

# European Parliament sends the Commission and Council its checklist for a "WTO-compatible EU carbon border adjustment mechanism"

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On March 10, 2021, the European Parliament ("EP") adopted a resolution "Towards a WTO-compatible EU carbon border adjustment mechanism" ("CBAM"). This mechanism, which is a key component of the December 2019 European Green Deal, is planned by the European Commission to be the subject of a proposal for a regulation in June 2021. It would introduce a carbon price on certain goods, when imported from countries outside the EU that are considered to have less robust carbon pricing arrangements than the EU. The main purposes of the CBAM would be to discourage EU businesses from moving their production to countries with less ambitious climate change policies, (carbon leakage) and to encourage a global move towards net zero carbon emissions by 2050 in line with the Paris Agreement. This briefing summarizes the EP's position on the following questions:

- What is the timeline of the CBAM?
- What are its objectives?
- What are the options for its design and coverage?
- What are the key issues to be determined during the legislative process?

## I. Timeline for a CBAM

In December 2019, the European Commission adopted its Communication on the European Green Deal. The key measures envisaged in this context include the proposal for a CBAM for selected sectors, scheduled for 2021. Preparatory work by the Commission includes a March 2020 inception impact assessment and a public consultation between July and October 2020.

On September 16, 2020, Commission President Ursula von der Leyen announced that a legislative proposal on the CBAM would be among the key new initiatives for 2021. On October 7, 2020, the European Parliament's Committee on the Environment, Public Health and Food Safety ("ENVI") published a draft report entitled "Towards a WTO-compatible EU carbon border adjustment mechanism". This draft report aimed for the introduction of a CBAM no later than 2023.

Adopted by ENVI on February 5, 2021, the report calls for the introduction of a CBAM as part of a broader EU industrial strategy, with a view to reducing the risk of carbon leakage. In addition, it analyzes aspects relating to the design and scope of a CBAM, and its possible contribution to the financing of the EU budget.

On March 10, 2021, the European Parliament adopted the resolution on a WTO-compatible EU CBAM with 444 votes for, 70 against and 181 abstentions ("Resolution").

The Commission is expected to present a legislative proposal on a CBAM in June 2021, as well as a proposal on how

to include the revenue generated to finance part of the EU budget.

## II. Objectives of the EP Resolution towards a WTO-compatible EU CBAM

The main objectives and scope of the Resolution on an EU CBAM are:

### 1. Ensuring that the price of imports reflects more accurately their carbon content

The EU's increased ambition on climate change must not lead to 'carbon leakage' as global climate efforts will not benefit if EU production is moved to non-EU countries that have less ambitious emissions rules. The Resolution supports a carbon price on certain goods imported from outside the EU, if these countries do not have sufficient climate change objectives.

A CBAM would create an incentive for European industries and EU trade partners to decarbonize their industries and therefore support both EU and global climate policies towards GHG neutrality in line with the Paris Agreement objectives.

### 2. Compliance with WTO rules and EU Free Trade Agreements ("FTAs")

The Resolution supports the introduction of a CBAM, provided that it is compatible with WTO rules and EU FTAs by not being discriminatory or constituting a disguised restriction on international trade. A CBAM should be exclusively designed to advance climate objectives and not be misused as a tool to enhance protectionism, unjustifiable discrimination or restrictions.

Such a mechanism should support the EU's green objectives, in particular to better address GHG emissions embedded in EU industry and in international trade, while being non-discriminatory and striving for a global level playing field. Revenues generated should be used as part of a basket of own resources (i.e. money that belongs to and can be spent by the EU centrally) to boost support for the objectives of the Green Deal under the EU budget.

### 3. Alternative to the measures that address the risk of carbon leakage in the EU's Emissions Trading System ("ETS")

In order to prevent possible distortions in the internal market and along the value chain, a CBAM should cover all imports of products and commodities covered by the EU ETS, including when embedded in intermediate or final products.

The Commission is currently assessing all the different options for the introduction of a CBAM, ranging from tax instruments to mechanisms using the EU ETS. The modalities for the design of a CBAM should be explored alongside the revision of the EU ETS so as to ensure they are complementary and consistent, and to avoid overlapping that would lead to double protection of EU industries.

### 4. Looking at carbon intensive sectors

By 2023, the CBAM should cover the power sector and energy-intensive industrial sectors such as cement, steel, aluminium, oil refinery, paper, glass, chemicals and fertilizers, which continue to receive substantial free allocations, and still represent 94% of EU industrial emissions.

The CBAM should be monitored through an independent body, under the auspices of the Commission, which should regularly report and provide transparent information to Parliament, the Council and Commission on request and at

least twice a year.

## III. Options for a CBAM

Various options arise for the most appropriate regulatory mechanism for CBAM that will comply with international trade law, including the WTO rules and EU FTAs and other trade agreements:

1. New excise duty/carbon tax on carbon intensive products, which would include a CBAM;
2. Border tax/import duty;
3. Border tax/import duty with export refund;
4. Carbon added tax;
5. Surrender of EU ETS allowances upon importation;
6. Surrender of "notional" EU allowances upon importation.

Many issues will have to be determined during the legislative process. For example:

- What treatment should apply to free allowances and export rebates if there is a CBAM, in order to comply with international trade law and to maintain the competitiveness of EU industry in third countries with lower carbon emissions standards?
- Which countries and product sectors should be subject to the CBAM in the light of their GHG emissions and international trade law, including the principles of non-discrimination and proportionality?
- What are the relevant technical criteria to be applied for the valuation of the carbon price of imports subject to the CBAM?
- What scope should there be for exporters or importers to claim a CBAM rebate by showing that particular goods have been produced with no carbon footprint (or a much lower one than might be assumed by looking at the regulatory and power systems of the country of origin as a whole)?

There will also be diplomatic issues to consider as the EU works with the US and other Western nations in coordinating climate change ambition ahead of the US-hosted International Climate Leaders' Summit and COP26. The US Trade Representative recently mentioned that they are considering a carbon border adjustment and indicated that they will work with US allies in promulgating any adjustment. That being said, John Kerry, US Special Presidential Envoy for Climate Change, warned the EU to hold off on promulgating a CBAM until after COP26. The tension between unilateral and global approaches is of course a perennial feature of the UN Framework Convention on Climate Change process of which COP26 is the latest instalment, with the Paris Agreement of 2015 having marked in some ways a radical departure from the previous "top-down" model followed, for example, by the Kyoto Protocol.

In June 2021, the Commission is expected to provide some answers by publishing the legislative proposal on a CBAM.

Please do not hesitate to contact us should you wish to know more about this topic.

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