The European Green Deal

Impacts on the EU ETS and potential elements of a BCA

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Roundtable on
Climate Change and
Sustainable Transition

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- The EGD can be seen as an outline of the new Commission's commitment to tackling climate and environmental-related challenges.
- It is presented as **a new growth strategy** aimed at transforming the EU's economy and lists measures and legislative initiatives aimed at **achieving net-zero emissions by 2050**.
- The European Green Deal can be seen as a collection of priorities, principles and areas where legislative proposals will be produced in the coming years. At this stage, it is very broad and all-encompassing, and still lacking much detail.

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- **The EGD presented a package:**
  - To be implemented in pieces
  - No overall discussion
- **Three observations:**
  1. Parts may be missing
     - International cooperation
     - Market for low-carbon products
     - Incentives for removals
  2. Parts of the package may be inadequate, e.g. funding
  3. Timing
     - Addressing Paris Agreement asymmetry
     - Difficulties in reacting to many pieces

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1. Increased 2030/2050 ambition – implications for the EU ETS?

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- Net-zero emissions by 2050 is now the official target for the EU;
- A 50% target by 2030 is envisaged for the EU as a whole, with 55% being explored;
- **How** will this be translated in a target for the EU ETS?
  - Effort-sharing between ETS and ESR?
- **When** will the target/LRF be revisited?
  - At the start of Phase 4 seems unlikely, as a proposal is only expected in June 2021
    - European Commission will have to propose **a start date** for the LRF in order to reach the updated 2030 target
  - How long will it take to reach an agreement? – last revision took 2.5 years of negotiations. This will have to be taken into account by the Commission in its proposal:
  - For simplicity reasons: new LRF to start in second half of Phase 4 (2026)

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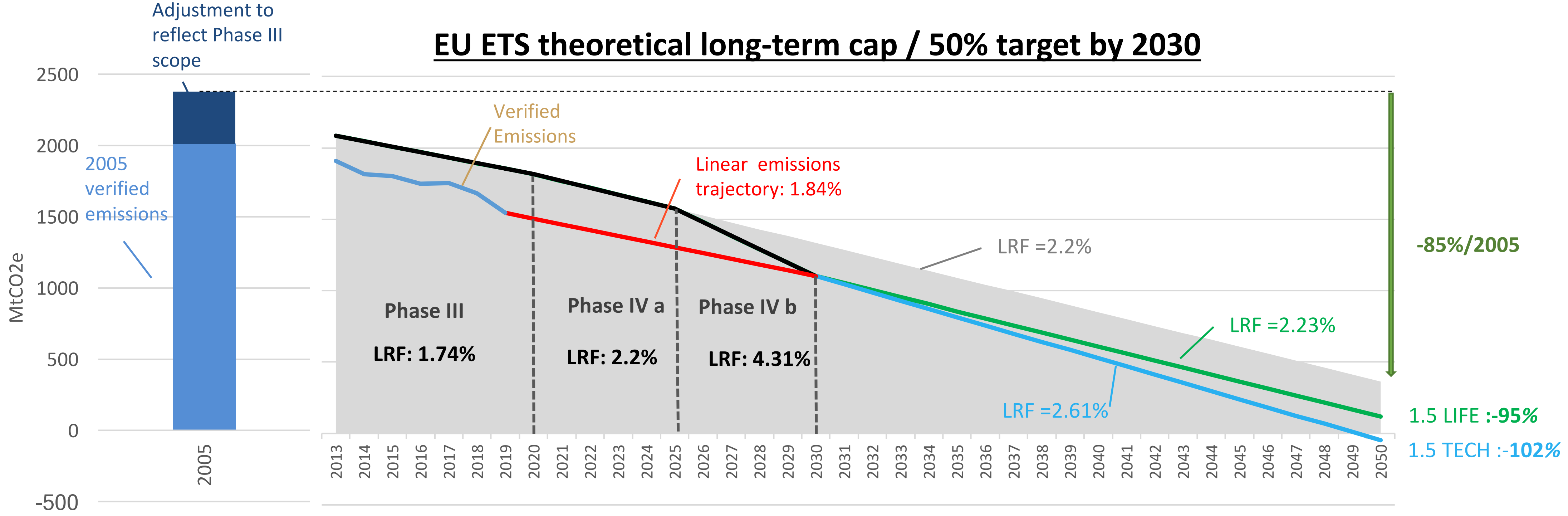
1. Increased 2030/2050 ambition – implications for the EU ETS?



