Alternatives and complements to BCAs

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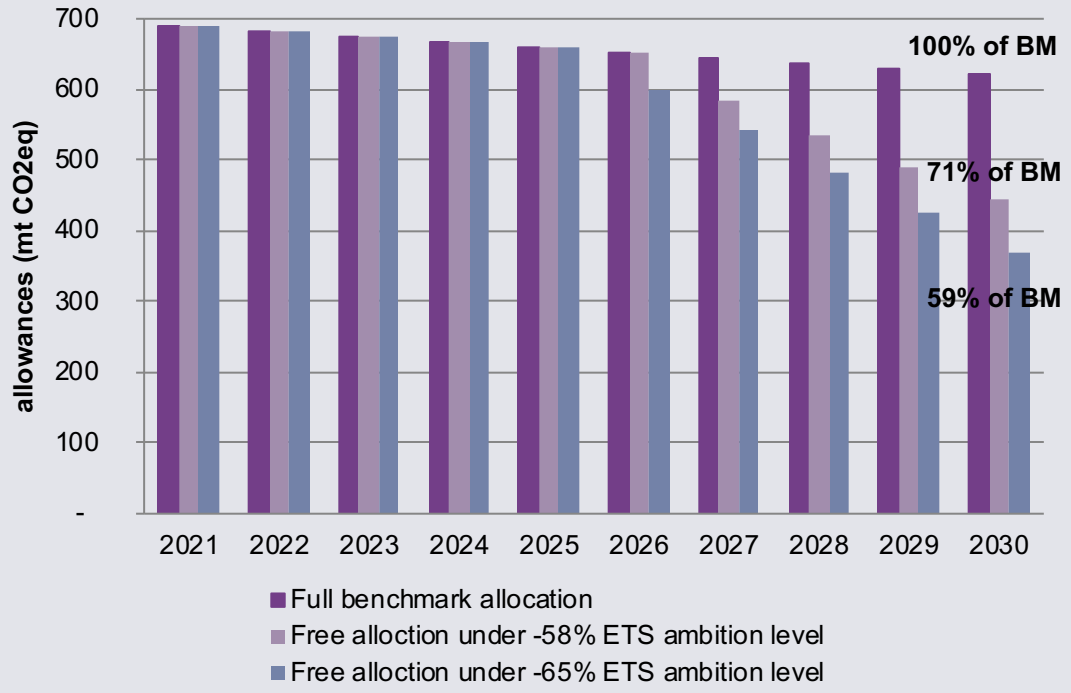
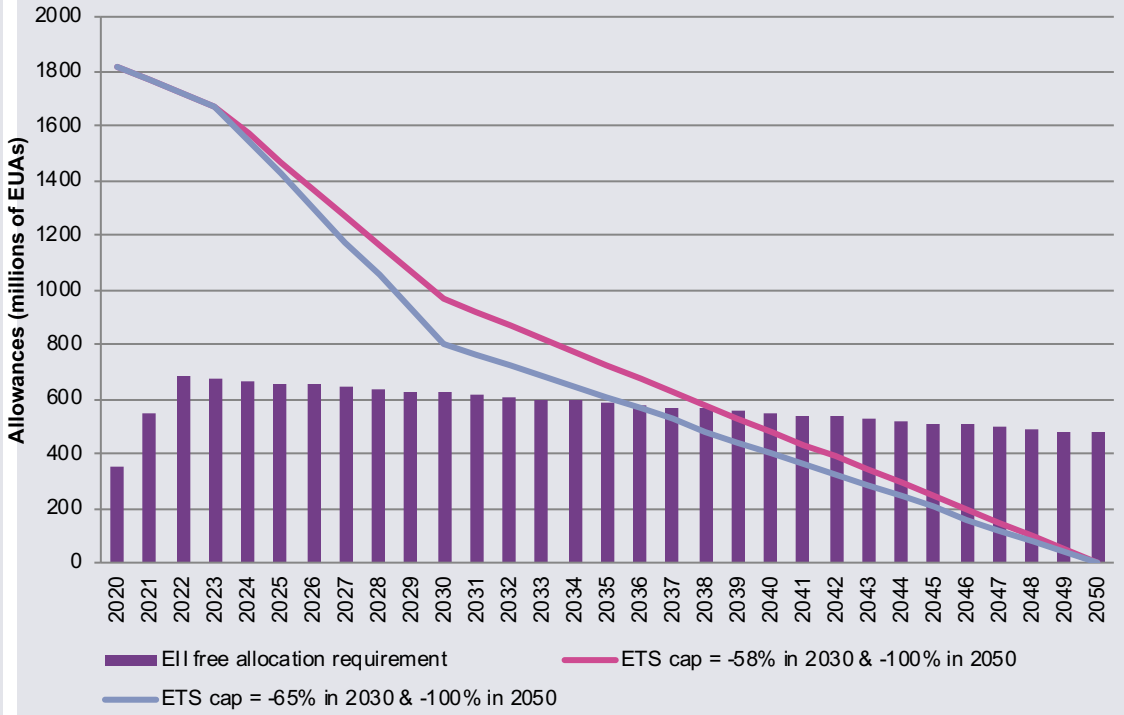
The current anti-carbon leakage system is not sustainable under higher EU climate ambition (1): we need to transition to a new anti-leakage system by ~2030/35

