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Border Carbon Adjustments and Industrial Competitiveness in a European Green Deal

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Driving industrial decarbonisation while safeguarding international competitiveness is a major policy challenge. As part of the European Green Deal, the EU is considering the introduction of a Border Carbon Adjustment (BCA) to ensure that the price of imports into the EU more accurately reflects the environmental costs of their carbon content. BCAs could be an alternative to free allocation to emissions-intensive trade-exposed (EITE) sectors as a measure to address the risk of carbon leakage in the EU's Emissions Trading System (ETS).

The EU is considering several design options for a BCA, including a carbon tax on selected products (both on imports and domestic production), a new carbon customs duty or tax on imports, or the extension of the EU ETS to imports. These options have in common that they only apply to imports, not to exports by EU producers. While a BCA for exports is not categorically excluded, it is less likely to be consistent with WTO rules and therefore less likely to be proposed than an import-only BCA.

A key point is that replacing free allocation by an import-only BCA would weaken the competitiveness of EU producers in foreign markets. The reason is that free allocation also helps support the cost competitiveness of domestic products that are exported to markets outside the EU. Therefore, a move to import-only BCAs does not necessarily make redundant the continued use of free allocation to help safeguard overall industrial competitiveness. While combining an import BCA with free allocation can increase the risk of legal challenges, such risks can be minimized with an appropriate design.

More broadly, policymakers need to navigate a complex trade-off: while free allocation can offer more holistic competitiveness support, BCAs lead to a stronger carbon price signal and raise additional government revenue. This trade-off may resolve differently across EITE sectors depending on the extent of their reliance on exports and on the value of a stronger abatement incentive.

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