

The Carbon Inclusion Mechanism proposal for the EU ETS Phase III: A first application of the BCA Guidelines

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“Carbon Inclusion Mechanism”

Measures against carbon leakage

EU ETS Directive Phase III (2013-2020)

- Benchmarked free allowances (top ten)
- Compensation for indirect carbon costs
- Global sectoral agreement
- **Inclusion of importers into the ETS**

CIM proposal by France: Motivation

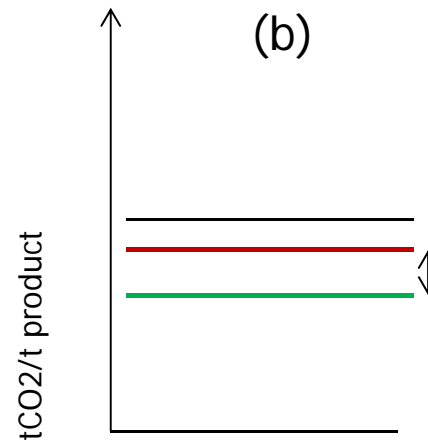
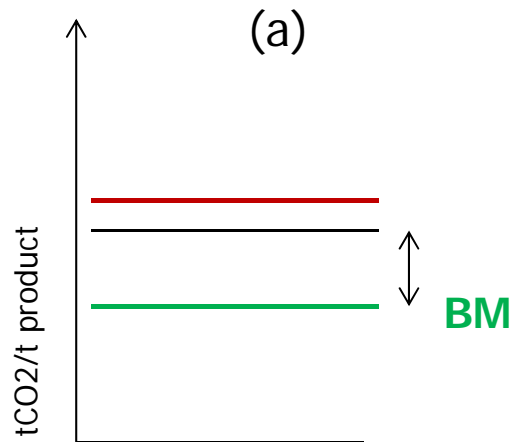
- Carbon leakage is being expected, although allowances will be handed out for free (with benchmarks),
- Create a level playing field between EU producers and foreign producers
- Create environmental integrity
- Leverage: prevent countries from free riding and give incentives to adopt appropriate measures for sectors
- Encourage low-carbon technology development so that the products will/could be exempt from the carbon inclusion mechanism

CIM proposal: Cornerstones

- applied to **sectors** “at risk”
- Sectoral **partnership** between the EU and each country hosting relevant sectors
- **LDCs** to be exempted
- An importer to submit the same amount of allowances as a domestic producer - levelling
- **Basis:** either no measurement of exact emissions, but application of average EU producer emissions in that sector
- **Or** the producer proves that his products sold in the EU are more carbon efficient than the EU average.

CIM proposal: Calculation

- The amount of allowances will be calculated using the EU benchmarks applied under the free allocation scheme (top 10 producers) and either (a) taking the difference to the EU average emissions in that sectors or (b) the verified data from imported product.



