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## CARBON BORDER ADJUSTMENT MECHANISM

*This document gives the reactions from the Finnish Steel and Metal Producers to the European Commission's inception impact assessment (IIA) on carbon border adjustment mechanisms. Given the expected potential higher climate ambition for 2030, we recognize that additional and improved carbon leakage provisions may be needed. However, we believe that alternative measures than proposed CBAM-options (in the IIA) are needed and give our analysis of the strength and weaknesses of the proposed 4 options. Our proposal is, that EU should research and develop a different way to strengthen the existing carbon leakage measures bearing in mind the basic principles laid out at the end of our reaction.*

EU's long-term objective is to reach climate neutrality by 2050. European Commission in its Green Deal states "should differences in level 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". The Paris Agreement on climate includes a mechanism, where countries can increase their nationally determined contributions of reducing their GHG emissions. The next stock-taking meeting takes place in 2023.

The sectors that should be covered by the border adjustment mechanism should be limited to those that are currently deemed having medium or high risk of carbon leakage under the ETS.

The adjustment must be designed so that it sets the carbon price for imported products at the same level as the corresponding products have in the EU due to EU regulations. Imported products should not be discriminated.

Importers of the relevant products shall be obliged to certify the carbon emissions or product environmental footprint of the product, taking into account both the direct and indirect GHG-emissions of the production. The certification must be verified by an independent third party, e.g. accredited inspection company.

The adjustment mechanism can create a level playing field inside EU-market, but not at the export market. This is why it is necessary to maintain the existing rules for carbon leakage, free allowances and compensation of indirect costs, for European export companies. These measures must continue until up to 2030.

Indirect costs compensation does not exist in all Member States or the level of compensation varies from country to country. This creates distortions in the EU single market that cannot be tolerated. In the connection of carbon border adjustment mechanism there should be a separate fund that collects the adjustment fees.

In the following we give our analysis of the several options of the future form of CBAM proposed in the IIA:

1. Carbon customs duty on imports
2. Carbon tax on selected products – both imported and domestic products
3. Carbon border tax on imports only
4. Extension of the EU ETS to imports.

### **1. Carbon customs duty on imports**

This measure could be described a financial equivalent of the industry costs due to the ETS scheme and indirect costs. In this option the Commission will use the EU Common Commercial Policy (art. 192 TFEU) as a legal basis for CBAM implementation.

Strenght:

- It is relatively transparent, as there will be a stable price listed to non-EU countries
- Another advantage of this measure is that it would be voted as on the qualified majority by Member States. Nevertheless, it is more difficult defend under the WTO law, as the only argumentation is exceptions of art XX GATT.

Weaknesses:

- It is difficult to set the right level of tariff  
In particular, it will create a real difficulty to define the real equivalent of the industry costs, especially in case of indirect costs. In case it has be defined for each imported product, the importer will have to provide some evidence (audit etc) that it will be very difficult/ nearly impossible to control. In case of an average costs benchmark based on EU industry costs it can be difficult to implement politically, and might look like a protective measure, unless the importer will have the possibility to provide evidence to get a discount, in case his costs are lower than the estimated benchmark. In practice, it may lead to difficulties related to enforcements and controls.
- It is not clear how it will work for the concluded EU Free Trade Agreements  
They will need to be changed on ad-hoc basis, so EU will have to re-negotiate with the concluded deals with a significant number of countries
- It is not obvious how non-EU producers will be incentivised to produce greener products. If the tariff is set on the average costs level, it will be no incentive for the companies to improve. In case of individual rebates, it will be very difficult to control.

### **2. Carbon tax on selected products, both imported and domestic products**

Strenghts:

- This option might be easier to implement
- This instrument can be implemented as an Environmental Policy measure, which means it can be easier defended under the WTO law in comparison to Commercial Policy measures. Nevertheless, as this is instrument is of fiscal nature, which means that all Member States should unanimously vote for this. Some Member States might not support this option politically
- It covers both domestic products and imports, which fulfils the WTO requirement for non-discrimination of imports. (art. III of the General Agreement on Tariffs and Trade)
- This option will be more accepted by third countries, as it is an environmental non-discriminatory measure, so the risk of trade tensions with third countries is diminished.

Weaknesses:

- It is an additional tax on EU producers
- If introduced only on several products, it will create imbalances in terms of value-chain.

