

Opinion – US Carbon Border Mechanism in the Twilight Zone

Written by Ann-Evelyn Luyten

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ANN-EVELYN LUYTEN, DEC 7 2021

In July 2021, the European Commission (Commission) introduced a Carbon Border Adjustment Mechanism (CBAM) in support of the European climate targets, which is to reduce 55% of carbon emissions compared to 1990 levels by 2030 and to become climate-neutral. The EU characterizes the CBAM as a climate measure that contributes to preventing the risk of carbon leakage, while emphasizing that it is compatible with World Trade Organization's (WTO) rules. The CBAM is based on the purchase of certificates by EU importers and the price of the certificates will be calculated based on the weekly average auction price of EU ETS allowances. However, the CBAM will initially apply only to the following sectors: cement, iron and steel, aluminium, fertilizers and electricity from 2023. During the transitional period (2023-2025), EU importers must correctly report the embedded emissions. From 2026, the CBAM fully enters into force with financial obligation to purchase CBAM certificates.

The US response to the EU CBAM proposal until now was friendly, but not enthusiastic. Even before the Commission announced the CBAM proposal, the US already raised its concerns about the mechanism both at the WTO Market Access Committee, and the Trade and Environment Committee in 2020. In particular, the US (and several other WTO Members) stressed that the CBAM must be consistent with WTO rules and must not constitute disguised trade barriers.

At the same time, the US appears to be not too concerned about the implications of the CBAM to its export to the EU for now. Chad Bown, a senior fellow at the Peterson Institute, estimates that the US export value to be affected by the EU CBAM will be around USD 1 billion. When comparing this estimated number to the Airbus-Boeing dispute, which had an economic impact of USD 7.5 billion on US export to the EU, this is relatively small.

However, the impact of the CBAM on US export to the EU could quickly become more significant when the EU expands the scope beyond the five targeted sectors. The expansion of the CBAM could take place in 2026 at the earliest, as the Commission will present a report on the application of the CBAM, which will cover possible extension of targeted sectors.

The US could choose to take a negative position against the EU CBAM in an attempt to slow down its introduction. In fact, the US is already taking this approach by expressing its concern on the CBAM at the WTO. Further, after his visit to Brussels in March 2021 to coordinate on climate issues ahead of COP26, John Kerry, the US Climate Envoy, stated that the EU should only consider introducing the CBAM as a "last resort". The US is expected to continue to use the WTO as a platform to question the CBAM's WTO compatibility.

At the same time, the US is less likely to introduce its own carbon border mechanism in the near future. When Biden became a president-elect, he pledged to introduce the US version of a carbon border tax. However, no details have been mentioned since his inauguration in January 2021. In addition, John Kerry mentioned in an interview in July 2021 that an introduction of an US CBAM might do harm to the on-going multilateral efforts that the US is engaged in to encourage other countries to strengthen their climate policies. This appears to be one of the reasons why the US did not make a statement on the CBAM during COP26.

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In the long run, the US may eventually introduce its own carbon border tax. In May 2021, John Kerry said President Biden had instructed officials to examine “what are the consequences, how do you do the pricing, what is the impact” of a carbon border tax. Moreover, in July 2021, Senator Chris Coons and Representative Scott Peters from the Democratic Party introduced companion bills that would impose a “border carbon adjustment” fee on imports of carbon-intensive goods into the US. Under the Democratic proposal, a tariff starting in 2024 would apply to roughly 12 percent of imports coming into the US and would target petroleum, natural gas and coal, aluminium, steel, iron and cement.

Another option for the US is to participate in a “Climate Club”. According to Nobel laureate William Nordhaus, a club of countries who implement a carbon pricing system should agree on an “international target carbon price”. While countries who are members of the climate club will not face any tariffs, other countries who refuse to join the club would face unilateral tariff applied to all their exports into the club. If, for example the EU, the US and China succeed in creating a climate club together with other countries, it will open up a promising avenue for higher climate ambition without fear of carbon leakage and create a strong incentive for other countries to join.

The US and the EU can cooperate closely to address carbon leakage as this will create a huge momentum in reducing carbon emission in a meaningful manner. While there are some positive comments coming from both sides of the Atlantic Ocean, they are often vague without any concrete actions. This means that the EU will become the first mover by introducing its CBAM in 2023. It remains to be seen if and when the US and other countries will join the force. We are likely to see a patchwork of different carbon pricing system in different jurisdictions before they take serious steps to discuss and implement a global carbon pricing system. However, this patchwork will make it more difficult for companies to implement a carbon pricing system and effectively reduce carbon emissions.

About the author:

Ann-Evelyn Luyten works as an EU Policy Expert at Cargill. She previously worked at the World Trade Organization as an Economic Officer and Training Officer. Her blogs have been published at the European Institute of UCL, EU Law Live and Trade Experettes