



Just enough – the EU proposal for a Carbon Border Adjustment Mechanism (CBAM)

Jan Cernicky

- › In order to counter the problem of Carbon Leakage, the EU needs an instrument, which at the same time protects its domestic industry and ensures the global effectiveness of climate protection measures.
- › Three approaches would be possible: a global solution, a Climate Club or a European Carbon Border Adjustment Mechanism (CBAM).
- › Since all approaches have strengths and weaknesses, EU climate policy should work on all three and not just focus on one solution.
- › The leaked draft of the EU Commission on the Carbon Border Adjustment is very limited and can thus only have an impact as a threat or as a first step.

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By 2030, German CO₂ emissions are supposed to decrease by 65 per cent compared to 1990 levels.¹ A massive transformation of the economy will be necessary to achieve this. Obviously, this will significantly increase the costs of climate protection. Production in the EU will become more expensive compared to regions that pursue climate protection less ambitiously. As a result, there is a threat of relocating production from Europe to those other regions. The European Commission has recently published a proposal for a Carbon Border Adjustment Mechanism (CBAM) as a protective instrument against so-called Carbon Leakage.²

The present brief paper will first give an overview of possible options for the EU to respond to the problem of Carbon Leakage. In the following, it will point out the need of an instrument for Carbon Border Adjustment. After commenting on the European Commission's leaked draft for introduction of a CBAM this paper concludes that climate diplomacy will remain important even after implementing the CBAM.

Competitiveness, climate protection and Carbon Leakage

For the debate about this instrument, it is important to emphasise that it should serve to protect both the climate and domestic industry. The impact on the climate may actually be limited, for example by the effect of *indirect* Carbon Leakage³. Nevertheless, even if this were to happen, Germany would not be able to opt out of the climate protection measures it has taken, especially in respect to the recent decision of the Federal Constitutional Court⁴. Thus, an instrument protecting the economy would still be necessary. Critics also argue that the problem of *direct* Carbon Leakage has so far hardly been measurable and that the previous protective measures for industry are thus sufficiently effective. This is true for the current situation, but it is very likely to change if the CO₂ price rises sharply.⁵

A CBAM is intended to protect the climate and domestic industry at the same time.

In order to protect the competitiveness of the domestic industry, there are two alternatives: either the industry is heavily subsidised or trade policy ensures that no Carbon Leakage can occur. In terms of regulatory policy, the latter option would certainly be the better one. There are three ways to do this:

1. A globally valid market pricing for CO₂ under a common global climate regime.
2. If some states are not willing to follow this idea of a CBAM, a "coalition of the willing" could set up a Climate Club. Candidates for this would be the EU, the United States and other OECD countries. These club members would agree to establish a uniform market based CO₂ that has to be paid. In trade with third countries, CO₂ offsetting would still occur.

3. The EU or other states or economic associations could decide on an individual CO₂ Border Adjustment Mechanism.

In view of the bureaucratic effort, the possibility of a globally valid CO₂ price is surely the most desirable. A Climate Club would also be a far better solution than a pure Border Adjustment – no new trade barriers would be set up against important non-EU trading partners. Therefore, climate diplomacy should continue to work on these solutions. It is thus realistic to set minimum standards within the global framework to limit *indirect* Carbon Leakage. Still, it does not seem very likely in the medium term that all countries in the world will be able to agree on ambitious climate targets. Thus, efforts to establish a Climate Club should also be taking place. This club could undertake more ambitious climate efforts.

A CBAM is a necessary element of a comprehensive climate-policy

Both solutions, however, depend on the willingness of other countries to cooperate. Especially former US president Donald Trump's politics have demonstrated that even among close partners, one can not rely without conditions on this cooperation. For the following reasons it is therefore advisable for the EU to develop its own instruments with a CO₂ Border Adjustment:

1. The EU creates a threat for third countries that are not very ambitious in terms of climate protection. They must thus expect their industry to lose competitiveness when it comes to imports into the EU. This would create an incentive to take their own climate protection measures, so that in the best-case scenario the Border Adjustment would no longer be necessary. China's greatly expanded commitment to climate protection is also due to this.
2. It is possible to design a Border Adjustment in such a way that it is compatible with other regional climate protection systems. In the best case, these systems could finally merge. This would be a first step towards a Climate Club and negative effects on trade would be limited. Organising the Border Adjustment via the trading of emissions certificates would make this possible. Importers would have either to buy certificates at the border or prove that they have already acquired certificates in a comparable trading system in their domestic region. It is to underline that the Commission's draft is considering this option. The corresponding regulations for the recognition of third-party certificates still seem rather vague, though.⁶

Global standards or a climate club would be an ideal solution – but their introduction is far from being certain.

