

Carbon Border Adjustment Mechanism – IndustriAll Europe answer to the Public consultation (28/10/2020)

For industriAll Europe, increasing the EU climate ambition in a context of global asymmetrical climate policies requires – among other instruments - a Carbon Border Adjustment Mechanism (CBAM) to create a level playing field between domestic producers and their competitors from third countries. If industriAll Europe supports the general idea of having an EU CBAM to accompany the efforts to reduce emissions by 2030 and 2050, many issues related to its design and implementation will require further discussion among our membership. The aim of this document is to present IAE preliminary views on the need for a CBAM and to identify the main issues to be further discussed to ensure that the future mechanism will secure mutual benefits for the EU climate policy and for the EU industry and its workers. industriAll Europe stresses the need to base the upcoming CBAM proposal on sound sectoral analysis and impact assessments mainly to avoid to entail effects which could be detrimental to the EU industrial value chains.

Process wise, industriAll Europe deplores the way the questionnaire of the consultation has been framed since it does not allow to provide explanations of the choices made or to answer with an adequate level of nuance. In the same way, having a detailed questionnaire, notably on the sectors and subsectors that should be covered, does not really make sense given the major review of the EU climate policy framework ahead of us in the context of the “Fit to 55 package”. We believe more important to first agree on the key requirements a CBAM should fulfil. As a result, we consider this document as the relevant reference to present industriAll Europe preliminary views on CBAM. For further steps of the decision making process, and in order to adequately inform policy-makers, industriAll Europe stresses the need to intensively consult social partners from the various concerned sectors. The EU should also promote a thorough consultation of social partners in third countries, especially non-EU/EFTA European countries, to avoid disruptive changes that would impact workers in these countries.

Background

- Reaching climate neutrality by 2050, as announced in the European Green Deal Communication, represents an unprecedented challenge for the EU. In the same way, moving the 2030 EU emission reduction target from 40 to *at least* 55% - as proposed by the European Commission - triggers fundamental questions for the future of many industries. This is especially true for sectors that combine high emission and trade intensities. Decarbonising energy-intensive industries (EII) will require the deployment of technologies that will imply, at least in the short term, significant investments and therefore extra-cost for the sectors at stake. The recently adopted “Masterplan for a competitive transformation of EU Energy-Intensive Industries”, identifies higher CAPEX, higher OPEX and important Infrastructure needs for the main technology options identified to decarbonise the EII.
- In an open economy, where companies have to compete on European and global markets, these extra-costs, coming from climate policy, will only be economically viable if a series of accompanying measures are taken. Pushing technologies to the market through aggressive innovation policies will be of the utmost importance while creating lead markets through for

instance standards, public procurements or contracts for difference will have a major role to play too.

- Still, a proportionate and targeted CBAM should protect the EU producers from the **unfair competition of goods imported** in the EU from countries where carbon pricing schemes are not comparable or not even existing. For sectors where this is economically relevant, it should also reduce the impact of carbon pricing instruments on **EU companies exporting to markets with low or non-existing carbon price**, in a way that **should not lead to significant relocation of downstream industries** .
- As shown by the recent failure to reach an agreement on the implementation of the Paris Agreement Article 6, having a global carbon-pricing system remains a concept without foreseeable implementation. Despite decades of intense negotiations, it has been impossible to make significant progress in the set up of a global carbon pricing mechanism. New initiatives need to be launched to level the playing field on the global markets EII are operating.
- In addition, EII remain important job providers in the EU (almost 6 million of workers in the EU) and are of the utmost strategic importance for a series of industrial sectors downstream the value chains (automotive, defence, shipbuilding, aerospace, rail, construction). Keeping and strengthening the related integrated value chains in the EU must be a political priority for the EU.
- As a result, an EU CBAM is an important element of a series of instruments that must lead to decarbonise these strategic sectors through innovation and investment without hampering their profitability and without threatening the related jobs.
- The recently published “Stepping up Europe’s 2030 climate ambition” has confirmed the intention of the European Commission to dramatically accelerate the pace of decarbonisation across sectors. It also announced a large and deep review of the EU climate-related policy instruments and notably a reform of the EU ETS with concrete legislative proposals expected for June 2021. In that context, we don’t think that identifying at this stage all the practical details of a CBAM would make a lot of sense. The European Commission should first identify the key requirements to be fulfilled to make the CBAM working accordingly and then come with operational details with the expected June legislative proposals.