Evaluation

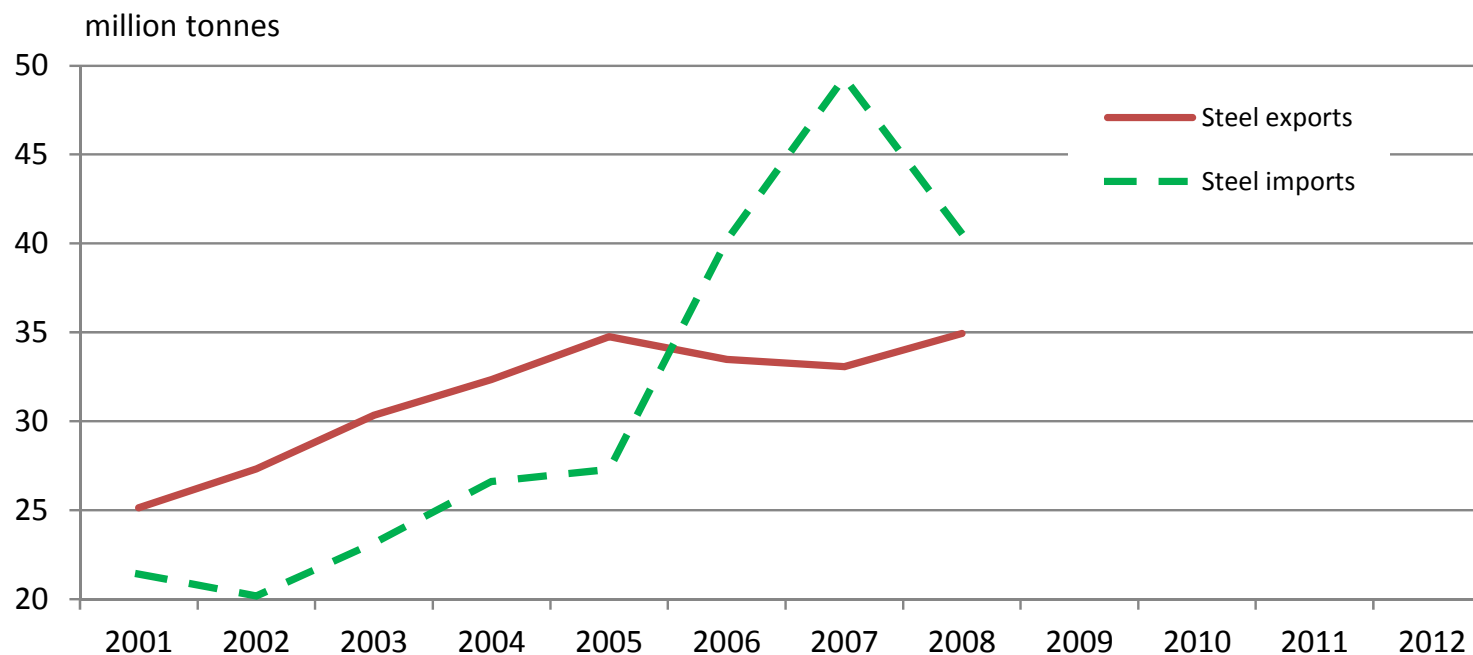
Main Trading Partners EU-27 in selected sectors 2007

	NACE	USA	Russia	China	Norway	Switzer- land	Turkey
Aluminium	27.42	4	2	6	1	3	
Basic iron & steel and ferro-alloys	27.10	4	2	3	Ukraine = 5	6	1
Other basic inorganic chemicals	24.13	1	4	2	3	(7)	
Fertilizers & nitrogen compounds	24.15	3	1		2		
Paper & paperboard	21.12	1	3	5	4	2	6

Source: Mohr, Graichen, Schumacher 2009, Data: 2007

Steel Trade Interaction EU until 2008

- Import/export relation of non-EU partners: major change in basic iron & steel (imports 2003: 44% to 2007: 57%)
- Net import boom until 2008



Source: World Steel Association and OECD

Discussion of the CIM along the Guidelines

BCA guidance	CIM proposal (+ = included)	Comment
Motivation	+	Motifs are explicit. Leverage is part of the agenda. (-)
Reducing leakage	+	limited by assumptions on average EU emission benchmark (+)
National policy effectiveness	(+)	EU policy is targetting global goal (+)
Transparency	+	As long as agreement on the adjustment level for sectors (-)
Feasibility	?	Administrative burden increases with individual proofs
Implementation, good gov.	?	Not clear from proposal
Coherent (WTO-, climate regime, other international principles)	+	Application could lead to discrimination of countries not able to submit individual data and proof
Exemptions&Support	+	LDC exempt, support offered thru sectoral deals
Trade-offs (leakage, motivation, transparency, discrimination)	+	Average EU emissions, not worst performer's emissions;

A first set of conclusions

- Unclear sectoral **coverage** – literally CIM would cover all 164 sectors identified as „at risk“, while EU benchmarking was undertaken for roughly one third of that number of sectors
- Meant as a **parallel** measure to support sectoral partnerships
- „EU-centric“: no mentioning of other international actions of relevance for a levelling, such as export taxes
- Nothing said about revenues
- Straightforward proposal, devil is in the implementation details