Source: ERCST, with data from the Commission

- 50% target by 2030 with an enhances LRF to start in 2026

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1. Increased 2030/2050 ambition – implications for the EU ETS?

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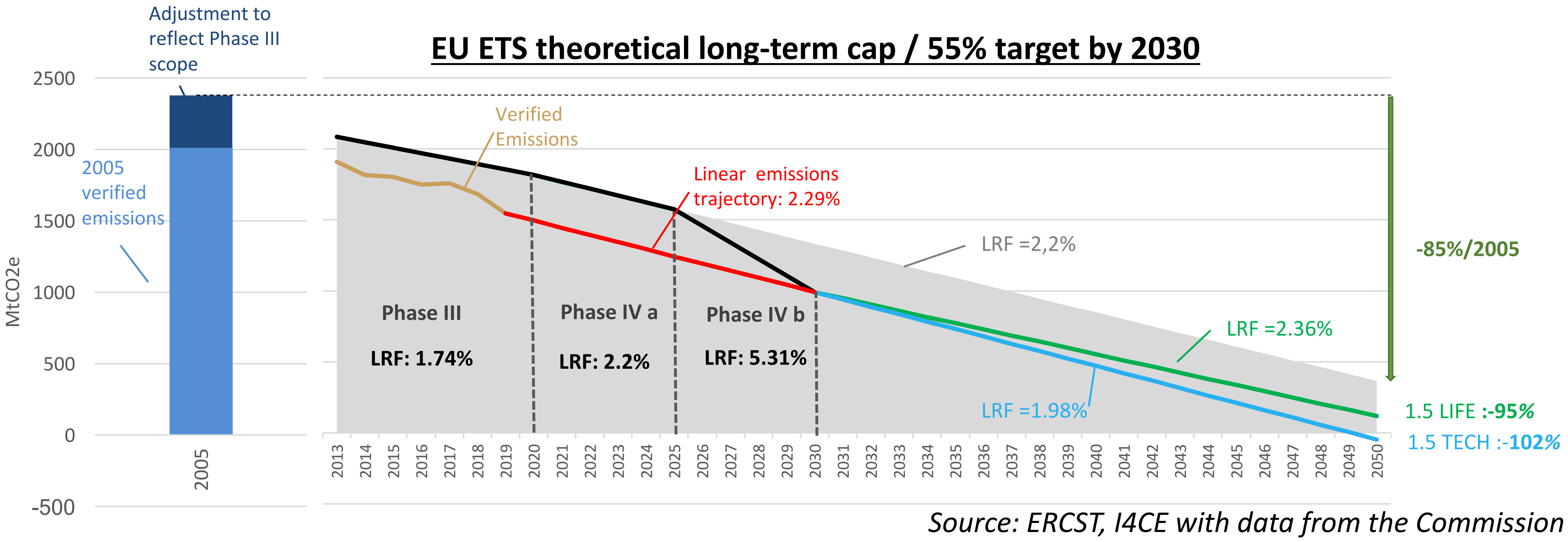

Source: ERCST, I4CE with data from the Commission

- 55% target by 2030 with an enhances LRF to start in 2026

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1. Increased 2030/2050 ambition – implications for the EU ETS?

