

EU Carbon Border Adjustment Mechanism and its implications for Switzerland and other countries

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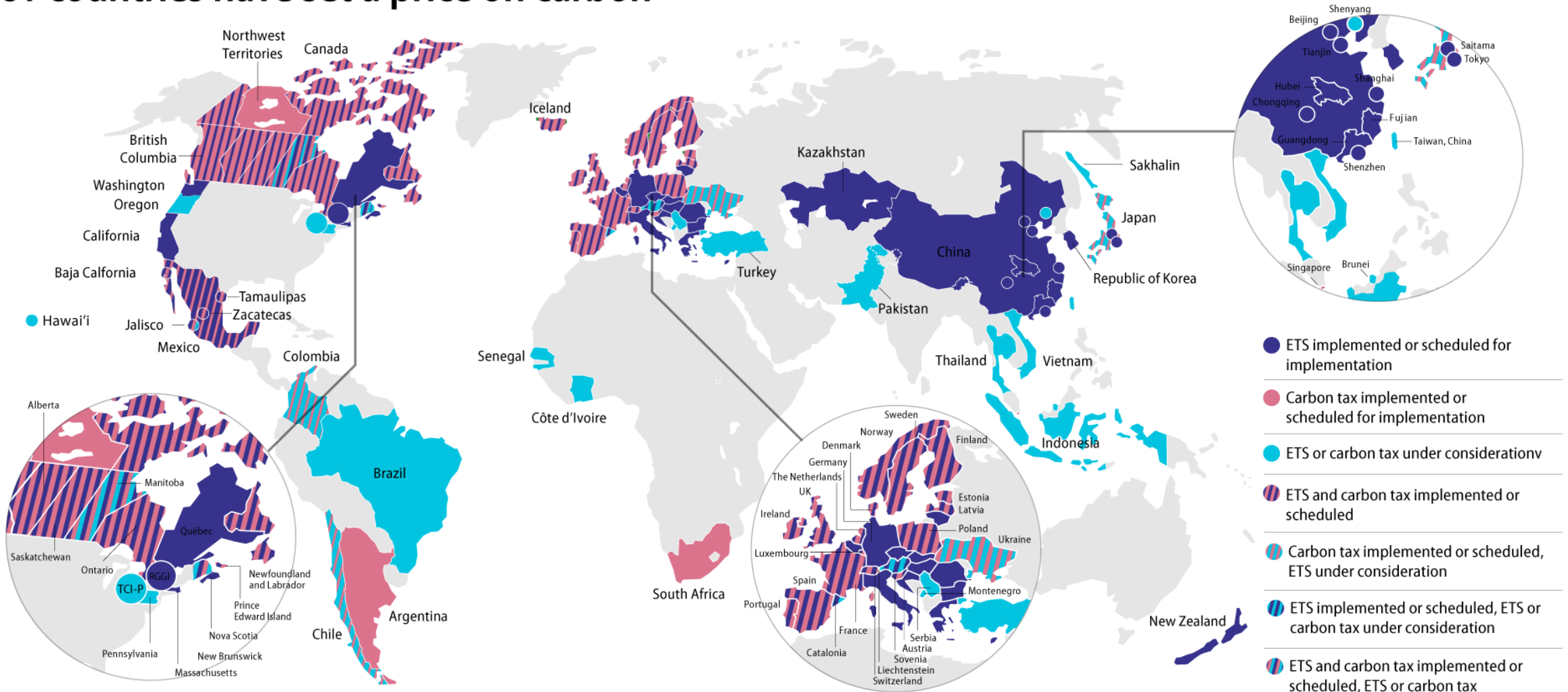
Swiss Energy Law Association Webinar
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Outline

