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ACEA Position Paper

Carbon Border Adjustment Mechanism

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INTRODUCTION

The members of the European Automobile Manufacturers' Association (ACEA) have a substantial stake in ensuring that the design of any carbon border adjustment mechanism (CBAM) has a minimal impact on the competitiveness of European manufacturing. ACEA believes that the system should be as equitable, predictable and burdenless as possible. At the same time, it should of course be capable of achieving its environmental goals.

European motor vehicle manufacturers are committed to making mobility climate neutral by 2050, in line with the objectives of the Paris Agreement. As part of that approach, many vehicle manufacturers have set ambitious targets to achieve net-zero carbon output by the end of the next decade.

Europe's automobile industry is already subject to the Emissions Trading System (ETS), given that many of its manufacturing facilities as well as those of its suppliers are regulated by it. The influence of the ETS on the industry will increase as Phase IV progressively removes free allowances from the system and the value of carbon certificates increases.

Our industry has a global sourcing strategy that depends fundamentally on an economic policy allowing for open and fair trade. Free movement of goods with limited barriers to trade is a vital component to the success of the EU automobile sector. This is relevant both to the import of materials and parts into the EU to allow for competitive, sustainable and innovative manufacturing, as well as to the export of finished vehicles to global markets.

With respect to the decarbonisation of fuels and the set-up of the CBAM, besides other policy measures put in place, all energy carriers need to be part of a stronger EU ETS to ensure the decarbonisation of the transport sector as a whole. This will be instrumental in decarbonising Europe's current vehicle fleet through all energy carriers (electricity, liquid and gaseous fuels, hydrogen, etc) and in pushing carbon to a price level that starts to drive real change.

KEY PRINCIPLES FOR CARBON BORDER ADJUSTMENT

Europe's objective to meet ever more ambitious environmental targets brings with it higher costs for meeting compliance requirements and rising CO2 prices. This expense creates risk; in particular the possibility of carbon and/or investment leakage. It could also lead to distortions in the level playing field within the single market if imports of comparable products made outside of the EU are not subject to similar environmental policy requirements.

These issues must be addressed to ensure that goods coming into the single market do not benefit from such a competitive advantage, and that businesses in Europe – faced with higher operational costs – do not resort to moving production or manufacturing out of the EU.

The European Commission has made clear that it intends to address this risk by applying an adjustment mechanism as part of its policy to counter climate change and to deal with the imbalance between domestically-produced and imported goods.

ACEA believes that, should such a system come into force (and without advocating that a CBAM is the correct way to address this imbalance), it must have some key principles at its core. Specifically, it should:

1. Consider very carefully the **impact on European manufacturing** and strive to minimise this to the greatest extent possible.
2. Ensure that it is **transparent and fair** in the level of equivalency it applies.
3. Be **manageable** in the level of complexity it creates.
4. **Avoid retaliatory measures** by third countries.

With these broad principles in mind, our priorities in the design of any carbon border adjustment mechanism are the following:

- **Competitiveness of European manufacturers**. We assume that, by its nature, such a mechanism will create both an administrative and financial burden for businesses that use imported goods in their manufacturing. Both burdens should be kept to a minimum.

  The competitiveness of European manufacturers on domestic and export markets needs to be considered very carefully. If such a mechanism injects further costs into our supply chain, then it will have a knock-on effect on the profitability of our members and/or on the ultimate costs for consumers. In particular, if CBA is applied to several different primary materials (even in just an initial phase) – such as steel, aluminium and certain chemical substances – then its cumulative impact will be strongly felt in sectors such as automotive.

Furthermore, if the measure is extended along the value chain to imported goods which use these primary materials in their manufacture, then this would also apply to parts used in automotive, possibly up to the level of the vehicle itself. Any such measure would have obvious implications for our sector.

It is critical that the European Commission's impact assessment **analyses the potential cumulative impact on our sector**. It should examine whether it will make European manufactured goods less competitive on domestic and export markets, and how such a competitive handicap can be reduced to the absolute minimum.

Concerning the design of the mechanism, the preferred solution for the automobile sector would be a **system placed at the EU border** that ensures that adjustment measures are applied before goods enter the customs territory of the Union. This would mean that purchase contracts could be concluded with third-country suppliers with the full cost of adjustment apparent to the EU-based buyer from the start. The goods would then be delivered with these costs already paid. This would limit the administrative burden on manufacturers and provide a higher level of transparency and predictability.

Nevertheless, European manufacturers would still have to carry the cost of border adjustment, as it will be passed on to them by the importer. The cost of the adjustment should be reasonable. It should be broadly equivalent to the actual costs incurred by European producers and enough only to ensure an economic level playing field.

- **WTO compliance**. The introduction of a carbon adjustment mechanism would have to be fully compliant with World Trade Organisation rules. It is critical that, whatever the design of the system, it is in keeping with Europe's multilateral commitments, including the Paris Agreement, and is robust enough to stand up to legal challenge.

  This means that such a mechanism must be non-discriminatory and proportional.

In this respect, it is also important that the EU **engage as much as possible with third countries** at a political level to ensure that the goals of such a measure are clearly understood. They should not be open to misinterpretation as a protectionist move to assist under-pressure sectors by shielding them from foreign competition. Should third countries seek to retaliate against such measures, the risk to the EU's global businesses like those in the auto sector is clear.

