

Principles and Best Practice in Border Carbon Adjustment:

A modest proposal

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This brief offers a preview of [Trade and Sustainability Review, Volume 1, Issue 4](#), which will feature commentary and analysis on the WTO's Twelfth Ministerial Conference.

Border carbon adjustment (BCA) is coming; it is no longer just a controversial hypothetical. As described in our recent report, the European Commission has proposed implementing a BCA mechanism by 2023, Canada has launched formal consultations on the shape of its own regime, and the United States and the United Kingdom have both vowed to follow suit.

More countries will probably follow as climate ambition becomes more meaningful. Sixty-three parties of the United Nations Framework Convention on Climate Change, representing 54% of global GDP, have [communicated a target of net-zero](#) to the Secretariat. Seven have put that target into law. Canada has a [legislated carbon price](#) rising to USD 140/tonne by 2030. The European Green Deal is credible enough that in early September 2021, the price of European Union emission allowances set [new records](#) at more than EUR 60/tonne—almost double their price from seven months earlier.

There is a direct link from that heightened ambition to BCA. Addressing climate change almost certainly means imposing substantial carbon costs on energy-intensive trade-exposed sectors such as steel, cement, aluminum, and chemicals. However, no country is willing to do that domestically if it simply means shifting greenhouse gas (GHG) emissions to competing sectors in other countries.

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So the inevitable partner to climate ambition is some sort of protection against leakage—that is, the increase of emissions abroad in response to strong domestic climate policies. And while BCA may be imperfect, complex, legally questionable, and politically explosive, it is also primary among the options for that sort of protection.

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BCA works by charging goods at the border a carbon price equivalent to what they would have paid had they been produced under the domestic carbon pricing regime. But that basic function can manifest in very different regimes, depending on the choice of design elements. The European Commission's proposed regime is starkly different from the most recent BCA proposal in the United States, the FAIR Act.¹ This is in part because of very different underlying climate regimes but also because of different choices on features, including crediting for foreign climate action.

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The variety of possibilities means that **any BCA regime will be situated along a spectrum that ranges from purely environmental in nature to highly protectionist**. As such, some have argued that there would be tangible benefit to international agreement on principles and best practice in elaboration and implementation of BCAs. Such an agreement might provide a bulwark against national protectionist pressures during the policy-making process, in the same way that multilateral trade rules now do.

Some will argue that such agreement amounts to legitimizing a tool they would rather never see put into practice. But the point is that it probably will be put into practice and, if so, there's value in guidance to make it as good as it can be.

Others may prefer a reactive strategy, taking any BCA to World Trade Organization (WTO) dispute settlement. But this course has its drawbacks. It would set the dispute settlement mechanism up for a highly divisive outcome; it would test a system that is currently broken, without a functioning Appellate Body; it would likely take years to resolve; and in the uncertain event that the complainant(s) won, the respondent would be strongly motivated to look for ways to avoid changing the offending measures, given the urgency of climate objectives.

¹ The *Fair Transition and Competition Act*, introduced by Senators Chris Coons and Gary Peters to the 117th U.S. Congress on July 19, 2021.



What follows is a list of proposed principles and best practices for the elaboration and implementation of BCAs. They are proposals only, designed to illustrate concretely the sort of agreement that might be reached through international discussions.

Principles

- **Primacy of leakage protection:** BCA should seek to prevent leakage—an environmental objective that involves enabling domestic climate ambition. It should not aim to preserve or increase the competitiveness of domestic firms,² as we have multilateral agreements to refrain from using trade measures to that end. Nor should BCA be used to coerce other countries to enact more ambitious climate policies; judging the adequacy of other countries’ climate ambition is not the prerogative of any one country.
- **Revenue sharing:** A significant portion of the revenue from a BCA should be rebated to exporting firms or countries, for example, by lowering producers’ costs to comply with the BCA regime.
- **No double protection:** BCA charges on foreign goods should be adjusted downward to account for any domestic measures that shield covered sectors from a full carbon price. Only the *effective* carbon price should be levied on imports. Failing to do so involves unfair double protection for domestic producers.
- **Credit for equivalence:** BCA should grant credit for effective carbon prices already borne by foreign goods in the country of export, as such carbon pricing reduces the risk of leakage. It should not grant credit for non-price foreign policies, assuming the border “adjustment” is to compensate for domestic price-based policies; the two types of policies are not equivalent.
- **Openness:** There should be meaningful and timely consultation on draft regulations with affected trading partners, and full transparency of the regime’s implementation and operation.

Best Practice in Elaboration and Implementation

- **Coverage:** BCA should only cover goods that are subject to domestic carbon pricing.
- **Challengeable assumptions:** If a default is used to determine the GHG intensity of foreign goods, foreign producers should be able to challenge that default by submitting actual data.
- **Downstream sectors:** BCA coverage should be extended to downstream sectors only if they face a risk of leakage equivalent to the thresholds used to qualify upstream sectors for coverage.
- **Exemptions:** There should be no national exemptions from BCA coverage based on national policies (e.g., based on the level of ambition in climate policies). As noted

² Preventing leakage will preserve the competitiveness of domestic firms in the face of carbon pricing. The argument here is that while preserved competitiveness may be a result, it should not be an objective.



above, no country has the prerogative to unilaterally judge the adequacy of other countries' climate ambition.

- **International standards for data:** GHG intensity data should be required in terms of an internationally recognized accounting regime, such as the GHG Protocol or ISO 14064. Ideally, all countries with BCAs that required such data would agree to the use of a single reporting standard.
- **Mechanisms for appeal:** There should be independent mechanisms to appeal any decisions or judgments taken under the BCA regime with respect to foreign producers or goods.

The ideal forum for discussion on principles and best practice would be a multilateral one that includes the voices of both those proposing BCA and those potentially affected by it. The WTO would seem to fit that bill.

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But to be clear: what's being proposed here is not a negotiated, binding consensus agreement among WTO members. Such an ambition is neither realistic nor useful. More appropriate might be discussion in an informal working group or, if necessary, in a forum parallel to the official WTO processes. The former has been [used to good effect in the past](#) when it's been given a concrete timeline and agreed set of deliverables.

But any such process would need to be accelerated. It is probably already too late to inform the EU's policy-making process, and the rush to greater climate ambition in other countries is being intensified by the increasing evidence of climate impacts and the resulting pressure on policy-makers to act.

A starting point might be at least raising the issue as a shared concern at the WTO's upcoming Ministerial Conference in November 2021 (MC12). This might come, for example, in [the statement currently being drafted](#) for the conference by a group of WTO members that have been meeting in so-called Trade and Environmental Sustainability Structured Discussions. That group [convened discussions on BCA](#) at its first meeting in March 2021 and could reference those talks as a way to get the issue on the table and recommend further work within the WTO proper.

The pace of developments in this policy space are such that MC12 is a crucial moment for WTO members to begin useful engagement on BCA—a policy tool that will have fundamental implications for the multilateral trading system.

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