
EVALUATING THE IMPACT OF CBAM ON DEVELOPING COUNTRIES

THE EU'S NEW APPROACH TO
MULTILATERALISM AND TRADE

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EXECUTIVE SUMMARY

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The EU's ambitions to decarbonise are laudable; however, the way in which its European Green Deal interacts with the rest of the world deserves further investigation, especially given that the success of the EU's climate, environment and energy policies largely depends on constructive cooperation with international partners. The case of the Carbon Border Adjustment Mechanism (CBAM) provides a key example through which we can understand that the European Green Deal will come to have a bearing on the manifold trade interdependencies the EU finds itself at the heart of and which risk being significantly affected. By retracing the long road the EU embarked on to reach a mature carbon market, this policy study highlights the blind spots that must still be tackled for the successful externalisation of the EU model through CBAM with respect to trading partners and developing countries. This includes addressing the sticking point of pricing equivalencies, the linking of markets and the need for compensatory measures where the EU CBAM imposes undue costs on trading partners, especially where such costs are in contradiction with requirements for climate justice.

1. INTRODUCTION

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With growing political tension among countries in the G20, there has been a revised view of multilateralism. Many see multilateralism at its ebb,¹ as there are demands for truly representative institutions, be it the UN² or the OECD, for example, in the case of tax matters. Co-operation matters in all fields; however, it is particularly difficult to achieve in some matters of climate change. The UN has been instrumental in shaping the discussions on climate change, notably, the conversation on the financing of mitigation and adaptation. While the Paris Agreement allows countries to set their own targets, in line with their priorities, domestic targets can be internationalised through the use of measures that curtail such trade and financial flows. For example, the onerous disclosure standards for foreign companies competing in domestic product markets, domestic financial investors in investments abroad or levies on countries that do not follow sustainability standards can be added costs. One such issue has become particularly problematic: the imposition of the Carbon Border Adjustment Mechanism (CBAM) by the EU. While developing countries see this as a measure that would impose costs, the EU sees this as a purely internal and environmental measure, given its imposition on EU-based importers.

The CBAM aims to apply a carbon price on imports, with the stated aim of tackling carbon leakage. However, empirical evidence suggesting that EU climate and environmental policies will indeed cause carbon leakage, or that CBAM is the best tool to deal with such leakage, is somewhat lacking.³ Nevertheless, the EU has proceeded to apply the levy to meet its internal targets for emission reduction.

As a result, trade-related tensions have escalated. Although the Emissions Trading System (ETS) is now working in its fourth phase, its calibration and agreement among EU countries was not particularly easy, since CBAM imposes a cost on traders in other countries. At the same time, the annual

revenue generated by CBAM is expected to be €1.5 billion (2018 prices) as of 2028.⁴ The economic impact on developing countries with significant trade ties with the EU may in fact be larger than the revenues generated by CBAM. As such, there have been demands for compensatory measures. Therefore, it is important to consider what the EU is able to distribute as grants or aid and whether this would attach any pre-conditions on use. The second question is whether the transfer would be government to government, which means that the government which receives such transfers would also have to meet transparency obligations, or whether such transfers would be government to business. The fact that for businesses the only way to “earn” a full exemption (i.e., no rate payment and no compliance cost) is by linking to the EU ETS may very well be unfair for those that are pioneering clean production technologies in regimes where carbon pricing cannot be implemented for political reasons (such as the USA) or because of the cost of implementing and enforcing the mechanisms (such as most low-income countries and low- to middle-income countries). This policy study documents the EU’s experience with ETS to demonstrate that, while such a system of pricing evolved and matured over a period, CBAM expects businesses in different jurisdictions to price in line with the EU’s carbon price without the necessary time for their own systems to evolve and mature.

2. THE EU AND MULTILATERALISM

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To understand and untangle the stress point that CBAM has created in multilateral fora, it must first be contextualised in the EU's role in these fora. For instance, many have ascribed a solidarising role in international climate negotiations to the EU, meaning the EU has generally sought universal agreements that circumscribe the role of the state, in favour of multilateral cooperation and a rules-based system.⁵ Simultaneously, in the aftermath of the 2009 Copenhagen Accord, which has been largely assessed as a failure of the EU's climate diplomacy, and in the lead up to the Paris Agreement, the EU increased the flexibility of its stance regarding top-down approaches.⁶ The EU also has a legacy of supporting climate justice in multilateral fora, notably in contributing to the drafting of the "common but differentiated responsibility" (CBDR) clause of the 1992 Rio Declaration. However, the latter, although advancing distributive climate justice (ensuring a fair distribution of the costs of climate action), has since become a barrier to effective and ambitious agreements.⁷ Rather than suggest doing away with distributive justice considerations, this demonstrates the need for substantiating higher-level principles with appropriate methodologies for their implementation, and the need for global enforcement mechanisms. The EU's often self-proclaimed "normative" role in leading by example in climate negotiations has also become the subject of increased scrutiny, with the EU's shift towards strategic autonomy suggesting the EU's support for multilateralism regularly correlates with the pursuit of its own interests.⁸ With the EU, as with any political actor, a clear gap can be identified between rhetorical commitments to climate justice and policy practice. In this vein, the implementation of CBAM risks further renegeing on the hard-won CBDR principle, depending on the cost pass-through imposed on trade partners. However, the effectiveness of CBAM, even in reducing emissions globally, is premised on it sending a strong geopolitical signal, which triggers international partners to implement their

own carbon-pricing instruments, or up their ante to match the EU's carbon-pricing instrument.⁹ With the announcement of the UK's plan to introduce its own CBAM by 2027, there is a clear sign that such a strategy has started to bear fruit.¹⁰ Such a conclusion entails that the EU CBAM is first and foremost a climate leadership tool, and further points to the limitations in the EU's self-identification as a "force for good" in the climate justice debate, and a return to forms of top-down approaches.¹¹ Indeed, the thus-far unilateral logic of CBAM stands in stark contrast to requirements for partnerships of equals, rather depending on instigating a carbon-pricing "Brussels effect". Until this is remedied, it will remain difficult to find coherence between the EU's support for multilateralism and climate justice on the one hand, and the distributive and procedural consequences of the policy instruments it chooses on the other. This dynamic tension presents key challenges for the successful implementation of CBAM, which are to be explored in the subsequent sections of this policy study.

