

5 October 2021

Personal information removed for proactive
release

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I refer to your email of 13 September 2021 in which you request the following under the Official Information Act 1982 (OIA):

Submission from the Ministry of Foreign Affairs and Trade titled: "EU's Proposed Carbon Border Adjustment Mechanism".

The information relevant to your request is attached. We have withheld some information under the following sections of the OIA:

- 9(2)(a): to protect individuals' privacy; and
- 9(2)(j): to avoid prejudice to negotiations.

Where the information has been withheld under section 9 of the OIA, we have identified no public interest in releasing the information that would override the reasons for withholding it.

Please note that we may publish this letter (with your personal details redacted) and enclosed documents on the Ministry's website.

If you have any questions about this decision, you can contact us by email at: DM-ESD@mfat.govt.nz. You have the right to seek an investigation and review by the Ombudsman of this decision by contacting www.ombudsman.parliament.nz or freephone 0800 802 602.

Nāku noa, nā



Julie-Anne Lee
for Secretary of Foreign Affairs and Trade



17 February 2021

➤ Minister for Trade and Export Growth

For action by

1 March 2021

EU's proposed Carbon Border Adjustment Mechanism

BRIEFING Decision Submission

PURPOSE This note outlines the state of play with the EU's work on a Carbon Border Adjustment Mechanism (CBAM), and proposes that New Zealand increase its engagement with the EU so that it is aware of and takes into account New Zealand views.

Tukunga tūtohua – Recommended referrals

Minister of Climate Change	For concurrence by	1 March 2021
Minister of Foreign Affairs	For information by	1 March 2021
Minister of State for Trade and Export Growth	For information by	1 March 2021
Minister of Agriculture	For information by	1 March 2021
Parliamentary Under-Secretary to the Minister for Trade and Export Growth	For information by	1 March 2021

Taipitopito whakapā – Contact details

NAME	ROLE	DIVISION	WORK PHONE
Greg Andrews	Unit Manager Rules, Sustainability and Intellectual Property	Trade Negotiations Division	s9(2)(a)
Todd Croad	Climate Change Specialist	Climate Change Division	

Mā te Tari Minita e whakakī – Minister's Office to complete

☐ Approved☐ Noted☐ Seen☐ Needs amendment☐ Declined☐ Withdrawn☐ Overtaken by events☐ See Minister's notes**Comments**

EU's proposed Carbon Border Adjustment Mechanism (CBAM)

Pito matua – Key points

- Carbon Border Adjustment Mechanisms (CBAMs) are a long-mooted but not-yet-introduced measure to ensure that imported goods pay a price for their carbon emissions that is comparable to the price paid by domestic producers. A CBAM may help to address concerns about emissions leakage or reduced competitiveness caused by the different application of carbon prices across jurisdictions; and to exert pressure on trade partners to take similarly ambitious climate action.
- The EU has moved quickly and is tracking towards publishing a formal legislative proposal on a CBAM by June 2021.
- The EU has reportedly narrowed the scope of its thinking to two possible options for a CBAM: impose a tax or excise duty at the border, or introduce a “notional ETS” obligation. The main difference between the two options is how CBAM contributions would be legally classified, and whether the price would be fixed or follow the EU carbon price.
- Indications are that the EU CBAM will apply initially to a narrow subset of industries including cement, steel, aluminium and chemicals. The aim is for it to be WTO-compatible, the coverage of which could be expanded over time. Technical details of the CBAM remain unclear.
- Some EU farmers’ lobbies have raised the prospect of the EU CBAM applying to agricultural imports, but this appears unlikely in the near future, as agriculture is not in the EU’s ETS and there are no plans to price or tax agricultural emissions in the EU.
- We consider it is now important to step up engagement with the EU on this matter. To date officials have closely monitored the EU’s work and registered New Zealand’s principled approach on CBAMS in general including the need for coherent and mutually supportive trade and climate policy responses.
- Officials recommend New Zealand now formally approach the EU setting out New Zealand’s interests in the EU’s development of a CBAM and our wish to engage bilaterally with the EU on this. This will ensure our views can be registered, including regarding our concern about possible trade protectionism arising from a CBAM.
- In order to engage further with the EU beyond this initial approach we will need to develop more fully New Zealand’s position on carbon border adjustment – both at a high level, and in terms of best practice operationalisation. This will help ensure a coherent approach across CBAM issues generally, and ensure that officials are able to engage meaningfully with the EU on its legislative proposal.