1. The purpose of CBAM
2. Design details
3. WTO law compliance
4. Implications for Switzerland and other countries

1. The purpose of CBAM

61 countries have set a price on carbon



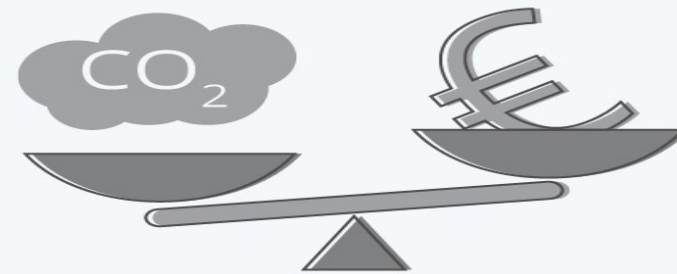
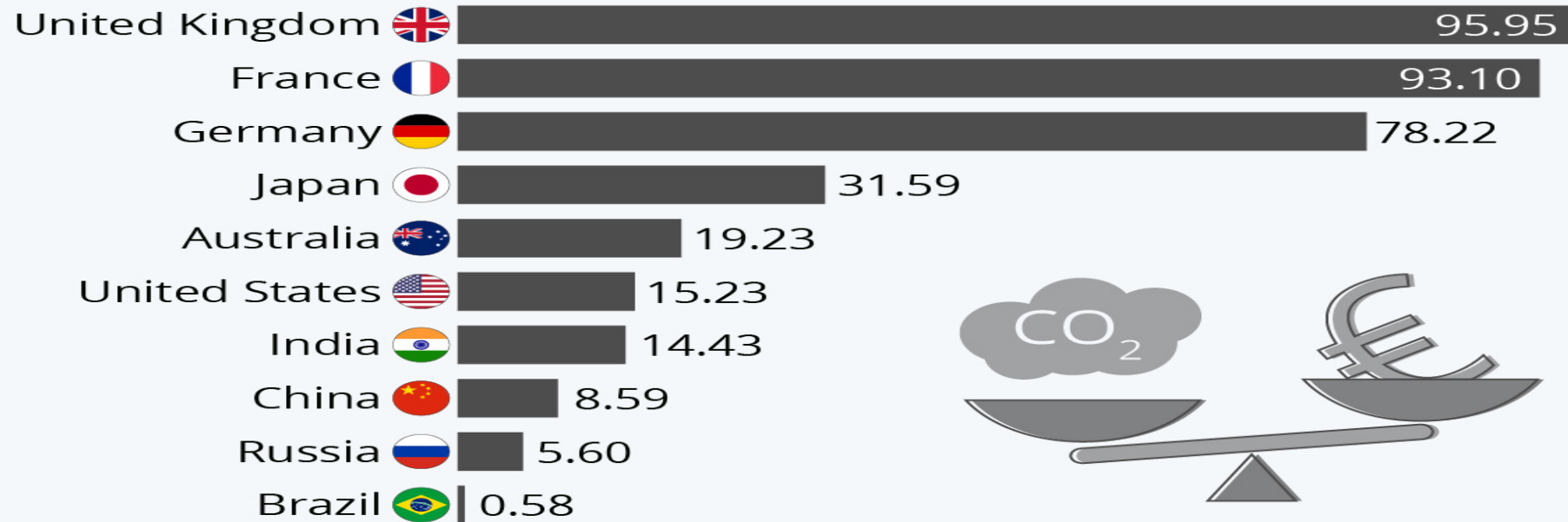
TCI-P = Transportation and Climate initiative Program
 RGGI = Regional Greenhouse Gas Initiative

Source: 10insightsclimate.science
 UEF // University of Eastern Finland

Adapted from World Bank, 2021

How the World Puts a Price on Carbon

Average carbon prices in selected countries in 2021
(EUR per tonne of CO₂)

