

The EU's Carbon Border Tax and the Fate of the Green Deal Diplomacy – which pathway for an inclusive Border Carbon Adjustment Mechanism?

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Often referred to as a technical tool to prevent carbon leakage, the EU's planned Carbon Border Tax is right at the heart of a broader geopolitical question. It reflects the EU Commission's willingness to play hardball in its Green Deal Diplomacy. No wonder the initiative has created a considerable global backlash. But there is a simple principle that can guide the way for an inclusive Carbon Border Tax: "Doing the least harm" – to the multilateral system, to developing economies, and to the EU's legitimacy as a climate leader.

While the European Green Deal has been widely hailed as a major leap forward for the EU's global climate leadership, the new climate strategy does include a controversial policy initiative that is likely to have considerable repercussions for EU trade partners across the world: a Border Carbon Adjustment Mechanism (BCA), commonly referred to as a carbon border tax. Such a carbon border tax would put a levy on goods imported into the EU, based on the emissions emitted during the production process – something which would allow the EU to prevent the relocation of industrial production to countries where climate policies are weaker (known as "carbon leakage").

Even though the European Commission notes in the Green Deal that the BCA is first and foremost a tool to reduce the risk of carbon leakage, the initiative goes way beyond the technicalities of preserving the EU's international competitiveness. In fact, the BCA is right at the heart of a broader geopolitical question: it reflects the Commission's willingness to play hardball in matters of climate politics by applying tough economic measures against less ambitious international actors. As one high-ranking EU-official put it recently on the BCA, "the EU cannot be naïve – if others are not committed [to climate ambition], we need to take action" (1) – a revealing statement that is characteristic for a new EU external climate policy, one that aims to be more assertive, more interest-driven, or to remain in "Brussels-jargon", more sovereign. Next to tackling carbon leakage, the BCA is thus directed at a further objective: inducing global, non-EU emitters to take stronger climate action by imposing a firmer climate diplomacy.

With that in mind, it is hardly surprising that the BCA has created a considerable global backlash. China has called upon the EU to avoid any form of "unilateralism and protectionism". (2) Russia has threatened to sue the EU at the WTO. (3) And Brazil and Indonesia have described the Union's attempts to project its climate objectives through trade as a new form of "colonialism". (4) Others might follow suit, especially those that are dependent on carbon-intensive industries (e.g. India, South Africa, Vietnam), putting a burden on the EU's aspiration to be an inclusive, legitimate international climate leader. (5) Things have been further complicated by the European Council's decision in July to use the BCA's revenues to fund the EU Corona-Recovery-Package, blurring the lines between the BCA as a climate policy tool for the global public good and a fiscal instrument for mere EU-internal purposes. (6)

1 See following Podcast from 27:15 onwards.

2 Reuters, 2019.

3 Euractiv, 2020.

4 Financial Times, 2019.

5 Bruegel, 2020.

6 SWP, 2020.

"Multilateral Purists" vs. "Climate Strategists" – the fate of the Green Deal Diplomacy

Given the international controversy on the BCA, two distinct policy narratives are at play within the EU, with foreign policy commentators split about the BCA's appropriateness as a tool for EU external action. On the one hand, there are those – one may refer to them as "multilateral purists" – for whom climate change is an exclusive matter for multilateralism, highlighting that the EU should refrain from any unilateral action that could undermine the integrity of the global trading regime or the Paris Agreement. As one prominent EU foreign policy observer argued recently (7), backed up by leading think tanks (8) and some export-oriented industries (9), "the EU, which has relentlessly championed open markets, will, ironically, trigger a conflict between climate preservation and free trade...this clash is unavoidable". On the other, there are those – perhaps best referred to as "climate strategists" – for whom the multilateral track has proven to be insufficient in the fight against climate change, emphasizing that the BCA is a necessary measure to protect Europe from climate dumping and create a more effective EU external climate policy. Initially a proposal by France, several thinkers have identified the initiative as a further step towards EU strategic autonomy. Some have even expressed hope that with the initiative the EU is finally leaving behind its geopolitical innocence. (10)

As such, the BCA has the potential to be a game changer in the external dimension of the European Green Deal. Its implementation and design, dependent on which of the two narratives will be at its core, that of "multilateral purists" or the other of "climate strategists", are likely to determine the fate and the external perception of the EU's Green Deal Diplomacy: integrative or confrontational; toothless or resolute.

