



THE EU'S CARBON BORDER ADJUSTMENT MECHANISM

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When she took office in December last year, European Commission President Ursula von der Leyen announced ambitious new climate goals for Europe and a new border levy aimed at ensuring fair competition with countries that do not impose a carbon constraint on their industries.

A question that has been gripping Brussels since then is how this new Carbon Border Adjustment Mechanism (CBAM) could work while ensuring compliance with WTO rules.



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Taxing times as EU mulls best way to price carbon at the border

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By Sam Morgan | EURACTIV.com



Steel is among the imports that are candidates for carbon border adjustment treatment. [Photo: Shutterstock]

EU climate officials are currently mulling how to deploy a so-called carbon border adjustment mechanism (CBAM) on imported goods, as part of the bloc's flagship Green Deal initiative, and it is proving to be a complex exercise.

The idea of slapping tariffs on imports that do not meet certain sustainability criteria has been around for a long time but it is only under Ursula von der Leyen's leadership that the European Commission has turned it into a political commitment.

As part of her executive's flagship policy, the European Green Deal, the design of a carbon border tax – referred to as an 'adjustment mechanism' to cast off the negative connotations associated with taxation – was made a priority.

Work is still ongoing behind the scenes to draft the CBAM, as the instrument has to be compliant with World Trade Organisation (WTO) rules, to prevent trade disputes, but also effective enough to promote the

EU's green principles, both externally and internally.

A public consultation on what the policy should look like and what imports it should target closed at the end of October and the Commission still plans to publish its proposal in the second quarter of 2021.

Which sectors will be covered by the policy are still unclear, although the Commission's director of trade defence, Leopoldo Rubinacci, did admit at [a EURACTIV event earlier](#)

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[this week](#) that the steel and cement industries are at the forefront because they are most exposed to so-called carbon leakage.

“Risk of carbon leakage means either that production is transferred from the EU to other countries with lower ambition for emission reduction, or that EU products are replaced by more carbon-intensive imports,” the Commission said in its public consultation.

A Carbon Border Adjustment Mechanism (CBAM) would ensure that the price of imports “reflects more accurately their carbon content,” the Commission added.

Crucially, the level of the tax would fluctuate according to the price of CO2 allowances on the emissions trading scheme, the EU's carbon market. EU sources say this is essential to ensure the tax is compatible with WTO rules as foreign exporters would be placed on an equal footing with European industries.

But the fundamental logic behind the EU executive's border tax efforts – that third-party countries and regions might not mirror the bloc's focus on sustainability without an extra push – is almost constantly changing.

Over the course of the last two months, China, Japan and South Korea have all made emissions-busting pledges of varying magnitudes, while Joe Biden's victory in the US presidential race will almost certainly shift Washington's climate policy.

That prompted the Commission's climate tsar, Frans Timmermans,

to claim this week that “the level of the carbon border adjustment mechanism and the intensity of its use will depend on our international partners”.

“If they do the same thing as we are doing, if they want to show the same ambition and go in the same direction, the need for it will be less,” he told participants at the annual European Business Summit.

Mauro Petriccione, the head of the Commission's climate directorate, told the same summit that a “climate-neutrality club” is now forming, citing China, Japan and a likely pending announcement by Canada as positive steps in that direction.

TALK IS CHEAP

Climate pledges only go so far though. China's has already been criticised for not including non-CO2 emissions, while there are doubts about how much US President-elect Biden can achieve early in his presidency, given opposition in the Senate.

A lot of global emissions are still on the table too: Russia, India, Brazil and Australia have shown little appetite so far to beef up their commitments, increasing the likelihood of the EU deploying the border tax once the finer details have been worked out.

Securing WTO-approval will be challenging but according to Simone Tagliapietra, an energy expert at the Breugel think tank, support closer to home will be easier to muster, given climate policy's close links with the job market.

“It is likely to get support across the EU, as European leaders seek to protect companies and jobs from the risks of carbon leakage,” he told EURACTIV, adding that the CBAM also provides the EU with a vehicle in which to export the Green Deal's principles.

