

GREENING CANADIAN BORDERS – CANADA CONSIDERS BORDER CARBON ADJUSTMENTS FOR CARBON-INTENSIVE IMPORTS

Posted on July 6, 2021

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Border Carbon Adjustments (“**BCAs**”) are being explored by various countries to support climate change initiatives.^[1] BCAs adjust the import prices of carbon-intensive goods to match the cost of locally produced goods impacted by carbon pricing regimes.

The Government of Canada announced in the 2021 Budget that it plans to develop BCAs as an element of Canada’s Climate Plan:

Border carbon adjustments make sure that regulations on a price on carbon pollution apply fairly between trading partners. If a different price on pollution is levied at source, the difference is accordingly applied on imports and exports between countries. This levels the playing field, ensures competitiveness, and protects our shared environment. An important part of advancing this work is ensuring a common understanding of border carbon adjustments and hearing views from interested Canadians, as well as working with Canada’s international partners.^[2]

Canada’s Climate Plan includes reducing greenhouse gas (“**GHG**”) emissions 30% by 2030 and reaching net-zero emissions by 2050.^[3] The Government anticipates that BCAs will help protect the competitiveness of key Canadian industries such as oil and gas, mineral production and chemicals while advancing Canada’s Climate Plan.^[4]

The Role of Border Carbon Adjustments

A BCA is a tariff on imported goods based on their carbon content. BCAs would be applied to imports of products from exporting countries that either do not have their own domestic carbon pricing regimes or have weaker domestic carbon pricing regimes than the importing country. In effect, BCAs are intended to “level the playing field” between the costs of producing carbon-intensive goods in domestic and foreign markets. BCAs also reinforce domestic efforts to incentivize production of “environmentally friendlier” goods.^[5]

BCAs have a critical role in deterring the “carbon leakage” that occurs when firms relocate production to

countries without, or with weak, carbon pricing schemes. Relocation allows firms to avoid the added costs associated from compliance with stricter emissions regulations.^[6] Carbon leakage results in global carbon emissions being redistributed to other countries rather than being reduced. In addition, domestic production and employment may decline from the relocation of manufacturing activities to foreign countries.

BCAs aim to equalize the basis of competition between foreign and domestically produced goods manufactured under different carbon compliance regimes. By raising the costs of imported products that are not fully carbon-priced in the exporting country, BCAs attempt to reflect the cost of producing similar goods at the carbon pricing level in the domestic market. BCAs also indirectly incentivize other countries to develop and meet more rigorous emission targets to avoid their exports being subject to BCAs.

Integrating BCAs within Canada's Carbon Pricing Regime

The Supreme Court of Canada ("**SCC**") recently upheld Canada's domestic carbon pricing regime as set out in the *Greenhouse Gas Pollution Pricing Act* ("**GGPPA**").^[7] The GGPPA establishes a minimum national standard for carbon pricing emissions that all Canadian provinces and territories must meet.

The SCC stated that climate change was a threat to human life and Canada should approach the issue through national and international efforts.^[8] The GGPPA decision appears to pave the way for a broad range of climate measures that could include BCAs.

Canada's federal carbon pricing system under the GGPPA is known as the Output-Based Pricing System ("**OBPS**"). The OBPS allows the provinces and territories to design and implement their own carbon-pricing regimes, as long as the programs meet the minimum federal requirements. For provinces and territories that do not do so, the federal OBPS functions as a backstop to ensure they are subject to carbon pricing at the federal level.^[9]

The CO₂ emissions limit for each facility regulated under the OBPS is calculated using a formula in the *Output-Based Pricing System Regulations*.^[10] A facility is required to pay for each tonne of carbon emitted above its limit for a year. The minimum price under the OBPS is currently C\$40 per tonne of CO₂, and will progressively increase to C\$170 per tonne of CO₂ by 2030.

An increase from C\$40 to C\$50 per tonne of CO₂ under the OBPS has been estimated to result in a 1-5% increase in production costs for Canadian manufacturers of goods in the iron, chemical, petroleum, and steel industries.^[11] In the absence of BCAs, carbon-intensive imported goods produced in countries that have carbon pricing at lower levels, or no carbon price at all, will have a cost advantage over Canadian goods.

It is expected that Canadian BCAs would be developed for imported products that compete with Canadian

products affected by the OBPS. In practice, implementing BCAs in Canada may be a complex process. Some provinces use cap-and-trade systems, while others apply direct prices on carbon. Given the variance in carbon-pricing implementation across Canada, designing a Canadian BCA that equitably protects producers in all provinces and territories may prove challenging.

