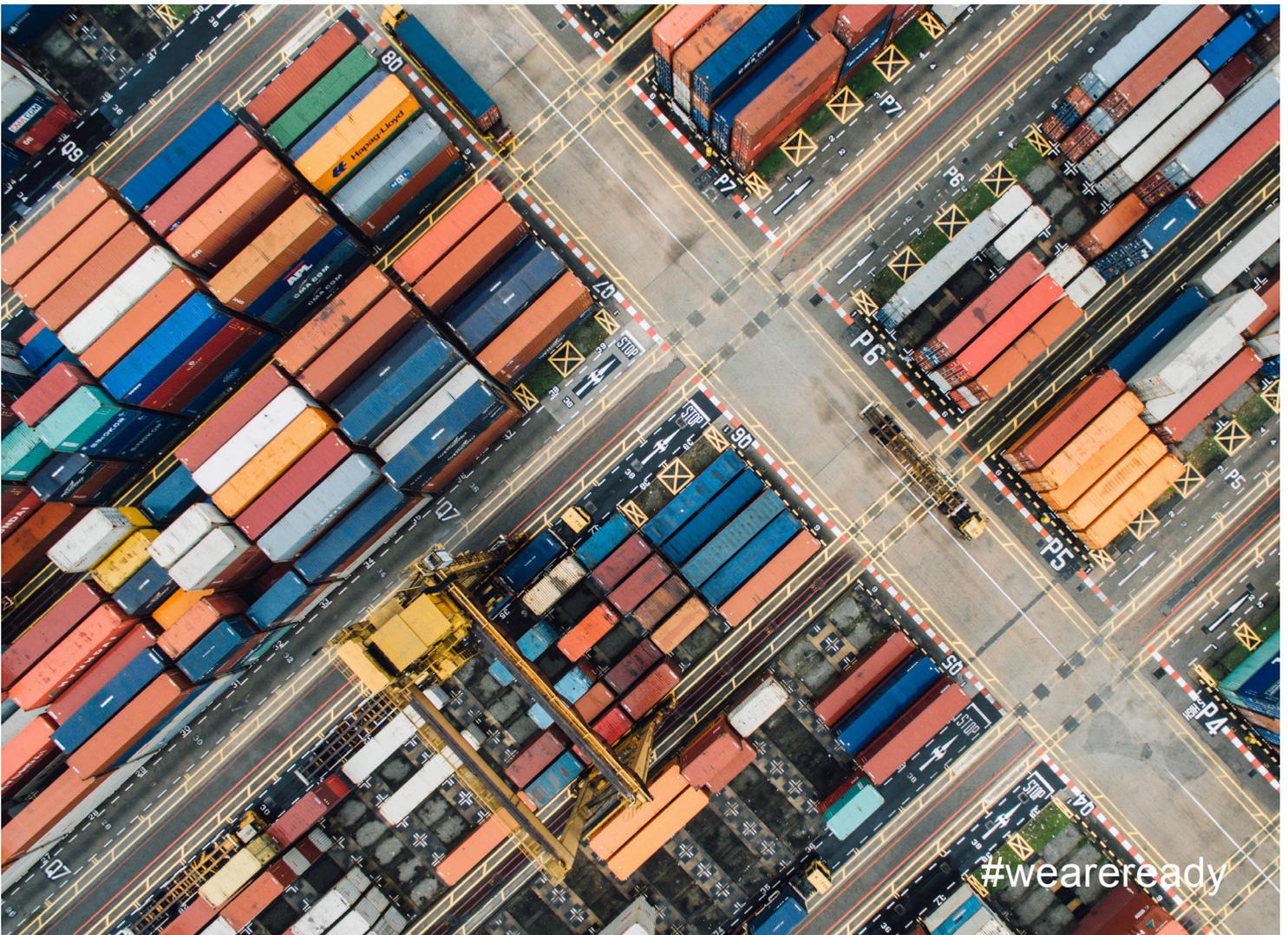


Position

Climate action and international trade

Requirements for a Carbon Border Adjustment Mechanism (CBAM)



Berlin, July 2021

Summary

If the EU introduces a measure for achieving the climate targets and safeguarding the competitiveness of industry in the EU, it should consider the following **criteria**:

