



BCA & other approaches: issues and options

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Andrei Marcu
Michael Mehling
Aaron Cosbey

ERCST

Roundtable on
Climate Change and
Sustainable Transition

Why BCA now?

- Running out of free allocation (2020 State of the ETS), what will happen next?
- Clear EU intention to lower the cap which accelerates and puts urgency to the issue
 - For sectors less exposed to carbon leakage, free allocation is foreseen to be phased out by 2030
- The **Carbon Border Adjustment Mechanism (CBAM)** could represent an alternative to free allocation against carbon leakage

Table 4: CSCF value in 2030 under 2 demand scenarios for 3 possible targets

	Conservative demand scenario	High demand scenario
Current target	100%	100%
50% by 2030	100%	72%
55% by 2030	100%	65%

Source: BloombergNEF

History of the BCA Objective

- The current debate is to **level the playing field** in order to:
 - protect against consumption carbon leakage
 - is it to increase the level of ambition
- The reality is that it is linking the playing field and in a “necessary” condition to these is a political decision to lower the cap
 - Should provide the level playing field at any level of cap
- EC Inception Impact Assessment => Public Consultations

European Commission main options

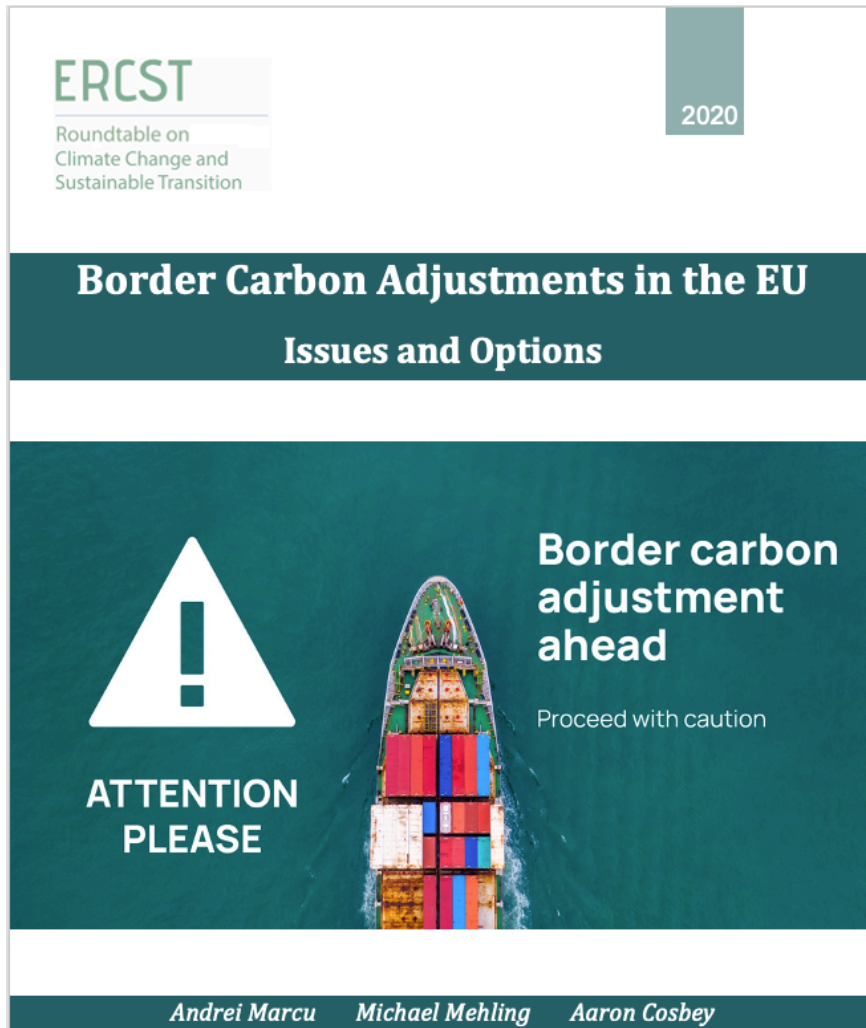
- **A tax applied on imports at the EU border**
 - On products whose production is in sectors that are at risk of carbon leakage
 - This could be a border tax or customs duty
- **An extension of EU Emission Trading Scheme to imports**
 - Requiring the purchasing of emission allowances under the EU ETS by either foreign producers or importers
- **Carbon tax (e.g. excise or VAT type) at consumption level**
 - On products whose production is in sectors that are at risk of carbon leakage
 - The tax would apply to EU production, as well as to imports
- **The obligation to purchase allowances from a specific pool outside the ETS**
 - Dedicated to imports, which would mirror the ETS price