Important implementation issues

While many aspects of the CBAM will require further technical and political discussions, IndustriAll Europe has already identified the following elements as guiding principles for the upcoming decision-making process:

- Choosing a **legal basis** that would allow to adopt the instrument through an ordinary legislative procedure (OLP) in order to avoid the unanimity requirement which is always an uncertain path to follow, is crucial to have the CBAM on time to complement the revised 2030 EU climate policy package and cope with its consequences for EII competitiveness. In other words, ART 192 §1 of TFEU offers a safer legal basis than Art 192 §2 a), or Art 113 (Taxation). Passerelle clause could be envisaged to circumvent the unanimity requirements related to taxation but if there is no unanimity to activate it, legal basis allowing for decisions through OLP must be the preferred option.

- The **scope** must be targeted to sectors that are really in need of such a system. Making a full list would require an in-depth assessment of sectorial business models but sectors with high emissions – energy or process related - and exposed to a fierce competition on EU and global markets should be a priority. Sectors such as steel and basic metal, cement, fertilizers, electricity would be the most obvious sectors to be covered by the CBAM, without prejudging what the final list might look like. To cope with technological, regulatory and market change, the CBAM should be dynamic and its scope should be regularly reviewed.
- To **limit the risk of delocalisation of manufacturing activities downstream** the value chain, CBAM should also apply to intermediate and finished products. A CBAM that would lead to off shore assembly or finishing industrial activities would be an unacceptable threat to employment in industries and would be in conflict with the EU industrial strategy. But to reduce administrative cost and keep the system manageable, regarding those goods, the CBAM should only focus on components with a high carbon footprint.
- **WTO compatibility and outreach.** A fair and regulated international trade, based on multilateral rules, remains important for the EU industry. A CBAM should not be designed in a way that would damage the EU industry insertion in global value chains. The EU CBAM must therefore be in line with WTO rules. It must be based on clear and non-arbitrary criteria in order to provide for equal treatment for all trade partners and also provide equal treatment for domestic and foreign producers. Beyond the legal dimension, the EU should launch a massive outreach strategy to explain in relevant international fora (WTO, UNCTAD, G 20, UNFCCC) and bilaterally how the CBAM will work. The aim must be here to limit retaliation measures from trade partners by reassuring them on the non-discriminatory nature of the CBAM, keeping in mind that retaliation measures can lead to the introduction of a complaint under the WTO dispute settlement system. Moreover, the CBAM implementation should not lead to disruptive changes for workers in third countries, and notably in non-EU European countries.
- **Level/ intensity of the adjustment.** The adjustment will have to be strictly proportionate to the additional costs due to the impact of the ETS allowances have on production costs. Indirect cost of the ETS through electricity price might be considered for the sectors at stake as well. Regarding the level of the “carbon adjustment”, it should be avoided to hurt disproportionately those industries downstream the value chain, that are not covered by the ETS, but for which access to the goods produced by EII is a matter of competitiveness. Affordable basic materials is a matter of competitiveness for a series of strategic sectors such as automotive, ship building, aerospace, rail supply equipment, energy equipment. The design of CBAM should protect EII against carbon leakage without threatening other sectors.
- **Link with existing instruments to cushion carbon leakage.** The European Commission Green Deal Communication presents the CBAM as an alternative to the existing instruments to protect industries from carbon leakage (mainly free allocation and compensation for the increase of electricity cost). This question will obviously require further discussion to ensure that no disproportionate windfall profits will be created but also to avoid disruptive change that might threaten short term profitability of sectors at stake. In the same way, the role of free allocation as a trigger to invest in existing plants should be explored. Moreover, preserving the competitiveness of EU exporting industries might require to explore hybrid systems where CBAM would target imports whereas free allocation would be used for exports.
- **Use of financial resources.** Combined with auctioning revenues, the CBAM might generate significant new and additional financial resources. Here again, taking a clear position on

where and how money will be used is premature. However, bridging the investment gap to decarbonise the industries covered by the ETS should be the main objective ascribed to these new public financial resources in order to speed up the roll out of breakthrough technologies and related infrastructures.

- **EU Recovery and Next Generation EU.** To overcome the COVID 19 related economic crisis the EU has decided to borrow 750bn EUR on financial markets. To soften the impact of reimbursement on Member states contributions without siphoning EU funds and programmes, new own resources should be adopted in the coming years. CBAM has been identified as a possible new resource for the EU budget. The main objective of a CBAM is to level the playing field and protect the EU industry from climate free-riding in third countries and it should be designed as such. Once the system will be operational, it should be seen if – and in what proportion – it can contribute to NGEU reimbursement.