

Proposal for a Carbon Border Adjustment Mechanism

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On 14 July 2021 the European Commission published a proposal for a Carbon Border Adjustment Mechanism (CBAM). The authors discuss the background and legal structure of what the Commission has presented as a climate measure. They also provide detailed commentary on the provisions in the current proposal, including discussion of the interaction between customs law and the proposed CBAM. Lastly they consider the international reactions to the CBAM, as well as CBAM initiatives elsewhere in the world.

Keywords: Carbon border adjustment measures, climate change, customs, European Union

I INTRODUCTION¹

On 21 July 2020 the European Council reached agreement on a COVID-19 recovery plan and a multiannual financial framework for 2021–2027.² The recovery plan includes proposals for increasing the own resources of the European Union by creating a new own resource based on non-recycled plastic waste (applying from 1 January 2021) and introducing a carbon border adjustment mechanism (CBAM) and digital levy (DST) (to apply from 1 January 2023 at the latest). The Council also proposed a review of the existing emissions trading system (ETS).

One year later, on 14 July 2021, the European Commission published its ‘Fit for 55’ package. The various proposals in this package relating to climate, energy, land use, transport and tax are aimed at reducing CO₂ emissions by 55% (compared with 1990) by 2030. This marks a significant step towards achieving the European Union’s ambition of being the first climate-neutral continent by 2050, while also reflecting international agreements, such as the Paris Agreement,³ to which the European Union has committed itself.

The ‘Fit for 55’ package includes a concrete legislative proposal for a CBAM.⁴ This is intended to create a level playing field by supplementing the ETS for imports. The effect of this will be to tax the CO₂ emissions associated with the production of certain imported goods. This will be in addition to the existing ETS, which taxes CO₂ emissions attributable to operators in the European Union.

In this contribution we discuss the CBAM proposal, focusing on the background to the proposal (section 2) and on its legal structure (section 3). We then comment on the proposal in its current form (section 4), followed (in section 5) by discussion of the CBAM proposal in a broader international perspective and ending with a conclusion (section 6).

2 BACKGROUND TO THE CBAM PROPOSAL

The ETS was introduced by the European Union in 2004.⁵ Operators to whom the ETS applies have to purchase certificates equating to the number of tonnes of CO₂ emissions generated by their production activities. Each

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¹ This contribution is an adaptation of an article previously published in Dutch, see M. L. Schippers & W. de Wit, *Voorstel voor een mechanisme voor koolstofcorrectie aan de grens (CBAM)*, Wfr (2021).

² Conclusions of the European Council, 17–21 July 2020 (COVID-19 recovery plan and multiannual financial framework 2021–2027), EUCO 10/20. The European Parliament and the Council reached agreement on the plan on 10 Nov. 2020.

³ Paris Agreement, OJ L 282, 19 Oct. 2016, at 4–18.

⁴ Proposal for a Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism, 14 July 2021, COM(2021) 564 final.

⁵ Directive 2003/87/ EC of the European Parliament and of the Council of 13 Oct. 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC (Text with EEA relevance), OJ L 275, 25 Oct. 2003, at 32–46.

year, the number of certificates available is cut, with the aim being to reduce the amount of CO₂ emissions to the target level by 2030. In this way, operators are incentivized to reduce their activities' environmental impact.⁶ The number of certificates available in the market each year is equivalent to the amount of CO₂ emissions in a specific year. Some of these certificates are allocated through an auction, while others are allocated free of charge, and a third category is reserved for new installations or expansions of existing installations. An operator with insufficient numbers of certificates can purchase additional certificates at auction or on a trading platform, or directly from other operators.

The ETS creates an incentive for businesses to shift production to countries outside the European Union because imports of goods produced outside the European Union are not covered by this scheme. Shifting production so as to circumvent the ETS is commonly referred to as 'carbon leakage'. In certain sectors, leakage levels are regarded as so high that operators in these sectors are allocated certificates free of charge. But the risk of carbon leakage nevertheless remains, with the result that the playing field for businesses manufacturing in the European Union, compared with that for businesses manufacturing outside the European Union and then importing their goods into the European market, is anything but level.

In an effort to create a more level playing field, the European Commission launched an investigation into the opportunities for also levying a CO₂ tax on imported goods within the limits imposed by the World Trade Organization (WTO) rules.⁷ Having examined a total of six proposals,⁸ the European Commission ultimately opted for a mechanism of adjusting carbon at the border, with certificates required to be held for imports of basic materials. Under the proposal, CBAM obligations are to be calculated on the basis of actual emissions, with the free allocation of ETS certificates to certain sectors being gradually phased out. The reason for this being the Commission's preferred mechanism is that taxing actual emissions will create as much as possible a level playing field for operators under the ETS, while the gradual phasing-out of free allocations of allowances for selected sectors will offer businesses and public authorities

certainty, and this measure was considered the most proportionate means of addressing the issue of climate change and helping prevent CO₂ emissions and carbon leakage.