1. should not be introduced without examining the alternatives, e.g. the direct launch of an international carbon emissions trading system;
2. should pursue the overarching objectives of limiting the burdens on business arising from climate action measures to the necessary minimum, and in particular of avoiding double burdens on companies (higher prices for goods with zero or reduced carbon emissions and a simultaneous levy at the border; i.e. it must be possible to evidence the embedded CO₂ emissions);
3. must realize a CO₂-reduction potential and prevent carbon leakage;
4. should be discussed and coordinated at international level, to avoid potential adverse reactions from our trading partners, additional trade disputes, and distortions of international trade and investments;
5. must comply with the WTO's rules and requirements and with the EU's international trade agreements;
6. must be designed to be legally certain and simple to administer;
7. must include a legal check under WTO law on how exports from companies based in the EU could be compensated for the strict CO₂ requirements.

Introduction

Ursula von der Leyen, President of the European Commission, already mentioned the creation of a **carbon border adjustment mechanism** (in the context of the European Green Deal) in her first major speech to the European Parliament. The idea is to introduce a levy initially on selected imports that cause emissions during their production in other countries, but which are subject to lower environmental standards there than those in the EU. This is intended to counteract **carbon leakage** (the relocation of economic activity to avoid higher environmental standards) and **competitive disadvantages** for European companies owing to stricter CO₂ regulations and higher carbon pricing by global comparison. The Commission has announced that it will present a legislative proposal in mid-July 2021 as part of the “Fit for 55”-package.

This initiative is closely connected with the pricing strategy for carbon dioxide within the EU, which until now has been regulated in some sectors by the European Emissions Trading System and to a certain extent by the EU’s Energy Taxation Directive. Discussions are ongoing as to whether this carbon pricing system should be extended to include additional sectors while simultaneously intensifying the price signal. A carbon border adjustment measure would apply to imports into the EU.

The adjustment mechanism applied at the EU’s external borders would aim to link **action on climate** with **safeguarding competitiveness** and thus to maintain the competitiveness of European businesses in view of higher environmental standards in the EU.

One possible **legal basis** depends on the design features of the mechanism. First and foremost, there is Article 192 (environmental measures including those of a fiscal nature) of the Treaty on the Functioning of the EU (TFEU). A measure of this type (excluding fiscal measures) would have to be passed by a qualified majority in the ordinary European legislative procedure.

We are calling on the European Commission to undertake a **comprehensive impact assessment** to examine in detail the numerous and complex effects of a European CBAM on (1) bureaucratic requirements, (2) additional costs to the companies, (3) effects on the climate – and all of this against the background of the potential distortions to international trade. The VDA is happy to be a constructive player in this process.

Strict requirements on the design of a CBAM

The VDA has committed to the goals of the **Paris Agreement and to greenhouse gas-neutral transport by 2050 at the latest**. Achieving the climate targets of the “Fit for 55” package will require huge efforts on the part of business and of society. The goal of the Paris Agreement is to realize these efforts on a global scale, because climate action policy is a global task that can only be resolved by the international community pulling together.

The VDA therefore fundamentally welcomes elements of the climate action policy, which lead to international comparability and a level playing field. However, this depends crucially on the international acceptance of these elements by our trading partners. There is enormous potential for well-founded (or even unfounded) irritations in international trade. The reactions of our trading partners could have serious consequences for the international value chains, and adversely impact the project of better action on climate change.

The German automotive industry acts worldwide to support the elimination of trade barriers. It is essential to create a global level playing field in order to avoid **competitive disadvantages** for businesses.

For this reason, border adjustment measures should only be considered if they are implemented jointly with our important trading partners and their concerns are taken into consideration right from the outset. Measures must be designed such that they do not result in competitive disadvantages for European businesses, and they must satisfy the following criteria:

- 1) They support the introduction of a global emissions trading system: the overarching goal is to introduce the most global emissions trading system possible in all sectors – a CBAM must assist in preparing for such a system.
- 2) It is imperative to avoid distorting international trade, in line with WTO requirements; the concerns of our important trading partners should be addressed from the outset.
- 3) The design features must be practicable and legally certain both for the companies and for the authorities.

This means, in detail:

1) Primary objective: a CBAM must support the introduction of a global emissions trading system

The most important objective of climate policy must be to effectively realize the climate targets in the most comprehensively global manner possible. Alongside agreed emissions regulations with – as far as possible – global validity, a unified, worldwide emissions trading system (for example) would also be part of such an approach. This represents a major challenge, but nonetheless it must be, and must remain, the goal of international climate policy. Here the EU can and should be an international pioneer.

