Carbon Border Adjustment Mechanism

The Federation of Austrian Industries' contribution to the European Commission's Inception Impact Assessment on CBAMs

The Federation of Austrian Industries (Industriellenvereinigung, IV) is the voluntary and independent representation of interests of the Austrian industry and its related sectors. It represents more than 4.500 members in the manufacturing sector, credit and insurance sector, infrastructure and industry-oriented services in Austria and Europe. In Austria, the Federation's members represent more than 80 per cent of domestic manufacturing companies. IV acts as the interface between business, politics and the wider public. On European level, the Federation of Austrian Industries is a member of BusinessEurope.

In December 2019, the European Commission published a Communication on the European Green Deal, in which it announced several initiatives including a carbon border adjustment (CBA) mechanism.

General remarks

The Federation of Austrian Industries acknowledges the political relevance of such a mechanism as well as the European Commission's intention to prevent that less-ambitious international partners undermine the EU's climate ambition. Given the fact that the EU only accounts for 10% of the world's greenhouse gas emissions, it is essential for the EU to complement its already ambitious climate targets with measures that create a global level-playing field for its companies, especially when they are interacting with Europe's main trading partners.

Designing a CBA mechanism will be politically challenging. The process needs to be systematic, well-thought through, and possible consequences need to be assessed, analysed and if deemed negative, mitigated thoroughly. It is pivotal to incorporate the following guiding principles into a possible CBA mechanism's design:

1. A possible CBA mechanism must not substitute current carbon leakage measures! Such an approach is highly problematic and could jeopardise the tool's legality as well as its effectiveness.

- The **EU Emissions Trading System** (EU ETS) is and should remain the **key market-based instrument** allowing the European industry and power sectors to economically reduce their GHG emissions. This includes current carbon leakage measures comprising compensation for direct and indirect[1] CO2-costs. Under the EU ETS, the system of free allowances provides the key stimulus for the best and most efficient industrial installations. Replacing the existing carbon leakage measures by an untested mechanism would create considerable uncertainties and risks for European industry.
- Additionally, by substituting free allowances, **European companies' competitiveness on export / third markets is jeopardised**. A CBA mechanism only encourages foreign companies to produce more environmentally friendly, if they want to enter the EU market. This effect, however, is not achieved on third markets / European export markets without carbon pricing. By continuing to grant free allowances to EU companies under the ETS, they are also able to assert competitive pressure on foreign producers on third markets. This guarantees to exert pressure on foreign installations to produce more environmentally / climate friendly. **Hence, deleting or phasing out free allowances and indirect cost compensations should be avoided at any cost.** This would even have the opposite effect to a CBA mechanism's purpose to create a level-playing field for Europe. Conversely, having a CBA mechanism set up in parallel to free allowances and indirect cost compensation allows for testing it at relatively low

[1] in some Member States

levels and impacts. There would be no double protection for industry, as the CBA mechanism would only align CO2-related costs between non-EU and EU installations.

- It is therefore very worrying that the Green Deal Communication published on 11 December 2019 as well as the Commission's Inception Impact Assessment state that the CBA mechanism "would be an alternative to the measures that address the risk of carbon leakage in the EU's Emissions Trading System".[2] This would entail an immediate shift to a system of full auctioning, in which costs, impact and commercial risks could become very burdensome.

2. A possible CBA mechanism must be in accordance with World Trade Organisation rules and other international obligations of the EU (e.g. United Nations).

- **WTO compatibility** avoids dispute procedures, improves regulatory predictability and prevents retaliatory counter-measures, which could only be justified in case the CBA mechanism is not in accordance with the WTO rulebook.
- A possible CBA mechanism should be based on the **grounds of environmental protection** (Art XX GATT (lit b + lit g)) in order to be WTO-compliant. Industrial relocalisation – carbon and investment leakage – would not only have a severe impact on prosperity and jobs in Europe, but would also have negative effects on the overall climate and environment, if production is shifted into world regions with less ambitious climate and environmental standards. The Austrian Institute for Industrial Ecology calculated that **one ton of reduced CO2 emissions in Austria due to relocalisation/offshoring leads to additional CO2 emissions of 1.9 tons abroad.** Other grounds of justification than environmental protection could face difficulties under WTO-rules (according to Article I GATT – Most Favoured Nation).
- A (European) CBA mechanism must not set a precedent for further restrictions on trade in the future based on other, non-environmental/climate-related matters. It will already be extremely challenging to reliably measure the carbon content of traded materials, especially if life-cycle CO2 emissions are considered.
- A CBA mechanism should only be introduced as a **temporary measure until an efficient, fair, global CO2-pricing system is in place**. The European Union should continue to work towards such a system on international level.

