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A Carbon Border Adjustment Mechanism considered by the EU Commission

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To reduce the risk of “carbon leakage”, where companies move production to countries outside the EU with less ambitious climate policies, leading to less economic activity in the EU and no reduction in greenhouse gas emissions, the EU commission is considering implementing a Carbon Border Adjustment Mechanism (CBAM) as an alternative to the current free allocation of allowances or compensation for the increase in electricity costs, which is basically a tariff on imported goods based on their carbon footprint. This mechanism proposes to counteract carbon leakage risk by putting a carbon price on imports of certain goods from outside the EU.

The VIK supports the discussion of the EU Commission to incorporate an improved emission trading scheme. In this regard, the VIK also generally welcomes all EU initiatives to improve carbon leakage protection for the European industry. The following aspects, however, should be taken into account¹. Before the outstanding issues and concerns listed below such as WTO compatibility, carbon footprint assessment, certification and verification system, risk of protectionism escalation, export refunds, etc. have been resolved, a CBAM system should not be introduced.

- A CBAM should not replace already existing measures such as the EU ETS free allowances and indirect cost compensation, since a CBAM alone will not provide sufficient carbon leakage protection.
 - It must be recognised that future free allocation of emission allowances will be further reduced, also due to new benchmarks, so it will be a challenge for the EU ETS to provide sufficient carbon leakage protection (already from the year 2021 onwards).
 - Also, current carbon leakage protection measures should only be replaced if a new measure ensures at least equivalent protection. Due to the unforeseeable consequences of a system change, the free allocation of

allowances and compensation of indirect CO₂ costs within the electricity price should be maintained at least for a transitional period.

- If a CBAM should be introduced, it needs to cover the entire value chain, from upstream to downstream production. Otherwise, the carbon leakage risk will only be shifted within the value chain, but not removed.
- There should be a complete cost compensation, for exporters, to offset increased production costs of climate-friendly technologies that disadvantage export into the global market. CO₂ avoidance costs must be compensated as well, to avoid not only carbon leakage, but also investment leakage.
- A CBAM comprises the substantial risk of lacking WTO compliance and potentially triggering international tariff conflicts as well as retaliation measures. Any such mechanism should be within the rules of existing WTO policies and not undermine the existing frameworks.
- There is currently no existing global agreement on how to determine carbon footprints of products and how to trace emissions throughout the value chain. As a consequence, the level of necessary bureaucracy as well as the risk of legal confrontation will increase. Carbon footprints lack clear scientific, objective, and reliable verification processes.
- Global certification systems would have to be implemented, to be audited by independent third parties. Risks of “green-washing” products for import into the EU, in particular those products that are energy-intensive by allocating CO₂-free energy to particular sectors (or even double-accounting CO₂-free energy), e.g. steel, cement or aluminium, must be considered.
- Another way of bypassing a carbon border tax would be transshipping, where products from a country without a carbon price are routed through a country with a comparable carbon price so that they appear to come from the second country.
- Funds generated through a CBAM should be used for the transformation of industry, such as supporting the research into and implementation of new, innovative technologies, and support systems such as, e.g., CfD (Contracts for Difference), or CCfD (Carbon Contracts for Difference).

Due to our concerns above and as it is questionable that a CBAM mechanism will sufficiently prevent carbon leakage, alternative methods that will provide carbon leakage protection and at the same time support the much-needed industrial transformation are equally important. To this end, different instruments such as, e.g., CO₂ consumption charges, CCfD/CfD or common international emission trading systems should be considered.

Der VIK ist seit über 70 Jahren die Interessenvertretung industrieller und gewerblicher Energienutzer in Deutschland. Er ist ein branchenübergreifender Wirtschaftsverband mit Mitgliedsunternehmen aus den unterschiedlichsten Branchen, wie etwa Aluminium, Chemie, Glas, Papier, Stahl oder Zement. Der VIK berät seine Mitglieder in allen Energie- und energierelevanten Umweltfragen. Im Verband haben sich etwa 80 Prozent des industriellen Stromverbrauchs und rund 90 Prozent der versorgerunabhängigen industriellen Energieeinsatzes und rund 90 Prozent der versorgerunabhängigen Stromerzeugung in Deutschland zusammengeschlossen.

ⁱ VIK would like to note that members of the automotive industry do not fully agree with this view, as they themselves are not energy-intensive, but are supplied by the companies that have participated in the preparation of the position as members of the VIK.