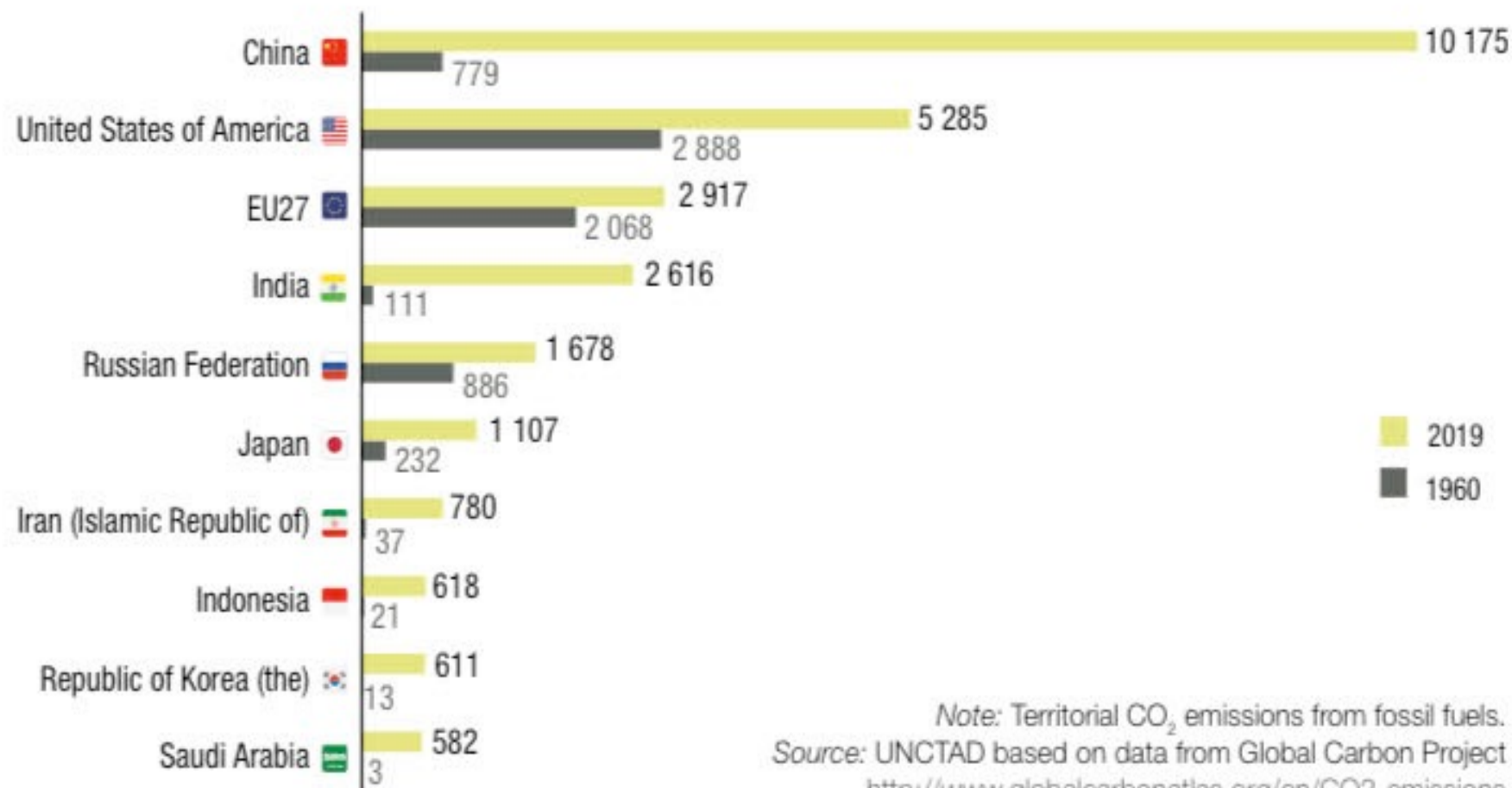


Based on taxes applicable on 1 April 2021.
Source: OECD



statista

Figure 1 | Yearly emissions in million Mt CO₂, 1960 and 2019, top ten global emitters in 2019.



