with a decisive role in the emergence and development of transnational regulation. It is based on the idea that as long as one country has certain advantages in the production of a good and another has none, it will always be more convenient for the latter to buy from the former than to produce in autarky; and for both to exchange goods respectively produced with greater efficiency. See A. SMITH, *An inquiry into the nature and causes of the wealth of nations* (1776), par. 15.

<sup>10</sup> Art II, par. 2, lett. a) *General Agreement on Tariffs and Trade* 1947, now in WTO law: «Nothing in this Article shall prevent any contracting party from imposing at any time on the importation of any product: (a) 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».

<sup>11</sup> See [http://wto.org/english/docs\\_e/legal\\_e/24-scm.pdf](http://wto.org/english/docs_e/legal_e/24-scm.pdf).

<sup>12</sup> Draft Ministerial Decision, *Advancing Sustainability Goals through Trade Rules to Level the Playing Field*, WT/GC/W/814, 17 December 2020.

<sup>13</sup> “The underlying idea of the US proposal is that industries located in certain countries benefit from weak or unenforced environmental laws and regulations by not being required to incur, and properly internalize, the costs of preventing

benefiting from the lowering of environmental standards, the latter can be challenged before the organization's dispute adjudication body, for its undue alteration of the free market.

This approach, similar to CBAM, overturns the perspective according to which the environment is seen as an exception to free trade, to be kept under control because of its protectionist effects. On the contrary, both proposals do not focus on the risk that excessively high forms of environmental protection could become barriers to trade, but on the fact that maintaining too low standards in this area alters the balance of world trade itself, to the detriment of "leveling the playing field". In this way, the most effective rules of the WTO are used to punish states that do not sufficiently protect the environment, which is no longer a resource that must be functionalized and adapted to trade and economic interests, since these, on the contrary, are now tools for pursuing ecological goals<sup>14</sup>.

Without considering the objective difficulties of its application in practice – due to the current inability of the international community to harmonize the criteria for defining, in a reliable and shared way, when certain standards comply or not with the required levels of environmental protection –, the aforementioned proposal, if compared to CBAM, confirms the innovative approach inherent in both visions. Such approach uses world trade rules – such as formal equality between operators in the various states – to make environmental protection effective and widespread on a global scale. Both, in addition, are transnational in nature: the Reform of ASCM, as a top-down decision based on rules harmonization; the Carbon Border

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or remediating environmental damage resulting from their production processes and thus gain an unfair competitive advantage, comparable to that obtained by subsidized industries", E. Cima & M.M. Mbengue, *'Kind of Green'. The U.S. Proposal to Advance Sustainability through Trade Rules and the Future of the WTO*, 10 ESIL 1 (2021), 2-3.

<sup>14</sup> Coherently, E. Cima, *From Exception to Promotion. Re-Thinking the Relationship between International Trade and Environmental Law* (2021), 233: «the focus of the proposal is instead on the role that can be played by trade remedies to advance sustainability goals through trade rules: rather than helping countries' 'green' measures by providing for a way to escape ASCM rules, what the US is suggesting is to 'punish' those countries that do not uphold certain fundamental levels of environmental protection, adding their practices to the list of actionable subsidies, under Article 5 of the Agreement».

Adjustment Mechanism, instead, as unilateral measure, with an extra-border effect.

CBAM is not only consistent with the open market system introduced both within the EU and with the Marrakesh Agreements of the WTO, but is also based on dynamics of a commercial nature, as it exploits the strength that the EU itself has on international markets. According to the vision of EU legislator, the risk of losing the access to European market is capable of discouraging carbon leaks<sup>15</sup> and pushing partner countries to define, in turn, carbon-pricing policies to combat climate change.

### **2.1. The Carbon Border Adjustment Mechanism and transnational governance**

One of the principles that constitutes the logical-legal basis of the described carbon tariff is that of formal equality, central to the law of the World Trade Organization, which imposes the same treatment on market operators, regardless of their geographical affiliation. In order to guarantee an equal treatment for all the States, the obligations under the Paris Agreement are to be kept in mind. Notably, recitals 1, 2 and 3 of Reg. 956 recall such Agreement, which demand a National Determined Contribution to nation States. All of them are required to plan a strategy to deal with global warming, although free to decide its content and the measures composing it<sup>16</sup>.

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<sup>15</sup> Carbon leakage or carbon leaks consists of the possibility that companies decide to produce certain goods or services abroad, avoiding the cost of the carbon footprint, but at the same time losing the European market field for the sale of their products. See, e.g., B. Bednar-Friedl, T. Schinko, & K.W. Steininger, *The Relevance of Process Emissions for Carbon Leakage: A Comparison of Unilateral Climate Policy Options with and without Border Carbon Adjustment*, 34 *Energy Econ.* 168 (2012), 168-180 and K. Kama, *On the Borders of the Market: EU Emissions Trading, Energy Security, and the Technopolitics of 'Carbon Leakage'*, 51 *Geoforum* 202 (2014).

