

Position Paper

Carbon Border Adjustment Mechanism (CBAM)

Significant technological advances and a comprehensive and well-balanced enabling policy framework will be necessary to ensure that the transformations the industry has already embarked upon to reduce its GHG emissions become fully effective, at a level that will be a game-changer for achieving the climate neutrality 2050 European goal.

In that journey, it is key that the European industrial competitiveness, both on the domestic market and in export markets, be safeguarded as long as climate protection measures are taken at different pace across the planet.

For many years now, such industry competitiveness and the risk of carbon leakage has been addressed by particular provisions of the EU ETS, through the granting of free allowances and the possible compensation by Member-States for the increase in electricity costs. Despite these measures, the plastics industry has suffered from a worsening net trade balance in the last years (for main polymers).

To achieve its climate ambitions, the EU Commission aims at reducing free allowances, strengthening the carbon price signal for EU actors but increasing at the same time the difference with countries without carbon pricing mechanisms. In addition, the plastics industry has recently seen most of its productions excluded from the list of activities that could benefit from indirect compensations. It is therefore key that new mechanisms allow the competitiveness of the EU plastics industry be safeguarded and risk of carbon leakage minimized.

Carbon Border Adjustment Mechanism (CBAM)

In its Fit for 55 package published on 14 July 2021, EU Commission proposed a Carbon Border Adjustment Mechanism (CBAM) to pursue the overarching objective of addressing the risk of carbon leakage in order to fight climate change by reducing GHG emissions in the Union and globally. This mechanism requires EU importers of certain products to register and buy CBAM certificates, of which the price will be based on the embedded direct emissions of the imported quantities and on the CO₂ EU pricing. It aims at ensuring that imported products are subject to a regulatory system that applies carbon costs equivalent to the ones that otherwise would have been borne under the EU ETS. For the products benefiting from CBAM, free allowances currently granted by ETS would be progressively phased out until complete deletion by 2036.

Initial short list of products to which CBAM would apply are those considered as representing the largest sources of GHG emissions in Europe and being at highest risk of carbon leakage: cement, iron & steel, aluminum, fertilizers (ammonia, urea, nitric acid, ammonium nitrate) and electricity.

Our views

Even if polymers are not in the scope proposed by the EU Commission, they could be considered in a later stage; in addition, certain polymers using some products of the current list as raw materials, such as ammonia, can be impacted by the proposed mechanism in its initial scope.

While we welcome the EU Commission's willingness to address the issue of competitiveness of the EU industry and risk of carbon leakage, we think that the proposed mechanism does not fully meet the requirements of the European plastics industry, for the following reasons:

- For the products in the scope of CBAM, the progressive phase-out of free allowances will lead to an increased cost of these products but also of all their downstream products, when produced in the EU.
 - CBAM addresses the competitiveness of EU products on the EU market (ie versus identical products imported in EU from outside-EU) but not for export markets (ie versus similar products produced outside EU and that will not bear additional costs when sold outside EU).
 - While CBAM enables to compensate the cost increase for products in its scope, competitive distortion will remain on downstream products that are as well impacted by a higher CO2 pricing. For these downstream products, imports in EU could be preferred to local production and EU production be less competitive on exports markets. Downstream value-adding stages could be motivated to relocate production outside the EU in order not to be displaced by foreign competitors.

As far as plastics industry is concerned, ammonia and nitric acid are important raw materials for the production of some plastics, including polyamides, whose competitiveness could therefore be reduced on the EU market as well as for export markets.

After the phase out, the CBAM sectors would then have to bear the full CO2 costs, which would severely limit the financial ability of companies to invest in low-carbon technologies.

- The current CBAM proposal only applies to direct emissions, while important parts of the plastics production, such as for PVC production, are powered by electricity, where the power sector's marginal carbon emission costs are passed into the electricity bills to plastics producers. These indirect emission costs contribute to a higher cost for the European plastics industry and would increase the carbon leakage risk if they were not considered for the setting of the CBAM for competing imported products. This challenge will grow when electrification plays an increasing role in reducing industry's direct emissions.
- The CBAM proposal based on products, aims at mirroring the EU ETS based on installations and therefore requires complex conversions for affected products, significant data requirements, bureaucracy, and controls - in the EU and globally.

- The proposed verification system must effectively minimize circumvention risks that reduce the effectiveness of CBAM as a carbon leakage protection tool. However, only vague mechanisms are enshrined in the draft that would prevent circumvention of the regulations. This makes the instrument vulnerable to circumvention strategies. It is also questionable how, in practice, the relevant data for determining CO₂ emissions can be collected without foreign producers (justifiably) being concerned about the adequate protection of their proprietary data.
- Disadvantages for importers, processors and exporters burden EU trade with other parts of the world - with the possible consequence that other continents gain competitive advantages over EU.
- In addition, the threat of different CBAM systems co-existing at global level, each with its own approach and bureaucracy, should be avoided at all costs.

Recommendations

The CBAM approach proposed by EU Commission, closely connected to the ETS system, only partially creates a level playing field between European producers and importers of the whole plastic value-chain. It does not entirely fulfil the needs of the plastics industry, characterized by complex value-added networks, co-production, a high export share and a significant use of electrical power likely to increase further.

In order to make it suitable for plastics, the CBAM current proposal should be reviewed to address the issue of shifting the carbon leakage risk to downstream value chains, the lower competitiveness of European industry on exports markets, as well as on the European market when it comes to products significantly impacted by indirect emissions. In addition, as CBAM is aimed at replacing the ETS system for the products in its scope, it is key to ensure that CBAM works properly and ensures at least the same level of protection as the existing system. Therefore, the new system should ensure a sufficiently long and smooth transition for the full and sole application of the CBAM, which should allow for a progressive and WTO-compliant phase out of free allowances currently granted by the ETS.

Only at these different conditions, we believe that the ongoing transformation to climate-friendly products and production processes can succeed at pace and at scale without significant losses in the competitiveness of European industry and damaging trade conflicts.

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