The EU emissions trading scheme (EU ETS)

- Limits emissions from around 10,000 installations in the power sector and manufacturing industry, as well as airlines operating between EEA countries.
- Cap-and-trade system: emissions allowances can be sold to others if in excess, and bought from others if in deficit.
- Operates in all EU countries plus Iceland, Liechtenstein and Norway (EEA-EFTA states).
- Covers around 40% of EU GHG emissions. Emissions from ETS sectors declined by 43% over 2005-2020.
- Big challenge: competitiveness concerns and carbon leakage, so far addressed through emissions allowances distributed for free to most vulnerable sectors ('emissions intensive and trade exposed').

Border carbon adjustment as an alternative safeguard to carbon leakage

- What to do when the emissions cap becomes too tight and **free allowances are not available** in enough quantities? - **Border carbon adjustment** is a proposed solution!
- Proposal for a regulation establishing a Carbon Border Adjustment Mechanism (CBAM) issued by the European Commission on 14 July 2021.

CBAM is multipurpose

enables the EU to

- address competitiveness concerns and avoid carbon leakage
- level the playing field
- target consumption emissions
- raise EU climate policy ambition
- nudge other countries to restrict emissions
- generate revenues

2. Design details

Sectoral/emissions coverage

Cement

2523 10 00, 2523
21, 2523 29 00,
2523 90 00

Electricity

2716 00 00

Fertilizers

2808 00 00, 2814,
2834 21 00, 3102,
3105 (except 3105
60 00)

Iron and Steel

72 (except 7202 and
7204), 7301, 7302,
7303 00, 7304, 7305,
7306, 7307, 7308
(excluding
prefabricated buildings
of heading 9406),
7309, 7310, 7311

