

# CLEAN ECONOMY WORKING PAPER SERIES

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## BORDER CARBON ADJUSTMENTS: WORKING PAPER SUMMARY

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## Border Carbon Adjustments: A Policy Brief

Stefan U. Pauer\*

*Prepared for the Economics and Environmental Policy Research Network (EEPRN)*

### Barriers to BCAs:

- Preference among both policy-makers and stakeholders for **alternative measures**, such as free allocation or output-based tax credits
- Opposition from **foreign governments**, sparking fears of trade war and retaliation
- **Domestic political opposition** to BCAs – for the above-mentioned reasons, or due to increased exposure to carbon price from (1) carbon-intensive imports or (2) domestically-owned facilities located abroad that sell into the domestic market
- **Circumvention** of BCAs

### Concerns that did not prevent BCAs:

- Legal concerns about WTO law and the US Dormant Commerce Clause
- Administrative complexity of BCAs
- Concerns that BCAs hamper international climate efforts
- Note: Opponents to BCAs might allege such concerns to reinforce their opposition, despite evidence to the contrary

### Conditions under which **policy-makers most likely adopt and implement** BCAs:

- Policy-makers apply BCAs **to extend the environmental reach** of domestic policy, and not merely to address competitiveness and leakage concerns
- Jurisdiction applying the BCA has an **import-oriented** economy, thus limiting its vulnerability to retaliation from other jurisdictions
- **Limited** presence of domestic industries that would experience an **increase in their exposure to carbon pricing** under the BCA from (1) importing carbon-intensive products or (2) owning facilities located abroad that sell into the domestic market
- **Limited** possibilities for **circumvention** of the BCA

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## Recommendations for policy-makers interested in developing BCAs:

- Deploy BCAs to **increase the coverage of domestic carbon pricing** by extending a carbon price on emissions associated with imports. Using BCAs for this purpose strengthens their viability. Also, NGOs are likely supportive if this motivation underpins efforts to put BCAs in place.
- Gauge market participants' **ability to circumvent** BCAs and carefully **evaluate** the feasibility of successfully countering such efforts.
- **Assess** the likelihood of political **opposition from other jurisdictions** in response to BCAs and contemplate whether government would be willing – and able – to withstand retaliatory measures from other governments in a bid to uphold a BCA.
- **Survey** domestic **stakeholder opinion** and secure the broadest possible political support. Industry stakeholders most likely to support BCAs are import-oriented and have corporate structures and industrial supply chains that do not extend beyond the jurisdiction.
- Exercise **caution** not to give credence to **false claims** that designing BCAs in compliance with WTO law or the US Dormant Commerce Clause would not be possible, or that the administrative complexity of implementing BCAs would be prohibitive.

## Research **findings based on** author's doctoral research project<sup>1</sup>:

- 4 **case studies** of experiences with and attitudes towards BCAs:
  - Inclusion of international flights in the EU ETS
  - Stationary installations in the EU ETS
  - Inclusion of electricity imports in California's cap-and-trade program
  - Industrial facilities in California's cap-and-trade program
- Case studies cover:
  - 2 **jurisdictions**: European Union, California
  - 3 economic **sectors**: manufacturing industry, electricity, aviation
  - BCAs considered, but never adopted
  - BCAs passed into law, but subsequently...
    - Suspended, or
    - Significantly weakened
- Research draws on a wide range of **published materials**, including **quantitative data**, and supplements these sources with information from 43 **expert interviews**

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<sup>1</sup> Stefan U. Pauer, *Border Carbon Adjustments in Support of Domestic Climate Policies: Explaining the Gap Between Theory and Practice* (PhD Thesis, Law, University of British Columbia) [forthcoming in 2019].