The draft of the European Commission

The problem, however, is that the system now proposed would be limited to a few goods: aluminium, steel, cement, fertilizers and electricity. This would significantly reduce the benefit of a CO₂ Border Adjustment, as it can easily be bypassed⁷ and thus hardly goes beyond the effect of the threatening backdrop. It is also noticeable that aluminium and steel appear in the list. The EU is currently levying protective tariffs on these two basic materials. A suspicion that the Border Adjustment is a hidden protectionist instrument will thus certainly resonate in the coming debate.

The proposed CBAM: Potential for misunderstanding as protectionism.

For this reason, if climate diplomacy does not make rapid progress, it would be necessary to expand the Border Adjustment significantly so that, ideally, there would no longer be any exceptions. So far, this seemed illusory, as the measurement and traceability of emissions were technically very limited. However, this is changing surprisingly quickly: Today, start-

ups such as Planetyly are increasingly able to map emission quantities realistically along the entire value-chain using innovative methods.

Conclusion – Trade policy and climate diplomacy are still significant

The challenges of climate protection exist worldwide; in a globalised economy, market-based instruments provide the best incentives and solutions. The EU should consider this principle when designing its concept. In respect to this, a CO₂ Border Adjustment would be the worst of the options currently presented. Still, in order not to depend on the goodwill of other states, the EU should – at least as a credible threat – design a comprehensive Border Adjustment that is as open as possible for third countries. The European Commission's draft has achieved this purpose only partially. It would make sense as a first step or as a threat – but not a Border Adjustment Mechanism that is effective on its own.

The EU Commission
has not proposed a
CBAM that is effective
in itself.

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- 1 According to figures from the Federal Environment Agency, a further reduction in emissions of around 40% is necessary in less than eight years. See for example: <https://www.bmu.de/pressemitteilung/treibhausgasemissionen-sinken-2020-um-87-prozent/>.
 - 2 So far there has been a leaked version that is not final in every detail. The final proposal is scheduled to be released in mid-July 2021.
 - 3 See i.e. considerations on „indirect carbon leakage“ in: Scientific Advisory Board at BMWi 2021: Ein CO₂-Grenzausgleich als Baustein eines Klimaclubs“, p. 7ff BMWi – Ein CO₂-Grenzausgleich als Baustein eines Klimaclubs. https://www.bmw.de/Redaktion/DE/Publikationen/Ministerium/Veroeffentlichung-Wissenschaftlicher-Beirat/gutachten-co2-grenzausgleich.pdf?__blob=publicationFile&v=12.
 - 4 With its ruling of April 29, 2021, the Federal Constitutional Court defined climate protection as a constitutional goal and underlined that it was necessary for Germany to take own measures for actual climate protection and thus not to provide any incentives for other states to undermine the necessary cooperation on climate-protection.
 - 5 For more precise calculations, see: Scientific Advisory Board at BMWi 2021: Ein CO₂-Grenzausgleich als Baustein eines Klimaclubs“, p. 10 ff, see link in footnote 3 – Ein CO₂-Grenzausgleich als Baustein eines Klimaclubs.
 - 6 For more detailed considerations, see: Cernicky, 2021: Commerce and the environment: the prospects of a mechanism for adjusting CO₂ limits. Trade and Environment: The Perspectives of a Mechanism for Adjusting the CO₂ Limits (ispionline.it). <https://www.ispionline.it/en/publicazione/trade-and-environment-prospects-carbon-border-adjustment-mechanism-29579>.
 - 7 Cf. Cernicky / Hartlieb 2020: Carbon border adjustment mechanism: Tax or tariff for the climate?, p. 4: <https://www.kas.de/en/analysen-und-argumente/detail/-/content/carbon-border-adjustment-mechanism-tax-or-tariff-for-the-climate>.

Imprint

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