

SYMPOSIUM ON CARBON BORDER ADJUSTMENTS

“CLUBBING IN THE CLUB”: COULD CLIMATE-RELATED TRADE ARRANGEMENTS SET THE PACE FOR FUTURE CLIMATE COOPERATION?

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The climate is changing, and so is climate diplomacy. Global treaties may be failing, while unilateral actions are proving to be contentious both within the climate and the trade regime. At the same time, countries need to be given the right incentives to participate in the fight against climate change and to start curbing their emissions substantially. The European Union’s (EU) decision to introduce a Carbon Border Adjustment Mechanism (CBAM) and the momentum around carbon pricing may be the perfect opportunity to revisit these ideas in the form of *clubs*. What if small groups of countries got together and set the pace for a new era in climate diplomacy? What if they relied on trade measures to do so? Clubs are not new in international law, let alone in international climate law. Compared to global approaches, they may avoid freeriding; compared to unilateral ones, they may reduce the risk of trade frictions. And not all major emitters need to participate right away. As few as two parties could start a climate club, a sort of *club within the club*, gradually catalyzing or influencing action on climate change. In this essay, we argue that climate clubs enable like-minded countries to assume more ambitious commitments and gradually pull in other countries with them.

The European CBAM in Reaction to a Failing Climate Diplomacy

The picture painted by the latest report of the Intergovernmental Panel on Climate Change published in April 2022 is nothing short of a doomsday scenario.¹ And just like our planet, international climate diplomacy seems to be doomed, at least according to a growing number of commentators, including Nobel-Prize-winner William Nordhaus.²

As an inherently global phenomenon, addressing climate change requires nations to cooperate. To do so effectively, in 1992 the international community adopted the UN Framework Convention on Climate Change as the main forum for climate negotiation and cooperation. With its 197 parties, however, this quasi-universal climate governance regime has had some difficulties in trying to accommodate and mediate between the different needs, interests, and capabilities of its members.³ Under these conditions, consensus is hard to come by. Even more

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¹ IPCC, [Climate Change 2022: Mitigation of Climate Change](#), Sixth Assessment Report (2022).

² William Nordhaus, [The Climate Club: How to Fix a Failing Global Effort](#), 10 FOR. AFF. 14 (May/June 2020).

³ David G. Victor, [The Case for Climate Clubs](#), E15 INITIATIVE, at 1 (2015).

worrisome is the voluntary nature of the key climate agreements and the resulting possibility of substantial freeriding.⁴ In fact, under the existing climate regime, countries can easily rely on the emissions reductions of others and avoid the costs of implementing reductions themselves.

Freeriding is a common hurdle to protecting a global public good or addressing global externalities. In other words, whenever countries cooperate to address a global problem, some inevitably end up contributing less than others, and some do not contribute at all. While common, freeriding can be extremely harmful in the context of climate cooperation as it can often lead to carbon leakage. Time is ticking away, and solutions must be sought to reduce the scope for freeriding and, as a result, the opportunities for carbon leakage.

Climate-related trade measures seem to be the most promising instruments to disincentivize free-riders because the main freeriding incentives that undermine the effectiveness of climate agreements are linked to trade.⁵ The EU is illustrative of these dynamics. For a long time, the EU has taken the lead in addressing climate change, and it has done so by, *inter alia*, establishing and progressively reforming the EU Emissions Trading Scheme (ETS). By placing a price on carbon within the territory of the EU, the ETS puts European companies at a disadvantage in competing with imports from countries where such schemes do not exist.⁶ Hence the need for trade measures to counteract the anti-competitive effect of the ETS.

The example of the EU has not been chosen at random. In fact, even when it comes to climate-related trade measures, the EU seems to be once again on the front line. After many years of discussion, CBAMs are only now becoming a reality, and all because of the European Commission proposal, on 14 June 2021, to introduce such a mechanism, “ensuring equivalent carbon pricing for imports and domestic products.”⁷ The goal of the European CBAM is to deter carbon leakage and avoid the loss of competitiveness that European companies may otherwise suffer as a result of higher prices on carbon.⁸

“Better Together”: The Perils of Unilateralism

Carbon border adjustments have often been recognized as offering “a promising response to leakage.”⁹ This is also true of the European Commission proposal for a European CBAM, which aims to address one of the thorniest problems of the existing climate change regime, while setting an example for other countries and fostering compliance with the Paris Agreement. The “promising” role of trade measures, and CBAMs in particular, has even been highlighted by the Intergovernmental Panel on Climate Change in its latest report.¹⁰

Of all the choices made by the EU in designing its own CBAM, the one that is the most questionable is the decision for the EU to go it alone. This choice is questionable from both a trade and an environmental law perspective. In the trade regime, the legitimacy and legality of unilateral trade measures to protect the environment

⁴ Nordhaus, *supra* note 2, at 12; see also William Nordhaus, *Overcoming Free-Riding in International Climate Policy*, 105 AM. ECON. REV. 1339 (2015).