"Conservative" demand scenario for free allocation

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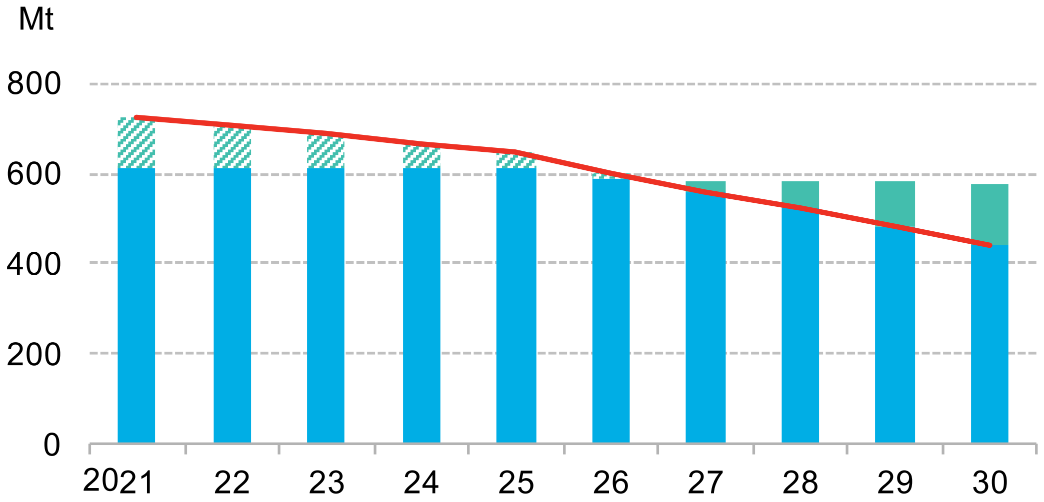
