# EU'S GREEN DEAL AND CARBON BORDER ADJUSTMENT MECHANISIM: A ROADMAP FOR TURKISH COMPANIES

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## 1. EU Carbon Border Adjustment Mechanism

The European Commission ("European Commission") announced on July 14, 2021 the proposal for a regulation that will form the legal basis of the Carbon Border Adjustment Mechanism ("CBAM"). This mechanism, which is defined as a carbon border tax, aims to charge a certain carbon price on the goods imported into the EU, especially on the ones produced without paying a price for carbon emissions. Thus, while the regulation and pricing for reducing carbon emissions within the framework of the EU Green Deal comes in, it is aimed to protect competitiveness of EU companies, which will have to comply with these regulations, against their competitors who have not paid a price for carbon emissions, and consequently to reduce the risk of carbon leakage.

The CBAM draft announced by the European Commission will enter into force as a regulation. Regulations, unlike directives, do not need to be transposed into national legal systems in EU member states, are directly applicable in all member states upon their entry into force. Thus, this means that member states will have no judicial discretion in how to implement CBAM and there will be a single legal procedure for CBAM at EU level, and all imports to EU countries will be subject to CBAM.

The draft foresees the application of CBAM primarily to imports from five carbon-intensive sectors. These sectors are cement, electricity, fertilizer, iron-steel and aluminium sectors, which bear the most risk of carbon leakage. It is quite likely that this list will be expanded to cover other sectors over time. The expansion of sectoral coverage would not require duplication of the legislative process, as the Commission would be able to enlarge the list. Therefore, it is critical for companies that are not currently on the list but in carbon-intensive industries, to follow the CBAM legislation closely and be prepared to comply with the CBAM requirements in a timely manner.

Each Member State will designate a competent authority which will carry out and implement the regulations set out by CBAM. Such designated authority will authorize the declarant, and only the authorized declarants shall be eligible to import goods into EU. Authorized declarants will have to submit an "CBAM declaration" annually to the competent authority. These declarations will include total quantity of goods imported, the total emissions embedded in the imported goods and the number of certificates that the declarant need to surrender. Each certificate surrendered by the importer will have a certain price. For this reason, although it is called a certificate, it will certainly be an additional cost for the imports.

In principle, the CBAM Draft provides for the declaration of the embedded actual emission value of an imported good instead of default emission values. The importing entities making the declaration shall ensure that the declared embedded emissions are verified by an independent auditor/verifier. In situations such as the authorized declarant's failure to provide the required information where actual greenhouse gas emission values cannot be verified, default values will be used to calculate the CBAM certificates to be surrendered.



The CBAM Draft also provides the opportunity to balance the carbon price paid in the country of origin of the imported good with the cost of CBAM, to support the use of carbon pricing elsewhere in the world. If a carbon price has already been paid in the country of origin for embedded emissions of the imported goods, declarants will have the opportunity to request a reduction in the number of certificates to be surrendered.

The proposal envisages January 1, 2023 as the start of a three-year transition period and full implementation from January 1, 2026. During the transition period, importers will only have a reporting obligation, importers will need to monitor and report their emissions before the full mechanism takes effect. The transition period will enable the European Commission to collect information on the carbon footprint of the producers. Payment of a carbon adjustment tax on imports will only begin as from 2026. The gradual inclusion of other sectors within the scope of CBAM during the transition period is undoubtedly among the objectives of the EU.

## 2. CBAM's Effects on Turkey

The CBAM to be implemented by EU will undoubtedly be a game changer in the global value and supply chain. Countries exporting to EU will be obliged to evaluate the effects of CBAM and determine their own climate policies to be able to remain competitive.

As the EU's sixth largest trading partner, Turkey is also analysing the possible impacts of CBAM on Turkish industry. Turkey's iron-steel and cement sectors, which rank in the tenth place in the world are the sectors that will be most affected by this regulation at the first instance.

Establishment of local mechanisms for carbon pricing in Turkey, in the near future is increasingly becoming a necessity. These steps will help the Turkish industry not to be adversely affected by CBAM. As a matter of fact, there are plans about creating market-based carbon markets within the framework of the Environment Declaration and the Draft Climate Law announced by the Ministry of Environment and Urbanization.[1]

Also in order for the carbon market to function properly and in a regulated manner, new services and financial products will be required which need to be provided by qualified and regulated service providers such as banks and other financial service actors. This would trigger a demand for a wide range of financial products and services, including project origination, financing, carbon credit brokerage and carbon trading services. European Bank for Reconstruction and Development ("EBRD") has initiated a support and training program regarding provision of financial services and products in carbon markets involving Garanti Bank, Yapı Kredi Bank, İşbank, Akbank, TSKB, Finansbank, Denizbank and Vakıfbank.

