IFIEC Europe's response to the Inception Impact Assessment on Carbon Border Adjustment Mechanism (CBAM)

Improving carbon leakage protection of the European Union

Executive summary

In December 2019, the European Commission adopted the European Green Deal. In relation to policy measures to prevent carbon leakage the European Commission considered the introduction of a carbon border adjustment mechanism. IFIEC Europe welcomes the initiative of the European Commission to assess how the carbon leakage protection of the European Industry can be enhanced when the EU's ambitions with regard to climate protection exceed these of other third countries. This is a prerequisite if Europe would like to maintain its climate ambition and leadership in the world. But IFIEC also recognizes that full carbon leakage protection with existing instruments becomes more and more difficult with increasing climate targets. IFIEC Europe recommends to take the following aspects into account, when designing new or improving existing policy measures that aim at reducing the risk of carbon leakage: In the following sections these aspects are described in more detail.

1. **Effective carbon leakage safeguard policies needed, especially with increased climate ambition.**
   It is crucial that the future carbon leakage protection policy mix remains at least as effective as the existing measures, both for importing and exporting sectors, so that the European industry can play an active role in the transformation of our economy into a low carbon society and to make the European Green Deal a success. The EU ETS with sufficient level of direct and indirect compensation shall remain the key policy for this. If additional carbon leakage protection policies are required due to increasing ambition, they must supplement rather than substitute the existing measures.
2. **Detailed impact assessment needed on all possible policy instruments.**
   In case of increased climate ambition, the European Commission should conduct a detailed impact assessment to thoroughly assess the effectiveness of a CBAM. In parallel, impact assessments on other potential or existing carbon leakage protection policies need to be conducted and compared with the effectiveness of a CBAM. Key is to fully understand the impact the introduction of a CBAM or alternative measures would have on all the stakeholders affected.
3. **Complete industrial value chains need to be assessed in transparent way in cooperation with all stakeholders.**
   Industrial sectors and value chains are very complex interdependent entities, affecting and affected by the competitiveness of their other value chain actors. The introduction of any new policy measure and their impacts must be carefully assessed, in order to avoid disrupting their functionality. The European Commission should also analyse the characteristics and needs of different value chains and industrial ecosystems. The analyses should be conducted in a transparent way and should closely involve all the stakeholders concerned. IFIEC believes that a structured dialogue and cooperation between the European Commission and the industry sector must be established to investigate the regulatory framework needed.

1 Objectives and policy options

The Commission notes in the IIA that the main objective is the reduction of greenhouse gas emissions and avoiding carbon leakage. We believe the EU ETS, with its cost compensation, is the most cost-effective policy measure to achieve greenhouse gas reductions in the EU while avoiding carbon leakage. The Commission then states that the "starting point of the exercise will be the new baseline scenario of the EU Green Deal and its higher ambition for 2030". IFIEC believes that an increase of the EU's climate policy ambition should in parallel be accompanied with an enhanced set of policy measures that provide the European industry with an effective carbon leakage protection.

1.1 Type of policy instrument

The Commission states in the IIA that it will carefully assess the legal and technical feasibility of different policy options and their compatibility with the EU's trade acquis and other international commitments of the EU as well as the EU's Emission Trading System (EU ETS) and existing policy measures that aim at reducing the risk carbon leakage. Three policy measures are listed in the IIA as possible options for the implementation of a CBAM: 1) a carbon tax on selected products, 2) a carbon customs duty or tax on imports, 3) an extension of the EU ETS on imports. In relation to this, the Commission has stated in its Communication "A New Industrial Strategy for Europe": "Should differences in ambition around the world persist, the Commission will propose a Carbon Border Adjustment Mechanism in 2021 to reduce the risk of carbon leakage, in full compatibility with WTO rules. This should be supported by strengthening our current tools to tackle carbon leakage."[1]

We welcome the approach of the Commission to strengthen the EU's current tools to prevent carbon leakage. Further developing and strengthening the existing policy mix is essential to provide an effective carbon leakage protection. A CBAM must be considered as an additional complementary possible option. In the assessment, the Commission should also assess the way to improve existing policy measures, as these policy measures have proven to be somewhat effective[2] in the past to prevent carbon leakage and would only need to be partially adapted to provide better protection.

IFIEC Europe agrees with the Commissions statement in the IIA that a careful assessment of the legal and technical feasibility of a CBAM should be carried out. Assessing the impacts of a CBAM in general and the impacts of its different policy design options on the EU ETS as well as its compliance with international treaties and law is highly important. IFIEC Europe notes that some further aspects should be taken into account: the assessment should also encompass aspects related to the political feasibility, including options for the implementation of a global monitoring system in collaboration with third countries.