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THE CARBON BORDER TAX IS CHARACTERISTIC FOR A NEW EU EXTERNAL CLIMATE POLICY, ONE THAT AIMS TO BE MORE ASSERTIVE, MORE SOVEREIGN

7 *Project Syndicate*, 2019.

8 *Bruegel*, 2020.

9 *Handelsblatt*, 2020.

10 *Euractiv*, 2020.

"Doing the least harm" – the pathway for an inclusive BCA

However, the BCA should not be reduced to a binary choice between confrontation and cooperation. There is indeed a third way between the two poles, a simple principle that can lead the path for an inclusive implementation of the BCA: "Doing the least harm" – to the multilateral system, to developing economies, and to the EU's legitimacy as a climate leader. For that, it will not be enough to make sure that the adjustment mechanism complies with WTO-rules, which, if properly designed, is possible. (11) More fundamentally, in order to avoid a new source of conflict on the international level, the EU will be required to tackle the BCA's global distributional effects as a matter of priority, not as an afterthought. That means a) consulting its trading partners at an early stage about the initiative's design and b) providing a detailed explanation on how the EU intends to support less developed actors to deal with the carbon border tax. As a starting point, the EU could do two things:

1. Launch a charm offensive for an inclusive climate club:

Intense diplomatic engagement with its external partners will be of critical importance for the EU, especially with those countries that have high stakes in industries which the BCA may target, such as cement or steel. When in 2012 the EU sought to include international aviation in its ETS, it has become painfully clear what happens if external partners are not sufficiently involved in EU climate policy, with some countries, including the US, even threatening sanctions against the Union. (12) To avoid that, the EU should launch a series of in-depth diplomatic dialogues, possibly through the G20 or the EU's existing Strategic Partnerships. Here, the EU should highlight that the BCA is not about creating a sealed-off "island of excellence", but rather about building an inclusive climate club, which rewards climate ambition and remains open to all countries that have implemented equivalent climate policies to the EU.

In this context, third-country equivalence criteria should be communicated as objectively and transparently as possible, providing affected countries with mechanisms to appeal against EU decisions to impose the BCA on them. (13) Such a shift of narrative, from confrontational border taxes to constructive economic inclusiveness, can already help easing the international tensions on the BCA.

11 Mehling et al., 2019.

12 FIA, 2014.

13 CER, 2019.

14 EU Commission, 2020

15 KAS, 2020

2. Couple the BCA with development cooperation:

In order to retain its international legitimacy as a climate leader, paying special attention to concerns of climate justice will be critical for the EU during the BCA's implementation. As such, any application of the BCA to countries covered by the "Everything but Arms" scheme should be avoided, since it would raise serious questions about the EU's commitment to the "Principle of Common but Differentiated Responsibility". Beyond that, the EU should maximize its support to third countries in order to facilitate their path to "EU-climate-equivalence". Here, the EU should a) extend its assistance to the development of carbon pricing mechanisms in the Global South, which, at the moment, is strongly focused on China (14) and too often fails to account for the specific institutional contexts of developing countries, (15); and b) provide developing and emerging economies with access to the EU's ETS-innovation fund, underscoring a positive narrative of economic inclusiveness. Finally, the EU could consider introducing a special transitional period for countries, which are about to implement EU-equivalent carbon pricing mechanisms but have not reached comparable carbon prices yet. During that period, the respective countries may at least partly be exempt from the BCA, demonstrating the EU's willingness to offer credible pathways to avoid the carbon border tax.

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