Signed by Vangelis Vitalis

Vangelis Vitalis
for Secretary of Foreign Affairs and Trade

EU's proposed Carbon Border Adjustment Mechanism (CBAM)

Tūtohu – Recommendations

It is recommended that you:

- | | | |
|----|--|----------|
| 1 | Note CBAMs are relevant to New Zealand's interests for both climate change and trade policy reasons, and intersect with carbon pricing and carbon markets policy. | Yes / No |
| 2 | Note EU work, with limited product coverage, is progressing on a CBAM, with a legislative proposal due in June. | Yes / No |
| 3 | Note the EU is considering two options – to establish a tax or excise duty, or to introduce a “notional ETS” obligation. | Yes / No |
| 4 | Note New Zealand's approach to date that CBAMs should be designed to ensure they contribute to their policy objective(s), are technically feasible, administratively efficient, scientifically robust, transparent, non-discriminatory, least trade restrictive and WTO compliant, and shaped and informed by consultations with interested partners. | Yes / No |
| 5 | Agree New Zealand should now formally approach the EU setting out New Zealand's interests in the EU's development of a CBAM and to formalise our wish to engage bilaterally with the EU on this. | Yes / No |
| 6 | Note that Ministerial engagement with EU counterparts from both a trade policy and a climate change perspective may be both helpful and necessary. | Yes / No |
| 7 | Note that further engagement with the EU beyond this initial approach will require a well-developed and detailed all of Government position on CBAMs. | Yes / No |
| 8 | Agree officials should develop such a position. | Yes / No |
| 9 | Agree that officials report back to you and other relevant Ministers with a more detailed position on CBAMs. | Yes / No |
| 10 | Agree officials report back to you and other relevant Ministers with options for further engagement with the EU on the EU's CBAM proposal. | Yes / No |
| 11 | Refer a copy of this submission to the Ministers of Climate Change, Foreign Affairs and Agriculture, as well as the Parliamentary Under-Secretary to the Minister for Trade and Export Growth. | Yes / No |

Hon Damien O'Connor
Minister for Trade and Export Growth

Date: / /

EU's proposed Carbon Border Adjustment Mechanism (CBAM)

Pūrongo – Report

New Zealand should approach CBAMs systematically...

1. Carbon Border Adjustment Mechanisms (CBAMs) are a long-mooted but not-yet-introduced measure to ensure that imported goods pay a price for their carbon emissions that is comparable to the price paid by domestic producers. A CBAM may help to address concerns about emissions leakage or competitiveness caused by the different application of carbon prices across jurisdictions; and to exert pressure on trade partners to take similarly ambitious climate action. It is possible that well-designed CBAMs could directly contribute to the Paris Agreement goals of climate change mitigation and consistency of financial flows with mitigation. Alternately, a poorly designed CBAM could achieve no environmental benefit, be a vehicle for trade protectionism and incompatible with multilateral legal commitments.
2. New Zealand relies upon both an effective global response to climate change and an effective multilateral trading system. While an ambitious multilateral approach to carbon markets, pricing and emissions leakage would be most desirable, this is not yet on the table. Consideration of CBAMs is somewhat localised currently (including by the European Union), but consideration of these mechanisms is likely to grow in the future.
3. It is in New Zealand's interest to influence and to help shape as far as possible consideration of these mechanisms, their objectives and design, to promote both our climate change and trade objectives. We could engage on an ad hoc basis (e.g. proposal-by-proposal), but are likely to be more successful if doing so on the basis of a joined-up New Zealand position on CBAMs. Developing this would involve the trade and international climate change lens, but also intersects with domestic carbon pricing and leakage prevention mechanisms (e.g. NZ ETS allocations and synthetic greenhouse gas levy) s9(2)(j)

