Border Carbon Adjustment in the EU
Key messages from WWF
March 2020

If introduced, the Border Carbon Adjustment must be implemented as an alternative to free allocation and within a wider set of policies to ensure the decarbonisation of industry

The implementation of a Border Carbon Adjustment (BCA) has been discussed for many years as a potential tool to ensure emission reductions and protect companies' competitiveness in the EU.[1] Its introduction could possibly play different catalyzer roles in contributing to EU's industrial decarbonisation, and influence third countries to join the club, by:

> **Raising revenues**: if BCAs are designed in a way of border tariffs, they could raise significant revenues for governments. These revenues should be 100% used for climate action in EU and abroad[2];
> **Acting as a political incentive**: incentivise other trading partners to establish their own carbon pricing measures, in order to retain the revenue rather than have it kept by EU[3], and therefore help these countries to reduce their emissions and potentially invest in low-carbon technologies[4];
> **Supporting regulatory alignment on the EU's environmental standards**: encourage current non-compliant third-countries partners to take action in complying with EU environmental norms & protections;

However, this highly depends on how the BCA will be designed and whether it will be based on the current carbon price.[5] In the **absence of an effective carbon price**[6], the implementation of a BCA cannot guarantee that it will play an important role in driving the EU industry's decarbonisation. Only with a **significant and rising carbon price**[7], a BCA could really encourage **investments in low-carbon technologies both in the EU and internationally**[8] and potentially **act on prices for commodities.** In the current COVID-19 context, the carbon price is sinking **and has reached its lowest levels** since July 2018 (16 euros per tonne), and will barely recover in 2020.[9] Therefore, **stabilising the ETS price at an effective level seems to be a priority prior** to implement any future BCA. The fall of the EU ETS price will have an impact on public income from auctioning revenues and therefore on the funding of the

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[1] See: https://www.euractiv.com/section/trade-society/news/france-details-plans-for-carbon-inclusion-mechanism/
[2] Currently, the EU collects revenues from customs duties as an own resources. A mechanism to make sure these revenues are redistributed and 100% used for climate action should be foreseen and designed.
[3] Sandbag (2019), "*An overview of the issues around introducing Border Carbon Adjustments in the EU*", p.28
[4] However, it is important to acknowledge the political challenge linked to a BCA's implementation; and make sure that other trade partners countries don't feel disadvantaged (this could impact the international climate change negotiations within the United Nations Framework Convention on Climate Change as well as international trade)
[5] There is too much uncertainty right now related to the design of such mechanism. Would it be based according to the current EU ETS carbon price or a higher forecasted carbon price?
[6] Current carbon price is € 24.20 per ton, which is too low to encourage EU countries/companies to start investing in cleaner technologies, see: https://markets.businessinsider.com/commodities/co2-european-emission-allowances
[7] An effective carbon price could be reached at € 80.00 per ton, but not before 2030, please see: https://www.imf.org/en/Publications/FM/Issues/2019/09/12/fiscal-monitor-october-2019
[8] Sandbag (2019), "*An overview of the issues around introducing Border Carbon Adjustments in the EU*", p.24
[9] See: https://www.argusmedia.com/en/news/2088228-eu-ets-price-slump-yet-to-boost-coal-plant-margins

Innovation fund. Measures to ensure that rapid carbon price falls are avoided need to be introduced for the phase four of the ETS (2021-2030).[10]

In this context, the new Commission president, Ursula von der Leyen, has requested both the Executive Vice-President for the European Green Deal Frans Timmermans and the Commissioner for Economy Paolo Gentiloni to design a proposal for a BCA that would be fully compliant with WTO rules and address the risk of carbon leakage in the EU.[11]

