

EU's CBAM, US Carbon Tax undermine international climate and trade laws

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July 22, 2021



Exclusive

Representational image. (Getty Images/iStockphoto)

opinion

The world needs innovative and collective solutions that can work for all; anything exclusionary will only be sub-optimal and ineffective

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UPDATED ON JUL 22, 2021 04:27 PM IST

Whether it is the unprecedented floods in Germany, heatwaves in the United States (US) and Canada, wildfires in California and parts of Australia, or droughts in Africa, there is a clear link between these extreme weather events and the climate crisis. The Assessment of Climate Change Over Indian Region, published by India's ministry of earth sciences last year, predicts an increase in average temperature by approximately 4.4°C relative to the recent past and consequent increase in frequency of summer (April–June) heatwaves, rise in surface temperature and humidity and amplification of heat stress, particularly over the Indo-Gangetic and Indus river basins.

The basic principle of the United Nations Framework Convention on Climate Change (UNFCCC), which was concluded at the Earth Summit, 1992, is “Common but Differentiated Responsibilities and Respective Capability” (CBDR-RC). The principle of “Differentiated Responsibilities” recognises that the largest share of historical and current global emissions of greenhouse gases (GHGs) has originated in developed countries.

The “Respective Capabilities” is a recognition of the different socio-economic status of countries. Flowing from this was the UNFCCC principle that “(T)he extent to which developing country Parties will effectively implement their commitments under the Convention will depend on the effective implementation by developed country Parties of their commitments under the Convention related to financial resources and transfer of technology...”.

As a result, the Kyoto Protocol (1997) placed binding emission reduction commitments on Annex I (developed) countries, while non-Annex I countries did not have binding commitments. Despite its promise, the Kyoto Protocol remained an unfinished story. The US refused to ratify it, Canada withdrew in 2012, and many of signatories refused to take commitments beyond 2012.

A key grouse for the US and other developed economies has been the need for emerging economies such as India, China and Brazil to make emission reduction commitments. The Paris Agreement (2015) mandated countries to set their commitments in the form of “Nationally Determined Contributions” (NDCs). It also set out principles of financial support by developed countries of \$100 billion in annual climate aid by 2020, a target that has not been achieved, exacerbating uncertainty and mistrust. There is no clarity on emission-reporting and rules for carbon offsets for a global carbon market. The Conference of Parties-26 (COP26) summit is expected to be held this year and the progress on core principles of the Paris accord by then is critical for realistic outcomes.

CBAM and US Carbon Tax

It is in this context that the proposal of the European Commission released on July 14 on carbon border adjustment mechanism (CBAM) needs to be seen. CBAM is part of a series of measures adopted by the EU to achieve climate neutrality by 2050, including the intermediate target of at least 55% net reduction in greenhouse gas emissions by 2030 (Fit for 55 Package).

CBAM envisages importers purchasing “CBAM certificates” that reflect the carbon price of the embedded emissions in the covered products that are imported into the EU. This requirement applies to imports of cement, electricity, certain fertilisers, and certain iron, steel and aluminum products from non-EU countries, except countries covered by the EU emissions trading scheme (EU ETS), ie Iceland, Liechtenstein, Norway and Switzerland. Other countries can enter into agreements with the EU for exemptions from CBAM, if they can demonstrate that they have an equivalent domestic carbon pricing mechanism.

Underlying CBAM are two concerns: (a) the “competitiveness concern”, ie to level the playing field between EU producers who pay a carbon cost, and importers who do not; and (b) the “environmental concern”- ie, a measure to “induce other countries or foreign producers to cut emissions”.

On the same day that the EU released its draft proposal for CBAM, there was news about Democrats in the US agreeing to include a tax on imports from countries that the US

considers as lacking aggressive climate policies. There are no details as yet on how this is proposed to be implemented.

Undermining International Climate Law and Policy

Both EU's CBAM and the proposed US carbon tax on imports, undermine the foundation of international climate law and policy, since their only concern is whether the import is from a country that applies the same emission reduction regulation that they have determined to be adequate; and not whether principles of international climate law have been implemented by that country.

The CBAM proposal acknowledges the bottom-up approach of the Paris Agreement, which involves each country setting its level of ambition; but notes that “we need to make sure that Parties are not undermining the effectiveness of each other’s policies.” It notes that “as long as significant numbers of the EU’s international partners have policy approaches that do not result in the same level of climate ambition as the Union, and differences in the price applied to GHG emissions remain, there is a risk of carbon leakage.”

