KAMARAJ IAS ACADEMY
Only IAS Academy by Grandson of "Perunthalaivar Kamarajar"

EU’s Carbon Border Tax: Measures to combat the impact

Published On: 25-04-2023

EU’s Carbon Border Tax: Measures to combat the impact

Why in News: The EU Parliament passed the Carbon Border Adjustment Mechanism Bill recently. It may become law next month after the approval of the EU Council.

A brief about EU’s carbon trading mechanism

Launched in 2005, European Union Emissions Trading System ('EU ETS'), a long-standing greenhouse gas emissions trading scheme, is a cornerstone of the EU energy policy to battle global warming.

The European Commission, in 2020, had approved a set of revitalised policies, collectively named "The European Green Deal", with a primary objective to curb climate change by dipping carbon emissions by EU nations in a phased manner, striving to become a net-zero emitter of greenhouse gases, by the year 2050

The blueprint of the deal includes review and revamping of various climate-related instruments, including the EU ETS.

Currently, ETS forms the core of the carbon market that works on a "cap and trade" principle. As per the scheme, a specified limit is set for emission of greenhouse gases and the same is issued to manufacturers as certificates/ permits.

Accordingly, any emission beyond the limit is penalised. Within said limit, industries are also allowed to receive or acquire emission allowances that can be traded with other companies, on a need basis. Instance, each allowance being a tradable instrument is equivalent to one tonne of carbon dioxide (CO_2).

The price per tonne of CO_2 is nomenclated as carbon price and the same is to be determined via market trends. Manufacturers that require permits to emit beyond the cap can also buy allowances from others having surplus cap, albeit the trade could be at a higher rate.

Accordingly, a rise in the carbon price would put EU producers at the risk of carbon leakage, i.e. losing out to low-cost imports from territories with less stringent climate regulations.

About Carbon Border Tax

To combat carbon leakage, the EU is embarking on an experiment that would expand its climate change policies to imports.

The policy is called Carbon Border Adjustment Mechanism ('CBAM') alias Carbon Border Tax which imposes importers and non-EU manufacturers to pay for the carbon emission linked to the goods they sell within EU limits

The CBAM will walk on the footprints of ETS, i.e., importers will be required to purchase carbon import certificates/ permits for each metric ton of CO_2 brought into the EU through specified goods.

The price of certificates could depend on carbon intensity of goods being imported and carbon price per metric ton which will be the same as domestic carbon price being paid by EU producers.

This tax is proposed to be implemented by the EU in 2 stages entering into force on October 1, 2023.

Under the 3 years transitional phase, only carbon emission reporting regulations would apply and there would be no requirement to pay Carbon Border Tax.

After the transition period, tax would be levied on varied goods in a phased manner from 2026 to 2034. By 2034, all the goods and materials imported in the EU will be encased with the applicability of CBAM.

But the EU is not alone in this. The UK, Canada, Japan, the US and others are also bracing up to levy CBT on imports. Forty per cent of India's merchandise exports go to these countries.

Impact of CBT on India's trade

The CBT is estimated to be 20-35 per cent tariff equivalent for most Indian products. This is far higher than the EU's average import tariff of 2.2 per cent for manufactured products.

This will render WTO and FTA (free trade agreement) commitments meaningless. CBT will significantly hurt the global trade of developing countries, including India.

India's exports globally and to the EU in

Sectors covered under CBAM	Number of India's tariff lines affected	India's exports ($ million)	
		World	EU
Iron ore, concentrates	16	1,619.6	322.9
Steel products	163	7,316.9	1,460.7
Iron and steel	473	11,770.3	3,696.4
Aluminium, products	85	9,866.4	2,734.2
Cement	14	93	5.7
Fertiliser	24	92	0.6
Hydrogen	1	0	0
Electrical energy	1	647.9	0
Total of above	**777**	**31,406.1**	**8,220.4**
India's total goods exports		4,53,325.7	73,670.2
Share of CBAM products (%)		6.9	11.2

Kamaraj IAS Academy
Plot A P.127, AF block, 6 th street, 11th Main Rd, Shanthi Colony, Anna Nagar, Chennai, Tamil Nadu 600040
Phone: **044 4353 9988 / 98403 94477** / Whatsapp : **09710729833**

Action for government

Set up carbon trading mechanism:

The price of carbon reflects the level of development. For example, the current carbon price per tonne is $107 in the EU, $34 in Australia, and $7 in China. Forty-five countries have a functioning emission trading system (ETS) like the EU, making firms pay for each tonne of carbon emitted.

The carbon tax paid by a firm in the home country is adjusted while paying CBT in the EU.

Under CBT, the EU will charge tax at $73 from Australia and $100 from China. India has no ETS so the EU will charge $107/tonne.

Re-designate taxes on essential products as carbon tax:

India does not have an explicit carbon tax system. However, it charges import and excise duty on petroleum products, natural gas, and GST on coal, steel, aluminium, etc.

Notifying all such taxes as carbon taxes for steel and aluminium and a few other sectors may be considered. Setting up a carbon trading mechanism is a pre-condition for this. If this can be done, the net impact of CBT may become lower or even zero in a few cases.

Create a cadre of energy auditors:

Energy auditors will play a crucial role in fair CBT paymentsImplementing the new tax will require the EU to assess carbon emissions for a given product precisely.

This has to be done for thousands of producers spread across the world. The EU intends to use auditors for this purpose, but the task of fair assessment remains complex.

Energy auditors will help the industry calculate the carbon intensity of products, help choose cleaner technologies, etc. They will also prepare emission-related documents for sharing with importing countries.

Start an industry awareness programme:

Create a dedicated group representing government, industry associations, and researchers to conduct such programmes. A beginning may be made with products immediately affected: steel, aluminium, fertiliser, electricity, cement, and hydrogen.

But as CBT will cover all sectors by 2034, all sectors must be aware of the new tax and its implications.

Devise a WTO-compatible retaliation mechanism:

When the US imposed import duties on steel and aluminium exported from India, India retaliated by imposing import duty on the equal weightage of imports from the US. India must think about designing a similar scheme to counter CBT.

Since all developing countries exporting to developed countries will suffer CBT, a common response would be effective.

Sign new FTAs after resolving the CBT issue:

High CBT will make FTAs-led zero duties meaningless. For example, 85 per cent of India-Japan trade occurs at zero import duties. When Japan implements CBT, Japanese products enter India at zero duty, but Indian products will pay high CBTs.

As India is at an advanced stage of finalising its FTA with the UK, it must seek clarification on this issue. CBT should be the top agenda for any FTA discussions of India with the EU, UK, Canada, and the US.

Use global platforms to expose the hypocrisy:

The way the EU defines net zero is inappropriate. It merely counts what is produced in the EU and not what is consumed.

The developed countries have already offshored their pollution, causing low-end manufacturing in China and other countries decades back

Kamaraj IAS Academy
Plot A P.127, AF block, 6 th street, 11th Main Rd, Shanthi Colony, Anna Nagar, Chennai, Tamil Nadu 600040
Phone: **044 4353 9988 / 98403 94477** / Whatsapp : **09710729833**