

INCEPTION IMPACT ASSESSMENT

Inception Impact Assessments aim to inform citizens and stakeholders about the Commission's plans in order to allow them to provide feedback on the intended initiative and to participate effectively in future consultation activities. Citizens and stakeholders are in particular invited to provide views on the Commission's understanding of the problem and possible solutions and to share any relevant information that they may have, including on possible impacts of the different options.

TITLE OF THE INITIATIVE	Carbon border adjustment mechanism
LEAD DG – RESPONSIBLE UNIT	DG TAXUD Unit C2
LIKELY TYPE OF INITIATIVE	Legislative proposal
INDICATIVE PLANNING	2021
ADDITIONAL INFORMATION	https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en

The Inception Impact Assessment is provided for information purposes only. It does not prejudice the final decision of the Commission on whether this initiative will be pursued or on its final content. All elements of the initiative described by the Inception Impact Assessment, including its timing, are subject to change.

A. Context, problem definition and subsidiarity check

Context [max 10 lines]

The **European Green Deal** adopted by the Commission on 11 December 2019 includes the goal of enshrining the long-term objective of climate neutrality by 2050 in legislation and increasing the EU's climate ambition to reduce greenhouse gases emissions by 50-55% from 1990 levels by 2030. In this context, the European Green Deal emphasized that *“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”*.

The Paris Agreement on climate, as well as strong international diplomacy and leadership, are the EU's main instruments to achieve higher climate ambition globally. By COP26 in November in Glasgow, Paris Agreement Parties need to communicate or update their climate commitments and submit their mid-century strategies, in line with the Paris objectives. The EU will continue to work with partners to raise the global ambition.

Problem the initiative aims to tackle [max 20 lines]

As long as many international partners do not share the same climate ambition as the EU, there is a risk of carbon leakage. Carbon leakage occurs when production is transferred from the EU to other countries with lower ambition for emission reduction, or when 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.

In this context, a carbon border adjustment mechanism would ensure that the price of imports reflect more accurately their carbon content. The measure would need to be designed to comply with World Trade Organization rules and other international obligations of the EU. It would be an alternative to the measures that currently address the risk of carbon leakage in the EU's Emissions Trading System (“EU ETS”).

Since 2013, the risk of carbon leakage has been effectively addressed for those sectors regulated under the EU ETS that are exposed to the risk of carbon leakage – such as for example steel - by granting free allowances, based on the emissions performance of the best installations under the system (benchmarks). The EU ETS Directive provides for this system to continue at least until 2030. In addition, since the price of carbon is incorporated in electricity prices and passed on to consumers, possibly becoming an indirect source of carbon leakage for some energy-intensive sectors, Member States have the possibility to compensate some electro-intensive industries for the increase in electricity prices resulting from the ETS, provided they comply with EU State aid rules.

Basis for EU intervention (legal basis and subsidiarity check) [max 10 lines]

The legal basis will depend on the design of the measure. Both article 192 (environmental measures including

measures of fiscal nature) and article 207 (common commercial policy measures) of the Treaty of the Functioning of the EU may be relevant.

This initiative is strongly linked to the pricing of carbon inside the EU, which is regulated for some sectors through the EU Emissions Trading System, and to some extent through the EU Energy Taxation Directive. A carbon border adjustment measure would apply to imports into the EU. For all these reasons, it is for the EU to take action.

B. Objectives and policy options [max 20 lines]

The main objective of the carbon border adjustment is fighting climate change by avoiding carbon leakage.

The starting point for the exercise will be the new baseline scenario of the European Green Deal and its higher ambition for 2030.

The Commission will develop a number of policy options based on the following building blocks:

1. Type of policy instrument:

The legal and technical feasibility of each measure will need to be carefully assessed, also in relation to the EU's trade acquis (the rules of the World Trade Organisation and EU's trade agreements) and other international commitments. The complementarity of the measure with internal carbon pricing, in particular the EU ETS, will also have to be assessed, as well as how it relates to the current measures to avoid the risk of carbon leakage. The measure should be commensurate with the internal EU carbon price.

Various options could include a carbon tax on selected products – both on imported and domestic products, a new carbon customs duty or tax on imports, or the extension of the EU ETS to imports.

2. Methodological approach to evaluating the carbon content and carbon pricing of imported products:

Under the EU ETS, a system of harmonised EU-wide benchmarks has been developed for industrial processes. To the extent that a sector is covered by the EU ETS, a border measure could be based on similar methodological considerations as for ETS, i.e. benchmark values, unless the exporter certifies a lower carbon content and/or a higher carbon cost at origin. The Commission will also look at alternative approaches, e.g. defining carbon content of products, taking into account their interaction with existing and future climate policies.

