

## EEB's views on a Carbon Border Adjustment

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The [European Environmental Bureau](#) is Europe's largest network of environmental citizens' organizations bringing together over 160 civil society organizations in more than 35 countries.

The EEB welcomes the opportunity to contribute to the public consultation launched by the European Commission on the introduction of a Carbon Border Adjustment as announced in the European Green Deal.

The introduction of a Carbon Border Adjustment has been discussed at EU level for the last ten years. It has also been an [EEB demand](#) shared by a wider NGO community, but lack of political support at EU level has hindered its introduction.

As long as designed for the right purpose and in the appropriate way, the CBA can indeed complement the EU policy framework to increase climate ambition both at domestic and global level by addressing emissions embedded in imports and in final consumption.

The instrument should not aim to address global competitiveness through an environmental tax but, instead, address a global environmental externality (contribution to climate change) through an effective and fair global trade measure.

### Our policy recommendations

#### Policy objectives

- The CBA must have a clear environmental purpose, which is that of enabling stepping up climate ambition both at EU and global level within the framework of the Paris Agreement. For the EU, science calls for an effort of at least -65% GHG emission reductions by 2030.
- The CBA must not be conceived as a trade defense instrument and must not obstruct the faster decarbonization of the EU industry and economy.
- The EU ETS Directive must be revised to aim to achieve a carbon price of at least at €100/ton CO<sub>2</sub> before 2030 and set the provision that 100% of ETS auctioning revenues are to be used for climate-related purposes only.
- The CBA will have to be based on a robust monitoring, reporting and verification system and avoid "carbon dumping", i.e. the risk that companies keep dirty steel at home and export only carbon free products.

- A harmonized carbon pricing at EU level is key to avoid distortions in the internal market (both across Member States and across sectors) and loopholes allowing the persistence of subsidies to fossil fuels.
- The use of the “passerelle clause” or enhanced cooperation procedure foreseen in the environment title of the TFEU for energy taxation measures that have an environmental nature needs to be introduced to facilitate the related decision-making process.

### **Instrument design**

- Initially, in the short-term implementation phase, the CBA could be linked to the EU ETS system.
- The CBA must consider the footprint and emissions embodied in major bilateral trade flows, including CO<sub>2</sub> emissions embodied in goods and services imported for intermediate and final use, regardless of their origin.
- Once introduced, the CBA must replace free CO<sub>2</sub> allowances for EU ETS sectors.
- The EU-wide product-based benchmarks need to evolve into carbon performance requirements, to be set on a broader performance basis focused on end-use, making the EU ETS carbon market more future-proof.
- Existing carbon pricing systems (ETS/taxes) in jurisdictions outside the EU must be factored in.
- In the longer term, alternative approaches for calculating emissions, such as carbon product standards, should not be ruled out.
- Revenues must be used only for climate-related purposes and in no way end up in subsidizing fossil fuels, including through subsidies such as State aid granted to EU ETS industry.

### **Social implications**

- Civil society must be involved through a multi-stakeholder structured dialogue as soon as possible to identify and address all the potential social implications and distributional impacts.

### **WTO aspect and global dimension**

- A radical shift in global trade policies is needed in the context of the WTO to make sure that tariffs agreed under WTO reflect welfare losses due to negative climate and environmental externalities.
- Historical responsibility and environmental equity and justice must be factored in when designing the instrument.
- Climate diplomacy should be undertaken in a timely and effective manner by the EU in all relevant international fora.

## Our key messages and arguments

### 1. Framing the right context

The EU ETS Directive (Recital 24) of 14 March 2018 mentions the CBA as an instrument *“to adapt or complement any existing measures to prevent carbon leakage with carbon border adjustments or alternative measures, provided that such measures are fully compatible with the rules of the World Trade Organisation, so as to include in the EU ETS importers of products which are produced by the sectors or subsectors determined in accordance with Article 10a of Directive 2003/87/EC”*.

We welcomed this provision. However, we fear that the current debate on the CBA is losing sight of the core objective: **the instrument should not aim to address global competitiveness through and environmental tax but, instead, address a global environmental externality (contribution to climate change) through and effective and fair global trade measure.**

For this reason, first and foremost, we ask the European Commission to propose an instrument with the **primary purpose of protecting the environment and driving the fight against climate change threat** and not as a purely trade defense tool to safeguard the competitiveness of European industry. For this to happen, a **radical shift in global trade policies within the context of the WTO is needed.**

When designing such an instrument, aspects such as **historic responsibility and environmental equity and justice** must be factored in the notion of equivalence.

