# 16. Proactive prevention of carbon leakage? The EU Carbon Border Adjustment Mechanism

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## 1. INTRODUCTION[1]

When the EU emissions trading system (EU ETS) started operating back in 2005 it was an international pioneer (see Vogler, Chapter 10 in this volume), meaning that companies based in the EU were facing policy requirements that their competitors elsewhere in the world were not (Wettestad and Jevnaker 2019). This made EU companies – and particularly energy-intensive ones less able to pass on regulatory costs to consumers – worry about 'carbon leakage', i.e. that production might be prompted to relocate to jurisdictions with more lax climate policy regulations. For a number of years, the main EU policy response to concerns about carbon leakage was to hand out generous amounts of free allowances to the most exposed, energy-intensive industries.

On 1 December 2019, Ursula von der Leyen became the new President of the European Commission. Her statements on the proposed climate-policy initiatives under her leadership – with a new European Green Deal as the overall umbrella – gave significant emphasis to establishing an EU Carbon Border Adjustment Mechanism (CBAM) to replace free allowances as the central EU policy response to the threat of carbon leakage (Politico 2020).

Actually, CBAM is far from a new idea, harkening back at least to 2007 (see e.g. Mehling et al. 2019). Multiple reasons have been given for *not* following this policy track – including practical challenges in calculation, the risk of disrupting global climate negotiations by upsetting key international partners, and worries that such a measure might contravene World Trade Organization (WTO) rules on promoting free trade (see Dobson, Chapter 25 in this volume). There are also complicated EU-internal policy interactions to be clarified, particularly regarding the EU ETS and the aforementioned free allowances handed out to counter possible 'carbon leakage' (see Wettestad 2009; Wettestad and Jevnaker 2016; Jordan and Moore 2020). Indeed, it has been claimed that replacing free allowances with an EU CBAM might mean a 'revolution of the ETS' (Politico 2019). However, a CBAM has also been hailed as a safety valve against carbon leakage in times of steadily increasing carbon prices, and the revenues it could raise are seen as one way to finance EU post-COVID recovery by the Commission, European Parliament (hereafter: Parliament), and the Member States in the Council. Thus, the CBAM should be viewed in the broader context of evolving EU decarbonization policy.

The main objective of this chapter is as follows. After outlining what the proposed instrument entails, with particular reference to its relationship to the ETS, the key question to be asked is: *why has this idea gained such prominence as a policy option, leading up to a formal proposal tabled in mid-2021?* Are the main reasons to be found in an increasing 'push' from within the EU, at sub-national, national or supranational political levels? Or does the explanation lie in the increasing 'pull' from the external policy landscape – for instance, the lack of climate-policy action on the part of main competitors, or the increasingly protectionist



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US policies pursued by former President Trump? Furthermore, in light of some international reactions so far, the chapter concludes by reflecting on the prospects ahead.

## 2. THE POLICY BACKGROUND: THE EU ETS

In the 1990s, the EU found itself struggling to agree on a forceful common climate policy instrument, and unable to adopt a carbon tax due to opposition not least from the UK and the need to adopt such instruments by unanimity (Wettestad 2000). As a flexible instrument, emissions trading was promoted on the global stage by the USA and some allies, but the EU was initially sceptical. After flexibility became an integral part of international climate policy in the Kyoto Protocol in 1997, however, a small group of policy entrepreneurs in the Commission managed to achieve a policy turnabout in the EU from 1998 (for details and references as to the initiation and evolution of the ETS, see e.g. Skjærseth and Wettestad 2008; Wettestad and Jevnaker 2016; 2019; Vogler, Chapter 10 in this volume). Until then, emissions trading in practice had been tried out nationally only in the USA and, moreover, in a different policy field (air pollution). Thus, by pioneering the ETS, the EU was entering uncharted regulatory territory – where rules and regulations would need to work in a setting consisting of many sovereign Member States with differing energy systems, regulatory cultures and material wealth. This diversity was further increased by the EU's enlargement to include countries of Central and Eastern Europe in 2004 (see Wurzel et al., Chapter 3 in this volume). The description of the EU ETS as 'the new grand policy experiment' (Kruger and Pizer 2004) was indeed an apt one.