3. The EU's supply with critical raw materials and semi-finished products must be guaranteed.

- A potential CBA mechanism must not reduce the availability or increase the price of critical raw materials not sufficiently sourced within the European Union for the European manufacturing sector and industry.
- Equally, the cost for **intermediate and semi-finished** products essential for European production must not be increased.

<u>Questions raised in the EC's Inception Impact Assessment:</u>

Q1 EC Inception Impact Assessment: Type of policy instrument

- A potential CBA mechanism should be built on an extended **import-ETS model.** The models price should be aligned with the ETS market price and with ETS benchmarks. Thus, the "**import price**" would be equivalent to the cost European companies are facing, which would increase the chances for WTO compatibility.
- The **obligation to pay** should lie with the producer based outside the European Union. The producer is obliged to report any CO2-related cost related to the production.

[2] Page 5 of European Commission, COM (2019) 640 final

Q2 EC Inception Impact Assessment: Methodological approach

- A CBA mechanism should be based on **EU ETS benchmark values** for industrial processes, unless the importer certifies lower carbon content or higher CO2-related costs at origin.
- **EU-internal carbon leakage measures can co-exist with a CBA mechanism** as free allowances are only partially contributing to achieving the benchmarks . In addition, they are already being decreased by a higher factor of 2.2% between 2021 and 2030.
- A CBA mechanism must cover the **full value chain.** If a European producer sources intermediate or semi-finished products from abroad to produce a final product in Europe, this producer must not face higher CO2-related initial costs than a competitor outside the EU.
- In the US, similar debates exist (*Liebermann, Warner* (America's Climate Security Act 2007, introduced in October 2017); *Bingman, Specter* (Low Carbon Economy Act of 2007, introduced November 2007)). The Lieberman/Warner bill introduces "**international reserve allowances**" that need to be bought by importers from countries without a comparable GHG-emission mitigation system in place. The price for an allowance is sector-specific and based on the national energy intensity of production minus any free allowances granted to the domestic sector.
- t is paramount that a CBA mechanism is **transparent, universal, easy to implement, objective and as unbureaucratic as possible.** Proper registration, verification and anti-fraud measures need to be implemented and supervised by an independent authority. On the other hand, obligatory EU-monitoring and on-site controls seem unnecessary.
- A CBA mechanism should be started with a **testing phase of at least one year**, during which CBA mechanism certificates/allocations/allowances are granted for free.
- If a potential CBA mechanism is introduced, it is to be **reviewed constantly**, analysing its effectiveness regarding climate/environmental protection and its impact on European competitiveness.

Q3 EC Inception Impact Assessment: Sectoral scope

- A potential CBA mechanism should only be started with **selected (sub-)sectors** to address uncertainty and explore possible legal challenges or retaliatory measures. If more sectors are added gradually, qualitative assessments must be a prerequisite to capture sector-specific issues and needs. Such a sectoral approach is also important to respect "**Common but Differentiated Responsibilities**" under the Paris Agreement.
- In particular (sub-)sectors should be included that (alternatively):
  - are particularly exposed to international competition
  - produce globally standardised products
  - represent a significant share of the EU's greenhouse gas emissions

<u>Open questions</u>

In addition to the points mentioned above, further questions need to be discussed, including but not limited to the following:

Q1. How would necessary carbon data for a CBA mechanism be collected and verified it in a reliable and transparent way?

Collecting and disclosing carbon content data and CO2-related costs would be decisive for successful CBA mechanism measures. The common Monitoring, Reporting and Verification (MRV) system for emissions as foreseen in the Paris Agreement must be developed further. How can this process be facilitated? Can plurilateral solutions lead to progress in this area?

Q2: How could the revenues generated with the CBA be used most effectively?

The impact assessment should look into how the CBA mechanism's revenues can be used to achieve its goals. For example, should the revenues flow into the EU ETS Innovation Fund or another fund to help bring the costs down for EU-based low-carbon RDI, or should it be used to fund low-carbon investments in third countries?

Q3: How to measure additionality of the CBA?

In a hypothetical situation, producers in third countries could reorganise their trade flows to export only their cleanest products/products produced in their most efficient installations to Europe, thereby minimising any CBA mechanism price, whereas dirty products/products produced in old/high-emitting installations are sold domestically or in other parts of the world without adequate carbon pricing. A CBA mechanism's effect to push other major economies to increase their climate actions might be significantly diminished. This would also put European producers exporting to other parts of the world at a significant cost disadvantage.

Q4: How does the Commission take the impact on the whole value chain into account?

The Federation of Austrian Industries stands ready to provide further input on the Commission's plans and will continue to provide feedback as these plans develop.