Russia has already cried foul at the EU's intention to deploy a border tax, warning that it will not be compliant with WTO criteria. Tagliapietra suggested that Brussels “should try to be as multilateral as possible to prevent trade disputes and claims of climate protectionism”.

“A sensible way to go would be to team-up with the US and jointly introduce CBAM in certain sectors. This process should be open to other countries as well, and fully transparent. This is the way to avoid climate policy-induced trade wars,” he added.

The Commission has already attempted to try and get out in front of any potential areas of dispute, announcing in September that any industries included in the border tax would [lose access to free pollution permits](#) under the EU's carbon market.

MAKING THE MECHANISM

A study by the University of Cambridge's Energy Policy Research Group recently looked into how the mechanism can be designed to reflect more accurately how many emissions companies are actually producing.

In one scenario, the Commission could decide to slap tariffs on a certain

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product from a certain country and just assume the carbon-intensity value of those imports. The study authors insist that methodology “runs counter to the economic logic of carbon pricing”.

Michael Mehling, one of the authors, told EURACTIV that the CBAM should not be a one-size-fits-all option and should offer flexibility to companies, which should in turn build support for the policy.

“There is also a chance that, by working transparently with other countries to agree on the process and applicable rules, the EU could actively help foster some degree of cooperation and mutual trust,” he added, suggesting that the bloc’s monitoring, reporting and verification (MRV) rules are the right candidate for that framework.

However, asked why the Commission would favour default assumed values over case-by-case assessments, Mehling said that avoiding the tailored approach would likely increase CBAM revenues and ratchet up the domestic effect on EU businesses.

“Compared to just using uniform reference values, moreover, it does add an additional layer of administrative complexity to process the MRV reports from foreign producers, which the Commission may be especially reluctant to face especially at the outset,” he added.

There are several other issues that need to be addressed. If companies are given the chance to declare their own carbon figures, Brussels will have to be wary of “resource shuffling”, where firms only export from their most efficient facilities.

Products manufactured in other less-green factories would then be sold on domestic markets, leading to no net decrease in climate impact.

PAYING THE BILLS

The EU executive calculates that the CBAM could bring in between €5-14 billion in annual revenues, depending on its scope and intensity. What should be done with those revenues is likely to be a topic of great debate.

As part of its proposal for a coronavirus recovery fund earlier this year, the Commission said that CBAM revenues could be used to pay off part the €750 billion in funds that the institution is going to borrow on the capital markets in the coming months.

However, the European Council stopped short of giving its approval to that aspect of the repayment plan and the Commission has been urged by other stakeholders not to use the funds for anything other than decarbonisation schemes.

“Emissions Trading Scheme revenues are best placed to become an important source of own-

revenues for the EU. CBAM revenues are intended to limit international competitive distortions rather than to generate revenue,” Breugel’s Simone Tagliapietra explained.

Ensuring that border tax funds are not seen as a cash grab by third-party countries feeds back into the EU’s climate diplomacy efforts and Brussels will be keen to dispel any notion that the CBAM is only about paying off its debts.

INTERVIEW

MEP Canfin: EU's carbon border adjustment mechanism 'is not a tax'

By Frédéric Simon | EURACTIV.com



"The heart of WTO compatibility is that the scope must mirror the ETS mechanism. And that raises the question of free CO2 quotas for European manufacturers, because we cannot have both border protection and free quotas," says Pascal Canfin. [© European Union 2020 - Source : EP]

The European Union's future carbon border adjustment mechanism must mirror the EU's own carbon market price and structure in order to be compatible with WTO rules, says Pascal Canfin

Pascal Canfin is a French MEP for the centrist Renew Europe group in the European Parliament, where he chairs the assembly's environment committee (ENVI). He spoke to EURACTIV's energy and environment editor, Frédéric

Simon. (To read the original interview in French, click [here](#)).