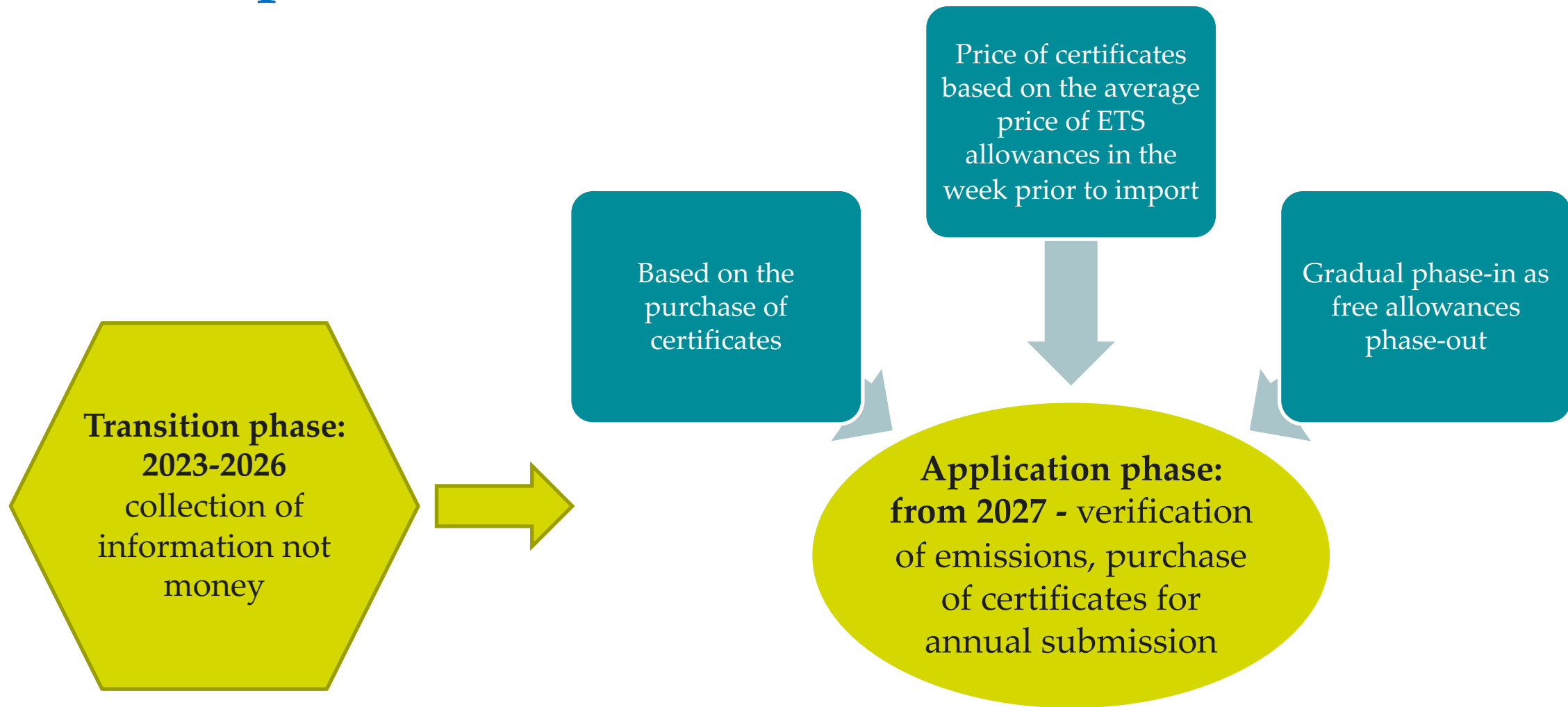
Aluminum

7601, 7603, 7604,
7605, 7606, 7607,
7608, 7609 00 00

Chemicals:
hydrogen
polymers
organic chemicals
ammonia

- Direct emissions (and indirect emissions).
- Payments will be calculated based on the actual level emissions. If actual emissions are not known, default values will be used.

Gradual phase-in



What does it mean for the importer to the EU?

2023-2025
(2026):

import products and collect
CBAM data on them

submit a CBAM
report on a
quarterly basis

2026 (2027)-
onwards:

verify the embedded
emissions

purchase
CBAM
certificates

submit the CBAM
declaration and
surrender the
certificates on an
annual basis

Exemptions from the EU CBAM

- Exempted are imports from countries with ETS linked to the EU ETS (e.g. Switzerland) – ‚linked‘ means having common market of emissions allowances (same carbon price)
- Not exempted are all others, including:
 - Imports from countries having ETS of another type or less stringent (e.g. South Korea)
 - Imports from countries having other measures of emissions reductions instead (e.g. US)
 - Imports from LDCs
- EU foresees the possibility of ‚crediting‘ for existing carbon prices in countries of imports. But how to determine the carbon price in case of command-and-control measures (e.g. standards)?

CBAM and electricity

- Emissions are to be determined based on default values. Applying actual data is possible but under strict rules. This is because of
 - the physical characteristics of electricity as a product, in particular the impossibility to follow the actual flow of electrons,
 - the fact that electricity trade is different from trade in other goods, notably because it is traded via interconnected electricity grids, using power exchanges and specific forms of trading, like, for example, market coupling,
 - the need to avoid risks of circumvention.

Recent developments in the adoption of CBAM

- CBAM proposal needs to be approved by the EU Parliament and the EU Council.
- The Parliament amended the proposal:
 - to expand the scope of products (to include also chemicals - hydrogen, organic chemicals and polymers) and emissions (to include also indirect emissions),
 - to abolish free allocation of allowances completely by 2032 (the phase-out starts in 2027),
 - to provide export rebates - until 2032, exporters should receive free allocations which will be gradually reduced.
- The Parliament accepted the amended version by its vote yesterday!

