India-EU Town Hall on Border Carbon Adjustments: An Update on Developments in the EU

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Why Are We Discussing This Now?

• Asymmetrical climate change policies
• Old methods may not work
• Increased level of ambition
  • Paris Agreement → continued asymmetry of climate efforts
  • European Green Deal
  • Carbon neutrality targets

• How do we deal with competitive pressures and carbon leakage?
  • Free allocation/compensation of indirect costs
  • Internationalization/linking/Article 6 Paris Agreement
  • Border carbon adjustments
  • Other options (e.g. consumptions charges; contracts for difference; product standards)?
    • **Consumption charges**: charge that extends the carbon price to consumers based on the weight and type of material in a final product
    • **Contracts for difference**: financial award for low-carbon investments based on the amount of avoided carbon and a set carbon price
New European Commission under Ursula von der Leyen takes office in December 2019, announces ambitious ‘European Green Deal’ with the following elements:

• Climate neutrality by 2050, to be enshrined in a ‘European Climate Law’ (also strong push to increase 2030 target from current 40%)

• Action on circular economy (e.g. single-use plastics), biodiversity conservation & sustainable farming, adaptation, ‘zero-pollution’

• ‘Sustainable Europe Investment Plan’ of €1 trillion for 2021-2030

• ‘Carbon Border Adjustment Mechanism’ to address trade impacts

→ Europe’s executive, the European Commission, is currently elaborating the legislative framework for these components on an ambitious timeline.
The „European Green Deal“
• Political Guidelines of 16 July 2019:
  ‘To complement this work, and to ensure our companies can compete on a level playing field, I will introduce a **Carbon Border Tax** to avoid carbon leakage. This should be **fully compliant** with World Trade Organization rules. It will start with a number of **selected sectors** and be **gradually extended**.’
Border Carbon Adjustment: What do We Know? (2)

- Mission Letter to Paolo Gentiloni, incoming Commissioner for the Economy, 10 September 2019:

  ‘You should lead on the proposal of a Carbon Border Tax, working closely with the Executive Vice-President for the European Green Deal. This is a key tool to avoid carbon leakage and ensure that EU companies can compete on a level playing field. The Carbon Border Tax should be fully compliant with WTO rules.’
European Green Deal Communication, 11 Dec. 2019:

‘Should differences in levels of ambition worldwide persist, as the EU increases its climate ambition, the Commission will propose a carbon border adjustment mechanism, for selected sectors, to reduce the risk of carbon leakage. This would ensure that the price of imports reflect more accurately their carbon content. This measure will be designed to comply with World Trade Organization rules and other international obligations of the EU. It would be an alternative to the measures that address the risk of carbon leakage in the EU’s [ETS].’
Member States Support BCA

EU nations pressure Brussels to bring forward carbon border tax proposals

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EU member states want Brussels to propose an EU carbon border adjustment tax earlier than 2021 to help safeguard the bloc’s heavy industry, several national ministers said on Thursday.

Council of the European Union meeting (27 February 2020):

• “The competitiveness of our industry is at stake due to the risk of carbon leakage, so we need to start working on in the second half of this year”, Maria Reyes Maroto, Spanish Minister for Industry, Trade and Tourism

• Germany, France and Italy [are also] “impatiently waiting” for Commission’s proposals on border measures
Member States Support BCA

- **Germany / France** supported the idea of CBAM supplementing the existing instruments in line with WTO in the [statement](#) on the **Recovery Package 18, May**

- The Ursula’s von der Leyen **Commission** put the BCA among the fiscal issues (DG TAXUD) leading to EU’s own resources and making it more likely to implement

- **Poland** is in line with the CBAM as a mechanism protecting EU’s competitiveness and potential source of funding to the modernization / innovation / just transition mechanisms
Inception Impact Assessment and results
Timeline

- Feedback period: 4 March-1 April 2020
- Commission adoption: planned for second quarter 2021

Issues to be studied:

