Dialogue Facility on ETS Development in Asia
Carbon Border Adjustment Mechanisms (CBAM)

Meeting report

Overview

The Asia Society Policy Institute is convening a series of private dialogue meetings that brings together experts in emissions trading system (ETS) development from select Asian jurisdictions. This initiative seeks to support the successful design and implementation of national ETSs in Asia, while building foundations for future market connectivity at Asian and international levels.

This meeting, held on 21st October 2021 by videoconference, focused on a policy that could have significant implications in Asia in terms of trade, compliance responses and ETS policy development, namely the EU's proposed Carbon Border Adjustment Mechanism (CBAM).

A key concern with implementing more ambitious climate policy is how to protect domestic industry's global competitiveness and prevent 'carbon leakage', that is, the transfer of production to jurisdictions with less ambitious climate policies that would lead to an increase in total emissions. Free allocation to emissions- and trade-intensive sectors has generally been adopted in ETSs to address this concern. However, the CBAM is emerging as an important alternative approach.

The EU's proposed CBAM will put a carbon price on imports of a targeted selection of goods from 2026 with the aim of ensuring that ambitious climate action in the EU does not lead to carbon leakage. There would be a gradual phase out of free allocation in the EU ETS from 2026 by 10 percentage points each year to reach zero in 2036, when industry would move to full auctioning.

Understanding the EU's proposed CBAM and its implications on affected sectors and organisations in Asia is very important. This meeting examined these topics through insights from EU officials involved in the development of the CBAM policy, David Boublil, Ioannis Zachariadis and Pasquale de Micco from the European Commission's Directorate-General for Taxation and Customs Union (DG TAXUD). Insights were also provided by key advisors on CBAM to the European Commission, Hubert Fallmann from Umweltbundesamt and Karsten Neuhoff from DIW Berlin. The implications on Asian jurisdictions were then considered, with contributions from a number of Asian representatives, including Jai-chul Choi, Korea's former Climate Change Ambassador and Co-President of Korea's Climate Change Center.

The meeting agenda is provided in Annex 1. The participants included policymakers, supporting officials and experts directly involved in the development and implementation of ETSs and related trade policies in Asia.

Summary

This meeting examined in-depth the EU's proposed CBAM, building up the understanding of this policy and its implications for Asia, both in terms of practical compliance and what it means for ETS development and cooperation. A summary of key points is given below.

Introduction to the EU's proposed CBAM

In providing the context for the proposed CBAM it was emphasized that it should be seen as a support measure within the EU's broader 'Fit for 55' policy package which aims to achieve at least a 55% reduction in EU's GHG emissions by 2030 compared to 1990, in line with the pathway to net zero GHG emissions. This package includes a steeper proposed cut in the EU ETS cap of 61% (from 43%) by 2030 compared with 2005 levels, with an expected corresponding increase in carbon prices, as has already been seen in late 2021. The CBAM is the EU's proposed solution to more effectively protect its industry from carbon leakage associated with such carbon prices, compared to the existing system of free allocation. It is not separate from the EU ETS and works to reinforce it.

It was stressed that CBAM is a climate measure not a trade measure. It is designed to mirror the EU ETS[1], whilst being compliant with WTO rules, with equal carbon pricing applied to imports into the EU.

EU businesses pay a carbon price on their production in the EU and under the CBAM companies importing specific goods into the EU will need to pay a carbon adjustment, corresponding to the price they would have paid if the goods had been produced under the EU ETS. The CBAM obligation will be adjusted to reflect the level of free allocation given under the EU ETS and carbon costs already paid in its own jurisdiction will be deducted (hence no 'double pricing').

The CBAM's coverage initially includes basic material products high up the value chain. These include cement and clinker, iron and steel products, aluminium, fertilisers and electricity. These were selected based on high risk of carbon leakage (high carbon emissions and / or high level of trade), substantial coverage (more than 45% of CO_2 emissions of ETS sectors) and practical feasibility. In subsequent phases there will be an extension to other goods.

The CBAM is aimed at incentivising decarbonisation in third countries by recognizing actual emissions (ie reflecting the impacts of climate policy in that country), by excluding countries applying the EU ETS or fully linking to it, and by deducting carbon costs already paid in third countries from the CBAM obligation[2].

There have been extensive bilateral discussions between the EU and third countries to solicit their views during the development of the CBAM policy. The proposed CBAM legislation is now subject to discussion by the European Parliament and the Council of the EU. This process can sometimes lead to significant changes to the original proposal. Furthermore, the proposal defines a framework for the CBAM functioning but many technical details will be developed at a later stage and covered by supplementary acts, and some technical details will be finalised only after the transitional period (2023 to 2025), when a legislative review of the CBAM regulation is expected.

