





# VDA position on a carbon border adjustment mechanism

## June 2020,

### Introduction

Ursula von der Leyen, the new President of the European Commission, already introduced the notion of creating a **carbon border adjustment mechanism** (CBAM) as part of the “European Green Deal” when she made her first major speech to the European Parliament. The idea is to impose a charge initially on selected imports that generate emissions during their production in other countries, but are subject to lower environmental standards there than those in the EU. This should compensate for what is known as “**carbon leakage**” (i.e. outsourcing economic activity to avoid higher environmental standards) and **competitive disadvantages** for European companies resulting from stricter CO<sub>2</sub> requirements and higher prices of CO<sub>2</sub> (by global comparison).

This initiative is closely tied to carbon pricing within the EU, which for some sectors has until now been regulated through the EU's emissions trading system (ETS) and to a certain extent by the EU Energy Taxation Directive. Discussion is ongoing of the proposal to expand this carbon pricing to include more sectors and to simultaneously reinforce the carbon price signal. A carbon border adjustment mechanism would apply to imports into the EU.

For all these reasons, it is now up to the EU to initiate measures, according to the European Commission in its explanatory notes to the first impact assessment.

According to the European Commission, the options for such a measure could include:

- a carbon tax on selected products – both on imported and on domestically produced goods,
- a new CO<sub>2</sub> customs duty or a tax on imports,
- or extending the EU emissions trading system to include imports.

The aim of having an adjustment mechanism at the EU's external borders is to link **climate protection with maintaining competitiveness** and thus to safeguard the competitiveness of the European economy in view of the higher environmental standards in the EU.

It is not a new **idea**. As early as 2010<sup>1</sup>, France proposed bringing in an environmental tariff on imports. This was taken up again by the Macron Government when it proposed a climate-and-energy levy and has now been transferred to the European level as part of the Green Deal<sup>2</sup>. The idea of a border adjustment mechanism still only exists as an announcement within the **European Green Deal**. It is currently being examined by the Commission.

The possible **legal basis** will depend on how the mechanism is fleshed out. Both Article 192 (environmental measures including taxation) and Article 207 (common commercial policy) of the Treaty on the Functioning of the EU might be relevant. A proposed taxation measure would be subject to the principle of unanimity.

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<sup>1</sup> EURACTIV: <https://www.euractiv.com/section/trade-society/news/france-details-plans-for-carbon-inclusion-mechanism/>

<sup>2</sup> Opening Statement by Ursula von der Leyen in the European Parliament Plenary Session:

[https://ec.europa.eu/commission/presscorner/detail/en/SPEECH\\_19\\_4230](https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_19_4230)

Political guidelines: [https://ec.europa.eu/commission/sites/beta-political/files/political-guidelines-next-commission\\_de.pdf](https://ec.europa.eu/commission/sites/beta-political/files/political-guidelines-next-commission_de.pdf)



## Current political status

On March 4, 2020, the **European Commission** published a **roadmap**<sup>3</sup> including the announcement of an **impact assessment**. In this context, the Commission will also conduct a study on the topic of a **carbon border adjustment mechanism**. Current studies of the energy markets and EU ETS will also feed into the impact assessment. Furthermore, a public consultation is planned to supply further information in the third quarter of 2020.

The College of Commissioners could adopt the **draft legislation** in the second half of 2021. This process will be headed by DG TAXUD / Paolo Gentiloni, Commissioner for Economy.

The **European Parliament** will commence working on a non-legislative own-initiative report in the second quarter of 2020. Responsibility for it will be shared by the committees for environment, trade and economic affairs.

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<sup>3</sup> [https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12228 Carbon Border Adjustment Mechanism](https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12228-Carbon-Border-Adjustment-Mechanism)  
Picture: Copyright European Commission 2020

## Evaluation

The VDA is committed to the goals of the **Paris Agreement**. Achieving these goals will demand huge efforts from both business and society. The aim of the Paris Agreement is to realize these efforts on a global scale, because climate protection policy is a global problem that can only be resolved through concerted action by the global community.

Here it is essential to have a global level playing field so that **competitive disadvantages** for companies do not arise. The EU wishes to prevent the relocation of companies to regions with less stringent climate protection regulations (which is known as “carbon leakage”).

The most important objective in climate protection policy must therefore be the **effective implementation of the Paris climate goals, as far as possible on a global scale**. This would include, alongside agreed emission requirements (agreed globally as far as possible) – for example – also a global emissions trading system. This is a major challenge, but at the same time it must be the goal of international climate protection policy both now and in the future. In this context, the EU can and should play an international pioneering role. However, if the other partners do not follow, or if the EU moves ahead too fast, carbon leakage effects will occur and competition will be distorted to the detriment of industry in the EU. Against this background, the idea of applying adjustment measures for globally traded goods to compensate for the consequences of different CO<sub>2</sub> standards around the world is an obvious choice, especially from a climate-protection viewpoint.

However, a closer look at the topic reveals **many practical questions**. The impacts and compatibility with the WTO’s international trade system in particular throw up crucial questions whose consideration is absolutely essential in the choice of a measure. This includes such things as negative reactions of affected (third-party) states, irrespective of whether the EU has de jure come up with a regulation that conforms to the WTO rules or not.