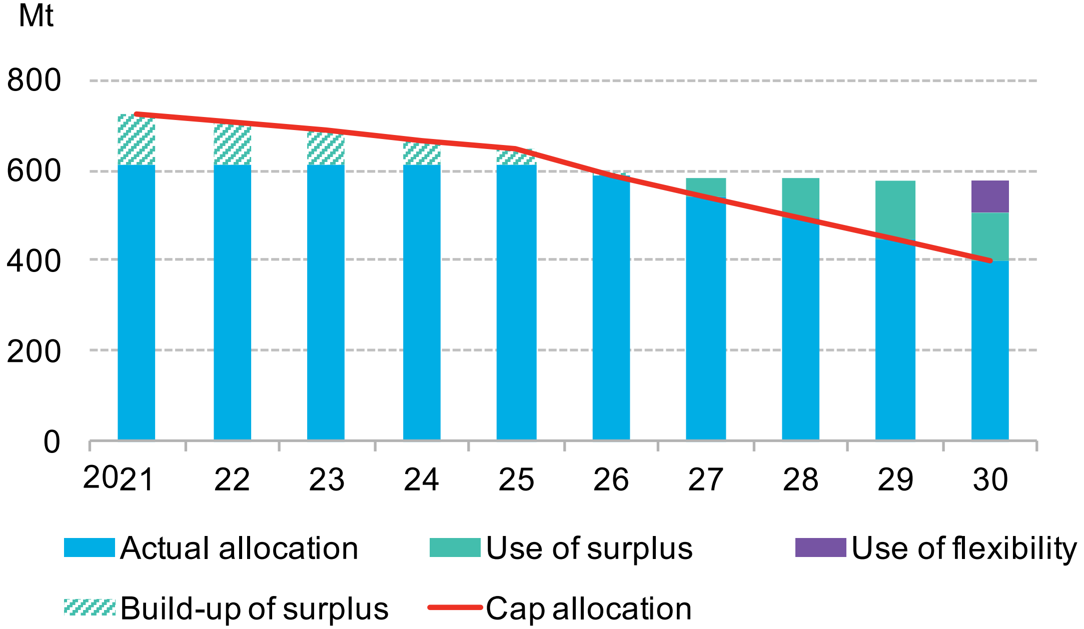
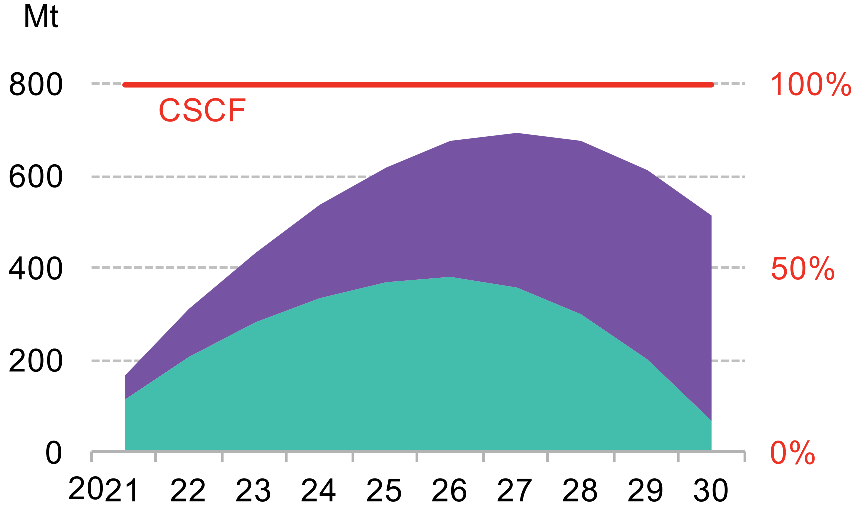
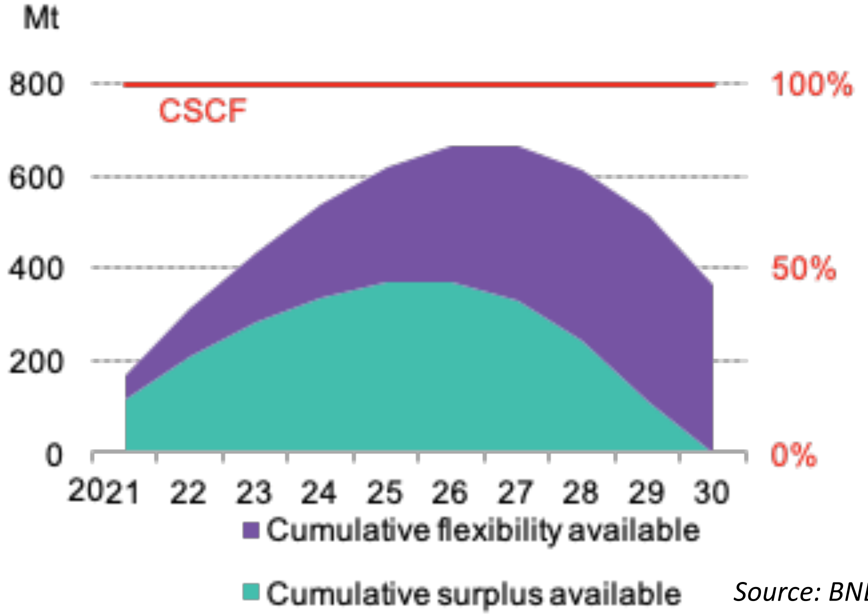
50% target by 2030



