

EUROALLIAGES Position Paper on the Carbon Border Adjustment Mechanism (CBAM)

Date: March 2020

1. Introductory remarks: a complex multi-dimensional bet

With the introduction of the [EU Green Deal](#) and the [Just Transition Mechanism](#), we understand the European Union is entering into a new phase of energy and climate regulation. While the main political driver is to design and implement a wide range of new legislative proposals to make Europe the first carbon neutral economy in 2050, the interplay of the existing legislation and the ambitious pace required to decarbonise will have a tremendous impact on all the economic actors of the Union. Should the agreement of the European Council to reduce GHG emissions by at least 55% in 2030 be confirmed by the Climate Law to be unveiled by the European Commission, the EU as a bloc will have to make the most dramatic and fastest GHG emissions reduction by any major economy ever.

In other words, this new regulatory era will need to define clear policy pathways for industry to cope with the already ambitious Clean Energy Package and the ETS Phase IV reform (2021-2030) adopted in the previous term. Currently, these regulatory frameworks are already shaping the evolution of carbon markets, the future penetration of renewables, the functioning of the electricity and gas markets, the EU energy governance and, ultimately, the potential of electrification in decarbonising the economy.

EUROALLIAGES is also aware of the potential transformation that the ETS system may undergo in the long run (post-2030) and the challenges that an evolving system with decreasing free allowances may pose to effectively protect electro-intensive industries from carbon leakage.

We therefore believe that the introduction of a Carbon Border Adjustment Mechanism (CBAM) should be assessed within this particular regulatory context and tested in some sectors before a EU-wide implementation is considered. Any new mechanism with the complexity of the CBAM, will inherently influence the behaviours of the economic actors operating in the integrated value chains of our economy.

This is the reason why EUROALLIAGES calls for a serious multi-dimensional assessment that includes not only energy and climate angles but also fundamental aspects of EU's trade and single market instruments and goals.

2. Our major concerns

The implications of any type of CBAM design are multiple and somewhat difficult to predict with accuracy. However, there is a number of expected challenges related to energy, trade and single market policy areas that require further European Commission's efforts in conducting a robust *ex-ante impact assessment together with a debate with stakeholders*.

Among the main challenges identified by our industry, we would like to stress the following concerns:

- a) **Any CBAM should not be designed to replace the current ETS carbon leakage architecture and regime at least before 2030**

We believe that the carbon leakage regime featured by the current ETS Directive (Phase 4) should remain the central mechanism to regulate this particular challenge and provide the most effective carbon

leakage protection for electro-intensive industries like ours until 2030. The introduction of a CBAM should not interfere or phase out the existing carbon leakage measures, as wrongly recommended by the [EU Green Deal](#) Communication published in December 2019¹, most notably; the allocation of free allowances for direct costs and the regulatory options provided in the State Aid rules for ETS indirect carbon compensation. These well-established mechanisms, effectively designed to provide very accurate and targeted carbon leakage mitigation over the last trading periods, should remain the backbone to enhance a better level playing field vis-à-vis third countries without cap-and-trade systems and, ultimately, prevent further carbon leakage of the EU's most exposed strategic industries.

b) Understanding the impacts in our sector's value chain is critical

EUROALLIAGES calls for a detailed assessment of the specificities of our sector's value chain. More specifically, this refers to upstream and downstream segments of the value chain, i.e. from the primary product down to the final product in the value chain. Inadequate schemes' designs or inappropriate impact assessments can lead to potential negative impacts on the competitiveness of our industry. More specifically, we note with concern a very likely risk which would be the disruption of our value chain as an inadequate implementation of a carbon tax may artificially encourage imports of secondary products of integrated value chains in Europe that may end up by penalising other vital parts of the chain (i.e. upstream) . The assessment of any CBAM should always consider the global (and not fragmented) dynamics of strategic value chains.

c) CBAM may have unintended effects on EU's trade defence instruments

EUROALLIAGES notes with concerns the potential unintended impacts (or regulatory loopholes) that a CBAM may have on the effectiveness of EU trade defence measures. For instance, the very recent introduction of environmental costs in some of the calculations in anti-dumping cases may collide or overlap with the imposition of a carbon adjustment against producers in third countries. This may lead to a potential "double-taxation" regime that may not only be challenged by third countries but also undermine the current system. We therefore call the European Commission to further explore and, if possible, clarify both the interaction and complex interlink between different types of CBAM designs/scenarios and the adequate implementation of the different EU trade defence instruments.

