

Mrs Ursula von der Leyen President European Commission Rue de la Loi/Wetstraat 200 1049 Brussels Belgium

22 June 2021

RE: CBAM, the ETS and the future of carbon leakage measures

Dear President, Sean Mrs. rem Ala heyen 1

Business across the Union is committed to the European Green Deal and the transition of our economies for a net-zero future. Companies are doing their utmost to upgrade their production processes, seeking to become ever more effective and sustainable.

However, while European firms are undertaking these efforts, they continue to compete on an uneven playing field; facing competitors who have to bear none or very little of their carbon costs. With the more ambitious EU 2030 targets and remaining uncertainties about third countries' plans to regulate industrial emissions, this disparity becomes even starker, making the protection against carbon and investment leakage more relevant than ever. Carbon leakage is already an unfortunate reality in many sectors, and it is crucial to prevent this phenomenon from undermining our competitiveness and cli-mate efforts.

The Commission in its Fit-for-55 package wants to address this issue with the proposal for a Carbon Border Adjustment Mechanism (CBAM). This novel measure can be an opportunity, among other measures, to strengthen the EU approach against carbon leakage and encourage trading partners to implement the Paris Agreement. However, it will be highly complex to implement and has the potential to inadvertently increase the carbon leakage risk instead of mitigating it, depending on the design choices.

Firstly, a substantial cut in benchmark-based free allocation for those sectors covered by the CBAM, if proposed, would go against the objective of the measure and potentially increase the risk of carbon leakage compared to the current system. While European companies would have to bear most of the carbon costs for 100% of their production, installations in third countries would only be subject to the CBAM for that share of their production which is exported to the EU. They will therefore be able to absorb the cost far more easily and continue to compete with European companies in the European and third markets in an even more advantageous position.

This becomes especially critical with a rising ETS price: with the current price rally expected to continue (which it likely will, given the ambitions of the Fit-for-55 package), companies in the EU exposed to a substantial decrease of free allocation and indirect cost compensation would have to increase product prices significantly. In highly competitive markets, this means losing out on global market share and leads to the loss

EU Transparency register 3978240953-79



of industrial jobs. As non-European producers of basic materials tend to have a carbon-footprint that is several times larger than that of their European counterparts, this effect would increase global emissions and set back the fight against climate change when we can least afford it.

Additionally, should the CBAM not be accompanied with any provisions for European companies to be compensated for their carbon cost when they export to third countries, the lower level of free allocation will put them at a decisive disadvantage on global markets. For energy- and trade-intensive industries, this could mean the end of their international competitiveness and their ability to export, initiating the shift of even more production (and emissions) into regions with laxer climate regulations and decreasing added value and industrial employment in for Europe.

For these reasons BusinessEurope <u>can only support an ETS reform, incl. CBAM, which encompasses the following elements:</u>

- The CBAM should cover those sectors which agree to be covered and its final design should be informed by the results of a pilot phase¹
- There must be no abrupt decrease in the level of free allocation or indirect cost compensation for those sectors covered by CBAM until a global level-playing field is reached or fully effective alternative arrangements are in place.
- Fully WTO-compliant export-supporting measures for those sectors that will be covered by CBAM should be considered to maintain their competitiveness on foreign markets.
- Effective measures addressing resource shuffling and possibilities for circumvention of the CBAM by foreign producers need to be added.
- While we understand that the increase of EU climate ambition will impact the amount
 of allowances available in the ETS, there are ways to ensure that adequate free
 allocation will be available until at least 2030 (e.g. by adjusting the auction share, or
 providing for the possibility of transferring shares from the MSR in order to cover free
 allocation needs).
- The LRF should be maintained as the primary lever to increase ambition in the ETS, as it is most predictable and better supports long-term investment decisions. Legislators must avoid heavy-handed interventions in the market, such as rebasing, which would increase volatility and uncertainty.
- As indicated above, benchmark-based free allocation is vital for maintaining a global level playing field while incentivising EU producers towards best performing plants. Both free allocation and indirect cost compensation, which addresses costs unilaterally faced by EU producers, will have to play an important role in the ETS beyond 2030.

¹ The results of the pilot phase must be evaluated by rigorous impact assessments which address the specific challenges that different sectors are facing with respect to carbon leakage.



We believe such a system would be fully WTO-compliant if the CBAM is levied on those emissions exceeding free allocation benchmarks. We also encourage the Commission to engage in diplomatic outreach with the EU's trading partners to mitigate the risk of trade retaliation and push for a swift increase in climate ambitions as well as the introduction of carbon pricing worldwide.

We strongly call on you to take these elements into due consideration when designing an ETS and a CBAM that will realize greater climate ambition, while maintaining the competitiveness of Europe's businesses and the supply of affordable goods for European consumers. We are looking forward to your proposals on 14th July and remain at your disposal for any questions until then.

Yours sincerely,

Markus J. Beyrer