

BRIEFING

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# Political Assessment of Possible Reactions of EU Main Trading Partners to EU Border Carbon Measures



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## BRIEFING

# Political Assessment of Possible Reactions of EU Main Trading Partners to EU Border Carbon Measures

### ABSTRACT

This briefing discusses the possible reactions of the European Union's larger trading partners to carbon border measures. Section 1 discusses experiences of carbon border adjustment-like regimes prior to the European Commission's announcement of the Green Deal. It focuses on the EU Aviation Directive, the US policy debate, and the Californian CBA for electricity. Section 2 considers reactions to the Green Deal announcement, based on informal discussion with officials from major trading partners to the EU. It identifies positive and negative reactions to the principle of an EU CBA, concerns about its design, criticisms and potential policy responses by these partners. Section 3 discusses the implications of our findings. It points to several features in the design and introduction of an EU CBA mechanism that we believe will importantly affect how partners will react to such mechanism.

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# 1 Carbon border adjustments prior to the Green Deal announcement

Carbon border adjustment (CBA) schemes are still very rare in practice. It is therefore difficult to make inferences based on history about what the reactions to CBAs within the Green Deal might be. But there are some pieces of evidence that might give some indication of potential responses.

## 1.1 The EU Aviation Directive

A 2008 directive on aviation emissions (2008/101/EC) extended the EU emissions trading system to aviation, requiring airline operators to deliver emission allowances based on the amount of carbon dioxide emitted during flights to and from EU airports. The directive went into effect in January 2012 and had strong CBA-like features. It is to date the only attempt to impose such a measure at international level.

A 'coalition of the unwilling' comprising 23 countries, including Brazil, China, India, Japan, Republic of Korea, Mexico, Nigeria, Russia and the United States, strongly opposed the directive in a joint declaration (Aviation, 2012). Their statement included a list of nine retaliatory actions (including '[a]ny other actions/measures') that might be taken by coalition members if the EU did not withdraw the directive. Several of these countries, including China and India, explicitly forbade their carriers from obeying the directive, and the US adopted legislation to this effect that could be invoked by the administration. Faced with such reactions, and in view of some progress in multilateral negotiations on emissions controls at the International Civil Aviation Organisation (ICAO), the EU withdrew the measure for intercontinental flights.

Importantly, the very strong negative reactions to the directive were not a response to its economic impact, which would have been quite marginal even for long-distance flights. Instead, the main source of contention was that the directive was perceived as imposing an extra-territorial regulation: the tax was based on total fuel consumption during intercontinental flights, and thus on activities taking place in other countries' airspace and over international waters. The clear message to learn from the attempt is that the EU should expect very strong negative reactions to measures that trading partners perceive as violating their sovereignty.

## 1.2 The lack of CBA mechanisms internationally

As of 1 November 2019, 21 national jurisdictions outside the EU (counting the UK as a non-EU country) had implemented or scheduled a domestic price initiative on carbon<sup>1</sup>, but none of these jurisdictions had implemented a CBA scheme. There were also 25 schemes implemented at sub-national level. Furthermore, 14 other national jurisdictions were considering introducing such initiative. These schemes vary greatly in coverage, and in the resulting price on carbon emissions.

Among the OECD countries with a carbon pricing scheme, several have trade agreements with the EU. These countries are of interest from an EU perspective since they are likely to share basic views regarding the regulation of carbon emissions with the EU.

OECD countries with both carbon pricing schemes and trade agreements with the EU are Canada, Chile, Iceland, Japan, Norway, South Korea and Switzerland. The case of Canada is a bit special, owing to its federal structure. Several Canadian provinces and territories have long implemented some form of carbon pricing scheme. Since 2019, carbon pricing also applies throughout Canada through a federal legislation that imposes a minimum level of pricing to all the provinces and territories. New Zealand, which is currently negotiating a trade agreement with the EU, maintains one of the most ambitious carbon pricing

<sup>1</sup> This subsection draws on the World Bank Carbon Pricing Dashboard; see <https://carbonpricingdashboard.worldbank.org>.

mechanisms in the world, besides the EU ETS. Finally, the United Kingdom also has a carbon pricing scheme.

The situation of China is also of interest since it is both a major emitter of greenhouse gases, and one of the EU's main trading partners. Since 2013, China has run regional emissions trading schemes, which currently exist in eight regions. These regional schemes are meant to prepare for China's launch of a national emissions trading scheme, scheduled to be introduced in 2020. The national scheme will initially only apply to the power sector, but it might later be expanded to cover seven other emissions-intensive sectors.

