Preventing carbon leakage through a border adjustment mechanism

Présent pour l'avenir

Ministère de l'écologie, de l'énergie, du développement durable et de l'aménagement du territoire

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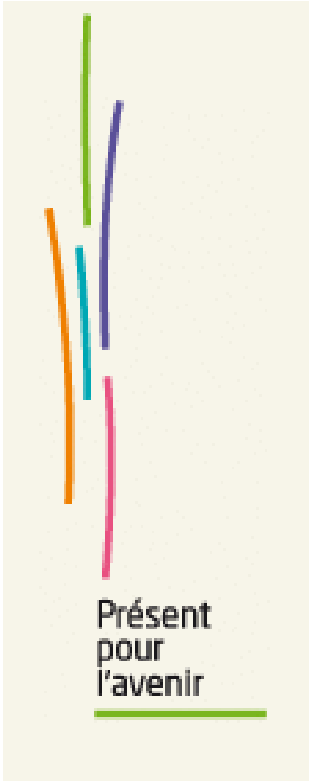
Outline

1. Carbon leakage is an environmental challenge
2. Free allocation addresses only part of the challenge
3. BAM: inclusion of importers in ETS
4. The WTO compliance can be secured
5. A need for predictability

An environmental challenge



- EU aims at cutting ETS emissions by 21% through an improvement of industrial processes:
  - Insure emissions reductions in EU
  - Prevent transfer of emissions outside EU

Free allocation addresses only part of the challenge

- Capping emissions increases marginal production cost (MPC)
- Auctioning allowances puts additional pressure on average production costs (APC)

- **Both** may lead to relocation of investment to countries not facing similar cost constraints

- Free allocation designed to alleviate impact on APC **only**

=> **risk of leakage remains** due to an increased MPC

BAM: Inclusion of importers in EU ETS

- Principles :
  - the importer has to surrender allowances to the EU
  - Similar constraints for national producers & importers (WTO compliance)

- What amount of allowances ?
- It is the difference between :
  - the average real emissions per ton of product in the EU (e.g. 2 t co2 per ton of steel)
  - the average amount of free allowances per ton of product in the EU (e.g. 1,5 t co2)

- Compatible with auctioning & any percentage of free allowances

BAM: Inclusion of importers in EU ETS

Importers from which countries ?

- Developed countries that do not have comparable emission reduction commitments
- Developing countries that do not contribute adequately to mitigation efforts, with regard to common but differentiated responsibilities

BAM: Inclusion of importers in EU ETS

How to prevent an increase of carbon costs due to such BAM ?

Allowances surrendered by importers in year N can be auctioned in year N+1

➢thus preserving the EU cap

WTO compliance can be secured

Some provisions of GATT could, in a first approach, cause difficulties:

- *Article I*: treatment of the most favoured nation
- *Article XI* : restriction to trade
- *Article II* : if considered as a tax or any kind of taxation

BUT

WTO compliance can be secured

Inclusion of importers in the ETS falls under the WTO exception regime GATT article 20 *§g*
" measures related to conservation of exhaustible natural resources »

Provided:

- EU installations and importers are subject to the same constraints
- BAM is based on environmental goal only
- BAM as a last resort after trying to negotiate an international agreement

A need for predictability

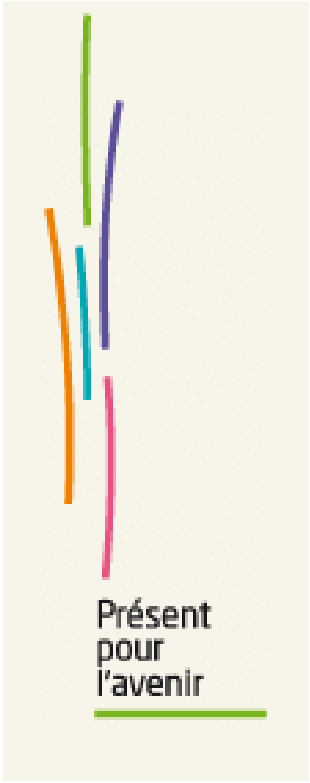
Current proposal:

- 2010 : EC sets the list of sectors subject to carbon leakage
- 2011 : EC proposes free allocation rules and provides substantive analysis of carbon leakage risks in light of international agreement post-2012

- **But**: Uncertainty may deter investments, clear predictable rules are necessary to drive industrial investment on the right path

French proposal:

- End of 2008 : determination of criteria for exposed sectors and BAM principles inside directive
- Mid-2009 : list of sectors + % of free allocation set per sector
- No later than 2010 : EC assessment of carbon leakage and appropriate instruments set up



Criteria to identify sectors subject to leakage

- Capacity to pass through direct and indirect effect of carbon price

In practice:

- Cost of carbon in a sector / Added value at stake
- Trade intensity of a sector / turnover of this sector
- Cost of transportation of goods
- ...

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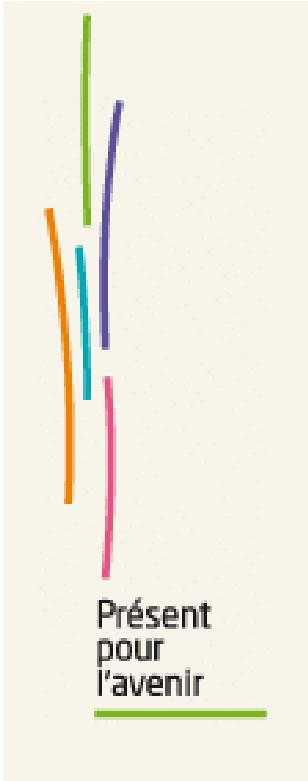

Thank you