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POLICY BRIEF

Carbon Border Adjustment Tax

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Summary

A carbon border adjustment is a tax on imports based on their assumed greenhouse gas emissions. Because carbon taxes harm domestic business competitiveness, carbon border adjustments are used to increase the cost of imports in order to prevent those imports from undercutting domestic businesses. The United States has no carbon tax and, therefore, raising a carbon border adjustment would be akin to erecting new tariffs on plainly protectionist grounds. Carbon border adjustments increase costs for households and businesses; in the absence of a domestic carbon tax, a border adjustment is especially distortionary and is rightly called a tariff.

Border Adjustment

A carbon border adjustment taxes imported goods based on their assumed greenhouse gas emissions. Carbon border adjustments can vary widely in scope. Some proposals would target only energy products and the most energy-intensive goods. An example of this approach could be seen in the proposed FAIR Transition and Competition Act of 2021[1]. That bill targeted oil, natural gas, and coal, but also aluminum, cement, iron, and steel. It left open the possibility of taxing *all* imports, however.

The administration of a border adjustment on emissions would be rife with uncertainty and vulnerable to exploitation. The United States imports goods from countries across the world, each with its own unique energy mix and policies in place. Accurately gauging the emissions entailed by imports is a fool's errand and would ultimately be determined by the political process and be subject to all of the vagaries that involves. As David Weisbach, a University of Chicago law professor and an expert in carbon border adjustments, told the New York Times regarding the 2021 proposal, "I've never seen a border adjustment that adjusts for regulatory costs. That's going to be hard to do."[2]

[1] *H.R.4534 - Fair Transition and Competition Act 117th Congress (2021-2022)*. https://www.congress.gov/bill/117th-congress/house-bill/4534.

[2] Friedman, Lisa. "Democrats Call for a Tax on Imports from Polluting Countries." *The New York Times*, The New York

Who Pays?

Carbon border adjustments would directly burden importers with a new form of tax. Importers would face the option of paying the tax or seeking new suppliers domestically. Because new suppliers will be costlier in many cases or may not be available domestically at all, importers can be expected to pass on the cost of the tax with higher prices for customers.

A carbon border adjustment would harm the U.S. economy by increasing prices of energy products, energy-intensive goods, and potentially much more.

Adjustment or Tariff?

Carbon leakage is the phenomenon in which high-emissions commercial activity flees from a jurisdiction with a stringent emissions regime to a jurisdiction with a less stringent regime. This can be as simple as a motorist filling up the gas tank across state lines or as complex as a multinational corporation relocating operations overseas. In all cases, carbon leakage undermines the ostensible justification for the stringent policy by *moving* the source of emissions, rather than *eliminating* those emissions. Moreover, in competition with foreign businesses that need not comply with stringent emissions standards, domestic businesses suffer. Thus, countries or jurisdictions with bona fide emissions policies seek to counteract carbon leakage through carbon border adjustments. The European Union, which has in place an Emissions Trading System (ETS), has thus established a carbon border adjustment.

The United States has numerous national and subnational emissions policies, but no unified price on greenhouse gas emissions, such as the European ETS. The EU carbon border adjustment requires the purchase of certificates corresponding to the emissions trading price by importers.[3] If the United States passes legislation to raise a tax at the border on the assumed greenhouse gas emissions of imports, it would lack the justification of the EU carbon border adjustment. In the absence of a unified policy, an American carbon border adjustment would be a tariff, a tax on imports *qua* imports.

Trade Compliance

A carbon border adjustment would be viewed unfavorably from the standpoint of firms and countries that export to the United States. Because the U.S. has no unified emissions policy in place, it is likely that a border adjustment on

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Times, 14 July 2021, https://www.nytimes.com/2021/07/14/climate/border-carbon-tax-united-states.html.

[3] "Carbon Border Adjustment Mechanism: Questions and Answers." *European Commission - European Commission*, Press Corner, 14 July 2021, https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_3661.

emissions would result in retaliatory measures from exporting countries and challenges to the policy being brought before the World Trade Organization.

According to Policy Guidance for U.S. GHG Tax Legislation and Regulation,[4] a collaboration between Resources for the Future scholars Brian Flannery and Jan Mares and World Trade Organization experts Jennifer Hillman and Matthew Porterfield, "If other nations believe that U.S. [border adjustments] constitute illegal domestic subsidies or discrimination against imported products, they can challenge them through WTO dispute settlement procedures or by more direct retaliation against U.S. exports. Such possibilities would place a cloud over the legitimacy of U.S. BAs that could damage relations with other nations in a way that further complicates both climate and trade negotiations, and such claims can take years to resolve."

Conclusion

A carbon border adjustment is a tax on imports and would increase costs across the U.S. economy. Because the United States has no unified emissions policy, raising a carbon border adjustment is tantamount to putting a new tariff in place. The administration of the tax on imports would itself be a costly, exploitable endeavor that could not succeed in adequately accounting for emissions across the hundreds of countries from which the United States imports goods. This incomplete policy almost begs for an even more damaging economy-wide carbon tax, which would saddle Americans with yet higher costs.

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[4] Flannery, Brian P., et al. "Policy Guidance for US GHG Tax Legislation and Regulation: Border Tax Adjustments for Products of Energy-Intensive, Trade-Exposed and Other Industries." *Resources for the Future*, Oct. 2020, https://www.rff.org/publications/reports/policy-guidance-us-ghg-tax-legislation-and-regulation/.