Thank you very much for your attention

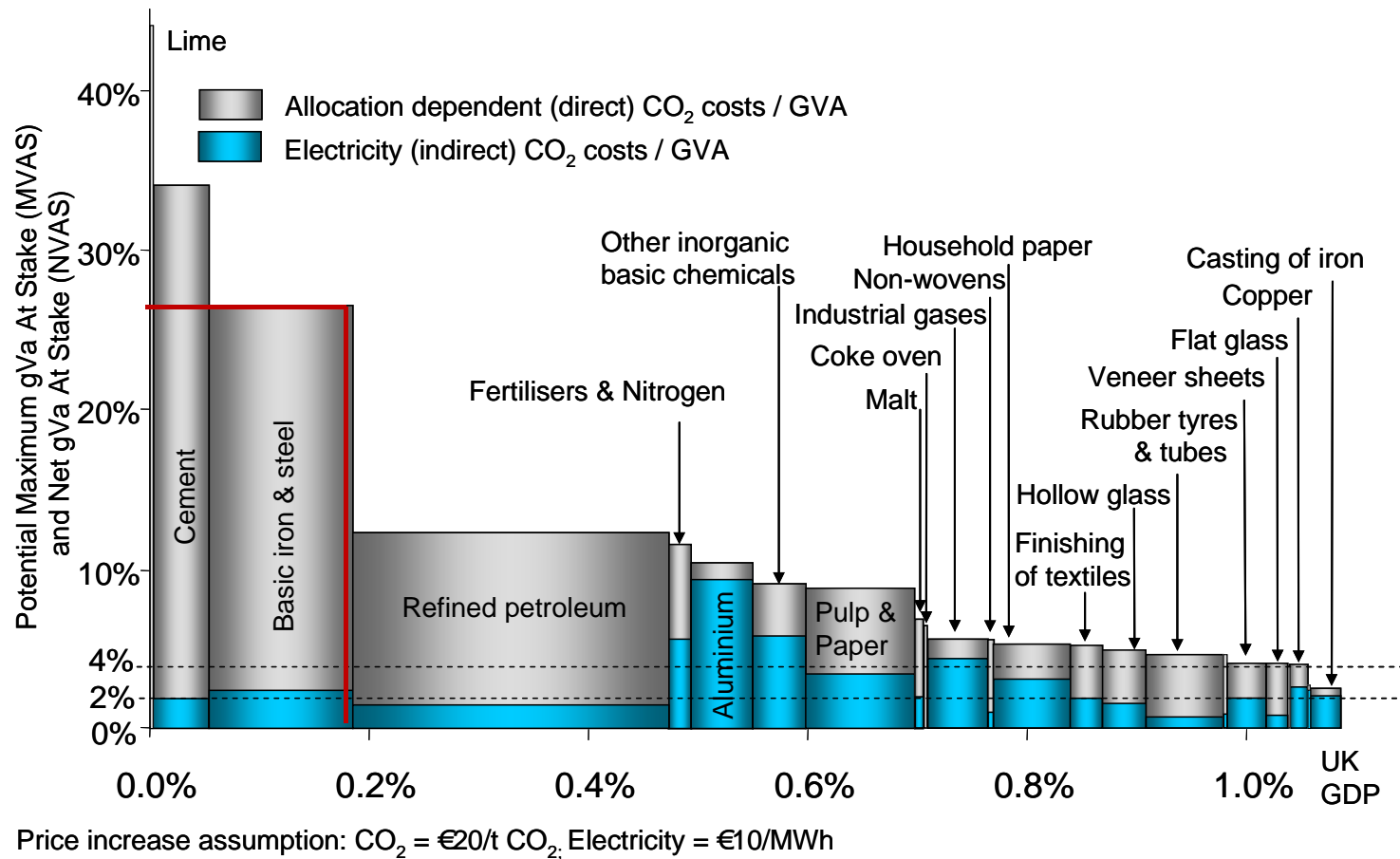
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Backup