**Climate diplomacy** should be undertaken urgently in all the different fora such as the United Nations, the OECD, the G7 and G20 to build up multilateral support and consensus for this measure.

A **multi-stakeholder dialogue involving citizens and the civil society must be built as soon as possible.** Citizens must be timely informed on the possible social and economic implications of such a measure, which is politically challenging and could backfire in terms of social consensus on the fight against climate change (“Gilet Jaunes”-like reactions). The contribution of civil society to identifying distributional impacts and redistribution aspects and outlining corrective measures will be fundamental to avoid the worst consequences of a possibly unpopular policy choice.

To facilitate and speed up the introduction and administration of the instrument, the **CBA should initially be linked to the EU ETS system.** In this way, it could be conceived as a **tax on imports** equivalent to the costs incurred by domestic industries to buy carbon permits under the EU ETS Directive. However, in due time, this measure will need to factor in other important sectors not covered by the ETS, as well as the complexity of consumption patterns across the economies.

Generating **revenues** (i.e. EC's proposal to use CBA revenues as "own resources" under the new EU Budget endorsed by the EUCO in July 2020), should not be the objective of the instrument: the primary aim must remain increasing the ambition of EU industrial climate performances and policies without putting in danger the EU economy – and to drive non-EU economies towards low-carbon production. It is of the utmost importance that such revenues are invested in **climate-related purposes only and in no way end up in subsidizing fossil fuels**, including through subsidies such as State aid granted to EU ETS industry.

This should go in hand with reviewing the provision on the use of **auctioning revenues** in the ETS Directive and establish that **100% of ETS revenues are to be used for climate-related purposes** (currently, Member States are bound to destinate only 50% of ETS auctioning revenues to climate-related purposes).

## **2. The CBA must set an ambitious climate objective**

Climate change is a global threat and requires a global effort. The complexity of global industrial value chains and multinational business structures today is such, that we need a shift in scope to look at emission sources in the wider perspective of consumption patterns through instruments like carbon footprint. For this, it is crucial to consider **footprint and emissions embodied in major bilateral trade flows, including CO<sub>2</sub> emissions embodied in goods and services imported for intermediate and final use**.

For reasons which go well beyond climate and are mainly due to the globalization agenda, over the past twenty years the EU has delocalized most of its production in the manufacturing sectors. Today, a large amount of the products sold in the EU market are semi-final/final products produced outside the EU in countries where costs of labour and other resources are lower. These products do not compete with EU products but are mostly EU-branded (cases in point are the textile sectors, with large companies such as ZARA, H&M, COS manufacturing their clothes in Southeast Asia, India, or the IT and home-appliances sectors).

According to recent studies on [emissions in traded goods](#) in 2017, **the EU is a net importer of emissions**. Moreover, the OECD finds that the proportion of foreign CO<sub>2</sub> embodied in final EU domestic demand has remained relatively constant, at around 25%, in recent years despite new EU measures such as the Emissions Trading Scheme (ETS) and Renewable Energy Directive coming into force during the observed period.

[EU statistics](#) for 2014-2018 confirm that CO<sub>2</sub> emissions due to **final use of three product groups with the highest CO<sub>2</sub> emission footprint** (electricity, gas, steam and air conditioning/constructions and construction work/food beverages and tobacco products) have remained constant. However, **the EU-27 emits 0.4 tons CO<sub>2</sub> per person more to produce exports than it avoids by importing goods and services. This means that the EU exports more emissions than it imports.**

Tackling CO<sub>2</sub> emissions today requires a complex approach based on a robust common methodology and the CBA should pave the way to introducing measures beyond the notion of “carbon leakage” as currently defined in the ETS Directive to address all embedded emissions of the products sold in the EU market, regardless of their origin.

