European Steel Tube Association
Association Européenne du Tube d'Acier

Boulogne, April 30th, 2020

Inception Impact Assessment: Carbon Border Adjustment Mechanism (CBAM) Response of European Steel Tube Association (ESTA)

The Steel Tube industry in EU is because of its industrial and commercial specificities particularly exposed to the risk of carbon leakage. Due to the rising cost of CO2, it is essential to reinforce the protective measures in front of this risk. We support the goal of the European Union to fight climate change and make Europe the most sustainable economy globally. To achieve those goals, it is essential to put in place policies which strengthen the Union's manufacturing industry and keep EU manufacturing value chains competitive.

A carbon inclusion mechanism at the EU's borders can be an effective mechanism if it works in addition to the existing protection mechanism, consisting of free allowance allocations and compensation for the indirect costs of CO2.

- The European Green Pact significantly enhances the European Union's climate ambitions with objectives to reduce CO2 emissions in the medium term (2030) and longer term (2050). These measures will further accentuate the differences in the level of ambition of EU states at the global level.
- In this context, fighting carbon leakage is a condition for preserving the competitiveness of the EU steel tube industry, which also contributes to the reduction of CO2 emissions on a global scale thanks to better technical performance while maintaining employment and investment in Europe.
- In addition to the carbon costs to which it is subject, EU industry must also finance its own decarbonation, in order to meet the objectives of reducing CO2 emissions contained in the law. This involves investments in R&D projects, decarbonation projects or investments in better equipment.
- In the European Green Pact, the Commission explains that carbon leakage can materialize in two ways: on the one hand, by off shoring production to countries with lower or even zero levels of climate ambition, and on the other hand in the form of an increase in imported goods with higher carbon content. While the allocation of free allowances responds to the first problem, a CBA may be an effective instrument to provide a solution to the problem of emissions integrated into imported products. For our sector, it is important that the establishment of a carbon inclusion mechanism at the borders take into account the following elements:
  - A carbon inclusion mechanism at the borders must be complementary to the existing systems for protecting against the risk of carbon leakage, which are the allocation of free CO2 quotas and indirect CO2 compensation.
    This would in no way constitute double protection insofar as the current protection systems are partial and digressive. Even with the allocation of free CO2 quotas and

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indirect CO2 offsetting, European producers bear a carbon cost to which foreign competition is not subject. This difference is likely to increase in the future.

- European industry must also bear the costs linked to the decarbonation of industry (R&D projects, investments) in order to achieve the CO2 reduction targets, set by the authorities. Replacing existing systems with a carbon inclusion mechanism at the borders would risk jeopardizing industry investment in decarbonation.
- A mechanism complementary to the existing system would reduce the negative impact of a CBA on prices for downstream sectors in the EU and preserve the value chain as a whole.

- As proposed by the Commission, the mechanism could be applied to a few pilot sectors. Other sectors could adopt the mechanism later.
  - As mentioned by EUROFER in their response to the inception impact assessment on CBA (attached: EUROFER paper on carbon border measures), when a CBA could be applied to steel semi-finished products and finished products such as coils, flat and long products (attached) it is also important to preserve downstream products mainly based on the steel industry such as steel tubes.
  - To have a coherent focus on products placed on the EU market and to ensure proper incentives for third countries to reach a common approach with the EU on carbon pricing, any CBA should not result in the impairment of the competitiveness of EU exports to third countries.

- It is important that the establishment of a CBA does not lead to an abrupt modification of the existing provisions, in particular the rules which govern the period 2021-2030, which have been recently fixed. Preserving a stable legal environment, favorable to long-term investment decisions, is a condition for the success of the decarbonation of our sector.
  Furthermore the economic crisis, induced by COVID19 , has highlighted the importance of maintaining industry in Europe especially for a strategic sector like steel tubes , as supplies from non EU countries could be at risk in emergency periods.

ESTA is a member of Aegis Europe and fully supports their response to the inception impact assessment on CBA (Attachment: Aegis Europe answer on CBA).

Dominique Richardot
Secretary General

EUROFER
The European Steel Association

EU GREEN DEAL ON STEEL

EU CLIMATE LEADERSHIP REQUIRES WATERPROOF CARBON LEAKAGE MEASURES

WHY A CARBON BORDER MEASURE NEEDS TO COMPLEMENT TEMPORARILY FREE ALLOCATION AND INDIRECT COSTS COMPENSATION IN THE TRANSITION TOWARDS CLIMATE NEUTRALITY

This paper clarifies the reasons why it is appropriate from environmental, economic and legal perspectives to implement initially a carbon border measure as a complementary provision in addition to the existing carbon leakage measures.

