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The Democrats' Border Carbon Adjustment Proposal

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By: Kenneth J. Markowitz, Gabriel Harrison (Public Policy Specialist), Isabel Root (Intern)

On Monday, July 19, 2021, Sen. Chris Coons (D-DE) and Rep. Scott Peters (D-CA-52) introduced The FAIR Transition and Competition Act of 2021 (S. 2378). The bill would, among other things, amend the Internal Revenue Code of 1986, as amended, by establishing a Border Carbon Adjustment (BCA). As proposed, the BCA may be likened to a value-added tax (VAT) and is intended to address the phenomenon known as "carbon leakage," wherein market actors attempt to avoid the cost of greenhouse gas regulations by sourcing products from less regulated jurisdictions. Proponents of border tax adjustments argue that they level the playing field for manufacturers in the United States whose emissions are subject to regulation[1]. The proposed legislation is expected to be included as part of the Democrats' infrastructure reconciliation package.

What is in the Democrats' proposal?

The bill outlines a plan to levy a tax on:

1. Imported goods from the steel, aluminum, iron and cement industries (sectors).
2. The production and products derived from petroleum, natural gas and coal (covered fuel).
3. Any other goods deemed necessary by the Secretary of the Treasury based on reliable emissions data and United States' interest.

For covered fuel, the tax would be levied beginning January 1, 2024, equaling the "domestic environmental cost incurred in the production of such fuel," multiplied by "the upstream greenhouse gas emissions of such fuel." For the aforementioned sectors, the tax would be calculated by the same formula, unless the product was produced in a sector for which reliable emissions data is unavailable, in which case benchmark emissions would be used in the formula. Exemptions include:

1. "Any country included on the list of Least Developed Countries on the most recent Development Assistance Committee List of Official Development Assistance Recipients published by the Organization for Economic Cooperation and Development."
2. "Countries that do not impose BCAs on the United States and have laws and regulations to reduce or eliminate greenhouse gases that are at least as ambitious as the United States."

Revenue raised from The FAIR Transition and Competition Act would pay for its implementation. If revenues exceed implementation costs, half of the excess revenues would fund researching and developing technologies to reduce greenhouse gases, and half would be used to create a so-called "Resilient Communities Grant" for each state. Such state grants would be distributed no later than April 1, 2025, based on factors including a state's population, climate vulnerability, and population of the workforce employed by the fossil fuel industry. These grants may be used by states to:

1. Provide job training for workers transitioning out of the fossil fuel industry.
2. Assess climate vulnerability.
3. Implement projects to combat climate vulnerability.
4. Assist frontline climate communities.
5. Alleviate historical burdens imposed on low-income communities and communities of color by environmental hazards.
6. Provide relocation assistance for climate refugees.
7. "Assist small businesses disproportionately affected by the BCA".

Below is a timeline of the bill's implementation:

July 1, 2023 (and annually thereafter)

- The Secretary of the Treasury will "determine the domestic environmental cost for each sector and the production of covered fuel based on the average cost" of complying with the United States federal, state, and local laws and regulations. These policies include the Clean Air Act, greenhouse gas emissions regulations for vehicles, and local fees on carbon.

- The administrator of the Environmental Protection Agency will also determine the baseline emissions for sectors by measuring the average greenhouse gas emissions of each sector to assess progress. To set "benchmark emissions," the administrator will "publish the production greenhouse gas emissions for the top 1 percent of the emitting production sites within each sector in the United States during the prior calendar year." These benchmark emissions are used to calculate the BCA tax in the absence of reliable data for products and industries.
- The Secretary will publish a report of countries exempt from the tax.

January 1, 2024

- The BCA is implemented.

April 1, 2025

- The Resilient Communities Grant is implemented and provided annually.

Quotes on The FAIR Transition and Competition Act of 2021

"We must ensure that U.S. workers and manufacturers aren't left behind and that we have tools to assess global progress on climate commitments" – Sen. Coons (*New York Times*)

"The FAIR Transition and Competition Act will facilitate a race to the top among U.S. companies to produce the next generation of clean energy and technology. The move would ensure we remain a key player in international cooperation on climate action and show the world that the U.S. is fully committed to addressing the climate crisis at home and abroad." – Rep. Peters

"Senator Chuck Schumer of New York, the majority leader, said he included the tariff because 'it prevents other countries from polluting.'" – Sen. Schumer (*New York Times*)

"This legislation will assert American leadership on the climate crisis, but we also can't be 'Uncle Sucker' where other countries, led by China, take advantage of what we are going to ask our country to undertake." – Sen. Markey (*New York Times*)

"I'm finding out there's a lot of language in places they're eliminating fossil…It's very, very disturbing." – Sen. Joe Manchin (D-WV) (*Roll Call*)

“The principle here is at least a methane fee, some kind of border adjustment, although there are serious technical challenges there,” Schatz said. “Our major hurdle is how to make it operate properly.” – Sen. Brian Schatz (D-HI) (*Roll Call*)

“If some country doesn’t have any constraints on carbon, is producing a product in an extremely dirty manner, and in your … country you’re putting in some more carbon restrictions — well that gives that foreign business an unfair advantage.” – Sen. Mark Warner (D-VA) (*Roll Call*)

“They’re proposing a border tax because they know punishing regulations and taxes will drive U.S. businesses overseas.” – Sen. John Barrasso (R-WY) (*New York Times*)

Sens. Lisa Murkowski (R-AK), Mike Braun (R-IA), Mitt Romney (R-UT) and Susan Collins (R-ME) considered a carbon border tax in June.

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[1] It is worth noting that the concept of a carbon border tax or adjustment is relatively new and that, to our knowledge, no country has passed or implemented such a tax. As a result, the effectiveness of such a tax is inherently speculative. Nevertheless, an analysis of 25 studies found that a carbon border tax could reduce leakage by an average of six percentage points. That said, the United States is not alone in considering this option: on July 14, the European Commission announced plans for its first carbon border tax, calling it the “Carbon Border Adjustment Mechanism”, which would require foreign companies to pay a fee, already required for European companies, for each ton of carbon dioxide produced.

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