55% target by 2030







Source: BNEF

”High” demand scenario for free allocation

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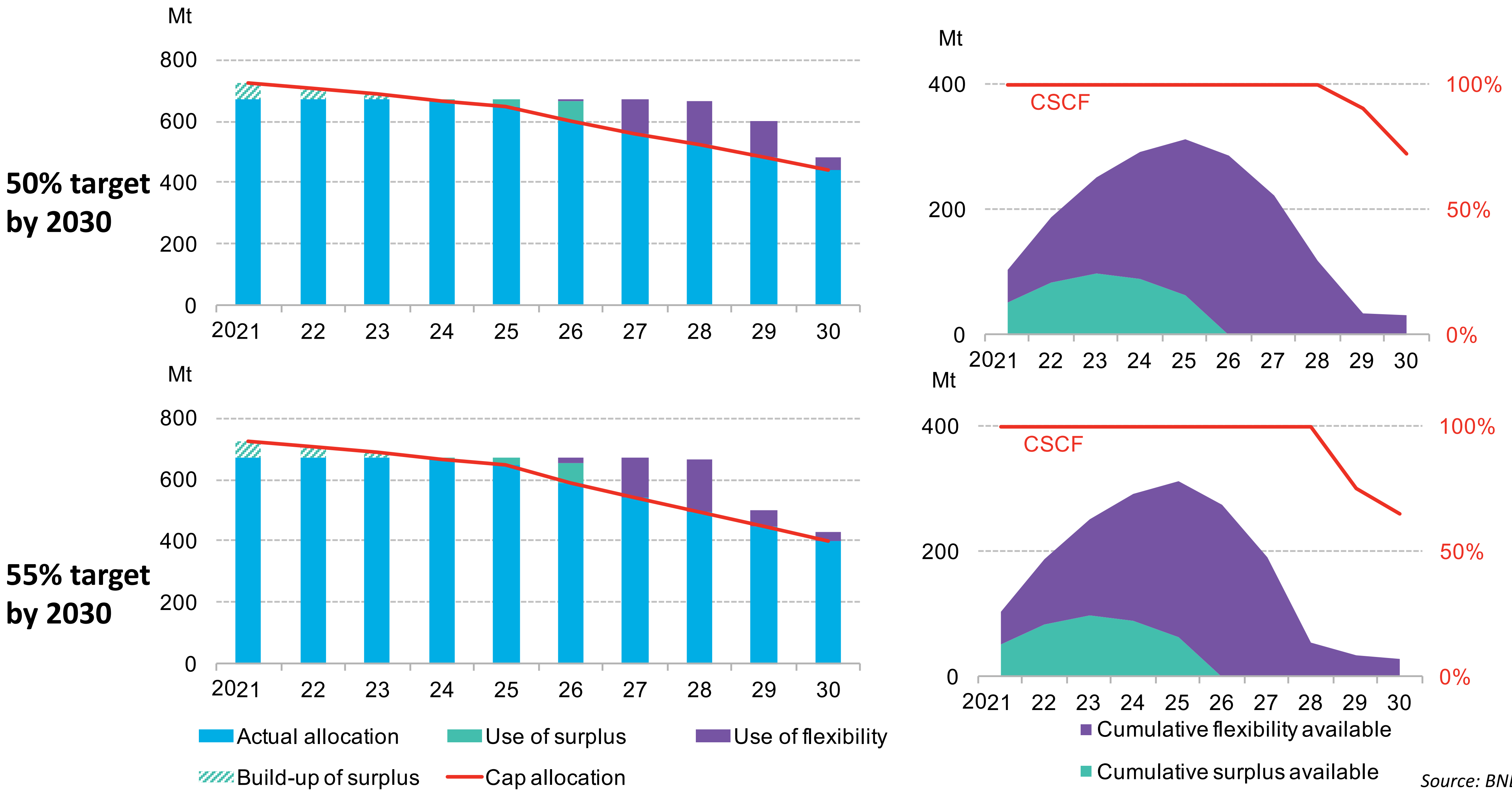
1. Increased 2030/2050 ambition – implications for the EU ETS?



Source: BNEF

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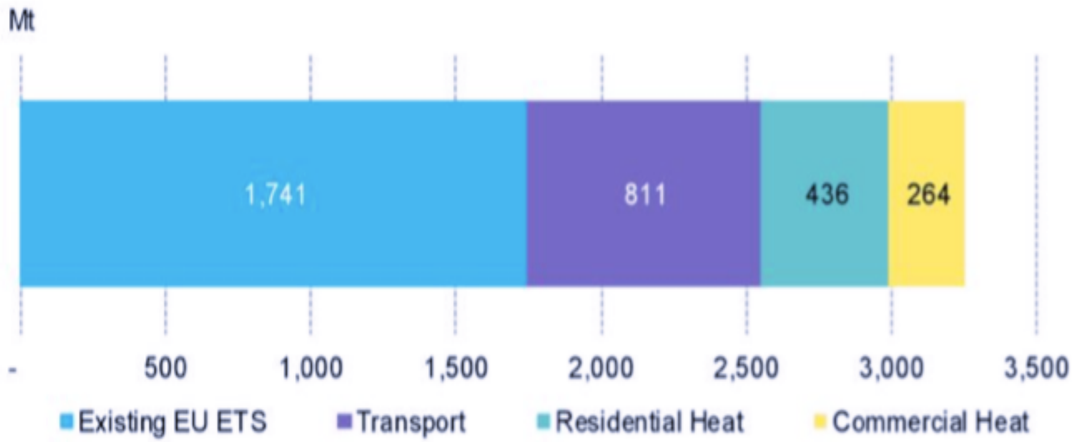
2. ETS Scope increase?