The EU Green Deal is a landmark for the EU leadership in the international fight to climate change. The Green Deal proposes to step up substantially not only the long-term climate objectives for 2050 but also the short-term ones for 2030. Considering the current Intended Nationally Determined Contributions (INDCs) of international partners, this is likely to increase even further the differences in levels of ambition worldwide. This trend can be assessed by the end of 2020, when signatories of the Paris Agreement need to submit their final NDCs as well as their mid-century strategies.

In this context, avoiding the risk of carbon leakage is a pre-condition for preserving both the environmental integrity of EU climate policy and industrial competitiveness, since it contributes to reduce emissions at global level while maintaining jobs and investments in Europe. This will also be instrumental in facilitating the social acceptance of EU leadership in climate ambition.

Due to the market characteristics of the sector, tackling successfully the risk of carbon leakage in the steel industry is particularly relevant. As recognised in the 2018 Commission Communication "A clean Planet for All" as well as in the 2015 Impact Assessment accompanying the Commission proposal on the post 2020 EU ETS Directive, the steel sector is the most exposed among all energy intensive industries, both in terms of possible impact on output and on investment.

The Green Deal underlines that the risk of carbon leakage can materialise in different forms, "*either because production is transferred from the EU to other countries with lower ambition for emission reduction, or because EU products are replaced by more carbon-intensive imports*". As long as there is no international binding agreement with a global carbon price and equivalent efforts, it is essential that the EU legislation adopts effective measures that avoid all forms of leakage in the short term but also in medium term.

While free allocation is designed mainly to address the risk of production relocation, a carbon border measure can be an effective instrument to address structurally the emissions embedded in trade. This measure should take into account the carbon intensity and related costs in the EU and compare them with third countries.

The border measure should be applied for a transition period until breakthrough technologies reach sufficient market penetration and CO_2-lean products represent a critical mass in the market. It represents a broader contribution to a clean planet, as it is also an effective tool of political diplomacy to foster climate ambition in third countries so that deeper emission reductions are delivered globally. Furthermore, it would provide additional revenues to the EU that should be fully

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used for climate measures, in particular for the development and upscaling of industrial breakthrough technologies.

An effective carbon border measure needs to take into account both direct and indirect costs of the EU ETS and to create incentives for third countries' competitors to implement similar emission reductions. As proposed by the Commission, it should apply initially only to few sectors and others could opt in gradually. In the case of steel, it could initially apply only to steel finished and semi-finished products such as coils, slabs, plates, bars, billets, etc, and be extended to steel input materials (scope 3 emissions). A workable solution should preserve also those downstream products that are primarily based on steel, such as tubes, fasteners and wire drawings. The EU could adopt "Agreements of Equivalence" with third countries that either join the EU ETS or have identical CO_2 cost constraints for their industry, in which case there will be no border measure.

The effectiveness of the border measure will depend on the details of its design and its ability to tackle delicate issues such as the risk of absorption and source shifting.

With regard to the former, it is important to consider that EU carbon costs are applied to the entire EU production, while any border measure would likely apply only to the marginal tonnes that third countries' producers export to the EU, hence having the possibility to absorb such costs throughout their entire production. As an example, an EU producer with a total production of 5 million tonnes of steel and an average carbon cost of 10€/tonne will pay €50 million, while a third country producer with the same total production but exporting to the EU 5% of its production (250,000 tonnes) would face only costs of €2.5 million, which are much easier to absorb. By doing so, the EU imports would still set the price at a low level that does not reflect the actual carbon cost. From the example, it is clear that a measure based on average carbon costs spread over the entire EU steel production would not align the true costs of EU domestic producers with those of imports, continuing to erode EU domestic steel producers' competitiveness and render EU climate legislation increasingly ineffective.

Source shifting refers to the possibility that a third country producer exports to the EU the low carbon footprint products while selling products with high embedded emissions in other markets. This practice, which is prohibited in the Californian ETS, may prove difficult to identify and discipline.