⁵ Rafael Leal-Arcas & Andrew Filis, *International Cooperation on Climate Change Mitigation: The Role of Climate Clubs*, EUR. ENERGY & ENVTL. L. REV. 195, 198, 214 (2021).

⁶ Gary Clyde Hufbauer, Jisun Kim & Jeffrey J. Schott, *Can EU Carbon Border Adjustment Measures Propel WTO Climate Talks?*, PETERSON INST. INT’L ECON., at 1 (Nov. 2021).

⁷ Eur. Comm’n, *Proposal for a Regulation of the European Parliament and of the Council Establishing a Carbon Border Adjustment Mechanism*, COM/2021/564 final, at 17 (hereinafter CBAM Proposal).

⁸ *Id.*

⁹ Michael A. Mehling, Harro van Asselt, Kasturi Das, Susanne Droegge & Cleo Verkuijl, *Designing Border Carbon Adjustments for Enhanced Climate Action*, 113 AJIL 433 (2019).

¹⁰ IPCC, *supra* note 1.

have been debated since the very first trade/environment conflicts. While unilateral acts are not prohibited *per se*, they can become “contentious” when they are associated with the imposition of values by one country on another, as an expression of disapproval of the latter’s environmental behavior,¹¹ and when they hide protectionist or discriminatory intent. This is generally the case when a unilateral trade measure is adopted without prior cooperation from the potentially affected countries. The World Trade Organization (WTO) Appellate Body made this point very clearly in its *Shrimp/Turtle* report. The fact that the United States had negotiated an agreement with some countries but had failed to do so with the complainants was considered by the Appellate Body as “plainly discriminatory and unjustifiable” and was the main reason why the United States initially lost the case.¹² Moreover, the Appellate Body stressed that “the protection and conservation of highly migratory species of sea turtles . . . demands *concerted and cooperative efforts* on the part of the many countries whose waters are traversed in the course of recurrent sea turtle migrations.”¹³

Such *concerted and cooperative efforts* are similarly required by most international environmental law instruments. Both the environmental and the climate regimes are built around the idea of cooperation. One of the goals of the 1992 Rio Declaration on Environment and Development is the establishment of “a new and equitable global partnership through the creation of new levels of cooperation among States.”¹⁴ After stressing the importance of cooperation among states, Principle 12 of the Rio Declaration adds that “[u]nilateral actions to deal with environmental challenges outside the jurisdiction of the importing country should be avoided. Environmental measures addressing transboundary or global environmental problems should, as far as possible, be based on an international consensus.”¹⁵ Similarly, climate change instruments adopted since the adoption of the Bali Action Plan in 2007 have been very clear in stressing the fundamental importance of long-term cooperative action and global cooperation.

Welcome to the Climate Club(s)

Questionable unilateralism aside, the European CBAM represents a concrete attempt to reconceptualize climate action by proposing a different incentive structure. Integrating trade and climate policies can potentially go a long way in addressing the freeriding plague that affects the existing global climate regime. Rather than going it alone, however, countries can find other like-minded countries and form coalitions, and use these coalitions to redefine the relationship between trade and climate goals.

This was precisely the idea behind the launch of the Structured Discussions on Trade and Environmental Sustainability on November 20, 2020 by a group of WTO members including, among others, the EU, Australia, Canada, Japan, Mexico, Costa Rica, and Senegal. It was within these Structured Discussions, for instance, that the United States proposed amending the text of the WTO Agreement on Subsidies to “punish” those countries that do not uphold certain fundamental levels of environmental protection.¹⁶ Along the same lines, groups of countries have advanced their environmental and climate objectives in free trade agreements and

¹¹ Philippe Sands, *“Unilateralism,” Values, and International Law*, 11 EUR. J. INT’L L. 291, 293 (2000).