The European Commission has said it will apply a [carbon border adjustment mechanism](#) on countries that do not make sufficient commitments on climate change. How can the Commission determine what is sufficient? Would signing the Paris agreement, for example, be enough?

Answer We must first go back to the

objective of this measure. What we want in the European Parliament is a mechanism which mirrors the ETS – the EU carbon market – and which is therefore adopted by qualified majority. A tax would have to be approved by unanimity, which would complicate decision making. It would also risk being rejected by the WTO as a protectionist measure.

By contrast, the border adjustment mechanism that we want to put in

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place could be technically integrated into the ETS, there are several ways of doing that.

The second thing we want to avoid is “carbon leakage” whereby industries shift their production to countries where CO₂ emissions are not priced. The sectors most affected are well-known, chiefly steel and cement.

What we want is a level playing field – but compared to what? European steel and cement producers are already facing additional production costs linked to the carbon constraint imposed on them by the ETS. These constraints will only increase with the EU's new climate targets for 2030.

Faced with these very real constraints, we have to compare with what other countries are doing. This is the question we must ask ourselves.

If on the opposite side, we have political commitments for 2060, that is not good enough. This is what China has done. Even though I welcome this political commitment, at present China does not impose a carbon price on steel production, for example.

Therefore, exempting China on the sole basis of this political commitment would not be serious. If I put myself in the shoes of a European steel or cement producer, I would not accept it. It doesn't solve the short-term problem.

How could an industrial sector in a country like China escape the future European mechanism?

The only two tools that can be objectified – and compatible with the WTO – is either an explicit price on carbon emissions, like we have in Europe with the ETS, or an equivalent price in terms of standards.

The concrete commitment that can be objectified is the price of carbon. In the future European mechanism, it will act as a lock by adjusting the cost in relation to an equivalent: for example standards at sectoral level. A standard is equivalent to an implicit carbon price. To achieve a certain level of performance, it allows determining which carbon price would have to be applied.

And to escape the future European mechanism, it would be necessary to demonstrate that a carbon price has indeed been applied to the sector concerned?

Yes of course. Otherwise, what would that mean? If we are satisfied with declarations of intentions that do not translate into facts, we would not protect our manufacturers from climate dumping.

Coming back to China, while its commitments are laudable from a diplomatic point of view, it is of no value from the point of view of industrial competition. Of course, I am delighted that China has made this commitment. But to escape the future European carbon border adjustment mechanism, it has to be translated into reality. Otherwise, it is not concrete.

And among the tools to measure these commitments, there is only the carbon price or the equivalent in

terms of standards.

How can we precisely quantify the carbon cost imposed on an industrialist in a foreign country? What elements of proof will they have to provide?

It's quite simple, there are several options that we have already started discussing in the European Parliament. For example, we can take the electricity mix of the country, that of the group targeted by the mechanism, or the electricity mix of the production site itself. That remains to be seen.

But this information is very easily traceable. If you choose the country's electricity mix, this is easily available information, and if it is a company's site that is targeted, there are contracts and invoices, so it's very simple.

Then this should be applied to the carbon content of the products you import. If, for example, we have an electricity mix with a given CO₂ intensity “x” and a carbon content “y”, we make a simple proportional calculation and apply a price. The resulting price would be Europe's carbon price minus what might have already been paid locally. From that moment, we then have a level playing field.

The next question is what to do with the income generated by this adjustment mechanism. And there are basically two logics, two ways of approaching this that we must reconcile.

The first is the environmental logic according to which part of the

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revenue would go to finance the ecological transition of the countries concerned, especially the poorest countries. The second logic is that part of the income goes to finance the repayment of the European recovery plan – or parts of it, probably the green chapter.

In the end, it will be necessary to find the right compromise between these two logics so that the mechanism is WTO-compatible. If the proceeds only go towards the EU recovery plan, without traceability, with no environmental objectives and without any returns to certain countries, especially the poorest, I think we have to be concerned.

So there will have to be a balance between the two and I will work on it on my side in Parliament.