However, if the other partners do not follow the EU's example, or if they find that the EU is leaving them behind as it pushes forward, the result will be carbon leakage effects and distorted competition to the detriment of EU industry. Given this background, the idea of balancing out the consequences of different CO₂ standards around the globe by means of adjustment mechanisms for globally traded goods is an obvious one, especially from a climate action viewpoint.

Within the framework of the introduction of border adjustment measures, efforts should be made to replace the existing **national adjustment mechanisms**, such as the free allocation of CO₂ allowances for branches of industry with particularly heavy burdens within the EU emissions trading system, or compensation for the electricity price under the German Renewable Energy Sources Act (RES). **A CBAM can thus represent a preliminary stage on the path to a unified worldwide emissions trading system into which all other climate action regulations would be integrated.**

2) Avoid distortions of international trade by means of close multilateral cooperation: address the concerns of our important trading partners from the outset.

It is essential to have a transparent and, most importantly, close cooperative exchange and coordination with the global trading partners/third-party states and the WTO. The German automotive industry actively supports the elimination of trade barriers worldwide. It is crucial to have a global level playing field in order to avoid competitive disadvantages for businesses. Various states that are important trading partners for German exporters have already made it clear that they regard border adjustment as arbitrary and unjustified discrimination. The trade disputes with the US alone have demonstrated the conflict potential that lies in reciprocal

import duties. Therefore, given the risk of renewed trade disputes, an unbalanced “climate tariff” should be considered very carefully so as not to give the impression of protectionist measures. A European CBAM should not create new trade disputes, and neither should it exacerbate existing ones.

The VDA has always spoken in favour of not confounding **trade policy with goals of other policy areas**. At the same time, the VDA actively supports a multilateral, rule-based framework for international trade and investment. All possible measures instituted to avoid carbon and investment leakage, that is, any trade-policy or investment-policy measure taken by the EU, must therefore ensure compatibility with the WTO rules and international trade agreements. It should always be borne in mind that the trade-policy signal sent out by a European border adjustment mechanism can go beyond a purely legal assessment of WTO conformity.

3) Legally certain and practicable design is essential

The German automotive industry calls for the clearest and simplest regulations possible, in order to avoid considerable legal and planning uncertainty and a large number of disputes over the application of the regulations. A carbon border adjustment mechanism is per se an extremely complex system with multiple interdependencies. For the successful implementation of a CBAM it will be crucial to design the requirements for the companies affected to be both practicable and legally certain. The creation of new European authorities and dispute settlement mechanisms assumes a high degree of international coordination and acceptance in order to act effectively. Excessive regulations, and those that companies can hardly satisfy, are to be avoided. Closer involvement of the industries affected by a border adjustment mechanism is therefore necessary, also to allow an assessment of the dynamics of global supply chains and an analysis of the respective effects (emissions monitoring).

Conclusion: CBAM must be able to fit into a global ETS

The German automotive industry welcomes the international approach to climate action measures, along with instruments that render the price of emissions comparable not only globally, but also across sectors. That is the only way to achieve efficient action on climate change. However, within this expedient approach, a European border adjustment mechanism must not result in distortions of international trade or in further trade disputes. At the same time, such a mechanism must be practicable and legally certain both for the companies and for the state authorities. These conditions are best met by implementing a multi-sectoral carbon price based on an emissions trading system. This carbon price should be anchored in close international cooperation with all important trading partners of the EU, and ideally on a global basis.

If these criteria are satisfied, the German automotive industry is in favour of steps towards multi-sector emissions trading at European level, and ideally worldwide. The next steps must therefore be directed towards an internationally coordinated carbon-pricing system based on the CBAM, which is oriented on emissions trading and is compatible with the WTO regulations. Any measure taken must be practicable and legally certain for the companies affected.

Contacts at the VDA:

Dr. Kurt-Christian Scheel

Managing Director

kurt-christian.scheel@vda.de

Götz Schneider

Head of Department Traffic & Transport Policy | Climate, Environment & Sustainability

goetz.schneider@vda.de

Dr. Karoline Kampermann

Head of Department Economic Policy, Foreign Trade & Customs, SME Policy and Taxation

karoline.kampermann@vda.de

Angela Mans

Head of Foreign Trade & International Relations, Customs

angela.mans@vda.de