- Type of policy instrument:
  - carbon tax on selected products (imports & domestic)
  - a new carbon customs duty or tax on imports
  - extension of the EU ETS to imports
- Methodological approach to evaluating the carbon content and carbon pricing of imported products
- Sectoral scope
Feedback to IIA overview

• **219 submissions** presented by April 1, 2020

• Both from the EU and outside:
  • Companies/business organizations (62), business associations (89), academic/research institutions (10), consumer organizations, individuals (21), non-governmental organizations (21) and (4) public authorities (from Malta, Sweden, Ukraine, Italy)

• Based on the quality and the relevance of the submissions, the overview of **32** was presented in the summary **in alphabetical order**

• Most numerous categories were put in the **synthesis** (industry/associations, NGOs, think tanks/research institutes)
The key elements of the synthesis focus on the following aspects:

• The perceived objective of a BCA (environmental, competitive, diplomatic, fiscal);

• Developing policy options:
  • Type of policy instrument;
  • The methodological approach to evaluating the carbon content;
  • Emissions/sectoral and geographical/trade scopes;

• The use of revenues (internal, external);

• The operationalization of a BCA (cooperation)
Carbon Border Adjustment Mechanism (CBAM) topic of high interest and relatively high on the agenda

The feedback was generally positive both from NGO and business circles

Most submissions focus on the essence of the mechanism, less on the scope of the IIA itself

As a consequence of submitted papers, there will be need for further thinking how to design the mechanism and a single or multiple formula for calculating the adjustment
Direction of ERCST Study
ERCST Activities

• **Project:** ‘Border Carbon Adjustments in the EU: Issues and Options’
  • Full **Report** by Summer/Fall 2020
  • Submitted **Feedback** to the Inception Impact Assessment consultation

• **Ongoing stakeholder engagement and convening:**
  - March 5th: Dissecting and Assessing CBAM Design Options
  - March 25th: High-Level International Roundtable
  - April 15th: Evaluating Alternative CBAM Scenarios
  - May 28th: Inception Impact Assessment Feedback Summary & Synthesis
  - June 9th: Exploring Alternatives to the CBAM

• **International outreach** (‘Virtual Town Halls’) to EU trade partners:
  USA, South Korea, India, Japan, South Africa, Mexico, Russia, Ukraine

Our Approach: Decomposing, Evaluating & Comparing

• **Nine Design Elements:**
  - Coverage of trade flows
  - Policy mechanism
  - Geographic scope
  - Sectoral scope
  - Emissions scope
  - Determination of embedded emissions
  - Calculation of adjustment
  - Use of revenue

• **Five Evaluation Criteria:**
  - Environmental benefit
  - Competitiveness benefit
  - Legal feasibility
  - Technical and administrative feasibility
  - Political feasibility

• **Scenario-Building:**
  - ‘Most Probable’
  - ‘Play it Safe’
  - ‘Go Getter’

• **Comparisons with alternative instruments**
### Example: Decomposition of BCA Design Steps (here: ‘Trade flow’)

<table>
<thead>
<tr>
<th>Option</th>
<th>Environmental Benefit</th>
<th>Competitive-ness Benefit</th>
<th>Legal Feasibility</th>
<th>Technical &amp; Administrative Feasibility</th>
<th>Political &amp; Diplomatic Feasibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Imports Only</td>
<td>Relatively greatest benefit due to maximum emissions coverage</td>
<td>Levels the playing field in the domestic market</td>
<td>Strongest case under Article XX GATT</td>
<td>More complex to implement due to data gaps and limited jurisdiction</td>
<td>Controversial as a unilateral, extraterritorial measure</td>
</tr>
<tr>
<td>Exports Only</td>
<td>Relatively lowest benefit due to reduced emissions coverage and pot. incentive for carbon-intensive exports</td>
<td>Levels the playing field in foreign markets</td>
<td>Risks being considered a forbidden subsidy under SCM Agreement; weak Art. XX GATT case</td>
<td>Least complex to implement because purely domestic and data readily available</td>
<td>Least controversial because purely territorial measure with no obligations for foreign producers</td>
</tr>
<tr>
<td>Imports &amp; Exports</td>
<td>Environmental benefit between the two cases above</td>
<td>Levels the playing field in both domestic &amp; foreign markets</td>
<td>Same as above, plus even greater risk under SCM Agreement</td>
<td>More complex to implement for imports due to data gaps and limited jurisdiction</td>
<td>Most controversial because of extraterritoriality and perceived protectionism</td>
</tr>
</tbody>
</table>
Example: BCA Scenario-building (here: ‘Most Probable’, 1/3)