For this reason, it is urgently necessary to coordinate with worldwide trading partners. Countries such as the US and Australia, whose governments have a different approach to climate protection, could regard the border adjustment as arbitrary and unjustified discrimination. The trade conflicts with the US alone have demonstrated what conflict potential there is in mutual customs tariffs. An unbalanced “climate tariff” should therefore be very carefully weighed up against the risk of renewed trade disputes, to avoid giving the impression of protectionist measures.

The VDA has always expressed its support for keeping **trade policy** separate from **other policy objectives**. At the same time, the VDA is working toward a multilateral, rule-based framework for international trade and investment. All possible measures taken to avoid carbon and investment leakage (i.e. any trade related measure or investment policy measure by the EU) must therefore ensure compatibility with WTO rules and international trade agreements.

Until now, **no convincing concept has been presented** showing how a new model e.g. a possible border adjustment mechanism, could be implemented in practice. For many products it is difficult to determine and verify a “product carbon footprint” (the amount of CO<sub>2</sub> a product contains). This applies particularly to complex products such as vehicles whose production and supply processes consist of multiple stages.

The **Paris Agreement** allows the definition of CO<sub>2</sub> reduction targets tailored to the individual countries. They are dependent upon the current per capita CO<sub>2</sub> emissions and the economic entity, the level of prosperity and the financial options available for implementing CO<sub>2</sub> reductions. If the EU now wants to balance out the various reduction paths of the individual countries by means of a border adjustment mechanism, it may possibly undermine the Paris Agreement’s approach of specifically permitting individual country targets. In this light, a conflict with the Paris Agreement could develop.

The question also arises of whether future border adjustment mechanisms would replace or should supplement existing **national adjustment measures**, such as cost free allocation of CO<sub>2</sub>

certificates in the EU ETS for branches of industry that are especially heavily burdened or the electricity price compensation under the German Renewable Energy Act (EEG).

We therefore call on the European Commission to conduct a **comprehensive impact assessment** to examine the numerous and complex effects of possible carbon adjustment mechanisms in detail. The VDA will be happy to play a constructive role in this process.

If the EU introduces a mechanism for achieving the climate targets and safeguarding the competitiveness of industry in the EU, it should take the following **criteria** into account:

## Criteria

A carbon border measure:

1. should be discussed and coordinated internationally to avoid potential negative reactions from our trading partners and other trade conflicts;
2. should genuinely realize a CO<sub>2</sub> reduction potential;
3. must not distort international trade or investment;
4. should conform to the rules and requirements of the WTO and the EU's international trade agreements;
5. must not discriminate against or favor any party;
6. should take into consideration the possibility that strict CO<sub>2</sub> requirements in the EU will put exports from companies located in the EU at a disadvantage on price;
7. must not lead to additional burdens on business;
8. should not be introduced without examination of alternatives such as an international trading system of CO<sub>2</sub> certificates.

At the very least these criteria would have to be satisfied to prevent negative impacts of the proposed mechanism. In addition, a number of questions still await clarification, which show how very **complex** the project of introducing a carbon border adjustment mechanism is.

## Unanswered questions

A large number of questions are also awaiting clarification in connection with the introduction of a border adjustment mechanism. Some examples are given below:

# Unanswered questions

1. The European Commission speaks increasingly of an “instrument” or a “mechanism” instead of a “tax.” What would comparable options be like that do not include a customs tariff or a tax? How would the mechanism be systematically positioned, and what would be its legal nature: a tax, a customs tariff, an additional levy? Who would have (administrative) responsibility?
2. Would the mechanism apply only to CO<sub>2</sub> output during production, or would it apply generally to all emissions and thus also to the release of nitrogen oxide and HFCs?
3. For which sectors and which products would the levy be envisaged? Will the emissions of the actual product or of its manufacture be assessed? How can international production chains then be traced?
4. How would a border adjustment be linked with the carbon leakage list individually for each sector affected in accordance with the ETS Directive?
5. How will the amount of the levy be oriented to comparable certificate prices in the EU's emissions trading system?
6. What is the primary purpose of the mechanism? Is the focus on trade policy, environment policy or consumer policy purposes (compatibility with WTO regulations)?
7. Would such a mechanism have to be regarded as an obstacle to imports (depending on its design)?
8. Would this be compatible with existing free trade agreements (depending on its design and the FTAs that have been negotiated)?
9. How should a CBAM be fleshed out so that it is compatible with WTO law (focus would have to be on environment policy goals)?
10. How should a CBAM be fleshed out so that it is not regarded as a protectionist measure under the guise of CO<sub>2</sub> reduction?
11. Which institution/organization would be responsible for verifying the CO<sub>2</sub> content of products?
12. Would a CBAM that originally applied solely to basic raw materials also be applicable pro rata for example to the steel used in a vehicle produced abroad?
13. In the case of a CBAM levy, would the entire path of environment policy development of the various countries be taken into account (as envisaged in the Paris Agreement)?
14. In the future, will products first be subject to a high CO<sub>2</sub> tax and then, when exported, qualify for relief / subsidies financed from tax revenue?
15. How will the EU's trading partners react what countermeasures can be expected? And what should the reaction to them be in the context of the existing WTO regulations?

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