¹² United States – Import Prohibition of Certain Shrimp and Shrimp Products, [Appellate Body Report](#), WT/DS58/AB/R, para. 172 (Oct. 12, 1998).

¹³ *Id.*, para. 168 (emphasis added).

¹⁴ United Nations Conference on Environment and Development, Rio de Janeiro, Brazil, June 3–14, 1992, [Rio Declaration on Environment and Development](#), pmbl., prin. 7, UN Doc. A/CONF.151/26/Rev.1 (Aug. 12, 1992).

¹⁵ *Id.*, prin. 12.

¹⁶ Elena Cima & Makane M. Mbengue, *“Kind of Green”: The U.S. Proposal to Advance Sustainability through Trade Rules and the Future of the WTO*, 10 ESIL REFLECTIONS (2021).

investment treaties, such as the Comprehensive Agreement on Investment between the EU and China, announced on 30 December 2020.¹⁷ Another illustrative example is the ministerial declaration on fossil fuel subsidies issued by a group of fifteen WTO members, highlighting the group's "shared understanding" on the need to cooperate to achieve "effective disciplines on inefficient fossil fuel subsidies."¹⁸

A similar "shared understanding" could motivate a group of countries to gather around a CBAM proposal and form a climate coalition or *club*. The climate regime itself is familiar with the creation of groups, and even sub-groups of countries. The UN Framework Convention on Climate Change, for instance, not only divides its parties into different groups, but it also contains provisions that expressly recognize the parties' right to come together to pursue specific policies to further the objectives of the convention.¹⁹ Similarly, the Kyoto Protocol provided mechanisms—such as emissions trading, joint implementation, and the clean development mechanism—that did not apply to all of its parties but rather allowed for bilateral or plurilateral cooperation to achieve emission reductions. Last but not least, Article 6 of the Paris Agreement, which was complemented by its own rulebook at the 2021 UN Climate Change Conference, expressly acknowledges the right of its parties to "pursue voluntary cooperation in the implementation of their nationally determined contributions to allow for higher ambition in their mitigation and adaptation actions."²⁰

The creation of groups of countries is, in other words, entrenched in the tradition of the climate regime. Once a group of like-minded countries decides to introduce incentives for its members and mechanisms to penalize countries that do not participate, that group becomes a *club*. Whether we call them "climate clubs, carbon clubs, carbon market clubs, club-like arrangements, climate mitigation clubs,"²¹ does not really matter. What matters is the existence of a cooperative arrangement to govern a public good and to provide appropriate incentives for its members, which generally translate into penalties for non-members.²² This way, a climate club could combine trade instruments and climate policies, creating costs for non-members and thereby avoiding freeriding. Moreover, unlike in the case of a unilateral CBAM, the same mechanism adopted by a climate club would not rely on trade merely as a punitive measure but rather as a cooperative tool, allowing its members to trade in clean energy and cooperate on technology. In other words, it would not only help to overcome freeriding, but would also meld trade and climate goals.

It Takes Two

Reaching an agreement on the design of a climate-related trade measure like a CBAM could prove difficult even within a group of like-minded countries.²³ The difficulty lies in transforming the countries' "shared understanding" into a concrete policy or measure. However, not all major emitters need to necessarily participate in the effort, at least in the beginning. In fact, even just a small handful of nations agreeing on climate action could suffice to kickstart a new club, or a small club within an existing club.²⁴

¹⁷ [EU-China Comprehensive Agreement on Investment](#) (2021).

¹⁸ [Ministerial Statement on Fossil Fuel Subsidies](#), WTO Doc. WT/MIN(21)/9/Rev.1 (Dec. 14, 2021).

¹⁹ [United Nations Framework Convention on Climate Change](#), 31 ILM 849, Arts. 4, 12 (May 9, 1992).

²⁰ [Paris Agreement to the United Nations Framework Convention on Climate Change](#), TIAS No. 16-1104, Art. 6 (Dec. 12, 2015).

²¹ [Leal-Arcas & Filis](#), *supra* note 5, at 200.