3 LEGAL STRUCTURE OF THE CBAM

The European Union has issued its proposal for introducing a CBAM in the form of a regulation. This means that if the legislative proposal is adopted, it will be directly applicable in the EU Member States and will not need to be transposed into national legislation.

Interestingly, the European Commission made reference to Article 192(1) of the Treaty on the Functioning of the European Union (TFEU) for the legal basis of the proposal. This Article forms the legal basis for European Union measures aimed at protecting the environment. Article 191 TFEU sets out the objectives of the EU's environmental policy, including its efforts to deal with climate change. The fact that the measures based on Article 192(1) in conjunction with Article 191 TFEU were approved under the EU's ordinary legislative procedure without the requirement for unanimity (qualified majority) is remarkable, given that Article 192(2) TFEU excludes 'provisions primarily of a fiscal nature' from being adopted in this manner. Instead, such provisions require the Council to act unanimously under a special legislative procedure,⁹ in accordance with the usual decision-making procedures for harmonizing indirect taxes. In this respect, see Article 113 TFEU, which states that unanimity is required on decisions pertaining to the harmonization of indirect taxes in the internal market, and Article 114(2) TFEU, which states that unanimity is also required for fiscal measures other than indirect taxes where these relate to the internal market.^{10,11}

The question is what exactly is meant by 'provisions primarily of a fiscal nature', given the absence of specific case law on what a provision of such nature comprises. In effect, and as discussed in more detail below, the CBAM introduces a levy on imports of certain basic materials, based on the CO₂ emissions embedded in these materials, with the aim of the mechanism being to protect EU producers of these basic materials who fall within the scope of the ETS rules. This is to be done by requiring all market participants to purchase CBAM certificates. In view of the wide-ranging

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⁶ This can be done by downscaling production or switching to more sustainable products or by greening production processes.

⁷ Commission Staff Working Document Impact Assessment Report, Accompanying the document Proposal for a regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism, 14 July 2021, SWD(2021) 643 final.

⁸ The proposals examined were: (1) a carbon tax on imports of basic materials, with emissions based on the EU average; (2) import certificates for basic materials, with emissions based on the EU average; (3) import certificates for basic materials, with emissions based on actual emissions; (4) import certificates for basic materials, with emissions based on actual emissions and continuation of free allowances for selected sectors for a transition period; (5) import certificates for basic materials, even if these are part of finished goods based on actual emissions; and (6) excise duties.

⁹ Regarding Art. 192(2) TFEU, see ECJ 30 Jan. 2001, C-36/98 (*Spain/Council*), ECLI:EU:C:2001:64.

¹⁰ We refer in this respect to the proposal, submitted at the same time as the CBAM proposal, for a Council Directive amending Directive 2003/96/EC, restructuring the Union framework for the taxation of energy products and electricity (recast), COM (2021) 563 final of 14 July 2021 (also referred to as the 'Energy Taxation Directive'), in which the Commission used Arts 113 and 192(2) TFEU as the combined legal basis.

¹¹ Regarding application of Art. 114(2) TFEU, see ECJ 29 Apr. 2004, C-338/01 (*Commission/Council*), C-338/01 and ECJ 26 Jan. 2006, C-533/03 (*Commission/Council*), ECLI:EU:C:2006:64.

scope applied by the Court of Justice of the European Union (ECJ), the possibility that these provisions constitute ‘provisions primarily of a fiscal nature’ cannot be excluded.¹² However, the European Commission defended the legal basis underlying the proposal by stating in the Explanatory Memorandum that the primary purpose of the CBAM legislation is to address the issue of climate change. Whether this explanation is sufficient remains to be seen, but it could well prove controversial.

In all other respects, the CBAM follows the structure provided for in the Treaty of Lisbon; in other words, the proposal in its current form will serve as a basic regulation, with the European Commission subsequently proceeding, insofar as mandated to do so by the basic regulation, to adopt a delegated and an implementing regulation elaborating the basic regulation. Importantly, neither the delegated nor the implementing regulation will be permitted to encroach upon the essential or even the non-essential parts of the basic regulation.

4 COMMENTARY ON THE PROPOSED CBAM

4.1 Introduction

This section comments on the European Commission’s proposal for a CBAM in its current form. However, the proposal still has to be approved by the European Parliament and the Council, and so may be amended in certain respects.

In discussing the proposal we consider the importation of basic materials (section 4.2), basic materials liable for the CBAM (section 4.3), the authorized declarant (section 4.4), optional registration of operators or installations established in a third country (section 4.5), reporting and financial obligations (section 4.6), territorial exceptions (section 4.7), the competent authorities (section 4.8), penalties (section 4.9) and lastly the date on which the provisions are intended to come into force and the transition period (section 4.10).