The introduction of a national trading scheme could be an important step for China to deliver on its intended nationally determined contribution to the objective of the Paris Agreement. At the same time, however, we note that, at the COP 25 meeting in Madrid in December 2019, China expressed dissatisfaction with insufficient climate financing commitments by advanced countries, suggesting that perhaps China's own commitments are conditional on yet to be determined financial contributions by advanced countries. At this stage, we find it hard, therefore, to assess China's actual position on the Paris Agreement.

Policymakers in countries with carbon-pricing schemes have no doubt been aware of the potential for carbon leakage and reduced competitiveness of their domestic industries, and of the option of addressing those implications with CBAs. It bears repeating that they have so far chosen not to implement such schemes.

It seems plausible that a combination of factors has contributed to the lack of CBA schemes. One is that carbon-pricing schemes have for the most part not been ambitious enough to generate significant leakage and lost competitiveness for domestic industries. A second factor is that jurisdictions that have introduced carbon prices have often addressed concerns about leakage and competitiveness through exemptions for threatened domestic industries, or by issuing free allowances of emissions certificates.

However, the fact that no national jurisdiction has implemented a CBA might also suggest that the fear of retribution by trading partners has played a role.

### 1.3 The US debate

More than decade ago, several climate bills and proposals that included some form of CBA mechanism were discussed by the US Congress, but none entered into law. Examples include: the bipartisan Low Carbon Economy Act of 2007 submitted by Jeff Bingaman and Arlen Specter; the bipartisan America's Climate Security Act of 2007 by Joe Lieberman and John Warner; and the American Clean Energy and Security Act of 2009 by Henry Waxman and Edward Markey.

Several climate proposals that included CBAs have also been discussed more recently by the US Congress. Examples include: the American Opportunity Carbon Fee Act of 2018 introduced by Senators Whitehouse and Schatz and Congressmen Blumenauer and Cicilline; the Climate Protection and Justice Act of 2015 by Senator B. Sanders; and Joe Biden's 2019 Plan for a Clean Energy Revolution and Environmental Justice.

The above-mentioned proposals have all been introduced by Democrats. But there have also been calls for climate action by Republicans, albeit outside of Congress. One example was the Conservative Case for Carbon Dividends in 2017, endorsed by former secretaries of state, secretaries of the Treasury and chairs of the Council of Economic Advisers during Republican administrations.

There have also been high-profile calls from academics for action on the climate that involve CBAs. Most significantly, in 2019 more than 3500 economists, including 27 Nobel laureates and 15 former chairs of the Council of Economic Advisers, jointly made a bipartisan declaration on the need for US carbon taxation, supported by a CBA (See Akerlof et al, 2019).

Outside of the Trump Administration, therefore, there seems to be some support among US politicians and economists in favour of a US climate policy that includes a CBA mechanism.

## 1.4 The Californian CBA for electricity

California has had, since 2011, a cap-and-trade programme that includes a CBA mechanism for imports of electricity into the state (see Pauer, 2019). Californian electricity imports come from other US states, from northern Mexico and some Canadian provinces. However, the CBA mechanism was watered down shortly after its adoption because of pressure from a group of Californian utilities. Several observers consider it to be ineffective as a result.

The Californian CBA mechanism was introduced without opposition from Canada or Mexico. But the trade volumes involved are very small: Canada and Mexico accounted for less than 0.5 percent of Californian electricity consumption in 2016.

## 2. Reactions to the announcement of the EU Green Deal

In this section, we assess the reactions of third countries to the announcement by the European Commission that, as part of the European Green Deal, it plans to propose a border carbon tax to avoid carbon leakage.

Such an assessment is not easy since at the time of writing (in February 2020) all we know about the Commission's plan is what it announced in its European Green Deal Communication published on 11 December 2019:

'As long as many international partners do not share the same ambition as the EU, there is a risk of carbon leakage, either because production is transferred from the EU to other countries with lower ambition for emission reduction, or because EU products are replaced by more carbon-intensive imports. If this risk materialises, there will be no reduction in global emissions, and this will frustrate the efforts of the EU and its industries to meet the global climate objectives of the Paris Agreement.