[1] European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, A New Industrial Strategy for Europe, COM(2020) 102 final, p. 8.

[2] Carbon and investment leakage have occurred in some sectors, despite the introduction of measures for carbon leakage protection. In the European non-ferrous sector 10 out of 35 primary aluminum smelters that were based inside the EU have closed. Investments have been redirected to third countries and the production has subsequently been replaced by CO2 intensive imports from these countries.

1.2 Methodological approach to evaluating the carbon content and carbon pricing of imported products

The Commission considers benchmarks as an approach to implement a CBAM and states: "To the extent that a sector is covered by the EU ETS, a border measure could be based on similar methodological considerations as for the ETS, i.e. benchmark values […]". IFIEC Europe notes that an approach that relies on carbon intensity could result in high administrative costs (see section 2.3 below). Moreover, not all production processes of a sector participate in the EU ETS. Implementing a CBAM with benchmark values would therefore either require that a) the CBAM and its benchmarks applies to all importers as well as non-ETS producers[3] or b) that the CBAM and its benchmarks applies only to imports that are manufactured in facilities with characteristics similar to those listed in Annex I of the EU ETS directive.

- Option a): including non-ETS installations in the CBAM would result in double pricing, as various EU member states have introduced carbon pricing mechanisms at the national level in form of carbon taxes as well as national trading schemes. The CBAM would in this case increase the risk of carbon leakage substantially, unless the national carbon pricing policies are removed.
- Option b): including only installations from third countries in the CBAM that match the characteristics of Annex I of the EU ETS directive would require the collaboration with third countries and independent verifiers. Proofing and monitoring that a product was indeed manufactured in an ETS-like installation would be necessary to avoid that products are falsely declared as being manufactured in non-ETS-like installations to circumvent the CBAM.

The Commission has stated that it will assess alternative approaches such as defining the carbon content of products. We agree that alternative methodological approaches should be analysed. A system for disclosing the carbon content of a product has not been developed so far. The data that would be required for this approach would at least include the information about the content of the product, the carbon footprint of each of the production processes involved in the production of each component (direct and indirect emissions)[4]. To take the whole value chain intro account, the Commission should also consider the emissions related to the transportation of imported products. Also, this approach would require the cooperation of third countries and independent verifies.

1.3 Sectoral scope

In relation to the sectors that could be covered by a CBAM, the Commission states in its IIA that "[a]n important part of the work will also relate to the selection of sectors subject to this measure. A scoping in terms of sectors concerned will have to be defined to ensure that the measure applies where the risk of carbon leakage is the highest". We believe that sectors at risk of carbon leakage should all be equally well protected and argue that this should not automatically result in the introduction of a CBAM. Rather, a policy measure should fit the needs of the industry. The legislator should duly take

[3] Excluding non-ETS installations would most likely result In WTO complaints from third countries.

[4] Existing norms allow for different modes of emission allocation for processes producing several products in combination, e.g. either by value or by mass. This leads to results which can differ by a factor of 10.

the characteristics of the industry into account, such as the complexity of its value chains, and then decide whether a CBAM or another policy measure is more appropriate as a complementary measure.

2 Preliminary assessment of expected impacts

The Commission noted in its IIA that the impacts of a CBAM on the economic, social, environmental and administrative dimension would need to be assessed. We agree that the impacts a CBAM would have on these dimensions should be assessed carefully.

2.1 The economic dimension

With regard to the economic dimension, the Commission specifically aims at assessing the impact on industrial value chains and effects on downstream and upstream sectors as well as economic efficiency of the policy measure. IFIEC believes that this is necessary, especially in case the CBAM would not be applied to finished goods due to the complexity of the model but more to upstream goods or activities: implementing a CBAM at the EU border would increase the prices of upstream goods that are imported and subsequently processed in installations within the EU. It will be important for the impact assessment to calculate the estimated increased costs of the CBAM throughout the value chain, and whether this in turn would result in an increased import of finished goods in Europe.

The Commission also aims at analysing the effects a CBAM would have on third countries and their markets. We believe that such an assessment is relevant. The analysis should be conducted in a transparent way and should closely involve all the stakeholders concerned. IFIEC believes that a structured dialogue and cooperation between the Commission and the industry- and energy sector must be established in addition to the envisaged public consultation, to thoroughly discuss and investigate the regulatory and trade related framework needed to prevent carbon leakage and to successfully master the transition to a low carbon economy.

The Commission states in the IIA that it expects positive impacts of a CBAM on research and innovation as well as the development of low-carbon products. IFIEC Europe believes that such an effect will only be realised, if certain additional conditions are met. The development of breakthrough technologies for the production of low-carbon products will require additional financial support, which must not be limited to technology innovation support, but also cover new applications and scale ups. To bridge the so-called 'valley of death', market barriers for low-carbon innovations must be removed.