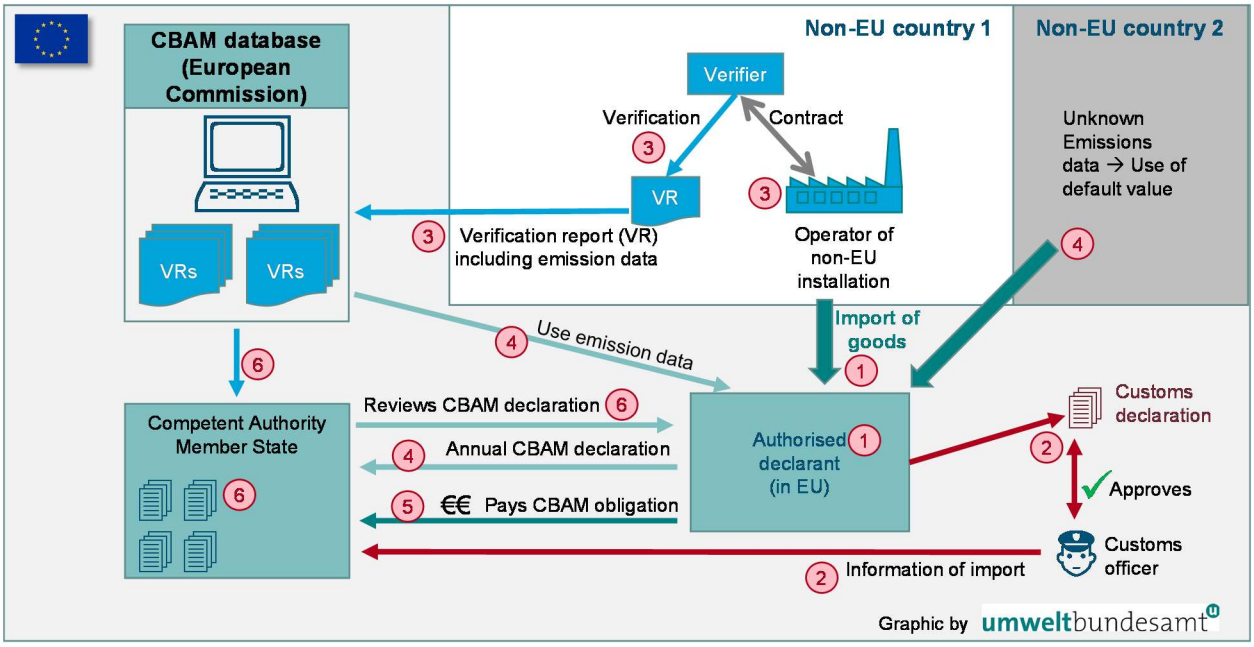
[1] It replicates as much as possible the relevant details of the EU ETS, with some minor explained differences including the calculation of price (average trading price of EU ETS allowances in the week prior to import), tradability of CBAM certificates, quantitative limit, validity over time and declarative system.

[2] Including carbon costs paid at a sub-national level

Compliance and MRV aspects

The proposed regulatory system is designed to impose no less favorable treatment to imported products than the EU ETS imposes on EU products.

The entity responsible for paying the CBAM obligation is the importer in the EU (the 'authorised declarant'), who must seek authorisation in its EU Member State before carrying out imports. The authorised declarant must submit a 'CBAM declaration' to the competent authority in the Member State, containing the quantity of goods imported, their 'embedded emissions' and the number of CBAM certificates to be surrendered (taking into account the carbon costs already paid in the country of origin). The authorised declarant must ensure it has sufficient CBAM certificates available (purchased from the CA) and surrender these in line with the embedded emissions of imported goods. The penalty for non-compliance will be the same as under the EU ETS, ie €100/t CO_2 not surrendered, plus surrender of the missing certificates. An overview of this system is shown below.



The embedded emissions will be based on actual emissions data verified by a verifier accredited in the EU or, if not available, default values[3]. There are potentially extensive monitoring requirements for the production of the imported good including emissions, input streams (and their emissions), output streams, splits of emissions according to product mix and the carbon price.

Implications on ETS development in Asia

The purpose of the CBAM as a carbon leakage protection measure was emphasized. In an ideal world, no carbon leakage protection would be needed, which would be the case if all countries had similar carbon pricing in place (ideally, linked ETSs). As such, the proposal enables an exemption of countries from the CBAM if there is a full linking agreement between their carbon pricing system and the EU ETS.

[3] Default values will be determined by the European Commission based on EU ETS data and will be designed to encourage use of actual values.

To minimize CBAM costs of its exporters to the EU a jurisdiction will need to have a carbon pricing policy that results in net carbon costs similar to that of the EU ETS, given that any carbon costs already paid in its own jurisdiction will be deducted from the CBAM obligation. For an ETS this will require a cap that is ambitious enough. In practice, this is likely to be required anyway if the GHG emission reduction targets of the carbon pricing policy are aligned to the pathway for achieving net-zero GHG emissions to meet obligations under the Paris Agreement.

