



Border Carbon Adjustments in the EU – Issues and Options

Stakeholder Meeting – Brussels, 5/3/2020

Andrei Marcu, ERCST
Michael Mehling, ERCST
Aaron Cosbey, ERCST

ERCST

Roundtable on
Climate Change and
Sustainable Transition

ERCST activities

- Project “Border Carbon Adjustments in the EU – Issues and Options”
- Report by Summer/Fall 2020
- Feedback to Inception Impact Assessment
- Discussion & Synthesis Paper on Feedback to IIA (May 28)
- International outreach
- EU wide outreach
- Organized discussions:
 - March 5th Stakeholders Meeting
 - March 25th High Level Meeting

Project Schedule

Timing	Action
March – July 2020	Preparation of the Draft report (analysis of BCA issues and options as well as alternatives to BCA)
April – July 2020	Webinars – EU & International Feedback & Public consultation
August 2020	Feedback on Draft report
September 2020	Launch Report in Brussels
Sept - Nov 2020	Tour of EU MS& international activities
September – December 2020	International activities

BCA Definition

- **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

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. consumption 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

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

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 prejudice 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 ambitions 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

The ERCST High Level Webinar March 25

- BCA seen as having created significant reactions in the past in EU trading partners
- International aviation in EU ETS still remembered as a tango by many
- What is needed is climate policy that benefits both domestic competitiveness and global climate is “*sweet spot*”
- BCA is part of toolbox, but not first option: low carbon products market crossing EU borders and high carbon price signal
- Developing country first reaction is: discrimination under pretext of climate policy: green protectionism

March 25 Highlights

- Any BCA will fail as a punitive action; we need a cooperative approach. Any scope of discussion? Under what forum?
- Some “technical “issues that were emphasized
 - Free allowances
 - Instrument options – it could be a carbon tax, a customs duty or, to some extent, an extension of the EU ETS
 - Key sectors start-up/pilots(fuels, cement, steel, electricity)

Feedback to IIA

- Objectives should be clear and include both carbon leakage and acknowledge competitiveness
- The IA should examine broader set of solutions – not only BCA
- Timing of any mechanism is critical
 - Is it envisaged only after 2030
 - Needs to be part of the package not a promise that will/MAY come ex-post
- Decompose into 12 design options: policy mechanism, trade coverage, geographic scope, etc.
- Focus on 5 criteria: environmental objectives, competitiveness, legal feasibility, technical feasibility, administrative implications
- Examine socio-economic impacts:
 - In EU
 - Outside EU

ERCST BCA Report Concept

- Decompose and analyze the main elements of BCA design and implementation (see below)
- Analysis based on 5 criteria (see below)
- Elaboration and analysis of 2-3 ‘policy packages’ that describe what a BCA could look like in practice

BCA Elements

- **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?

Criteria of Analysis

- **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**

Relevant Provisions of the GATT

Non-discrimination principles in WTO law:

- **Most-Favoured-Nation:** equal treatment of trading partners (Art. I GATT)
- **National Treatment:** equal treatment of domestic & foreign products (Art. III GATT)

Exemptions are possible under specific circumstances:

- Art. XX (b) GATT: measures '**necessary**' to protect human, animal or plant life or health
- Art. XX (g) GATT: measures '**relating to**' the conservation of exhaustible nat. resources
- Chapeau: "not ... a means of **arbitrary** or unjustifiable discrimination between countries where the same conditions prevail, or a **disguised restriction** on international trade"

Some consequences for BCAs:

- BCAs should **avoid differentiating** between trade partners & **account** for climate efforts
- BCAs should ensure fairness & **due process** and be preceded by serious **negotiations**
- BCAs should demonstrate a sufficient **environmental nexus**
- BCAs to exempt **exports** and BCAs **coupled with free allocation** are legally problematic

Criteria of Analysis

- **Environmental benefit:** Effectiveness in preventing emissions leakage, spurring innovation 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**