When the initial Directive was adopted in 2003, the ETS was meant to be the cornerstone of EU climate and energy policy. By then, the EU also had adopted several other policy instruments, including a renewable energy Directive that set indicative national targets (see Knodt, Chapter 14 in this volume, Romppanen, Chapter 15 in this volume). Overall, however, EU-level climate policy was not particularly strong, and the policy mix around it was developing only gradually (Boasson and Wettestad 2013). As a 'great experiment', the first ETS trading period, 2005–2007, was set up as a pilot phase, and allowances were largely handed out for free. The second phase coincided with the first commitment period of the Kyoto Protocol, 2008–2012. During this phase, however, the financial crisis struck, resulting in lower emissions, a gradually increasing surplus of allowances and a sinking carbon price. By the time of the third phase, 2013–2020, the system had become far more harmonized, and more allowances were auctioned. As a response to the low carbon price, a Market Stability Reserve (MSR) was adopted in 2015, to function as an automatic market thermostat from 2019 (Wettestad and Jevnaker 2016, 2019).

The stage was then set for the 2021–2030 phase, the main rules for which were adopted in 2018. This reform contributed significantly to increasing carbon prices, but also in 2019 the launching of a 'European Green Deal' and a more ambitious EU climate policy, and new ETS reforms as part of a 'Fit for 55' 'super-package' (European Commission 2021). So much for the context and background. Let us now turn to the main theme of this chapter: *the emergence and evolution of the idea of a Carbon Border Adjustment Mechanism.*

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## 3. THE EMERGENCE AND EVOLUTION OF THE CBAM OPTION IN THE EU

### 3.1 The Initial Launching – and Rejection – of the Idea

The idea of a Carbon Border Adjustment Mechanism (CBAM) has been debated internationally for more than a decade. In the EU, the energy-intensive industries in particular have long been concerned about an uneven international economic playing field (Skjærseth and Wettestad 2008). As noted already, the initial policy response was to distribute a generous number of free allowances to these industries. For this reason, a specific border measure was not on the agenda in the years leading up to the launching of the EU ETS in 2005.

In 2006, the process of putting in place revised rules for the third phase of the EU ETS, 2013–2020, started (Skjærseth and Wettestad 2010). Here the relationship to other countries was discussed, but only in connection to possible linkage to other trading schemes and links via the UN's Clean Development Mechanism (CDM). The issue/option of carbon border adjustment did not feature in discussions (see e.g. European Commission 2006).

However, as noted by Mehling et al. (2017), the issue did come up in connection with this process. In 2007 the Commission produced an internal ETS draft Directive which included the possibility to introduce a border tax mechanism in Article 29, addressing carbon leakage and international competitiveness effects: the 'Future Allowance Import Requirement' (FAIR) proposal. This would have applied to products exposed to risks of carbon leakage or unfair international competition until such time as trade partners agreed to 'binding and verifiable action to reduce greenhouse gas emissions comparable to the action taken by the Community' (Art. 29, 1). However, the FAIR option was not included in the formal Directive proposal in 2008, nor in the subsequent decision-making process (Mehling et al. 2017: 27), although the issue was heavily debated in the USA at the time (van Asselt and Brewer 2010).

There was also discussion of such a measure among EU Member States. The French government floated a 'non-paper', sketching a 'carbon inclusion mechanism' for imports in sectors at risk of carbon leakage – requiring countries outside the EU with no, or less-ambitious, climate policies in place to buy allowances for imports. The paper referred several times to the need for such a mechanism to be WTO-compatible. However, concerns about the potentially disruptive effects on the negotiations on a post-Kyoto global climate treaty contributed to the scrapping of the proposal (Mehling et al. 2017: 27).

In mid-2008 came a first extension of the scope of the ETS: it was decided that the aviation sector was to be included in the ETS from 2012. The initial intention was to include flights into the EU, as well as domestic trips between Member States (Anger and Köhler 2010; Vogler, Chapter 10 in this volume).