3. LINKS BETWEEN CBAM AND THE EU ETS

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The CBAM is part of the EU's strategy to price carbon so as to achieve emission reductions, and as such the price points of certificates to be surrendered by importers are determined by the weekly auction price of emission allowances in its ETS. Since CBAM is linked to ETS, it is essential to understand the context and evolution of the market as well as the flexibilities afforded to countries. The EU introduced ETS through a binding regulation¹² that was to achieve the EU's obligations under the Kyoto Protocol. The linking directive initially allowed the use of Kyoto Credits, such as certified emission reduction (CER) units and emission reduction units. It was launched in 2005 and its coverage expanded to all EU member states plus Iceland, Liechtenstein and Norway.¹³ An ETS allowance permits an entity to emit one tonne of CO₂ and in its initial phase member countries were allowed to draw up their national allocation plans (NAPs) based on objective and transparent criteria. That is, the NAP would be based on the member country's Kyoto target and projected progress. The caps could be decided by the state, unless they conflicted with state aid rules.¹⁴ The NAPs were prepared ahead of the launch of ETS. The process was long and complex, as the European Commission (EC) reviewed these plans for non-discrimination between companies/sectors and compatibility with targets, and in some cases reduced the proposed allocations (14 out of 25).¹⁵ The EC's decisions on NAPs led to litigation. Member states and corporations (heavy industry and energy production) challenged the discretion of the EC, where a number of these cases pertained to administrative limits to approving the national action plans under the directive.¹⁶ The cases brought by governments have had some success, for example, in *Republic of Estonia v Commission of the European Communities* and *Republic of Poland v. Commission of European Communities*, the Court held that the Commission infringed the principle of

sound administration.¹⁷ Therefore, in its initial phase, the ETS allowed for national autonomy, even though the EC did reserve the right to revise the national plans. Eventually, the regional market developed, allowing for greater cohesion.

However, it took a long time for the EU ETS to move from the trial phase in 2005-07 to its full applicability. The experience also demonstrates that there is inherent tension between respective national goals and priorities. In the first phase, sector coverage was limited to power generation and energy-intensive sectors and almost all business allowances (2,100 million¹⁸) were free. Since this was an early phase, there was no data on emissions and the caps were set on the basis of estimates. Some members used auctioning and some used benchmark-based allocation. To make the system work, grandfathering¹⁹ of allowances was also permitted to avoid carbon leakage, even though it was criticised for distorting competition.²⁰ It is expected that, under such conditions, the allowances would be more generous than those required to meet the targets, and the price of allowances in fact fell to zero in 2007.²¹ Grandfathering was eventually abandoned, and the free allowances to energy installations were taken away in 2013.

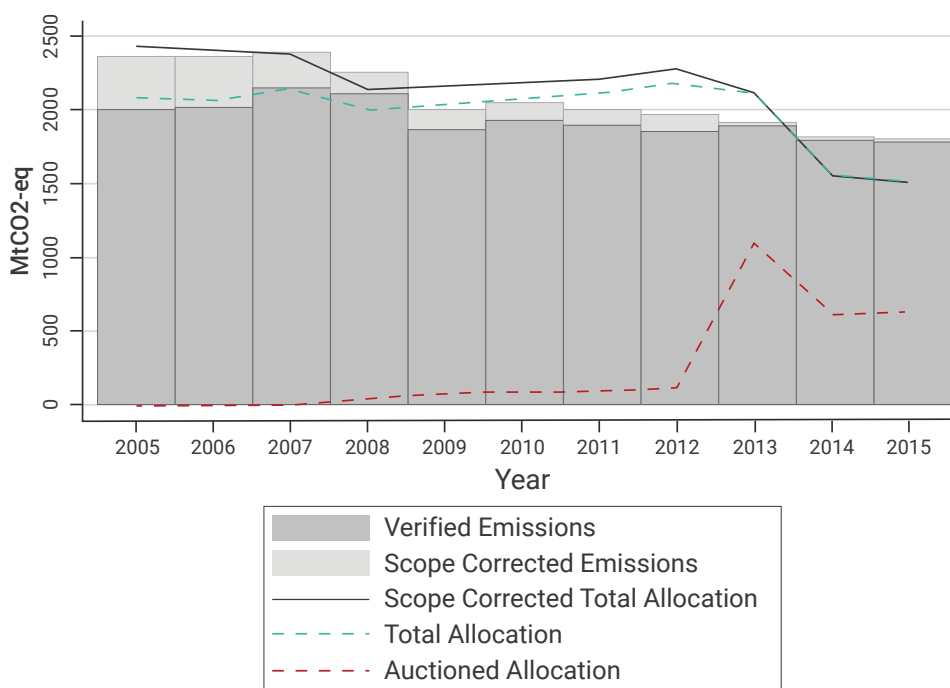
In the second (2008-12) and third phases (2013-20), more stringent caps were applied (Figure 1). In the second phase, the allowances were 6.5% lower compared to 2005 and the penalty was raised. In this phase, the free allocations fell to 90% and international credits of 1.4 billion CO₂ equivalents could be purchased, a union registry²² replaced national registries, and the European Union Transaction Log replaced the Community Independent Transaction Log. As ETS moved to the third phase, the system changed considerably; there was an EU-side single cap on emissions, auctioning became the default for

