ROUND TABLE
ON SUSTAINABLE DEVELOPMENT

Border Carbon Adjustments: What shape in the post-COVID geopolitical and economic landscape?

Summary of the 40th Round Table on Sustainable Development[1]
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The 40th Round Table on Sustainable Development followed a previous discussion on border carbon adjustments (BCAs) held in February 2020. Thirty-nine high level participants[2], including six current and former ministers, one deputy minister and two state secretaries, along with experts and other stakeholders from the public and private sector, academia and the international arena, discussed features and possible implications of a Carbon Border Adjustment Mechanism to be proposed by the EU. Other policy measures aimed at mitigating carbon leakage in a context of growing ambition to tackle climate change were also discussed. Due to the COVID-19 pandemic, the meeting was conducted as an online videoconference, which allowed for both verbal debate and parallel exchanges in the chat window.

Border carbon adjustments (BCAs) are receiving increased attention as a potential policy tool to support climate and environmental objectives between trading partner countries. The European Green Deal has intensified discussion on whether BCAs could complement measures already in place under the EU Emissions Trading System (EU ETS). Many countries are stepping up commitments to ensure a green recovery from the COVID-19 crisis and take more ambitious climate action, with more concrete plans to reduce emissions, as evidenced by recent announcements by the Japanese Prime Minister and the Korean government, as well as ongoing discussions in other major economies, notably in the US Congress. The specificities of measures to be introduced differ according to countries' income level, geographical location and regional trade.

BCAs come with pros and cons. In the context of accelerating climate ambition in some countries and a divergence in effective carbon prices, BCAs can help tackle the growing risk of carbon leakage. At the same time, limited real-world experience and complexity of implementation mechanisms have raised concerns over "climate protectionism" and potential incompatibility with World Trade Organization (WTO) rules.

The economic impact of BCAs and reactions from affected trading partners will depend on the actual carbon price implicit in the mechanism as well as on a number of design features. These include whether and how climate policies in countries outside a BCA are considered, product scope and use of revenues.

A number of alternatives and complementary measures to BCAs are also being considered. In particular, there is growing interest in trade agreements that include climate commitments and other possible multilateral measures.

The Round Table discussion centred on the following three questions, which led to vivid exchange of views:

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[1] This summary does not reflect the views of the OECD Secretariat or its member countries. It is prepared under the authority of the Chair of the Round Table on Sustainable Development. The European Climate Foundation's support of the 40th Round Table on Sustainable Development is gratefully acknowledged.

[2] Forty percent of the meeting participants were women.

- In the current geopolitical and economic context, what are the prospects for BCAs and possible complementary and alternative environmental measures to foster increased ambition on climate globally by limiting carbon leakage?
- What specific design features (sectors, countries, scope) would best achieve the goals of BCAs while ensuring their acceptability and avoiding their being perceived as an extra territorial fiscal or competitiveness measure?
- What are the possible uses for BCA revenues and how could they help achieve environmental goals while addressing the possible challenges to the agreement and implementation of BCAs?

A background note that supported the discussion is available here. A more detailed paper prepared by the OECD Secretariat ("Climate Policy Leadership in an Interconnected World: what Role for Border Carbon Adjustments?"), which reviewed the technical and legal specificities around BCAs and other alternative instruments, was shared with meeting participants.

Main messages

- **Climate change is a global challenge that requires a global response**. Many countries are prioritising a green recovery, including measures to achieve carbon neutrality, but there is still a long way between agreeing on the goal and the means for achieving it. Adequate carbon pricing is far from reality, and as climate ambition accelerates, so does the risk of carbon leakage.
- **BCAs are a possible tool for tackling carbon leakage**. They are one policy option in the toolkit for achieving carbon neutrality. BCAs require careful consideration of a number of design features, including product scope and use of revenues. Initial application to a small number of energy-intensive sectors would facilitate their implementation.
- **They are one of multiple possible measures.** For some participants, BCAs are not necessarily the most efficient way to tackle carbon leakage, though they could provide a "carrot and stick" approach if introduced as an intermediary measure in combination with other policy measures. BCAs could serve as a transitory measure until a globally acceptable solution is found.
- **BCAs raise a number of concerns**. Participants identified various risks regarding the design and implementation of BCAs, in particular regarding measurement, reporting and verification of embodied carbon, WTO compatibility, and ability to contain carbon leakage. From a macroeconomic perspective, the main concern was that BCAs could be seen as a punitive measure rather than an incentive (hence as a non-tariff barrier), negatively impacting global trade and economic growth. The introduction of BCAs could also affect progress on ongoing climate discussions, including in a UN and G20 context. Any BCA would require a co-operative approach at the international level to avoid exacerbating trade tensions.
- **BCA design requires careful assessment, international dialogue and a co-operative approach**. Given their impact on trading partners, the introduction of BCAs should be preceded by an international dialogue to discuss their design, implementation, potential consequences and use of revenues, as well as a thorough evaluation of possible alternatives, to improve their political acceptability. BCAs also need to overcome feasibility issues and address concerns regarding compliance with international and regional rules.
    - Some participants argued that BCAs would need to be sector-neutral in order to avoid high compliance and emissions costs for parts of the industries concerned. However, a sector-specific approach focused initially on a few energy-intensive and trade-exposed sectors would be easier to implement.
    - A sectoral approach would need to guarantee a level-playing field. Export rebates may need to be reconsidered. Any approach would need to consider application for imports, both from the side of guaranteeing "green" imports/exports and avoiding double taxation, in case imported/exported products have already been priced at the source (country of origin); as well as from the side of supply security for importing countries.