- In relation to the metals industry it will be very difficult to define the identical product due to the variety of products and specifications. For example, would a metal produced with means of coal be identical with a metal produced with means of electricity? In any case robust methodology is needed.
- It is not very clear, how the legislator envisages a measure applicable on domestic products as well, considering the current ETS scheme and indirect costs. Most probably, it is meant as an additional measure after and/or instead of existing ETS scheme.

### **3. Carbon tax on imports only**

Strengths:

- The carbon tax might be easier to implement, as it requires a price that importers need to pay.
- This instrument will be implemented as an Environmental Policy measure, which means it can be easier defended under the WTO law in comparison to Commercial Policy measures. Nevertheless, as this instrument is of fiscal nature, which means that all Member States should unanimously vote for this. Some Member States might not support this option politically.

Weaknesses:

- It will be considered discriminatory by third countries, which will increase the risk of trade tensions and possible WTO disputes.
- In order to calculate it, there is a need to know internal and external carbon prices and footprints. In addition, this information should be regularly updated. Thus, in practical terms, it is very difficult to implement it in a practical way.

### **4. Extension of the EU ETS to imports**

In this case importers would have to buy ETS allowances. If from the same ETS pool as EU producers, it might have an impact on EU market. If EU will create a separate pool for third countries companies, it might be considered as a discriminatory measure, so will again lead to trade tensions and WTO disputes.

## **Conclusions:**

As a conclusion the Steel and Metal Producers of Finland want to emphasize that all of the proposed options by the Inception Impact Assessment on Carbon Border Adjustment Mechanism have some advantages, but also some significant disadvantages. Therefore, there is no ideal option, so far, that would suit the purpose.

As a contribution by the Finnish Steel and Metal Producers we would like to offer our view on the basic mandatory principles to be incorporated to the possible system:

1. It is necessary that the system provides strong international incentives to decarbonise manufacturing conditions in third countries, but in the first place this requires an EU CBA which provides a level playing field with third country producers which are not subject to the same environmental constraints.
2. Any CBA regime must be based on the actual carbon footprint of imported products, i.e. not a simple average benchmark or ad valorem, for example. In other words, a product with a high carbon footprint must be taxed materially higher than a similar product with a materially lower carbon footprint.

3. To ensure proper incentives for third countries, any EU carbon pricing system, including a CBA mechanism, should not apply to products exported from the EU.
4. A carbon border adjustment mechanism must not replace, and a priori any transitional period of partial CBA application must not endanger:
  - An effective EU trade policy, including existing ordinary import duties and trade defense measures (anti-dumping, anti-subsidy and safeguards);
  - Existing EU carbon leakage measures, i.e. ETS free allowances, until a CBA mechanism is fully in place and seen to be effective;
  - Currently applied EU indirect cost compensation, to the extent the CBA mechanism does not effectively cover the entire supply chain, including energy inputs;
  - EU regulatory relief foreseen in the State Aid Guidelines on Energy and Environment (EEAG).
5. While the avoidance of additional administrative burdens is important, an effective CBA mechanism requires a legitimate and robust monitoring, reporting and verification (MRV) system for collecting and disclosing the direct and indirect emissions of the affected products. The effectiveness of the mechanism will depend on the details of its design and its ability to adapt in the face of absorption and source shifting.
6. Throughout the process of putting in place a comprehensive CBA mechanism, transparency and close dialogue with trading partners will be important.
7. To be coherent with the objective of the CBA, and the EU climate policy objectives in general, funds raised from the CBA should be used primarily to encourage investments in carbon-reducing technologies. Some of the funds raised could be used to provide assistance for (low-income) consumers to ease consumer burdens and increase societal support for the arrangements.

Contact: Kimmo Järvinen, managing Director, [Kimmo.jarvinen@techind.fi](mailto:Kimmo.jarvinen@techind.fi), phone +358 43 825 7642

## **ABOUT FINNISH STEEL AND METAL PRODUCERS**

Finnish Steel and Metal Producers is the voice of the Finnish Steel and Metal producers and major metal recyclers in Europe. With an annual turnover of €12bn, our members represent an essential part of the European machine- and construction value chain and employ directly and indirectly some 50 000 people. Together with the European mining and recycling industry, we are leading Europe towards a more circular future through the endlessly recyclable potential of metals.