Coverage of Trade Flows

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Imports	Relatively greatest benefit due to maximum emissions coverage	Levels the playing field in the domestic market	Strongest case under Article XX GATT	More complex to implement due to data gaps and limited jurisdiction	Controversial as a unilateral, extraterritorial measure
Exports	Relatively lowest benefit due to reduced emissions coverage and pot. incentive for carbon-intensive exports	Levels the playing field in foreign markets	Risks being considered a forbidden subsidy under SCM Agreement; weak Art. XX GATT case	Least complex to implement because purely domestic and data readily available	Least controversial because purely territorial measure with no obligations for foreign producers
Imports & Exports	Environmental benefit between the two cases above	Levels the playing field in both domestic & foreign markets	Same as above, plus even greater risk under SCM Agreement	More complex to implement for imports due to data gaps and limited jurisdiction	Most controversial because of extraterritoriality and perceived protectionism

Initial Takeaways from Consultations

- **Exports need protection:** If a BCA only covers imports, some other form of relief may be needed for exported products. A BCA that does not make provision for exports will encounter strong opposition from industry and other stakeholders
- **Options** to support exports other than including them in a BCA include continued free allocation or compensation payments
- **Continued role of free allocation raises important questions:** will it remain in place or see gradual or immediate phase-out? What happens in sectors not covered by the BCA?

Policy Mechanism

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Carbon Tax	Neutral (depends on level of carbon price)	Neutral	Requires unanimous vote in the Council	Relatively easier to implement due to absence of trading component	Neutral
Customs Duty	Neutral (depends on level of carbon price)	Neutral	Can be adopted with qualified majority vote	May be easiest to implement due to ability to build on existing customs infrastructure	Neutral
Extension of the EU ETS	Neutral (depends on level of carbon price, and to lesser extent on price volatility/predictability in the market)	Neutral	Can be adopted with qualified majority vote, but potentially riskier under trade law (esp. re. exports)	Relatively more difficult to implement due to integration in/link to EU ETS market	Neutral

Initial Takeaways from Consultations

- **Extension of EU ETS raises important follow-on questions:** Would allowances be taken from the cap or from a newly created ‘virtual’ pool of allowances?
- **Council voting requirements may change:** Part of the European Green Deal process includes revisiting the unanimity requirement for fiscal measures
- **Policy mechanism has implications for revenue use:** Tax revenue accrues to Member States, customs duty revenue is shared between EU budget and Member States, EU ETS revenue would likely flow into the innovation and modernization funds. This question could feature in the negotiations on the Multiannual Financial Framework (MFF) for the EU budget

Implications for Free Allocation

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Free Allocation Unaffected	Least beneficial because of muted price signal	Most beneficial: playing field levelled inside and outside the EU	Could be considered a forbidden subsidy under SCM Agreement; weak Art. XX GATT case	Relatively difficult to implement due to continued need to define EITE alongside BCA	Relatively most controversial due to perceived unfairness
Free Allocation Gradually Substituted	Moderately beneficial because price signal strengthened	Moderately beneficial: playing field inside/outside EU levelled during transition period	Somewhat less risk of violating SCM Agreement; relatively stronger case under Art. XX GATT	Relatively most difficult to implement due to added need to decide on transition process	Relatively less controversial due to perceived fairness
Free Allocation Rescinded Immediately	Most beneficial because price signal strongest	Least beneficial: risk that playing field not levelled inside/outside EU, depending on BCA	Strongest case under SCM Agreement and Article XX GATT, but may result in compensation claims	May be easiest to implement if need for EITE benchmark definition falls away	Relatively least controversial due to perceived fairness

Geographic Scope

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
All Countries	Greatest coverage of emissions	Levels the playing field vis-à-vis all countries	Least risky under Article I GATT	Relatively more complex due to inclusion of largest number of countries	Somewhat controversial because perceived as unfair & protectionist
Exemption of Least-Developed Countries	Modest loss of emissions coverage; could change over time	Levels the playing field for the most important competitors	Risks violating Art. I GATT, but aligns with est. principles & practice (eg CBDR)	Relatively the least complex due to flat exclusion of large number of countries	Least controversial because perceived to be fairer and less protectionist
Exemption on Environmental Grounds (e.g. Carbon Price, Party to Paris Agreement)	Loss of emissions coverage may be offset by incentive to strengthen climate policies	Levels the playing field vis-à-vis countries with weaker constraints (may only be partial)	Risks violation of Art. I GATT, will likely need recourse to Art. XX GATT	Relatively most complex due to large number of countries and need to determine/compare environmental effort	Most controversial because of differentiation & rating other countries' behavior

