

## **CARBON BORDER ADJUSTMENTS**

### **European Ceramic Industry proposals for a comprehensive impact assessment**

#### **Summary:**

In the context of the Covid-19 breakout where European democracies are experiencing situations and measures that had not been seen since World War II, any forthcoming EU policy will need to be adapted to the new societal and economic challenges which will arise in the aftermath of this crisis. Independently from the future impact of this crisis which cannot yet be anticipated, the impact assessment by the Commission of the proposed Carbon Border Adjustments (CBAs) mechanism should primarily try to understand if, when and how can CBAs strengthen existing carbon leakage measures. The impact assessment should also assess how the mechanism can preserve the competitiveness of EU products on export markets. The impact assessment should also address the fact that for sectors with similar characteristics as in the ceramic industry, CBAs do not appear to be neither feasible nor efficient in strengthening carbon leakage measures. Consequently, it will be even more important for these sectors to maintain the existing system of free allocations for best performers, potentially combined with other complementary policy instruments.

#### **Introduction and context:**

*The current health and sanitary emergency phase that Europe is dealing with is generating serious impacts on the economic stability of all EU Member States. These critical conditions require extraordinary interventions by the European Commission, which will inevitably require a reconsideration of the policies and instruments adopted and/or planned so far in order to avoid the collapse of the productive systems and the social cohesion in many countries. In this context the comments contained in this position paper should therefore be understood only as a technical contribution to the debate concerning Carbon Border Adjustments in the context of the inception impact assessment and future impact assessment.*

On 11 December 2019, the President of the European Commission, Ursula von der Leyen, unveiled the “European Green Deal” and the proposed the introduction of a Carbon Border Adjustment mechanism. With more than 1.200 installations in ETS manufacturing products as diverse as bricks & roof tiles, wall & floor tiles, refractory ceramics for industrial kilns, sanitaryware, expanded clay, clay pipes, tableware or flower pots, the European ceramic industry is well positioned to understand under which conditions Carbon Border Adjustments (CBAs) can be an effective instrument to help energy intensive industries moving towards carbon neutrality while remaining fully competitive, safeguarding economic and social aspects while achieving environmental goals. These 1.200 ceramic installations are mostly small emitters, representing more than 10 % of all ETS installations but less than 1% of ETS sectors’ carbon emissions. Largely composed of SMEs competing at global level, the ceramic industry is highly sensitive to overly complex and burdensome regulations and requires well balanced and simplified policy instruments.

In this context, Cerame-Unie sees the need for the impact assessment to take into account the following considerations:

**1) Carbon Border Adjustments should be designed to strengthen carbon leakage protection in the long term**

Depending on the outcome of the ongoing decision making process on ETS benchmark updates and on the fluctuations of the carbon price (from 30€ to 50 €/tCO<sub>2</sub>), the European ceramic industry anticipates an ETS cost under Phase IV ranging from € 1 Billion to € 3 Billion, assuming that carbon leakage measures and the 2030 targets for the ETS sector remain unchanged. In the absence of any carbon leakage measure, the cost for the sector would range from € 3.8 Billion to € 6.3 Billion. Over the last years the European ceramic industry has done great investments to maintain its competitiveness in a globalised economy and reduce the carbon content of its products. **Any decrease of the carbon leakage protection foreseen until 2030 would significantly jeopardise the ability of the sector to further invest in new and breakthrough technologies or to develop key technologies further to bring them to the market (marketability).**

**Policies merely increasing carbon costs on EU manufacturing without duly considering the carbon leakage risk will reduce EU carbon emissions from manufacturing as a result of relocation but will increase the EU's consumed carbon due to imports from countries with lower or non-existing carbon costs on manufacturing. That is why the main objective of CBAs should be to strengthen existing carbon leakage measures.**

**2) The CBA proposal shall be adapted to the characteristics of different industrial sectors**

Since the objective of CBAs will be to create an incentive for the decarbonisation of EU imports, this tool may only make sense for products where the EU market penetration of imports is already high. Consequently, **CBAs should primarily be targeted at sectors that are import intensive (as opposed to export intensive).** However, CBAs should always be conceived as a tool to complete and strengthen existing carbon leakage measures so as to deliver a genuine level playing field, not to replace those carbon leakage measures.

