AEGIS EUROPE

European Commission Public Consultation
on the Carbon Border Adjustment

Response of AEGIS Europe

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AEGIS Europe is an industry alliance that brings together more than 20 European trade associations committed to manufacturing in the EU, a truly level playing field, and the fostering of growth through rules-based free and fair international trade. Our members account for more than €500 billion in annual turnover, as well as for millions of jobs across the EU. We support the goals of the European Union to fight climate change and make Europe the most sustainable economy globally. To achieve those goals, it is essential that the EU put in place policies that strengthen the Union's manufacturing industries and keep EU manufacturing value chains competitive.

A general remark in relation to the Commission's consultation on the carbon border adjustment mechanism (CBAM) is that many of the questions are so vague that answers could be misinterpreted or, even worse, might be used to justify a course of action which AEGIS Europe did not intend to support. Accordingly, AEGIS Europe only answers those questions which it views as unambiguous.

This note which accompanies the questionnaire response highlights the issues of highest and common concern for EU manufacturers regardless of the option chosen for the CBAM legislative proposal.

Free allowances and indirect costs compensation must remain

First and foremost, AEGIS Europe wishes to highlight that regardless of the form the Commission might propose for a CBAM, and the sectors and products to which it would apply, the introduction of a CBAM cannot be seen as a justification for the ending of free allowances and indirect costs compensation.

It is absolutely necessary to maintain free allowances and indirect costs compensation under the ETS reform in order to avoid abrupt modifications of the legal framework and disruptive impacts, as well as to minimize the impact on downstream partners in the value chains.

Indeed, the impact of the introduction of the CBAM would depend very much not only on its design, but also on the manner of its implementation and enforcement. In any event, a CBAM cannot simply and automatically be seen as compensating the loss of other EU measures

intended to counteract carbon leakage, especially in the light of the EU's increased climate ambitions.

In addition, even if the CBAM itself were reimbursed with regard to products exported from the EU, a CBAM would not address the carbon leakage related to the ETS costs of sectors which export. With the increase in EU climate ambitions, those costs are only going to rise, and a CBAM would not address this aspect of the difference in climate ambitions between the EU and third countries. Thus, free allowances must be maintained, and even additional measures will be needed, to safeguard a level playing field and the export competitiveness of EU manufacturers.

Furthermore, indirect costs compensation addresses the carbon leakage risk related to the indirect carbon costs of electricity (which refer to the carbon costs in electricity use) in the EU rather than indirect emissions (which refer to carbon emissions in electricity).

For all these reasons, the introduction of a CBAM cannot be a justification for the ending of existing free allowances and indirect costs compensation.

Complementary measures are essential for sectors where a CBAM would not be effective against the risk of carbon leakage

A CBAM would not be effective for some sectors highly exposed and facing investment and carbon leakage, making it essential to consider complementary measures for them, in addition to free allocations and indirect costs compensation maintained at the level currently foreseen for Phase IV of the ETS, to ensure the equal treatment of all products placed on the EU market with regard to the costs and limitations of decarbonisation measures.

In particular, because carbon leakage is a reality and will increase with the EU's higher climate ambitions, additional complementary measures need to be considered for sectors and products for which a carbon leakage risk is identified but to which a CBAM would not apply.

For some, product manufacturing standards could be one tool to limit access to the EU market of products representing a carbon footprint above a certain threshold, and thereby limit carbon leakage to the extent products made in the EU have a carbon footprint below that threshold.

In any event, these complementary measures must first be identified and then elaborated and assessed in close consultation with concerned stakeholders, including industry.

A CBAM would need to apply to all imports of a given product regardless of source or origin

Regardless of its form, and to be coherent with the aim of encouraging global efforts against climate change, a CBAM would need to apply to imports from all sources, whatever the trade or economic designation of those sources. In other words, there should be no exceptions for developing countries, least developed countries or countries with preferential trade arrangements with the EU. Allowing for exceptions would not be coherent with the EU's green objectives and it would simply complicate administration as well as increase opportunities for circumvention.

The only possible adjustments of the cost element of any CBAM, including the establishment of linkages with third country carbon costing and reduction mechanisms, must be conditional on the provision of verifiable data which is in fact verified to establish effectively comparable carbon costs and reduction obligations in the places where the essential manufacturing steps occur, with proper mechanisms also in place to address non-cooperation (even partial), circumvention, absorption, source shifting, etc.

The measurement of emissions for imports must avoid giving importers undue advantage

The measurement and definition of the carbon footprint of imported products is critical to the creation of a robust and effective CBAM, regardless of the form of the CBAM.

Ideally, the EU must introduce full carbon accounting for all products placed on the EU market, covering the entire value chain, upstream and downstream, from the primary raw materials and other inputs (including energy) down to final end products, and include transport to the EU port of final destination. This would require a thorough analysis of the whole supply chain for each sector in order to capture sectoral specificities and needs, especially during any transitional period.

This in turn would require an entire administration capable of investigating the total manufacturing emissions in the places where the essential manufacturing steps occur, including a proper and efficient system of measurement, with incentives and sanctions to maximise the cooperation of importers and their third country suppliers. As a baseline principle, access to the EU market should be granted only to those third country producers that provide their data in a timely and complete manner, and allow it to be verified.

To the extent a transitional system based on default values is used until full carbon accounting is possible, the methodology used must

- not allow free-riding or increase substantially the risk of avoidance that would undermine the environmental objective of the measure;

- avoid giving an undue advantage to importers, especially as the carbon footprint of EU industry must decrease under ambitious climate targets written into EU law;

- reflect the relevant cap or limitation on EU carbon emissions, as well as the cost for those emissions which are permitted.