Initial Takeaways from Consultations

- **Country-by-country differentiation:** A ‘country list’ is one option under consideration, but such a list would invariably have to be updated regularly
- **Criteria for differentiation are unclear:** Linking BCA coverage to ratification of the Paris Agreement, for instance, would currently only mean that the U.S., Turkey and some least developed countries are covered – not a politically likely scenario
- **Differentiation could also be producer-based:** Such differentiation is then a matter of how to calculate embedded carbon (see below)

Sectoral Scope

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Basic Materials only (EITEs)	Relatively the least beneficial because of reduced emissions coverage	Levels the playing field for a limited number of products	Art. XX GATT: less complex, but also less environmentally beneficial	Least complex because of limited scope and relative availability of data	Least controversial due to limited scope (esp. with narrowly traded goods)
Basic Materials (EITEs) & Electricity	Relatively greater environmental benefit due to expanded emissions coverage	Levels the playing field for a larger number of products	Art. XX GATT: more complex, but also greater environmental benefit	Relatively more complex due to expanded scope and additional data need	Relatively more controversial due to expanded scope (but: electricity narrowly traded)
Basic Materials, Electricity & More Complex Products	Relatively greatest benefit due to maximum emissions coverage	Levels the playing field for the greatest number of products, including domestic manufacturers that use covered inputs	Art. XX GATT: most complex, but also greatest environmental benefit; still: necessity unclear	Most complex to implement due to significant data gaps and technical challenges	Relatively most controversial due to expansive scope, data & technical challenges and trade intensity of goods

Initial Takeaways from Consultations

- **Tension between broad and narrow coverage:** only broad coverage addresses impacts for downstream producers, but is harder to implement; narrow coverage may require additional provisions for downstream producers and substitution between sectors
- **Testing with pilot sectors likely:** Sectors with low trade-intensity (e.g. only traded with immediate EU neighbor), such as cement and electricity, may offer useful piloting experience with limited risk
- **Coverage has important socioeconomic implications:** 40% of employment in EITEs is located in Central and Eastern Europe, where insufficient protection against leakage could threaten social cohesion

Emissions Scope

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Direct (Scope 1) Emissions	Relatively lowest environmental benefit due to lower emissions coverage	Levels the playing field with regard to cost of direct emissions only	Art. XX GATT: least complex, but also least env'tally. beneficial	Relatively least complex due to limited data needs	Relatively least controversial due to most limited scope
Indirect (Scope 2) Emissions from Energy	Relatively greater environmental benefit due to expanded emissions coverage	Levels the playing field with regard to cost of direct emissions & indirect energy emissions	Art. XX GATT: more complex, but also greater envt'l benefit	Relatively more complex due to additional data needs	Relatively more controversial due to expanded scope
Other Indirect (Scope 3) Emissions	Relatively greatest environmental benefit due to highest emissions coverage	Levels the playing field with regard to cost of all direct & indirect emissions	Art. XX GATT: most complex, but also greatest envt'l benefit; still: necessity unclear	Relatively most complex due to greatest data needs	Relatively most controversial due to most expansive scope

Initial Takeaways from Consultations

- **Scope 1 (direct emissions):** broad agreement that these should be covered
- **Scope 2 (indirect power emissions):** most advocate for these also to be covered
- **Scope 3 (other emissions, incl transport, inputs):** no consensus on whether these emissions, or some part of them, should be covered. Methodologically difficult, and massive data challenges

Determination of Embedded Emissions (1/2)

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Calculation at product level (each shipment)	Most accurate measurement, so highest environmental benefit	Levels the playing field facility by facility - strong	Strong case under Art. XX: non-arbitrary	Highly complex data needs, esp. if scope 3 covered	Relatively controversial - burdensome
Benchmark: best practice domestic/global	Relatively weak benchmark, allows most leakage	Assumption benefits foreign producers ==> uneven playing field	Strong case under Art. XX: less discriminatory	Least complex: data mostly available	Relatively less controversial - low burden, beneficial assumptions
Benchmark: worst practice domestic/global	Relatively strong benchmark, allows least leakage	Assumption penalizes foreign producers ==> benefits domestic	Weaker case under Art. XX: punitive	Least complex: data mostly available	Highly controversial - punitive assumptions

