

Intelligence MEMOS



From: Jon Johnson
To: Federal Departments of Global Affairs, Environment, and Natural Resources
Date: June 29, 2022
Re: LATEST CONGRESSIONAL CARBON BORDER ADJUSTMENT MECHANISM INITIATIVE – FOR REAL OR FOR SHOW?

The *FAIR Transition and Competition Act* introduced last July, which provided for a carbon border adjustment mechanism (CBAM), was never enacted.

Four Democratic senators have now introduced the *Clean Competition Act* providing for a “carbon intensity charge” (in effect a CBAM) on imports. The calculations are convoluted, with carbon intensity calculations for primary goods (such as iron, steel, aluminum, cement, glass, pulp, and paper, as well as other manufactured products the manufacture of which produce comparable carbon dioxide emissions) and finished goods (goods with component parts comprised of primary goods.) The goal is to level the playing field between US firms that are paying to meet federal emissions goals and businesses in nations that have less stringent rules and therefore lower costs.

The charge, effectively a tariff, is payable by the importer not later than September 30 of the calendar year following the year of importation. Like the FAIR Act, the charge does not apply to goods imported from least developed countries. Unlike the FAIR Act, the *Clean Competition Act* does not penalize US trading partners that apply CBAMs to goods imported from the US.

The *Clean Competition Act* would also impose a carbon intensity charge on domestically produced primary goods, the calculation (also convoluted) of which is based on domestic US data.

Carbon intensity charges are refunded to US persons who export domestically produced primary goods. In this respect, the US scheme under the *Clean Competition Act* is superficially similar to GATT and WTO sanctioned “border adjustments.” A classic example is Canadian GST/HST, which is imposed on goods sold domestically as well as imported goods but is refunded on goods exported from Canada.

However, Canadian GST/HST and the *Clean Competition Act* carbon intensity charges are not comparable. Canadian GST/HST applies to imports in the same manner as applied domestic goods, while the basis for *Clean Competition Act* carbon intensity charges on domestic US goods is different from the basis for these charges on imported goods.

Treating imported goods differently from domestic goods violates GATT 1994/WTO the national treatment obligations unless a nation invokes GATT Article XX, which includes exceptions for protecting human, animal or plant life or health and for conservation of exhaustible natural resources. These are possibilities but there is no assurance that either will apply.

The *Clean Competition Act* may never be enacted. Senate passage will require at least 10 Republican senators, plus all 50 Democrats, to overcome a filibuster. As well, current inflation concerns make this a particularly inopportune time to introduce legislation that raises costs, no matter how worthy.

But if this legislation does become law and is applied against imports, there will be considerable pushback regardless of WTO exceptions. The BASIC countries (Brazil, South Africa, India, and China) strongly oppose carbon border adjustments. Developing countries will insist on special and differential treatment, which WTO law sanctions. US opposition to the self-judging nature of such claims will not prevent them from being made.

If the *Clean Competition Act* is for show and suffers the same fate as the FAIR Act, Canada can ignore it. However, if the *Clean Competition Act* becomes law, Canada will have to adapt to it.

The Canadian government clearly takes climate concerns seriously and has (either directly or through co-operating provinces) adopted measures to curtail domestic greenhouse gas emissions. CBAMs are a logical extension of these measures.

Canada should encourage a co-ordinated approach to CBAMs among trading partners (including the US) wishing to take positive action to address climate change. However, Canada should continue to exercise caution before adopting CBAMs on its own.

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