Should differences in levels of ambition worldwide persist, as the EU increases its climate ambition, the Commission will propose a carbon border adjustment mechanism, for selected sectors, to reduce the risk of carbon leakage. This would ensure that the price of imports reflect more accurately their carbon content. This measure will be designed to comply with World Trade Organisation rules and other international obligations of the EU. It would be an alternative to the measures<sup>2</sup> that address the risk of carbon leakage in the EU's Emissions Trading System.'

Our assessment is based on two types of evidence: informal interviews with third-country representatives based in Brussels<sup>3</sup>; and foreign (non-EU) media reports. It should be emphasised at the outset that all the responses we received from foreign officials were prefaced by the remark that it was too early to offer official reactions, since the EU has not yet made concrete proposals, and therefore that their comments were personal.

We divide our assessment into four parts: positive and negative reactions by third countries to the principle of an EU CBA mechanism; concerns about the design of the EU CBA mechanism; criticisms of the EU in relation to the design of the EU CBA mechanism; and potential policy responses to EU CBA measures.

<sup>2</sup> Such as the free allocation of emission allowances or compensation for the increase in electricity costs.

<sup>3</sup> We met representatives from six G20 countries, three advanced and three emerging ones

## 2.1 Positive and negative reactions to the principle

Foreign officials and media that we consulted generally welcomed the European Green Deal as a potentially important contribution to meeting the objectives of the Paris Agreement. Foreign reactions to the CBA component of the European Green Deal were however more mixed. Here a distinction should be made between the principle of a CBA and the design of the EU CBA mechanism.

Views on the principle of a CBA ranged between quite positive and quite negative.

### 2.1.1 Like-minded countries

It seems plausible that an EU CBA has more chances of being accepted by countries that themselves have undertaken some form of carbon pricing initiative. Indeed, in a recent endorsement of a CBA scheme as a solution to leakage and competitiveness problems, The Financial Times' editorial board argued that an EU CBA mechanism 'offers the distant but tantalising prospect of the EU joining forces with like-minded nations to create 'climate clubs' big enough to prod laggards into faster emissions cuts' (See FT Editorial Board 2020).

The group of 'like-minded' countries with respect to the climate problem, and potentially to the introduction of a CBA, presumably includes the OECD countries, which already have carbon pricing schemes and have trade agreements with the EU. These countries comprise of Canada, Chile, Iceland, Japan, Norway, South Korea and Switzerland, plus New Zealand which has an ambitious carbon pricing mechanism and is currently negotiating a trade agreement FTA with the EU. The United Kingdom is also likely to join the group. It should be noted however that while seemingly like-minded with regard to the acceptance of the need to take action against the climate problem, none of these countries has announced formally or informally that it supports, or plans to introduce, a CBA mechanism.

The situation of Iceland and Norway is special. Together with Liechtenstein, these two countries are members of the European Economic Area (EEA), and as such operate the EU ETS scheme. They cannot, therefore, be considered as 'third countries' as far as the EU climate policy is concerned. Depending on the exact design of the EU CBA mechanism, they are likely therefore to have to apply it if and when the EU introduces the mechanism. Industry reactions to the EU CBA in these countries seem two-sided.

On the one hand, the energy-intensive sectors, including the electricity sector itself, seem to welcome the principle of a CBA. For instance, the president and CEO of Statnett, Norway's power grid system, recently wrote that 'Europe should champion the creation of...a [carbon border] tax. In fact, it could well be the single most important facet when it comes to meeting our climate ambitions' (Lont 2019). His argument was that a European CBA mechanism will position Europe as an attractive location for green production that consumers will demand in the coming years and protect European producers from 'cheap carbon intensive alternatives'. He also argued that a European CBA mechanism will bring trading partners to the negotiating table on climate issues. 'This will probably not move the US in the first round, but China will definitely be interested in sitting down with the EU to discuss how international carbon pricing can be more effective. Paying taxes to Europe will seem attractive, compared to the possibility of losing access to an important market. Acting together with the EU on climate change should be the first and best option. Hopefully, after some years, the US will follow – at least certain states could do so' (Akerlof et al., 2019).

On the other hand, sectors or companies that export their products to countries outside the EEA seem to be fearful that applying the EU CBA mechanism could lead to trade retaliation that would damage their exports.