- EGD opens the door for inclusion of a number of sectors:
  - Shipping/international aviation
  - Road transport/buildings
- Inclusion of maritime shipping seems increasingly likely → how will it be included in the ETS? Similar to aviation?

Figure 6: Effect of adding EU-wide heat and transport to current EU ETS ($MtCO_2$)



Source: EU Commission, BloombergNEF

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3. Border Carbon Adjustment?

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- EGD sets out the aim of the commission to propose a BCA
- Still little details known, but it is sure that developing this will take some years.
- It would likely start with a number of selected (1/2/3?) sectors and be gradually extended, and it will be an *alternative to Free Allocation*.
    - Note: a side-effect of the introduction of a BCA as an alternative to free allocation would lower the risk of the CSCF being triggered.

BCA: Definition

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- **Border carbon adjustments (BCAs)** seek to alleviate negative effects of uneven climate policies by including imports and/or exempting exports
- They have three main **objectives**:
  - level the playing field in competitive markets
  - prevent leakage of carbon emissions to jurisdictions with weaker policies
  - incentivise trade partners to strengthen their own climate efforts
- They can take different **forms**:
  - a tariff or other fiscal measure applied to imported goods
  - extension of regulatory compliance obligations (e.g. ETS) to imports
  - a tax exemption or regulatory relief for exports

BCA: Why Are We Discussing This Now?

- **Asymmetrical climate change policies**
- **Old methods may not work**
- **Increased level of ambition**
  - Paris Agreement → continued asymmetry of climate efforts
  - European Green Deal
  - Carbon neutrality targets
- **How do we deal with competitive pressures and carbon leakage?**
  - Free allocation/compensation of indirect costs
  - Internationalization/linking/Article 6 Paris Agreement
  - Border carbon adjustments
  - Other options (e.g. consumptions charges; contracts for difference; product standards)?
    - **Consumption charges**: charge that extends the carbon price to consumers based on the weight and type of material in a final product
    - **Contracts for difference**: financial award for low-carbon investments based on the amount of avoided carbon and a set carbon price

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BCA: What Do We Know So Far?

- **Political Guidelines of 16 July 2019:**

  ‘To complement this work, and to ensure our companies can compete on a level playing field, I will introduce a ***Carbon Border Tax*** *to avoid carbon leakage. This should be* ***fully compliant*** *with World Trade Organization rules. It will start with a number of* ***selected sectors*** *and be* ***gradually extended****.’*

BCA: What Do We Know So Far?

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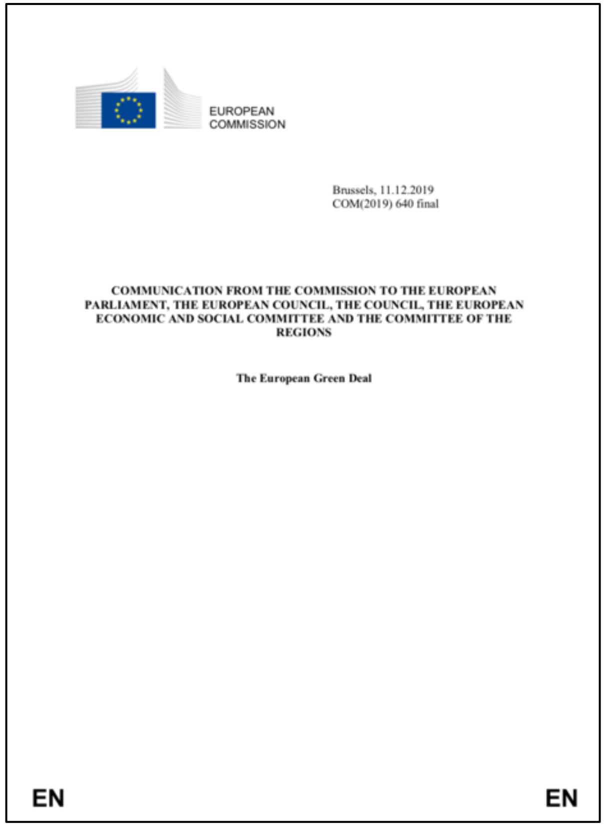
COM(2019)640 on the European Green Deal of 11 December 2019