WTO Legal Issues

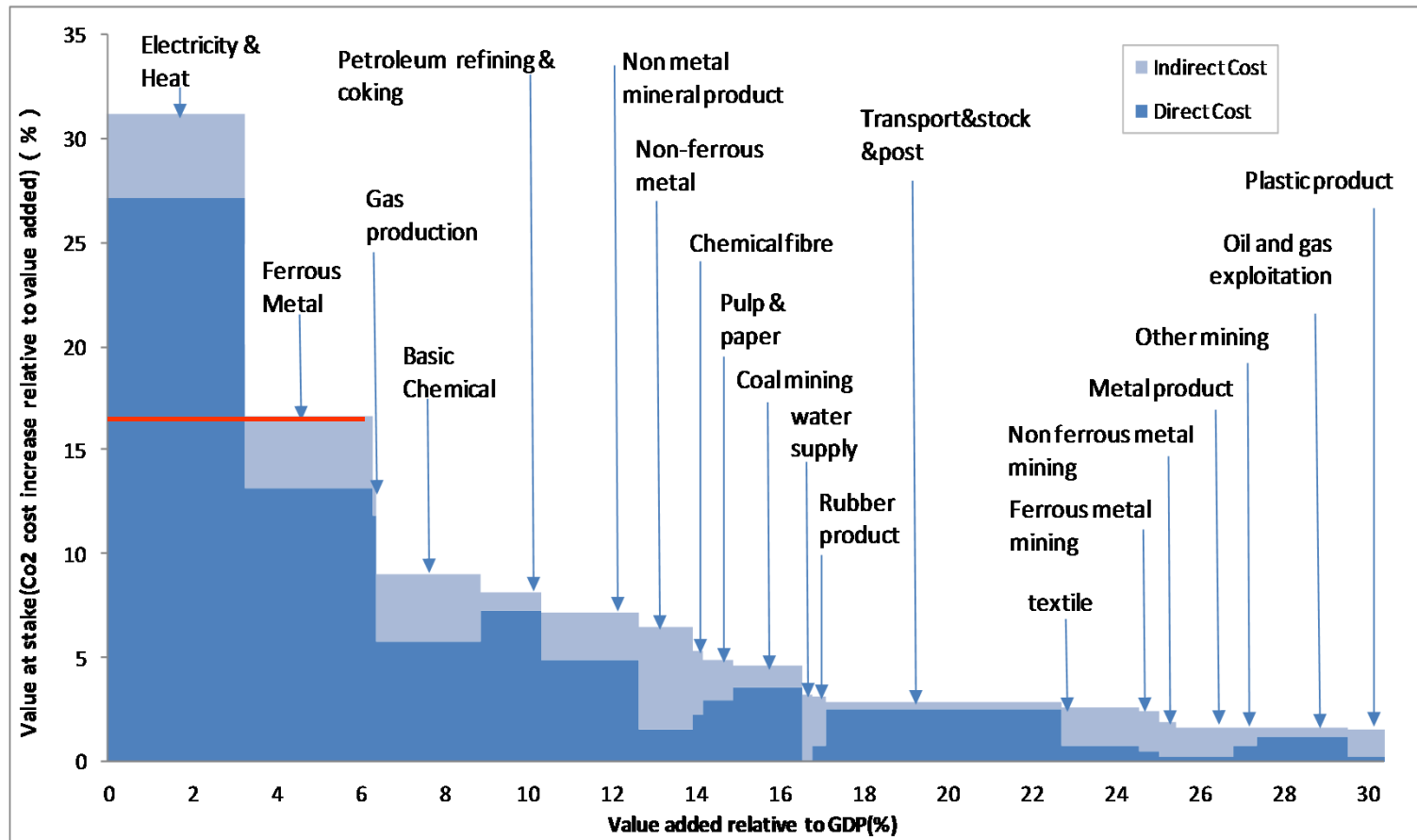
- **Key principles: non-discrimination and most-favored-nation approach**
 - Read: treat all imports equal to domestic like products; guarantee trade favours to all WTO members
- **WTO rules prefer 'product' measures**
 - Read: base border measures on incorporated characteristics rather than production processes
- **Only 'product' or 'consumption' measures can be imposed also on imports (VAT v. income tax)**
- **WTO prefers application of 'internal' measures to imports (e.g. VAT or asbestos ban) over purely 'border' measures**
- **Allowance requirement for imports is based on/triggered by 'foreign' emissions and 'importation' not internal sale or internal factor**
- **Charges (import tariffs, border tax), not border regulation subject to 'border tax adjustment'**

UK industry: CO₂ pricing (€20/tCO₂)



