



## POSITION OF THE LITHUANIAN CONFEDERATION OF INDUSTRIALISTS ON THE CARBON BORDER ADJUSTMENT MECHANISM (CBAM) REGULATION AS PART OF THE 'FIT FOR 55' LEGISLATIVE PACKAGE

This document sets out the main principles and concrete policy recommendations to the European Union institutions and national decision makers on the Regulation of the Carbon Border Adjustment Mechanism (CBAM) as part of the 'Fit for 55' legislative package.

LPK strongly supports the initiative to create the CBAM. Given the EU's climate neutrality commitments and the lack of comparable climate action among major trading partners the CBAM has the capacity to address carbon and investment leakage, preserve competitiveness of European industry and encourage an increased global climate ambition, thus levelling the playing field for our companies.

Key elements in more detail:

- I. The link between the CBAM and the reform of the ETS is one of the key regulatory issues. In order to maximize effectiveness both instruments, it is necessary to focus on the conditions for their compatibility.
  - i. The allocation of free allowances to CBAM sectors must depend on CBAM's effectiveness and on the assessment of its real impact. Since under the current proposal importers will not incur any financial costs during the transitional period (2023-2026) (only reporting obligation will apply), it will not be possible to assess the *actual* impact of the adjustment on EU and third country producers after this period. For this reason, LPK proposes that the decision on the gradual reduction of free allocation to CBAM sectors and its speed takes place not earlier than 2030 and only following a thorough assessment of reliability and effectiveness of a *fully functioning* CBAM (in terms of risk of carbon leakage, impact on investments and export competitiveness, situation on the global markets).
  - ii. Competitiveness of exports of CBAM sectors and downstream sectors needs to be taken into account when determining the relationship between CBAM and free allocation and when deciding on extension of CBAM coverage to other

sectors. While CBAM aims to ensure a level playing field mainly for imports, ETS protection of high-risk carbon leakage sectors mitigates the impact of CO<sub>2</sub> costs on their international competitiveness. In the absence of assessment of actual effectiveness of CBAM, there is a risk that CBAM sectors that will lose a part of allocated free allowances will be forced to comply with more stringent ETS requirements, undertake efforts to become more sustainable and reduce their emissions, while at the same time competing on foreign markets with producers that may not face the same pressures. Therefore, according to LPK, decisions on the continuity of protection from carbon leakage should only be made after 2030 and only after a full assessment of the effectiveness of CBAM and the situation of exporting CBAM sectors in third markets. LPK also urges that if free allocations were to be reduced after 2030, fully WTO-compliant measures to support exports by CBAM sectors should be considered.

- II. LPK understands the added value of the transition period, especially in view of its objectives to ensure readiness of EU Member States' authorities to implement the new mechanism, to facilitate adaptation of EU and third country companies and to allow time for EU diplomacy to increase CBAM's acceptance, reduce risks of retaliation and to encourage greater ambition to reduce emissions and to implement similar mechanisms. At the same time, LPK advocates for the earliest possible and faster implementation of CBAM in its full extent: the sooner it becomes fully operational, the earlier it will be possible to assess its effectiveness, identify its shortcomings, remedy them and to take more confident informed decisions on free allocation to the CBAM sectors. LPK also points out that if it is decided not to collect a CBAM charge during the transitional period, it is necessary to come up with control mechanisms and specific criteria according to which the effectiveness of CBAM can be assessed during this period. This assessment of the transitional period should not prejudge the assessment of the impact of fully operational CBAM.
- III. In the initial phase, the scope of CBAM could be limited to the proposed sectors. In the long run, more sectors and subsectors should be included, such as raw materials and even more complex products. It should be noted that when planning inclusion of new (sub)sectors, it is necessary to consult with individual (sub)sectors in order to properly assess their specifics. Certain (sub)sectors envisage risks as the proposed CBAM model is not considered fully compatible with specifics of their activities, which is especially relevant for exporting sectors who lack assessment of impacts on exports and appropriate support measures. Inclusion of other sectors should only be implemented after a thorough assessment of the effectiveness of the fully operational CBAM, and not immediately after the transition period.

IV. Assessing the decentralized system of administration of CBAM proposed by the European Commission, LPK draws attention to the risk that national authorities of the EU Member States may be interpreting the rules differently, the mechanism might not work equally smoothly enough depending on resources and administrative capacity of individual Member States, which might create conditions for circumvention and distortions in the EU internal market. Given the decentralized system, LPK calls to ensure necessary support to national authorities, in particular customs, and to secure supervision and smooth and uniform implementation of the CBAM regulation across the EU, including timely and comprehensive implementation guidelines, strict institutional competencies, and a uniform liability regime.

Alternatively, LPK considers it appropriate to set up an EU-level body responsible for monitoring the implementation of the new mechanism, supporting the implementation process, and ensuring uniform implementation in the Member States. Such a body could also manage a central database of data related to the administration of CBAM.

V. On the structure and methodology.

LPK supports the proposed CBAM model: the obligation to purchase allowances from a separate pool dedicated to imports that directly reflects the price of ETS allowances, which would ensure equivalent carbon costs between imports and goods produced in the EU in a transparent way. According to LPK, CBAM should cover not only direct emissions but also include indirect emissions that occurred in the production of the electricity used to produce the product. In the longer run a reflection should be launched about coverage of emissions throughout the product's value chain.

Calculation of carbon content of imported products should be based on product-specific benchmarks for free allocation under the ETS, representing the average emissions content of installations of a particular producer. Importers should be given the possibility to demonstrate their actual emission levels for the manufactured product, calculated and verified by independent verifiers. If data on actual emissions from installations is not provided, default values should be applied. It is particularly important that these default values setting average emissions intensity for each product produced in a third country, as well as the 'markup' applied by the European Commission, would provide a strong incentive and encourage third country manufacturers to switch to declaring verified emissions. It is important to ensure that engagement of third-party verifiers to establish actual embedded emissions can be done practically and cost-efficiently and does not impose excessive administrative burden.

Finally, LPK supports the principle that the CBAM should apply equally, without exception, to all imports from all third countries, regardless of their origin. To ensure a

true level playing field, the European Commission's assessment of third-country carbon pricing systems and their recognition in the process of levying CBAM charge, requires a careful consideration of possible forms of compensations, e.g., through tax rebates, linked to carbon pricing schemes (not only those given at the point of export and specifically to exports only).

#### Avoiding circumvention of the rules.

Assessing the Commission's proposal, it is evident that there are limited measures against circumvention. CBAM should provide adequate protection against all forms of circumvention, including transshipment strategies, resource shuffling, absorption, and others.

LPK recommends the following measures:

- i. In the case of substitution of imports between primary inputs/raw materials and semi-finished or finished goods (depending on the applicable CBAM regime) – through implementation in a long term of a CBAM that covers multiple parts of the value chain.
- ii. In the case of resource shuffling or 'source shifting' (allocation of low carbon production only to the EU) – through basing the calculation of carbon content of a particular producer on the average of all of his installations
- iii. In case of transshipment strategies if the possibility for exempted countries is included though application to imports of rigorous monitoring, reporting and verification (MRV) rules.

It is necessary to anticipate what further measures may be needed and whether the measures listed are sufficient.

#### VI. Regarding the use of revenues generated by CBAM.

Revenues from CBAM should be used in the EU to reduce the risk of carbon and investment leakage, to invest in the development of low-carbon technologies, to fund infrastructure and to contribute to the research initiatives in this field. CBAM revenues should also be used to strengthen the Modernization Fund.