Moreover, considering the potential legal and technical complexity of CBAs, **such measures seem to be mainly feasible for homogeneous processes and products perceived as commodities.**

**For sectors such as the ceramic industry which has been considered as exposed to carbon leakage not because of import penetration but more as a result of a high carbon intensity combined with high exposure to exports and other market characteristics (e.g. low profitability and cost pass through ability, prospective exposure to imports, exposure to imports from countries in the peripheries of the EU, substitutability of products, etc.) while having a positive impact on the energy performance of buildings and contributing positively to the EU's environmental goals through its longevity and recyclability, CBAs would certainly be less efficient in establishing a fair level-playing field than existing carbon leakage measures.** Moreover, CBAs may prove very difficult to apply to heterogeneous products, disaggregated sectors and sectors with a high proportion of SMEs, three characteristics which prevail in the ceramic industry.

For such products and sectors as in the ceramic industry **it will be even more important to ensure the continuation of existing direct and indirect carbon leakage measures (including compensation of the indirect costs for the next ETS trading period).**

### 3) CBAs should preserve the competitiveness of European producers on export markets

It is necessary to ensure the competitiveness of EU exports to third countries, where the carbon constraint is absent or less ambitious than in the EU. The mechanism should thus include a **solution for exports**. For this purpose, **additional measures should relieve from EU ETS extra-costs European products exported to non-EU markets without (or with less ambitious) carbon reduction policies**. Since Art. XX of the GATT does not refer to the objective to maintain competitiveness as a ground to justify general exceptions, **the EU institutions should explore all possible legal basis to secure a level playing field for EU exports, including Art. XVI of GATT on subsidies**.

Moreover, the **risk of retaliation** from our trading partners should not be underestimated. The US have already warned the EU about possible punitive measures against the EU if they found the system to be protectionist in its essence.

### 4) CBAs should be WTO compatible

The mechanism needs to be fully **WTO compatible**, and thus should be built upon the key WTO principles of non-discrimination, differentiation and “likeness”. The possibility to derive from these principles shall be assessed under the exception allowed under article XX (g)<sup>1</sup> of the GATT, for environmental and climate objectives. **The measure must be justified by the objective to reduce consumed carbon**.

Accordingly, **the impact assessment by the European Commission should envisage different methods to determine the level of the carbon costs to be borne by imported products. Methods to be assessed include:**

- Carbon costs equivalent to the EU worst performers’ benchmark;
- Carbon costs determined by the real monitored emissions corresponding to the imported product.

**The assessment of these methodologies should take into account:**

- The capacity to deliver on the objective of reduction of domestic and global consumed carbon emissions;
- The ability to consider the full carbon content of products including the transportation phase of goods;
- The practical feasibility of these methods for different products and sectors, as different methodologies will entail different levels of complexity;
- The reliability and exposure to fraud and circumvention of these methods.

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<sup>1</sup> Art. XX (g) of the GAAT: “Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures: (g) relating to the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption;”

**By no means should the Carbon Border Mechanism foresee the possibility to grant exemption to the benefit of imports from least-developed or developing countries.** Considering the existing and future competition in many sectors between these countries and the European production, such exemption would seriously undermine the environmental objective of the measure.

**5) The proposal for CBAs should have a strong enforcement chapter**

The CBA proposal should anticipate the risks of circumvention of the mechanism and should ensure that provisions are foreseen to prevent such unfair practices through traceability, certification of the carbon footprint (reflecting the full life cycle and including notably shipping emissions) and enforcement of the rules of origin. The mechanism should avoid the use of average data and privilege product specific environmental data.

**6) Revenues from CBAs should be allocated towards the low carbon transition of the European industry**

The revenues resulting from the mechanisms should be allocated to transition and adaption towards the carbon neutrality of the European industry through a harmonised approach that equally covers all ETS sectors across Europe.

**7) The impact assessment should also consider other regulatory instruments**

The impact assessment should also assess the feasibility and efficiency of other regulatory instruments likely to strengthen the level-playing field by completing existing carbon leakage measures:

- **A VAT type taxation** applied to domestic products and imports reflecting their **carbon footprint**;
- The **strengthening of EU Trade Defence Instruments**, notably through a better consideration of environmental costs in the calculation of the dumping and injury margins;
- **Improving traceability and enforcement of rules of origin**;
- **Other trade instruments**:
  - **Multilateral trade instruments**:
    - Industrial subsidies and overcapacities (strengthening of WTO rules, use of EU anti-subsidy rules to tackle the absence of environmental costs as illegal subsidies)
    - **Tax measures on transport**
    - Further **negotiations under Art. 6 of the UNFCCC on emissions trading and carbon markets**
  - **Bilateral – Free Trade Agreements**
  - **Unilateral**:
    - **Public Procurement**
    - **General System of Preferences (GSP)**