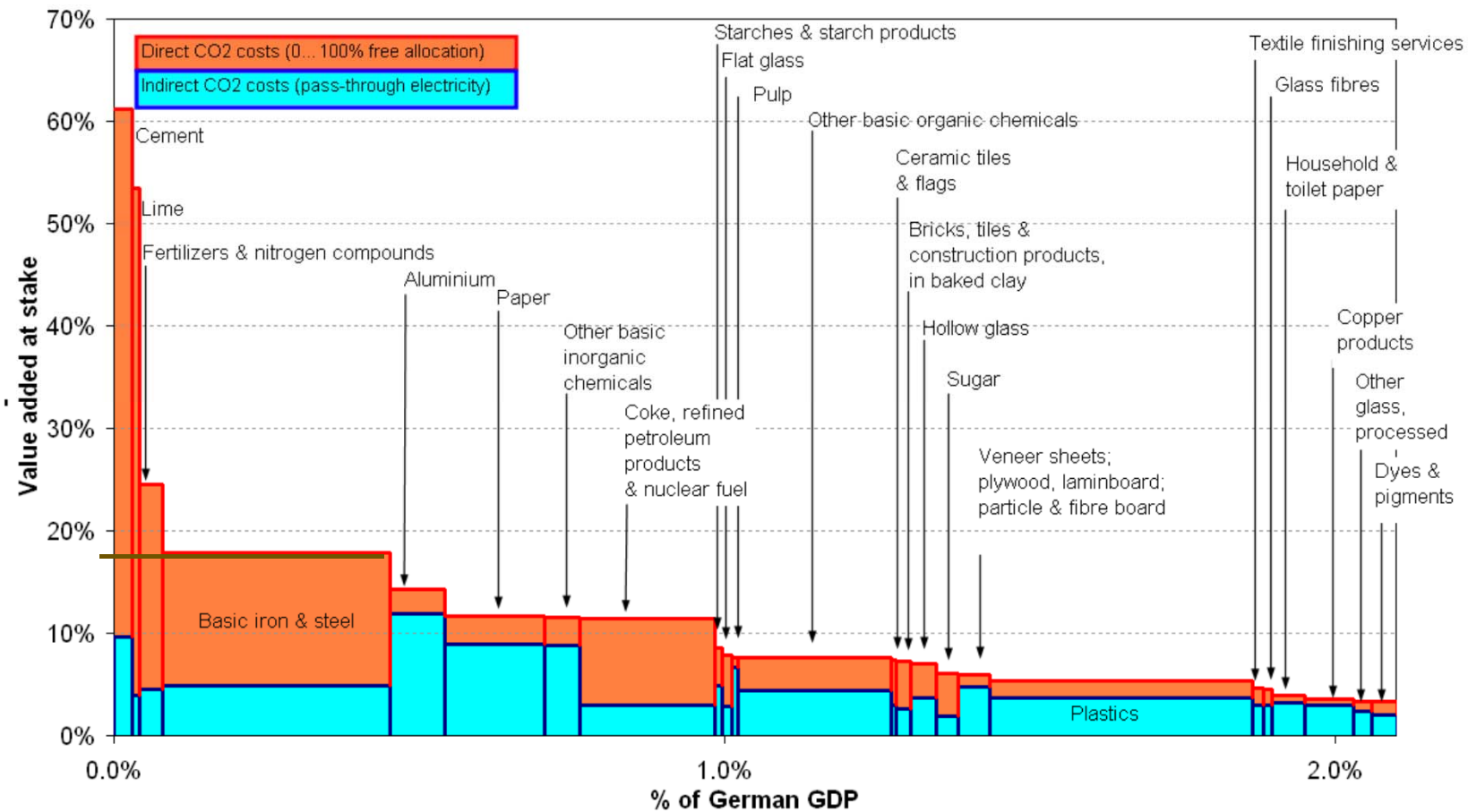
Source: Hourcade, Demailly, Neuhoff and Sato 2007.
Data: 2004