4.2 Importation of Basic Materials

Importation of basic materials (section 4.3) will trigger the obligations entailed in the CBAM proposal. The concept of ‘importation’ aligns with the provisions of Article

201 of the Union Customs Code (UCC),¹³ which states how the customs procedures provide for the release of non-Union goods ‘for free circulation’ in the customs territory of the European Union (Article 3(4)). Based on this alignment, we assume that the territorial scope of the CBAM legislation will be the same as the European Union’s customs territory as described in Article 4 UCC (except for the territorial exceptions discussed in section 4.7). We also assume from the aligning with Article 201 UCC that both ‘regular’ and ‘irregular’ importations of basic materials will be within the CBAM’s scope of application.

4.3 Basic Materials

Annex I of the CBAM proposal includes a list of the combined nomenclature (CN) codes that form the basis for assigning goods to the various tariff categories. The CN codes listed in Annex I cover five categories of basic materials: cement, iron and steel, aluminium, fertilizers and electricity. In practice, given that not all CN codes for these five categories fall within the scope of the CBAM legislation, and categorization often depends on very detailed product specificities, questions may arise as to whether certain imported goods fall within the scope of the CBAM legislation. Under customs law, economic operators can apply for binding tariff information (BTI) if they are uncertain about a categorization or want to avoid after-the-event discussions with the customs authorities. A BTI provides certainty about goods’ classification in the CN, as well as binding customs authorities *vis-à-vis* the economic operator, and vice versa. For reasons of legal certainty, it is recommended that the BTI should also bind the competent authorities *vis-à-vis* the holder of the BTI, and vice versa.

The European Commission has opted not to extend the current CBAM proposal to include products in which basic materials are embedded. This means, for example, that European car manufacturers are subject to the CBAM if they import steel and aluminium for producing their cars, whereas this is not the case if they import cars in which steel and aluminium have already been processed. The fact that products in which these basic materials have been processed are excluded from the CBAM means the risk of carbon leakage will continue.¹⁴ While this risk is limited in the case of products, such as fertilizers and

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¹² See inter alia: ECJ 3 Mar. 1988, 252/86 (*Bergandi*), ECLI:EU:C:1988:112. See also P. M. Herrera, *The Concept of Tax in the EC Treaty and in the Failed European Constitution: (1) Fiscal and Tax Provisions*, in *The Concept of Tax*, EATLP International Tax Series, vol. 3, 216 and 254 (B. Peeters ed. 2005). Herrera refers to the potential for unduly circumventing the unanimity rules on taxes under the guise of ‘consideration for services’ and ‘charges’. On the various legal bases for environmental taxes, see W. de Wit, *Europese aspecten van milieubeheer*, in *Hoofdzaken Milieubeheer* 53–55 (E. P. J. Wasch ed., Deventer: Kluwer 2019).

¹³ Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 Oct. 2013 laying down the Union Customs Code, *OJ L 269*, 10 Oct. 2013, at 1–101.

¹⁴ This was also acknowledged by the European Commission in the impact assessment report (see Commission Staff Working Document Impact Assessment Report, Accompanying the document Proposal for a regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism, 14 July 2021, SWD(2021) 643 final, part 1/2, at 24–25) and has been recognized in research: see J. Stede, S. Pauliuk, G. Hardadi & K. Neuhoff, *Carbon Pricing of Basic Materials: Incentives and Risks for the Value Chain and Consumers*, DIW Discussion Papers No 1935, 12–16 (2021). See also M. L. Schippers, *Bedrijven ontvluchten Europa Door CO₂-tax [CO₂ Tax Will Drive Businesses Out of Europe]* (radio broadcast), in *De Ochtendspits*, BNR (interview) (23 July 2021), <https://www.bnr.nl/nieuws/economie/10448968/bedrijven-ontvluchten-europa-door-co2-taks> (accessed 17 Nov. 2021).

electricity, that do not undergo any further processing before being supplied to the final consumers, it is a very real risk in the case of basic materials such as cement, iron and steel, and aluminium, which do undergo further processing after importation. The risk of carbon leakage is also the reason why free allocations of certificates to selected sectors under the ETS are being phased out gradually and why the European Commission plans to use the transition period (section 4.8) to assess whether the list of basic materials currently liable for the CBAM needs to be expanded. In the impact assessment reports other aggregated sectors have been considered like polymers and (in)organic chemicals. For now the European Commission decided to limit the CBAM in scope and only include basic materials with a high risk of carbon leakage in the corresponding EU ETS sectors while at the same time trying to limit complexity and administrative burden.

4.4 Authorized Declarant

Only authorized declarants may release the basic materials into free circulation (Article 4). With reference to Article 5(15) UCC, the CBAM proposal defines a declarant as ‘a person lodging a customs declaration [...] in its own name or the person in whose name such a declaration is lodged’. Declarants wanting to become authorized declarants have to submit a request to the competent authorities in the country in which they are established. Although the concept of establishment is not defined in the CBAM proposal, we expect this will be aligned with customs law and specifically Article 5(31), UCC. Under this Article, being established in the customs territory of the European Union means:

- in the case of a natural person, any person who has his or her habitual residence in the customs territory of the Union;
- in the case of a legal person or an association of persons, any person having its registered office, central headquarters or a permanent business establishment in the customs territory of the Union.