Determination of Embedded Emissions (2/2)

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Benchmark: average carbon intensity of EU producers	Somewhat weak benchmark, allows more leakage	Assumption benefits foreign producers that perform worse than EU average ==> uneven playing field	Strong case under Art. XX: less discriminatory	Least complex: data mostly available	Relatively less controversial - low burden, somewhat beneficial assumptions
Benchmark: best foreign practice	Relatively weak benchmark, allows more leakage	Assumption benefits foreign producers ==> uneven playing field	Strong case under Art. XX: less discriminatory	Relatively complex due to limited data availability	Relatively less controversial - low burden, beneficial assumptions
Benchmark: worst foreign practice	Relatively strong benchmark, allows least leakage	Assumption penalizes foreign producers ==> benefits domestic	Weaker case under Art. XX: punitive	Relatively complex due to limited data availability	Most controversial - punitiv assumptions
Hybrid benchmark: scope 2 actual foreign	Accurate measurement, may allow little leakage	Depends on the assumptions for non-scope 2	Balance: strong Art. XX case on scope 2; non-scope 2 depends on assumptions	Relatively complex due to additional data needs	Relatively controversial - depends on non-scope 2 assumptions

Initial Takeaways from Consultations

- **Ideally we would use actual emissions data, product-based.** We have EU LCA data for a few sectors, from PCF exercises, and we have the benchmark data used to determine vulnerability to leakage
- **But the data requirements for this are monumental,** especially if we propose to differentiate by country, by producer. Probably we will need to use default values at product/sectoral level (e.g., 90th percentile EU producer)
- **Domestic or global?** No consensus on whether the default should be based on EU emissions intensity values, or global values
- **Individual producer challenges:** Broad agreement that individual foreign producers should be able to challenge any default values (as should domestic producers), with verified emissions intensity data

Calculation of Adjustment

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
No consideration of foreign policies	No leakage, but also no incentive for good foreign environmental practice	Offers more than full protection	Vulnerable under Art. XX: arbitrary	Most feasible option	Relatively controversial - seen as unfair
Consideration of price-based policies	No leakage, but also limited incentive for good foreign environmental practice	Offers slightly more than full protection	Strong case under Art. XX: less discriminatory	Feasible, but more complex	Relatively less controversial
Consideration of price-based and regulatory policies	No leakage; full incentive for good foreign environmental practice	Offers full protection	Strongest case under Art. XX	Very complex: hard to equate regulatory policies to prices	Potentially least controversial, depending on details of adjustment methodology

Initial Takeaways from Consultations

- **Crediting or no?** The basic question is whether to credit foreign producers for costs of climate policies in the country of export. It's possible to conceive of a system (like VAT) that doesn't do so. But opinion seemed to be that some crediting would be needed.
- **Price-based only, or regulatory as well?** The more complex question is: which policies to consider? Clearly price-based policies such as ETS and carbon tax should be covered. But what sorts of regulatory policies might also be covered? How to distinguish which are climate-related? Would be challenging to keep abreast of all relevant regulations and their impacts in all exporting countries.

Use of Revenue (1/2)

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Refund to covered domestic firms	No leakage impacts; may enable environmental improvements	Offers more than full protection; domestic subsidy	Likely illegal under SCM Agreement; weakens case under Art. XX	Complex but feasible	Relatively controversial - seen as unfair
Refund to covered foreign firms	No leakage impacts; may enable foreign environmental improvements	Offers more than full protection; foreign subsidy	Strong case under Art. XX	Very complex, but feasible	Controversial domestically
Put into general revenue	No leakage impacts; no environmental impacts	Neutral impacts	Neutral legal implications	Straightforward, feasible option	Not particularly controversial

Use of Revenue (2/2)

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Domestic fund for climate innovation	no leakage impacts; likely to create environmental improvement	May increase domestic competitiveness	May weaken case under Art. XX	Complex but feasible	Not particularly controversial
Domestic fund for competitiveness	No leakage impacts; may enable environmental improvement	Likely to increase domestic competitiveness	Likely weakens case under Art. XX	Complex, but feasible	Would be seen as controversial by trading partners
International fund for climate	No leakage impacts; likely to have positive climate impacts	Neutral impacts	Strengthens case under Art. XX	Straightforward, feasible option	Would be seen positively by international partners

Initial Takeaways from Consultations

- **No international transfers.** Domestically, it probably will not fly to have transfers of funds back to country of export. Slightly less controversial would be transfers to some international climate fund.
- **Funding for innovation, modernization.** Broad agreement that revenues should be used, at least in part, to support increased competitiveness of covered sectors, through modernization and innovation.
- **Hypothecation of taxes.** There seemed to be support for hypothecation. But if the policy instrument were a tax, hypothecation of the funds may be restricted in some member states.