China: carbon tax impact eq. to €12/tCO₂



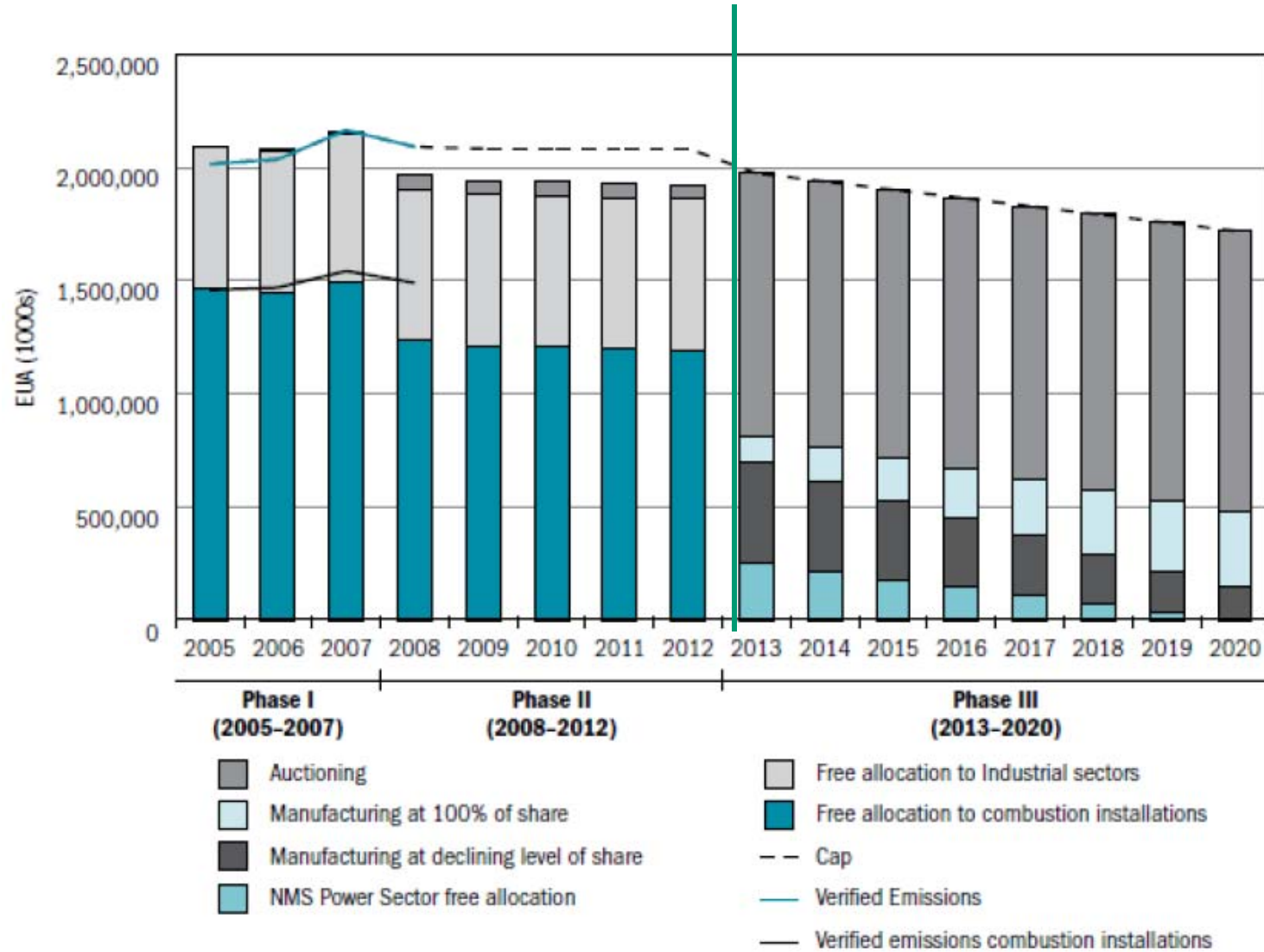
Source: Wang, Li, Xiong, Data: 2007
Climate Strategies, forthcoming

German industry: CO₂ pricing (€20/tCO₂)



Source: Graichen et al. 2008, Data: 2005

Allocation and Emissions in the EU ETS



Source: Climate Strategies, GMF 2009

Some Distinctions and Design Features

- **Actual carbon emissions vs benchmark on product only?**
 - applied to imports from all origins satisfies *non-discrimination* principle
 - ‘Best available technology’ *assumption* for the adjustment for *direct emissions* costs satisfies MFN principle
- **Benchmark level: Best available technology or ‘Average performance’**
 - Average performance is plausible but consistency with National Treatment could be debated
 - with provision for *cleaner* manufacturers to acquire corresponding allowances only?
 - Could create incentives for ‘cleaner’ producing companies to provide audited trail
 - Relates more directly to PPM and definition of ‘like products’
 - Essential for electricity-intensives BAs to have impact