

EUROPEAN COMMISSION CONSULTS ON A CARBON BORDER MECHANISM

Date: 29 July 2020

European Policy and Regulatory Alert

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On 11 December 2019, the European Commission (Commission) unveiled the [European Green Deal](#) (Green Deal), an ambitious environmental and climate set of policy proposals aiming to achieve carbon neutrality in Europe by 2050. More concretely, the Green Deal emphasized that “should differences in levels of ambition worldwide persist, as the EU increases its climate ambition, the Commission will propose a carbon border adjustment mechanism, for selected sectors, to reduce the risk of carbon leakage.”

To this end, on 22 July 2020, the Commission initiated a consultation process on a possible proposal for a carbon border adjustment mechanism (CBAM) that would aim to ensure that the price of imports reflects more accurately their carbon content. The Commission notes that the CBAM would be an alternative to the current free allocation of allowances or compensation for the increase in electricity costs that address the risk of carbon leakage because of carbon pricing in the EU's Emissions Trading System (ETS).

Moreover, the Commission also sees the CBAM as a tax policy option to finance the post-COVID19 economic recovery in Europe. In the [COVID-19 recovery deal](#) agreed by European leaders a few days ago, carbon taxation, with an estimated potential to raise between €5–14 billion annually, features as one of the possible additional new revenue sources for the EU budget and to finance the post-COVID-19 EU economic recovery.

KEY FEATURES OF THE CARBON BORDER MECHANISM

An EU CBAM will make more expensive the import of carbon intensive products and will lead to shifting consumption towards more sustainable products in the EU and in non-EU countries. In this context the Commission's [public consultation](#) on the carbon border mechanism seeks input on the following aspects:

The form that the carbon border adjustment mechanism could take

The Commission consultation indicates that the mechanism could take one of the following forms, all of which should be aligned with the Green Deal policies, current EU legislation and the EU's international obligations:

- A tax applied on imports at the EU border on a selection of products whose production is in sectors that are at risk of carbon leakage, which would take the form of a border tax or customs duty on selected carbon intensive products;
- An extension of the EU Emissions Trading System (EU ETS) to imports, which could require the purchasing of emission allowances under the EU ETS by either foreign producers or importers;¹
- The obligation to purchase allowances from a specific pool outside the EU ETS dedicated to imports, which would mirror the ETS price;

- A carbon tax (e.g. excise or VAT type) at consumption level on a selection of products whose production is in sectors that are at risk of carbon leakage. The Commission indicates that this option would apply to EU production, as well as to imports.

Determining the carbon content of imports

The Commission outlines a number of options concerning the calculation of the carbon content of imports, taking into account their interaction with existing and future climate policies. These include, among other things, product benchmark values and methods for the verification of carbon content, where the exporter will have to certify a lower carbon content and/or a higher carbon cost at origin.

The priority sectors that the carbon border mechanism should focus on

The Commission consults on a list of sectors, where the risk of carbon leakage is the highest. In fact, the January 2020 [draft guidelines on ETS State aid](#) suggest that the production of aluminum, iron, and steel and the manufacture of pulp and paper are among the sectors exposed to a genuine risk of carbon leakage.

NEXT STEPS

It is clear that the implementation of a carbon border mechanism would affect companies in every sector, regardless of whether they are established in Europe or paying the levy directly or indirectly. This means that no matter which form the CBAM will take, it has the potential to push both EU and non-EU companies towards reducing their carbon footprint. By engaging in the consultation, businesses have the opportunity to make their views and circumstances known and increase chances of avoiding unintended consequences that too many times are the produce of new measures of this type. It is also the time for companies that have strong reservations or concerns about the CBAM to express them by responding to the consultation. The feedback period for the consultation will run until 28 October 2020, with a legislative proposal currently planned for the second quarter of 2021. Importantly, a more technical consultation for specialized audiences will follow, while dialogue with third countries will take place through World Trade Organization channels.

FOOTNOTES

¹ The EU ETS system works by putting a limit on overall emissions from covered installations, which is reduced each year. Within this limit, companies can buy and sell emission allowances as needed, while some allowances are provided for free to certain industries on the basis of harmonised rules. In particular, the Commission will evaluate the carbon border's mechanism complementarity with the EU ETS taking into account that any new measure should be commensurate with the internal EU carbon price.

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