### 3.2 Failure in Copenhagen – Not Bolstering the Case for a CBAM

The 2009 Conference of Parties in Copenhagen was a fiasco, failing in its ambition to deliver a new international climate treaty committing countries to binding emission reductions (Dimitrov 2010). In theory, this should have strengthened the case for a carbon border adjustment measure, because the failure meant greater uncertainty as regards prospects for levelling the international regulatory playing field. However, this strengthening did not occur. Although Germany had initially backed the idea of a CBAM, it had steadily become more hesitant,

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fearing such a measure would damage its export-dependent economy by provoking retaliation from trading partners. One German minister even likened the idea to 'eco-imperialism' (Reuters 2009; Euractiv 2018).[2] The broader explanatory picture will be discussed in further detail later. First, however, let us examine the carbon leakage debate at several key decision-making milestones after the Copenhagen summit.

The first such milestone in the development of EU climate and energy policy was the debate that began in 2010 on carbon leakage prospects and setting the stage for 2050. Specifically, in May 2010, the Commission presented an analysis of options for moving beyond the already adopted 20 per cent GHG reductions by 2020, with an assessment of the risk of carbon leakage (European Commission 2010). Concerning carbon leakage, the Communication noted that the carbon price had become lower than originally foreseen. This meant that energy-intensive sectors would probably end up with a 'very considerable' number of unused, freely allocated allowances to be carried over into phase three of the ETS (2013–2020). That would put these sectors in a comparatively better position in the face of international competition compared with 2008 estimates. Hence, the Communication concluded: 'the measures already agreed to help energy-intensive industries – free allocation and access to international credits – remain justified at present' (ibid.: 10).

The issue of an import-focused carbon border mechanism was also discussed, with allowances to be bought to cover the emissions of certain imported goods. However, it was noted that this would give rise to broader trade/WTO policy issues, as 'a number of emerging economies have already signalled their concerns related to this issue' (European Commission 2010: 12). Several administrative challenges related to such a mechanism were also noted, including verification and monitoring challenges and accounting for embodied carbon in imported goods. The Communication ended up discussing other options to protect energy-intensive industries – like a more targeted approach to the nature and recognition of international credits in the ETS. Such a targeted approach would protect EU industries by banning credits emanating from projects in sectors such as steel, cement and aluminium from countries other than the least developed ones.

This approach to the nature and recognition of international credits was followed up in 2011. It was decided that, from 2013, only CDM credits from least developed countries would be allowed for use. This was accompanied by discussions on a 2050 'roadmap' for EU climate and energy policy. A key document was the 2011 Communication from the Commission 'for a competitive low carbon economy in 2050' (European Commission 2011). The Communication confirmed earlier findings that existing measures provided 'adequate safeguards', but also 'noted the findings on options for addressing carbon leakage in the Communication of May 2010, including on the inclusion of imports into the ETS' (ibid.: 9). Thus, the carbon border adjustment issue remained on the agenda, but rather low down.

The financial crisis that hit the world in late 2008 resulted in a gradual lowering of emissions and, as a consequence, demand for allowances. This also meant a declining carbon price from 2010 and increasing frustration among those Member States that preferred a reasonably high price, such as the UK, the Netherlands and Sweden. In response, the Commission launched a carbon market reform process in 2012, which came to dominate the EU climate policy agenda in the years up to 2015 (Wettestad and Jevnaker 2016).

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### 3.3 France Tries Again – But Fails

The focus on low carbon prices and carbon market reform did not deter France from raising the CBAM issue again in 2012; this time under the François Hollande administration (Euractiv 2012). However, the initiative did not receive much support from other Member States, with the exception of Italy. In 2012, the EU also allowed countries to establish nationally specific CO2 compensation mechanisms, in order to strengthen its 'carbon leakage regime' further. Several countries followed up on this, including Germany, Finland, Norway and the UK. Together with a rather low carbon price in those years (around €5), this arguably reduced interest in establishing complicated mechanisms such as a CBAM.

In 2013, the process of developing a more specific EU climate and energy roadmap for 2030 was started. This focused generally on how to handle the malfunctioning of the EU ETS, under which a significant surplus had accumulated, accompanied by a rather low carbon price (Wettestad 2014). Regarding carbon leakage, the focus remained on the provision of free allowances. This was reflected in the outcome of the EU Council summit in October 2014, stating that:

> free allocation will not expire; existing measures will continue after 2020 to prevent the risk of carbon leakage due to climate policy, as long as no comparable measures are undertaken in other major economies, with the objective of providing appropriate levels of support for sectors at risk of losing international competitiveness (European Council 2014: Conclusions, section 2.4.).