This implies that any default values used for the measurement of emissions and the related charge would need to be set at a sufficiently high level, and that the system be resourced and flexible enough to adjust rapidly to trade flow manipulation.

The use of EU benchmarks (which are based on the best 10% of EU installations) would undermine entirely both the environmental rationale of the CBAM and its effectiveness. Indeed, it would represent unrealistic assumptions about the carbon footprint of third country production, and would not provide any substantial incentive for importers and third country producers to cooperate and reduce their carbon emissions.

To the extent actual data would be utilised, there would again need to be a baseline principle that access to the EU market would be granted only to those third country producers that provide their data, for all their production, in a timely and complete manner, and allow it to be verified.

In addition, exporting producers and importers must be required to provide data for total production of all related companies so as to allow the identification of significant source shifting / shuffling potential (i.e. the potential to avoid a CBAM by sending to the EU products with a low carbon footprint and selling on other markets products with a high carbon footprint).

In relation to verification, it is essential that there be controls on the measurement of emissions by independent bodies specifically authorised by the EU for such purposes. Those bodies must be subject to the requirements, controls and sanctions laid down by EU law.

It would in any event not be acceptable simply to make use of the Commission Product Environmental Footprint method, which does not measure the carbon footprint as such and has issues in its implementation.

Downstream carbon leakage must be avoided

In relation to each of the options described in the Commission's CBAM questionnaire, there is an indication that a proposed CBAM would apply only to certain sectors considered to be at risk of carbon leakage, and even then only to a selection of products of those sectors. While the overall impact of a CBAM would depend on the exact design of the measure, this selectiveness in the application of a CBAM raises a concern about the possible increased risk of carbon leakage of EU industries operating downstream from the sectors to which the CBAM would apply, when those sectors are also exposed to global competition and cannot pass on carbon costs without the risk of losing market share.

At a minimum, to the extent the scope of the CBAM would be fixed to cover only selected products within certain sectors for some period of time,

- existing carbon leakage measures need to remain in place in order to mitigate the possible impact on downstream sectors,

- the CBAM should be extended if feasible to certain downstream products as appropriate and with the agreement of any sectors concerned, based on an evaluation of the cost impact on operators in those downstream sectors, as well as of the degree of their exposure to the various forms of carbon leakage that might result from the CBAM itself.

The extension of the CBAM to certain downstream products should occur both:

- at the introduction of the CBAM, when justified based on an initial evaluation of the downstream cost impact and carbon leakage exposure, and

- at any point following the introduction of the CBAM, when justified based on an updated evaluation of the downstream cost impact and carbon leakage exposure.

In any event, any CBAM on inputs should be rebated upon export of downstream products from the EU as necessary and consistent with the environmental rationale of the CBAM and the intention to provide an incentive for third countries to introduce proper carbon costing mechanisms.

Sanctions must be timely and effective to preserve the integrity of the CBAM

There must be strong sanctions for any non-cooperation (even partial) by importers or third country producers. Non- or partial cooperation includes the submission of untimely, incomplete, false or misleading emission footprint declarations, or the lack of full cooperation with on-site verification visits at the places where essential manufacturing steps occur. EU importers must have final legal responsibility for the veracity of declarations and those without an adequately clean track record must be required to put up sufficient guarantees prior to importation.

In addition, a CBAM framework must provide effective and timely sanctions of any

- source shifting / shuffling;

- absorption of the carbon emission costs by the exporting producer/importer, as well as any government subsidisation of those costs;

- activities undertaken to circumvent the application of the CBAM.

For example, major source shifting / shuffling could be sanctioned with a surcharge on the existing CBAM, a shift to a default value CBAM at a sufficiently high level, or the measurement and allocation of a carbon footprint determination based on total production emissions of a given producer, or of a given country's producers in cases where there is substantial State involvement in setting industrial policy for that sector.

It is to be noted that circumvention activities may include the activities of individual companies, the activities of a combination of companies, or the activities of one or more entities under the direction of governments or government agencies.

In any event, any failure (even partial) of third country producers to provide full and timely cooperation in an EU investigation of such activities should result in the denial of EU market access to their products.

Third country linkages must be based on compatible systems, monitored and enforced

Any agreements for linkage with third countries must be predicated only on comprehensive and effectively implemented carbon pricing across borders at a level of ambition which is at least high as the EU's and results in similar costs and limitations for a similar carbon footprint in a given sector. Such agreements must also include provisions for adequate monitoring, verification and sanctions.

The EU must not delay the application of a fully effective CBAM due to pending discussions about linkages with third countries.

Additional administration is inevitable in relation to an effective CBAM, but clear EU-level rules, including an importer pre-notification requirement, can foster efficiency

The establishment, implementation and verification and enforcement of a proper CBAM mechanism will unavoidably involve new requirements for EU importers and third country exporters, as well as require additional EU and Member State resources. The aim to minimize the additional burdens cannot outweigh the need for the CBAM to be sufficiently robust, enforceable and enforced in order to contribute meaningfully to the attainment of the EU's climate objectives.

Specifically, there need to be sufficiently detailed rules at EU level to ensure the availability of complete and timely information, and the application of effective and dissuasive Member State measures to penalise avoidance. In addition, there needs to be sufficient Commission involvement to handle properly contacts with third country producers and to ensure a harmonised approach to the application of the CBAM.

In order to allow Member States to be most efficient in the implementation of a CBAM, all importers should be required to pre-notify to the relevant EU customs authorities complete CBAM-related information concerning the imports, including the places where the essential manufacturing steps have occurred or are occurring and full details of the carbon footprint determination, so as to allow sufficient time for appropriate controls.