<table>
<thead>
<tr>
<th>Design Element</th>
<th>Option</th>
<th>Environmental Benefit</th>
<th>Competitive-ness Benefit</th>
<th>Legal Feasibility</th>
<th>Technical &amp; Administrative Feasibility</th>
<th>Political &amp; Diplomatic Feasibility</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Trade Flow Coverage</strong></td>
<td>Imports Only</td>
<td>Strong benefit due to maximum emissions coverage</td>
<td>Levels the playing field in the domestic market only</td>
<td>Strong case under Article XX GATT</td>
<td>Intermediate complexity due to data gaps and limited jurisdiction</td>
<td>Somewhat controversial as a unilateral, extra-territorial measure</td>
</tr>
<tr>
<td><strong>Policy Mechanism</strong></td>
<td>Extension of the EU ETS</td>
<td>Neutral (depends on level of carbon price and price volatility/predictability in market)</td>
<td>Neutral</td>
<td>Can be adopted with qualified majority vote, but potentially risky under trade law</td>
<td>High complexity due to need to integrate in/link to EU ETS market</td>
<td>Likely neutral (relative to other options, such as carbon tax)</td>
</tr>
<tr>
<td><strong>Effect on Free Allocation</strong></td>
<td>Gradual Phase-out of Free Allocation</td>
<td>Moderately beneficial because price signal strengthened</td>
<td>Moderately beneficial: playing field inside/outside EU levelled during transition period</td>
<td>Moderate risk of violating SCM Agreement; relatively strong case under Art. XX GATT</td>
<td>Relatively most difficult to implement due to added need to decide on transition process</td>
<td>Moderately controversial due to perceived fairness (no ‘double protection’ of EU producers)</td>
</tr>
</tbody>
</table>
## Example: Comparison of BCA Scenarios

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Design Choices</th>
<th>Environmental Benefit</th>
<th>Competitiveness Benefit</th>
<th>Legal Feasibility</th>
<th>Technical &amp; Administrative Feasibility</th>
<th>Political &amp; Diplomatic Feasibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>‘Most Probable’</td>
<td>Trade Flow Coverage: Imports only, Extension of the EU ETS Exemption of LDCs Basic materials &amp; electricity Scope 1 &amp; Scope 2 Benchmark (avg. EU) Price-based policies Domestic innovation fund</td>
<td>Extends carbon price to imports &amp; replaces free allocation; but use of averages limits benefits</td>
<td>Effectively levels the playing field in the domestic market, but not in foreign markets, nor downstream</td>
<td>Likely to pass muster under WTO law due to Article XX GATT; requires qualified majority vote in the EU Council</td>
<td>Intermediate complexity in terms of data needs and administrative/regulatory framework</td>
<td>Intermediate risk of controversy as a unilateral, extra-territorial measure</td>
</tr>
<tr>
<td>‘Play it Safe’</td>
<td>Trade Flow Coverage: Imports only, Extension of the EU ETS Exemption of LDCs Basic materials only Scope 1 only Benchmark (best practice) Price-based policies International climate fund</td>
<td>Extends carbon price to imports; limited scope and use of generous averages limits benefits</td>
<td>Somewhat levels the playing field in the domestic market, but not in foreign markets, nor downstream</td>
<td>Very likely to pass muster under WTO law due to Article XX GATT; requires qualified majority vote in the EU Council</td>
<td>Lowest complexity in terms of data needs and administrative/regulatory framework</td>
<td>Lowest risk of controversy as a unilateral, extra-territorial measure</td>
</tr>
<tr>
<td>‘Go Getter’</td>
<td>Trade Flow Coverage: Imports and exports, Extension of the EU ETS Exemption of clim. leaders Basic+complex goods, elec. Scope 1, 2 &amp; 3 Actual emissions Price and regul. policies Domestic innovation fund</td>
<td>Extends carbon price to imports, but exempts exports; broad scope and actual carbon intensity strengthen benefits</td>
<td>Effectively levels the playing field in domestic and foreign markets as well as downstream</td>
<td>My not pass muster under WTO law due to SCM and complexity; requires qualified majority vote in the EU Council</td>
<td>Highest complexity in terms of data needs and administrative/regulatory framework</td>
<td>Highest risk of controversy as a unilateral, extra-territorial measure</td>
</tr>
</tbody>
</table>
## Example: Comparison across Instruments