Scenario-Building:

- **“Most Probable”**: A scenario based on current information as provided by the European Commission in Communications, the Inception Impact Assessment, and verbal statements by officials
- **“Play it Safe”**: A scenario that seeks to minimize legal risk, political pushback and administrative complexity through a design that trades off environmental and competitiveness benefits for safety
- **“The Go-Getter”**: A scenario that maximizes environmental and competitiveness benefits, but does so by incurring legal risk, potential diplomatic pushback and administrative complexity

Scenario 1: “Most Probable” (1/3)

Design Element	Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Trade Flow Coverage	Imports Only	Strong benefit due to maximum emissions coverage	Levels the playing field in the domestic market only	Strong case under Article XX GATT	Intermediate complexity due to data gaps and limited jurisdiction	Somewhat controversial as a unilateral, extra-territorial measure
Policy Mechanism	Extension of the EU ETS	Neutral (depends on level of carbon price and price volatility/predictability in market)	Neutral	Can be adopted with qualified majority vote, but potentially risky under trade law	High complexity due to need to integrate in/link to EU ETS market	Likely neutral (relative to other options, such as carbon tax)
Effect on Free Allocation	Gradual Phase-out of Free Allocation	Moderately beneficial because price signal strengthened	Moderately beneficial: playing field inside/outside EU levelled during transition period	Moderate risk of violating SCM Agreement; relatively strong case under Art. XX GATT	Relatively most difficult to implement due to added need to decide on transition process	Moderately controversial due to perceived fairness (no ‘double protection’ of EU producers)

Scenario 1: “Most Probable” (2/3)

Design Element	Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Geographic Scope	Exemption of Least Developed Countries	While exclusion of LDCs reduces emissions coverage, initial focus on EU neighbours renders this de facto moot	Levels the playing field for goods from the most relevant countries (advanced developing countries with weaker constraints)	Risks violation of Art. I GATT, will likely need recourse to Art. XX GATT	Intermediate complexity due to need to define and apply environmental criteria for exemption	LDC exemption not very controversial because perceived to be fairer and less protectionist
Sectoral Scope	Basic Materials (EITs) & Electricity	Intermediate environmental benefit due to expanded emissions coverage	Levels the playing field for an intermediate number of products	Art. XX GATT: more complex, but also greater environmental benefit	Intermediate complexity due to expanded scope and additional data needs	Moderately controversial due to expanded scope (but: electricity narrowly traded)
Emissions Scope	Scope 1 and Scope 2 Emissions	Intermediate environmental benefit due to expanded emissions coverage	Levels the playing field with regard to cost of direct emissions & indirect energy emissions	Art. XX GATT: more complex, but also greater envt'l benefit	Intermediate complexity due to additional data needs	Moderately controversial due to expanded scope

Scenario 1: “Most Probable” (3/3)

Design Element	Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Determination of Embedded Emissions	Benchmark: Average Carbon Intensity of EU Producers	Somewhat weak benchmark, allows more leakage	Assumption benefits foreign producers that perform worse than EU average ==> uneven playing field	Strong case under Art. XX: less discriminatory	Low complexity: data mostly available	Moderately controversial - low burden, somewhat beneficial assumptions
Calculation of Adjustment	Consideration of price-based policies	No leakage, but also limited incentive for good foreign environmental practice	Offers slightly more than full protection	Strong case under Art. XX: less discriminatory	Feasible, but somewhat complex	Moderately controversial
Use of Revenue	Domestic Fund for Climate Innovation	No leakage impacts; likely to create environmental improvement	May increase domestic competitiveness	May weaken case under Art. XX	Complex but feasible	Not particularly controversial