allocation and there was a harmonised method for allocation of free allowances. 57% of the allowances were auctioned and 88% were distributed based on verified 2005 or average 2005-07 emissions, while 10% were allocated to 16 lower-income states under the solidarity provision.²³ More sectors joined the list, including gas, and 300 million allowances were set aside for new entrants. Banking of allowances was also permitted, that is, the allowances with businesses at the end of the second phase could not be used in the third phase but, instead, an equivalent amount could be created by the deletion of phase 2 allowances and their simultaneous creation in phase 3.²⁴ There is an annual compliance (measurement, reporting and verification, MRV) requirement for the EU ETS. The operators are required to submit emissions reports and data is verified by an accredited verifier. Once verified, the operator must surrender allowances before 30 April of that year.²⁵ Every year, the allowance for stationary installations is expected to decline by a linear reduction factor (LRF) of 1.74%, and in the fourth phase, this reduction factor will be 2.2%. Ten member states with a GDP per capita below 60% of the EU average

in 2013 may opt to continue allocating part of their auction volumes as free allowances to the energy sector up to 2030, under Article 10c of the ETS Directive.²⁶ So far, Romania, Bulgaria and Hungary will use this provision.²⁷ It is observed that the result of free allowances is that large companies make a windfall profit from the sale of these allowances, while charging consumers for a non-existent carbon price. It is estimated that between 2008 and 2014, energy-intensive companies made over €24 billion, and most profits were made in Germany, the UK, Spain, France and Italy.²⁸

The first two stages of ETS were marked by an allocation that was exceeded by emissions, and only in the third phase was there a marked shift in approach. Nearly seven years of preparation were necessary to bring the EU to the current state of ETS. The sectors that were covered by ETS were predominantly electricity/heat (82%), followed by pulp and paper (78%), mineral and metals (75%), and to a lesser extent chemicals (42%).²⁹

Figure 1. Overall cap and verified emissions from EU ETS stationary installations 2005-2015.



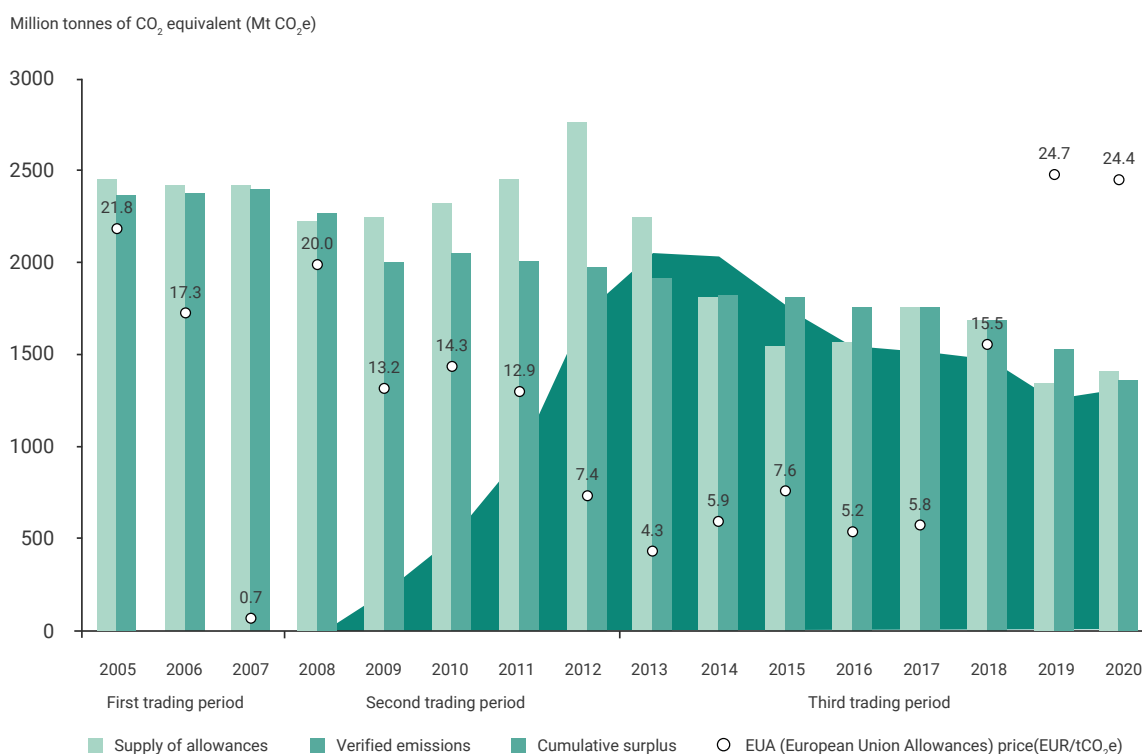
Source: Dechezlepetre et al. (2023).

Experience of ETS shows that carbon-pricing mechanisms cannot begin with full coverage and without the provision for free allowances in the early stages. This, in fact, has a bearing on the price of ETS allowances and led to prices that were low, especially between 2012 and 2017 (Figure 2).

In fact, the recently announced Effort Sharing Regulation (ESR) offers countries the flexibility to meet their targets for emission reductions, including the timeline for their achievement. For example, to help them achieve their targets, based on October 2014 European Council conclusions, six member states, whose national reduction targets were above the EU average and their cost-efficient reduction potential (i.e., Belgium, Denmark, Ireland, Luxembourg, Austria and Finland), can use a limited number of EU ETS allowances to cover emissions in the effort-sharing sectors, by cancelling allowances that would otherwise have been auctioned. Malta was given the same option, as it had not allocated any

free EU ETS allowances to industrial installations in 2013. Member states may also benefit from a safety reserve under certain conditions, provided that the overall EU emissions reduction target is met. The EC also proposes the creation of an additional reserve for member states based on “non-used” greenhouse gas removals generated in the EU. The additional reserve would act as an insurance and only become effective if the EU reached its 2030 target of reducing net greenhouse gas emissions by at least 55%. The maximum contribution of net removals to reaching the -55% target is fixed at 225 MtCO₂Eq by the European Climate Law.³⁰ Therefore, as the coverage of pricing expands, the option for smaller economies to adjust with the use of free allowances is important for its legitimacy.

Figure 2. The price of emissions allowances in the EU.