No mention was made of a border adjustment mechanism.

### 3.4 The Paris Agreement, Continued French Campaigning and Increasing Parliamentary Activism

By 2015, the EU's focus was turning to the critical twenty-first United Nations Conference of Parties (COP21), due to be held in Paris in December, with a new global climate policy framework in the making. As regards the EU ETS, negotiations on a Market Stability Reserve completed the final stages: the MSR was adopted in May 2015, with operation beginning in January 2019 (Wettestad and Jevnaker 2016). In the wake of the Paris Agreement, whose decentralized approach offered no substantial means to address carbon leakage concerns, France again began pressing for a CBAM, circulating another 'non-paper' on a 'carbon inclusion mechanism' in February 2016. The mechanism would apply to imported products in the ETS, meeting criteria such as a high carbon intensity and a significant share of total GHG emissions in Europe. It was also proposed to test the mechanism in the cement sector (Mehling et al. 2019: 28; Carbon Pulse, 13 March 2016).

The French proposal was picked up by the European Parliament, which had started discussing the revision of the ETS for the fourth trading period (2021–2030). Parliament's Environment Committee (ENVI) took up the proposal and included it in its overall ETS reform package. However, although important parts of the package were endorsed by the plenary in February 2016, including a doubling of the MSR intake in the period 2019–2022, the border mechanism part of the package was voted down (ICAP 2016). However, France did not cease campaigning for a border mechanism. Discussions in Parliament continued through the spring of 2016, although they did not top the agenda. Rapporteur Ian Duncan's report (May 2016)

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made no mention of a border tax mechanism; regarding carbon leakage protection, it proposed a ‘tiered approach’.

The process continued in the autumn of 2016. In October, the Parliament’s Industry Committee (ITRE) put forward main positions, with several proposed free allocation changes – but no border measure (Carbon Pulse, 13 October 2016). However, a border mechanism for the cement sector was included in the long list of amendments voted on by the Environment Committee in December 2016. The final text adopted included a proposal to establish a border measure for sectors with a trade intensity less than 10 per cent over the period 2009–2013, which effectively ruled out any free allocations to cement, lime, brick and tile producers, but required importers of those products to buy allowances. The European cement association CEMBUREAU reacted negatively, stating that ‘a border adjustment mechanism that does not apply to all sectors alike is discriminatory and legally flawed’; and deemed it ‘appalling’ that the sector had not been properly consulted (Carbon Pulse, 15 and 16 December 2016).

Prior to the plenary vote on ETS reform in the Parliament in February 2017 it was reported that the cement sector lobbied heavily against being excluded from the carbon leakage list (ENDS Europe, 7 February 2017). In a debate ahead of the vote, the border mechanism issue stood out as the most controversial one, with significant opposition to this part of the ENVI package of measures. The Greens supported such a mechanism; large entities like the European People’s Party (EPP) seemed split on the issue, whereas smaller groupings such as the centre-right European Conservatives and Reformists Party (ECR), the far-right Europe of Nations and Freedom (ENF), and the Eurosceptic Europe of Freedom and Direct Democracy (EFDD) were all opposed (Carbon Pulse, 13 February 2017). Following the plenary vote on 15 February, most of the ENVI proposal was adopted – but not the border measure proposal. Altogether 424 MEPs had voted against, 248 for, with 20 abstentions. The cement sector would remain on the carbon leakage list (Carbon Pulse, 15 February 2017). The ball was then passed to the Council and the Member States, forging a Common Position. Agreement was reached in late February – again, with no mention of a border mechanism. Germany was reported as pushing for continued free allowances to energy-intensive industries (EU Observer, 1 March 2017).

In May 2017, Emmanuel Macron was elected French President, ‘continuing a long-running preference among French leaders for border adjustments’, according to Carbon Pulse analysts (Carbon Pulse, 8 May 2017). The trialogue meetings of final policymaking negotiations (the Commission, Parliament and Council) and the process then developed throughout the autumn of 2017, with rules for free allowances and carbon leakage in the 2021–2030 phase among the key issues (ENDS Report, 28 June 2017). But, due to the outcome in the Parliament plenary that spring, the border mechanism option was not included at this point. Donald Trump had been elected US President in 2016 and declared in June 2017 that the USA would withdraw from the Paris Agreement. In response, some leaders began advocating the imposition of carbon taxes on US exports to the EU (VOA News 2017).

