



What trade can do for climate

Introduction

European businesses support the EU ambition to reach net-zero greenhouse gas emissions (climate neutrality) to reach the objectives of the Paris Agreement. BusinessEurope published its energy and climate strategy¹ in April 2019 to explain the five key framework conditions and related actions on how this could be achieved by around mid-century, the last condition of which concerns the climate actions taken by other major economies.

The publication came amidst intense ongoing discussions on how the EU could better leverage its trade policy to achieve its climate policy objectives. Not only should this be seen in the context of the potential effects that global trade can have on emission levels²; it is essential to also promote the positive contributions from bilateral and multilateral trade on reaching climate objectives. This paper lists several ways in which trade agreements could contribute to the global climate agenda. European businesses support high standards in the environmental area and pursuing these standards also in our trade agenda can boost the competitiveness of European businesses and make trade more climate-friendly.

That said, it is important that the European Green Deal takes a systematic and holistic approach to the trade and climate agenda. The sustainability triangle of climate action, competitiveness, and security of supply of energy and critical resources remains central. Furthermore, in order to enable the distribution of European state-of-the-art technologies globally, the market access element in trade policy is of paramount importance. It is therefore essential that the design of policy options linking the trade and climate agendas strike a careful balance between ensuring a global level-playing field to support European competitiveness and enhancing access to foreign markets while effectively complementing domestic climate-related measures.

The risk that production is transferred from the EU to other countries with lower ambitions for emission reduction, or because EU products are replaced by more carbon-intensive imports (“**carbon leakage**”) as well as the threat of more companies deciding to gradually favour investments outside of the EU (“**investment leakage**”) is real as long as global actions are not aligned and is impacting the European economy and the labour market. Such leakage effects also have a negative impact on overall global emissions, given that production standards in many other regions are not as high as in Europe.

¹ [BusinessEurope](#), 2019.

² Increased production levels and market distortions, impact on land-use and natural resources, transport emissions



Therefore, it is crucial to maintain well-functioning flanking measures such as the system of free allowances for best performers and indirect cost compensation under the EU Emissions Trading System (EU ETS) in order to protect competitiveness and minimise the risk of carbon/investment leakage.

While trade agreements can help incentivise a level playing field in the environmental area, an overburdening of the EU's trade agenda could come at the expense of the EU's negotiation leverage on its core economic interests. Therefore, a sensitive balance has to be found on how to use trade as leverage for climate goals while not scaling back on the economic purpose of the trade agenda.

Recommendations for policy action

How?

There are a number of options that can be explored at multilateral, bilateral and unilateral level. Given the global nature of the climate challenge and the highly integrated global supply chains, multi- and plurilateral solutions are expected to have the most significant impact on global emission levels and are thus preferable over other options. However, decision-making on international level takes time and often entails a high degree of compromise. Furthermore, what now becomes a more pressing issue is the urgent reform and modernisation of the WTO, which could also represent an unprecedented opportunity to update and coordinate the global trade and climate and environment agendas with other major economies.

Bilateral agreements can reach more tailored ambitions depending on the specifics of the relationship and the economic development of the countries. For example, they can focus on technology exchange when it comes to developed nations such as Japan, or technical assistance, capacity building and funding of sustainability projects with developing nations such as Vietnam (e.g. through the European Fund for Sustainable Development). They can also function as building blocks towards a plurilateral and finally a multilateral agreement.

Unilateral action can be used to lead the global environmental agenda by example and incentivise global partners to join the ambition. That said, possible unilateral measures will have to be carefully designed. They should comply with existing international rules and commitments (e.g. under the WTO), avoid trade distortions and consider potential risks for competitiveness and the economic interests of the EU in case of retaliation or other negative consequences if global partners do not align their ambition.



