



EDITORIAL ANALYSIS

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EU's Carbon Border Adjustment Mechanism calls for a well-hedged response

Syllabus: GS2/ Government Policies & Interventions; GS3/Conservation In Context

- The European Union's Carbon Border Adjustment Mechanism is likely to hurt India's economic interests.

Carbon Border Adjustment Tax

- **About: The European Union** has proposed a policy called the Carbon Border Adjustment Mechanism (CBAM) to **tax products** such as **cement and steel** that are **extremely carbon intensive**, with effect from 2026.
 - It is a **duty on imports** based on the **amount of carbon emissions** resulting from the production of the product in question.
- **Significance:**
 - **Discouraging emissions:**
 - As a price on carbon, it discourages emissions. As a trade-related measure, it affects production and exports.
 - The EU claims to be **concerned with the relocation of production** to countries with **less ambitious climate policies**, undermining EU's and global climate objectives.
 - **The CBAM also has an economic driver.**
 - By 'equalizing' the price of carbon between domestic products and imports, the EU claims to **promote fair competition**, leveling the playing field **between EU and non-EU businesses**.

How would the CBAM work?

- If implemented as planned, **EU importers** will have to buy **carbon certificates corresponding to the carbon price** that would have been paid in the EU, if the goods had been produced locally.
- The **price of the certificates** would be calculated according to the auction prices in the EU carbon credit market.
 - The amount of certificates required would be **defined yearly** by the quantity of goods and the embedded emissions in those goods imported into the EU.

- The CBAM would initially apply to imports of **cement, iron and steel, aluminium, fertilizers and electricity**.
- The **UK proposes levying CBT** on cement, chemicals, glass, iron and steel, non-ferrous metals, non-metallic minerals, paper and pulp, fertiliser, and power generation.
 - The list will gradually expand to cover all products by 2034.

Challenges & criticisms

- **Need of clarity:** As carbon pricing is a useful device against climate change, the CBAM does have a clear principle behind it.
 - The EU's Emissions Trading System (ETS), its cap-and-trade mechanism, has revealed flaws that cast doubts on its efficacy. Controversies have arisen over fudged offsets, suggesting that the ETS can be distorted.
- **Questions on CBAM levy:** A CBAM levy can be questioned if sought to be imposed post-2026 at the ETS rate.
 - China's price is roughly a tenth of that and India's net-zero goal of 2070 and low cost base overall both suggest it would be even cheaper here.
 - So what the EU claims as an equalizer could also act as an import barricade in the shape of punitively high tariffs.
- **No rightful focus:** According to few experts, Carbon Tax is unjust. CBT may not help in reducing pollution as there is no focus on lowering wasteful consumption.
- **Market distortion & trust deficit:** At COP27 BASIC group opposed the 'carbon border tax'. They have jointly stated that carbon border taxes, that could result in market distortion and aggravate the trust deficit amongst parties, must be avoided.

BASIC Group

- **BASIC**, a group constituting **Brazil, India, South Africa and China**, and therefore large economies that are significantly dependent on coal, has for several years voiced common concerns and reiterated their right to use fossil fuel in the interim during their countries' eventual transformation to clean energy sources.

Challenges for India

- **Acting as a trade barrier:** With the EU's Carbon Border Adjustment Mechanism (CBAM) in effect from 1 October, India's exports of carbon-laden products to Europe—mainly aluminium and iron-and-steel—have been burdened with green reporting rules which is a trade barrier in itself.
 - This action by the EU is likely to hurt our economic interests, which explains why the government might protest it as an unfair tariff at the World Trade Organization (WTO).
- **Uncompetitive exports:** India's products have a higher carbon intensity than its European counterparts, the carbon tariffs imposed will be proportionally higher making Indian exports substantially uncompetitive.
- **May push for similar regulations worldwide:** International climate policies (including CBAM) will compel other countries to impose similar regulation eventually translating to 'a significant impact' on India's trading relationships and balance of payments.

Suggestions

- **Minimising Impact:** CBT will affect lakhs of small and big firms. Indian exporters **must factor in CBT into their costing** and prepare to minimise its impact.
- **Focusing on greener production options:** The rate of CBT depends on how much carbon has been emitted during production to make the export product.
 - So, there is a need to explore greener production options for the production of the concerned commodities.
- **Sharing emission data:** Indian exporters of **steel, aluminium, cement, fertiliser, hydrogen, and electricity** will need to share precise emission data with the counterpart EU importers, who will share the data with the CBT authorities.
 - The producers' data would include **installation-wise production** details like the number of products, verified emissions reports, and data regarding the embedded emissions of each type of goods.
 - Scientifically capturing this data **will need the help of energy auditors.**
- **Using power generated from renewable energy:** This will immediately lower the carbon load — fossil fuels like coal, oil, or natural gas cause 75 per cent of global carbon dioxide emissions. **Wind, solar and green hydrogen are current options.**
 - However, switching to new technology is expensive and may only be feasible in some cases.

Way ahead

- Anything that distorts trade flows must duly be put to scrutiny. It will give us a realistic view of future trade dynamics and help exporters hedge their risk of green barriers.
- Transparency and non-discrimination should remain key principles of any global understanding, and that should also ensure that carbon-related measures do not unnecessarily restrict trade.

Daily Mains Question

[Q] The European Union's Carbon Border Adjustment Mechanism (CBAM) is likely to hurt India's economic interests. Analyse. Suggest measures to be undertaken by exporters & other stakeholders in response to the CBAM.