



Crediting carbon prices in the CBAM

Launch Event Report 3, 5 October 2023

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ERCST

Roundtable on
Climate Change and
Sustainable Transition

Crediting under Article 9 and why it Matters

- Article 9 of the CBAM Regulation allows **crediting** a foreign **carbon price effectively paid** for covered goods imported into the EU:

Declarants “may claim ... a reduction in the number of CBAM certificates to be surrendered in order to take into account the carbon price paid in the country of origin for the declared embedded emissions. The reduction may be claimed only if the carbon price has been effectively paid in the country of origin.”

- Crediting helps ensure that foreign producers bear **the same carbon cost** as EU producers by not charging them twice
- Failure to credit foreign carbon pricing would undermine an important **incentive** and risk violating **international trade rules**

Options to Account for Climate Action in Trade

- Article 9 reflects a **choice to credit** foreign climate policy efforts, but simultaneously **narrows crediting** to carbon prices effectively paid
- This was not the only option available to the EU for Article 9. Existing or proposed policies have also considered crediting i.a.:
 - An “**effective**” carbon rate under pricing policies for carbon and energy
 - An “**implicit**” carbon cost of complying with pricing & non-pricing policies
 - Overall climate ambition or comparability of effort via an **exemption**
- Crediting only carbon pricing has the advantage of being **conceptually straightforward** and **mirrors** the policy CBAM adjusts for (the EU ETS)
- It may however see **pushback** from trade partners for interfering with the nationally determined process of policy choice and ignoring CBDR-RC

Crediting carbon prices when implementing the CBAM

- CBAM recognizes prices effectively paid by imported products
- There is a need for an organised and objective test for what is being credited

A few proposed tests:

- 1. Is the carbon price explicit, i.e. visibly stated (tax) or revealed (market)?**
- 2. Does crediting contribute to the objectives of the CBAM?**
 - A. Addressing carbon leakage by ensuring foreign producers pay equal amount as local for CO₂
 - B. Promoting decarbonisation in third countries
- 3. Is it consistent with the EU ETS?**
 - A. Instruments recognized by the EU ETS
 - B. EU ETS-like instruments

Crediting carbon prices when implementing the CBAM

Where do explicit carbon prices come from?

1. Compliance systems

- i. Emissions trading systems (absolute or also intensity-based target?)
- ii. Taxation (on all domestic production or only on exports?)

2. Voluntary systems

- i. Credit certification systems (Verra, Gold Standard)
- ii. Systems for voluntary commitments (e.g. SBTi) that may allow for the use of third-party certification systems, or that may have their own credit certification system that can be used

Crediting for carbon price paid in emissions trading systems

- **Domestic credits:**

- + Represent a visible price and an effective payment (and cost) that the exporter has incurred in a climate regime
- The EU ETS, although it has a provision on domestic offsets, has consciously never triggered that provision

- **Considerations:**

- Ensuring that a particular product entering the EU pays the same amount for embedded emissions as domestic producers do under the EU ETS
- Overall burden that domestic and foreign producers face in meeting CO₂ obligations. By allowing use of offset credits towards compliance in the exporting country emissions trading system, as opposed to only allowances (assuming that credits are cheaper than allowances), the overall carbon cost of foreign producers would be diminished, and that would fail to level the playing field
- Quality of the offsets

Crediting for carbon price paid in emissions trading systems

- **International credits:**
 - + Represent a visible price and an effective payment (and cost) that the exporter has incurred in a climate regime
 - The EU ETS does not allow international credits
- Similar considerations as domestic credits

Crediting for carbon price paid in voluntary systems

- **Voluntary offsetting:**

- + Regardless of whether importers pay to a voluntary or compliance system, they will face the same cost (Δ to CBAM certificate price)
- CBAM will likely not credit voluntary instruments

- **Considerations:**

- Uncertainty exists, but regulator-set compliancy systems have higher probability of acceptance
- Granting recognition may lead to considering other systems to avoid discrimination – where are the limits?
- Quality of the offsets

Other variations of carbon pricing and borderline cases

1. Carbon pricing paid only on exports

- + Nothing in Article 9 directs that a carbon price must be paid on a sector-wide basis (i.e., on both exports and non-exports)
- Would diminish overall carbon cost faced by foreign producers, and that would fail to level the playing field

2. Taxes, fees and charges not directly linked to GHG intensity of production (ex. fossil fuel excise taxes)

- Lack essential character of carbon price and not equivalent to EU ETS
- It would need to account for similar charges within the EU
- Would be a challenging and complex process to administer, as well as diplomatically controversial and potentially illegal under WTO rules
- (+) Trade partners may begin converting excise taxes to carbon taxes

Other variations of carbon pricing and borderline cases

3. Climate-related regulations imposed on producers:

- Non-price-based regulations governing CBAM-covered sectors imposing cost on producers
- Crediting for such regulations without also debiting for similar regulations within the EU would undercut leakage prevention (similar challenges to point 2)

4. Carbon prices paid by producers of input goods (precursors):

- In the case of complex goods, presumably any carbon price paid by the producers of input goods (precursors) would also be valid grounds for claiming a reduction
- Country of origin of the relevant precursors, or the country of origin of the final good?

5. Carbon prices revealed under a tradable performance standard:

- Ex. The Australian Safeguard Mechanism that sets a facility-level GHG intensity standard (baseline) that covered installations must meet. If they beat the standard, they are issued credits that can then be sold to those that do not. The prices for which those credits are sold is a carbon price paid by the purchasing installations for carbon emitted in excess of the baseline
- CBAM credit would have to account for the fact that the purchasing installation only paid for its residual carbon. Any emissions up to the baseline level were not assessed a carbon price

Implementation of Carbon Pricing in Third Countries

- Carbon pricing is **challenging to implement** in practice; as with any climate policy, **non-compliance** and even fraud are a **reality**
- Administrative **capacity constraints**, weak institutions and different regulatory cultures can undermine rationale of crediting
- **Documentation** and **certification** requirements set out in Article 9(2) will therefore gain importance; further **guidance** is needed
- Still, the same carbon price will have **varying real-world effects** in different countries, and this may spill over to crediting debate

Conclusions

- Article 9 **narrows crediting** to carbon pricing effectively paid, but leaves considerable **uncertainty** about borderline cases
- **Future guidance** to operationalize Article 9 will have to address this uncertainty to **avoid confusion** among trade partners and producers
- Crediting should further the **objectives** of the CBAM, and aim for **consistency** with the policy it adjusts for, the EU ETS
- These criteria suggest that crediting will be applied **relatively narrowly**, and is likely to exclude offset credits and voluntary carbon pricing
- Not all domestic and foreign stakeholders will **agree to this approach**, and the EU should be prepared to **explain and defend it**