

EFET position paper on the EU Carbon Border Adjustment Mechanism

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The European Federation of Energy Traders (EFET)¹ welcomes the opportunity to contribute to the Commission's public consultation on a Carbon Border Adjustment Mechanism (CBAM).

We welcome the Commission's intention to ensure *"the complementarity of the measure with internal carbon pricing, in particular the EU ETS,"*² and that the prospective CBAM is *"commensurate with the internal EU carbon price."*³

We believe that the CBAM should be integrated with the EU ETS by way of expanding the EU ETS to cover imports into the EU. This design option will allow the CBAM to deliver on its main goal – ensuring that the price of imports reflects more accurately their carbon content – in an efficient and transparent way, while strengthening the international role of the EU ETS, the world's largest emissions trading market.

This approach will be in line with the 2030 Climate Target Plan, which foresees a reinforced role for the expanded and refined EU ETS as a key tool for cost-effective greenhouse gas emissions reduction. Introducing a CBAM integrated with the EU ETS would therefore ensure

- A) Full alignment of the CBAM with the existing energy and climate policy framework and carbon pricing in the EU;
- B) Ease of implementation of CBAM by way of using the existing EU ETS infrastructure;
- C) Transparency and a level playing field when it comes to the price of carbon paid by importers and EU producers respectively.

In order to ensure the efficient functioning of a CBAM integrated with the EU ETS, its design should be based on the following principles:

A) Introduction of a CBAM in a given sector must entail gradual phase out of free allocation in this sector.

This principle is instrumental to deliver on one of the policy objectives of CBAM, which is to provide an alternative to free allocation. Using the existing common EU benchmarks, standards and infrastructure designed to limit carbon leakage will help reducing administrative complexity of CBAM implementation and ensure its transparency.

B) A decrease in free allocation should be matched with the corresponding increase in the auctioning share of the EUAs.

Auctioning is the default method of allocating allowances within the EU ETS, which ensures transparency of allowances' allocation and puts into practice the 'polluter pays' principles without causing market distortions.

¹ The European Federation of Energy Traders (EFET) promotes competition, transparency and open access in the European energy sector. We build trust in power and gas markets across Europe, so that they may underpin a sustainable and secure energy supply and enable the transition to a carbon neutral economy. We currently represent more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org.

² Inception Impact Assessment for a Carbon Border Adjustment Mechanism, European Commission, p.2

³ Ibid.

An increase in the auctioning share of the EUAs and the potential expansion of the EU ETS would allow boosting the financing of clean energy innovation across the sectors covered by the EU ETS and beyond. The Commission's communication on the EU budget powering the recovery plan for Europe recognises the important role of auction revenues generated by the EU ETS in supporting Europe's economic recovery.⁴ More specifically, the communication estimates that the EU ETS could generate revenues for the EU budget of about EUR 10 billion, depending on the evolution of the carbon price and the expansion of the system to other sectors.⁵

We urge the Commission to avoid introducing the obligation to purchase allowances from a specific pool outside the ETS dedicated to imports, as it would lead to market fragmentation and add a substantial layer of administrative complexity to the design and implementation of a CBAM.

We would also like to recall that the possibility of including importers of products covering sectors exposed to significant risks of carbon leakage is already mentioned both in the 2003 EU ETS Directive (2003/87/EC) and the revised EU ETS Directive (2018/410).⁶

In addition to that, the recent draft opinion of the European Parliament's Budget Committee on CBAM "acknowledges that **the primary purpose of [...] CBAM must be to enable internationally effective carbon pricing schemes.**"⁷ Introducing a CBAM integrated with the EU ETS would ultimately incentivise closer alignment between carbon abatement measures and climate policy instruments outside the EU and the EU ETS, including potential establishment of emissions trading systems at national and at regional level outside the EU and their prospective linking with the EU ETS. This approach would support the expansion of carbon trading both within Europe and internationally, which constitutes the most efficient solution to address carbon leakage and to reduce global CO₂ emissions cost-effectively. At the same time the application of a CBAM should also take into account the level of social and economic development of export countries along the lines of the WTO rules referred to as "special and differential treatment" (S&D) provisions.

In this context, a CBAM integrated with the EU ETS could also give an impetus to the ongoing work carried out at international level on Article 6 of the Paris Agreement - which provides for the use of international carbon markets for achieving the emissions reduction targets set by the Parties - one of the key topics on the agenda of the upcoming COP26.

Therefore, if a third country has an ETS linked to the EU ETS, the CBAM should not be levied; this approach would further support the expansion of the EU ETS at a global scale.

None of the alternative CBAM design options would be as efficient and transparent as integrating CBAM with the EU ETS

As discussed above, we believe that integrating CBAM with the EU ETS by way of expanding the EU ETS to cover imports into the EU constitutes the most efficient and transparent CBAM design option.

⁴ See the Commission's communication on the EU budget powering the recovery plan for Europe COM (2020) 442, p.15

⁵ Ibid.

⁶ See Article 10b of the EU ETS Directive (2003/87/EC)

⁷ 2020/2043(INI), p.3

A carbon border tariff or a tax will not deliver the benefits for the EU carbon market and efficient carbon leakage reduction which a CBAM integrated with the EU ETS would bring.

Ensuring compatibility of such a design option with WTO rules, as well as its transparency, credibility and administrative ease, will also be challenging, in particular, if applied to basic energy commodities, such as electricity and gas. Indeed, any imposition of a tariff or charge on just a selection of standard transactions will impede cross border trade in liquid, open, pan-European wholesale markets in power and gas. By contrast, cross border deals in energy intensive industrial products like cement or steel are fewer, more quality specific and less standardized.

Most importantly, however, the introduction of a carbon border tariff or a tax may bring a number of adverse consequences and impede rather than facilitate international carbon abatement. More specifically, a tax/ tariff system may lead to a waterbed effect whereby a decrease in emissions in one country (or sector) is offset by an increase in other countries (or sectors), i.e. exporters could - to some extent – “reroute their products from countries that levy carbon tariffs to unregulated markets.”⁸

Furthermore, including additional environmental and sustainability characteristics of products, other than CO₂, is challenging due to a lack of international standards, as well as credible and transparent monitoring and reporting systems. Moreover, as researchers point out, companies might object to disclosing details of their supply chains’ performance “which are often considered to be trade secrets.”⁹

Ultimately, tariffs and taxes are less amendable than emissions trading schemes to international linkages or enabling trade of carbon reduction credits. Choosing an alternative design option over a CBAM integrated with the EU ETS would therefore be a missed opportunity for Europe to strengthen the international role of the EU ETS, and foster expansion of carbon trading internationally, in order to address carbon leakage and to reduce global CO₂ emissions cost-effectively.

⁸ A European carbon border tax: much pain, little gain, Bruegel, 2020, p.8

⁹ Ibid.