Reproduced from “Emissions, allowances, surplus and prices in the EU ETS, 2005-2020”. European Environment Agency.

The ESR has several mechanisms to help member states comply with their targets in a cost-efficient way:

Member states may 'bank and borrow' emission allocations. In years where emissions are lower than their annual emission allocations, member states can bank surpluses and use them in later years. In years where emissions are higher than the annual limit, member states can borrow a limited amount of allocations from the following year. Member states can also buy and sell emission allocations between themselves, thus increasing the cost efficiency of reaching the overall EU emissions reduction target. In addition, member states can use a limited amount of credits generated in the land sector by removals of greenhouse gases to comply with their targets under the ESR.³¹

Such flexibilities are critical at the inception of a market mechanism for pricing emissions. Similar to ETS, the ESR allows member states the space to adapt. Yet, CBAM, where applicable, does not offer any adjustment mechanisms to other countries. The flexibilities afforded under the ETS across various stages, though flawed, do not exist, as CBAM comes at a time when the EU's internal pricing mechanism has matured. The question is why such a price should then be applicable to units in developing countries.

4. EQUIVALENCE IN PRICING

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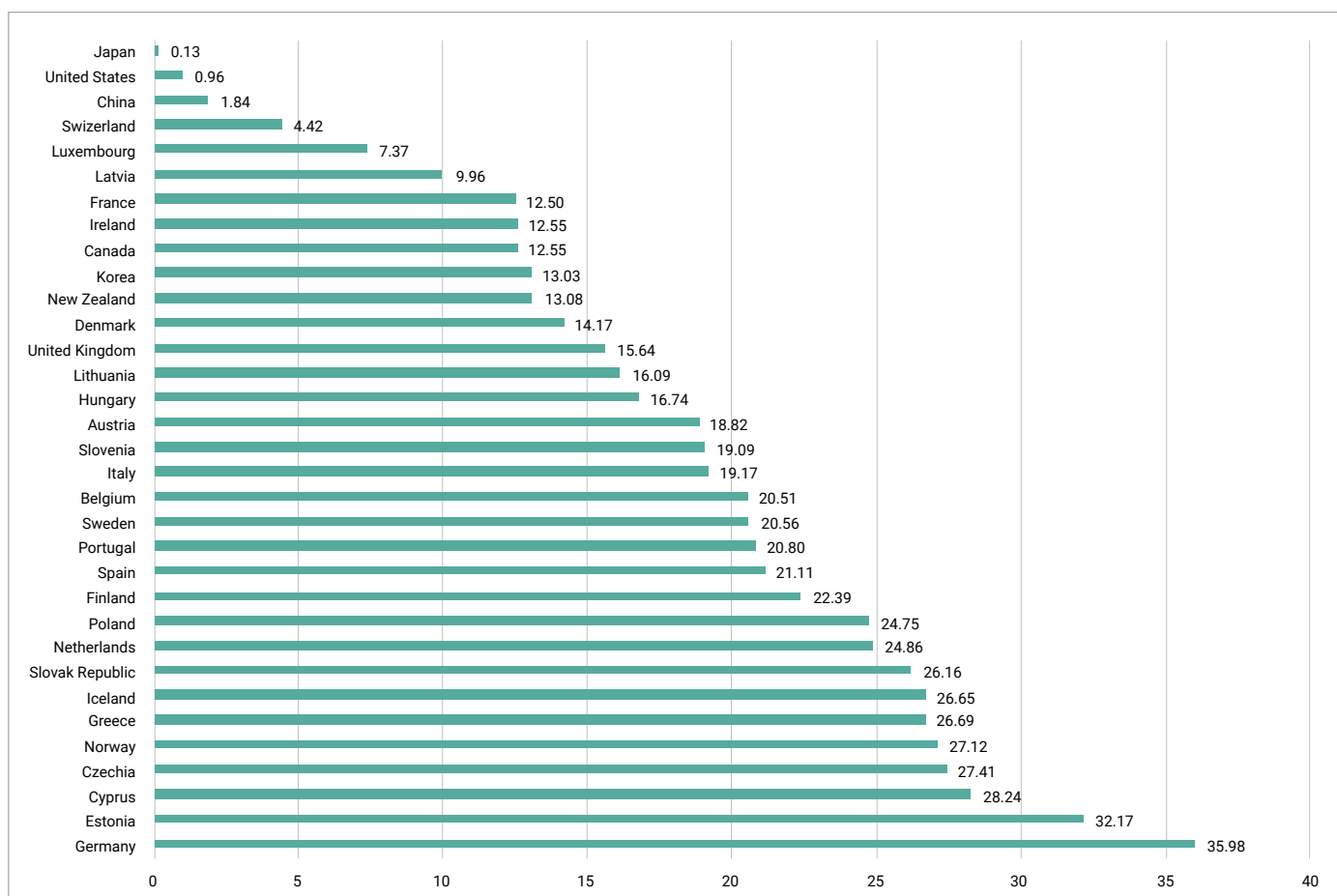
4.1 Considerations for pricing across jurisdictions

The desired outcome for the EU at the regional level was harmonisation, but the limits to achieving this with other partner countries needs to be examined, especially where the targets, even under ETS, have yet to lead to a convergence in prices across countries. For a trading partner transacting with the EU, the price of an ETS auction, used to determine

the price of CBAM certificates, may be far in excess of the prevailing carbon prices in the respective countries (Figure 3).³²

The price for CBAM certificates, as mentioned, will be determined based on a weekly auction price of ETS,³³ which were an average of €71.01 in the week of 4-12 December 2023.³⁴ The phasing out of free allowances will take place at the same time as the phasing in of CBAM during 2026-2034.

Figure 3. Price of a permit in 2021 at constant 2021 prices (€ per tonne of CO2).