Timeline of the project

- **Project** “Border Carbon Adjustments in the EU: Issues and Options”
 - **Report** launch 30 September 2020
 - Economic Impact Methodology event 14 October 2020
- Submitted **Feedback** to Inception Impact Assessment consultation
 - Discussion & Synthesis Paper on Feedback to IIA (May 28)
 - Public consultation questionnaire until October 28
- **International outreach** (‘Virtual Town Halls’) with EU trade partners: USA, South Korea, India, Japan, South Africa, Mexico, Russian Federation, Ukraine
- **Stakeholder engagement and convening:**
 - March 5th: Dissecting and Assessing CBAM Design Options
 - March 25th: High-Level International Roundtable
 - April 15th: Evaluating Alternative CBAM Scenarios
 - May 28th: Inception Impact Assessment Feedback Summary & Synthesis
 - June 9th: Exploring Alternatives to the CBAM
 - September 10th: Public Consultations Discussion

<https://ercst.org/border-carbon-adjustments-in-the-eu/>

Report 30 September -- Structure



Takeaways

1. Introduction
2. The EU context
3. Townhalls
4. Analysis of BCAs
 - 4.1 Consumption charges
 - 4.2 Contracts for differences
5. Assessment of Other Approaches
- 6. Different instruments for different functions**
7. Concluding thoughts

Our Approach: Decomposing, Evaluating & Comparing

• Design Elements:

- Coverage of trade flows
- Policy mechanism
- Geographic scope
- Sectoral scope
- Emissions scope
- Determination of embedded emissions
- Calculation of adjustment
- Use of revenue

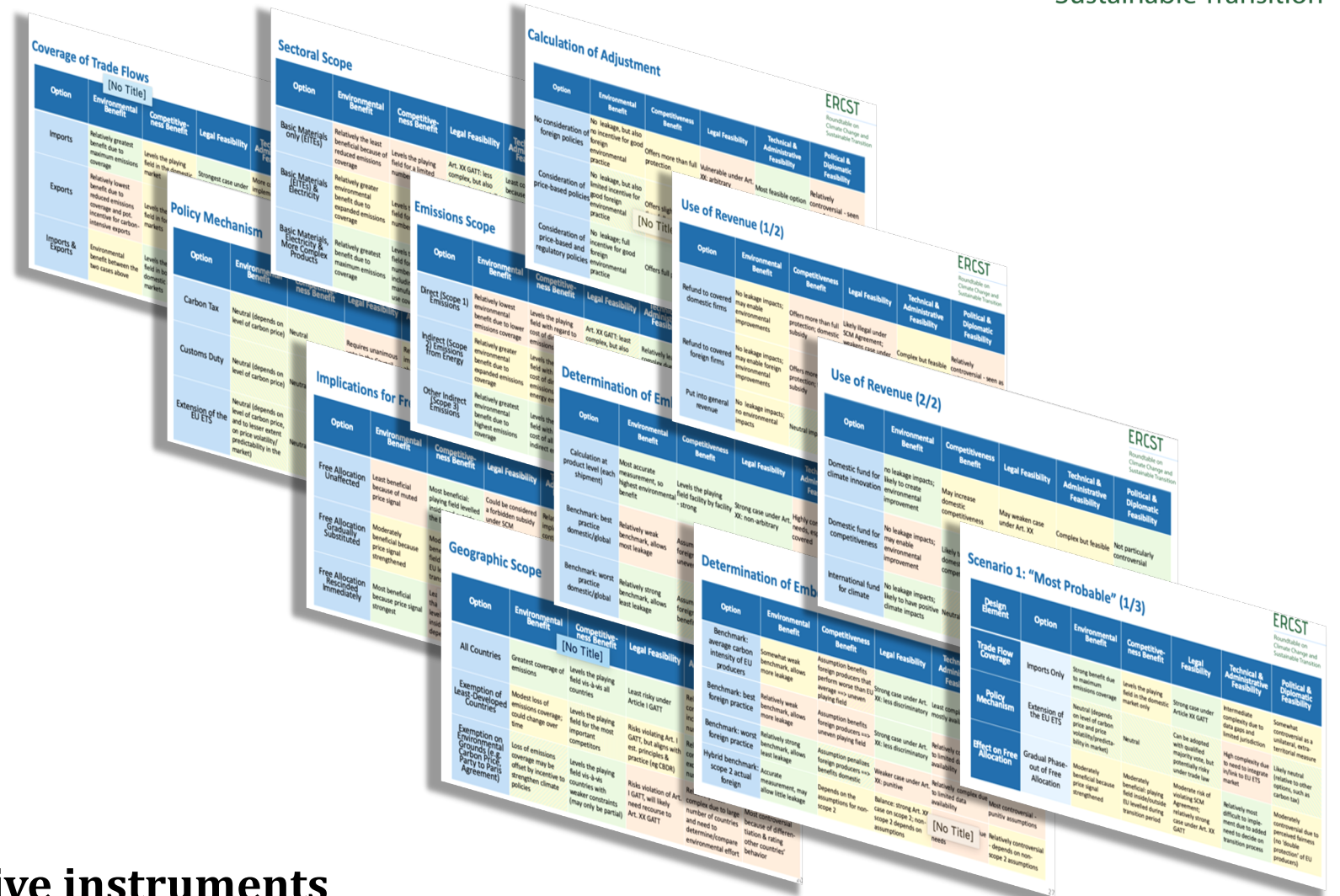
• Evaluation Criteria:

- Environmental benefit
- Competitiveness benefit
- Legal feasibility
- Technical and administrative feasibility
- Political feasibility
 - Material neutrality
 - Global environmental benefits

• Scenario-Building:

- 'Most Probable'
- 'Play it Safe'
- 'Go Getter'

• Comparisons with alternative instruments



Example: Decomposition of BCA Design Steps (here: 'Trade flow')

Option	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Imports Only	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 Only	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

Example: Comparison of BCA Scenarios

Scenario	Design Choices	Environmental Benefit	Competitiveness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
'Most Probable'	<p>Trade Flow Coverage: Imports only</p> <p>Policy Mechanism: Extension of the EU ETS</p> <p>Geographic Scope: Exemption of LDCs</p> <p>Sectoral Scope: Basic materials & electricity</p> <p>Emissions Scope: Scope 1 & Scope 2</p> <p>Calc. of Embedded Carbon: Benchmark (avg. EU)</p> <p>Calculation of Adjustment: Price-based policies</p> <p>Use of Revenue: EU budget</p>	Extends carbon price to imports & replaces free allocation; but use of averages limits benefits	Effectively levels the playing field in the domestic market, but not in foreign markets, nor downstream	Likely to pass muster under WTO law due to Article XX GATT; requires qualified majority vote in the EU Council	Intermediate complexity in terms of data needs and administrative/regulatory framework	Intermediate risk of controversy as a unilateral, extra-territorial measure
'Play it Safe'	<p>Trade Flow Coverage: Imports only</p> <p>Policy Mechanism: Extension of the EU ETS</p> <p>Geographic Scope: Exemption of LDCs</p> <p>Sectoral Scope: Basic materials only</p> <p>Emissions Scope: Scope 1 only</p> <p>Calc. of Embedded Carbon: Benchmark (best practice)</p> <p>Calculation of Adjustment: Price-based policies</p> <p>Use of Revenue: International climate fund</p>	Extends carbon price to imports; limited scope and use of generous averages limits benefits	Somewhat levels the playing field in the domestic market, but not in foreign markets, nor downstream	Very likely to pass muster under WTO law due to Article XX GATT; requires qualified majority vote in the EU Council	Lowest complexity in terms of data needs and administrative/regulatory framework	Lowest risk of controversy as a unilateral, extra-territorial measure
'Go Getter'	<p>Trade Flow Coverage: Imports and exports</p> <p>Policy Mechanism: Extension of the EU ETS</p> <p>Geographic Scope: Exemption of clim. leaders</p> <p>Sectoral Scope: Basic+complex goods, elec.</p> <p>Emissions Scope: Scope 1, 2 & 3</p> <p>Calc. of Embedded Carbon: Actual emissions</p> <p>Calculation of Adjustment: Price and regulat. policies</p> <p>Use of Revenue: Domestic innovation fund</p>	Extends carbon price to imports, but exempts exports; broad scope and actual carbon intensity strengthen benefits	Effectively levels the playing field in domestic and foreign markets as well as downstream	My not pass muster under WTO law due to SCM and complexity; requires qualified majority vote in the EU Council	Highest complexity in terms of data needs and administrative/regulatory framework	Highest risk of controversy as a unilateral, extra-territorial measure

