

The Proposed Foreign Pollution Fee Act

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Introduction

Senators Bill Cassidy (R-La.), Lindsey Graham (R-S.C.), and Roger Wicker (R-Miss.) have introduced to the 1st session of the 118th Congress an amendment to the U.S. Internal Revenue Code that would levy charges on imports deemed more carbon intensive than competing U.S. goods. Titled the **Foreign Pollution Fee Act**, the bill may succeed where other U.S. border carbon adjustment proposals have failed, both because it does not impose any carbon costs on U.S. producers and because it draws on bipartisan support for restricting imports from China.¹

This note unpacks the substance of the Act in detail and offers opinions on that substance, laid out below in a series of **facts/commentary** couplets that focus on the Act's key elements.² It concludes by arguing that the bill would be highly complex to administer, offers too much discretionary power to administrators, and is more focused on geopolitics and protecting U.S. producers than it is on protecting the global climate.

Unpacking Key Elements of the Act

Covered Goods: Facts

The Act would cover 15 broad categories of products. Coverage would be for 6-digit Harmonized System-level products (i.e., many very specific products) from the following categories:

¹ Underlining the latter goal, the press release accompanying the bill characterizes it as: “An American plan to address the nexus between energy, economic development, supply chains, national security, and the environment at the expense of China and Russia.”

² The commentary in this note pointedly avoids opining on the legality of the Act under World Trade Organization rules, leaving that question to those more qualified to judge.



- aluminum
- biofuels
- cement
- crude oil
- glass
- hydrogen, methanol, or ammonia
- iron & steel
- lithium-ion batteries
- minerals: graphite, uranium, silicon, manganese, cobalt, lithium, nickel, and copper
- natural gas
- petrochemicals
- plastics
- pulp and paper
- refined petroleum products
- solar cells and panels
- wind turbines

Covered Goods: Commentary

This is a huge number of individual products at the 6-digit level. Iron & steel alone has 55 covered 4-digit level categories, for a total of over 350 6-digit level products.

It's not clear what the criteria were for including these goods. The inclusion of lithium-ion batteries, solar cells and panels, and wind turbines, none of which has a high value of embedded carbon relative to value added, shows that the intent goes beyond prevention of carbon leakage to protection of domestic producers from competition in key sectors.

In that same vein, the procedure for adding more products fails to spell out any criteria, for example, related to climate impacts, or risk of leakage, or unfair trade practices. Any sector that can muster petitioners representing 50% or more of domestic production will be added to this list. This feature turns the Act into an indiscriminate builder of protective walls for U.S. producers.

The Charges: Facts

The charges will be based on how much more greenhouse gas-(GHG-)intense foreign production of a product is on average than U.S. production. They will be specified as percentages of the value of goods (ad valorem charges) that rise as the differential rises, falling into at least 25 tiers. The Act does not specify the value of the charges; those would be set by the Secretary of the Treasury within 2 years of passage. They would be individually set for each tier of each covered product.



The value of the charges would be specified so as to achieve three phases of reductions in the GHG-intensities of imported goods. In the first 6-year phase, the goal would be to reduce goods with greater than 50% differential to less than 50%; to reduce products with between 50% and 25% differential to less than 25%; and to reduce goods with less than 25% differential to less than 10%. The second and third phases would see charges set to ramp up that level of ambition in similar fashion.

The Charges: Commentary

This would be a Byzantine regime, with an individually tailored rate set for each of the 25+ tiers for each of hundreds of 6-digit products, set so as to achieve a given percentage reduction in the GHG intensity of foreign production of each product. Specifying tiered ad valorem charges such that they achieve those final goals for each product would be pure voodoo economics.

In contrast to the European Union's (EU's) Carbon Border Adjustment Mechanism, the ad valorem rates would not correspond to the embodied GHGs in the products—that would be difficult since the United States does not have a carbon price to reference—but would instead be married to the goals described above.

There would not be credit for a carbon price paid in the country of export. Under carbon pricing regimes, producers with high emissions are already penalized for those emissions by paying a high carbon price. The pollution fee specified in this Act would create a double charge on GHG emissions for such exporters.

Pollution Intensity: Facts

Pollution in this Act means GHG emissions. In order to calculate the amount due for any given product, the United States needs to know the value of the product imported, the rate of charges assessed, and the differential between U.S. average GHG intensity for that product and that of foreign producers.

Estimating the GHG intensity of U.S. and foreign producers for the various products would be done by the National Laboratory Advisory Board. Established under the Act, the board is chaired by directors of national laboratories and the chair of the Council on Environmental Quality, with one director from each relevant federal agency, and two representative CEOs from each of the 15+ covered sectors.

Pollution intensity values would be reassessed every 3 years. Recycled inputs, such as scrap steel and aluminum, would be assigned a zero value of embedded GHGs. Carbon capture and storage would be allowed to reduce estimated pollution intensity. Pollution intensity values would be assigned to foreign producers based not on geographical location, but on the country of ownership, operation, or majority finance of the facility.



If the data used is from modelling not primarily aimed at producing GHG-intensity values, or is focused on a subnational region, a 20% GHG-intensity penalty would be added.