In addition to these requirements, the requirement for the primary economic activities to be performed in the European Union means a declarant has to have substance. We understand the reason for requiring establishment in the EU; this also applies in various customs law procedures. Consideration could be given to abandoning the

requirement for establishment if the importation entails only a reporting obligation, while emissions are zero (as in the case, for example, of returned goods or if a CO₂ price has already been charged in the state of origin). For the sake, however, of legislative simplicity (and, therefore, limiting the number of exceptions) and also in order to make checking by the customs authorities easier, we would regard maintaining the establishment requirement in these cases as justifiable.

As well as the establishment requirement, parties wanting to qualify as authorized declarants have to meet various other conditions, as shown by the information to be included with requests for registration (Article 5(3)). These include having an Economic Operators Registration and Identification (EORI) number¹⁵ and complying with conditions reminiscent of some of the conditions applying to parties wanting to be classified as an Authorized Economic Operator (AEO).¹⁶ These include evidence of their proper compliance with tax and customs requirements and of being operationally and financially able to meet their obligations under the CBAM proposal. We expect these conditions to be elaborated in delegated or implementing legislation, in the same way as the UCC, in which details of the conditions for being classified as an AEO are set out in Articles 24 to 28 of the Commission Implementing Regulation laying down the UCC.¹⁷ In order to reduce the administrative burden for competent authorities and authorized declarants alike we would be in favour of allowing certain conditions to be regarded as being met if the customs authorities have already designated the applicant as an AEO.

Under Article 16(1), successful applications for the status of authorized declarant result in declarants being assigned a unique CBAM account number. Authorized declarants are granted access to the national database in which their details are registered. We regard the requirement, under Article 14(1), for the competent authority in each Member State to establish a national database as somewhat puzzling. We do not see the benefit of setting up twenty-seven separate databases as this makes it difficult for the European Commission to maintain an overview and to analyse and perform checks on information becoming available. This requirement also creates an additional burden for economic operators, not least because of the risk of each Member State imposing different conditions. Having twenty-seven separate national databases is also at variance with the database to be set up at a Union level for registering operators and installations established in a third country. From an IT perspective, setting up a

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¹⁵ Economic Operators Registration and Identification number.

¹⁶ Being an Authorized Economic Operator means being regarded by the customs authorities as a ‘trusted party’ and therefore being eligible for various simplified customs procedures. Such operators also enjoy various financial benefits because the bank guarantees they have to provide for certain customs procedures can then be provided for lower amounts.

¹⁷ Commission Implementing Regulation (EU) 2015/2447 of 24 Nov. 2015 laying down detailed rules for implementing certain provisions of Regulation (EU) No 952/2013 of the European Parliament and of the Council laying down the Union Customs Code, *OJ L* 343, 29 Dec. 2015, at 558–893.

database for authorized declarants at a Union level should also be possible, particularly given the experience gained in recent decades from setting up customs databases such as the EORI, BTI and AEO databases at a Union level.

The final question concerns who, in practice, will act as authorized declarants. As mentioned earlier, an authorized declarant has to be a person established in the European Union. This means that international goods transactions in which the seller is responsible for completing the import formalities (also referred to as DDP supplies)¹⁸ will have to be conducted through an EU-established declarant. Sellers not established in the European Union already have to comply with this requirement, given that customs legislation requires the declarant to be established in the European Union; where that is not the case, an indirect customs representative has to be appointed. These representatives act in their own name, but for the account of the party they are representing. However, only a few parties offer this service, given that an indirect customs representative is jointly and severally liable, with the party they represent, for any customs liabilities arising in respect of the imports. The shortage of indirect customs representatives became all too evident after the end of the transition period provided for in the Brexit withdrawal agreement.¹⁹ The European Commission needs to be aware of this issue and to do everything possible – for example, publishing guidelines and offering online or other training – to encourage parties currently operating as indirect customs representatives to expand their activities. Businesses established in the European Union will also regularly need to arrange for a customs representative to handle their imports, even though such persons will often operate as direct representatives; in other words, in the name and for the account of the represented party. At present, these service providers, too, lack the knowledge and expertise needed to act as authorized declarants. This will also apply to EU-established businesses wanting to declare the basic materials for importation themselves. Here, too, therefore, the European Commission should give proper consideration to our above recommendation if disruptions to trade are to be avoided and the risks of non-compliance limited.