### 3. The instrument must consider the global dimension

In order to facilitate and speed up its introduction and administration, **the CBA could initially be linked to the EU ETS system.** In this way, the CBA could be conceived as a tax on imports equivalent to the costs borne by domestic industries to buy carbon allowances under the EU ETS. The cost would clearly vary depending on the country trade balance and importers would be required to pay a border carbon tax equivalent to the cost of buying the necessary number of carbon allowances at market price, for the average domestic company to produce the same product. However, some EU ETS industries deemed at risk of carbon leakage still receive a number of free CO<sub>2</sub> allowances until 2030. Therefore, **once it is introduced, the CBA will have to replace the granting of free CO<sub>2</sub> allowances to these industries to avoid double protection. This would create a veritable level playing field and make sure the CBA does not evolve into a protectionist tool and can be subsequently challenged by the WTO.**

Moreover, while creating a level playing field, the Commission should be careful to design **an instrument that will not delay the decarbonization of European industry.** For this, the CBA should complement a package of measures which will accelerate the decarbonization of industry to contribute to step up EU’s climate ambition by 2030. The revision of the EU ETS Directive should strengthen the CO<sub>2</sub> price (through lowering the ETS emissions cap and creating shortage of permits in the market) and introduce a carbon floor price to drive the shift to renewables and energy efficiency and circular economy.

The debate on the CBA has been hijacked by European industry which claims that the instrument should **provide additional protection to the free CO<sub>2</sub> allowances they already receive on the basis of a deemed risk of carbon or investment leakage.** Some EU industrial sectors have significant trade unbalances with non-EU countries which have not been driven primarily by the CO<sub>2</sub> price but by other economic factors linked to global trade (including oversupply).

Moreover, **today many jurisdictions outside Europe already have a carbon pricing system.** According to the World Bank (2020), there are currently 61 price initiatives (implemented/scheduled) at global level, of which 31 ETS and 30 carbon taxes. Therefore, the CBA will have to factor in such carbon pricing instruments in the calculation of the **equivalence** of the related tax for the specific product.

The CBA will have to be robust monitoring, reporting and verification system and avoid **“carbon dumping”**, i.e. the risk that companies keep dirty steel at home and export only carbon free products. This principle must be applied both ways (EU vs non-EU and vice-versa), meaning that we need to also

avoid that EU industry produces clean materials for the EU market and keeps on exporting dirty ones to less environmentally demanding markets.

#### 4. The EU ETS must be fit for purpose

The **EU-wide product benchmarking system** is technically complex and has many weaknesses, including lack of ambition and insufficient incentives for industries to improve their performance.

Benchmark values which set carbon efficiency levels to define the amount of free emission allowances now require a rethink. Current benchmarks set on a restricted range of high-emitting products and associated processes result in the free allocation of allowances for the worst-polluting installations. **ETS benchmarks need to evolve into carbon performance requirements, to be set on a broader performance basis focused on end-use, making the EU ETS carbon market more future-proof as a result.**

Driving clean industrial transformation needs a combination of market and non-market policy instruments. **The EU's Industrial Emissions Directive (IED) should be used to reinforce the market-based approach of the EU ETS** by ensuring full coherence on addressing all relevant environmental impacts, including climate protection. Greenhouse gas mitigation should be specifically included in the IED, as well as strengthening compliance monitoring with Environmental legal requirement.

**Alternative approaches, such as assessing the carbon content of products**, seem a more reliable solution despite being also challenging. One way to proceed would be to define default values according to materials and country of origin, with the possibility offered for concerned exporters to show a better carbon profile through primary data.

**Carbon product standards** for materials sold in the EU's single market and applying both to domestic and foreign producers, have strong environmental impacts and should be taken into consideration for further elaboration at EU level and be accompanied by an effective multilateral strategy to introduce them at global level.

#### 5. The EU should lead a radical change in the WTO and global trade policy

The WTO must be repurposed for fair and sustainable trade rules. The world today is very different from what it was when the WTO was established. Geopolitics have shifted, inequalities have increased, both between and within countries, and the climate and biodiversity crises have worsened. The WTO must evolve to better respond to these new challenges and priorities, in line with the framework of the **Sustainable Development Goals, the Paris Global Climate Agreement and the Convention on Biological Diversity**. Climate efforts in the WTO have so far focused on reducing trade barriers for 'green' products: exemption on the motive of positive externalities. Establishing a system for pricing (positive and negative) externalities from the production of traded products should be addressed by the WTO as a contribution to the fight against climate change. **The WTO could also play a role in renegotiating tariffs for the most polluting products: tariffs for negative externalities.**

The WTO should not impose any restrictions on the sustainability information requirements or performances that a trading partner can have, including with regard to the impacts of manufacturing processes to produce a product or material. On the contrary, the **WTO should progress towards a system of global transparency and disclosure of life cycle information and sustainability profiles starting with extracted raw materials, minerals and biomass.**

Currently, for various reasons, **tariffs agreed under WTO do not reflect welfare loss due to negative climate and environmental externalities.** Firstly, the climate issue was not appreciated in policy circles in the late 1980s and early 1990s when current tariff schedules were negotiated. The current tariff regime does not reflect climate and environmental impacts. Secondly, trade negotiations do not take into account environmental aspects due to economic interests and geo-politics. Thirdly, **the goods classification system does not distinguish between products according to the emissions that are released in their production process**, and tariff negotiations typically use broad formula that do not appropriately reflect climate effects or environmental impacts. The proposed new approach would use an existing, and reasonably well-functioning, multilateral framework to help address the global climate and environmental crises.