The spring of 2018 then saw a gradual increase in the carbon price, in February 2018 climbing above €10 for the first time since 2011. In March it was reported that the French government would (continue to) push for a border adjustment mechanism, aimed at countries that had not signed the Paris Agreement (Euractiv 2018). In July 2018, the carbon price hit a high of €17 (Carbon Pulse, 19 July 2018).

In November, the Commission presented its strategy for a climate-neutral Europe (European Commission 2018). Its Communication noted that ‘[t]he EU will use its … trade policy to

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support global transition to low-carbon development pathways' and 'proactive and corrective policies may be needed to ensure a fully and competitive playing field' (pp. 21–22). This highlights an interesting departure in the framing of its climate policies, in the sense that its links to trade and foreign policy make CBAM as much an instrument of international diplomacy, designed to bring international partners into line with the EU's emission reduction ambitions, as anything (see also Youngs and Lazard, Chapter 11 in this volume, Dobson, Chapter 25 in this volume). However, no specific, explicit new measures for protection against carbon leakage were presented.

## 3.5 The European Green Deal and the Renewed Push for CBAM

The new European Parliament elected in May 2019 featured an increased number of seats for the Greens (up to from 51 to 70 seats) (*The Guardian* 2019). As noted above, getting an EU CBAM adopted had always been a central priority for the Greens. The 2019 Parliament election was accompanied by the process of approving a new Commission and Commission President. In hearings held in July, German nominee Ursula von der Leyen spoke of the need to consider introducing a CBAM, noting that 'this is not an easy point, but one we have to take on' (EU Observer 2019; Carbon Pulse, 10 July 2019). Her manifesto reflected this (Political Guidelines 2019). Observers saw this as a move deliberately intended to placate the important Green votes in the approval process (interviews 2020).

The border mechanism discussion picked up speed in the autumn of 2019. In early October, Commission representatives pledged 'swift work' on carbon border measures as a response to Trump administration decision to impose tariffs on EU-made planes (10 per cent) and French wine (25 per cent). However, WTO head Roberto Azevedo warned that such an EU measure could be construed as protectionist, and advised caution (Carbon Pulse, 3 October 2019). Cautious signals also came from German Chancellor Merkel at an EU summit in December, where she warned that a carbon border measure would risk exposing European companies to tit-for-tat protectionism from abroad (Politico 2020).

Newly confirmed Commission President von der Leyen then continued to highlight a carbon border mechanism as a central part of the new 'Green Deal' drive (European Commission 2019). A proposal was to be put forward in 2021. However, she also praised the development of carbon pricing policies in China and California, indicating that such developments might mean that no border measures would ultimately be necessary (Politico 2020; Carbon Pulse, 22 January 2020). In late February 2020, just before the COVID-19 crisis hit the world, the border-measure idea received significant support from Member States at a Council meeting. As reported in Carbon Pulse (27 February 2020), the Spanish Minister for Industry, Trade and Tourism noted that 'the competitiveness of our industry is at stake due to the risk of carbon leakage, so we need to start working on [the measure] in the second half of this year'. According to Luxembourg's minister attending the meeting, several other Member States – among them France, Germany and Italy – were 'impatiently waiting' for the Commission's proposals on border measures. Further, France indicated that the process could be accelerated by starting with a limited number of industries, such as cement and steel.

However, the German position was somewhat ambiguous. German State Secretary Doerr-Voss called for the system of free allowances to be maintained even if a border measure were introduced. This was vehemently opposed by environmental NGOs, keen to reduce or abolish the free allowance regime (Carbon Pulse, 27 February 2020). By March,

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the COVID-19 crisis hit Europe, affecting Italy and Spain in particular. The Commission rejected calls for a speedier process, indicating the spring of 2021 as the launching date for the proposal, preceded by a public consultation in the third quarter of 2020.