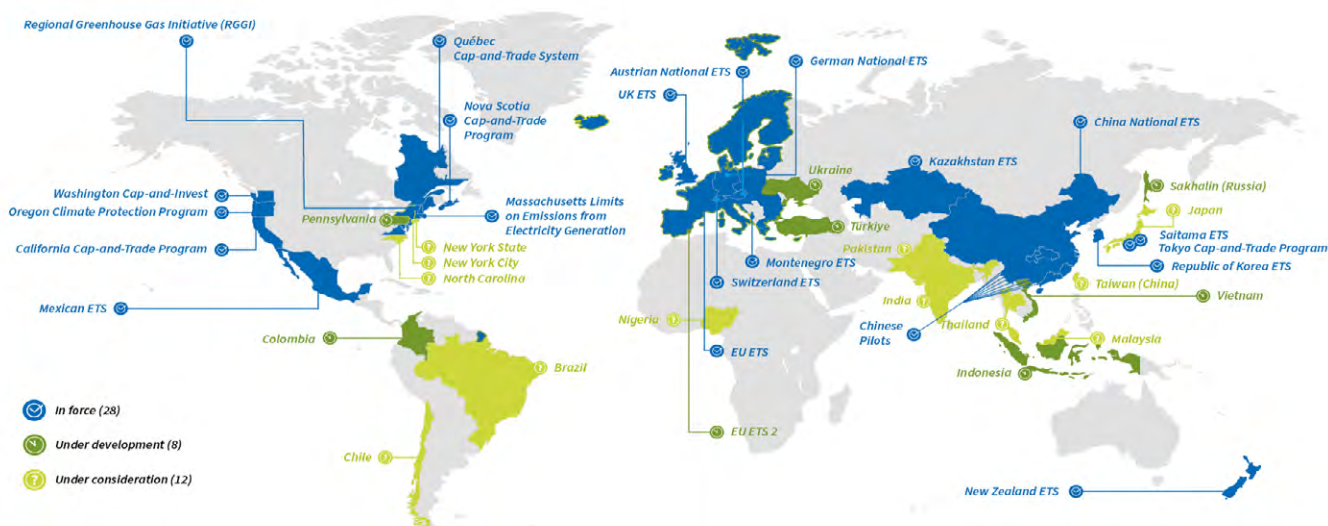
Source: OECD.

The CBAM certificates are priced on the basis of embedded emissions, which the regulation refers to as the emissions that occur in the process of production of the goods but not physically incorporated in the goods, that is, it covers scope 1 and 2 emissions.³⁵ Actual emissions are taken into account while determining the rate of CBAM; where such values are not available, default values are taken based on the average emission intensity of the 10% worst-performing EU installations for that type of industrial goods. As long as there are free allowances, it is expected that, to maintain equivalence, these allowances would be factored in while determining CBAM on a product import. The law therefore accommodates such concerns, as it is suggested that CBAM would apply to the proportion of emissions that do not benefit from free allowance under the EU ETS.³⁶ In the absence of allowances or full pricing, CBAM will apply at a higher rate on imported goods. Thus, even though free allowances allow some relief to developing-country exports, this is likely to stop after their phasing out after 2026. Furthermore, any effective carbon price paid in respect of these measures in the country of origin will be deductible.³⁷ The effective carbon rate is

computed by taking into account the actual price, coverage of emissions and applicable rebates. Rebates are any amount, monetary or otherwise, that reduces the amount due or paid by the person liable for payment of a carbon price.

There are two further concerns with regards to pricing. Firstly, the benchmark for price determination is installations in the EU. These installations may have benefitted from financial and technological support, and thus, would be operating at different levels of energy efficiency. In calculating the CBAM levy, comparing the units operating within the EU and non-EU countries would not consider such differences. Secondly, there are costs associated with reporting of emissions. The form for CBAM requires detailed information of direct and indirect emissions along with the methodology used for the carbon-pricing mechanism applicable to imports, which includes taxes or regional ETS under which the product is covered. All of the information for the computation of levies is to be reported quarterly. This would present a significant cost in terms of compliance, especially where small and medium enterprises constitute a large share.

Figure 4. Functional and proposed carbon markets.



Source: ICAP.

Not only are there differences in pricing, but there are also differences in the level of preparedness across countries. As seen in Figure 4, there are countries that have carbon markets (national, regional or state) either in place or work is in progress. The regional coverage of existing markets is limited. Similarly, there are few countries that also apply a carbon tax. Thus, even though the EU's CBAM covers carbon taxes, levies and mandatory reporting schemes,³⁸ as measures compatible with the levy, developing countries must seek clarification from the EC on what constitutes a rebate for third countries, as many would be in receipt of transition support. Thus, there are countries that can engage with the EU on the basis of their tax systems, as well as domestic carbon-pricing mechanisms to be included. However, this still leaves issues with differences in free allowances or financial support provided in the country of origin being different, on account of differences in economic priorities, from those in the EU.

4.2 Linking of markets

A critical aspect of the application of CBAM is how it will link to international carbon-pricing arrangements. Over the years, the EU has adopted a strategic approach to increase the use of carbon pricing. In 2020, the EU signed a Linking Agreement with the Swiss that accorded mutual recognition of Swiss and EU emission allowances. Switzerland maintains a separate system from the EU ETS but applies a similar scope to that of the EU ETS.³⁹ There are other multilateral arrangements, such as the International Carbon Price Action Partnership, and then there are two important markets that the EU has been working with closely to develop. The first is China, which carried out a three-year project to support the design and implementation of an ETS between 2014 and 2017. The EU and China have a Memorandum of Understanding⁴⁰ to enhance co-operation on emissions trading. There is also the Korean Emission Trading System (KETS), which was launched in 2015 and covers around 66% of Korea's greenhouse gas emissions. It is supported by the EC through a technical assistance project focussed on building the necessary capacity to implement KETS. There are different ways in which the ETS

system can be linked; this could, for example, be the way proposed between the EU and Australia, or the way in which Norway and the EU ETS had a one-way link where regulated entities in Norway could use EU allowances for compliance. These are a few examples of how the EU has been trying to externalise its strategy to price carbon. There are many functional and proposed carbon markets around the world, but each of these has a different coverage and mechanics. Therefore, even where the markets are developed and linked, the average prices could differ based on allowances to sectors, and CBAM would still impose costs on companies that have received preferential treatment under their national carbon market.