*‘Should differences in levels of ambition worldwide persist, as the EU increases its climate ambition, the Commission will propose a **carbon border adjustment mechanism**, for selected sectors, to reduce the risk of carbon leakage. This would ensure that the price of **imports** reflect more accurately their carbon content. This measure will be designed to **comply with World Trade Organization rules** and other international obligations of the EU. It would be an **alternative** to the measures that address the risk of carbon leakage in the EU’s [ETS].’*


EUROPEAN COMMISSION

Brussels, 11.12.2019
COM(2019) 640 final

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

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BCA: What Do We Know So Far?

Inception Impact Assessment Roadmap (4 March 2020)

Timeline

- Feedback period: 4 March-1 April 2020
- Consultation period: First quarter 2020
- Commission adoption: planned for second quarter 2021

Issues to be studied:

- Type of policy instrument:
  - carbon tax on selected products (imports & domestic)
  - a new carbon customs duty or tax on imports
  - extension of the EU ETS to imports
- Methodological approach to evaluating the carbon content and carbon pricing of imported products
- Sectoral scope

Ref. Ares(2020)1350037 - 04/03/2020

European Commission

INCEPTION IMPACT ASSESSMENT

Inception Impact Assessments aim to inform citizens and stakeholders about the Commission's plans in order to allow them to provide feedback on the intended initiative and to participate effectively in future consultation activities. Citizens and stakeholders are in particular invited to provide views on the Commission's understanding of the problem and possible solutions and to share any relevant information that they may have, including on possible impacts of the different options.

TITLE OF THE INITIATIVE	Carbon border adjustment mechanism
LEAD DG – RESPONSIBLE UNIT	DG TAXUD Unit C2
LIKELY TYPE OF INITIATIVE	Legislative proposal
INDICATIVE PLANNING	2021
ADDITIONAL INFORMATION	https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en

The Inception Impact Assessment is provided for information purposes only. It does not prejudge the final decision of the Commission on whether this initiative will be pursued or on its final content. All elements of the initiative described by the Inception Impact Assessment, including its timing, are subject to change.

A. Context, problem definition and subsidiarity check

Context [max 10 lines]

The **European Green Deal** adopted by the Commission on 11 December 2019 includes the goal of enshrining the long-term objective of climate neutrality by 2050 in legislation and increasing the EU's climate ambition to reduce greenhouse gases emissions by 50-55% from 1990 levels by 2030. In this context, the European Green Deal emphasized that *"should differences in levels of ambition worldwide persist, as the EU increases its climate ambition, the Commission will propose a carbon border adjustment mechanism, for selected sectors, to reduce the risk of carbon leakage"*.

The Paris Agreement on climate, as well as strong international diplomacy and leadership, are the EU's main instruments to achieve higher climate ambition globally. By COP26 in November in Glasgow, Paris Agreement Parties need to communicate or update their climate commitments and submit their mid-century strategies, in line with the Paris objectives. The EU will continue to work with partners to raise the global ambition.

Problem the initiative aims to tackle [max 20 lines]

As long as many international partners do not share the same climate ambition as the EU, there is a risk of carbon leakage. Carbon leakage occurs when production is transferred from the EU to other countries with lower ambition for emission reduction, or when EU products are replaced by more carbon-intensive imports. If this risk materialises, there will be no reduction in global emissions, and this will frustrate the efforts of the EU and its industries to meet the global climate objectives of the Paris Agreement.

