

# **Cluster Bananero**

ECUADOR

## **Feedback to the Carbon border adjustment mechanism**

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## I. Introduction: the importance of banana industry for Ecuador's development and EU-Ecuador partnership objectives

The European Union (EU) is one of the most important partners for our product<sup>1</sup>: in 2018 the European market represented the biggest share of our sales, 32,5% of total<sup>2</sup>.

Banana industry produces more than 3 billion US\$ in Ecuador. It represents the second most exported product, just behind oil. It is a national scale economy that involves other sectors: paperboard, plastics, logistics, etc. It is considered an "ice breaker" economy: banana industry reaches new ports around the world for other Ecuadorian products to find a market there. It creates 250.000 direct jobs, and more than 30.000 indirect ones.

Considering the importance of banana industry for Ecuador's economy, the amount of jobs that it creates, the environmental, economic and societal projects that it involves<sup>3</sup>, the Ecuadorian Banana Cluster plays an important role within the framework of the current EU-Ecuador FTA, being fully committed as a reliable partner to achieve the objectives stated on the Title on Trade and Sustainable Development.

Therefore, it is of crucial importance that the EU takes into consideration in its Impact Assessment the **consequences that a Carbon Border Adjustment Measures (CBA) may have in Ecuador's social and economical development.**

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## II. How CBA should be designed

As initially suggested by the European Commission<sup>4</sup>, one of the main objectives of the EU with the CBA is to ensure European companies do not have competitive disadvantages compared to companies from countries with lax climate regulations, and to prevent companies from simply moving carbon-intensive production to third countries to avoid the EU's environmental standards (also known as carbon leakage).

The objective of the CBA is to allow the EU to pursue ambitious climate objectives to reduce greenhouse gases (GHGs) released into the Earth's atmosphere, whilst ensuring that domestic efforts do not simply serve to drive production and GHGs emissions elsewhere.

However, absent a revenue redistribution policy, the **adjustment cost will ultimately be borne by the final consumer** (in the EU) according to their consumption habits. Therefore, measures must be put in place to ensure that the tax is socially just and does not disproportionately impact low-income households.

Additionally, **the risk of carbon leakage is still being debated in research**<sup>5</sup>, i.e. the risk that without the CBA, EU climate regulations might create perverse incentives for more imports from countries outside the EU which might be harming the environment, climate and rights.

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<sup>1</sup> "Assessing the economic impact of the Trade Agreement between the European Union and Ecuador", European Commission, available at: [http://trade.ec.europa.eu/doclib/docs/2016/september/tradoc\\_154964.pdf](http://trade.ec.europa.eu/doclib/docs/2016/september/tradoc_154964.pdf)

<sup>2</sup> According to ACORBANE statistics: <http://www.acorbanec.com/>

<sup>3</sup> <https://www.followmetothefield.com/es/>

<sup>4</sup> "Mission Letter of Paolo Gentiloni, Commissioner for Economy", 1 December 2019, available at: [https://ec.europa.eu/commission/commissioners/sites/comm-cwt2019/files/commissioner\\_mission\\_letters/mission-letter-paolo-gentiloni\\_en.pdf](https://ec.europa.eu/commission/commissioners/sites/comm-cwt2019/files/commissioner_mission_letters/mission-letter-paolo-gentiloni_en.pdf)

<sup>5</sup> "A European carbon border tax: much pain, little gain", Bruegel, 2020, available at: <https://www.bruegel.org/2020/03/a-european-carbon-border-tax-much-pain-little-gain/>

In this paper we do not undertake to assess climate impacts of this tool. Instead, this paper should be seen as a complementary analysis of socio-economic impacts to accompany analysis from a climate perspective.