Multilateral and Plurilateral

a. Environmental Goods Agreement (EGA)

The negotiations on the Environmental Goods Agreement were launched in the WTO in July 2014 and involve 46 nations. The aim is to eliminate tariffs on products that can help achieve environmental and climate goals (e.g. renewable energy, waste management, resource and energy efficiency, air pollution etc.). If agreed, the benefits would extend to the entire WTO membership. Despite its rather limited scope on goods and tariffs (e.g. neither services nor non-tariff barriers are included) and disagreements on the conceptualization, progress on this agreement would be an important first step on the way to a broader compromise. Currently the negotiations are stalled among others due to the inability to agree on a list and definition of “green goods”. An agreement is not easy as developing countries are sensitive to opening their markets to imports from developed countries while at the same time, they try to include in the list certain goods that are not recognised as being “green” by developed economies. Furthermore, some products and sectors are excluded from preferential treatment despite contributing to environmental protection.

Other initiatives can also be supported by the EU, such as the Agreement on Climate Change, Trade and Sustainability (ACCTS)³ that, among other things, aims to eliminate tariffs on environment goods and generate new commitments on environmental services. As a first step, WTO members could bind tariffs sending an important policy signal to businesses and investors that governments are committed to increase the uptake of such goods and related technologies.

⇒ **Renewed efforts should be focussed on resolving the conceptual and political deadlock in the negotiations of the WTO Environmental Goods Agreement. Furthermore, including services embedded in environmental goods would make a future EGA more efficient and should therefore be seriously explored. The design of the EGA must avoid new administrative burden for companies, e.g. in customs procedures and in view of rapid technological development. The list should therefore be regularly reviewed.**

⇒ **As the scope of the WTO Environmental Goods Agreement is rather limited and only targets tariffs, parallel discussions should also continue on other issues critical for this sector like non-tariff barriers, standards and rules in key areas like Intellectual Property. The removal of non-tariff**

³ Launched by New Zealand, Costa Rica, Fiji, Iceland and Norway in September 2019. URL: <https://bit.ly/2SfmPSE>



barriers is absolutely key in ensuring a level-playing field and market access even after tariff removal.

- ⇒ In view of a broader WTO Agreement, initiatives such as the Agreement on Climate Change, Trade and Sustainability (ACCTS) should be closely followed and potentially supported also by the European Union.**
- ⇒ The WTO Committee on Trade and Environment should be used more systematically and formally, and should explicitly facilitate cooperation between the WTO and the UNFCCC. For example, national trade policy reviews could assess whether such policies are helping or hindering the respective climate commitments.**

b. Industrial subsidies and overcapacities

Europe should look for ways to appropriately deal with overproduction and market distortions created by subsidies and State-Owned Enterprises (SOEs) by modernizing its own legal framework and working towards effective multilateral rules. Diverging rules on subsidies not only create significant global market distortions but also has a big impact on local production intensities and consequently emissions. There are ongoing trilateral talks between the EU, the US and Japan to agree on stricter definitions and rules on subsidies and SOEs at WTO level. There are also sectoral initiatives such as the OECD Global Forum on Steel Excess capacity that should continue despite low commitment from key players like China. Ultimately, success will depend on the ability to include major world trading partners and producers in the scope of action, in particular China.

- ⇒ Industrial subsidies and the role of SOEs as one of the main factors leading to overcapacities need to be well framed and effectively disciplined at WTO level. Sectoral negotiations, e.g. in the steel and aluminium sectors, are welcome to address the most critical sectors.**

c. UNFCCC - Article 6 of the Paris Agreement on emission trading and carbon markets

The move towards climate neutrality will need to see the worldwide introduction of a robust carbon price signal reflecting ambitious decarbonisation trajectories worldwide (such as the ETS). European business is behind the EU ambition of net-zero greenhouse gas emissions (climate neutrality) and sees international carbon markets as one key essential element for this vision to become reality. Binding rules



and procedures that are respected by all participants in international carbon markets need to be laid down in the rulebook of Article 6 of the Paris Agreement. Preferably, all carbon pricing mechanisms should be harmonised over time to create a global carbon price. This is important, because international cooperation under a well-functioning Article 6 could save at least US\$250 billion annually by 2030.⁴ It would also contribute to creating a global level-playing field and make discussions about carbon/investment leakage less relevant. What will be important for such convergence is to establish binding accounting rules that reflect the fact that economies are highly interlinked and strengthen the awareness that climate mitigation is a global effort.