In this context, a carbon border adjustment mechanism would ensure that the price of imports reflect more accurately their carbon content. The measure would need to be designed to comply with World Trade Organization rules and other international obligations of the EU. It would be an alternative to the measures that currently address the risk of carbon leakage in the EU's Emissions Trading System ("EU ETS").

Since 2013, the risk of carbon leakage has been effectively addressed for those sectors regulated under the EU ETS that are exposed to the risk of carbon leakage – such as for example steel - by granting free allowances, based on the emissions performance of the best installations under the system (benchmarks). The EU ETS Directive provides for this system to continue at least until 2030. In addition, since the price of carbon is incorporated in electricity prices and passed on to consumers, possibly becoming an indirect source of carbon leakage for some energy-intensive sectors, Member States have the possibility to compensate some electro-intensive industries for the increase in electricity prices resulting from the ETS, provided they comply with EU State aid rules.

Basis for EU intervention (legal basis and subsidiarity check) [max 10 lines]

The legal basis will depend on the design of the measure. Both article 192 (environmental measures including

BCA: Elements

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- **Coverage of trade flows:** imports, exports, or both?
- **Policy mechanism:** tax, customs duty, extensions of EU ETS, or other?
- **Scope**
  - *Geographic scope:* all countries, or narrower scope/exemptions?
  - *Sectoral scope:* basic materials, electricity, compound manufactured goods?
  - *Emissions scope:* direct emissions only, or also indirect emissions?
- **Determination of embedded emissions:** based on avgs. or actual data?
- **Calculation of adjustment:** explicit carbon price differential, other?
- **Use of revenue:** EU budget, environmental investment, climate finance?
- **Institutions and process**
  - *Institutional governance:* designated institution/agency?
  - *Process flow and timeline:* study of feasibility/impacts, consultations, expiration?

BCA: Criteria of Analysis

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- **Environmental benefit:** Effectiveness in preventing emissions leakage and incentivizing climate action by trade partners
- **Competitiveness benefit**: Ability to level the competitive playing field and shield European industry against competitive disadvantage
- **Legal feasibility:** compatibility with international law, especially WTO law and the international climate regime *(see separate slide)*
- **Technical and administrative feasibility:** technical viability; complexity and cost of implementation (e.g. resource or data needs)
- **Political feasibility** with domestic constituencies and Member States, as well as potential to **disrupt diplomatic and trade relations**

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4. Use of revenues?

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- EC proposed to allocate 20% of auctioning revenues to its own budget in the European Green Deal;
- Council draft conclusions of 14 Feb 2020 included a proposal to have a new source of ’own revenues’: any revenues generated by the EU ETS exceeding the average annual revenue *per* Member State generated by allowances auctioned over the period 2016-2018 → significantly more than 20%
- EGD also includes wording on increasing the amount of EUAs available for the Innovation Fund + Modernisation Fund
    - Note: regardless of an increase in the amount of EUAs, the size of these funds is expected to increase as prices are expected to rise in a 50/55% scenario

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5. Review and role of the MSR?

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- Implementation of the EGD could simultaneously decrease *(tighter cap)* and increase *(additional overlapping policies)* the risk of oversupply in the market;
- The review of the MSR is scheduled in 2021, and will take place before the EU ETS directive will be revisited *(EC proposal only expected by the summer of 2021).*
- How is one to review the MSR parameters when many of the EU ETS parameters can be expected to change?
- **Will the 2021 MSR review become an "empty shell"?**

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- **What role will the EU ETS still play after 2030?** Will there still be enough liquidity for proper market functioning? *Expanding the scope of ETS could be one way of ensuring sufficient liquidity.*
- **Incentivising negative emission technologies** – not much wording on this in the EGD but it is an issue that is becoming increasingly important, and is increasingly being discussed in the EU – what role can the EU ETS play?
- In a world where the EU has increasingly higher ambition levels, and a world where BCAs get introduced, assessing and comparing climate efforts by other countries is becoming increasingly important → **effective operationalisation of Article 30 of the directive**?
- Increase flexibility / cost-efficiency – revisit the possibility to use credits generated by EU domestic projects and/or international projects (link to Article 6 of PA)