- A pricing mechanism based on absolute costs could bring about inequalities between countries of different income levels and should be avoided.
- Existing alternative pricing mechanisms to BCAs in different parts of the world may render BCAs inessential, as long as these sector-based mechanisms are complementary or comparable.
- A life-cycle approach to measuring embodied carbon could be an effective way of addressing limits to existing mechanisms.

- **Revenues from BCAs could be targeted to both domestic and international climate and environmental actions**. Countries affected by carbon leakage, where technological transformation would be necessary to maintain production activities, are a natural candidate for domestic use of revenues. But revenues could also be used internationally to support areas highly affected by the low-carbon transition (e.g. developing countries, mining regions), increasing the political acceptability of BCAs.
- **BCAs need to take into account both WTO rules and Paris Agreement mechanisms under Article 6**. For some participants, mechanisms established under Article 6 combined with domestic carbon markets in emerging economies could remove the need for BCAs and potentially reduce their legitimacy. Commencing discussions on a new measure while current discussions on carbon markets and pricing are ongoing could jeopardise negotiations.
- **Climate policies are not the only policies that need to be WTO compatible.** Trade policies must also take up the climate imperative. One participant summarised this as "a BCA must be WTO compatible, but the WTO must also be climate compatible". A revision of WTO rules might be necessary to help unlock the current standstill.
- **A "coalition of the willing" could lay the ground for more collective and ambitious action, in compliance with WTO rules**. For those supporting an intermediary solution, measures such as BCAs were seen as having the potential to motivate third countries to act on climate change objectives without production shifts to countries without carbon reduction policies. Therefore, any BCA system needs to be transferable and complementary to existing national emissions reduction strategies and measures. If political will exists, the technicalities – albeit complicated – could be agreed upon. A BCA system could also provide opportunities for developing countries to exploit renewable resources.
- **Emissions trading schemes (ETS) remain an important tool to support the transition to a low-carbon economy**. A number of countries have introduced emissions trading schemes, though some have been inefficient in stopping carbon leakage or reducing CO_2 emissions, as seen in specific sectors. While there is no evidence for significant leakage due to the EU ETS to date (with some specific exceptions), several participants pointed out that this may change as prices rise in future. A revision of free allocations and indirect compensations to enhance minimising the risk of carbon leakage was viewed by many as the best way forward. If BCAs are introduced, they would need to be coherent with ETS. At the same time, if more of the major emitters introduce a minimum carbon price and roll out ETS, the need for BCAs will be reduced.

<u>Suggestions for next steps</u>

Round Table participants acknowledged that the issue of border carbon adjustments was important and timely, but contentious. During the meeting, varied and sometimes differing opinions were expressed by representatives of different sectors and regions of the world.

The following possible next steps are proposed:

- Better and more analytical calculation of carbon leakage is necessary to measure the scope of the problem and project the consequences of both action and inaction. Accounting for non-price policy measures in other countries is also important. The OECD could provide analytical support in this area, including for specific sectors.
- If BCAs are introduced as a multilateral and transitory measure, there will be an urgent need for discussions and negotiations at the highest political level. The OECD could facilitate discussions on

better aligning climate and trade policies (including potential WTO developments), bringing together stakeholders of opposing views in an attempt to dilute inconsistencies and form consensus on next steps.

By conducting this meeting virtually, 30.39 metric tonnes of carbon emissions were saved. This is equal to:

- 3,420 gallons of gasoline consumed
- 33,486 pounds of coal burned
- 3.5 homes' energy use for one year
- 5 homes' electricity use for one year
- 70.4 barrels of oil consumed
- 3,875,704 smartphones charged

To sequester the same amount of emissions, 503 tree seedlings would need to grow for ten years.

Source: Carbon Footprint (2020) Carbon Footprint Calculator: https://calculator.carbonfootprint.com/calculator.aspx?tab=8