Particular care should be taken to ensure that any measures are in full compliance with bilateral commitments that the EU has made in the context of its extensive network of **third country FTAs**.

- **Gradual and measured application**. The system should be applied first in a limited way and in certain specific sectors – logically those most at risk of carbon leakage. Only after it has been successfully deployed in those sectors should it be scaled up and applied to others.

  Both exporting producers from third countries and their European trading partners need to have sufficient advance notice on how the system will operate and what costs it will generate. Reaching a level of equivalence in terms of costs should happen over a period of time. Global supply chains, some built up over decades, should be given time to adjust. In our sector for example, contracts for the supply of goods typically vary between 5 to 9 years. Border adjustment has not been factored into existing contracts and cannot be until there is a much clearer picture of how such a mechanism will operate and the cost it will create for imported carbon.

  Securing a level playing field must also respect the legitimate expectations of traders. It would not be equitable to apply the full cost of adjustment in one step and/or without sufficient notice.

- **Coverage**: The application of adjustment measures to imported primary materials only could result in circumvention through the export of further processed or manufactured goods with the same primary product to the EU. The complete value chain of all goods manufactured using the primary material to which border adjustment applies should be considered to avoid shifting the issue from one point in the value chain to another. As already noted, however, such complete value chain coverage will add further cost and significant complexity to the system.

It would, for example, create many concerns about the ability to correctly calculate the carbon content of goods manufactured in third countries. The calculation of the carbon content of goods that are derivatives of products subject to border adjustment measures should be based on a reasonable method, which is standardised and transparent to all stakeholders.

Ultimately any instrument should secure equal treatment of European and non-European products regarding their CO2 footprint.

- **Exemptions at country level**. Where third countries implement environmental policies that achieve a CO2 output cost comparable to that of the European Union, then exporting producers from that country should be allowed an exemption from the adjustment measures. It is important to ensure equitable treatment for goods that are already subject to similar compliance requirements to those in the EU, to avoid that producers from those countries effectively pay twice. Such exemptions would incentivise more ambitious environmental targets in third countries. As effecting change in such policy must be a primary goal of border adjustment, rewarding similar levels of ambition with exemptions should be allowed.

- **Reductions / exemptions at an individual producer or installation level**. European manufacturers are investing significantly in carbon neutrality and sustainability throughout their supply chain. Many automobile manufacturers, for example, have highly ambitious targets to deliver carbon neutral supply chains by the end of the next decade. Non-European suppliers of European motor vehicle manufacturers will also be expected to contribute to these targets by delivering goods to carbon neutral specifications. In this way, compliance will also have a cost for third country suppliers in our sector. The Commission should consider the possibility for third country producers to receive carbon price reductions or exemptions, where applicable. Such treatment would need to be audited and certified by competent, independent third parties in a cost-effective manner.

  Allowing for exemptions when specific exporting producers or their installations reach a compliance level equivalent to the benchmarks in place in the EU could also help counter arguments that border adjustment is motivated by a protectionist impulse.

- **Effect change**. Ultimately, the goal of the border adjustment mechanism should not be just to rebalance the cost of compliance between EU domestic and third country producers, but to also effect change in third country environmental policy.

The European Union should continue to take the lead in international cooperation on climate matters. It should support efforts for an international or global ETS, ideally a system aligned and integrated between our major trading partners, in order to more radically and equitably address the complexity of the costs involved in carbon reduction.

CONCLUSIONS

European motor vehicle manufacturers are committed to making mobility at first carbon neutral and then, ultimately, climate neutral by 2050. ACEA supports policies and instruments that can help achieve these goals.

At this stage there are many critical unknowns in terms of the design and application of a carbon border adjustment mechanism, how it would impact key EU industries such as automotive, and how it would be received internationally.

If implemented, the mechanism should adhere to a number of key principles. It should **minimise any impact on the competitiveness** of European automobile manufacturing; ensure **transparency and fairness** in the level of equivalency it applies; be **manageable** in the level of administrative burden it creates; and **avoid retaliation** from third country trading partners.

Only if all these key principles are respected should the EU endeavour to apply a CBAM.

ABOUT THE EU AUTOMOBILE INDUSTRY

- 14.6 million Europeans work in the auto industry (directly and indirectly), accounting for 6.7% of all EU jobs
- 11.5% of EU manufacturing jobs – some 3.7 million – are in the automotive sector
- Motor vehicles are responsible for €398.4 billion of tax revenue for governments across key European markets
- The automobile industry generates a trade surplus of €74 billion for the European Union
- The turnover generated by the auto industry represents more than 8% of the EU's GDP
- Investing €62 billion in R&D per year, automotive is Europe's largest private contributor to innovation, accounting for 33% of the EU total

REPRESENTING EUROPE'S 15 MAJOR CAR, VAN, TRUCK AND BUS MANUFACTURERS

ACEA
European Automobile
Manufacturers' Association
+32 2 732 55 50
info@acea.auto
www.acea.auto

twitter.com/ACEA_auto
linkedin.com/company/acea
youtube.com/c/ACEAauto