Despite the implementation of a carbon leakage list[12] by the European Commission (EC) for sectors qualified at risk, the evidence for the occurrence of carbon leakage as defined by the EU ETS Directive[13] and due to its implementation has been extensively argued.[14] So far, the European Commission has not been able to deliver evidence of carbon leakage in Europe. Our diagnosis is that, **in the absence of a significant carbon price**, there is a risk of an investment leakage rather than a carbon leakage in Europe. The latest EIB investment report (2019/2020) anticipates that EU manufacturing firms are planning to decrease investment in Europe for the year to come due to the slowing growth of the real GDP in Europe over the last year.[15] The current EU political context also has an impact on the EU firms' intention to invest in Europe (e.g. Brexit). Moreover, there is a need for investments signals now in manufacturing industries, especially in sectors with particular relevance to climate action such as chemicals, steel and cement as most of the plants' installations in Europe will need to be refurbished or replaced in the course of the next decade.[16] Investment in low carbon technologies, for these targeted heavy industries, must take place during this reinvestment phase in order to reach the carbon neutrality target by 2040. In this context, the BCA makes investment into emission intensive technology less attractive, but it would not provide an incentive or support for investment into low carbon technologies in Europe. Therefore, **the implementation of a BCA alone** will not mitigate this investment leakage and encourage industries to invest in low-carbon technologies in the EU. Thus, BCA **is not a 'silver-bullet', and its implementation alone will not be sufficient to achieve the carbon neutrality target by 2040**.

In designing a BCA, we ask that, if introduced, such measure should:

- Be designed and implemented as an **alternative** to free allocation of allowances in the ETS. A phase-in of BCA needs to be linked to phase out free allocation.[17] The European Commission Communication on the European Green Deal is proposing the BCA as an alternative to free allocation. We support this proposal in the case of BCA introduction[18];

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[10] Centre on regulation in Europe (March 2020), The COVID-19 crisis: a crash test for EU Energy and Climate policies, p.1.

[11] See: https://ec.europa.eu/commission/sites/beta-political/files/mission-letter-paolo-gentiloni_en.pdf

[12] The Carbon Leakage list was implemented in 2013 and gives higher share of free allowances to sectors, which qualifies as being at significant risk of carbon leakage compared to other industrial sectors. Please, see: https://ec.europa.eu/clima/policies/ets/allowances/leakage_en

[13] See Article 10b of the revised EU ETS Directive

[14] Ecorys (2013): https://ec.europa.eu/clima/sites/clima/files/ets/allowances/leakage/docs/cl_evidence_factsheets_en.pdf

[15] EIB (2019), Investment report 2019/2020, p.6: https://www.eib.org/attachments/efs/economic_investment_report_2019_key_findings_en.pdf

[16] Agora (2019), "*The Clean Industry for Europe (CI4E) – Package: Towards a climate neutral industry 2050*", Policy Brief, p.1.

[17] Sandbag (2019), "*An overview of the issues around introducing Border Carbon Adjustments in the EU*", p.15: https://sandbag.org.uk/wp-content/uploads/2019/12/2019-SB-Border-Adjustments_DIGI-1.pdf

[18] European Commission (2019), Communication on the European Green Deal, p.5: https://ec.europa.eu/info/sites/info/files/european-green-deal-communication_en.pdf

- Be designed in a way that it would cover only **energy-intensive sectors under EU ETS**, mainly steel, cement, and basic chemicals;[19]
- Be part of a wider set of policies to enable and promote the investment in low carbon industrial processes, energy efficiency measures and renewable energies to achieve the decarbonisation of industry. The introduction of **BCA is not the solution to tackle the lack of investment in low-carbon technologies**. In order to build a successful low carbon industry within the EU, it is key to develop a clear policy framework containing the following measures:
    - **Strong public innovation policy** targeted towards market introduction of low carbon technologies, which will ensure investments in low carbon technologies through a robust innovation fund and exclude support for fossil lock-in technologies;
    - **Contracts for difference or alternative measures** such as subsidies to mitigate investment risks and support heavy industries dealing with the higher operational costs of low carbon technologies;
    - **Obligation to purchase low carbon materials** through public procurement and introduction of norms, quotas and standards for low carbon materials to create a lead market for low carbon technologies.

Preserve and strengthen the EU Industry while achieving its decarbonisation, and reach carbon neutrality by 2040, will be possible only through the right regulatory environment.

[19] Sandbag mentions that it should be restricted to sectors with the following characteristics: 1) sectors covered by EU ETS (power and energy intensive industries sectors); 2) currently classified as t „risk of carbon leakage“ by the EU Commission; 3) sectors should be able to manage the monitoring and verification processes linked to the implementation of a BCA. See: Sandbag (2019), "*An overview of the issues around introducing Border Carbon Adjustments in the EU*", p.20: https://sandbag.org.uk/wp-content/uploads/2019/12/2019-SB-Border-Adjustments_DIGI-1.pdf