International Consideration of BCAs

The European Union is expected to announce its proposed “Carbon Border Adjustment Mechanism” (“**CBAM**”) regulations in July 2021, and they could enter into effect as early as 2023.^[12] The European Parliament and member states will need to approve the CBAM proposal before it comes into force.^[13]

At the June 2021 G7 Summit in the United Kingdom, leaders “acknowledge[d] the risk of carbon leakage” and committed to “work collaboratively to address this risk and to align our trading practices with our commitments under the Paris agreement.”^[14] However, no consensus was reached in support of BCAs. The strongest opposition to BCAs amongst the G7 countries currently comes from the United States and Japan, the only G7 countries without national carbon-pricing regimes.^[15]

Designing BCAs that are World Trade Organization Compliant

BCAs will almost certainly be scrutinized under the World Trade Organization’s dispute settlement regime. The *General Agreement on Tariffs and Trade* (“**GATT**”) provides that countries cannot use tariffs to discriminate in favour of domestic producers of goods.^[16] A WTO-compliant BCA will need to be non-discriminatory, applying clear and consistent principles for all countries. A WTO-compliant BCA will likely also need to account for carbon pricing already applied in the exporting country to avoid placing domestically produced goods at a market advantage relative to the imported goods.

Alternatively, if a BCA fails the non-discrimination requirements under the GATT, it may still be justified under one of the General Exceptions in Article XX of the GATT.^[17] They allow a trade measure to be exempt from the GATT where necessary for the protection of human, animal or plant life, or where necessary for the conservation of exhaustible natural resources.^[18] Clean air has been recognized as an exhaustible resource.^[19] However, a trade measure cannot be used as an excuse for arbitrary or unjustified discrimination or to disguise a restriction on international trade.^[20]

Canadian Government Consultation Process

The Government has announced that it will begin a BCA consultation process with exporters and importers of carbon-intensive goods in summer 2021. Broader public consultations are expected later in fall 2021.^[21] Firms that produce and sell carbon-intensive products may want to participate in these consultations to ensure that level playing field, regulatory burden and other considerations are fully understood by the Government.

McMillan will provide updates on the development of Canadian and international BCAs in upcoming bulletins.

[1][ps2id id='1' target=''] Canada, the United States, the European Union, and the United Kingdom are among the jurisdictions considering the use of BCAs in the future.

[2][ps2id id='2' target=''] Government of Canada Department of Finance, *Budget 2021: A recovery Plan for Jobs, Growth, and Resilience* (Ottawa: Department of Finance, 2021) at 176 [*Budget 2021*].

[3][ps2id id='3' target=''] For more information about Canada's net-zero emissions initiative, please refer to McMillan's bulletin [Canada Legally Commits to Net-Zero Emissions by 2050](#).

[4][ps2id id='4' target=''] Government of Canada, "[Progress towards Canada's greenhouse gas emissions reduction target](#)" (accessed 12 July 2021)

[5][ps2id id='5' target=''] *Budget 2021* at 176.

[6][ps2id id='6' target=''] European Commission, "[Carbon leakage](#)" (accessed 12 July 2021)

[7][ps2id id='7' target=''] *References re Greenhouse Gas Pollution Pricing Act*, 2021 SCC 11.

[8][ps2id id='8' target=''] For more information, please refer to McMillan's bulletin [Supreme Court of Canada Upholds Federal Carbon Pricing Regime](#).

[9][ps2id id='9' target=''] Ontario, New Brunswick, Manitoba, Prince Edward Island, Saskatchewan, Yukon, and Nunavut rely on the federal OBPS, although New Brunswick and Ontario are currently in the process of transitioning from the federal OBPS to their own provincial carbon pricing programs.

[10][ps2id id='10' target=''] *Output-Based Pricing System Regulations*, SOR/2019-266, ss. 36-43.

[11][ps2id id='11' target=''] International Monetary Fund, "[Four Charts on Canada's Carbon Pollution Pricing System](#)" (accessed 12 July 2021)

[12][ps2id id='12' target=''] European Parliament, "[Legislative Train Schedule: A European Green Deal](#)" (accessed 12 July 2021)

[13][ps2id id='13' target=''] European Parliament, "[Ordinary legislative procedure](#)" (accessed 12 July 2021)

[14][ps2id id='14' target=''] The White House, "[Carbis Bay G7 Summit Communique: Our Shared Agenda for Global Action to Build Back Better](#)" (accessed 12 July 2021)

[15][ps2id id='15' target=''] World Bank, "[Pricing Carbon](#)" (accessed 11 July 2021)

[16][ps2id id='16' target=''] *General Agreement on Tariffs and Trade*, 30 October 1947, Article II and Article III, UNTS 187 (entered into force 1 January 1948) [*GATT*].

[17][ps2id id='17' target=''] *GATT*, Article XX.

[18][ps2id id='18' target=''] *GATT*, Article XX (b) and Article XX (g).

[19][ps2id id='19' target=''] World Trade Organization, "[WTO rules and environmental policies: GATT exceptions](#)" (accessed 11 July 2021)

[20][ps2id id='20' target=''] World Trade Organization, "[WTO rules and environmental policies: GATT exceptions](#)" (accessed 11 July 2021)

[21][ps2id id='21' target=''] *Budget 2021* at 176.

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A Cautionary Note

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