## 2.1.2 Other countries

Countries on the negative side fell into two camps. The first comprised the minority that does not subscribe to the Paris Agreement – essentially the Trump Administration, which plans to formally withdraw from the Paris climate accord in 2020 (Strokes 2020). The second group comprised those who subscribe to the Paris Agreement, but claim that CBAs are contrary to the spirit if not the letter of the Agreement. This view was articulated, for instance, by members of the Chinese delegation (Liqiang 2019) to the United Nations climate change conference held in Madrid from 2-13 December 2019. Their argument was essentially that there is no need for CBAs under the Paris Agreement since all countries have agreed to implement relevant emissions policies. However, according to some analysts like Kortum and Weisbach (2016), ‘it is not clear that on its own, [the Paris Agreement] eliminates concerns about leakage’ (Kortum and Weisbach, 2016), even more so if some countries do not belong to the Agreement or do not abide by it.

Although the current US administration is clearly opposed to the Paris Agreement, and therefore also to CBAs, which would likely hit US exports to the EU in the event it ultimately withdraws from the Paris Agreement, there are others in the United States who favour ambitious domestic measures to eliminate carbon emissions and their accompaniment by a CBA system. A December 2019 Bloomberg article noted that ‘Europe shouldn’t let itself be dissuaded [by the US from introducing CBAs]. Plenty of smart [American] people think carbon border taxes are necessary, including Ben Bernanke and Alan Greenspan, both former heads of the Federal Reserve’ (Bryant 2019). Both were part of the call by more than 3500 US economists referred to in the previous section (See Akerlof et al. 2019).

## 2.2 Concerns about the design

Regardless of whether they support the principle of a CBA mechanism, many of those we consulted voiced concerns about its actual design and implementation by the EU (or for that matter any other jurisdiction). The two main concerns are that the EU CBA mechanism could be protectionist and/or unfair. We examine both issues in turn.

Many of our interlocutors expressed the view that, even though they understand the logic and purpose of the EU CBA mechanism as a climate instrument, they are concerned that its design and implementation will transform it into a protectionist trade instrument. Press reports have largely echoed such concerns about ‘green protectionism’.

Our interlocutors from emerging countries also voiced concerns about the unfairness of an EU CBA mechanism. They questioned the notion, advanced in the European Green Deal Communication, that their countries should share the same ambition as the EU. They argued that, in accordance with the Paris Agreement, they should be subject to lower climate targets because they are responsible for lower past emissions than the EU and other advanced countries. Hence, the EU CBA mechanism should not apply to them, or at least it should apply at a lower rate than the domestic EU carbon tax.

During our discussions, all our interlocutors from emerging countries cited one example to illustrate their concern that EU ‘green’ measures are sometimes both protectionist and unfair: the implementation of the EU’s Renewable Energy Directive II (REDII), which will result in a gradual ban on counting palm oil toward the EU’s target for the share of renewables in 2030. The ban decision results from a determination by the European Commission that palm oil is the only biofuel feedstock crop to be deemed as ‘high-risk’ in terms of the indirect land use change (ILUC) it causes.

The restriction on palm oil is viewed by Indonesia and other tropical countries that export it as a protectionist measure designed to favour alternative crops as a source of oil for biofuel, including rapeseed and soybeans, which are grown in Europe. This view seems to be shared also by emerging and developing countries which do not produce palm oil.

The classification of palm oil as 'high-risk' ILUC was also viewed as unfair by many of these countries for two different but complementary reasons. First, it was viewed as a unilateral decision by the European Union rather than the result of a bilateral or multilateral process involving palm oil-producing countries. Second, the use of ILUC, such as the conversion of tropical forest land to plantations, by advanced countries as a criterion to ban imports of certain products from developing or emerging countries is viewed as illegitimate by the exporting countries. They consider that advanced economies practiced deforestation on a massive scale in earlier times, both in their own territories and in many tropical countries, and that the correct approach to deal with the global deforestation problem must involve action by the advanced economies themselves.

## 2.3 Criticisms

All the foreign (non-EU) officials we met were critical of the fact that, so far, they have had *no dialogue* with EU officials about the EU CBA mechanism, either bilaterally or multilaterally.

In our interviews, there was general sense that the EU should not pursue a unilateral approach to CBAs, but instead that it should engage in bilateral and multilateral discussions with its trading partners.

We sensed real frustration from close partners, with whom the EU has partnership agreements, about not being kept informed by the EU of its intentions about the CBA mechanism.