d) CBAM should be compliant with the World Trade Organisation (WTO) rules

We recommend any CBAM to be WTO compliant. The introduction of a CBAM without a clear green light from the WTO would most probably trigger a wave of WTO complaints against the EU by third countries. If the EU were to lose such disputes, what would follow would either be the EU amending its CBAM or WTO authorising retaliation against the EU. Those scenarios should be taken into account in

¹ We firmly oppose to the EU's Green Deal Communication paragraph in page 5 which states what follows : "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 [...] It would be an alternative to the measures that address the risk of carbon leakage in the EU's Emissions Trading System". The footnote number 10 in the same page defines "measures" as free allocation of emission allowances or compensation for the increase in electricity costs.

the Commission's upcoming impact assessment work, which should include a sensitivity analysis of CO₂ prices based on the impact of a CBAM and the evolution of the carbon price.

e) Testing a CBAM for some selected sectors should be temporary

The introduction of any potential CBAM for few sectors – as it seems to be intended - could probably be the most pragmatic policy option to test the system and, ideally, optimise its design. EUROALLIAGES believes that any theoretically *well-functioning CBAM* for few sectors may level the playing field with third countries but, at the same time, may also create unfair market conditions for sectors that will not benefit from the scheme in the EU single market. It is necessary therefore to investigate in depth the impact on the few “trial” sectors, how rapidly can be expanded CBAM to other sectors with their respective specificities and consider compensation mechanisms for sectors that will lack ETS and CBAM protection together.

f) Defining a workable and accepted carbon content methodology for products

One of the most serious challenges that any CBAM will face is to define the carbon content from third countries' products imported into the EU² including both direct and indirect emissions. As one of the most electro-intensive industries, EUROALLIAGES stresses with concern that any system assessing the real carbon content of imported products may create certification/regulatory loopholes where fake green products are imported without a carbon adjustment and out-compete the EU domestic production. Moreover, there is no global system today for assessing the carbon content of imported products and the discussion in the EU to define carbon footprint based on life cycle analysis is far from over.

In addition to this, we believe that the European Commission should seriously consider a “reverse CBAM” for products – manufactured in a responsible way – and exported outside the EU. Such support should also be assessed against the WTO legal framework before it is launched by the EU.

This relatively *technical discussion* can quickly become a political issue between the EU and its trading partners. EUROALLIAGES therefore recalls that only a simple, transparent, fair and workable approach to calculate direct and indirect CO₂ content for products may provide a sound basis to launch a CBAM system but this approach should first be fully tested and endorsed in the EU before it applies to third countries.

3. Conclusion: our policy asks

In light of our concerns, EUROALLIAGES recommends the following:

- 1. Any CBAM system that intends to replace or remove the carbon leakage regime featured by the ETS Directive should be disregarded.** We invite the European Commission to reflect on scenarios in which CBAM will adequately complement the necessary carbon leakage protection of highly exposed sectors like the one represented by EUROALLIAGES.

² Alternative proposals to launch template values for regions or countries will be very challenging, as these values could discriminate the best environmental performers (i.e. producers with the lowest CO₂ emissions) within the selected regions or countries.

2. **The upcoming impact assessment should be the starting point of a broader discussion between the EU institutions and all the stakeholders potentially concerned.** The debate should not be detached from the New Industrial Strategy and the upcoming Climate Law.
3. **The impact assessment should address WTO compliance and the potential interlinks between different CBAMs and EU's trade defence instruments.**
4. **While EUROALLIAGES is open to CBAM trials for selected sectors, the European Commission should provide details about the expected impacts for the sectors that will fall outside the scope of the mechanism** and, ultimately, explain how these will be protected from higher carbon leakage risk.
5. **EUROALLIAGES is ready to contribute with material and data to be assessed as a specific sector that may benefit from a future CBAM.** Our members are ready to participate in this exercise provided that confidential or sensitive data is not published and that the results are not considered as an official endorsement of the system.

For further information, please contact:
Euroalliances
Nadia Vinck - Director EHS and Scientific Issues

E-mail: vinck@euroalliances.be