A case in point are **negative land use changes causing carbon emissions** (such as deforestation, draining of wetlands, ploughing of grasslands or over-grazing) in third countries driven by EU import of primary products or processed foods. These should be subject to a strict carbon border. Particularly, when it comes to **high-risk products such as palm oil, cocoa/coffee/tea, protein crops for livestock feed, timber and energy biomass** etc. importers of products from primary production and of processed food products must apply due diligence and monitor the supply chain to guarantee that no climate-harming land use change was caused by the production. If this cannot be guaranteed, the imports should either be stopped or be subject to appropriate carbon border measures.

## **6. Carbon pricing in the EU needs to be harmonized**

How is carbon priced in the EU single market? In too many ways, depending on the type of instrument (ETS vs national taxes) and the geographical scope.

In the **EU ETS**, due to historical oversupply of CO<sub>2</sub> permits in the market, largely driven by the system of free CO<sub>2</sub> permits to industry, the price has been below 20 EUR/tonCO<sub>2</sub> for most of the past ten years. It is now around 24EUR/tonCO<sub>2</sub> and expected to rise by 2030, as the ETS emission reduction target becomes more stringent and less CO<sub>2</sub> free permits will be granted, and due to the effect of other EU policies (RED II, EED, Ecodesign etc.).

Outside the EU ETS, so far 15 Member States have introduced **national carbon taxes** on top of the CO<sub>2</sub> price regulating the ETS sectors. National carbon taxes vary widely, both in scope and amount, and range

from less than 1EUR/tonCO<sub>2</sub> in Poland to over 100EUR/tonCO<sub>2</sub> in Sweden. The overall picture is uneven and makes it difficult to estimate the real impact on emissions reductions, the economics (costs/benefits) and their potential contribution to the EU GHG emission reduction targets.

This situation not only leads to **distortions in the internal market** (both across Member States and across sectors) but, more worryingly, to **loopholes allowing the persistence of subsidies to fossil fuels under many forms** (tax exemptions and reductions, State aid etc.). It also leads to an overall lack of effectiveness of the price signal which must contribute to drive the decarbonization of the economy.

The **Energy Taxation Directive (ETD)**, which establishes minimum taxation regimes for motor and heating fuels in the EU, is a case in point. It has never been revised since when adopted in 2003 and **does not factor in the carbon content of fuels**, while allowing for very advantageous taxation for gas and for a large number of energy uses. The potential to reform the ETD to allow explicit carbon pricing has failed in 2015 (the EC withdrew the proposal) due to opposition of some Member States, combined with the unanimity requirement for tax policy. No attempts have been made to using the enhanced cooperation procedure or the “passerelle clause” to move to Qualified Majority Voting, which itself requires unanimity to be introduced (see paragraph below).

## **7. The Treaty legal provisions on tax policy for environmental purposes must be implemented**

In the [Communication on Moving towards a qualified majority voting \(9 April 2019\)](#) in the area of EU tax policy, the EC points out that unanimity has resulted in several obstacles to efficient decision-making and proposes to **use the “passerelle clause” established in the environment title of the TFEU for energy taxation measures that are primarily of an environmental nature**, such as measures aiming at reducing CO<sub>2</sub> and other polluting emissions or improving energy efficiency, which are key priorities of the EU’s Energy Union strategy and of the Paris Agreement. Moreover, the **principle of enhanced cooperation** is laid down in the Treaty of the European Union (art. 40-45) to allow a coalition of like-minded countries to progress without being held back by others. So far, there have been no policy initiatives to use either the passerelle clause or the enhanced cooperation procedure. However, the urgency of climate change, Brexit and the commitment to the EGD and a carbon neutral Europe create a context where solutions rejected in the past may be reconsidered. Only with economic signals helping drive a transformation towards sustainability will the economy be part of the solution to the climate crisis.