It is expected that, given the relatively low price of allowances across countries and because in the early stages countries would prefer a price cap through taxes and/or free allowances, the equivalence in pricing may be difficult to achieve, possibly also on account of non-recognition of other measures.

In the past, there have also been arrangements where countries could export the CER to the EU ETS. This was particularly important from the point of view of developing countries. Four countries are reported to have dominated the CER exports to EU member states – India, Brazil, China and South Korea – accounting for 95% of exports in the second trading phase.⁴¹ China and India remained an important source of CERs, even in 2021.⁴² Although there was a risk in CERs in secondary markets not being usable for compliance in the EU ETS, during the second phase, quantitative restrictions were applied to the use of international credits (% of NAP) and then quantitative and qualitative controls were put in place in phase 3.⁴³ Thus, there was delinking of the EU ETS and the voluntary international carbon market. A similar linking is not expected as the EU decides to reduce domestic emissions.⁴⁴ With the carbon credit mechanism, under the United Nations Framework Convention on Climate Change's (UNFCCC's) Clean Development Mechanism, still in use in countries such as India where a large number of these CERs are issued to energy companies,⁴⁵ it is important for the EU to clarify if these mechanisms will be covered under CBAM, even if they do not

permit these for trade under the ETS. The non-recognition of these credits would, in turn, mean that more stringent pricing would be imposed on developing countries, which would be expected to establish carbon markets swiftly.

4.3 Economic impact of CBAM

There are some estimates of the cost of CBAM and these, in turn, will have an impact on the overall competitiveness of trading partners. As per one estimate,⁴⁶ , at 100% coverage of CBAM, that is upon the phasing out of free allowances in the EU, China will pay a CBAM duty of €150 per tonne on exports; India €173.8 per tonne ; Russia €168.7 per tonne; Turkey €59.6 per tonne; and the USA €65.7 per tonne.⁴⁷ If one were to estimate the unit value of steel exports to the EU, the cost associated with CBAM for the USA, India and China would be 7.75%, 16.06% and 7.21%, respectively, of the 2022 prices.⁴⁸ In the case of aluminium, India depends on the EU significantly, with a 25% share of its exports to the region. Similarly, 14.3% of China's exports of aluminium are to the EU. The CBAM cost per tonne of primary aluminium will be €10.82 for China and €19.98 for India.⁴⁹ This is less than 1% of the value of imports of aluminium. The World Bank,⁵⁰ estimates CBAM exposure index and identifies countries that will be impacted for each category of product. This factors in the share of exports and embodied carbon payment per unit of US dollar export to the EU of the country. For example, in the case of iron and steel, India (23.5% exports to the EU) and Kazakhstan (3.9% exports to the EU) rank highest in exposure across the world. Electricity exports by Russia (73.1% exports to the EU) will be severely impacted, and cement exports from Belarus (33.9% exports to the EU) will be affected.

The important question is whether, and to what extent, these costs will be passed on to consumers, or whether they will be absorbed by producers in the country of origin where there may be a margin to compete. It is possible that even with CBAM there are countries that may retain their competitive advantage. For example, India and the USA fare well in comparison to other countries based on 2022 prices. Therefore, in some cases, the CBAM

levy may not fully take away the cost advantage, as has been argued by some. This, however, requires a detailed examination. A study by CRU suggests that there may be moderate increases in the prices of steel products after the imposition of CBAM.⁵¹ There are studies that have looked at the impact on trading partners. In projections where the scope of CBAM is widened, as is the stated aim of the EU, Beauflis et al. find that low- and middle-income countries that trade with the EU would be disproportionately exposed to relative upstream pressure caused by the EU CBAM, albeit one with lower intensity.⁵² In fact, among trading partners, those most impacted in terms of output are Zimbabwe, Albania, Armenia, Montenegro, Ukraine, Bahrain, Macedonia, Bosnia-Herzegovina, Serbia, Moldova and Mozambique.⁵³ A study by LSE and the African Climate Foundation⁵⁴ corroborates that Africa will be most negatively affected, with its exports declining by 5.72%,⁵⁵ and even though there may be some diversion of exports to India and China, there is expected to be a fall in GDP. For example, Mozambique's GDP is expected to be negatively affected by 1.6%.⁵⁶ This includes direct and indirect suppliers of inputs. As specified by Magacho et al., the macro-economic exposure of these different countries largely hinges on their "reliance on carbon-intensive industries as a source of foreign currency, fiscal revenue, employment and wage income", meaning that building in sensitivity to the specific idiosyncrasies of trading partners would go a long way to mitigating the adverse effects of CBAM.⁵⁷ In light of the heterogeneity of trading partners, a recent brief suggests fine-tuning the EU's technical and financial assistance to include country-specific CBAM impact assessments to ensure the EU CBAM becomes "a green development tool".⁵⁸

An additional consideration is that producers within economies are not homogenous. In fact, there is some degree of concentration across product lines. Taking aggregate iron and steel exports, it is observed that two companies, Tata Steel Ltd and JSW Steel, accounted for 11.43% and 20.01% of India's exports to the market, respectively. Both these companies are located in the EU and both these entities are currently covered by ETS. In 2022, the installations of these companies reported different levels of allocations and verified

emissions. For example, as per the ETS registry in 2022, the JSW Italy Pombino installation reported an allocation of 28,848 and verified emissions of 32,827. Tata Steel's Netherlands Ijmuiden BV BKG 1 unit reported allocations of 10,224,070 and verified emissions of 5,822,618,⁵⁹ whereas the BKG 2 unit closed its account in 2021. Therefore, each of these companies will be able to adapt differently to the ETS. There is a possibility that, in the short term, where there are overlaps in products of EU and other country operations, some of the demand may be met through the EU-based operations. Therefore, even though CBAM imposes a standard that is relatively stringent, and there is a need for dialogue between the EU and developing countries, the latter must also engage with multinational enterprises that have technologies in the EU to discuss the potential for technology transfers.