<table>
<thead>
<tr>
<th>Policy Option</th>
<th>Proposal/Variant</th>
<th>Environmental Benefit</th>
<th>Competitive-ness Benefit</th>
<th>Legal Feasibility</th>
<th>Technical &amp; Administrative Feasibility</th>
<th>Political &amp; Diplomatic Feasibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Border Carbon Adjustment</td>
<td>“Most Likely”</td>
<td>Extends carbon price to imports &amp; replaces free allocation; but use of averages limits benefits</td>
<td>Effectively levels the playing field in the domestic market, but not in foreign markets, nor downstream</td>
<td>Should pass muster under WTO law due to Article XX GATT; requires qualified majority vote in the EU Council</td>
<td>Intermediate complexity due to data needs and administrative/regulatory framework</td>
<td>High degree of controversy as a unilateral, extra-territorial measure</td>
</tr>
<tr>
<td>Consumption Charge</td>
<td>“Inclusion of Consumption”</td>
<td>Internalizes cost of carbon across value chain, but no or limited differentiation</td>
<td>Without free allocation: only protects against its own competitive-ness impacts</td>
<td>Does not impinge on WTO/state aid rules; but may require a unanimous vote in the EU Council</td>
<td>High complexity due to data needs and administrative/regulatory framework</td>
<td>Likely minimally controversial as purely internal measure, but increases prices à material substitution</td>
</tr>
<tr>
<td>Contracts for Difference</td>
<td>“Carbon Contract for Difference”</td>
<td>Strong incentive to scale up early-stage clean technology; but scope limited to selected projects (and by available resources)</td>
<td>Levels the playing field between clean and dirty products, but only affects competition w. foreign producers for selected projects</td>
<td>Does not impinge on WTO rules if open to foreign bidders; should pass muster under state aid rules if competitive tender</td>
<td>Relatively easier to implement due to limited scope and provision of data</td>
<td>Relatively least controversial as a support measure</td>
</tr>
</tbody>
</table>
Takeaways from Analysis & Stakeholder Events (I)

Selected Design Elements:

• **Trade flow coverage:** Debate about leakage also needs to consider role of European exports and their competitiveness in foreign markets

• **Free allocation:** Replacing free allocation will face considerable pushback in the EU, making a phased approach more likely

• **Sectoral scope:** Basic goods with relatively low trade-intensity – such as cement – may offer a good piloting opportunity; also possible: electricity

• **Determination of embedded emissions:** Use of default values with individual adjustment is very likely, but choice of default plays large role

• **Revenue use:** International revenue transfers face political obstacles
General Observations:

• **Objective:** No credible BCA can avoid violating free trade disciplines; justification as an *environmentally* motivated measure is thus key

• **Intrinsic tradeoffs** across multiple criteria between narrower scope and more aggregation vs. broader scope and more granularity

• **Downstream impacts** and **substitution effects** have to be considered

• Avoiding **resource shuffling** and evasion tactics will be a challenge

• **Other instruments**, e.g. consumption charges & contracts for difference, can help address certain aspects of leakage, but there are **no silver bullets**
Thank you!