A first round of consultations, linked to the 'inception' impact assessment, had taken place in the spring. Over 160 submissions were recorded, making it clear that the future of free allocation in the ETS would be a crucial issue in the subsequent policy process. As before, the cement association CEMBUREAU was at the forefront of those favouring a continuation of the (shrinking) free allocation system, and strongly opposed replacing this system with a border measure. Russian steel and aluminium producers, in line to be particularly affected by the instrument, expressed worries as well; a CBAM could be 'counterproductive for both the climate change and competitiveness of EU industries' (Carbon Pulse, 24 July 2020). In late May 2020, the Commission put forward a proposed revised 2021–2027 budget and a short-term coronavirus recovery plan, the latter amounting to €750 billion. This was to be financed by grants (€500 billion) and loans (€50 billion). As part of the revenue foundation, the Commission indicated possible CBAM revenues of some €5–14 billion, 'depending on the scope and design' (European Commission 2020, 27 May Communication; Carbon Pulse, 27 May 2020).

In early June 2020, the Commission confirmed its intentions of putting forward a CBAM proposal in the spring of 2021. Speaking at a think-tank webinar, Sabine Weyand, Director-General of the Commission's trade department, stated that a CBAM could not be combined with continued free allowances for 'affected sectors', noting that 'you cannot have a double whammy for [such] sectors' (Carbon Pulse, 3 June 2020). At this stage, new negative reactions to a possible EU CBAM appeared in the EU-external environment. Speaking to reporters after a BRICS (Brazil, Russia, India, China and South Africa) summit in July 2020, Maxim Reshetnikov, Russian Minister for Economic Development, stated that Russia was 'extremely concerned' about the EU plan which was seen as contravening WTO rules. The EU was allegedly 'using its climate agenda to create new barriers'. A KPMG analysis indicated that a strict CBAM regime could cost Russia around €3 billion between 2025 and 2030 (Carbon Pulse, 24 July 2020).

A second round of EU consultations began in summer 2020, to gather views from stakeholders and trade partners on what a CBAM might look like; this was to run until October 2020. Ministers at the Council had begun to exchange views on the measure, with several governments (including Austria, France and Spain) expressing support. A general call for the Commission to conduct a thorough study on the consequences of a CBAM and possible alternatives to prevent carbon leakage was also issued (Carbon Pulse, 24 July 2020).

Further cautionary reflections from a senior Commission official in late September showed the delicate balancing involved. Gerassimos Thomas, Director-General of the Commission's Taxation and Customs Union, stated that the CBAM was 'no silver bullet': it was part of a more comprehensive package that included the ETS Directive and the Energy Taxation Directive. He also emphasized that a CBAM would have to be WTO-compatible. Adding that the CBAM would generally support a package of measures contributing to an increasing carbon price, he also indicated that all CBAM revenues would serve to finance the NextGeneration EU programme (the €750 billion recovery package) (Carbon Pulse, 30 September 2020; for more on the recovery package, see Quitzow et al, Chapter 24 in this volume).

Incoming Trade Commissioner Valdis Dombrovskis followed up by emphasizing that the introduction of a CBAM should mean the gradual phase-out of free allowances. But

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the Commission would have to be 'very careful in assessing the design of the CBAM and how these two systems fit together' and ensure that the measure would be compliant with WTO rules. This gradual phase-out of free allowances combined with the introduction of a CBAM was further confirmed by Diederik Samsom, head of cabinet for DG CLIMA chief (and Executive Vice President with responsibility for the European Green Deal) Frans Timmermans, in October 2020. Power production was a core initial sector, along with cement and steel. Subsequent candidates were aluminium, fertilizers, and chemicals (Carbon Pulse 2 and 13 October 2020).

The leading MEP in the Parliament (the rapporteur) on the CBAM issue was the French Green, Yannick Jadot. In a draft report, Jadot supported the idea that a CBAM would raise revenues for the EU budget and the recovery programme. However, he emphasized that 'the main objective should be industrial decarbonization, while protecting our industry' (Carbon Pulse, 22 October 2020).

When the Parliament's ENVI Committee discussed Rapporteur Jadot's report in late October, a clear majority supported phasing out free allowances in connection with the introduction of a CBAM. The Parliament's largest grouping, the EPP, was the only voice in the Committee to favour the continuation of free allowances, even after the establishment of a CBAM (Carbon Pulse, 28 October 2020). DG CLIMA chief Frans Timmermans further expressed a cautious attitude in November. Recent carbon neutrality and net zero pledges by certain key economic competitors (such as China, Japan, South Korea and South Africa) could render an EU CBAM 'less necessary'. These pledges could therefore lessen the impact of, or even shield these countries, from a CBAM. Speaking at an EU–Russia climate conference, acting director Benjamin Angel in the Commission's tax department (leading the CBAM dossier), further clarified that two main CBAM design options were being considered: either the implementation of a tax at the border, or forcing exporting countries to buy carbon allowances. Russian representatives reiterated their earlier negative stance, considering a CBAM as 'very negative' and calling for harmonized actions (Carbon Pulse, 16 November; 3 December 2020).