<sup>16</sup> Paris Agreement, Arts 3, 4 and 6. As known, the main *rationale* of the Agreement is not to standardize and harmonize measures to tackle climate change, but to admit differentiated responsibilities and to recognize different capacities and different national circumstances for the implementation of policies to combat the phenomenon. This view is confirmed by the National Climate Action Plan (*Intended Nationally Determined Contribution* - INDC). In their INDCs, countries disclose the actions they will take to reduce their greenhouse gas emissions in order to achieve the objectives of the Treaty: the INDCs are mandatory, but their content is not constrained, being left to the discretion of nation states.

Hence, given that the EU and its Member States are implementing a series of measures that are particularly attentive to reducing the carbon footprint of industrial and economic activities in general, it would constitute a serious imbalance – from the point of view of competition – if operators from other countries did not commit to similar costs. In this sense, the divergence between the level of action of the EU and third countries would lead to an indirect subsidy effect similar to that which the US would like to discourage with the proposed amendment of Art 5 of the ASCM, referred to in the previous paragraph. In front of this, as international law proved its incapacity to agree a common and cooperative solution, the EU tries to spread its approach by a transnational measure for all the operators.

Although it is undeniable that “climate change is by its very nature transnational in its causes and effects”<sup>17</sup>, it is also true that national States are so far resisting this force, unwilling to leave, while determined to maintain, their discretion in climate and environment decision-making. With CBAM, the EU goes beyond this fragmentation, adopting a *de facto* transnational regulatory measure, attempting to enhance a higher level of environmental protection not only in Europe but also outside its borders.

### **3. Creating environmental markets, setting environmental limits to markets and using markets for the environment**

The Carbon Border Adjustment Mechanism, as seen, does not limit itself to regulating the market, but is also based on a

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<sup>17</sup> «This is only reinforced by globalization. Decisions and choices regarding how to produce goods are taken in one country and are implemented in another country, possibly on a different continent. Due to these global supply chains, goods are transported all the way to a different country, where they are consumed. Notably waste is also processed in yet a different country with a risk of pollution for air, ground, or water due both to the waste being dispatched abroad and the waste processing itself in countries where health and environment regulations may be patchy or poorly enforced. People located in different legal orders are affected by this process directly (for instance when they come in contact with polluted components) and indirectly (for instance when their land and crops are affected by this pollution sometimes years later after the cause of pollution arose)», Y. Marique, “*Transnational*” *Climate Change Law. A case for reimagining legal reasoning?*, 1 French Y.B. Pub. Law 70 (2023).



market system, which, despite extra costs to pay, leaves operators free to act in the economic context. With respect to other similar instruments and with reference to the relationship between the State and free trade, four aspects are to be stressed.

In the first place, the measure consists of a transnational public intervention to face transnational environmental problems. It affects private operators' freedom, restricting it, but to push them towards less polluting production methods. Public authorities – in this case supranational and only secondarily national – do not act by prohibiting, coercing, punishing or imposing a certain behavior, but by making one cheaper than another. To do so, they also use coercive and restrictive instruments, as well as an authorization system attributed to national authorities, but then they rely on the reaction of economic actors operating on the market, which are still free to pollute, although paying a cost for it.

Secondly, CBAM is in line with the market-regulation process, but at the same time it makes it evolve because, while implementing an egalitarian policy – extended to domestic and foreign producers – it introduces trade barriers, which first the GATT and then the WTO had the task of eliminating. It forces producers – whether importers or domestic companies – to increase production costs, with higher prices for consumers, in contrast to the theory of “comparative advantages”, as well as to the main objectives of free-trade legislation. Nevertheless, this derogation from the principles of free trade is justified by an overriding interest – tackling climate change –, which must weigh across all operators and be suffered in an equal fashion.

Thirdly, the EU uses both a market instrument and the strength of its market to impose a regulatory measure that restricts the freedom of action of traders. The European institutions bend and direct private subjects' choices imposing what in fact operates as a carbon tax, with the dual purpose of both influencing the decisions of operators and obtaining revenue to be used in the ecological transition. However, the application of this measure is not undisputed, since it risks encouraging, rather than preventing the carbon leaks. It is precisely this last aspect to inform the strategic attempt of the EU, because the importance of accessing the European market is, for many operators, greater than the convenience of producing with lower environmental costs.

Moreover, by acting as a virtuous example, the EU promotes the sharing and trans-nationalization of good practices.