4.5 Registration of Operators and Installations Established in Third Countries

Article 10(1) allows operators and installations established in a third country (estimated number: 510) to request registration. If their request is accepted, the operator or

installation will be added to a central database to be set up at an EU level. Once the operator or installation has been registered, they can opt to share verified information with an authorized declarant (Article 10(7)). Registrations in the database, which are valid for five years, create various obligations for the operator or installation, including the requirement to calculate the embedded CO₂ emissions for each type of basic material produced by the installation, to verify information on the embedded CO₂ emissions and to retain a copy of the verifier's reports for four years (Article 10(5)).

4.6 Reporting and Financial Obligations

4.6.1 CBAM Declaration

By 31 May each year, each authorized declarant will have to submit a CBAM declaration for its imports of basic materials in the previous calendar year (Article 6). For each type of basic material imported, the CBAM declaration must specify:

- the total quantity imported, expressed in megawatt hours (MWh) for electricity and in tonnes for other basic materials;
- the total embedded emissions, expressed in tonnes of CO₂ emissions per MWh of electricity or in tonnes of CO₂ emissions for other basic materials;
- the number of CBAM certificates corresponding to the total embedded emissions in the basic material imported less any carbon price paid in a country of origin (section 4.6.3).

As well as applying to basic materials released into free circulation immediately upon arrival in the European Union, the obligation to report CO₂ emissions can also apply to basic materials covered by special customs arrangements, and specifically in the following cases:

- If materials are sent for processing or further processing in the European Union under the Inward Processing regime (the processing is then carried out under suspension) and the processed product is then released into free circulation, the CBAM legislation will apply.
- If EU goods are sent for processing or further processing outside the European Union under the Outward Processing regime and subsequently re-imported, customs duties are due only on the added value. In the case of the re-imported goods, the CBAM legislation will apply if the processed products qualify as the basic materials referred to in Annex I (section 4.3).

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¹⁸ The International Chamber of Commerce has compiled a set of standards (Incoterms) that parties can include in their contracts to specify how costs, risks and obligations relating to transport, insurance, permits and customs formalities are to be divided between the seller and buyer. One of these Incoterms, Delivered Duty Paid (DDP), covers situations in which the seller of the goods is responsible for completing the export and also import formalities.

¹⁹ M. L. Schippers, *Brexit: It's All About Brexit*, MBB, 13 (2021).

In this case, no reporting obligation applies during the transition period (section 4.10).

- In the case of returned basic materials (i.e., basic materials exported from the European Union and subsequently re-imported without any further processing), a reporting obligation applies even though the authorized declarant will have to report the CO₂ emissions as ‘zero’. In these situations, no reporting obligation will apply during the transition period (section 4.10).

4.6.2 CBAM Certificates

By 31 May of each year, authorized declarants will have to submit CBAM certificates corresponding to the emissions embedded in the basic materials to be imported (Article 22(1)). The authorized declarant cannot, however, wait until the end of the year to purchase these certificates because the number of CBAM certificates on the declarant’s account in the national registry at the end of each quarter has to correspond to at least 80% of the embedded CO₂ emissions in all the basic materials imported since the start of the calendar year, with the default values being used to calculate the CO₂ emissions in such cases.

CBAM certificates are bought from the competent authority in each state (Article 20). Each certificate is assigned a unique unit identification number, which is registered on the authorized declarant’s account in the national registry, along with information on the price and purchase date of the certificate. As CBAM certificates are assigned a unique unit identification number and purchases are listed on the authorized declarant’s account in the national registry, CBAM certificates would not seem – in contrast to ETS certificates – to be transferrable.²⁰

The price of CBAM certificates is to be linked to the average weekly closing price of the ETS certificates (Article 21). An authorized declarant who has purchased too many CBAM certificates may later offer them for repurchase, up to a maximum of one third of the total CBAM certificates purchased (Article 23). As certificates cannot be transferred, authorized declarants only have an incentive to purchase excessive numbers of certificates if, for example, prices are relatively low. Meanwhile the

opportunities to wait for low prices will be limited, given that, as explained earlier, certificates corresponding to a certain amount of emissions have to be purchased by the end of the quarter.

4.6.3 Emissions to Be Reported; CO₂ Charges to Be Deducted; Verification

In principle, the CO₂ emissions to be reported are the actual emissions associated with the production of the basic materials, with the method for calculating these emissions being as set out in Annex III of the CBAM proposal. The calculation only has to take account of direct emissions; in other words, the emissions directly relating to the production of the goods and over which the producer has direct control (Article 3(15)). Default values are assumed if the actual CO₂ emissions cannot be satisfactorily determined. From a legal perspective, there would not seem to be anything in the CBAM proposal to prevent default values being used in cases where actual values are higher. Given what the CBAM proposal is intended to achieve, allowing this would not seem logical, even though the competent authorities do not seem to have been given any tools to prevent it. In this respect, therefore, it would be advisable to amend the proposal accordingly so as to avoid the possibility of abuse.