The biggest steel producers are multinationals with production sites in several countries. How can the carbon border adjustment mechanism be applied to this type of globalised group without penalising production sites located in Europe? I am thinking for example of ArcelorMittal.

It is precisely the opposite: if Europe increases the price of carbon without putting in place a mechanism that prevents climate dumping, then a foreign production site will automatically become more competitive than a European production site of the same group.

And so without a carbon border adjustment mechanism, there is precisely a risk of carbon leakage and relocation of production outside the EU. This would be doubly counterproductive – first from an

economic and industrial point of view, and secondly from an environmental point of view because we would relocate production to countries which have lower environmental standards than us. So it's a double loss, that's precisely what we want to avoid.

It is also for this reason that the compatibility of the mechanism with WTO rules is essential: we do not want to enter into a trade war under any circumstances. I recently had discussions with Chinese officials on the subject as well as with the new US administration.

The message must be clear: Europe is not entering a logic of green protectionism or trade war. The mechanism we are proposing is neither arbitrary nor unilateral – on the contrary, we want it to be compatible with the WTO. And as long as it is compatible with the WTO, it is also compatible with the rules that we have set ourselves at European level, and that the Chinese and Americans have accepted.

So rather than starting a trade war, on the contrary, we are playing the game of multilateralism.

What is WTO-compatibility based on exactly? Is it based on the fact that the mechanism is linked to the price of carbon on the ETS?

Indeed, one of the elements is that the structure of the mechanism must be as close as possible to the EU carbon market. The fact that this is not a tax, and that it applies to both European and imported products, are essential and favourable elements here with regards to the WTO.

The second element is the purpose of the mechanism: if the aim is to protect the environment, and the legal basis is linked to environmental objectives, we demonstrate to the WTO that the mechanism is linked to a climate goal that is recognised by the WTO and not linked to customs duties which are aimed at financing other objectives.

The heart of WTO compatibility is that the scope must mirror the ETS mechanism. And that raises the question of free CO₂ quotas for European manufacturers because we cannot have both border protection and free quotas.

This is where a smart adjustment will have to be found, for example by phasing out free quotas at the same time as the border adjustment mechanism is being put in place. The same tonne of carbon emitted by a European installation cannot be covered both by the carbon border adjustment mechanism and by free allowances because this would be a double compensation that is not compatible with the WTO.

In any case, WTO compatibility is a total red line: without it, we are entering a trade war logic and there will be no majority in the European Parliament to support the mechanism.

PROMOTED CONTENT

DISCLAIMER: All opinions in this column reflect the views of the author(s), not of EURACTIV Media network.

The Carbon Border Adjustment Mechanism: ensuring fairness

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By Ben De Vos | NLMK



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‘I want Europe to be a global advocate for fairness’, [said](#) President von der Leyen in her State of the Union address in September. But how do we design fairness into the Carbon Border Adjustment Mechanism (CBAM)?

The CBAM is an incredibly ambitious project, and as ‘fairness’ is often in the eyes of the beholder, how can we actually ensure we ‘level the playing field in a WTO-compatible way’, as the President argued in the same speech?

Ben De Vos is the CEO of NLMK International.

OUR CBAM CONUNDRUM

The NLMK Group is an international steel producer, with over 52.000 employees worldwide. In Europe, we employ around 2.000 people directly, with manufacturing plants in Belgium, Denmark, France and Italy, and thousands indirectly – our contractors, service companies, suppliers, etc. Our business model primarily consists of producing semi-finished steel products (slabs)

at our facilities in Russia, close to raw material deposits. We then ship these slabs to our sites in Europe, to transform them into finished products closer to our customers, including for the car, construction and offshore wind industries – [last summer we supplied the steel needed for a next-generation floating offshore wind farm off the coast of Portugal](#). We not just employ people – we also add value in the EU: from 30% to 100% depending on the product, contributing to EU GDP and to EU exports abroad.