With reference to this last point, one of the most interesting and original aspects of the measure in question is that it is based on the existence of an extra-national market – the European one – which breaks down trade barriers within it, between States, becoming particularly attracting for operators. It is precisely because of the comparative advantages that are thus constituted in the common European market that its commercial strength can be used to adopt restrictions and impose barriers that would otherwise be unworkable or at least inconvenient. It is because of the European common market that the Union itself can impose the CBAM at its borders, without fear of being subjected to any significant free-rider behavior or relocation of production by operators: through the centrality and commercial strength of the European market in the world trade scenario and thanks to the compactness of internal governance, the Union can apply restrictions on the same continental market. EU's transnational regulatory measure is based on internal cooperation, among Member States, and on competitive markets outside its borders, affecting the economic expectations of all those producers who are now forced to bear higher costs to sell their goods in certain territories.

Finally, the mechanism has a further final effect, still linked to the economic strength and commercial outlet of Europe, but related to a transnational conditioning of public choices of regulation and intervention<sup>18</sup>. Even non-European nation States, aware of the drop in exports (or its higher cost) due to the barriers placed at the borders by the EU, will be more inclined to intervene at the domestic level with measures and tools designed to discourage production of polluting goods, in favor of methods with low (or no) carbon emission. Therefore, the transnational effect of CBAM not only concerns the choices of private operators, but also the economic policies of States and other public actors.

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<sup>18</sup> See A. Bradford, *The Brussels Effect. How the European Union Rules the World* (2020).

#### 4. Conclusive remarks

The Carbon Border Adjustment Mechanism is an EU measure with a transnational effect, to provide a global reaction to climate change. It is important for at least four reasons.

Firstly, from a political, strategic and programmatic point of view: the European Union – aware of the fact that the path towards climate neutrality is on the one hand necessarily global and to be shared with non-EU countries, and on the other hand devoid of effective coercive tools on such a vast and heterogeneous scale – aims to show the world the way forward for the ecological transition. It does not do this through cooperation, but by exploiting its commercial strength (access to the EU market for goods and services from abroad), and conditioning the production methods of the economic operators. *A fortiori*, the mechanism is an economic policy instrument working not only as a limit to free trade and freedom in production processes, but also to avert a risk of “carbon leaks”, which could lead to an increase in total emissions worldwide and thus undermine the EU’s efforts towards climate neutrality.

Secondly, the Carbon Border Adjustment Mechanism marks an important turning point towards market-regulation policies, traditionally aimed at breaking down, reducing or eliminating trade barriers, so decreasing transaction costs to facilitate the exchange of goods. With the new measure, a burden is placed on producers – both importers and domestic – that increases, at least in the short-term, production expenses and therefore the final prices for consumers. Nevertheless, this type of intervention serves precisely to conform the choices of operators, pushing the latter to carry out activities to low (or zero) polluting impact because it is more convenient. This is an approach that marks a distinction from the policies of the past, but which does not deny the logic and rules of free trade and competition, because it provides for a justified, non-discriminatory and normatively predefined derogation. Nevertheless, it leaves open the question of the effects of such a policy on production.

Thirdly, linked to this last point, the EU decision also marks a reversal of the trend in the relationship between public authorities and private initiative. The latter, in the name of environmental protection, is directed – through an economic burden – to a less polluting, but potentially (at least in the short term) more expensive economic production. Nonetheless,

precisely with the gains of this taxation, the public authorities can provide incentives, facilitations and mechanisms for protection, assistance and support for the various non-polluting activities, thus creating a virtuous circle that in the medium term could also make this type of mechanism unnecessary. CBAM is thus economically advantageous for the public purse and allows for compensatory and adjustment interventions, which can facilitate the transition to less polluting production models. This means relying on public authorities' activity: they must be able to offer the necessary guarantees of impartiality, efficiency and effectiveness, in particular with regard to measures to prevent carbon leakage, which cannot follow an arbitrary and discriminatory course. In addition, they are called upon to contribute to offering an alternative path to private entities, not only by discouraging unsustainable economic activities, but also by eliminating or simplifying bureaucratic barriers to undertaking sustainable ones, so as to make the latter effectively convenient.

Finally, the impact of CBAM is surely transnational, meaning it affects rules concerning national States relationships in two much globalized issues as trade and climate. It consists of a restrictive approach, as it alters choices of private subjects operating in the global market. In this sense, it may diminish the comparative advantages of free trade and encourage flight to cheaper and more polluting production models, even if this is offset by the strength of the European market and the opportunities it offers to operators. In addition, it is transnational as it does not involve only European companies, consumers and public authorities, while influencing as well foreign actors, conditioned – by a non-formally binding disposition – in their economic decisions. Finally, it is not based on authorities' transnational cooperation, but on authorities' transnational competition: even if there is not a supranational regulation applying the same provisions to all the operators, CBAM may produce a global effect, grounded on economic convenience and working for the rest of the world as a transnational *quasi*-binding measure affecting companies and traders.