The CBAM also requires emissions to be verified by an independent, accredited verifier (Article 8). The impact assessment report assumes annual verification costs of between EUR 1,000 and EUR 10,000 per installation.²¹ The conditions to be met by an independent verifier align with those set out in Regulation (EU) 765/2008²² and Implementing Regulation (EU) 2018/2067.²³ It is important that a verifier has no relationship with the authorized declarant or – if acting for an operator or installation – with the operator or installation. In practice, this means a verifier cannot also be used to provide advice or other CBAM-related services, in the same way as the provision of tax advice must, in practice, be separated from the provision of auditing services.

The calculation of the CO₂ emissions to be reported can take account of a carbon price paid in the country of origin. The country of origin is defined in the same way as in the customs legislation for determining goods of

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²⁰ If they turn out to be transferrable, the question arises as to whether EU Member States will be allowed to apply a VAT reverse-charging mechanism, as Art. 199(a) of the VAT Directive currently allows them to do for ETS certificates.

²¹ Commission Staff Working Document Impact Assessment Report, Accompanying the document Proposal for a regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism, 14 July 2021, SWD(2021) 643 final, part 2/2. at 84.

²² Regulation (EC) No 765/2008 of the European Parliament and of the Council of 9 July 2008 setting out the requirements for accreditation and market surveillance relating to the marketing of products and repealing Regulation (EEC) No 339/93 (Text with EEA relevance), *OJ L* 218, 13 Aug. 2008, at 30–47.

²³ Commission Implementing Regulation (EU) 2018/2067 of 19 Dec. 2018 on the verification of data and on the accreditation of verifiers pursuant to Directive 2003/87/EC of the European Parliament and of the Council (Text with EEA relevance), *OJ L* 334, 31 Dec. 2018, at 94–134.

non-preferential origin. This means that goods are regarded as originating from a specific country if they are wholly obtained in that country or, where more than one country is involved in the production of the basic materials, in the country where the goods underwent their last substantial processing. If a carbon price has been paid in the country of origin, a lower number of certificates can be submitted for the basic materials imported, and this has to be verified by an independent party. It is not yet clear which countries charging a carbon price on basic materials will be eligible for this 'discount', although the World Bank recently stated in a report that forty-five national and thirty-five regional governments currently provide for a carbon price to be charged on CO₂ emissions.²⁴ The European Commission has also been granted delegated and implementation powers regarding Article 9 of the CBAM proposal, in which provision is made for the 'discount' on the number of CBAM certificates to be submitted. As choosing the country of origin for deciding whether a 'discount' is granted may lead to 'origin-shopping', it is to be seen whether these delegated and implementing provisions will also include anti-abuse provisions.

4.7 Territorial Exception

Article 2(3) of the CBAM proposal includes a territorial exception, whereby the CBAM does not apply to goods originating in countries and territories listed in Annex II of the proposal. Under Article 2(5), countries and territories are included in Annex II if:

- The EU ETS applies to that country or territory or a bilateral agreement has been concluded with that third country or territory that fully links the ETS of that third country or territory to that of the EU; and
- The carbon price paid on the basic materials is charged in the same way as in the ETS.

At present, this applies to the following countries and territories: Iceland, Liechtenstein, Norway, Switzerland, Büsingen, Helgoland, Livigno, Ceuta and Melilla.

A territorial exception also applies in the case of the electricity market, providing various cumulative conditions are met (Article 2(7)). However, Annex II does not list any countries currently meeting these conditions.

Surprisingly, Annex II also does not include Turkey, despite this country being in a customs union with the EU. This shows once again that although the CBAM is subject to customs formalities, it is not entirely equivalent to the imposing of import duties.

4.8 Competent Authorities

Most of the responsibility for implementing the CBAM legislation has been vested in the competent authorities as designated in the CBAM proposal. It is up to the national Member States to designate the authorities to be entrusted with implementing the legislation. In due course, a list of the competent authorities in each Member State will be published in the *Official Journal of the European Union*.

In view of the close link with customs law, it is conceivable that certain Member States will opt to vest responsibility for implementing the CBAM legislation in their country's customs authorities. Although the CBAM proposal makes a distinction between competent authorities and customs authorities, we do not see this as an obstacle preventing customs authorities in a Member State from being designated as the competent authorities for implementing the CBAM legislation. Some Member States, such as the Netherlands, set up a new authority (in this case, the Dutch Emissions Authority) to implement the ETS and may extend this body's responsibilities to include the CBAM legislation, although the Dutch customs authority will clearly also play an important role in implementing it.

4.9 Penalties

Authorized declarants failing to surrender the required number of CBAM certificates when submitting their CBAM declaration by 31 May will be liable for a penalty. With regard to the penalties applying, Article 26 refers to the ETS regime, which leaves it up to the national Member States to determine the applicable penalties. The penalties imposed may be of an administrative or criminal law nature, but must in any event be effective, proportionate and dissuasive. Furthermore, they do not release the authorized declarant from the obligation subsequently to purchase the total number of certificates required.