3. Sectoral scope:

An important part of the work will also relate to the selection of sectors subject to this measure. A scoping in terms of sectors concerned will have to be defined to ensure that the measure applies where the risk of carbon leakage is the highest. The assessment will take as starting point the study currently underway that the Commission launched to identify the risk of carbon leakage in the third and fourth trading phases of the EU ETS.

C. Preliminary assessment of expected impacts [max 20 lines]

Likely economic impacts

The impacts will vary depending on the design and in particular on the sectors covered by the adjustment mechanism. The economic efficiency and the impact of any given option on the value chain as well as the induced effects on downstream and upstream sectors of a product will need to be assessed.

The measure is part of the European Green Deal, which is a new growth strategy that aims at transforming the European Union into a modern, resource-efficient and competitive economy where there are no net emissions of greenhouse gases in 2050 and where economic growth is decoupled from resource use. It will contribute to decarbonisation while ensuring that the competitiveness of EU industry is not jeopardised by carbon leakage.

Positive impacts on innovation and research are expected from the Green Deal. A carbon adjustment will make it more expensive to import carbon-intensive products, which at the same time can spur changes towards more sustainable products in the EU and in third countries.

The effects of the measure on the EU and third country markets have to be analysed.

Likely social impacts

Social and employment impacts will need to be assessed. The European Green Deal emphasises the need to ensure a cost-effective, just, socially balanced and fair transition to a carbon neutral economy.

The impacts will depend to a great extent on the sectors concerned. A carbon border adjustment may increase the price of consumer products including those related to basic needs. Therefore, the analysis will need to consider the potential impact on living standards, especially those of vulnerable groups.

The measure may have positive effects in terms of jobs by avoiding the substitution of EU production by production from third countries with lower climate ambition.

These impacts will also be compared with the likely social impacts of inaction, i.e. increasing the EU climate ambition without any new measures addressing carbon leakage.

Likely environmental impacts

The objective of the measure is to prevent environmental harm. A well-designed border adjustment mechanism should improve the effectiveness of policies aimed at fighting climate change in the EU. It should also indirectly promote the adoption of similarly ambitious policies by our trading partners and thus contribute to the reduction of global emissions even further.

Likely impacts on fundamental rights

No impact on fundamental rights is expected.

Likely impacts on simplification and/or administrative burden

To apply a carbon border adjustment, traders and authorities may need to determine the greenhouse gas emissions associated with the production of an imported product. In order to limit the administrative burden, the options considered should build on existing and agreed methodologies. Ancillary verifications, controls and audits of installations in third countries may be needed. The design of the measure will take into account the need to minimize administrative burden.

D. Evidence base, data collection and better regulation instruments**Impact assessment**

An impact assessment will be carried out to support the preparation of this initiative and to inform the Commission's decision. The impact assessment will be based on a dedicated study and will rely on the findings of the parallel impact assessment on the revision of the EU ETS, the impact assessment of the revision of the Energy Taxation Directive and the impact assessment of the EU's increased level of ambition regarding climate change for 2030.

In view of the economic analysis, both economic models and appropriate quantitative tools will be used in order to study the macroeconomic impact as well as the impact on households of the proposed options.

Evidence base and data collection [max 10 lines]

Data and information will be needed for the assessments and analyses underpinning this initiative. A dedicated study on the measure as well as other on-going studies notably on the energy markets and on the EU ETS will provide necessary data.

Data on carbon border adjustment mechanisms in place in California and Quebec should be sought.

Data available on current risk of carbon leakage as well as data on carbon footprint and carbon intensity of different sectors will be used.

Data is also available on the functioning of the EU ETS.

Moreover, the OECD database on effective carbon tax rates can be a valuable source of data.

Consultation of citizens and stakeholders [max 10 lines]

The aim of the public consultation will be to allow all stakeholders to give their views on all the aspects of a carbon border adjustment measure. The consultation will be based on a questionnaire. It will run for a minimum period of 12 weeks and will be made accessible via the Commission's Better Regulation Portal https://ec.europa.eu/info/consultations_en.

In addition, events will be organised at different phases of the impact assessment, in relation with the evolution of international discussions in UN, G20 and other international fora to gather the views of stakeholders and inform

them.

The main expected stakeholder groups to be consulted through the public consultation are:

- Member States / public authorities
- Business associations (energy intensive industries, transport, other industries, other services)
- Non-governmental / civil society organisations
- Citizens (individuals)
- Workers associations / trade unions
- Consultancies, think tanks, research / academic institutions

In addition to the general public consultation, a more technical consultation for specialised audiences will take place. Dialogue with third countries will take place through WTO channels and other channels.

Will an implementation plan be established? [max 5 lines]

An implementation plan will be prepared together with the legislative proposal.