

EXTERNAL NOTE

Carbon Border adjustment mechanism

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Summary

FEB questions for the impact assessment about the carbon border adjustment mechanism.

1 Introduction

The new President of the European Commission, Ursula Von der Leyen, is highlighting the European Green Deal as one of the Commission's top priorities. European Commission Vice-President Frans Timmermans is responsible for fleshing out its details, which should happen within 100 days of the new Commission taking office.

Talking about the European Green Deal during his hearing before the European Parliament, Frans Timmermans said there would be "a carbon border tax to level the playing field for European products if other countries do not go as far as us, or refuse to go in the right direction" and "if you don't want to do that [take part in the emission trading system] we have no other option but to correct this difference in carbon footprint at the border with a tax."

Since the introduction of an instrument to shape the Carbon Border Adjustment seems very likely, BusinessEurope has created a task force 'Trade and Climate'. In preparation for an upcoming meeting of the task force, FEB is considering which questions will need to be answered during the impact assessment that the European Commission has announced about the Carbon Border Adjustment instrument.

2 Questions

2.1 Objective

Is the instrument the European Commission intends to introduce primarily aimed at:

- reducing greenhouse gas emissions in Europe;
- reducing greenhouse gas emissions outside Europe;
- protecting European industry from a competitive disadvantage as a result of CO₂ emissions (creating a level playing field for companies established in the EU); or
- establishing alternative financing for the EU?

The proposed instrument must undergo an *impact assessment*. Regardless of the instrument's prime objective, the impact assessment must ascertain its impact on emissions inside and outside Europe, the competitiveness of European companies and the European budget.

In addition, the European Commission must also assess the risk of trade reprisals (retaliation) by third countries and, where necessary, be able to quantify them, too.

2.2 Alternatives

Did the European Commission only consider the possibility of a Border Adjustment Tax when developing the instrument it intends to introduce, or were other options for realising a Border Carbon Adjustment considered?

2.3 ETS

The emission trading system (ETS) is the tool developed by the European Union to reduce greenhouse gas emissions by industry in Europe. What impact will the Commission's proposal have on the ETS?

Does the Commission intend to adapt the ETS to imports (remember, the ETS applies to industry, not products)?

If so, how will the overall number of quotas in the ETS be adjusted? Will products destined for export outside the EU henceforth be exempted from the ETS or removed from the system? Such a system would mean shifting the focus of climate policy from production (where emissions occur) to consumption (where the products that caused emissions are consumed).

The ETS applies to activities from Annex 1 of the EU ETS Directive (2003/87/EC). Will the proposed instrument therefore only apply to imported goods produced via foreign activities corresponding to those listed in Annex 1 of the EU ETS Directive?

Companies can make use of free emission allowances within the ETS. Will it be possible to retain those allowances under the proposed instrument?

2.4 Imports and exports

EU climate policy is now aimed at reducing emissions within the EU, regardless of whether goods manufactured in the EU are consumed there or subsequently exported. If importers to Europe from countries with a less restrictive climate policy, or none at all, end up having to pay an EU levy to thereby cancel out their cost advantage over EU producers, EU exporters would have to be reimbursed for costs incurred as a result of EU climate policy, to cancel out their competitive disadvantage compared to local producers. How might exporters be compensated and how much will that cost?

2.5 Emissions stemming from imported products

How will the EU calculate the greenhouse gas emissions associated with the production of imported goods? Will it only take account of the energy emissions occurring during the production of the imported goods? If not, which other (direct and/or indirect) emissions will be taken into account?

2.6 EU economy

Might the proposed instrument end up pushing the importing of goods higher up the value ladder? What impact would this have on the European economy? And how would it change greenhouse gas emissions by importing countries?

Will the proposed instrument only take account of the quantity of energy used to produce the imported goods or consider other factors as well?

2.7 Compliance with trade agreements

How will the EU guarantee a level playing field for European industry if it makes the implementation of the Paris Agreement a prerequisite for trade agreements with third countries or a condition for launching FTA negotiations?

2.8 Compliance of the proposed instrument (CBAM) with WTO rules

How will the European Commission ensure that this border-adjusted measure (BAM) complies with WTO rules? And in particular with:

- i. Article I GATT - Most-favoured nation treatment - a clause prohibiting discrimination between products exported by third countries.
- ii. Article II & III GATT - To comply with Articles II.2 and III.2 GATT, the BAT should be imposed on a 'like' product and be considered equivalent – at least not in excess – to an internal tax, whether applied directly or indirectly.
 - 1. Can the ETS system be considered an (indirect) internal tax under WTO rules?
 - 2. Can CO₂ emissions be considered an input that is physically incorporated in the product?
 - 3. Which benchmark and CO₂ pricing methodology will be used to calculate the adjustment mechanism ?
 - 4. Will the foreign product subjected to a BAM be considered a 'like' product?
- i. Article III GATT - National treatment on internal taxation and regulation - clause requiring similar treatment for national and imported products, as well as prohibiting protectionist measures. There is a clear link here with the ultimate objective of the BAM, namely establishing a "level playing field" or reducing CO₂ emissions.
- ii. Article XX GATT - General exceptions - clause providing for exceptions for measures taken to protect human life (b) or conserve natural resources (g) (if similar measures are taken at national level).