EURACOAL
European Association
for Coal and Lignite
AISBL

EURACOAL Response to Public Consultation

on a Carbon border adjustment mechanism
(Ares(2020)1350037 – 4 March 2020)

Background

The European Commission is preparing to propose a carbon border adjustment (CBA) mechanism for selected sectors to reduce the carbon-leakage risk associated with EU climate and energy policy. This would replace the current system whereby free EU emissions trading system (ETS) allowances are granted to certain industrial sectors based on emission benchmarks and, in some member states, state aid is offered to electro-intensive sectors that pay a heavy burden in the form of the higher electricity prices that result from the EU emissions trading system (ETS). Any mechanism must be compliant with World Trade Organization (WTO) rules.

WTO compatibility

WTO case law has not provided rulings on climate taxes. Article XX(b) of the General Agreement on Tariffs and Trade (GATT) allows measures that are "necessary" to protect human, animal or plant life or health. However, would a CBA applied at the EU level make a material contribution towards the global climate objective? Also, are there better policy options that would be less disruptive to trade?

GATT Article XX(g) allows trade measures that are "related to" the conservation of exhaustible natural resources in conjunction with restrictions on domestic production or consumption. It is argued that clean air could be such a natural resource that can be depleted by pollutants, including greenhouse gases (GHGs).

Here, it should also be noted that Article 3 of the the UN Framework Convention on Climate Change (UNFCCC) states that climate protection measures should not constitute a means of arbitrary or unjustifiable discrimination, or a disguised restriction to international trade.

A domestic EU tax on carbon-intensive products (*e.g.* on steel, cement and aluminium), applied equally to imports, is one way forward and is WTO compatible. However, taxation in the EU is a national competence and an EU carbon tax would require unanimity across member states. It is for this reason that the EU adopted the EU ETS and also explains why the Commission is now exploring a CBA mechanism, rather than the carbon border tax that President von der Leyen sought in her mission letters to European Commissioners dated 10 September 2019.

EURACOAL response

EURACOAL understands that calls for a CBA mechanism are a logical counterbalance to the EU's stringent, unilateral policies linked to climate action. We believe that European industrial competitiveness has been severely compromised, although we note that reports for the Commission suggest that this is not the case (*e.g.* reports of the Carbon Leakage Evidence Project). In 2017, the Commission concluded that, "While at present, ETS costs constitute a very small share of the total costs for industrial sectors covered by the ETS, even for energy intensive industries, the situation might change in the future".[1] The situation has changed and it is for that reason that we support measures to "level the playing field" for EU industry. In fact, such measures are now essential and should apply to all sectors, including the power sector. However, whilst we can see the pros and cons of a CBA mechanism, we remain neutral on whether or not to introduce such a mechanism as there may be better alternatives.

The Commission states that, "the main objective of the carbon border adjustment is fighting climate change by avoiding carbon leakage." EURACOAL believes that another objective of any measure introduced should be to preserve jobs and economic activity in Europe by enabling EU industry to compete on a level playing field.

Currently, EURACOAL has not reached a position on a CBA mechanism. We await concrete proposals, but offer some initial views here in our response paper.

1. A global carbon emissions trading system – the ideal solution

Before considering other options, we suggest that the European Commission's highest priority should be a diplomatic effort to engage with the world's top carbon emitters – say the G20 countries – to agree an international carbon trading system. With such a system in place, the carbon-leakage issue would disappear as each nation would face a common carbon price. We note that this was also the stated intent of Article 6 in the UNFCCC Paris Agreement which came into effect at the beginning of 2020 and which EURACOAL supports.

2. Scope of a CBA mechanism

To grant carbon-leakage protection to selected sectors is a market distortion. Other similar but competing sectors, would be disadvantaged. For example, steel, aluminium, cement (concrete), timber and plastics are often interchangeable in construction and product design. Decisions on what materials to use are typically made on a techno-economic basis. It would be a market distortion if EU officials had the power to assess the carbon penalties applied to particular materials for two reasons. Firstly, such assessments could never be "correct" as there is no perfect way to calculate embedded carbon emissions. Secondly, the Commission proposes to apply a CBA only to "selected sectors" which would effectively determine the market competitiveness of selected materials. This is unfair and would discourage the competitive forces that lead to better and more innovative products; CBAs for selected sectors would pre-empt decisions on material choice and might therefore unnecessarily *increase* carbon emissions when, for example, lightweight steel components produced in the EU are replaced by imported plastic ones. Any mechanism should cover *all* sectors of the economy, including the electricity sector which the Commission acknowledges is threatened by imports from countries that do not participate in the EU ETS.[2]

3. GHG emissions associated with imported products

The Commission is exploring how assessments of the embedded carbon in imported products should be carried out by analysing and inspecting production facilities in third countries. It would be impossible for the EU to carry out such activities on foreign territories where it has no

[1] Ares(2017)5046070 – 16 October 2017

[2] Commission Delegated Decision (EU) 2019/708 of 15 February 2019 supplementing Directive 2003/87/EC of the European Parliament and of the Council concerning the determination of sectors and subsectors deemed at risk of carbon leakage for the period 2021 to 2030, C(2019) 930 final

jurisdiction. The Commission would therefore have to fall back on *assumed* values for the carbon emissions associated with particular processes. Once again, the transparency and fairness of a CBA mechanism would be compromised if arbitrary decisions were taken based on embedded-carbon assumptions. Instead of a level playing field, it would penalise some at the expense of others and have unverifiable and uncertain environmental outcomes. These complexities point to the need for a simpler, more transparent, fairer approach that can be applied more easily to *all* sectors.

4. Carbon trade wars

Any imposition by the EU of a CBA mechanism, or any other form of carbon border taxation, would inevitably lead to a trade war with third countries. We saw this when the USA imposed tariffs on steel, kicking off a trade war which continues today. Other countries would view a CBA as protectionism. It is for the EU to decide if it wants to take this approach to trade, but EURACOAL itself has always championed open and transparent markets with fair competition on a level playing field, the international coal trade market being an excellent example. Of greater concern to EURACOAL today is the import of coal from countries where production is subsidised which competes unfairly against unsubsidised EU producers.

5. A universal carbon border adjustment mechanism

A simpler approach should be considered, one that is not subject to arbitrary decisions made with imperfect knowledge.

The EU could elect to impose a carbon border tariff on the totality of its international trade. This can be done by taking the value of any particular trade and imposing a tax based on the overall CO_2 or GHG emissions per unit of GDP of the trading partner.[3] No new administration is needed as the carbon tariffs could be added to existing tariffs collected through existing customs arrangements. Country-by-country GHG emission data is available from the UNFCCC, albeit with a three-year delay, and GDP data is available from the World Bank. The rate of carbon tariff, in terms of euros per tonne of carbon dioxide equivalent (tCO_2e), would have to be set unilaterally by the EU or by multi-lateral agreement.

Such an approach may also lead to trade wars, but the retaliatory measures would hopefully be limited to third countries imposing import tariffs on goods from the EU at the *same rate*, based on the EU's carbon emissions per unit of GDP. In practice, such tariffs would disadvantage poorer nations *vis-à-vis* wealthier ones who can afford cleaner, more expensive energy sources. As such, it could reduce trade and lead to impoverishment or even resentment.

There are no easy answers to encourage the rest of the world to follow the EU and adopt equally tough climate policies. EURACOAL looks forward to a wider debate on this important topic and will reach a position on a CBA mechansim after a proper internal debate of a concrete proposal from the Commission.

1 April 2020

[3] Tariff (€) = value of goods (€) × national GHG emissions (tCO_2e) / GDP (€) × carbon tariff (€/tCO_2e)