If the EU would increase its climate targets for 2030 to 50 % to 55 % and would introduce a CBAM whilst other third countries would not raise their ambitions related to climate protection, export-oriented sectors would face the issue that their existing products become more and more uncompetitive at the world market, due to a rising EU ETS price and low or no carbon prices abroad, whilst low carbon products are not competitive on the world market either, due to the fact that in most cases the investment and operational costs of low carbon processes are much higher compared to existing production processes. Therefore, indirect cost compensation and free allocation should be maintained and improved and a rebate for exported goods for carbon avoidance costs should be foreseen to protect export-oriented production from the risk of carbon leakage. If a cross sectoral

correction factor is applied, the rebate should also apply to exports of current products, while taking into account which carbon leakage protection measures exist per sector.

If a CBAM is introduced the revenues should be primarily used to support exports. The remainder of the revenues should be used to reduce electricity cost of small and large-scale consumers. Reducing electricity prices is key for the success of the Green Deal, as most low-carbon production processes will either be using electricity directly or indirectly (e.g. via hydrogen and synthetic fuels produced form electricity). Other parts of the revenues should be used to facilitate research and development of low-carbon technologies as well as their market uptake and further improvement (e.g. energy and resource efficiency). We believe that a CBAM will not suffice to create a low-carbon economy and that the European industry further needs support of the European Commission and EU Member States.

2.2 The social dimension

The Commission points out that a CBAM could lead to price increases of consumer products, including products for basic needs. IFIEC requests an in-depth reflection on carbon pricing policies that focus on a carbon signal in production and consumption. The Commission should consider to mitigate these impacts by reducing other cost that consumers must bear. As stated above reducing electricity cost of industrial consumers can help to facilitate the market uptake of low carbon technologies. Reducing electricity cost can also help to make manufacturing less expensive, which in turn could mitigate price increases of consumer products.

2.3 The administrative dimension

The Commission states in the IIA that the introduction of a CBAM may require traders and authorities "to determine the greenhouse gas emissions associated with the production of an imported product" and that "[a]ncillary verifications, controls and audits of installations in third countries may be needed". There is currently no system in place neither in the EU nor at global level to determine and compare the carbon footprint of domestic and foreign products and/or producers. A robust monitoring, reporting and verification system will need to be established, ensuring legal certainty and equal treatment of international competitors.

From our point of view, determining the greenhouse gas emissions associated with the production of an imported product is a must or in other words an essential precondition for the functioning of a CBAM. Without the proper knowledge about the greenhouse gas emissions resulting from a production process a CBAM is prone to fail, as companies from third countries could otherwise claim that their products are carbon neutral and generate windfall profits.

The Commission has noted in its IIA that the administrative burden should be minimized and proposed to this end to use greenhouse gas emission benchmarks for imports from third countries. If a company certifies "a lower carbon content and/or a higher carbon cost at origin" for its product, the CO_2 cost related to the product would be adjusted. This approach would limit the need to assess the production process of companies in third countries to cases where companies prove that the carbon content of their product is below the benchmark. Ancillary verifications, controls and audits of installations in third countries would still have to be conducted on a regular basis to verify the actual emissions related to a product. Therefore, verifications should be conduction by an independent international

organisation. If the Commission considers to use a benchmark-based approach, the CBAM should apply a uniform benchmark. Differentiating between different third countries, country groups or regions could encourage exploitation. Products from one country with a relatively high benchmark could be transported other countries with lower benchmarks and exported from there into the EU.

3 Conclusion

In addition to the existing carbon leakage policy measures, additional protection is required. Therefore, IFIEC welcomes that the Commission will conduct an impact assessment. We suggest that this in-depth reflection should be extended to carbon pricing policies in general and on all possible policy options that would help mitigate carbon and investment leakage for exposed industries with regard to import and export. We would like discuss our arguments and ideas for a future EU energy and climate policy[5] with the Commission in more detail, to further contribute to the successful implementation of the European Green Deal.

About IFIEC Europe

IFIEC Europe represents 13 national European associations that comprise - on a cross-sectoral level - those industrial sectors for which energy is a significant component of production costs. IFIEC´s membership represents a diverse set of industries including: aluminium, automobile, brewing, cement, chemical, copper, fertilizer, food, glas, industrial gases, metals, paper, pharmaceutical, plastics and steel.

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[5] IFIEC Europe (2019): Coherent EU industry and energy policy will ensure a carbon neutral future. A paradigm shift requiring a new balance between energy supply and demand, Brussels, online available via: https://www.ifieceurope.org/fileadmin/user_upload/Coherent_EU_industry_and_energy_policy_will_ensure_a_carbon_neutral_future__IFIEC__August_2019_.pdf.