## 3. Roadmap for Turkish Companies and Exporers

While the preparatory work for the CBAM is being carried out by the EU Commission, Turkish companies that export or aim to export to the EU must act

[1] https://pmrturkiye.csb.gov.tr/wp-content/uploads/2020/12/Taslak-Iklim-Kanunu-1.pdf

promptly in the face of this game-changing regulation and improve their production and supply chains accordingly. Considering that the implementation will start in 2023 at the latest, the following roadmap can be suggested for enterprises that export to EU countries:

### i. The benchmark value determined for greenhouse gas emissions for products in the specified sectors should be considered

The benchmark values to be applied on each an activity between 2021-2025 were announced by the European Commission in March 2021.[2] Manufacturers and exporters producing in Turkey should first find out whether their emissions are higher or lower than the benchmark values announced by the European Commission. For example, the benchmark value determined for iron casting facilities was declared as 0.282 $tCO_2e$/ton. Therefore, a Turkish company producing iron castings should determine whether it is above this value/unit of production and how much it exceeds. After this analysis, producers with carbon emissions above these benchmark values should take the necessary measures to reduce their emissions. Otherwise, they will have to buy emission permits, or emission credits when the regulation becomes effective.

### ii. Greenhouse gas emissions must be tracked and reported accurately

In our country, greenhouse gases arising from certain activities are reported to the Ministry of Environment and Urbanization within the scope of the Regulation on the Monitoring of Greenhouse Gas Emissions (the "Regulation"). However, the Commission may bring a new approach to how the calculation will be made under the new CBAM. The total emission rate of the relevant product may be calculated by adding the emission resulting from international freight transportation (logistics), (i.e. transportation of products from Turkey to the EU) and the emission generated during the production process of that product. Similarly, the emissions linked to the supply chain may also be included. For example, the emission of a raw material or intermediate input of a product during the production and transportation process may be added to the total emission of the final product. Therefore, it is advised to make the carbon emission calculations according to the internationally accepted standards to make a more realistic comparison.

### iii. Carbon heavy activities must be determined in the entire production process

Companies should focus on identifying the heaviest emission sources. Improvements made in these activities will have a more impactful reduction in the emission figures. Collecting and analysing the data on a monthly or daily basis rather than annually, would guide the enterprises better as to which time periods they should focus on reduction of the emissions. Changes to be made in work programs or maintenance periods will contribute to emission reduction.

### iv. Climate change targets of companies in the supply chain should be questioned

Emissions from companies in the supply chain are not currently reported within

[2] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12792-Emissions-trading-system-benchmarks-for-free-allocation-of-emission-allowances-in-2021-25_en



the scope of the Regulation in Turkey. Inclusion of the suppliers in emission reduction efforts, will increase reduction opportunities, and will help to identify low-cost mitigation opportunities that can be realized jointly with the suppliers, especially given that certification and monitoring of the emissions throughout all supply chain will be tightened within the next few years by EU.

In parallel to the above, enterprises which do not necessarily export products themselves but supply raw materials or intermediate goods to other companies which then export their goods to EU, will also be affected by the CBAM. As the exporters will need to report or take in to account the emissions for the entire supply chain, the suppliers of these companies will be asked and pressured by their customers to reduce their emissions. The suppliers who cannot achieve this will lose their competitiveness. In addition, since there are many regulations that require companies operating in the EU to align their supply chains with the Green Deal, Turkish companies, which are the suppliers the companies in the EU, will have to take the necessary steps to align their emission levels.

### v. Awareness of employees on climate change

It is important to organize trainings and events to train and create awareness among the employees about climate change and greenhouse gas emission sources. By ensuring the participation of employees in these processes, innovative ideas, and suggestions for reducing emissions will be developed. The companies which engage their employees better to emission reduction initiatives, will execute and implement these processes with greater success.

### vi. Feasibility studies should be initiated for medium and long-term reduction targets.

Small and medium-sized companies that may be affected by CBAM will be able to benefit from various supports which will be provided by the EU. Therefore, by planning medium and long-term measures to reduce the emissions, the companies will become more competitive and prepared to benefit from the said supports and funds.

### vii. Easy access to finance and investment resources

Efforts and investments to reduce greenhouse gas emissions will not only save companies from carbon tax, but also enable them to access financing easier and cheaper in near future. Within the framework of the EU Green Deal, EU-based credit institutions and development banks such as the EBRD; will primarily choose or will become obligated to finance the activities which meet the greenhouse gas emissions targets set by EU.

Likewise, companies that managed to reduce their greenhouse gas emissions will be able to access investments easier from foreign investors and private equity and venture capital funds and will be able to easily qualify the criteria of investors. Investments funds, private equities and similar investors who provide equity investments are increasingly choosing to invest in companies with green or sustainable activities, and they will need to allocate a certain part of their investments to sustainable activities due to regulatory requirements or shareholder/stakeholder activism.

## 4. Conclusion

As a result, investments, and efforts to reduce greenhouse gas emissions will undoubtedly require some additional financing and investments for companies. However, companies that do not plan or make this investment in advance may have to bear much greater costs such as carbon tax, loss of competitiveness in the supply chain, or difficulty or inability to access financing and investment. These risks, which may come across as a threat, may as well turn into opportunities and competitiveness with advance planning and alignment.

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