

**TREATMENT OF ALLEGED CARBON COST BURDENS IN THIRD COUNTRIES**

**EXECUTIVE SUMMARY**

**PART 3 OF A LEGAL ANALYSIS COMMISSIONED BY AEGIS EUROPE**



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## EXECUTIVE SUMMARY

1. The CBAM will have to be designed to ensure a broad equivalence in terms of the total regulatory burden imposed on EU-produced products as compared to the burden imposed on foreign products brought into the customs territory of the EU to account for the cost of carbon.
2. The CBAM will also have to apply to a given product brought into the customs territory of the EU regardless of origin to remove incentives to maintain or increase carbon intensive production in certain third countries and jeopardize the EU's objective to reduce GHG emissions. Exceptions for developing countries or least developed countries would not be consistent with the *Enabling Clause* under the WTO agreements.
3. The export adjustments will have to be established to prevent carbon leakage associated with exports from the EU. Export adjustments will thus have to be provided to goods produced within the EU and exported to third countries that do not have equivalent carbon limitation and pricing policies.
4. The CBAM and the export adjustments are components of the EU ETS. The CBAM will have to apply to goods brought into the customs territory of the EU, even if those goods are subject to special procedures such as the inward processing regime. EU inward processors will thus have to report the carbon costs embedded in the goods placed under the inward processing procedure, even if those goods are re-exported outside the EU. In case EU processed goods placed under the inward processing regime are re-exported to a non-EU country with which no specific relationship has been established regarding the implementation of the Paris Agreement, this EU inward processor will be eligible to export adjustments. However, if the EU processed goods are re-exported to a third country which has equivalent pricing and reduction systems, the EU inward processor will not be eligible to the export adjustments. This approach is in line with the EU's objectives to reduce GHG emissions, will avoid risks of carbon leakage and will prevent discrimination between EU products and foreign products on a third-country market in which there are equivalent carbon limitation and pricing policies.
5. The CBAM and the export adjustments, as components of the EU ETS, may need adjustment if a foreign product has been subject to effectively comparable carbon costs and reduction obligations in the place where essential manufacturing steps occur. These adjustments will be necessary to avoid a "double carbon cost" on a foreign product brought into the customs territory of the EU, or to avoid unjustified export adjustments for EU products exported to a country that has equivalent carbon costs, assuming the absence of equivalent mechanisms (i.e., CBAM and export adjustments) in the foreign country.
6. In the absence of equivalent pricing and reduction systems in place in a third country, a foreign product can still obtain an adjustment of the CBAM if it can demonstrate its carbon footprint. Different scenarios can be considered. First, to the extent that the carbon footprint of the foreign product brought into the customs territory of the EU is properly documented, certified and verifiable, the amount concerned could be used to determine the quantity of carbon allowances that will have to be purchased by the

importer. Second, to the extent that the carbon footprint of the foreign product brought into the customs territory of the EU cannot be determined accurately, the carbon footprint could be based on the average carbon footprint for the sector in the country of origin if this carbon footprint can be properly documented. Third, to the extent that there will be no reference available for the foreign products originating from the country concerned, a default value could be set by the EU authorities that could be based on the most carbon intensive production methodology known to exist in the country of origin of the foreign products.

7. For goods brought into the customs territory of the EU originating from third countries with which a specific relationship has been established with respect to the implementation of the Paris agreement, the EU will have to ensure that an equivalent effective regulatory burden is imposed on the foreign product compared to the EU product. The following considerations are of particular relevance when addressing the equivalence (and thus any partial or full reciprocity) of carbon costs burdens between EU and foreign products.
8. First, the equivalence of carbon pricing and reduction systems will have to be reflected both in the laws and in the practical implementation of the foreign system. The Third country linkages must be based on compatible systems, duly monitored and enforced. It will thus be important to ensure a periodic review and adaptation of the reciprocity of carbon pricing systems, as is the case for the implementation of the EU ETS.
9. Second, there will be a need to verify that the carbon cost borne by the foreign producer is not compensated or neutralized in any ways through other domestic measures that could jeopardize the EU's overall climate objectives. This approach can imply with respect to third countries where significant distortions in the system have been identified that the EU should not accept to consider any equivalence of carbon cost system and should assume that EU products and foreign products originating from these third countries are not subject to an equivalent regulatory burden applied on an even-handed basis until the situation has been corrected.
10. Third, if the EU recognizes that a carbon pricing and reduction system exists in third countries, which is however not equivalent, it could assess the possibility to modulate the CBAM and to account only for the difference between the foreign and EU systems.
11. Fourth, if the EU concludes that third countries have equivalent carbon pricing systems, it should not simply exempt that origin from the relevant parts of the EU ETS – namely the CBAM and the export adjustments. Instead, it would be key to maintain in place the overall mechanism but to implement a simplified administrative procedure and exemptions of CBAM compensated payment at the EU border (or the absence of the granting of export adjustments) to limit the risk of circumvention.

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