The EU claims that CBAM does not amount to interfering with policy choices in third countries. But this is precisely what it will do, since it essentially requires goods imported into the EU follow the same rules as the goods produced in the EU. NDCs of each country are based on reduction of economy-wide emissions; EU’s approach will, however, mandate that sectors manufacturing goods for export to the EU, will be penalised, not for any violation of the domestic or international law by the country of export, but for not matching EU’s emission requirements. And it is here that the EU’s CBAM clashes with the foundation of international climate law and policy, which is premised on differential responsibilities.

Whether it is the EU’s CBAM or the proposed carbon tax in the US, in setting the expectation that all countries need to share their level of “climate ambition”, they are suggesting a one-size-fits-all approach that would pretty much lead to burial of the CBDR-RC principle.

CBAM is a unilateral trade measure and World Trade Organization (WTO) inconsistency arises on account of at least two basic principles.

First, the charge/cost imposed by CBAM would be over and above the tariffs negotiated and bound by EU members under their WTO commitments.

Second, the EU would be unilaterally judging domestic climate responses of exporting countries, and assessing what products from which country would need how much value of CBAM certificates. Furthermore, the preferential treatment for free allowances or other concessions for goods manufactured within the EU may also result in discrimination between imported and domestically manufactured goods. The EU’s legal assessment notes potential for justification of the CBAM as an exception to WTO commitments; but for

this, the EU must demonstrate that there was no other less trade restrictive alternative.

While legal scholars engage in hypothetical arguments on how CBAM may be adjudicated at WTO, there are prominent voices, such as that of Paul Krugman, who recently argued that “given the threat of climate change, our response should be to revise or ignore trade law”. This emotional response of one of the strongest votaries of trade liberalisation is reflective of the growing desperation and horror at the visible effects of the climate crisis across the world. It, however, ignores the inequitable impact of such a measure: Not only is there a question of inconsistency with rules of trade, but one which will only create inequitable distribution of wealth and resources, and potentially defeat any effective global solution.

A recent study by UNCTAD confirms that the introduction of carbon pricing coupled with a CBAM helps reduce CO2 emissions, inside and outside the EU, but also underscores that this reduction represents only a small percentage of global CO2 emissions.

More pertinently, UNCTAD notes that the introduction of a CBAM results in decline in exports in developing countries in favour of developed countries, which tend to have less carbon-intensive production processes. This will only exacerbate the inequitable distribution of the benefits of trade, and limit the possibility for export-led development in poorer countries.

Equity, Accountability, Effectiveness

The EU plans to start implementation of CBAM in a phased manner from 2023. It runs the risk of derailing hard-won gains of the rules of international climate policy, as well as international trade. India and other developing countries should consider engaging in discussions that seek to address the problems with innovative solutions that have equity, accountability and effectiveness at its core.

Raghuram Rajan's proposal for a “global carbon incentive” (GCI) is one such innovative solution that merits deeper understanding. Rajan explains that GCI is premised on the principle that every country that emits more than the global average of around five tonnes per capita of CO2, would pay annually into a global incentive fund, with the amount calculated by multiplying the excess emissions per capita by the population and GCI.

He notes for example, that if GCI started at \$10 per tonne, the US would pay around \$36 billion, and Saudi Arabia would pay \$4.6 billion; and that countries below the global per capita average would receive a commensurate payout. For instance, he estimates that Uganda would receive around \$2.1 billion. The underlying principle, Rajan explains, is that every country would face an effective loss of \$10 per capita for every additional ton that it emits per capita, regardless of whether it started at a high, low, or average level.

Rajan also succinctly explains how proposals for a tax on imports, alongside a domestic carbon tax, effectively applies the same tax rate to goods coming in from countries that do not have a carbon tax, and would therefore falter on the principle of fairness. On the

contrary, he explains, “they would let large importing countries impose their tax preferences on poor exporting countries and might serve as a Trojan horse for protectionism.”

The real and visible impact of the climate crisis is that the impact of emissions knows no borders, and it is the collective responsibility of all to address this in a cohesive, fair, and rational manner. The irony of the proposed EU and US unilateral approaches is that their nationalistic self-righteousness, fails to achieve anything effective to address the real underlying issues.

What we need is innovative, collective solutions that can work for all; anything exclusionary will only be sub-optimal and ineffective.

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The views expressed are personal