The cross-sectoral correction factor under higher EU ambition



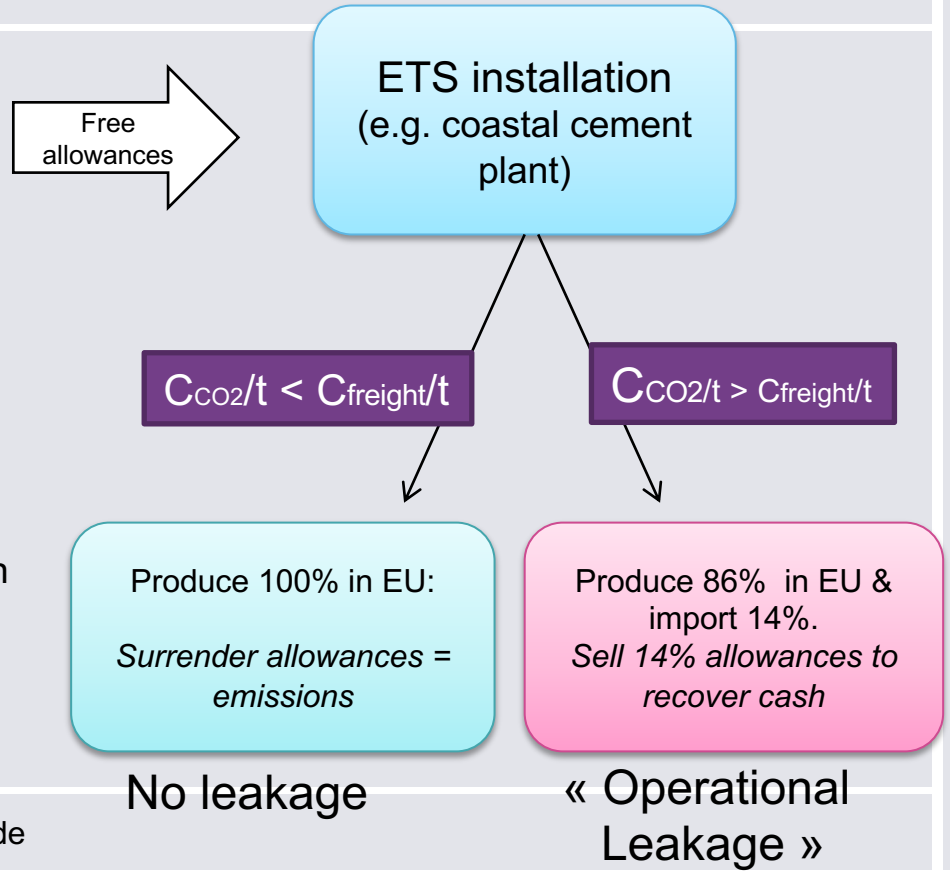
Free allocation and the EU ETS cap under higher EU 2030 ambition scenarios



Source: Agora Energiewende

The current anti-carbon leakage system is not sustainable under higher EU climate ambition (2)

1. Free allocation ex ante
2. Criteria CO2 price vs. freight cost:
3. Production location decision:



Source: Agora Energiewende

- Significantly higher CO2 prices also raise the risk of « operational » leakage
- Carbon prices of >40€+/tCO2 => international arbitrage between marginal units of production.
- *Under free allocation,* this can only be avoided by shifting to an ***ex-post output-based free*** *allocation* system.

BCAs could solve these problems…However, a unilaterally imposed EU BCA faces numerous obstacles.

- *The « export rebate problem »*
- *EU can't agree on sectoral scope (intersectoral competition)*
- *EU can't agree on product benchmarks*
- *Downstream product purchasers object*
- *Ineffective policy design (scope, resource shuffling, indirect emissions)*
- *International opposition/retaliation*
- *Unfavourable WTO ruling*

⇒ **High stakes: Failure could kill EU ambition discussion; partial implementation prolongs investment uncertainty / leakage risk**

⇒ **High uncertainty: Complementary / fallback solutions needed.**

Proposed alternatives to BCAs (1)
Carbon Contracts for Difference

Pros	Cons
→ Covers incremental cost of utlra low CO2 production vs. conventional competition → Option to replace free allocation via cash subsidy for innovative low CO2 producers → Easily compatible with BCAs if introduced	→ Doesn't protect conventional assets → Not financially sustainable in long run → Depends on national funding capacity (EU wide

Conclusion: Only for innovative low CO2 producers: partial and temporary solution.