“Most Probable”: Some Key Features

- **Overall:** a relatively balanced scenario that avoids excessive complexity and legal risk while still achieving meaningful benefits; one tradeoff: limited emissions coverage
- **Scope and Coverage chosen to minimize risk and complexity:** Focus initially on very few sectors (cement, electricity) with low trade intensity and limited methodological challenges, allowing the EU to experiment and learn while only negotiating with a small set of trade partners (EU neighbors) and companies
- **Use of default values substitutes for producer data, but producers can prove actual carbon intensity:** This design choice, included in past policy proposals (e.g. French Non-Papers), reduces administrative complexity while offering a process that ensures equal treatment of clean foreign and domestic producers
- **Higher uncertainties concerning other features:** We think exemption of LDCs is likely, and that BCA revenue will flow into the innovation and modernization funds; less clear is whether and how trade partner policies are considered

Scenario 2: “Play it Safe” (1/3)

Design Element	Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Trade Flow Coverage	Imports Only	Strong benefit due to maximum emissions coverage	Levels the playing field in the domestic market only	Strong case under Article XX GATT	Intermediate complexity due to data gaps and limited jurisdiction	Somewhat controversial as a unilateral, extra-territorial measure
Policy Mechanism	Extension of the EU ETS	Neutral (depends on level of carbon price and price volatility/predictability in market)	Neutral	Can be adopted with qualified majority vote, but slightly riskier under trade law	Relatively high complexity due to need to integrate in/link to EU ETS market	Likely neutral (relative to other options, such as carbon tax)
Effect on Free Allocation	Free Allocation Rescinded Immediately	Most beneficial because price signal strongest	Least beneficial: risk that playing field not levelled inside/outside EU, depending on BCA	Strongest case under SCM Agreement and Article XX GATT, but may result in compensation claims	May be easiest to implement if need for EITE benchmark definition falls away	Relatively least controversial due to perceived fairness

Scenario 2: “Play it Safe” (2/3)

Design Element	Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Geographic Scope	Exemption of Least Developed Countries	While exclusion of LDCs reduces emissions coverage, initial focus on EU neighbours renders this de facto moot	Levels the playing field for goods from the most relevant countries (advanced developing countries)	Risks violating Art. I GATT, but aligns with established principles & practice (eg CBDR)	Relatively the least complex due to flat exclusion of large number of countries	LDC exemption least controversial option because perceived to be fairer and less protectionist
Sectoral Scope	Basic Materials only (EITEs)	Relatively the least beneficial because of reduced emissions coverage	Levels the playing field for a limited number of products	Art. XX GATT: less complex, but also less environmentally beneficial	Least complex because of limited scope and relative availability of data	Least controversial due to limited scope (esp. with narrowly traded goods)
Emissions Scope	Direct (Scope 1) Emissions	Relatively lowest environmental benefit due to lower emissions coverage	Levels the playing field with regard to cost of direct emissions only	Art. XX GATT: least complex, but also least env'tally beneficial	Relatively least complex due to limited data needs	Relatively least controversial due to most limited scope

Scenario 2: “Play it Safe” (3/3)

Design Element	Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Determination of Embedded Emissions	Benchmark: Best Practice	Relatively weak benchmark, allows most leakage	Assumption benefits foreign producers --> uneven playing field	Strong case under Art. XX: less discriminatory	Least complex: data is mostly available	Relatively least controversial - low burden, beneficial assumptions
Calculation of Adjustment	Consideration of price-based policies	No leakage, but also limited incentive for good foreign environmental practice	Offers slightly more than full protection	Strong case under Art. XX: less discriminatory	Feasible, but more complex than no consideration of foreign policies at all	Moderately controversial, because some climate policies will not be considered
Use of Revenue	International Climate Fund	No leakage impacts; likely to have positive climate impacts	Neutral impacts	Strengthens case under Art. XX	Straightforward, feasible option	Would be seen positively by international partners

“Play it Safe”: Some Key Features

- **Overall:** Limited geographic, sectoral and emissions scope as well as use of generous carbon intensity default assumption reduce the complexity and risk of the BCA, but also compromise its environmental and competitiveness benefits
- **Embedded carbon determined on the basis of a generous benchmark favoring foreign producers:** By assuming that other producers are as efficient as a best practice benchmark, the likelihood of discrimination is minimized
- **Revenue feeds into an international climate fund:** Done in a way that is truly additional to existing climate finance pledges is likely to be least controversial, while also strengthening the legal case of the BCA under Article XX of GATT
- **Free allocation phased out immediately:** Phasing out free allocation is important to avoid the perception that the measure favors EU producers and strengthen the case under Article XX of GATT, but incurs risk of domestic political ire and possible litigation