Example: Comparison across Instruments

Policy Option	Proposal/ Variant	Environmental Benefit	Competitive- ness Benefit	Legal Feasibility	Technical & Administrative Feasibility	Political & Diplomatic Feasibility
Border Carbon Adjustment	“Most Probable”	Extends carbon price to imports & replaces free allocation; but use of averages limits benefits	Effectively levels the playing field in the domestic market, but not in foreign markets, nor downstream	Should pass muster under WTO law due to Article XX GATT; requires qualified majority vote in the EU Council	Intermediate complexity due to data needs and administrative/regulatory framework	High degree of controversy as a unilateral, extra-territorial measure
Consumption Charge	“Inclusion of Consumption”	Internalizes cost of carbon across value chain, but no or limited differentiation	Without free allocation: only protects against its own competitiveness impacts	Does not impinge on WTO/state aid rules; but may require a unanimous vote in the EU Council	High complexity due to data needs and administrative/regulatory framework	Likely minimally controversial as purely internal measure, but increases prices → material substitution
Contracts for Difference	“Carbon Contract for Difference”	Strong incentive to scale up early-stage clean technology; but scope limited to selected projects (and by available resources)	Levels the playing field between clean and dirty products, but only affects competition w. foreign producers for selected projects	Does not impinge on WTO rules if open to foreign bidders; should pass muster under state aid rules if competitive tender	Relatively easier to implement due to limited scope and provision of data	Relatively least controversial as a support measure

International Townhalls: Partners

- **Nicholas Institute** for Environmental Policy Solutions at Duke University (**USA**)
- The Council on Energy, Environment and Water (**India**)
- Climate Change Center of **Korea**
- Graduate School of Public Policy at **Tokyo University (Japan)**
- Iniciativa Climática de **México**
- Institute for Natural Monopolies Research (**Russian Federation**)
- **European Business Association** in Kiev (**Ukraine**)
- The **South African Institute** of International Affairs (**South Africa**)

International Town Halls: Main Messages

- General **awareness** of the process, but some **skepticism** that it will happen
- **Governments** generally more concerned, see CBAM in a political light and in the light of the Paris Agreement
- **Environmental Organizations** see an opportunity to make the case for an increase in the level of ambition
- **Business representatives** concerned, but are not ready to take strong positions

International Town Halls: Main Messages

- Allow for **crediting** of **existing policies**
- Allow for process to **challenge** carbon intensity default values
- Use of **CBAM revenues**
- **Cooperation** on the design and implementation of the CBAM
- Consideration of **alternative policies**

Key issues

Key issues/challenges:

- **Trade flow coverage:** Consider role of European exports and their competitiveness in foreign markets
- **Free allocation:** Replacing free allocation will face considerable pushback in the EU, making a phased approach more likely
- **Sectoral scope:** Basic goods with relatively low trade-intensity – such as cement – may offer a good piloting opportunity; also possible: electricity
- Avoiding **resource shuffling** and **evasion tactics** will be challenging
- **Revenue use:** International revenue transfers face political obstacles
- **Crediting for foreign policies:** complex but likely necessary

High Level Takeaways

- **Context.** Europe's CBAM is being elaborated as we approach several important crossroads. Timeline rapidly shrinking. EU not alone in challenges of leakage and competitiveness.
- **Raising ambition and solving leakage are intertwined.** EU's announced global leadership on climate welcome and necessary, but unlikely to materialize if no solution to leakage and competitiveness problems. Not a sufficient condition, but necessary one (free allocation vs BCA).
- **Legal challenges.** WTO compatibility and GATT Article XX environmental exemptions – are they constraints? Implications for BCA design and implementation
- **Complexity** makes it impractical for large number of complex products
- **CBAM: a silver bullet?** EC has hopes on border carbon adjustment. It puts pressure on a useful instrument, but it is no silver bullet; problems may keep it from ever being adopted. CBAM needs a framework emerging at different levels of governance in the EU - internal vs external (poss. export rebates)

Different Instruments for Different Functions

Three fundamental issues need to be addressed by a BCA and other approaches:

- Continuation of carbon leakage protection
- Impact of free allocation on downstream carbon price signals
- Creation of a market for low carbon products
- Possibilities for combination of instruments

The tools identified (BCA, consumption charges, CCfD) will play different roles and meet different needs

A more robust approach is to **identify what functions each of these tools can address on their own, or possibly in combination**

Different Instruments for Different Functions

Possibilities for combination of instruments

- **CBAM** meant to accompany EU ETS - a CBAM has many advantages, but can only be used selectively and with clear purpose.
- **Consumption charges** ensure cost of carbon is internalized under free allocation. It would fix problem of free allocation muting carbon price signal.
- **CCfDs** not intended to deliver functions of CBAM or free allocation. Can be synergetic to an ETS when carbon price too low with funds levied through a CBAM, consumption charges or auctioning.
- Need for combining policy instruments to meet all functions listed