We consider that, if eventually the EU will design the CBA, it should be guided by the following principles:

1. **Global environmental benefit:** a CBA should be designed with global climate, environment and social objectives at its core, and should be flexible and nuanced enough to avoid causing perverse incentives in other countries that ultimately lead to more harm.
  2. **Policy Coherence for Development:** a CBA should be coherent with development policy objectives and avoid any negative impact on the economies of developing countries, including via flanking measures.
  3. **Equity:** acknowledging the EU's climate debt towards developing countries, as early industrialized countries have already consumed most of the global carbon budget and must undertake steeper emission reductions to keep the planet under 1.5°C of average global warming.
  4. **Existing EU-Ecuador bilateral commitments:** special approach towards the multilateral FTA, in order to encourage the existing obligations assumed between parties and consider impact on tariff-free access to the EU market.
  6. **Fairness and progressivity:** considerations of progressivity must be applied to both the exporting developing countries as well as importing EU countries, to ensure the CBA does not create an additional, disproportionate burden on low-income households in Europe nor negative impacts on jobs and inequality in Ecuador.
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### III. Carbon adjustments and WTO

The WTO is responsible for regulating when a border adjustment is admissible and when it is not through the General Agreement on Tariffs and Trade (GATT). For carbon border adjustments to be admissible, the tax applied (or credited) must be applied on both foreign and domestically produced products. The tax cannot unduly burden a foreign derived product. Moreover, the tax can only be applied on a product, not a process (also referred to as '*taxes occultes*' or hidden taxes under WTO rules)<sup>6</sup>. *Taxes occultes* are not admissible under WTO regulations.

It follows from the above that, under WTO regulations, the following requirements are necessary for a carbon border adjustment to be admissible:

1. An equivalent tax ought to be applied on a like-domestic product<sup>7</sup>. The concept of equivalence requires the tax rate of the national product and the imported product to be similar, so that no undue burden is applied on the foreign derived product in such a way that it might constitute a hindrance to trade.
2. The tax must be levied on a product and not a process. Carbon taxes would therefore be admissible if employed both domestically and at the border, but the same might not hold

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<sup>6</sup> "A Proposition for a Multilateral Carbon Tax Treaty", T. Falcao, 2019, IBFD Online Books.

<sup>7</sup> Like-product is the WTO terminology to designate a similar product.

true for energy taxes (if they apply in the production process, not to the finished product) – although a conclusion cannot be reached until the details of the policy are revealed.

A key challenge for the carbon border adjustment intended by the EU is whether it will be a mechanism able to differentiate between the environmental impact of products produced in different ways, or whether it will only be able to recognize whether the import is burdened by a domestic carbon tax in the exporting country.

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#### IV. Carbon footprint of the banana supply chain<sup>8</sup>

The calculation of a carbon footprint of a product is the sum of all materials, energy and waste across all lifecycle activities thereof, multiplied by emission factors and global warming potentials (GWPs). The carbon footprint of the banana industry is spread across the entire value chain, which can be divided into three broad steps: production and packing, transport and shipping, and ripening (for exported bananas). However, it is relevant to point out that only 15%–20% of world banana production is traded globally (the biggest banana producing countries such as India or Brazil export very little and keep most for domestic consumption).

ISO 14064 standard on quantification of emissions and removals of greenhouse gases represents a fundamental instrument for the estimation of carbon footprint in banana companies. ISO standards 14040 and 14044 on Life Cycle Assessment (LCA) and PAS 2050 Carbon Footprint Verification (published by the British Standards Institution) provide a recognized framework for carbon footprint and lifecycle analysis.

However, **the results can vary considerably depending on the chosen methodology, scope and boundaries, and because every study needs to be adjusted to local conditions and emission factors.** For example, some carbon footprint studies take into account the steps of land use change and consumer transport and wastage in the calculation scope. Within the evolving field of carbon footprint, calculation methodologies are multiple and still under construction to fit with growing expectations.

Despite bananas being an important product, only few carbon footprints analyses have been published, and the results have varied depending on the methodology and data: from 324g to 1.124kg CO<sub>2</sub>e/kg of bananas.

Although they defined different boundaries, banana carbon footprint studies have identified maritime transport (including refrigerants) as the main contributor to the banana supply chain carbon footprint, followed by the manufacture and use of fertilizers and the manufacture and preparation of carton boxes in packing stations.

These aspects should be taken into consideration when designing CBA for banana import from Ecuador.