As long as there is no agreement on the Article 6 rulebook, the EU can also consider entering into more bilateral talks with regions and countries on linking carbon markets. For example, the EU has recently concluded its negotiations to link with Switzerland's ETS and will hopefully do so also with the UK if and once they establish their own system.

In addition to cooperating on carbon markets, the UNFCCC offers a unique stage for Europe to exchange good practices on its climate policy frameworks and standards with its global trading partners.

- ⇒ **An agreement on Article 6 under the Paris Agreement's Rulebook on carbon markets should be concluded as soon as possible. The UNFCCC negotiations should also continue to be used by the European Commission to share experiences on other aspects such as policy frameworks and standards.**
- ⇒ **The EU should also continue exploring ways to cooperate and link its carbon market with those of other regions.**

d. International standards and environmental labels

Environmental standards, product declarations and labelling have a significant potential to function as tools of competitiveness for Europe. More information on production processes could support Europe's green competitive edge and inform consumers about the true environmental footprint of imported goods. European businesses stand ready to trade environmentally friendly technologies, expertise and other solutions to the rest of the world. As many value chains are global, well-

⁴ [IETA](#), 2019. The economic potential of Article 6 of the Paris Agreement and implementation challenges



functioning markets require common standards and certificates for green products and services, as well as mutual recognition of said standards and procedures.

The European Commission can export – by means of diplomacy and trade discussions – the many potential benefits of Europe’s regulatory frameworks, standards and labels to third countries to harmonise them along clear, objective criteria based on scientific evidence, while taking into account local specificities.

⇒ **The EU should work together with third countries to harmonise standards, labels and regulatory frameworks in order to boost the functioning of global value chains and facilitate the commercialisation of green products and services.**

e. CO₂ pricing on international transport

CO₂ pricing should encourage the deployment of the most efficient and least pollutant energy carriers used for the international transportation of people and freight. Ideally, CO₂ pricing initiatives on carbon emissions of transport are coordinated at the international level in order to maintain a level playing field, especially between developed nations. That said, if European institutions will explore more unilateral measures, it is important that any agreed EU legislation on CO₂ pricing for transport is immediately discussed with trading partners and other third countries through diplomacy and bilateral negotiations. Upscaling EU legislation to the plurilateral or multilateral level would be most effective for reducing global transport emissions.

Bilateral – Free Trade Agreements

a. Tariff reduction schedules and non-tariff barriers on environmental goods and services

In the absence of a multilateral/plurilateral agreement on the liberalisation of environmental goods and services the EU could use its Free Trade Agreements to further support trade of environmental goods under certain conditions. The process, including current considerations on a possible fast-track tariff dismantling for environmental goods or priority to specific goods that are needed to achieve more ambitious climate goals, must be discussed in close cooperation with EU business. Any tariff liberalisation process should be accompanied by an elimination of non-tariff barriers and strong regulatory cooperation. Furthermore, there are many practical implementation questions that arise and first need to be thoroughly assessed. A facilitated trade of state-of-the-art technology would not only support climate



ambitions around the world but would also create significant opportunities for European businesses to provide their highly innovative and competitive goods and services.

The ambition and scope of the provisions that can be included in an agreement have to adjust to the needs and economic development of the negotiating partner. In addition, as was already done in the EU-Japan EPA and is foreseen for the EU-Mercosur agreement, trade agreements can be used to refer to climate commitments such as those under the Paris Agreement, provided that they incentivise trading partners to adopt more ambitious climate objectives. In general, BusinessEurope supports an approach that rewards trading partners to enhance their climate action.