4.10 Effective Date and Transition Period

It is envisaged that the CBAM will come into force on 1 January 2023, with a transition period applying until 1 January 2026. Different reporting obligations will apply during the transition period, while declarants will also not yet need to have purchased CBAM certificates. This means that apart from the administrative burden and the costs associated with that, the CBAM will not have any financial implications until 1 January 2026.

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²⁴ The World Bank, *State and Trends of Carbon Pricing* 10 (2021).

During the transition period, customs authorities will have to inform the declarant (who does not yet need, therefore, to be an authorized declarant) of the reporting obligations no later than when the basic materials are released into free circulation. The customs authorities will then share the information on the imported basic materials²⁵ with the competent authorities. As explained in section 4.6.3, this requirement relates only to basic materials released into free circulation and to products processed under the Inward Processing regime that include the processing or further processing of basic materials. In contrast to the rules applying after the transition period ends, the declarant will have to submit this CBAM declaration to the competent authorities on a quarterly basis. Failure to do so within one month after the end of the quarter will result in proportionate and dissuasive penalties being imposed by the competent authorities (no link appears to be made to the penalties applying under the ETS in this respect).

During the transition period, and based on the information supplied by the customs authorities to the competent authorities and the CBAM reports, the European Commission will analyse whether the aims of the CBAM legislation are achievable. Among other things, it will also assess whether the current list of basic materials in Annex I of the CBAM proposal needs to be expanded to include, for example, components and finished goods containing basic materials specified in the current proposal. Consideration will also be given to including indirect emissions in the CO₂ emissions to be reported. Lastly, countries may be added to Annex II (territorial exemptions) if and when they comply with the conditions set out in section 4.7.

5 CBAM PROPOSAL IN A BROADER INTERNATIONAL PERSPECTIVE

Reactions from various exporting countries – some non-European countries, but also countries within Europe but outside the EU – started coming right after the European Commission published its CBAM proposal on 14 July

2021.²⁶ In most cases, these reactions – particularly from the top ten exporting countries, which will be particularly affected,²⁷ – were of dissatisfaction with the proposal. Russia, for example, is particularly worried about trade barriers; these are largely uncharted at present as they depend on as yet unpublished delegated and implementing legislation.^{28,29} As the lack of rules in this respect makes it difficult to calculate the embedded emissions, performing an accurate impact assessment will also be challenging. China has meanwhile said that the CBAM will violate WTO principles and undermine mutual trust in the global community and the prospects for economic growth.³⁰

It remains to be seen whether the trading partners of the EU will take action in the coming months and years and, if so, what this action will entail. In this regard we expect the trading partners to act in one of three possible ways. The first group of countries will not take any action, either because they are not affected or because the expected costs of the CBAM for exporters from those countries are low. The countries likely to be in this category include, for example, countries that are already excluded from the CBAM because of being listed in Annex II (see section 4.7). The second and third groups comprise countries that are not in favour of the EU CBAM because, for instance, they believe that, by not making a distinction between low- and high-income countries, the CBAM is targeting only developing countries or because they fear that the administrative obligations the CBAM imposes on traders will mean the mechanism will adversely impact on international trade. The second group will consequently respond by introducing targeted trade measures such as additional tariffs or carbon taxes on EU products. However, these kinds of trade measures are allowed only if the EU's introduction of the CBAM proposal in its current form violates its obligations under WTO law and after a successful procedure has been conducted at the WTO's Dispute Settlement Body. Whether a WTO member will start such a procedure is, however, rather doubtful since, on the one hand, recent events have shown that not all WTO members start a procedure at the WTO Dispute Settlement Body before imposing trade measures and, on

Notes

²⁵ The declarant's EORI number, the CN codes, the amounts, the country of origin of the basic materials, the declaration date and the customs procedure.

²⁶ It is, of course, hardly surprising that countries have reacted to the CBAM proposal; indeed, the EU had expected this and had in fact already performed a political assessment of possible reactions by its main trading partners; see Briefing of the European Parliament, Political Assessment of Possible Reactions of EU Main Trading Partners to EU Border Carbon Measures, PE 603.503 – Apr. 2020.

²⁷ If we exclude the territories for which an exception applies, the 10 exporting countries most affected are Russia, Turkey, Ukraine, United Kingdom, China, South Korea, India, Egypt, Belarus and Morocco. This top 10 is based on a combination of the statistical data included in figures 10-1 to 10-4, Commission Staff Working Document Impact Assessment Report, Accompanying the document Proposal for a regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism, 14 July 2021, SWD(2021) 643 final.

²⁸ The CBAM will impact on Russia the most. Importers of Russian basic materials are expected to face CBAM costs of 442 million euros in 2023 (the first year of paying for emissions under the CBAM) and roughly 1.9 billion euros in 2035 (the end of free allocation); see A. Assouf, T. Burns, B. Tsang, D. Vangenechten & B. Schäpe, *A Storm in a Teacup: Impacts and Geopolitical Risks of the European Carbon Border Adjustment Mechanism*, Sandbag report (2021).