3. WTO law compliance

CBAM design features raising issues under WTO law

- Use of CBAM certificates: Is CBAM a tax or a regulation? (different national treatment rules, additional constraints for export rebates)
- Use of default values: Are imports charged more than EU products? (non-discrimination rules)
- Adjustment on exportation: Do export rebates constitute prohibited subsidies? (subsidy rules)
- Revenue recycling: Are revenues used only for fiscal purposes? (protectionist vs environmental intents - important for justification as an environmental measure)
- Design of exemptions: Are exemptions consistent with the environmental objective of the CBAM? (important for justification as an environmental measure under GATT Art. XX)

For more, see Kateryna Holzer, *Carbon-related Border Adjustment and WTO Law* (Edward Elgar, 2014).

Justification as an environmental exception

- Most likely the EU CBAM will need to be justified as an environmental exception under GATT Article XX

Relevant paragraphs

Art. XX(a) – Protection of public morals, e.g. *EU ban on sales/import of seal fur*

Art. XX(b) – Protection of public health (also health of animals and plants), e.g. *EU ban of the use and import of construction materials containing asbestos*

Art. XX(g) – Preservation of exhaustible natural resources (environmental protection), e.g. *US restrictions of import of shrimps for protection of turtles*

Chapeau

Measures must not be applied in a manner which constitutes a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail or a disguised restriction on international trade

Assessment of the compliance of the EU CBAM with the Chapeau of Article XX

Arguments for compliance

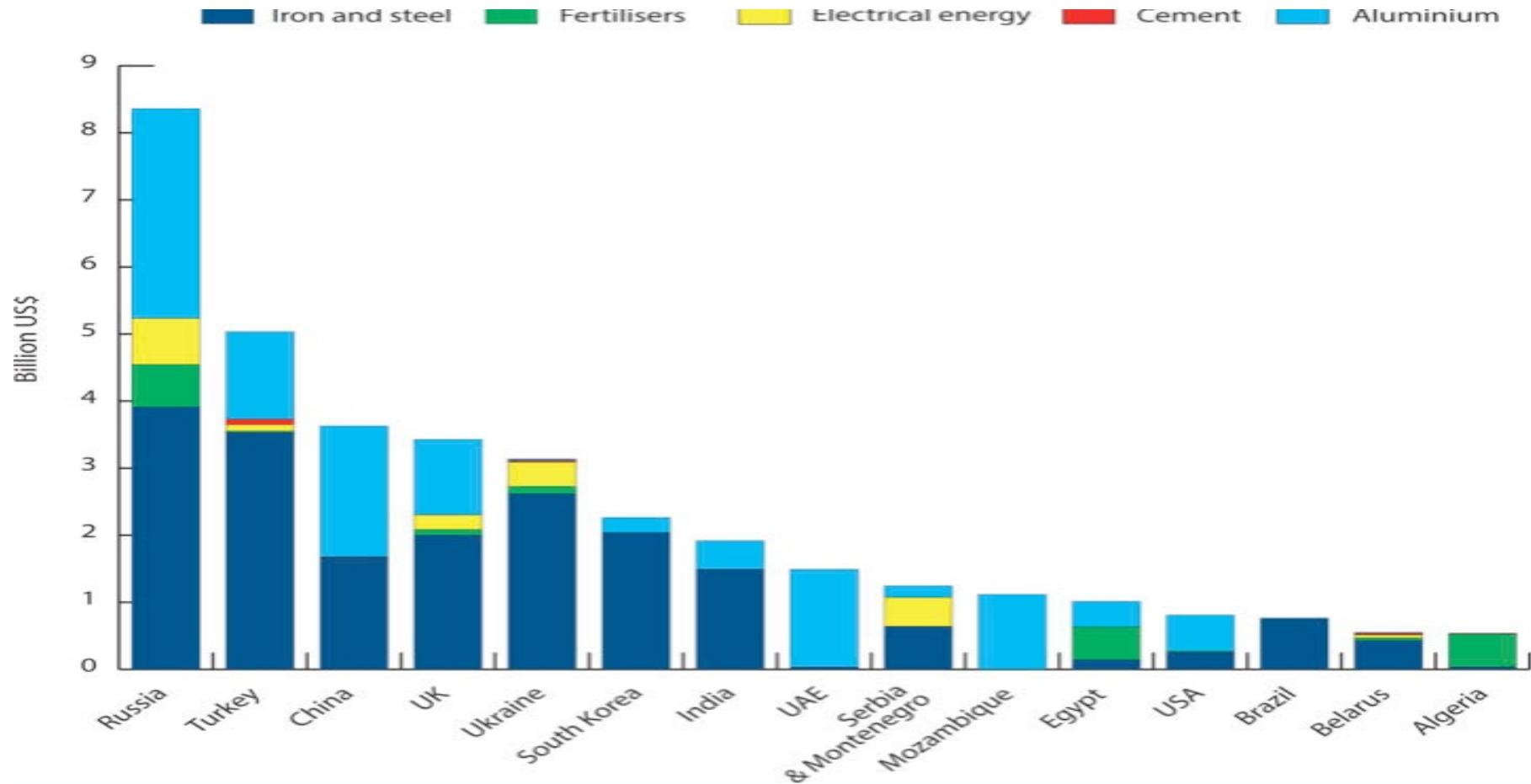
- ✓ Based on jurisprudence (*Brazil-Retreaded Tyres & EU-Seals*), a measure should take into account conditions in other countries which are relevant for the measure's objective.
- The objective of CBAM is to prevent carbon leakage → CBAM should exclude imports from countries with a carbon leakage safeguard, which is the same carbon price ensuring the level playing field. The same carbon price is only possible in linked ETSs → Imports from countries with linked ETSs should be excluded.