These complex issues need to be fully solved in order to have an effective carbon measure. Applying full auctioning as soon as the border measures is implemented would expose the whole EU production to the full carbon costs in the decisive period where breakthrough technologies are being developed and upscaled. As long as EU imports would be setting the steel price at lower value, this situation would cause the concrete risk of leaking emissions, jobs and investments to third countries, hence undermining on one side the environmental integrity of the mechanism and on the other side the social acceptance of EU leadership in climate policy. This would be counterproductive for the successful implementation of the Green Deal.

Against this background, and considering all the elements below, it is essential that a carbon border adjustment is implemented as a complementary measure in addition to existing carbon leakage provisions in the transition towards climate neutrality:

- A carbon border measure aims to reach the combined environment objectives of the EU policy: reducing emissions, avoiding carbon leakage and complying with the costs of the cap & trade system. A complementary border adjustment would not lead to double protection, since existing carbon leakage measures are already partial and digressive. In fact, even with free allocation and compensation, EU producers bear carbon costs that are not applied to extra EU competitors. This divergence will further increase in the future.
- Moreover, EU producers are subject not only to compliance costs for the difference between their emissions and free allocation and between indirect costs and compensation (i.e. the

"trade" element of the EU ETS), but also to the full abatement costs that are necessary to develop the breakthrough technologies required to fulfil the emission reduction targets (i.e. the "cap" element of the EU ETS). A border adjustment replacing the existing carbon leakage measures would undermine their financial ability to invest in those technologies.

- While it is important to develop the border adjustment as soon as possible, its implementation should not lead to abrupt modifications of existing provisions in order to secure legal certainty for long term investment decisions. In particular, rules on carbon leakage measures for the period until 2030 have been adopted very recently and should not be modified.
- A carbon border measure implemented as a complementary instrument would also reduce the direct impact on trade flows and would mitigate trade tensions as it would provide a longer transition for negotiations with international partners to align climate ambition.
- Similarly, a border measure complementary to free allocation and indirect costs compensation would decrease the product price impact on downstream sectors within the EU, hence better preserving the entire value chain.
- As long as it is uncertain whether a border measure may address the environmental and competitiveness concerns linked to EU exports in third countries, a border measure with full auctioning for EU producers would burden them with the full carbon costs, thereby undermining their ability to access export markets.
- If a carbon measure is implemented with full auctioning for some sectors, the legal framework will lead to significant distortions of competition against other sectors that are still largely shielded from the carbon costs through free allocation and indirect costs compensation.
- It is clearly possible to design a WTO compliant carbon border measure that complements free allocation and indirect costs compensation in a transition period, since there is no WTO legal obligation to reduce or phase out these measures.

While a border adjustment based on the equivalent direct and indirect ETS costs can be an effective measure in the initial transition phase, a long-term regulatory framework is required for the advanced transition phase and the post-transition, i.e. when the breakthrough technologies reach sufficient market penetration and CO_2-lean steel represents a critical mass of the market, but operation costs are still significantly higher than for competitors with CO_2-intensive production. Such framework should be based on the actual CO_2 footprint of the product over the entire life-cycle, requiring the development of a proper accounting system, both at EU level and at the border

Inception Impact Assessment: Carbon Border Adjustment Mechanism (CBAM)

Response of AEGIS Europe

AEGIS Europe is an industry alliance that brings together more than 20 European manufacturing associations committed to manufacturing in the EU on a truly level playing field ensured by a rules-based free and fair international trade. Our members account for more than €500 billion in annual turnover, as well as for millions of jobs across the EU. We support the goal of the European Union to fight climate change and make Europe the most sustainable economy globally. To achieve those goals, it is essential to put in place policies which strengthen the Union's manufacturing industry and keep EU manufacturing value chains competitive.

We ask the Commission to consider the points expressed below in designing a proposal for any CBA mechanism. As a preliminary comment, and in the light of the current health and sanitary emergency and the economic crisis that will follow in the EU, it will be essential to adapt decarbonisation policies to the new context, in particular to avoid the collapse of productive systems and social cohesion throughout the EU.

1. Fundamentally, a CBA mechanism must be designed so as to contribute to the objective of decarbonisation in the EU by strengthening and completing existing measures protecting European industries from the risk of "carbon leakage", or the risk of relocation of manufacturing and investment. Accordingly, free allocations should be maintained as a complement to border measures to avoid all forms of carbon leakage. On the other hand, it must be recognised that for some sectors, CBAs may not be appropriate and complementary measures in addition to free allocations and indirect costs compensation should be considered. The underlying aim is to ensure the equal treatment of all products placed on the EU market with regard to the limitations and costs of decarbonisation measures.