All our interlocutors referred to the two multilateral frameworks that are relevant as far as BCAs are concerned: the Paris Agreement and the World Trade Organisation. The European Green Deal Communication states that the EU CBA mechanism 'will be designed to comply with World Trade Organisation rules and other international obligations of the EU.'

The sense that we have is that our partners would like something more than assurances that the EU CBA mechanism will comply with the EU's obligations under the Paris Agreement and WTO rules. Partners want the design of the mechanism to be *discussed, or perhaps even negotiated*, within these two international fora.

A *China Daily* article written in Madrid during the UN 2019 climate change conference, and the day after the publication of the Green Deal Communication in Brussels, clearly stated the Chinese position: 'Lu Xinming, deputy director-general of climate change at China's Ministry of Ecology and Environment, said that such a tax would amount to unilateralism as does the US decision to withdraw from [the] 2015 Paris climate agreement' (Liqiang 2019).

This criticism by foreign diplomats seems to be dismissed by some influential European observers, who recently noted that '[...] commentators like to warn about the diplomatic turmoil such a measure would unleash in the delicate relations with other countries. While they are right that unilateral action by the EU will be unpopular with affected trading partners, as early reactions from the United States and China confirm, they seem to ignore the radically altered political context in which this option is currently being discussed. Frequent parallels drawn to the inclusion of international aviation in the European carbon market and the fierce backlash that decision triggered fall short: At the time, trade relations were strong, and Europeans cautious about disrupting sensitive negotiations on what would eventually become the Paris Agreement. Now, we not only have an open-ended climate treaty, but unilateral US action has set off a cascade of retaliatory trade restrictions that have deteriorated trade relations to a point not seen in decades' (Mehling et al. 2019).

Their view seems to be that Europeans should not feel bound by the Paris Agreement nor by WTO rules since the entire multilateral framework is anyway collapsing. This view was not shared by most of our interlocutors.

## 2.4 Policy responses

Finally, what will be the policy responses of the EU's foreign trade partners to the announcement by the von der Leyen Commission that it plans to introduce an EU CBA mechanism, and what would be the reaction if the EU goes ahead with such plan?

There are several possible options for the EU's trade partners. One is to do nothing, either now or later when the CBA mechanism is introduced. This seems unlikely if the Green Deal gathers political momentum within the EU and the plan turns into serious action. In this case, the EU would introduce significant domestic measures to reduce carbon emissions, and such measures would be accompanied by CBAs that will affect EU trade in an equally significant manner. Given the size of the EU market, one would expect that trade partners will act or react accordingly.

A second option would be to adopt domestic measures commensurate with the high level of ambition that the EU seeks for itself and other countries. If this were the case, the need for EU CBAs would disappear. This is essentially what President von der Leyen said at the World Economic Forum Annual Meeting in Davos in January 2020. According to the *Financial Times*, von der Leyen said she was encouraged by Beijing's attempts to impose a domestic carbon price to avoid being hit with an EU CBA, but warned this was just a 'first step towards a level playing field'. She added 'If this turns into a global trend, we will have a global level playing field where no carbon border tax will be necessary' (Kahn and Rachman 2020).

But it is unlikely that all countries will adopt appropriate measures to have a global level playing field. In that case, a third option for the countries deemed by the EU as not having adopted 'appropriate' measures, will be to challenge the EU. Such action could take a range of forms, from litigation at the WTO to the implementation of countermeasures.

In our conversations with foreign diplomats, it was clear that the first option – that the EU's trade partners will do nothing – was the least likely. It was not clear, however, whether option two or three would more likely as far as their countries were concerned. No-one told us that their country would be likely to increase its climate ambition because of the EU CBA plan, nor that it would plan to retaliate against EU imports, although several indicated that litigation at the WTO would be likely. Many told us that they will be closely watching how China and the United States react.

As far as the United States is concerned, Wilbur Ross, the US Commerce Secretary told the *Financial Times* that 'Depending on what form the carbon tax takes, we will react to it — but if it is in its essence protectionist, like the digital taxes, we will react' (Tett, Giles and Politi 2020).

## 3. Discussion

What can we conclude about the possible responses of the EU's main trading partners to an EU CBA mechanism, if implemented?

First, the reactions of trading partners do matter. We thus disagree with the occasional argument that the trading system is already in such disarray that the cost of further souring relations with trading partners would be very small. With the exception of the US, and to a lesser extent the countries that have been most severely hit by the tariff increases imposed by the current US administration, WTO members seem to largely respect their commitments in relation to tariffs and probably also other policies. There is also continuing daily cooperation between WTO members in many areas to remove trade barriers and to ease trade tensions. There would thus be a lot at stake if the WTO were to be threatened.