- ⇒ **Future bilateral agreements could explore options on targeted provisions on trade in “environmental goods and services”, including non-tariff barriers, and aim to reach more ambitious commitments in this area providing that these measures go hand in hand with a guarantee of effective market access and an environmental level playing field. The scope of such provisions should adjust to the needs of the negotiating partner, work on the basis of rewarding rather than punitive actions, and reflect their real level of economic development and climate ambition.**
- ⇒ **In the case of Turkey, a modernisation of the Customs Union would offer a valuable opportunity to achieve a multiplier effect in combatting climate change alongside with supporting supply chains, including provisions on sustainability and a reference to the Paris Agreement, as well as appropriate support programmes and mechanisms.**

b. Targeted provisions under Economic Partnership Agreements with ACP economies

The Economic Partnership Agreements between the European Union and African, Caribbean and Pacific countries currently include a varying degree of provisions on climate and the environment and their enforcement, as these were not specifically included in the original mandate of 2002. The same is also true for specific chapters on investment, which are part of the “rendezvous clauses” for most EPAs. Given the big potential in ACP markets for green and sustainable goods and services to accompany their economic growth, the right path should be laid out to decouple economic growth from greenhouse gas emissions, as has been done in Europe. This can include a wide range of provisions from tariff reductions, reduction of non-tariff barriers, technical assistance, capacity building and “green” investment.

- ⇒ **In the ongoing process towards an update of the negotiating mandates and broadening of the agreements a trade and sustainable development**



chapter should be foreseen with specific attention to the needs of the respective partner countries.

⇒ The broadening of the agreements should aim to include an investment chapter and can, in that framework, also foresee incentives for “green” investment under certain conditions, e.g. specific sectors or activities.

c. Capacity building / technical assistance

Capacity building and technical assistance are a crucial part of Europe’s trade relations, especially with developing countries. There is still a large scope to extend these actions and specifically target climate-related and environment-related issues. This can take place in the form of classic workshops and trainings for policymakers, businesses and social partners, or for instance business-to-business workshops on best practices and the benefits of environmentally sustainable business models. In addition, it is important to start educating children at an early stage about environmental and climate impacts. Therefore, collaboration with educational bodies and authorities should be strengthened with a particular focus on increasing female participation in STEM (science, technology, engineering and mathematics) competences.

Green investments in the form of grants, guarantees and other financial instruments can be promoted in the framework of the European Fund for Sustainable Development.

⇒ Businesses stand ready to explore possibilities on how companies can be involved in specific capacity building exercises and projects for technical assistance in developing countries.

⇒ The EU should publish its overall priorities and approach on capacity building on climate and consult stakeholders on how these could be further developed, complemented and monitored.

d. Enforceability of sustainability chapters

The new generation of EU Free Trade Agreements always includes a chapter on Trade and Sustainable Development (TSD). Its aim is to promote the uptake of high labour, environmental and human right standards by the partner country through close cooperation and strong engagement from civil society organisations. There are discussions on how to improve the enforceability of the sustainability chapter namely what actions can be taken in case any of the trading partners breaches the agreement. BusinessEurope recognises the need to improve effectiveness in the



enforcement of the TSD chapter. This could be done by streamlining procedures and including specific timelines for each of the actions in the chapter. However, we believe that economic sanctions are not the most effective approach due to shortcomings relating to the triggering requirements, the scope of the sanctions and the resulting limitation of EU negotiating leverage with third countries.

⇒ **BusinessEurope supports the strengthening of enforcement of existing scope and content in TSD chapters. A dialogue and incentive-based approach with the established system of dedicated government bodies (TSD Committee and Trade Committee) and the civil society structures (Domestic Advisory Groups and Civil Society Forums) should be maintained. Further efforts can be made to make the procedure more effective by including specific timelines for each of the actions.**

Unilateral

a. Public procurement

As around 14% of the EU's GDP is spent on public procurement, it can be a key monetary tool for the European Commission and the member states to boost innovation and production in low-carbon technologies. However, the public sector still very often chooses proposals based on the lowest price, not least due to a lack of clear and objective methods and standards on how to assess and weigh the environmental performance of a product over its lifecycle or a service.

