Course on Climate-Smart Trade and Investment for Sustainable Development

Climate polices and international trade: Implications of the EU’s Carbon Border Adjustment Mechanism

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The Commonwealth
Trade Hot Topics
A Special Focus on Trade, Environment and Climate Change
Outline

Overview of the EU’s Carbon Border Adjustment Mechanism (CBAM)

CBAM’s implications for international trade

Key issues and challenges around the CBAM

Conclusion
Overview: Salient features of the EU’s CBAM

- Pricing embedded carbon (direct and indirect) at the border for specified imports according to the emission intensity of goods’ production processes
- Transitional period from 1 October 2023 to 1 January 2026, and phase-in period for 8 years from January 2026
- Resolution entered into force on 16 May 2023 and the first report to be generated on 31 Jan 2024.
- In phase 1, the CBAM will apply to more than 500 products in six energy intensive sectors (EU deal reached on the CBAM: what you need to know)
- Imports originating from countries having their own carbon pricing or ETS could seek abatement in CBAM charges.
Industrial sectors with strong forward and backward linkages are exposed to the CBAM

- Iron and steel: Canada, the UK; India, South Africa, Malaysia
- Aluminium: Canada and the UK; Mozambique, India, South Africa, Papua New Guinea
- Fertilisers and chemicals: The UK, Canada; India, Singapore, South Africa, Jamaica
- Cement: The UK, South Africa
- Electricity: The UK

Pie chart showing the percentage exposure:
- Iron and steel: 54%
- Aluminium and aluminum products: 18%
- Electricity: 18%
- Fertilisers: 5%
- Cement: 3%
- Hydrogen: 1%
- Chemicals: 1%
Rational of the CBAM

Carbon leakage occurs when companies based in the EU move carbon-intensive production abroad to countries where less stringent climate policies are in place than in the EU, or when EU products get replaced by more carbon-intensive imports: [Source: Carbon Border Adjustment Mechanism (europa.eu)]

- Iron and steel
- Aluminium
- Fertilisers and chemicals
- Cement
- Electricity and hydrogen

Absence of emission reduction policies globally

Competitiveness loss

Carbon leakage
Mechanics of the CBAM

- Non-EU firm in energy intensive sector
  - Domestic carbon pricing
    - Charges paid abroad >= EU carbon price: No CBAM charge
    - Charges paid abroad < EU carbon price: Pay the difference in carbon price
  - No domestic carbon pricing: CBAM charges in full

- Iron and steel
- Aluminium
- Fertilisers and chemicals
- Cement
- Electricity and hydrogen
CBAM timeline: Transition to full implementation
Implications for international trade

- EU-bound exports in CBAM exposed sectors
- Regional break up
Exports from energy intensive sectors at risk

- EU-27’s total imports in 2022: US$7.4 trillion (29%)
  - Exports at risk of the EU CBAM:
    - $556 billion (of $1,310 global total)
    - 42% of exports from these selected sectors
    - 7% of all EU-bound exports
  - Recent BCA announcements (for instance, United States; Canada; Japan; UK and others) could place large exports from these energy intensive sectors at risk ($1.3 trillion).
Distribution of global trade exposed to the CBAM across regions (US$ billion, %)*

<table>
<thead>
<tr>
<th>Region</th>
<th>EU-27 bound (US$ billion)</th>
<th>RoW (US$ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>555.5</td>
<td>755.0</td>
</tr>
<tr>
<td>South America</td>
<td>8.3</td>
<td>87.4</td>
</tr>
<tr>
<td>North America</td>
<td>10.2</td>
<td>84.2</td>
</tr>
<tr>
<td>Asia</td>
<td>74.0</td>
<td>295.0</td>
</tr>
<tr>
<td>Africa</td>
<td>15.5</td>
<td>28.3</td>
</tr>
<tr>
<td>East Asia</td>
<td>46.5</td>
<td>332.6</td>
</tr>
<tr>
<td>South Asia</td>
<td>9.7</td>
<td>19.0</td>
</tr>
<tr>
<td>LDCs</td>
<td>2.7</td>
<td>3.9</td>
</tr>
</tbody>
</table>

*Data for 2022*
Commonwealth members’ trade exposed to the CBAM

<table>
<thead>
<tr>
<th>Region</th>
<th>EU-27 (US$ billion)</th>
<th>Rest of world (US$ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Commonwealth</td>
<td>21.1</td>
<td>102.5</td>
</tr>
<tr>
<td>Developed</td>
<td>12.4</td>
<td>64.6</td>
</tr>
<tr>
<td>Developing</td>
<td>8.7</td>
<td>38.0</td>
</tr>
<tr>
<td>Asia</td>
<td>1.9</td>
<td>10.2</td>
</tr>
<tr>
<td>Africa</td>
<td>4.9</td>
<td>20.3</td>
</tr>
<tr>
<td>Caribbean</td>
<td>0.4</td>
<td>2.5</td>
</tr>
<tr>
<td>Pacific</td>
<td>1.4</td>
<td>5.0</td>
</tr>
<tr>
<td>Vulnerable groups</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Small states</td>
<td>4.2</td>
<td>49.1</td>
</tr>
<tr>
<td>LDCs</td>
<td>0.5</td>
<td>5.9</td>
</tr>
<tr>
<td>SIDS</td>
<td>1.9</td>
<td>7.6</td>
</tr>
</tbody>
</table>
Issues and concerns regarding the CBAM

- WTO compatibility
- Administration and compliance
- Revenue generation and usage
- Treatment of developing countries and LDCs
Under certain conditions, Members can adopt trade-related measures aimed at protecting the environment provided they do not constitute a disguised barrier to trade or discriminate between countries.
Administrative challenges around implementation (1)

- Absence of universal measurement standards for assessing product-specific emissions (MRV)
- Capacity constraints in developing countries to measure emissions and complete procedural formalities
- Complications around abatement (production place vs. default emission averages)
- Effectiveness to reduce global emissions
Developing countries perspectives on the CBAM

- Undermines the spirit of multilateralism

- Potential conflict with Paris Accord and United Nations Framework Convention on Climate Change (UNFCCC) principles:
  - Nationally Determined Contributions (NDCs)
  - Common but Differentiated Responsibilities and Respective Capabilities (CBDR-RC)

- Potential conflict with the WTO rules (MFN, and NT)
  - Green protectionism; shifting climate mitigation burden on others
  - Forcing countries to align their trade policies with the EU
Some thoughts from African members

- African continent could lose $26 billion per annum due to the EU’s border taxes.

- South Africa’s exports at risk of the EU CBAM:
  - $1.5 billion
  - 4% potential decline in the EU-bound exports

- Fragile economies (LDCs, for example Mozambique) not exempt

- Knock on effects on upstream sectors, leading to increase in poverty, inequality and unemployment

- Potentially violates WTO’s provisions on non-discrimination

- Inclusion of indirect emissions (scope 2 and scope 3) could have significant negative effects.
Alternative carbon pricing proposals

A: Universal carbon floor price

- $75-advanced economies
- $50-high income countries
- $25-low income and emerging markets

B: Climate clubs (G7)

Inclusive vs. exclusive clubs

CBAM + Climate Club=Carbon Customs Union
4. Conclusion and way forward

- Need for more global cooperation and coordination.
- Multilateral agreement similar to the Paris Accord or Glasgow Climate Pact
- Dissemination of environmental technologies
Thank you!