5. CAN REVENUE BE RECYCLED?

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There are social implications of the EU's approach to decarbonising. The EU therefore considers ways in which it addresses the internal cost versus external costs through its funding mechanisms. That is, not only will CBAM adversely impact the trade and output of trading partners, but it will also raise the cost of imports, thus impacting EU consumers. The EU has internal measures to allocate funds towards social costs from the transition. For example, the Just Transition Fund, aimed at supporting re-skilling, job search assistance and the creation of new firms, among other activities/priorities, will be operational between 2021 and 2027 with a total budget of €19.32 billion, of which €10.87 billion will be under the NextGenerationEU (NGEU) program.⁶⁰ In the case of CBAM, it is important that the costs to developing countries are taken into consideration. There are recommendations that the revenues from CBAM be made available for redistribution to developing country partners, where the imposition of costs is likely to have the most deleterious effects. As Beauflis et al.⁶¹ point out, the revenues will accumulate at the cost of trading partners in low-income countries with less-diversified economies (in North and Sub-Saharan Africa).⁶² The EC's estimates of revenue generated are much lower than some of the other studies, such as that of Beauflis et al. The EC estimates a revenue of €19 billion a year (2018 prices) of own resources from ETS, and €1.5 billion of own resources per year as of 2028 from CBAM.⁶³

The revenues are linked with the EC's plans to finance the reimbursement of borrowing from NGEU. There are however alternative suggestions, which include using CBAM revenues to compensate affected countries. The concept of recycling carbon taxes has been observed in the domestic context in countries such as Costa Rica, Denmark, Finland, Norway and Sweden at the national level, and in Quebec and Alberta at the sub-national level.⁶⁴ From the success of these measures, there may also be potential for, at the very least, a partial redistribution of CBAM, to mitigate some of its perverse social consequences.

CBAM revenue will be collected by the competent authority of the member state, and the state will be allowed to retain 25% of the revenue, with the remainder being made available to the EU budget.⁶⁵ Therefore, any recycling of the revenue will require initiatives at both the member state and EC levels. The current regulation provides scope for extending financial support to countries that will be impacted by the measure. For example, the regulation states that

The Commission should strive to engage in an even-handed manner and in line with the international obligations of the Union with the third countries whose trade to the Union is affected by this Regulation, in order to explore the possibility for dialogue and cooperation regarding the implementation of specific elements of the CBAM. The Commission should also explore the possibility of concluding agreements that take into account the carbon pricing mechanism of third countries. The Union should provide technical assistance for those purposes to developing countries and to least developed countries as identified by the United Nations (LDCs).⁶⁶

The language suggests that the scope for negotiation is limited to pricing arrangements and support for technical assistance. There is a lack of clarity on the treatment of differences in pricing on account of nationally determined allowances or the preferred use of credits under CDMs. The EC provides for the option of budgetary support to meet Paris Agreement goals to LDCs and requirements imposed by the regulations.⁶⁷ The potential for budgetary support is welcome, but it should be clarified that these contributions – made necessary by the distortions to trade introduced by the EU – should not then count towards the contribution of climate finance under the UNFCCC. Therefore, the contributions under the Paris Agreement must be separate and in addition to such commitments. The

EU's contribution is capped at the annual allocation under the multiannual financial framework that specifies the EU's support of international climate finance, although the EU is working on new own-resource-based revenues generated by the sale of CBAM certificates. In 2022, the EU's contribution to international climate finance was €28.5 billion, and it is possible that the compensation of CBAM can be more generous than the measured direct trade impact on its partners.⁶⁸ The question then is how the redistribution is determined. For example, should this be linked to historical emissions or to trade share? Depending on the metric selected, the outcome will change. There are alternative suggestions for exemptions from CBAM that are compatible with the CBDR and the enabling clause of the WTO.⁶⁹ This is rejected by experts, as it would result in positive leakage and is not expected to result in emission reductions. A rebate or lump-sum transfer is another suggestion. That is, the CBAM revenue is transferred to the affected country, which further redistributes it. This would have to be on the basis of some indicators, such as per capita income compared to EU or historical impacts of anthropogenic warming on economic output, which are estimated to strongly benefit Africa, South-East Asia and South America.⁷⁰ There are however difficulties with the application of such redistributive mechanisms, as countries within EU member states may also seek out financial support for consumers that are impacted by price changes arising from such measures rather than those available to traders.⁷¹ Therefore, such internal and external concerns need to be balanced.

6. WAYS FORWARD FOR CLIMATE JUSTICE

6. WAYS FORWARD FOR CLIMATE JUSTICE

The CBAM is a measure that sits well within the EU's ambition to decarbonise. However, it will distort the relative position of its trading partners that are less likely to be able to seek remedy through international trade dispute resolution mechanisms. Particularly, since the measure is viewed as an internal/domestic and environmental measure, it is likely to be compliant with WTO rules and the principle of common but differentiated responsibility is less likely to be applied to trade. The EU's logic is clear to the extent that there is a theoretical risk of carbon leakage. However, it brings with it the complications of external impact. The levy of CBAM does not take into account the allowance and prices prevailing in other countries, which, in turn, are a function of the internal priorities of its trading partners. Therefore, expecting a carbon price equivalence overlooks the flexibilities afforded under the Paris Agreement. The logic of allowing countries to set their own Nationally Determined Contributions and net-zero targets is no longer valid if there are external measures that expect sectoral and regional ambitions which outpace these national commitments. In the past, evidence of carbon leakage has been weak, and if one were to assume that this were the consequence of free allowances, with the EU moving towards a more stringent ETS, the risk might become pronounced. Yet, this ignores the 18 year head start that the EU had in developing a well-functioning market. In the past, it has tried to export its model of carbon pricing through partnerships with countries such as Korea and China, but, as we see, the prices are low in these markets. The CDM was used more widely by developing countries, but then again the EU has had an evolving approach to acknowledging their use in ETS. The CBAM allows for different pricing strategies, including taxes to be included in the computation of payment of CBAM; however, imposing a tax means the price of carbon will not be dynamic, and it imposes an added cost arising

from shifts in the EU's policy, such as its approach to regional security, which can create feedback from energy prices to the ETS. Moreover, there are the more complicated issues of the benchmarking of emissions based on installations in the EU and the verification and measurement of emissions.