Second, in our discussions with officials, it was said that any conflict over an EU CBA mechanism will be played out mainly between the EU and the other two economic giants, China and the US. These countries are also among the EU's biggest trading partners. It is therefore of crucial interest to determine their likely

reactions. If the current US administration remains in power after 2020, the US will be a likely target of an EU CBA mechanism, and it also seems likely that the US will take countermeasures. It is noteworthy however that there is widespread support for federal climate measures among Democrats, and (seemingly) also among parts of the Republican Party. If these forces were to take over the administration, there is a high probability that the US will implement federal carbon pricing, supported by a CBA mechanism. This would tend to reduce the difference between EU and US carbon-pricing policies, and thus reduce US exposure to an EU CBA mechanism. It might also make it less likely that the US will argue against an EU CBA mechanism.

With China, the situation is less clear, at least to us. Our impression is that they might be less opposed to the EU CBA mechanism itself, than to the process of the EU designing and implementing the measure unilaterally.

Third, and most important in our view, the reactions to an EU CBA mechanism will depend crucially on how it is introduced. The EU has projected itself as a defender and promoter of a rules-based multilateral order in terms of both trade at the WTO and climate policy under the Paris Agreement. One of the main messages from our interlocutors in our interviews was that it would sound odd, therefore, if the EU were to pursue a unilateral track with respect to a CBA mechanism without first, or at least in parallel, pursuing a multilateral, or plurilateral, track at the WTO and/or within the framework of the Paris Agreement.

Fourth, trading partners are concerned about the possibility that an EU CBA mechanism would be used for protectionism rather than climate preservation. It will therefore be important that any CBA mechanism should be designed to be highly transparent and non-manipulable by special interests. Pursuing a multilateral approach would also go some way to allay fears of protectionism.

Fifth, some trading partners believe they might be unfairly targeted by an EU CBA mechanism, because they have not contributed as much as industrialised countries to the climate problem, or because of their lower income levels. Addressing this issue will probably be one of the most difficult aspects of the design of a CBA mechanism. Again, pursuing a multilateral approach, especially within the framework of the Paris Agreement, would put to rest some of these concerns.

Sixth, it seems plausible that international reactions to an EU CBA mechanism will depend on how broadly the scheme's scope will be. One option would be for the CBA scheme to only target *a few pollution-intensive sectors*, rather than a scheme that applies across most or all traded products. This seems to be the option chosen by the von der Leyen Commission, which announced in its European Green Deal Communication a CBA mechanism for 'selected sectors'. A narrower approach will plausibly spark fewer adverse reactions from trading partners, for several reasons. First, applied narrowly, the CBA will be smaller in magnitude and thus less confrontational. Second, provided the choice of sectors is appropriate, the CBA mechanism would undeniably target a significant problem. Third, a scheme that only applies to a few sectors will be more transparent than a scheme that applies across a broad range of industries, and will be thus less open to protectionist abuse, especially if the sectors involved have fairly simple production technologies. As we have noted, the possibility for protectionist abuse worries EU trading partners. It will be important however, for the EU to have considerable domestic production in the targeted sectors. Otherwise the scheme will be seen as protectionist, and likely trigger countermeasures and/or WTO disputes.

Finally, another avenue to explore might be to develop customs classifications that would make it easier to distinguish between products according to their carbon footprints. The World Customs Organisation (WCO) should be involved in such a process. Our discussions with members of the WCO Secretariat indicated an awareness of the issue, but also that any initiative would have to come from WCO members.

In conclusion, we tend to agree with those who argue that the actual implementation of EU CBAs would be fraught with dangers for international relations. But we also recognise that the threat of such CBAs could

be helpful in advancing towards a world with net-zero carbon emissions. The challenge, therefore, will be to design an EU CBA mechanism in such a way that it minimises the potential costs to the international system, while maximising the chances that it reduces global carbon emissions. In our view, the best way to meet this challenge would be to pursue a two-track approach during the design phase, with one track involving EU stakeholders, and one track involving foreign partners. The second track should be pursued both bilaterally (especially with countries that are parties to EU trade agreements) and multilaterally at the WTO and within the framework of the Paris Agreement.

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