Furthermore, third country bidders, who are able to participate in Europe's procurement market, are not always subject to the same standards or state aid rules as those applicable to domestic bidders. This creates competitive distortions, and so the European Commission has recently published a relevant guidance⁵ for member states on how to deal with bidders from outside the EU, e.g. by not only taking the price but also Europe's high standards into account. At the end of the day, governments should practice what they preach when implementing agreed policies and help create a critical mass for new ideas. European Commission proposals like the International Procurement Instrument (IPI) could also potentially offer additional impetus by providing the EU with greater leverage to level the playing field.

⁵ [European Commission](#), 2019. New guidance on the participation of third country bidders in the EU procurement market



The role of public procurement in stimulating climate action outside Europe will only be effective if access to third countries' public procurement markets is guaranteed and implemented.

- ⇒ **The Commission should also consider additional options on how to use public procurement to boost climate action both inside and outside of Europe and assess criteria on how environmental and climate standards in procurement offers can be taken into account in a coherent approach also within Europe. The initiative to develop instruments to calculate the lifecycle costs for certain products is welcomed.**
- ⇒ **Activities on further professionalization of public procurement, especially also with a view to increased information and training regarding green public procurement, should be intensified both on EU and national level.**
- ⇒ **Member States should ensure that third country bidders respect the same environmental standards as domestic bidders to ensure a level-playing field for products and services.**

b. Generalised Scheme of Preferences (GSP)

The GSP+ mechanism already foresees a tool for the EU to move beneficiaries to protect forests and sustainably manage natural resources.⁶ However, current GSP tools limit the EU's power to influence beneficiaries. The possibility to increase the EU's options to do so through the GSP tool should be foreseen through the current review of the GSP regulation.

- ⇒ **Climate change and sustainable development aspects should be enhanced in the upcoming revision of the EU GSP Regulation, together with measures to strengthen implementation of existing provisions.**
- ⇒ **In accordance with the European Parliament resolution on the matter⁷, the Commission should move to include the Paris Agreement in the 27 core international conventions list that GSP+ beneficiaries should comply with, and incentivise them to converge with the EU's ambition over time.**

⁶ For more info, see [EPRS](#), 2019. Using trade policy to tackle climate change

⁷ [European Parliament](#), 2019. Resolution of 14 March 2019 on the implementation of the GSP Regulation (EU) No 978/2012



c. Carbon border adjustments (CBA)

Carbon Border Adjustments are a sensitive measure and BusinessEurope at this point does not take a position neither for nor against it. It is however essential that the exact goals, guiding principles and open questions formulated in annex to this paper feed into the design of the upcoming impact assessment on whether a CBA is needed, desirable and feasible over the longer term and how it should be designed for the EU as a net exporting continent.

In terms of goals, a CBA if designed and implemented efficiently could offer an effective way to convince other world economies to **converge with the climate objectives** of Europe so as to reduce global GHG emissions. By doing so, a CBA should also aim at minimising the threat that production is transferred from the EU to other countries with lower ambition for emission reduction, or because EU products are replaced by more carbon-intensive imports (**'carbon leakage'**) as well as the threat of them deciding to gradually shift more investments outside of the EU (**'investment leakage'**) depending on the carbon price. These two goals are intrinsically related with each other: The threat of investment leakage and carbon leakage cannot be fully mitigated as long as others are not also aiming to move to a climate neutral economy at the same speed as Europe. Therefore, the priority should be given to establishing well-functioning international carbon markets and a global carbon price in line with Article 6 of the Paris Agreement, which would eventually render the CBA discussion obsolete.

Designing a CBA will be politically challenging and subject to many risks, practical problems and uncertainties. Nevertheless, it is pivotal that the impact assessment considers any CBA option along the following guiding principles:

A. WTO-compliant

The impact assessment should look at how each CBA option is compliant with the current WTO rulebook. Compliance with the WTO rulebook is not only crucial to avoid risky dispute procedures and improve regulatory predictability for the implementation, but also to minimise the risk of retaliatory measures by our major trading partners. Transparency and close dialogue with trading partners will be very important to minimise any risks.