This all means we’re an EU

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importer, a local producer and an investor. What's more: a recent assessment of our emissions – using the European methodology – showed that NLMK's CO₂ footprint is lower than the average of EU integrated producers and closer to EU best-in-class benchmarks.

Making sure then the CBAM is fair – meaning that it ensures equal treatment of EU and foreign producers – will be crucial for the viability of the CBAM (including its WTO-compatibility), but also of particular importance to NLMK given our business model embedded in a global supply chain, and our CO₂ footprint achievements to boot.

AN IAM FOR THE CBAM: CHOOSING A 'SUPERIOR POLICY OPTION' OVER 'ONE SIZE FITS ALL'

We don't have all the answers, so we asked two leading experts from MIT (at the Center for Energy and Environmental Policy Research) and the University of Cambridge (at the Energy Policy Research Group) to help us figure out what 'fairness' across borders could look like for the CBAM.

Their conclusions from this investigation can be found in a [recently released study](#), in which the researchers propose a so-called individual adjustment mechanism (IAM) within the CBAM: a 'superior policy option', with significant economic, climate and legal benefits, and implementable in practice, building on the existing emissions

reporting methodology & process. Such a mechanism would allow producers from outside the EU to demonstrate their actual carbon intensity relative to an established default value.

For a combination of reasons, the Commission when designing the CBAM may consider a 'default' or benchmark value to determine the carbon intensity of imports – the scope of such a value could be EU-based or even global, and based on a 'worst in class' vs. 'best in class' criterion as outlined in the paper. Regardless, such a 'one size fits all' approach would run counter to the stated main objective of the CBAM – 'fighting climate change by avoiding carbon leakage': cleaner producers would get charged the same amount as higher-carbon producers – in direct contradiction to the legal principle that 'the polluter should pay'. In addition, this approach also increases the risk of violating international trade law and of incurring international retaliation, as the CBAM's justification on environmental grounds would be shakier.

NOT REINVENTING THE WHEEL: HOW THE IAM WOULD WORK

The CBAM with an IAM would allow producers to demonstrate their actual carbon intensity compared to the default value. It would be a voluntary mechanism, giving the option to EU importers to use the IAM, and allow for any foreign producer to be rewarded for their individual

decarbonization efforts compared to more carbon-intensive importers or local producers.

To do so, importers would have to provide information documenting the actual emissions associated with production of the imported goods. This process would be the same as the one for domestic good under the EU ETS, following the established monitoring, verification and reporting (MRV) of emissions as part of an annual compliance cycle, including independent third-party verification.

THE CLOSING ARGUMENT: THE BENEFITS OF THE IAM, ALTERNATIVES & THE NEXT STEPS

To conclude, there are major benefits to including an IAM as part of the CBAM:

1. It will provide a stronger economic incentive for foreign producers to reduce their carbon intensity, improving the prospects of the CBAM to reduce global CO₂ emissions effectively
2. Second, the IAM improves the CBAM's chances of being compatible with WTO rules and non-discriminatory, supported by past case law as described in the study
3. Third, it would level the playing field for low-carbon and relatively more expensive products vis-à-vis CO₂-