The policymaking ball then passed to the Parliament's Industry Committee (ITRE) in December. By a slim margin (37 votes to 32, including all EPP MEPs), its opinion stated that free allocation should be phased out if the EU were to proceed to adopt a CBAM. The final text called on the Commission to 'analyse the possibility to start the implementation of the mechanism with a gradual phasing out of free allowances'. The ITRE opinion was then passed on to ENVI's Rapporteur, Jadot (Carbon Pulse, 19 December 2020).

Meanwhile, in a policy brief issued in December, two former EU senior climate policy officials, Jos Delbeke and Peter Vis – who had experienced first hand the international opposition to including foreign airlines in the ETS – argued against using CBAM revenues for Member States and as 'EU own resources' to fund the pandemic recovery package on the grounds that it might well anger other countries. They argued that the revenues should instead be used to support developing countries, especially least developed countries and small island states. Further, they deemed it 'difficult' for a CBAM and free allocation to coexist; and held also that compensation schemes for indirect carbon pricing costs should be discontinued (Delbeke and Vis 2020).

In early January 2021, the Commission then published a summary of over 600 responses to the second, public consultation on the proposal (European Commission 2021). Over half of the responses came from business associations and companies. This summary showed that a tax

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applied on imports at the EU border was considered the 'most appropriate' option by a narrow margin, followed by setting a tax at consumption level on a selection of products. More politically feasible options, such as a scope extension of the ETS or purchasing allowances outside the ETS, were considered 'somewhat relevant'. The Commission also confirmed its intention to make a CBAM 'an alternative' to the existing carbon leakage protection measures.

In February 2021, Valdis Dombrovskis, European Commission Executive Vice-President responsible for trade, stated that the CBAM would probably take the shape of a 'notional' emissions market. That would force importers to buy allowances from a separate pool at prices mirroring the value of EU allowances, although these units would not be tradable (Carbon Pulse, 18 February 2021).

The ENVI Committee also adopted its position in February. A compromise text calling for the 'parallel, gradual, rapid, and eventual complete' phase-out of free allowances was adopted by a large majority, spanning the S&D, liberals at Renew Europe, the Greens/EFA, and centre-right EPP. The full Parliament then adopted its non-binding report in early March. The introduction of a CBAM from 2023 on was adopted by 444 votes to 70, but only after a narrow majority had supported deleting text calling for the complete phase-out of free allowances when a CBAM was introduced. This deletion led as many as 181 MEPs to abstain, among them the Greens (Carbon Pulse, 10 March 2021). These developments highlight how, although the Parliament has been a central driving force for the introduction of a CBAM, there is significant internal disagreement as to the exact manner in which to do so, and particularly on the relationship between a CBAM and the role of free allowances.

The Commission's formal proposal for a CBAM was eventually put forward on 14 July, as part of the 'Fit for 55' package, with the following key elements:

- It is to be launched in 2023 with a three-year transition period during which importers will have to monitor emissions but not surrender any allowances.
- The sectors covered will include iron and steel, aluminium, cement, chemicals, electricity, fertilizers and refineries.
- The system will take the form of a 'notional' ETS in which importers will purchase 'CBAM allowances' at a price mirroring the average closing prices of ETS allowances each calendar week.
- Importers will need to submit a 'CBAM declaration' to national registries, possibly aided by an EU-wide CBAM authority.
- Free ETS allowances will be gradually phased out – by 10 per cent annually – starting in 2026, with full phase-out by 2035.
- Such a designed mechanism is in line with WTO rules (European Commission 2021).

