

# Addressing Exports in the EU Carbon Border Adjustment Mechanism

## *Policymaker Summary*

### **Authors**

*Andrei Marcu, Michael Mehling, Aaron Cosby, Alexandra Maratou*

## Who we are

ERCST is an independent, not-for-profit think tank, registered under Belgian law, based in the heart of the European quarter in Brussels. The mission of ERCST is to provide a neutral space where policymakers and regulators can meet stakeholders, and discuss climate change policy, including how to manage a sustainable transition to a low-carbon society. While focused on European climate policy, ERCST fully recognises, and incorporates in its activities and thinking, the global dimension of climate change policy. Our annual [State of the ETS Report](#) and our [work stream on CBAM](#) have become a well-acknowledged source of expertise for EU and International policymakers and professionals in the climate field.

## Supporters:

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European exports constitute a substantial share of overall production in sectors covered by the proposed EU Carbon Border Adjustment Mechanism (CBAM), while in terms of carbon intensity, EC exports, in many instances, compare favorably to foreign production. Consequently, it is highly likely that foreign production replacing EU exports will result in carbon leakage and loss of production and jobs in the EU along the whole value chain.

As currently proposed, however, the CBAM would only focus on averting carbon leakage, and the accompanying consequences, related to loss of domestic market share. It does not seek to limit or reverse emissions leakage related to substitution of European exports in global markets, despite the impact assessment carried out for the CBAM showing that an absence of any such safeguard will result in a considerable decline in European exports.

Given the importance of exports for both the economic viability of EU producers and the environmental objectives of the EU climate policy, this gap in the scope of the proposed CBAM regulation has understandably risen to the forefront of the policy debate, becoming a “red line” issue for key constituencies, and threatening to undermine political support for this indispensable component of the European Green Deal and accelerating climate ambition.

But just as the CBAM proposal from the European Commission and currently tabled amendments in the European Parliament and soon from the Council are far from “guaranteed to comply” with WTO law, so also would an export adjustment not necessarily represent a violation of WTO law. The fact of the matter is that neither the CBAM itself nor an export adjustment can be implemented entirely free of legal risk, all the more so since there has been no directly relevant case law to offer greater legal clarity.

As the legal analysis in this report has shown, however, reasonable arguments can be put forward – and indeed have been put forward by the EC with regard to free allocation under the EU ETS – to demonstrate that an export adjustment need not amount to a prohibited export subsidy. In other words, the legality of both the CBAM and an export adjustment may remain fundamentally uncertain, yet a reasonably strong case can be made for both legally.

Ultimately, it will be a matter of political courage to balance risks and benefits and make the right decision.

It also bears noting that emissions trading systems – as a response to an evolving and serious global crisis – were not in wide use when the current rules of the WTO and much of its subsequent case law were adopted. Future interpretations of these rules and relevant case law will need to recognize the dramatically changed political and societal environment in which the CBAM as well as any export provisions will be applied. In the face of a climate emergency, other measures that were previously unthinkable have now become acceptable, and the same is likely to occur with the CBAM.

Based on our assessment of proposals and discussions with a diverse group of stakeholders, as well as an in-depth analysis of the economic, political, legal, and environmental implications of an export adjustment, we believe that an export adjustment can be designed in a way that limits

legal risks while opening the door to a policy option that is likely to prove pivotal for public and stakeholder support of the European Green Deal.

Our analysis suggests that an export adjustment that leverages the dynamic incentive and existing administrative and regulatory structures of the system for free allocation of EUAs offers the most favorable balance of environmental effectiveness, practical feasibility, and limited legal risk.

While there is thus a hypothetical WTO or national retaliation risk, the solution for export-related leakage proposed by ERCST is described in the text box below:

#### **Incentive-aligned Export Adjustment Certificates**

- European producers of goods covered by the CBAM are required to annually declare the embodied emissions and volumes of covered goods exported to third countries during the preceding calendar year.
- Based on the existing product benchmarks used for free allocation of EUAs, these producers are issued non-tradable and non-transferable export adjustment certificates corresponding to the emissions intensity of the 10% least carbon intensive producers in the EU, or – for the 10% most efficient exporters – the actual emissions embodied in exported goods, prorated to reflect the gradually declining share of free allocation obtained by the producers.
- For the next compliance period, producers holding export adjustment certificates can exchange these for EUAs used towards compliance with their obligation to surrender EUAs for emissions from covered activities. The EUA will have to come from under the cap to ensure that the cap is not compromised.
- By providing an export adjustment based on product benchmarks, this approach retains a dynamic incentive for exporters to reduce the carbon intensity of production, counteracting an incentive to shift activities from production of goods for domestic consumption to goods destined for export.
- Also, by providing only partial remission of emission costs, a benchmark-based approach lowers the likelihood of overcompensating exported products relative to the compliance burden faced by products consumed domestically. Similarly, by being operationalized through export adjustment certificates rather than a financial reimbursement, it avoids the need to determine a process and timeline to establish the monetary value of EUAs (such as the weekly average closing price), which could introduce arbitrariness and again contribute to overcompensation. Finally, unlike EUAs or a financial reimbursement, export adjustment certificates do not constitute a direct transfer of funds or of tradable goods or services. Instead, they provide a partial remission of the costs borne by exported goods to comply with obligations under the EU ETS.

If the risk of a potential WTO conflict takes precedence over the risk of export-related leakage and a deindustrialized EU, however, then the gradual phase-out of free allowances as proposed by the European Commission, with additional backloading of the decline of free allocation towards the end of the 2036 deadline, could be a fallback option supported by ERCST.

Ultimately, the decision on whether or not to include an export adjustment under the CBAM is a political and not a legal one, reflecting the political priorities of the EU and a careful calibration of potential risks and benefits. Moving ahead with the CBAM without a solution to an important

potential carbon leakage channel such as leakage from exports is at best unwise, and at worst a political miscalculation that will be difficult and expensive to fix *post facto*.