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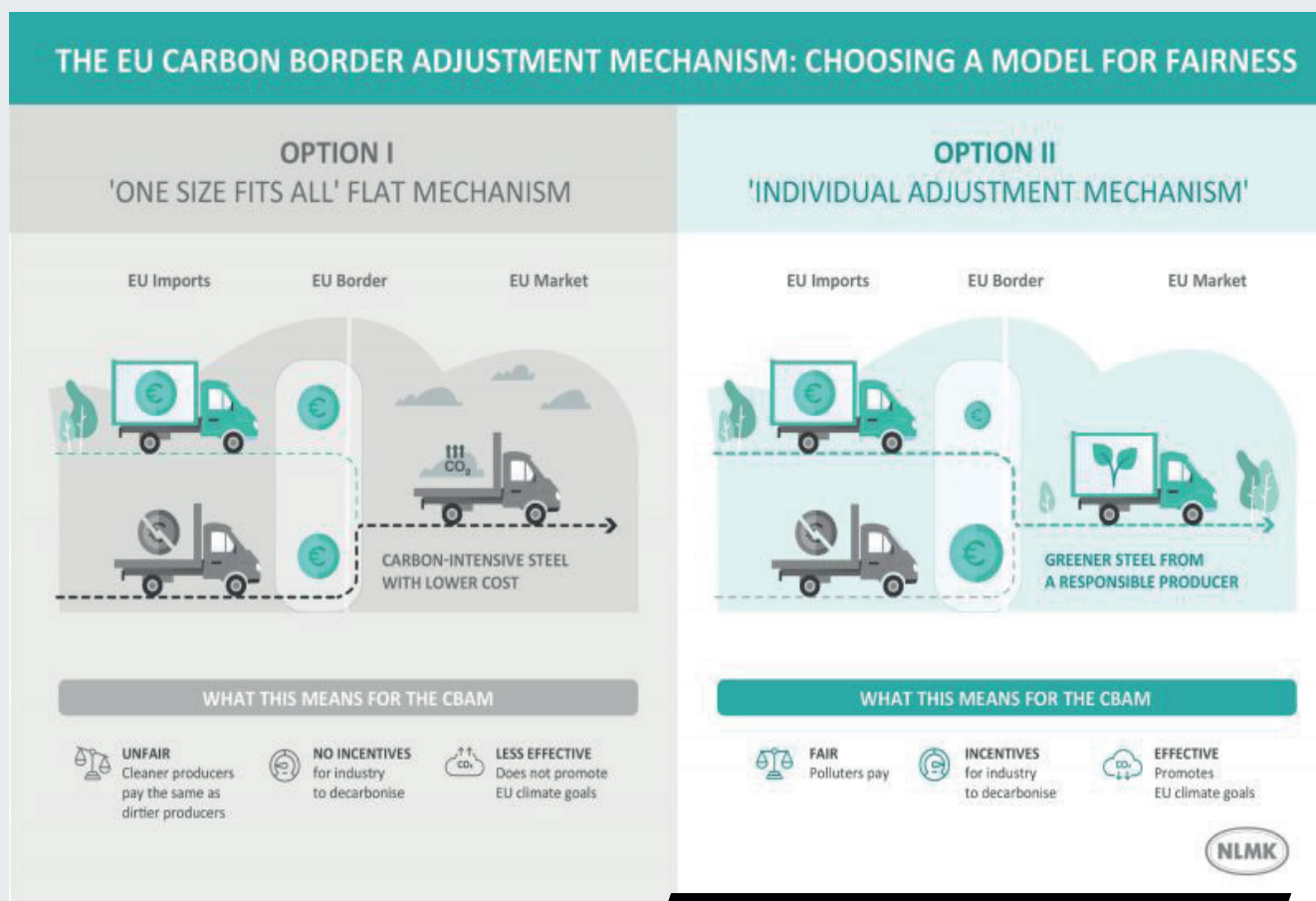


Figure 1: 'one size fits all' vs. 'Individual Adjustment Mechanism'
Infographic: The EU Carbon Border Adjustment Mechanism.

intensive goods, which are usually manufactured with lower costs. Opening the market for 'greener' products would promote the EU's environmental goals and would further drive a change in the consumption patterns.

As the Commission is now analysing the responses to the CBAM consultation, they will have to make several major decisions in the near future, including which policy instrument to use, and which sectors

will be covered. To avoid unintended effects, including for downstream sectors which might witness an increase in production costs and thus be exposed to additional competition from abroad, the Commission might consider targeting a carbon charge at the consumption level as a priority option.

If the final choice is for an EU Carbon Border Adjustment Mechanism, we would firmly argue that it needs to have an Individual Adjustment Mechanism – only then

will it be effective in combating global climate change and be WTO-compatible. Then the EU can also claim to be a global advocate for fairness.



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