Foreign-provided data can be used only where rigorously verified.

Pollution Intensity: Commentary

It will be extremely difficult to get accurate estimates of national average GHG intensity for each of the covered products in each of the U.S.'s trading partners. Not only is that a lot of numbers, but it is data that's not available at a meaningful level of disaggregation. The pragmatic solution will probably be to assign a score to an entire class of goods, such as iron and steel, rather than the hundreds of products covered by that classification. But even that will be challenging, since good data in many countries simply don't exist.

The membership of the board is problematic; it will be dominated by at least 30 CEOs of U.S. producers, with their influence watered down only by a few federal agency representatives, the chair and the deputy chairs. There is clear potential for self-serving recommendations.

The provision on foreign ownership on its face looks designed to prevent exporters from rerouting investment from countries with high GHG-intensity production to those with low GHG-intensity production. But that rationale doesn't hold since such rerouting would actually be a global environmental win. The real rationale is likely to prevent Chinese investment from migrating to third countries to get around China's harsh treatment under the Act.

The assumption of zero GHG-intensity for recycled inputs is beneficial to U.S. steel producers because they predominantly use a (cleaner) production method fed by scrap; it would be disadvantageous to producers in places like China and the EU that do not. Similarly, the allowance of credit for emissions captured, utilized, and stored (CCUS), is probably assumed to be beneficial to the United States in future, given the significant subsidies offered for CCUS technology under the U.S. Inflation Reduction Act.

Exceptions: Facts

Any products with a GHG-intensity differential of less than 10% are not charged. Nor are goods for which there is deemed to be too little U.S. production, with a default threshold of 5% of domestic consumption.

Goods produced in countries with a free trade agreement (FTA) with the United States may be exempted. To qualify for that exemption, the products must have a GHG-intensity differential of less than 50%, and 100% of all components must be produced in the United States or an FTA country. Non-market economies are not eligible unless they are low-income or lower-middle income countries with an international partnership agreement with the United States.



Exceptions: Commentary

The 100% local content requirement as a condition of eligibility for producers in FTA countries is manifestation of the fundamental economic objectives of the Act.

Circumvention: Facts

If the Secretary determines that there is circumvention of the Act, the variable charges will be raised accordingly. Circumvention might be in the form of strategic lowering of prices, or domestic subsidies, to offset the Act's variable charges.

Beating the Default: Facts

Foreign producers are allowed to have their facility-level GHG-intensity data used in place of the default national sectoral average figures, a possibility that would reward relatively clean production. To do so, they would need to conclude a facility-specific agreement (FSA) with the United States Trade Representative. Congress would need to be informed of any FSA negotiation, be briefed on the agreement's contents, and not raise any objections. To qualify for an FSA, a producer would need to

- follow all standards legally imposed on U.S. producers (e.g., Clean Air Act, National Environmental Policy Act, but not necessarily limited to environmental standards);
- install real-time pollution monitoring equipment;
- if the facility's GHG-intensity is higher than the U.S. average (or higher than the average in the cleanest country with which the United States has an international partnership agreement), enact and achieve measurable benchmarks to a 10-year path to equalling the United States or other country's levels, and enact and achieve benchmarks for the next 10 years to arrive at 50% of those levels;
- ensure that any pollution reduction technology used to achieve the benchmarked milestones contains no less than 50% U.S. components;
- allow physical access, including spot checks, to U.S. inspectors or their agents to ensure overall compliance.

FSAs would not be available to most state-owned facilities in non-market economies.

Beating the Default: Commentary

This is an important feature. Cleaner foreign producers should be rewarded for their investment and initiative, not saddled with higher-GHG national average defaults. But it is rendered useless by the onerous requirements attached to it.

The process is akin to treaty making, needing Congressional notice and approval. The substance of the requirements is inequitable; U.S. producers are not required to install costly real-time



monitoring equipment or allow for spot checks to verify their reported GHG emissions data. Requiring that foreign producers be current with and comply with the daunting body of U.S. regulations applicable to U.S. producers is unreasonable. The requirement for decarbonizing technology used for achieving benchmarks to be 50% sourced from the United States is also unreasonable and potentially increases compliance costs. It is hard to imagine a foreign producer for whom the benefits of an FSA would justify the costs of these requirements.

International Partnership Agreements: Facts

At the direction of the President, the United States Trade Representative can negotiate international partnership agreements (IPAs) with countries, groups of countries, or countries participating in an international forum such as the Organisation for Economic Co-operation and Development. The agreements can cover one or more products, and would grant special treatment to producers of those products in the partner countries.

Among other benefits, concluding an IPA would allow a partner country's covered products to be assessed zero charges if their GHG intensity was up to 50% greater than the U.S. average. Also, partner countries would not be subject to the 20% GHG-intensity penalty for subnational data or data from other types of modelling. IPAs would have other benefits for low-income and lower-middle-income countries, described below.