- The CBA mechanism must in principle apply regardless of the country from which a product is imported. For example, the CBA must apply to products from a given country regardless of the preferential status of that country under EU legislation and/or the designation of that country as a developing country by a multilateral institution.

- The CBA mechanism must reflect the cap or limitation on EU carbon emissions as well as the costs for those emissions which are permitted.

- A carbon border mechanism must not replace, and *a priori* any transitional period of CBA application must not endanger, existing direct and indirect EU carbon leakage measures, including ETS free allowances and indirect costs compensation.

- A CBA mechanism designed in this manner can then provide strong incentives for third countries to decarbonise local manufacturing, and reach a common approach with the EU on carbon pricing and related issue.

2. This implies that:

- A CBA mechanism must not only consider the carbon footprint of imports but also reflect the overall carbon footprint of making those or similar products in the places where the essential manufacturing steps take place. Thus, while a CBA mechanism must in principle be based on the actual carbon footprint of imported products, i.e. not a simple average benchmark or *ad valorem*, other policies may be relevant in setting the carbon cost to be imposed on imports.

  Measuring the carbon footprint of imports and reflecting the total manufacturing emissions in the places where the essential manufacturing steps take place requires a proper and efficient system of measurement, with incentives and sanctions to maximise the cooperation of importers and their third country suppliers. In cases where data is not made available in a timely and complete manner, or cooperation is otherwise materially deficient, default values should be used which do not allow an opportunity for free-riding. The general acceptance of on-site verification visits at the places where essential manufacturing steps take place must be considered a fundamental requirement for cooperation.

- While full carbon accounting should, in principle, ultimately cover the entire value chain, upstream and downstream, from the primary raw materials and other inputs (including energy) down to final end products, and include transport to the EU port of final destination, a transitional approach with a border measure focused on the most carbon-intensive steps is a practicable starting point. Full carbon accounting in turn will require a robust analysis of the whole supply chain for each sector to capture sectorial specificities and needs, especially during any transitional period.

- A CBA mechanism must provide for appropriate and efficient cost adjustments to address trade flow manipulations such as source shifting and CBA absorption. This is an essential element to ensure the effectiveness of a CBA in tackling carbon leakage.

- Any steps taken to simplify measurements must not significantly increase the risk of CBA avoidance. In addition, the CBA mechanism must provide sufficient scope for adjustments to address any inadequacy that arises or becomes evident after implementation.

- To have a coherent focus on products placed on the EU market and to ensure proper incentives for third countries to reach a common approach with the EU on carbon pricing, any CBA should not result in the impairment of the competitiveness of EU exports to third countries.

3. While the minimisation 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 in the production of the affected products.

4. Also, while CBA enforcement would naturally be entrusted to Member States, there need to be sufficiently detailed rules at EU level to ensure the availability of timely information and the application of effective and dissuasive Member State measures to penalise avoidance.

5. Throughout the process of putting in place a comprehensive CBA mechanism, transparency and close dialogue with trading partners will be important. However, the EU must not be held hostage to delays in finding agreement before putting in place a fully functioning CBA mechanism. In addition, the EU must:

- be prepared to defend fully its CBA mechanism under existing international agreements, including the WTO Agreements, without backing down in the face of unilateral pressures from third countries;
- not revise the CBA mechanism in the context of agreement on bilateral or multilateral instruments that are only meant to support "green" technologies/products (e.g. Environmental Goods Agreement) or achieve other aims besides comprehensive and effective carbon pricing across borders;
- ensure that third country carbon pricing and limitation arrangements are effectively implemented, and compatible with EU arrangements (i.e. impose similar costs and limitations for a similar carbon footprint in a given sector), before agreeing to make any linkages with the systems of those third countries.

6. To be coherent with the objective of the CBA, and EU climate policy objectives in general, funds raised from the CBA should be used primarily to encourage research and innovation in carbon-reducing technologies related to manufacturing and facilitate their application in the EU.

7. The upcoming CBA impact assessment should be an integral part of a broader discussion between the EU institutions and all the stakeholders potentially concerned. In particular, the design of a CBA proposal should not be detached from the discussion and implementation of the New Industrial Strategy for Europe. At the same time, the elaboration of a CBA proposal should not pre-empt the strengthening and development of other EU policy instruments which can contribute to mitigating the risk of carbon leakage through a fair level playing field in relation to the many environment- or health and safety-related costs borne by the EU manufacturing sector but not fully by producers outside the EU.

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