

FEDIL'S POSITION ON CARBON BORDER ADJUSTMENT (CBA)

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The Green Deal acknowledges the risk of carbon leakage for reasons of costs related to climate policies “either because *production* is transferred from the EU to other countries [...], or because EU products are replaced by more carbon-intensive *imports*” **.

While free allocations address *production relocation issues*, CBA can effectively address emissions embedded in *imports*.

The most concerned EU industries are those that have both: high energy consumption *and* high trade intensity. Examples in Luxembourg are the aluminium and steel industry.

With increasing carbon costs, trade intensity in other energy intensive manufacturing sectors such as glass and cement production is expected to rise. We can expect their call for a CBA on a mid-term time horizon.



ETS' additionalities for climate protection can be leveraged when carbon leakage protection measures (free allocations & indirect cost compensation) are **complemented** by carbon import prevention measures (CBA) in the concerned EU industries.

**[EU communication on Green Deal](#), December 2019, page 5

HOW CAN COMPLEMENTARY CBA HELP TO REACH EU CLIMATE OBJECTIVES?

The complementarity of CBA is not going to undermine climate objectives as the free allocations are only partial and increasingly degressive, and it is still capping the total permissible EU emissions. Thus climate objectives are not put in doubt.

On the contrary, without CBA, the competitiveness gap between EU producers and third country manufacturers will continue to widen as besides the free allocations and indirect cost compensations that are both partial and degressive, EU producers bear the full costs of developing and switching to low-carbon technologies, including higher post-switching operational costs.

CBA can furthermore incentivise third countries to either join EU ETS or to introduce an own carbon pricing system and thus help to close the competitiveness gap and reach global climate objectives.

A widening competitiveness gap is known to be a prime source of carbon leakage and increasing carbon embedded imports. CBA can help to slow down this gap to further widen and thus contribute to climate objectives.

MAJOR DESIGN CHALLENGES OF A CBA

An effective CBA measure must address the two challenges below:

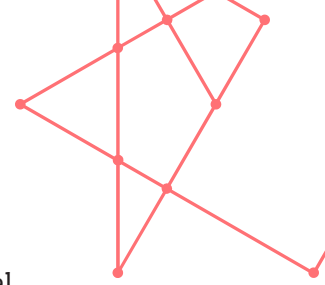
1. **Absorption risk may prevent closure of competitiveness gap:**

-While EU carbon costs apply to the entire production of an EU company, a carbon border measure is likely to apply only to the marginal volumes of a third country producers' export to the EU – hence, third country producers can dilute and absorb costs of a CBA throughout their entire production.

2. **Source shifting may prevent climate protection:**

-Third country producers may reorganise to export to the EU their lowest carbon footprint products while products with high embedded emissions are sold to other markets.

While the development of CBA must progress rapidly, CBA implementation cannot substitute free allocations and indirect cost compensations as long as the above two points are not fully understood and mastered.



ESSENTIAL DESIGN ELEMENTS OF A CBA

- Apply CBA initially on few energy intensive industries (EII), such as steel and aluminium with the option for other sectors to gradually join;
- Start with EII's finished and semi-finished products, such as coils, slabs, plates bars, etc to be extended gradually to the a wider range of the value chain;
- Implement CBA as a complementary measure to existing carbon leakage provisions in the transition towards climate neutrality;
- Implement CBA to neutralise the costs of EU ETS for EU exports towards countries with no or lower carbon prices than in the EU;
- Determine goods' carbon footprint by including their transport-related emissions as well as other EU regulated pollutants (NO_x, SO_x, etc.);
- Include provisions into CBA to reverse the trend of increasing exports of secondary raw materials to empower circular economy.