Exemption of goods from the CBAM will be possible if the jurisdiction where the goods are produced has an ETS that is fully linked to the EU ETS. Pre-requisites for such linking would include an ETS design that leads to a similar effective carbon price as the EU ETS as well as comparability of key technical details. These include at least, but not limited to, a cap-and-trade design with an absolute emissions cap, similarity in scope (at least for the goods covered by the CBAM)[4], a robust and credible MRV system, strong third party verification and a strong enforcement regime.

Perspectives on CBAM

The primary objectives for the policy and its key elements were understood and the logic of prioritizing on a limited number of goods from high-emitting sectors was recognized, limiting the number of affected parties. However various issues were raised, including the need for proper consideration of indirect emissions (important in Asia where allocation for indirect emissions can be a necessary temporary measure in ETSs before electricity markets enable full carbon cost pass-through) and the technical and logistical difficulty in calculating embedded emissions.

In the case of Korea, the proposed CBAM has served as a motivation for the government to adopt more ambitious climate goals. These include 'Korea New Deal - National Strategy for a Great Transformation' (July 2020) comprising a Digital New Deal and Green Deal, the 2050 carbon neutral goal (Oct 2020), followed by 'Framework Act on Carbon Neutrality and Green Growth' (Sept 2021) and the updated 2030 NDC (Oct 2021) comprising a 40% (from 26.3%) GHG emission reduction target by 2030 compared to 2018 levels. This revised target, if formally adopted, would lead to a correspondingly ambitious K-ETS cap, due to the methodology linking the cap to the national emission reduction target. The effect of the proposed CBAM has also been to support an enabling environment for business toward 2050 carbon neutrality with major business associations joining a '2050 carbon neutrality group' (including petrochemicals, semiconductor and display, cement, steel and refineries) and operation since 2021 of the K-RE100 initiative focusing on voluntary transition to renewable energy.

In Taiwan the EU's proposed CBAM has had a similar effect to encourage more ambitious climate action, for example with Taiwan's largest industry group, the Chinese Federation of Industries recently publishing a white paper supporting carbon pricing including a carbon fee and emissions trading. Previously the group opposed this. Furthermore, it is reported that Malaysia's plans to launch a domestic ETS are at least partly driven by the EU's proposed CBAM.

Opinions on challenges and opportunities for the EU in relation to the CBAM were shared including (1) working in harmony with partner countries for example through further technical cooperation on introducing carbon pricing and training on CBAM-related issues, and mobilizing a climate ambition club focused on carbon neutrality goals through policy dialogue to enhance climate action; (2) give consideration to the use of CBAM revenue to engage partner countries in climate action for example by contributing to the Green Climate Fund (GCF), Global Environment Facility (GEF) and Least Developed Countries Fund (LDCF); and (3) engage

[4] i.e. coverage of the same industrial activities or sectors as the EU ETS, covering the same GHGs and using similar boundary definitions of what is an 'installation'.

relevant international agencies in climate action for climate neutrality by 2050 including realignment of various policies with 2050 climate neutrality goals, developing global carbon market in a climate-trade supportive way and sharing the legitimacy and applicability of CBAM as an enabling policy tool. Overall, it was suggested that the CBAM should serve as a vehicle for strengthening climate action in a virtuous way.

Annex 1: Agenda

Welcome and introduction		
5 mins	Welcome remarks and introduction	Alistair Ritchie Asia Society Policy Institute
Session 1: The EU's proposed CBAM		
20 mins	Introduction to the EU's proposed CBAM, how it will work and its implications and impacts on affected sectors and organisations in Asia	David Boublil European Commission
15 mins	Q&A and discussion	
20 mins	Technical aspects of the EU's proposed CBAM including monitoring, reporting and verification (MRV), compliance and scope issues	Hubert Fallmann Umweltbundesamt
15 mins	Q&A and discussion	
10 mins	Break	
Session 2: Implications of EU's proposed CBAM in Asia		
20 mins	The CBAM in the eyes of climate observer - the perspective of the Former Ambassador for Climate Change for Korea	Jai-chul Choi Climate Change Center, Korea
25 mins	Reactions across jurisdictions on the EU's proposed CBAM including implications on ETS development in Asia	Representatives from different Asian jurisdictions
10 mins	Comments on implications of EU's proposed CBAM on ETS development in Asia	Hubert Fallmann Umweltbundesamt
Session 3: Other CBAM design options		
20 mins	Alternative CBAM design options and their impacts Reflections and comments on CBAM discussions	Karsten Neuhoff DIW Berlin
10 mins	Q&A and discussion	
Conclusions		
10 mins	Summary of key points Expectations for future meetings	Alistair Ritchie Asia Society Policy Institute