...and directly engage with the EU CBAM

4. A well-considered New Zealand position on CBAMs is desirable. However, a driver for this work is the EU's consideration of a CBAM for the EU. This is progressing rapidly and will result in a legislative proposal in June 2021. New Zealand needs to move quickly to formally register our interest in the CBAM to ensure our views are registered.
5. The objective of the EU's work on a CBAM is to ensure that the price of imports reflects more accurately their carbon content. The measure would be an alternative to the current free allocation of allowances that compensate EU producers for the increased cost of energy through the EU Emissions Trading System (ETS).
6. European Commission officials have made progress in developing a CBAM. In March-April 2020 the Commission held consultations on an impact assessment, which attracted 224 submissions, predominantly from business. It subsequently launched a public consultation which closed at the end of October 2020. This consultation was based on a broad proposal a number of options for the CBAM:
 - A tax applied on imports at the EU border on a selection of products whose production is in sectors that are at risk of carbon leakage. This could be a border tax or customs duty on selected carbon intensive products.

EU's proposed Carbon Border Adjustment Mechanism (CBAM)

- An extension of the EU Emissions Trading System (ETS) to imports, which could require the purchasing of emission allowances under the EU ETS by either foreign producers or importers.
 - The obligation to purchase allowances from a specific pool outside the ETS dedicated to imports, which would mirror the ETS price.
 - A carbon tax (e.g. excise or VAT type) at consumption level on a selection of products whose production is in sectors that are at risk of carbon leakage. Under this option, the tax would apply to EU production, as well as to imports.
7. The European Commission is now on course to publish its legislative proposal for a CBAM in June 2021, with the objective of having it in force in 2023, depending on the legislative process. Following the public consultation the Commission has reportedly narrowed the scope of its thinking to two possible options:
- Establish a (border) tax or excise duty, or;
 - Introduce a “notional ETS” obligation.

The main difference between the two proposed models is how they would legally classify contributions to the CBAM, and whether the price was fixed or followed the EU carbon price.

8. According to the Commission's public consultation, most stakeholders want a wide coverage approach that deals with all the relevant parts of the supply chains and extends to everything covered by the ETS. Indications to date, however, have been that the CBAM is likely to apply initially to a narrow subset of industries that include cement, steel, aluminium, and chemicals. The Commission, however, has emphasised that coverage is a secondary question for the time being. At this point it was more important to have a solid system in place. The aim is to establish a WTO-compatible mechanism, which over time could be adjusted to incorporate more product categories and complex supply chains.
9. In considerations of design, coverage and applicability to products from certain jurisdictions, s9(2)(j)
- (to ensure understanding of the New Zealand ETS) as well as the broad sectoral coverage of, and targeted free allocation in, the New Zealand ETS, may be an asset for New Zealand.

Agriculture

10. Inevitably, the prospect of the EU's CBAM applying agricultural imports has arisen. However, the treatment of agriculture in the EU would seem to preclude a true CBAM in the near future. Agriculture is not in the EU's ETS and there are no plans to price or tax agricultural emissions in the EU. In fact, the general idea in the EU's “Farm to Fork” strategy (its food sustainability road map) is to pay producers for taking actions to address climate change and other environmental measures through modifying the direct payments system.
11. Nevertheless, Farm to Fork measures such as the proposed biodiversity requirements, and limits on pesticides and fertilisers, will increase EU farmers' costs and make their products less competitive vis-à-vis some third country products. As a result, there is a strong push by farmers' lobbies for requirements to be introduced that would mean all imports of agricultural

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products have to meet the EU's environmental (and animal welfare) standards. The current focus of these discussions however, is not the CBAM, but rather the internal EU negotiations between the EU Council, Parliament and Commission on CAP reform. A number of member states are also questioning the WTO legality of such a potential approach. s9(2)(j)

12. In terms of the question of general coverage, New Zealand's phasing in of pricing of agricultural emissions from 2025 at the latest, may also be an asset for New Zealand relative to other jurisdictions.