Scenario 3: “The Go-Getter” (1/3)

Design Element	Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Trade Flow Coverage	Imports & Exports	Environmental benefit between the two cases above	Levels the playing field in both domestic & foreign markets	Weaker case under Art. XX and greatest risk under SCM Agreement	More complex to implement for imports due to data gaps and limited jurisdiction	Most controversial because of extraterritoriality and perceived protectionism
Policy Mechanism	Extension of the EU ETS	Neutral (depends on level of carbon price and price volatility/predictability in market)	Neutral	Can be adopted with qualified majority vote, but potentially risky under trade law (esp. re. exports)	High complexity due to need to integrate in/link to EU ETS market	Neutral
Effect on Free Allocation	Gradual Phase-out of Free Allocation	Moderately beneficial because price signal strengthened	Moderately beneficial: playing field inside/outside EU levelled during transition period	Moderate risk of violating SCM Agreement; relatively strong case under Art. XX GATT	Relatively most difficult to implement due to added need to decide on transition process	Moderately controversial due to perceived fairness (no ‘double protection’ of EU producers)

Scenario 3: “The Go-Getter” (2/3)

Design Element	Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Geographic Scope	Exemption on Environmental Grounds (e.g. Carbon Price, Party to Paris Agreement)	Loss of emissions coverage likely offset by stronger incentive to strengthen climate policies	Levels the playing field vis-à-vis countries with weaker constraints (may only be partial)	Risks violation of Art. I GATT, will likely need recourse to Art. XX GATT	Relatively most complex due to large no. of countries and need to compare environmental effort	Most controversial because of differentiation & rating other countries' behavior
Sectoral Scope	Basic Materials, Electricity & More Complex Products	Relatively greatest benefit due to maximum emissions coverage	Levels the playing field for greatest no. of products, incl. domestic manufacturers that use covered inputs	Art. XX GATT: most complex, but also greatest environmental benefit; necessity unclear	Most complex to implement due to significant data gaps and technical challenges	Relatively most controversial due to expansive scope, data & technical challenges & trade intensity of goods
Emissions Scope	Scope 1, 2 and 3 Emissions	Relatively greatest environmental benefit due to highest emissions coverage	Levels the playing field with regard to cost of all direct & indirect emissions	Art. XX GATT: most complex, but also greatest envt'l benefit; necessity unclear	Relatively most complex due to greatest data needs	Relatively most controversial due to most expansive scope

Scenario 3: “The Go-Getter” (3/3)

Design Element	Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Determination of Embedded Emissions	Calculation at Product Level (each Shipment)	Most accurate measurement, so highest environmental benefit	Levels the playing field facility by facility - strong	Strong case under Art. XX: non-arbitrary	Highly complex data needs, esp. if scope 3 covered	Relatively controversial - burdensome
Calculation of Adjustment	Consideration of Price-based and Regulatory policies	No leakage; full incentive for good foreign environmental practice	Offers full protection	Strongest case under Art. XX	Very complex: hard to equate regulatory policies to prices	Potentially least controversial, depending on details of adjustment methodology
Use of Revenue	Domestic Fund for Climate Innovation	No leakage impacts; likely to create environmental improvement	May increase domestic competitiveness	May weaken case under Art. XX	Complex but feasible	Not particularly controversial

“The Go-Getter”: Some Key Features

- **Overall:** Goes all out to maximize environmental benefits and protect EU industry, but at the expense of being highly complex, risky and controversial
- **Maximizes scope and granularity to achieve its goals:** Covers imports and exports, the largest numbers of sectors and all emission scopes, and calculates emissions at product level to ensure environmental & competitiveness benefits
- **Sends strong signal to other jurisdictions:** Exempts countries with comparable climate efforts to incentivize more climate action and a converging playing field
- **Free allocation phased out gradually:** Free allocation only phased out gradually to balance environmental and competitiveness benefits
- **Revenue used for climate innovation:** Revenue stays with EITE sectors and strengthens their competitiveness, yet also achieves environmental benefits