There is no doubt that developing countries, especially in Africa, will pay the cost of CBAM, as the African Development Bank estimates the cost to be \$25 billion;⁷² this is far in excess of the EC's own estimates of revenues, illustrating the politics at play behind the predictions of CBAM's economic impact as well as the nature of impact. The UNCTAD estimates that doubling the EU carbon prices from \$44 to \$88 results in a higher global emissions reduction from 13 to 21%, whereas the introduction of CBAM only adds 0.8 to 1.3 percentage points.⁷³ The estimates of revenue are, in fact, not certain, as many effects are expected to come into play with implementation. With the lack of stability in revenues, the EU may find itself in a difficult situation as countries demand compensation for adverse impacts.

The impact is also not expected to be uniform within and between developing countries, where there are large firms from India, for example, that are already covered under ETS and may be able to share technology; nonetheless, this will entail immediate capital expenditures or they may choose to move production to the EU. There are also product-specific differences on the expected magnitude of impacts. Then there are small companies that will be more adversely impacted. The question then is whether the measure is effective and inclusive. There are recommendations to recycle the revenues from CBAM, which may need to be balanced with internal concerns, as EU member states are less likely to back a proposal that redistributes all revenues

externally. The budget process of the EU allows greater resources to be given as climate finance, but these should be linked to the effects of CBAM and not be counted towards the contributions required under the UNFCCC. Until the EU is able to reconcile the dual approach it follows internally of exemptions and compensations with its stricter external approach, CBAM, whether an internal or environmental measure, is likely to attract retaliatory measures.

APPENDIX

APPENDIX

Table 1. India's exports of iron and steel to the EU.

Year	Value (thousand \$)	Volume (tonnes)	Unit price (thousand \$/tonne)
2013	3,135,555	2,422,868	1.294150156
2014	2,847,984	2,195,011	1.297480514
2015	2,353,026	1,878,172	1.25282775
2016	2,745,506	3,211,158	0.854989384
2017	4,324,576	4,915,975	0.879698534
2018	3,835,574	92,988,625	0.041247776
2019	3,633,813	3,861,516	0.941032745
2020	2,830,537	2,865,526	0.987789676
2021	7,487,022	6,209,509	1.205734946
2022	6,149,828	5,684,450	1.081868606

Table 2. US exports of iron and steel to the EU.

Year	Value (thousand \$)	Volume (tonnes)	Unit price (thousand \$/tonne)
2013	2,519,240	1,122,827	2.243658195
2014	2,581,221	5,48,647	4.704702659
2015	2,351,847	927,787	2.534899713
2016	2,127,935	919,061	2.315335979
2017	2,638,046	1,713,358	1.539693397
2018	2,698,571	1,726,633	1.562909431
2019	2,458,110	1,658,979	1.481700492
2020	2,107,733	2,534,097	0.83174914
2021	2,353,661	3,501,770	0.672134663
2022	2,700,675	3,186,477	0.8475426

Table 3. China's exports of iron and steel to the EU.

Year	Value (thousand \$)	Volume (tonnes)	Unit price (thousand \$/tonne)
2013	7,103,333	4,920,749	1.44354711
2014	9,483,624	7,705,322	1.230788798
2015	8,721,479	9,949,082	0.87661143
2016	7,466,977	8,028,781	0.930026239
2017	7,546,380	5,865,916	1.286479384
2018	8,980,946	5,901,266	1.521867681
2019	8,605,416	3,566,314	2.412972049
2020	7,451,267	3,127,820	2.382255692
2021	12,174,647	5,648,884	2.155230484
2022	14,686,881	7,062,805	2.079468568

Source: Estimated from UNCTAD data.

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- The installation is participating in a compulsory GHG reporting scheme, i.e. only monitoring and reporting (and perhaps verification) are mandatory, but there is no carbon pricing involved;
 - The installation participates in an emission monitoring scheme at the installation (non-mandatory), which can include verification by an accredited verifier; for eligibility, again it can be assumed that a fixed set of monitoring rules provided by an accepted governance body must exist. Certain GHG reduction projects, such as e.g. under the CDM (the UN's Clean Development Mechanism), may qualify."
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This policy study provides a critical analysis of the European Union's Carbon Border Adjustment Mechanism (CBAM) from the perspective of developing countries, emphasizing the potential economic impacts and trade-related tensions that may arise from its implementation. While the EU's commitment to decarbonization through its European Green Deal is admirable, the CBAM's design and enforcement could impose costs on developing nations, particularly those with close trade ties to the EU. The CBAM aims to prevent carbon leakage by applying a carbon price on imports; however, its effectiveness in doing so remains to be seen. Moreover, the brief underscores the challenges posed by the CBAM's expectations for businesses in other jurisdictions to align with the EU's carbon pricing, despite the lack of time and resources for partners' equivalent systems to evolve as they did within the EU's own Emissions Trading System (ETS).

We also address the broader implications of the CBAM for global cooperation on climate change, especially in the context of strained multilateralism. As developing countries view the CBAM as an external imposition rather than a purely internal EU measure, it risks exacerbating trade tensions and undermining international climate agreements. Furthermore, the economic impact on developing countries may exceed the revenues generated by the CBAM, leading to calls for compensatory measures. The brief concludes with recommendations for developing nations to engage in negotiations with the EU to ensure a more equitable implementation of the CBAM, considering the principles of climate justice and the unique challenges faced by lower-income countries in adapting to stringent environmental standards.

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