B. EU ETS-compliant

The EU Emissions Trading System (EU ETS) is and should remain the key market-based instrument for Europe's industries and power sector to cost-effectively reduce their GHG emissions. This includes the system of free allowances that provides the key stimulus for industry installations under the EU ETS to be amongst the best in



class⁸ and the compensation of indirect ETS costs. For example, if the CBA is designed and implemented as an import-ETS system, maintaining the existing free allowances system next to a CBA would not necessarily amount to double protection. In fact, if importers can demonstrate with verified data that their imports are at least as efficient as the best in class, they can avoid a CBA charge. This would be the equivalent for importers to receiving free allowances. To avoid new market distortions between EU producers and importers, the existing system of free allowances should then also be maintained for EU producers.

Replacing the existing carbon leakage measures by an untested mechanism could create considerable uncertainties and risks for the European industry. For example, shifting to a system of full auctioning when a CBA is in place would:

- **Increase the risk of retaliation.** Under the current EU ETS Directive, free allowances will gradually decline over Phase IV (2021-2030). This can be reflected towards importers through a CBA charge that gradually increases over time. Through this approach, importers will have time to adjust to a system where the CBA charge rises gradually. However, if the CBA replaces the free allowances system for EU producers overnight, then importers should also be faced with a CBA no matter how efficient their imports are produced, in order to avoid market distortions with EU producers. In this case, the “pain” of the CBA measure will be considerably high even for importers importing products from the most efficient installations in the world. Consequently, the risk of retaliatory measures by trading partners will increase significantly.
- **Create significant investment uncertainty.** Firstly, the EU ETS Directive including free allocation and indirect cost compensation has only very recently been revised for the period until 2030. Changing this recently adopted legislation by scrapping free allocation and indirect cost compensation would disrupt long-term investment decisions already taken. Secondly, EU producers not only face compliance costs (the EU ETS costs), but also abatement costs since they make investments in breakthrough technologies to reduce emissions. A CBA fully replacing existing carbon leakage measures would significantly impact a company’s financial ability and willingness to invest in such breakthrough technologies in Europe.
- **Decrease European companies’ cost-competitiveness in third markets.** A CBA mechanism could encourage foreign companies to produce more

⁸ The EU identifies the 10% most efficient installations for each sector on the EU ETS carbon leakage list. Based on the average of these best in class, product benchmarks are designed. If a domestic installation beats the benchmark, that installation in theory receives all its allowances for free, otherwise it has to buy part of all of its allowances on the market, depending how far it is removed from the benchmark.



environmentally friendly if they want to enter the EU market, but not necessarily if they want to access their own market or third markets without carbon pricing. EU companies losing free allowances would therefore be at a disadvantage vis-à-vis these foreign companies when competing for third markets access. This is the reason for continuing the system of free allowances for the best in class as is currently the case under the EU ETS Directive.

C. Comprehensive, transparent and manageable (administratively & financially)

The design and WTO-compatibility of any CBA option will be difficult to assess with certainty. Therefore, while analysing the effectiveness of the CBA in tackling carbon and investment leakage, the impact assessment should look at how each CBA option would fare in terms of ensuring fairness, additionality, transparency and predictability, also at a sector level. This needs to consider both European businesses that could potentially bear the additional administrative requirements and see their value chains impacted, as well as Europe's trading partners that need full clarity from the EU as to which objective criteria will be used to assess their exports to the EU. Depending on the options, access to reliable and sound information from third countries and companies would be the preferred option, though Europe could consider other options when there is a particular issue concerning the ability of third countries and companies to provide reliable data (e.g. provide capacity building or use global fallback benchmarks). As said before, full transparency and early dialogue with trading partners will be key for implementation.

D. Initially limited in scope

Uncertainty must further be addressed in the impact assessment by looking at how any CBA option could initially be started with only one or a few (sub-)sectors, and what are the likely risks of legal challenges and retaliation for doing so. If other sectors are to be included gradually, quantitative and qualitative assessments should be carried out in order to capture certain sectorial specificities and needs. Furthermore, the design of any CBA has to avoid that carbon leakage is just transferred to the next level of the value chain.