Arguments against compliance

- There can be different measures to reduce emissions or price carbon (an ETS is not the only one). Besides an explicit carbon price, there might be an implicit one, which is burdensome for producers. Countries that reduce emissions by other means cannot be punished → Imports from countries with all sorts of carbon restrictions should be excluded.
- Least developed countries are not responsible for emissions → Their imports should be excluded, also on moral grounds.

4. Implications of EU CBAM for Switzerland and other countries

EU imports of covered products



Source: Centre for European Reform

Reaction of other countries to the EU CBAM

- Bringing disputes to the WTO
- Retaliating through suspension of concessions
- Introducing their own CBAMs (e.g. Canada, China, S. Korea - ?)
- Cutting emissions and increasing climate policy ambitions (pledges under the Paris Agreement - ?)
- Circumventing

Concerns about circumvention

- *Resource shuffling*: carbon-intensive products are substituted with low-carbon products only to be exported to the EU; the latter instead sold and consumed outside the EU.
- *Transshipment*: covered products enter the EU indirectly via exempted countries by onward export, or displace products in exempted country sold to the EU.
- *Product modification*: a product is processed just enough to fall outside the coverage threshold of the CBAM.
- *Dodging domestic policies/measures*: e.g. trade partners introduce a carbon price but fail to enforce it or find ways to refund producers.
- *Splitting shipments*: splitting products shipments to fall under *de minimis* threshold etc.

For more, see Andrei Marcu, Michael Mehling & Aaron Cosbey, *Understanding Circumvention*, ERCST, 2022.

Implications for Switzerland

- The EU is the largest market for Switzerland (e.g. pharmaceuticals, steel etc.).
- Switzerland is exempted from the EU CBAM based on the ETS linking arrangements (same ETS price).
- Should Switzerland adopt its own CBAM?
- Risk of circumvention through transshipment and product modification through Switzerland.
- Switzerland can replicate the EU CBAM.
- Swiss CBAM proposals pending discussion in the Swiss Parliament (e.g. two proposals of the Green Party of 25.08.2020 and 18 March 2021).

For more, see Kateryna Holzer, *The pending EU CBAM: Quo vadis Switzerland? Global Trade and Customs Journal*, 2021 vol. 16, issue 11/12.