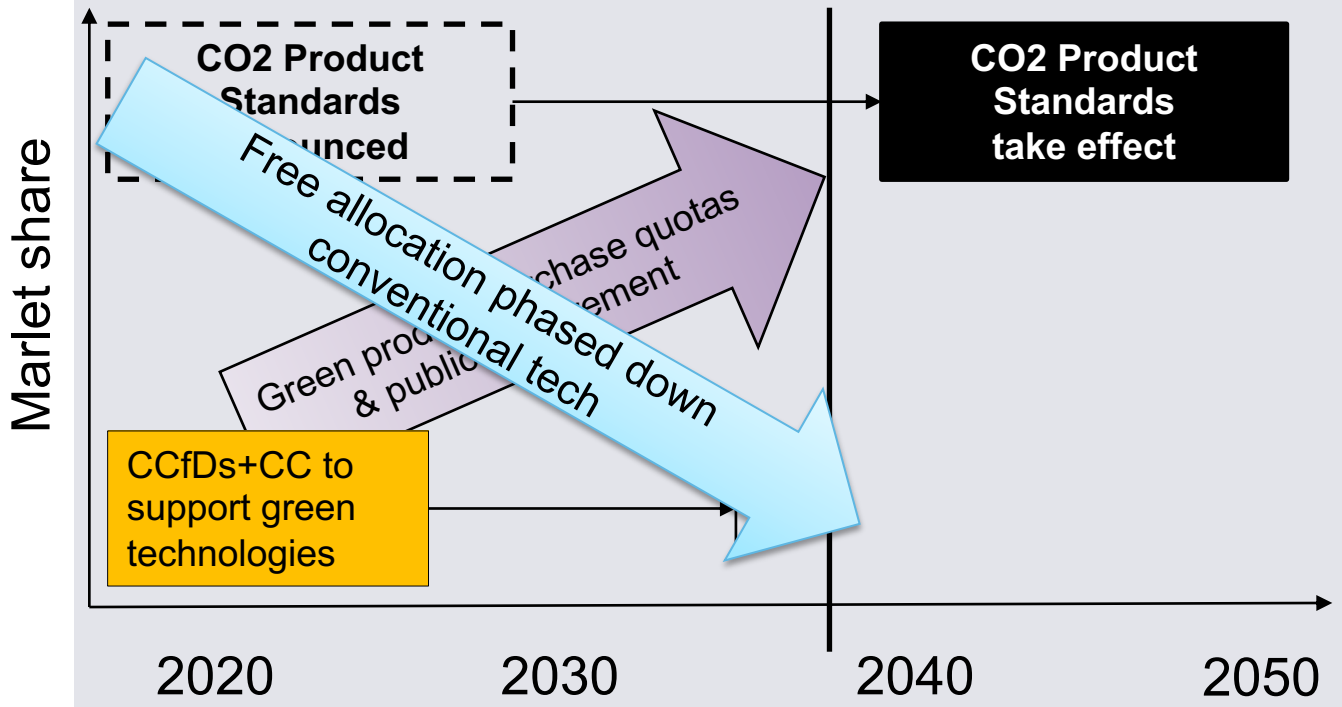
Proposed alternatives to BCAs (2)
Output-based allocation + « Consumption Charge »

Pros	Cons
→ Reduces BCA legal risks related to export rebate question → Simplifies adminstration by placing a weight-based charge on consumption of basic materials in the internal market → Raises funds from consumers for innovation	→ How would one reconcile output-based free allocation at conventional benchmark with ETS cap? With/ auction revenue allocations? → Weight-based charge disadvantages green products → Would require unanomous support in Council.

Conclusion: good for raising funds,
less desirable for long-term leakage protetion.

How might carbon product standards work as a carbon leakage policy?

Standards: E.g. EU internal market for steel



- Build on examples of EU Timber and Fisheries policies, Montreal Protocol
- From a certain « sunset » date, EU internal market would only accept EII products produced according to given ultra-low-CO2 standard.
- This would apply to imports and domestic production equally
- Green product quotas and public procurement used to implement gradually
- In parallel, free allocation to conventional tech is reduced gradually as share of green market (and thus production sites) increases.

Proposed alternatives to BCAs (3)
Low carbon production standards

Pros	Cons
→ Precedents under WTO & EU law → An internal market (not a border) measure → Could be introduced gradually via progressive scaling of other policies to create markets → Helps to provide clarify for investment in Low CO2 options → No regret if BCA works: also helpful for transition	→ Technological uncertainty → Agreeing on long term standards across EU → Similar admin requirements to BCA (third party certification of foreign production tech.)

Conclusion: Could not be implemented immediately.
Potential back up LT strategy if BCAs not possible

Summary

- To aim for higher ambition, the EU's current anti-leakage system must begin to change radically
- In the short term, the EU has two/three main tools:
  - **CfD payments** *for low-CO2 projects* (replacing free alloc.);
  - temporary, **output-based free allocation** *for conventional assets*
  - **BCAs** *for small no. of sectors* (if feasible)
- In long term, two main options**:**
  - **BCAs** *(theoretically possible, but high uncertainty)*
  - **Carbon product standards** *(can only be implemented gradually)*
- **CfDs and CPS are desirable for the transition anyway, therefore « no regret » options.**

Thank you!

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