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Carbon Border Adjustment Mechanism

1. Introduction

The document below is an attempt to draw preliminary conclusions on the concept of an EU-level adjustment mechanism on imports of products whose manufacturing process is accompanied by carbon dioxide emission ("Carbon Border Adjustment Mechanism", CBAM). It is based on the input of three sectors of the Polish economy associated in Business & Science Poland, namely **fertilisers, fuel-refinery and non-ferrous metal production**.

From the perspective of the above-mentioned sectors, introduction of CBAM at EU level is justified due to the need for support of the EU's efforts to mitigate CO_2 emissions. Lack of burden-sharing for the imported goods with a cost equivalent to that borne by the European industry means that non-European producers are not motivated to undertake pro-climatic efforts. This is counter-productive to the EU actions on environmental issues and furthermore poses a threat to the development of industry and jobs preservation in the EU[1].

The introduction of CBAM will serve the following purposes:

- will be an incentive to reduce the carbon footprint by the non-EU producers,
- reduce the incentive to relocate the EU industry under pressure of climate costs in the EU,
- restore the competitive balance of European energy-intensive industries vis-à-vis producers outside the EU.

2. Possible form of CBAM

Sectoral approach

Due to the innovative nature of this instrument, CBAM should be introduced gradually and on sector-by-sector basis.

During the testing phase of this concept, the system should be simple and easy to use, and the risk of retaliation should be minimised. These criteria are primarily met by the fertilizer sector which could, therefore, be covered by CBAM in its first phase. The following are in favour of covering the **fertiliser** sector:

- Easy calculation of the carbon footprint in the product
- Significant imports into the EU and small exports outside the EU
- A limited number of exporters to the EU, which would facilitate the system management.

The fuel sector[2] would also be a beneficiary of CBAM. In addition, sector-specific market access regulations would facilitate the management of the system (see further below).

[1] According to Carbon-Cap.eu, emissions generated within the EU fell by 13% between 1990 and 2010, but the actual EU carbon footprint increased by 8%. Many EU countries are net importers of carbon present in the end products.

[2] It would be preferable to cover only the diesel market for CBAM, as the European fuel sector is a net diesel importer. Gasoline imports to the EU are small while exports are significant.

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The non-ferrous metal production sector should not be included in the CBAM pilot phase. This is due to two factors:

- the pro-export nature of this activity and the related possibility of retaliation,
- challenges regarding the need to include also indirect emissions in the CBAM, i.e. those generated in the production of electricity, which is an important cost element for this sector.

3. Border Fee

The fee resulting from CBAM should apply when the foreign product is admitted to the EU market, i.e. at the moment of importation. The importer under the customs procedure has the necessary information needed to determine the amount of any CBAM fee: name of the goods, customs code, as well as the manufacturer and the country of origin.

In the case of the **fuel sector**, this solution can be modified. Due to the requirements of the Renewable Energy Directive (RED), admission to the market of the imported fuel as well as the EU-produced fuel takes place under the strict supervision of the market regulator or tax administration. This enables efficient charging of fees under the existing fuel admission system.

The collection of fees at this point for both EU and imported fuels would also enable the introduction of more far-reaching solutions, i.e. the transfer of the carbon footprint fee from the **production** process (as currently assumed by the ETS) to the level of fuel **consumption**.

The preferred solution, however, is to introduce an additional fee at the border (or at another entry point to the market), **rather than extending the existing ETS to imports** as well. If ETS would include the imported goods, the demand for allowances will increase sharply and increase prices to the unbearable levels. This would imply the need to increase the amount of emission allowances and would politically complicate the process.

The **amount of the fee** should take into account:

- **the difference between the product's carbon footprint in the EU** (determined on the basis of the ETS reference point) and **the country of origin of the imported product**,
- the average price of the EU emission allowance.

ETS generates the cost per ton of a given product manufactured in the EU according to the formula: carbon footprint in a product x price of emission allowance[3]. As a rule, a similar cost should be charged to the imported product.

4. Basis and individual rate

In this way, the basic fee for a given product from a given country would be **calculated and automatically updated** and charged at the border.

Due to the WTO requirements, the border fee cannot be discriminatory. Therefore, the system should provide for the possibility of adapting the fee as much as possible to the **specific level of emissions of the imported product** and the possibility for the individual exporter to show that it is:

- lower than the adopted reference point in the EU,
- lower than the one adopted generally or for a given country.

[3] The cost of emission allowances is evolving, therefore, an average of several months should be used. This would imply an analogy to the anti-dumping system which allows the calculation of the duty rate based on historical data.

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The fee set in this way would be **individual**. A similar solution occurs under the system of anti-dumping and countervailing measures.

The individual rate should be calculated according to the same formula as the EU reference point: *carbon footprint x average EU emission price* (in the chosen period).

5. Existing tools and CBAM

There is an argument in the discussion that as a consequence of the introduction of CBAM, it is necessary to eliminate the existing instruments preventing *carbon leakage* (ETS free allowances, compensation for indirect emissions).

In our view the conditionality "CBAM" or "existing instruments" is flawed.

- CBAM's aim is to incorporate imports into climate policy. This is the only instrument responding to the problem of the EU's carbon footprint related to imports.
- CBAM is a new concept which requires testing and a pilot approach. Replacing the proven instruments with an unverified one would be irresponsible towards the EU industry and provoke resistance - to the detriment of the EU climate policy.
- Further, free ETS allowances and compensation for indirect emissions seem to be the only WTO compliant instrument to counteract the loss of competitiveness of the European industry on export markets, where competitors are not burdened with the cost of climate policies. CBAM will not address this problem.
- In designing a CBAM, it is also imperative to take into account the costs of indirect emissions, i.e. those resulting from the use of electricity in industrial processes imposed by the ETS costs.

6. Summary

The CBAM system outlined as above would create market incentives for importing low-carbon products into the EU and wold be an economic incentive to reduce emissions worldwide. In addition, due to the possibility of obtaining a lower rate adequate to the individual emission level, the system will force exporters to strive for some form of confirmation by the EU that their emission level is below the EU reference point. Such a "certification" system would be the first step to introduce the EU ETS to EU trading partners. If companies from these countries are already "certified" in the ETS, the barrier of introducing a similar system in that country will decrease.

About BSP

Business and Science Poland (BSP) connects the experience of leading Polish enterprises with the EU agenda. We represent the knowledge and interests of successful entities, which employ over 100 000 workers in Poland, EU and globally. We are committed to advancing the values of EU Common Market in sync with the needs to transform it responsibly and effectively.

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