E. Only climate-related

Part of the risk of any CBA measure is that it sets a precedent for further restrictions on trade in the future based on other, non-climate related matters. It will already be extremely challenging to reliably measure and verify the carbon content of traded materials, especially if full consideration is given to life cycle CO₂ emissions. Therefore, the EU should oppose calls for broadening the goals of any CBA option to anything else other than global climate action and the risk of carbon/investment leakage.



F. Limited in duration

As CBAs are in principle trade restrictive, the impact assessment should look into the ease with which CBAs could be adjusted or removed once breakthrough technologies reach global marketability, global climate ambitions are converged, and /or when retaliation occurs.



Annex: Open questions

In addition to addressing the aforementioned points, further questions need to be discussed, including but not limited to the following:

Q1. How to collect the necessary carbon data and verify it in a reliable and transparent way?

The collection and disclosure of carbon content data will be decisive for the success of measures relating to the carbon intensity of production worldwide. The system and procedure that will be applied for this must be an internationally recognised certification system that is objective and independent. How would information on carbon emissions in complex value chains with transforming products be gathered and processed? As part of implementation of the Paris Agreement, work on common Monitoring, Reporting and Verification (MRV) of emissions is under development. How to make progress faster? Digital solutions such as blockchain could be a potential solution to collect the necessary carbon intensity data in a transparent and efficient manner. Could the uptake of such solutions be accelerated via plurilateral channels and FTAs?

Q2: How could the revenues generated with the CBA be used most effectively?

The impact assessment should look into how the CBA's revenues can be used to achieve the two main goals, i.e. minimise carbon and investment leakage, as well as converging global climate ambitions. For example, should the revenues flow into EU internal climate funds, such as the EU ETS Innovation Fund to help bring the costs down of EU-based low-carbon RDI, or should it be used to fund low-carbon investments in third countries? An additional layer of complexity arises here in the form of additionality: For example, how to make sure that a third country doesn't simply reduce its domestic climate action expenditures by the same amount as it stands to receive from the EU's CBA revenues, thereby annulling the additionality effects of the CBA?

Q3: How to measure additionality of the CBA?

In a hypothetical situation, producers in China or elsewhere could reorganise their trade flows in such a way that the products produced in their cleanest installations are exported to Europe, thereby minimising any CBA charge, whereas the products from their dirtiest installations are sold domestically or to other parts of the world. Similarly, if the CBA is only charged on the imports of basic materials, it might encourage importers to move away from such materials and import more semi-finished products instead, which would not be subject to a CBA. In this situation, the CBA would simply transfer the risk of carbon and investment leakage to the next level of the value chain, and the net effect of a CBA on pushing other major



economies to increase their climate actions (and thus the net effect on global emission reductions) would be significantly diminished. This would surely still put European producers exporting to other parts of the world at a significant cost disadvantage.

Q4: How does the Commission take the impact on the value chain into account and how will we avoid that the competitiveness of the EU industry including its export capacity is eroded?

Assuming the CBA is not applied to finished goods but more upstream goods of activities, it will be important for the impact assessment to calculate the estimated increased costs of the CBA throughout the value chain, and whether this in turn would result in increased costs of imported goods in Europe and potentially undermine the EU's export capacity.

Q5: How will the CBA be aligned with existing customs' regimes and how will it be calculated?

The EU has an external tariff that includes in some cases preferential rates, for instance for countries that have a free trade agreement with the EU or countries that are GSP-Generalised System of Preferences beneficiaries. The applied duties are collected when the products are imported into the EU with some exceptional regimes, such as outward or inward processing. It will be important to define how the CBA will be calculated and how it will be collected from importers. For example, will it be added to the normal tariff of an imported product, or will it be based on an average amount paid on an annual/monthly basis?

Q6: How will technological progress/innovation be considered?

Technological progress is extremely fast in some sectors and areas, meaning that the carbon footprint of a product may change over time either because new production methods are established or the use of the product becomes less energy-intensive. This has to be taken into account, for example by means of a regular re-assessment to avoid discrimination and unfair treatment of products.