The requirements spelled out in an IPA would include agreements on methodologies for measuring GHG intensity and providing the ability of partners to verify monitoring and reporting in other partner countries. They would also include the "elimination of any fee or charge between countries that are parties to the agreement" and "elimination or reduction of other duties, import fees, and trade barriers maintained by the country related to covered products."

If concluding an IPA with an upper-middle-income country, or any country with a mutual defence treaty or security partnership with the United States, is determined to assist U.S. national security or geopolitical positioning, that IPA would grant the partner country the special Section 203 status normally reserved for low-income and lower-middle-income countries (described below).

International Partnership Agreements: Commentary

The requirement for the elimination of any fee or charge between parties is extremely broad and is probably intended to be with reference just to covered products. This requirement and the requirement for elimination or reduction of other duties, import fees, and trade barriers, are unclear. How much reduction of trade barriers would be acceptable? Will these requirements be spelled out in greater detail in individual IPAs to address the trade irritants of the day between the parties?

The IPAs represent a valuable exception to the Act, particularly for poorer countries (see below). Vague criteria for qualification give the United States a powerful lever for dismantling trade



barriers in partner countries. Moreover, the list of requirements spelled out in the Act is not exhaustive; IPAs may ultimately include more wish-list concessions unrelated to trade in the covered products.

Section 203 status is a valuable concession to upper-middle-income countries or countries in defence or security pacts with the United States. Granting it only where the United States determines it to advance its security or geopolitical positioning has nothing to do with climate change and everything to do with geopolitics.

It is highly likely that these requirements will be interpreted so as to prevent the negotiation of an IPA with any country that is applying a border carbon adjustment to covered products exported from the United States.

Treatment of Low-Income and Lower-Middle-Income Countries: Facts

Section 203 allows for special treatment for low-income and lower-middle-income countries if they have concluded an IPA with the United States. The first 5 years of such an IPA will apply no charges to covered goods. The next 10 years may extend that exemption if any new producers of the covered goods are not more than 50% more GHG intense than the average that prevailed at the time of entry into force of the IPA. Each subsequent 10-year period will again extend the exemption if new producers added in the previous period were not more than 25% more GHG intense than the prevailing average at the beginning of that period.

IPAs may also contain commitments of aid and technical support and less stringent initial requirements for GHG emissions monitoring.

Treatment of Low-Income and Lower-Middle-Income Countries: Commentary

The special conditions described here are welcome concessions to countries and producers with more limited means to comply with the Act. At the same time, they seem to contain incentives for continuous improvement to maintain charge-free status, which would be good form. The incentives, however, are strangely weak. A new facility 5 years from now in any country should be less GHG intense than the average of facilities existing today, which will include old inefficient plants, but the standard set is within 50% more GHG intense.



Concluding Thoughts

U.S. legislators should be applauded for exploring ways that trade policy can serve both climate and economic goals. However, the Act as drafted is flawed in three significant ways.

First, it will be complex to administer. It will involve specifying, and reassessing every 3 years, the average GHG intensity of hundreds of products in every U.S. trading partner. It will involve setting individual schedules of variable charge rates at more than 25 tiers for each of those hundreds of products. Customs officials will need to track which countries and which products are subject to which of the many provisions for special treatment and exemption.

Second, it allows for too much discretion in its application. Most fundamentally, the guidance for setting the variable charges amount to a *carte blanche*—almost any numbers could be justified. As well, there are no predictable objective criteria to determine who will receive some of the most important special treatment. IPAs will be negotiated at the direction of the President and may contain extraneous conditions. Facility-specific agreements can be held hostage by Congressional objections. Exemptions for upper-middle-income countries will only be granted if they are deemed to further U.S. security and geopolitical interests.

Finally, many individual facets of the Act add up to indicate that it is mostly focused on geopolitical positioning and protecting U.S. producers rather than on mitigating global climate change. The inclusion of goods like solar panels and critical minerals indicates that the aim is not the prevention of carbon leakage but rather the protection of key markets. Not crediting for carbon prices paid in the country of export means that foreign GHG emissions subject to carbon pricing will be double charged. Making facilities responsible for the GHG intensity of the country of ownership rather than the country of location makes sense for ringfencing Chinese investment but not for considering actual emissions. Methodological assumptions such as zero GHGs for recycled inputs will benefit U.S. producers, and more such assumptions may be forthcoming from a board that is dominated by CEOs of those same producers. Local content requirements as a condition of benefiting from the FTA exemption, or from the FSAs, have nothing to do with climate goals. The environmental benefits of allowing clean producers to challenge the national average defaults are effectively gutted by impossible conditions. Geopolitical and security objectives guide the granting of Section 203 treatment to upper-middle income countries. And countries with border carbon adjustment are certain to be shut out of the prospects for IPAs.

The emphasis on geopolitical aims, combined with excess discretion, synergistically make the Act a powerful tool for international influence and protection of domestic industry. That effect is exacerbated by the fact that literally any sector can be added to the list of covered sectors, depending only on mustering enough industry support for the ask. Some might argue that it is on those criteria that the Act should be judged, and on those grounds it may be effective, if unwieldy. But as a model for trade measures to address climate change or as a basis for international cooperation toward that end, it comes up well short.

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