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#### V. Potential impact on developing countries

A carbon border adjustment would be a tax levied at the border at a price that is commensurate with the carbon tax (or price) being applied domestically. An EU-wide carbon border adjustment would either (i) be commensurate with the cost borne by companies under the ETS; (ii) correspond to the carbon tax applied by each EU Member State (if the policy allows for different States to employ different tax rates); or (iii) be commensurate with a potential EU-wide carbon

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<sup>8</sup> "Carbon Footprint of the Banana Supply Chain", I6842EN/1/02.17, FAO, World Banana Forum, available at: <http://www.fao.org/3/a-i6842e.pdf>

tax, introduced into the common area. The objective of such a policy is to provide cost parity between the domestically produced and the imported product, so that they are both negotiated at equivalent prices within the EU common market, and so that domestically produced products are not disproportionately affected by the domestic tax.

The EU might consider granting a carbon border adjustment exemption to countries administering equivalent carbon taxes. Should the EU tax rate be higher than in partner countries, a partial exemption from the tax could be administered in the EU, corresponding to the rate employed in the third country of origin. Under a partial exemption system, the carbon border adjustment rate would correspond to the EU tax rate minus the rate already employed by the third state. The overall result would be to assess the carbon border adjustment at the full EU rate, while avoiding double taxation.

With or without these exemptions, **an EU carbon border tax may have an impact on developing countries in many ways:**

1. As products imported from developing countries might become less competitive than they are at the moment for the EU market if a carbon border adjustment is introduced, this could result in lower exports to the EU, with potential negative impacts on jobs in those countries if flanking measures as part of a just transition are not in place.
  2. Secondly, the carbon border adjustment would apply to goods from all countries, even the least developed countries. This does not take into account the Paris Agreement recognition that developing countries have differentiated responsibilities, as they have historically contributed far less to global emissions than early industrialized countries. While the EU should support an alternative development pathway, the EU should also respect the policy space of the countries in question, as well as international commitments in the area of climate action, finance and development. The EU could consider exempting least developed countries from a CBA or returning all proceeds from the CBA applying on imports from developing countries to those countries for their own budgetary needs.
  3. An additional concern is that the CBA, if it can only be adjusted down if exporting countries already implement a carbon tax or price, could in fact act as a penalty on developing countries for not having their own carbon tax. This ignores the fact that there are various legitimate reasons why some developing countries may have decided not to implement a national carbon tax, including fairness and equality concerns at domestic level - and that they might have more suitable policy options for supporting a just transition (for example, better royalties regimes on extractives). Carbon taxes, when poorly designed, can be regressive and have disproportionate impacts on people living in developing countries.
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## **VI. Conclusion**

Based on our analysis of potential impacts on developing countries, we conclude that, if the EU does decide to go ahead with a CBA, it must thoroughly consider in the Impact Assessment the following challenges:

1. Is the CBA an effective tool to discourage carbon leakage or high GHGs in countries exporting to the EU? Are there other measures that could be more effective, e.g. import standards regulations?

2. Is the CBA able to recognize and adjust when other national policies, practices or regulations beyond domestic carbon prices and taxes have led to reduced GHG emissions and benefits to the environment?
  3. Finding the right balance between respecting developing countries' policy space, export needs and the EU's policy coherence for development principle.
  4. How to ensure that low-income households in Europe are not unfairly and disproportionately penalized by higher prices on essential products? Social considerations will need to be taken into account to ensure that the cost of the carbon tax does not disproportionately fall on lower-income households, especially for products for which there are no sustainable alternatives currently available and accessible to them.
  5. Can the revenues from the CBA be used in a fair way? The revenues accumulated in Europe via the CBA when imposed on products imported from developing countries could be transferred back to the countries concerned for their own budgetary goals, in order to strengthen their domestic resource mobilization for financing of public services such as housing, education, health, environmental protection, or a just transition.
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## **VII. Our requests**

To consider in the Impact Assessment:

1. The social and economic consequences that a CBA may have on Trade and Sustainable Development (TSD) commitments assumed in the EU-Ecuador FTA.
2. The feedback on this issue from the sixth Sub-committee on TSD of the EU-Ecuador FTA.
3. The potential negative impacts on jobs in Ecuador.
4. The complexity of defining a clear single methodology to assess the carbon footprint of the banana supply chain.
5. The potential negative impact on low-income households in Europe when purchasing such an essential and affordable product as banana is.
6. All additional multilateral commitments, namely WTO and Paris Agreement.