²⁹ Cristina Brooks, *Trade Experts Positive on EU's CBAM, Despite Risk of Rich Nation-Poor Nation Rift*, IHS Markit, <https://ihsmarkit.com/research-analysis/trade-experts-positive-on-eus-cbam-despite-risk-of-rich-nati.html> (accessed 17 Nov. 2021).

³⁰ China says EU's planned carbon border tax violates trade principles, *Reuters* 26 July 2021 (<https://www.reuters.com/business/sustainable-business/china-says-ecs-carbon-border-tax-is-expanding-climate-issues-trade-2021-07-26/>) (accessed 17 Nov. 2021).

the other hand, the WTO Dispute Settlement Body is still not functioning to the best of its abilities, given the United States' continued blocking of appointments of new judges to the Appellate Body. While the third group of countries is also not necessarily in favour of the CBAM, rather than taking trade measures these countries are currently designing their own domestic carbon levies, with the aim of being included in Annex II of the CBAM proposal, which lists the territories excluded from the CBAM. In this regard we refer also to section 4.6.3, where we mentioned that forty-five national and thirty-five regional governments currently levy a certain form of carbon tax.

The EU CBAM may then be an accelerator and a blueprint and give other countries the confidence to introduce mechanisms similar to the CBAM. Canada, for example, puts a carbon price on goods produced in Canada and is now considering expanding the existing system to include imports.³¹ Based on the inquiries opened by the UK Parliament's Environmental Audit Committee on 24 September 2021, the UK also seems to be exploring whether or not to introduce a CBAM.³² Meanwhile, some countries that are publicly against the EU CBAM and have even threatened to take trade measures (i.e., countries in group 2) are also considering introducing systems closely aligned to the EU ETS so as to ensure recognition by the EU and thus inclusion in Annex II of the CBAM proposal (i.e., countries in group 3). Russia and China, for example, have regional ETS pilots running that have been designed in line with the EU ETS. And although Turkey does not currently have a domestic carbon pricing scheme, it already has a legal and institutional framework for cooperation with the EU in place that allows it to access the EU market relatively easily.³³

6 CONCLUSION

The CBAM proposal is the most far-reaching part of the European Commission's green strategy and has already caused quite some commotion. We are now waiting for the delegated and implementing legislation, which will undoubtedly provide more details. That being said, however, the proposal will first need to be put to the Council and to the European Parliament, both of whom may make changes. It will be particularly interesting to see whether the proposal and the system envisaged for the CBAM will be approved by the Council. Matters may well progress more smoothly if unanimity is indeed not required. The question also arises as to how countries not included in Annex II will react, and which conditions they will have to meet if they are to be included in this Annex. Also, there is the question of whether and to what extent the proposal accords with WTO rules and specifically the General Agreement on Tariff and Trade 1994 (GATT 1994). We have not discussed this aspect in this contribution, although it has been claimed in the literature on the subject that this should be possible, subject to stringent conditions, and as an exception.³⁴ Lastly, it should be noted that the CBAM proposal does not include export refunds for EU producers subject to the EU ETS exporting to countries not included in Annex II (and thus not having sufficient measures against carbon emissions). Such a measure would be complicated to implement, while probably running contrary to the GATT 1994 as an illegal export subsidy.³⁵

Notes

³¹ A. Arko, *A Canadian Border Carbon Adjustment? GATT Compliance and Underexplored Exceptions*, GTCJ, 9 (2021).

³² <https://committees.parliament.uk/work/1535/carbon-border-adjustment-mechanism/> (accessed 17 Nov. 2021).

³³ C. Kardish, M. Mäder, M. Hellmich & M. Hall, *Which Countries Are most Exposed to the EU's Proposed Carbon Tariffs?*, Resource trade earth (20 Aug. 2021), <https://resourcetrade.earth/publications/which-countries-are-most-exposed-to-the-eus-proposed-carbon-tariffs> (accessed 17 Nov. 2021).

³⁴ See in that respect, J. Englisch & T. Falcão, *EU Carbon Border Adjustments for Imported Products and WTO Law*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3863038 (accessed 17 Nov. 2021); A. Dias, S. Seeuws & A. Nosowicz, *EU Border Carbon Adjustment and the WTO: Hand in Hand Towards Tackling Climate Change*, (1) Global Trade & Cust. J. 15–23 (2020); M. O. Moore & Edwin Vermulst, *Carbon Safeguard? Managing the Friction Between Trade Rules and Climate Policy*, (1) Global Trade & Cust. J. 43–66 (2017).

³⁵ See for example on subsidies in general the website of the WTO: https://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm8_e.htm#subsidies and specifically on export subsidies in agriculture: https://www.wto.org/english/tratop_e/agric_e/factsheetagric17_e.htm (accessed 17 Nov. 2021).