WTO Compatibility

13. While many of the technical details of the future CBAM regulation will remain unclear until the proposal is published (and the ensuing legislative process runs its course), recent comments by the Commission suggest that the mechanism will feature two "safeguards" which the EU claims will help ensure WTO compatibility, regardless of the model chosen. On the one hand, any CBAM would not apply to exports from countries where there is a "similar measure" to the EU's ETS system. On the other hand, the Commission has said that producers will have the possibility to "prove" that their production standards are equivalent or better than those of the EU, although there are no details yet on how this would be possible. The Commission has also noted that if free carbon allowances for sectors covered under the CBAM remained (as is the case currently for some) this would affect the CBAM design and a similar 'rebate' would have to be built into the mechanism. The concept of a rebate on carbon costs for EU production exported is more difficult, but we understand this issue will be addressed in the June proposal.

New Zealand engagement with the EU

14. To date, officials have closely monitored the work of the Commission. We have engaged in preliminary discussions in Brussels following a broad principle-based approach to CBAMs in general - that they should be designed to ensure they contribute to their policy objective(s), be technically feasible, administratively efficient, scientifically robust, transparent, non-discriminatory, least trade restrictive and WTO compliant, and shaped and informed by consultations with interested partners. We have noted New Zealand is an advocate for coherent and mutually supportive trade and climate policy responses. We have also set out New Zealand's view that given the untested nature of CBAMs, and the risks posed by imposing tariffs on climate grounds, New Zealand strongly favours a multilateral, or failing that, an 'open plurilateral' approach to the design and application of CBAMs. Our view is that unilateral action will not deliver an optimal outcome and could invite retaliatory action that damages trade and delivers poor environmental outcomes
15. More broadly, New Zealand has strong interests in the ongoing development of a CBAM by the EU. These interests include bilateral trade, compatibility with the multilateral trading system, environmental effectiveness, and as a worked example of an alternative mechanism for preventing emissions leakage. Alongside this, New Zealand has a strong interest in cooperation with the EU on climate change and carbon markets generally and we want to make sure our trade, climate, CBAM and carbon market engagement are mutually supportive. It is in our interest therefore to ensure the EU is aware of our views and takes them into account as much as possible in the development of its CBAM.

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16. Therefore, we consider it is now important for New Zealand to step up its engagement with the EU, especially as it progresses towards a formal CBAM proposal, and as calls increase by EU lobby groups for the inclusion of agriculture imports. Accordingly, we consider it is important now for New Zealand to approach the EU directly setting out our interests in the EU's development of a CBAM and our wish to engage bilaterally with the EU on this.
17. Following this initial approach and in order to engage more directly and in substance with the EU over time as its CBAM work progresses, we will need to develop more fully New Zealand's position on carbon border adjustment mechanisms – both at a high level, and in terms of best practice operationalisation. This will help ensure a systematic approach across CBAM issues generally, and ensure that officials are able to engage meaningfully with the European Union on its legislative proposal.
18. Developing a detailed New Zealand position on CBAMs generally may bring benefits for engaging the EU specifically – for example it is possible we uncover relevant New Zealand expertise that may be of value to the Commission (e.g. the synthetic greenhouse gas levy, or use of 'Other Removal Activities' such as the export of methanol); or alternate ways to engage with the Commission that may be more warmly received (e.g. in the context of jurisdictions which do price emissions and have stakeholders concerned about competitiveness).
19. In engaging more directly with the EU we may be able to leverage off the existing work and relationships ^{s9(2)(j)} with DG CLIMA ^{s9(2)(j)} as well as through carbon market fora, such as the Florence Process or International Carbon Action Partnership. We would also likely follow our usual model of engagement on EU policy which is to engage with all relevant component parts of the EU including the Commission, Council, Member States (especially the rotating President, currently Portugal) and the European Parliament. Where possible, ministerial engagement would also be helpful, both from a trade and from a climate change perspective.