## 4. CONCLUDING COMMENTS

Why did the idea of an EU-wide Carbon Border Adjustment Mechanism come to gain prominence as a viable policy option? Firstly, France, as a country generally open to protectionist ideas, has certainly been a consistent advocate. Moreover, an EU CBAM had the potential to complement a similar French domestic initiative. For most of the period up to 2018/19, Italy was also positive. Initially, in the ETS pilot phase, Germany was also open to the idea. Then it turned lukewarm – probably to a large degree because the country's big energy-intensive

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industries have been satisfied with the carbon leakage regime based on free allowances, and have feared alienating trade partners; in addition came the long period of rather low carbon prices.

The Commission was also open to the idea from an early stage. Later, however, pressured by significant lobbying, it found free allowances to be a more feasible option; the Commission also got 'burnt' in 2012 by opposition from major trade partners to the inclusion of international flights in the ETS (see Vogler, Chapter 10 in this volume). When von der Leyen assumed the Commission Presidency in autumn 2019, it led to a new high-level drive for a CBAM, which eventually appeared as part of the European Green Deal.

Thus we see that, prior to 2019, the Parliament and particularly the ENVI Committee stand out as central CBAM policy entrepreneurs in the EU system, along with France. True, the Parliament has been internally divided on the issue – but its leadership is analytically interesting, and nuances the picture of the Commission as *the* Green Deal entrepreneur (Dupont et al. 2020). The appointment of the von der Leyen-led Commission and the advent of the European Green Deal must be seen as turning points; however, her support of the CBAM idea appears initially to a large degree a response to pressure from Parliament. In explaining why the concept gained wider support among Member States and industries, a first important background factor is the rising carbon price after 2018, with projected further increases towards 2030. There have been worries that the decreasing proportion of free allowances will not adequately protect industries if the carbon price approaches €100. Second, the EU has placed climate policy and the European Green Deal at the heart of its COVID-19 recovery package – and a CBAM could contribute sorely needed cash to finance this giant package. Third, President Trump's withdrawal from the Paris Agreement served to increase EU politicians' interest in more 'proactive' carbon border taxation.

What, then, are the prospects for the proposal? With projected substantially higher carbon prices, a CBAM may be deemed essential to prevent carbon leakage as free allowances are gradually phased out. The proposed longer phase-out period of such allowances helps to soften internal opposition. As to the external political environment, two interesting developments could be noted in the autumn of 2021: first, the CBAM proposal appeared already to have had some of its intended international effects, as countries such as Russia started to explore carbon pricing, making explicit reference to the EU proposal in doing so. This led Commission Vice President Frans Timmermans, to declare that the 'CBAM is already working even before its formal adoption' (Carbon Pulse November 10, 2021). However, and as a second point, a degree of scepticism and opposition remained on the part of some of the EU's key trading partners. At the COP26 climate summit in Glasgow in November 2021, the BASIC countries (i.e. Brazil, South Africa, India, and China) voiced their opposition (Carbon Pulse November 10, 2021). EU policymakers have been sensitive to such reactions, and it is likely that this will be reflected in some way in the final CBAM design.

In 2022, the CBAM dossier continued to move forward in the EU institutions, with active entrepreneurship from the French EU Presidency in the first half of the year. An important move by France, intended to make quicker progress, was to de-couple the discussion of two contentious elements of the proposal: the phase-out of free allowances and the issue of export rebates. France argued that those two issues primarily fell under the competences of the ETS review and should be discussed in that context by environment ministers, while the rest of the file should be taken forward by finance ministers. Several stakeholders were reported to have

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seen this critically, as a French Presidency failure to craft an early general agreement (Carbon Pulse 7 March 2022).

Finally, although much remains uncertain at the time of writing (in the spring of 2022), the Russian invasion of Ukraine in February 2022 marked a significant shift in the geopolitics of climate change, with potential implications for the CBAM proposal. Certainly, the vision propounded by some, such as incoming German Chancellor Scholz, of an EU-led climate club averting the need to activate border adjustments, encompassing the likes of China and India, as well as Russia (along with the United States), was rendered a much less likely prospect (Euractiv 2022). While the invasion may bring the EU and other Western countries closer together, including in their efforts to decarbonize their energy systems, the war and its economic consequences could equally push climate change, including carbon pricing, down on the political agenda, if not in the EU then in certain foreign governments that the CBAM proposal was intended to influence.

## NOTES

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2. For more on controversies over external effects on EU policy instrument choices, see Dobson, Chapter 25 in this volume.

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