²² [Nordhaus](#), *supra* note 2, at 15; *see also* Lutz Weischer, Jennifer Morgan & Milap Patel, [Climate Clubs: Can Small Groups of Countries Make a Big Difference in Addressing Climate Change?](#), 21 REV. EUR. CMTY. & INT'L ENVTL. L. 177, 177 (2012); Jon Hovi, Detlef F. Sprinz, Håkon Sælen & Arild Underdal, [Climate Change Mitigation: A Role for Climate Clubs?](#), 2 PALGRAVE COMMUNICATIONS 16020, 1072 (2016).

²³ *See* SCOTT BARRETT, [ENVIRONMENT AND STATECRAFT: THE STRATEGY OF ENVIRONMENTAL TREATY-MAKING](#) (2003).

²⁴ Myanna F. Dellinger, [Narrowed Constellations in a Supranational Climate Change Regime Complex: The "Magic Number" Is Four](#), 37 FORDHAM INT'L L.J. 373, 378 (2014).

The seeds of change could even be planted by just two countries. After all, the EU itself started with cooperation on steel and coal between two countries (France and Germany), was then joined by four more states, and so on until today’s much larger membership. And the same seeds of change can be found today in the area of climate cooperation. Bilateral initiatives are taking place more and more frequently. In October 2020, after two years of negotiations, Switzerland and Peru signed a carbon offsetting agreement, the first of its kind under Article 6 of the Paris Agreement. One year later, on October 31, 2021, the United States and the EU announced their commitment to negotiate the world’s first carbon-based sectoral arrangement on steel and aluminum trade by 2024. Motivated by the will to reduce carbon emissions, the agreement would include measures targeting imports from countries that produce carbon-intensive steel in an effort to avoid freeriding.²⁵ Moreover, the arrangement is intended to potentially become global, as it will be open to any country that decides to join the club.

Climate clubs for border adjustments are catching on. The latest Intergovernmental Panel on Climate Change report acknowledged that in their nationally determined contributions, parties mention “various trade-related mitigation measures, including . . . border carbon adjustments.”²⁶ The nationally determined contributions submitted by Mexico, for instance, reflect the country’s willingness to increase its reduction commitment from 25 to 40 percent, should a global agreement addressing important topics such as carbon border adjustments be adopted. However, countries do not need to wait for such a global agreement to be negotiated. The first step toward effective climate action could be taken by as few as two parties. Even within a broader coalition, two parties can create their own climate club, or join an already existing one, provided they are willing to pay the price of admission and receive the corresponding benefits.

“Members Only”? Clubs as Building Blocks of Global Climate Cooperation

The UN Framework Convention on Climate Change was never intended as the *only* forum for global climate cooperation. Differentiations in multilateral efforts are not only allowed but explicitly provided for in the text of the convention and in all of the other climate instruments adopted under its aegis. Since the very beginning, countries have been recognized as having common but differentiated responsibilities—they have been divided into groups and assigned different objectives and targets, based on the underlying assumption that developed countries should take the lead in the global effort to combat climate change and its adverse effects. Countries could and did form coalitions to more effectively achieve their own targets. Differentiation has continued with the Paris Agreement, although under a different form, where each country is free to define its own target.

Under the climate regime, countries were never meant to all go at the same pace. Some were always bound to take the lead and set the pace for others. In the 1990s, taking the lead meant introducing domestic carbon markets or prices and transferring technologies to less developed countries in exchange for carbon credits, thus promoting the local renewable energy sector. Today, it may require countries to build the foundation for a global agreement that would address an international carbon price or carbon border adjustments.

Climate clubs present countries with the opportunity to form a “coalition of the willing,” enabling them to assume more ambitious commitments and gradually pulling in other countries with them.²⁷ They can coexist in parallel with the global climate regime and contribute to its development rather than compete with it. A climate

²⁵ See, e.g., Todd N. Tucker & Timothy Meyer, *A Green Steel Deal: Toward Pro-Jobs, Pro-Climate Transatlantic Cooperation on Carbon Border Measures*, ROOSEVELT INST. (2021).

²⁶ IPCC, *supra* note 1, at 14–72.

²⁷ Leal-Arcas & Filis, *supra* note 5, at 209.

club equipped with a well-designed carbon border adjustment could provide strong incentives for other countries to join.²⁸ Let us not forget that the WTO itself started as a small club of twenty-three. Who is to say that, with the right incentives in place, a climate club would not succeed in stabilizing and gradually enlarging the international coalition of willing states? It takes two to start, but there is no limit to how many members could join in the end.

²⁸ [Nordhaus](#), *supra* note 2, at 16.