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US PERSPECTIVES ON CARBON BORDER ADJUSTMENT MECHANISMS

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The European Union is set to become the first regional bloc to implement a **carbon border adjustment mechanism (CBAM)** as a tool to mitigate the threat of carbon leakage. In doing so, the CBAM is taking centre stage in global discussions on climate and trade. The EU has plans to impose this policy on countries that do not have a price on carbon or where the price is lower than in the EU. Since the US does not have carbon pricing at the national level, covered imports from the US are expected to be subjected to the mechanism, at least to some extent.

On the EU's CBAM

The final proposal left space for the CBAM to implicitly account for regulatory ambition: **“when a country decides to reduce emissions through a regulatory approach, its goods would be subject to a lesser CBAM obligation when exported to the EU.”** The final text also leaves the door open for agreements with third countries as an alternative to the CBAM if they can demonstrate a high level of effectiveness and ambition on the decarbonization of a given sector. Considering that the US does not export a significant amount of the covered goods to the EU – steel, aluminium, fertilizers, cement and electricity - the CBAM initially is unlikely to have a huge impact on US industry.



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US CBAM Exposure: Percentage of total EU imports from the US for targeted industry ¹

Iron & Steel	Aluminium	Fertilizers	Cement	Electricity
1.2%	2%	2%	Less than 1%	0%

It's unclear where the US itself will land on implementing a domestic CBAM, with questions over how to design a CBAM without carbon pricing systems in place still unanswered. While carbon pricing is not a prerequisite, a price creates a common metric. However, CBAMs could be designed as tariffs on imports that do not meet embodied carbon content standards.

The US has already raised some concern over the EU's plans to implement a CBAM, but so far does not have an aligned position. After the first trip to meet with EU officials in March, **Climate Envoy John Kerry encouraged the EU to hold off on pursuing a CBAM** until after COP26. In June, Kerry seemed to see potential in using CBAMs to help with climate ambition, **"under the right circumstances and if designed properly"**. Meanwhile, US Trade Representative Ambassador Katherine Tai, who is responsible for the US response to the EU's CBAM hasn't taken a firm position. She warned in June she would **not rule anything out when asked if the US would retaliate against the EU for its CBAM**. When asked about a CBAM club, she commented that it was **"interesting" but needs further elaboration**. It's important to note the Section 232 tariffs on steel and aluminium are still in place on the EU, despite the recent **EU-US agreement to address the global overcapacity of steel**, which further complicates any discussion on CBAMs. Nonetheless, at the **G7 summit** and the **US-EU summit**, President Biden committed to working with leaders on addressing the risk of carbon leakage.. Since the release of the EU's CBAM, there has been little further reaction from the Biden Administration.

On a US CBAM

Shortly after the release of the EU's CBAM, US Senate Democrats included a **'carbon polluter import fee' in the budget resolution**, but provided few details. Senator Coons and Representative Peters introduced a CBAM bill that would place a tariff on the imports of aluminium, cement, iron, steel, gas, petroleum and coal starting in 2024. Knowing that the politics on carbon pricing are difficult in the US, the sponsors drafted the CBAM to be tied to the cost of compliance for

¹ Eurostat, 2019



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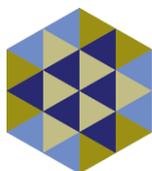
each sector from all federal, state, and local laws or regulations designed to reduce emissions, including everything from state-level carbon pricing schemes to fuel efficiency standards. The US proposal is not tied to carbon pricing, representing a major departure from the EU CBAM. The cost of compliance is then multiplied by the embedded emissions of the fuel or product. The bill leaves the option open for more sectors to be covered once reliable data is available. There are exemptions for least-developed countries and for countries that are at least as ambitious as the US and do not have a CBAM imposed on the US. The EU CBAM however does not offer exemptions. The legislation calls for the revenues to be used for the administration of the CBAM, research and development for decarbonisation technologies, environmental justice grants, community resiliency programs, transitional assistance for workers and support for small businesses.

Determining the cost of compliance for all laws and regulations down to the municipal level is expected to impose a high administrative burden on regulators since it is not anchored on a price on carbon. The sponsors hope to include their **bill in the upcoming infrastructure reconciliation package** that is currently being negotiated in Congress. The proposal has yet to receive the backing of President Biden.

The **Biden campaign climate plan** included reference to a “carbon adjustment fee or quota on carbon-intensive goods from countries that are failing to meet their climate and environmental obligations”. Many policies that are included in campaign plans are not necessarily implemented after elections. Earlier this year, in the **2021 Trade Policy Agenda**, Biden’s US Trade Representative included “the consideration of carbon border adjustments” alongside other climate provisions. Biden’s trade agenda for this year covered several environmental components, the line on CBAMs being a minor one. In May, Climate Envoy Kerry said President Biden tasked Administration officials to **explore the possibility of implementing a CBAM**.

The US nearly adopted a CBAM in 2009 as a part of the **Waxman-Markey cap-and-trade bill**, which passed the House of Representatives but failed in the Senate. The international reserve allowance program in Waxman-Markey would have required importers to purchase emission allowances from a separate pool to participate in the cap-and-trade program.

Since 2009, carbon pricing has largely fallen out of favour with many progressive stakeholders and decision makers for a variety of reasons, including the



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distributional impacts and concerns from the environmental justice community. There are still some think tanks, bipartisan coalitions and oil and gas companies that still push for carbon pricing, but it is now unlikely that the Biden Administration and Congress will pursue a comprehensive climate package that centres carbon pricing as the main tool in reducing emissions.

President Biden and Democrats in Congress are continuing to focus on other sector decarbonisation targets like decarbonising the power sector by 2035 through a Clean Energy Standard which is included in the **budget reconciliation resolution agreement framework**.

The US has taken a ‘carrot’ approach through investments and incentives for decarbonising industry instead of a strategy based on requiring deep emissions cuts. In December 2020, Congress passed **tax credits for carbon capture and sequestration** to incentivize industry to decarbonise. The reconciliation package is expected to include funding for research, development and demonstration of carbon capture retrofits for steel, cement and chemical production facilities. Considering that the Biden Administration is unlikely to target deep decarbonisation of industry through regulating emissions, it raises the question of what a CBAM would adjust for, as currently there would be no US industrial decarbonisation strategy that imposed costs to industry.

Alternatives to CBAMs

For several years, **labour unions in the US have supported CBAMs** to protect against carbon leakage and the offshoring of manufacturing jobs, which they still view as a condition to support climate policies targeted at industry decarbonisation. However, given that President Biden is pushing for a climate-focused infrastructure package, some stakeholders are supporting a measure known as **‘Buy Clean’**. The policy would require the US government to consider the embedded carbon emissions of construction materials like steel and cement in procurement for infrastructure projects. The goal is to create a market for products made with lower carbon production processes. In that case, the focus is on the emission intensity of the product rather than where the product is produced, thereby avoiding risks of discriminating against imports and avoiding WTO challenges. Developing a clean procurement policy can send a signal to the private sector that investments in new technologies to reduce emissions is profitable. The Administration could also have an opportunity to harmonise product standards with international partners.



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