



## **ADDRESSING SOURCE SHUFFLING IN THE ENVISAGED CBAM REGULATION**

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AEGIS Europe is an industry alliance that brings together more than 20 European manufacturing associations committed to the principles of free and fair international trade and an effective international level-playing field. Our members account for more than €500 billion in annual turnover and millions of jobs across the EU.

Even with the proposed amendments, the draft CBAM Regulation has significant gaps or loopholes that will undermine its effectiveness, will not prevent carbon leakage, and will reduce the revenue expected from the measure. These gaps or loopholes can be minimised if certain mechanisms are added to the Regulation. AEGIS Europe proposes 3 changes to minimise circumvention.

### **1) Calculating the emissions based on all installations of a manufacturer in the country of origin**

Source shuffling is a form of circumvention allowing foreign manufacturers to export their low carbon production to the EU, thus avoiding CBAM costs altogether, and to sell their high carbon production in countries with low carbon limitation requirements. This loophole is due to the definition in Article 7 and Annex III (point 2 and 3) that provides that the emissions to be measured are those of the ‘Installation’ which is “a stationary technical unit where a production process is carried out”.

Instead of addressing source shuffling as a circumvention practice, AEGIS Europe proposes to address this issue upstream by modifying of Article 7 and Annex III of the Draft CBAM Regulation.

The AEGIS Europe proposal is to switch from the current “product-consumption basis” to a “group-responsibility basis” in the country of origin, by imposing on a manufacturer from a third country the obligation to calculate the carbon footprint of its exports to the Union based on all its installations (and those of its related companies) in the country concerned.

A simple solution is to propose changing the definition (in Annex III) as follows: ‘all the installations of a manufacturer or related to a manufacturer in the country of origin’. There should be no change to the default provisions.

This solution requires a definition of “related” manufacturers. This can be culled from Trade Defence law or from Competition law.

The ETS applies to all installations of producers in the Union. Applying a CBAM on a product calculated on the basis of the carbon footprint for all the installations of a manufacturer (and those of its related companies) in the country concerned, would simply reflect the domestic requirements for imported products at the EU border. This is WTO compatible to the extent that the CBAM reflects at the EU border a domestic regulatory system and does not discriminate between imported and domestic goods.

This method of calculation will only cover direct emissions and, therefore, will not take into consideration the indirect emissions (scope 2) which are an important element of cost for the EU industry as a result of the calculation of electricity carbon content.

## **2) Default values for countries with distorted economies for the calculation of embedded emissions**

Calculating the embedded emissions for the purpose of CBAM in third countries can be very complex. In addition, it can be difficult to check if the embedded emissions reported are a fair picture of the reality.

False reporting of embedded emissions must be avoided. To meet this goal, simple methods and default values should be implemented until reliable and verified evidence of embedded emissions is provided. In that respect, the CBAM Regulation should include:

- For these countries where there is a limited practice of reporting embedded emissions, the EU Commission should introduce a simple method that avoids loopholes and allows easy checks by independent third parties.
- For these countries with distorted economies, such as China, which is the biggest polluter and whose carbon footprint is increasing every year, or Russia, the studies produced and published domestically may not be reliable as they are subject to strong governmental influence and distortions. Therefore, the publicly available data should not be considered as reliable. Instead, final default values should be implemented that are based on independent international studies.

## **3) Expansion of the definition of circumvention practices**

The definition of circumvention in Article 27(2) should be expanded to clarify that slight modifications of products to change the CN Code and thus to avoid the CBAM will not be allowed and that changes in the patterns of trade include cost absorption and cross compensation.

## ANNEX

### SUGGESTED AMENDMENTS TO DEAL WITH RESOURCE SHUFFLING WITHIN THE CBAM REGULATION

Preferred AEGIS Europe amendments on source shuffling (to switch to a manufacturing group in a country of origin rather than installation approach):

- i) Article 7(2): Embedded emission in good other than electricity shall be determined based on the actual emissions in accordance with the methods set out in Annex III points 2 and 3 **for all the installations of the group manufacturing the goods in the country of origin.**
- ii) Article 7(6): The Commission is empowered to adopt implementing acts concerning detailed rules regarding the elements of the calculation methods set out in Annex III, including determining system boundaries of production processes, emission factors, installation-specific values of actual emissions, **emission values for manufacturing groups in the country of origin, rules to identify manufacturing groups, installations involved in the manufacturing** and their respective application to individual goods .....
- iii) Annex III point 4.1: When actual emissions **of the group manufacturing the good,** cannot be determined by the authorized declarant ....

In the alternative, AEGIS Europe could adapt the amendments submitted by MEP Kloc that proposes amending the provisions on circumvention. The amendments define source shuffling, the consequences of source shuffling and the trigger to identify source shuffling.

AEGIS Europe should propose amending the Definition and the Trigger. There is no need to change the consequences.

For completeness, we set out these amendments as they currently stand:

**Definition:** AM 40 places source shuffling (called resource shuffling in the amendment) within the rules on circumvention procedures.

Source Shuffling is defined as: *redirecting to the Union the sales of goods covered by CBAM with lower embedded emissions that were sold to other markets during a reference period, while redirecting to other markets the sales of good covered by CBAM with higher embedded emissions that were exported to the Union during the same reference period, without a corresponding decrease in total embedded emissions for goods covered by CBAM of the producer in question (resource shuffling).*

**Trigger:** AM 41 provides that anti-circumvention procedures are triggered if there is a *“significant decrease in imported goods with high embedded emissions included in the scope of this Regulation produced by a foreign producer and corresponding increase of volume of imported goods with low embedded emissions produced by the same producer as set out in paragraph 2, point (c).*

**Consequences:** AM 42 provides that when the situation in *paragraph 2, point (c)* are occurring, it shall establish embedded emissions for the purposes of Article 7 at the level of the non-Union producer regardless of where goods are sold, instead of establishing embedded emissions only for the goods exported to the Union.

The AEGIS Europe changes:

AM 40: AEGIS Europe should seek a change to the **definition** as follows:

*Any change to traditional patterns of supply, or any practice, that directs to the Union, goods covered by CBAM without a corresponding decrease in total embedded emissions for goods covered by the CBAM of the producer or group of manufacturers of the goods in question (source shuffling)*

AM 41: The circumvention provisions should be **triggered** when

*There is a significant decrease in imported goods on the EU market with high embedded emissions included in the scope of this Regulation produced by a third country manufacturing group and a corresponding increase in volume of imported goods on the EU market with low embedded emissions produced by the same manufacturing group as set out in paragraph 2, point (c) while there is no indication that the volume of embedded emissions for the manufacturing group concerned has been reduced meaningfully.*

AM 42: **Consequences:** There are two options: i) keep the existing definition from Kloc; ii) introduce a penalty. A penalty clause could read:

*Importers established in the EU and/or exporting manufacturing groups engaged in source shuffling of exports to the EU will be required to submit emission allowances based on the default values referred to in Article 7(2).*

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