

The EU's CBAM has lent urgency to fair carbon prices

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SUMMARY

The EU plan of a carbon charge on imports is unfair and we should call out violations of the Paris pact

The EU's Carbon Border Adjustment Mechanism (CBAM) went into force on 1 October 2023. Covering iron and steel, aluminium, cement, fertilizer and electricity, it requires the direct and indirect carbon emissions of these goods to be reported for their import into the EU. The product categories include specified precursors and are expected to progressively cover more products. Studies by the World Bank and UNCTAD have highlighted that the CBAM could have a significant impact on the competitiveness of developing countries that export the covered goods to the EU.

The CBAM has a transition period. Reporting requirements run till the end of 2025. This is not as innocuous as it sounds. It includes reporting for products as well as specified precursors: (a) direct emissions (those from the production process) and indirect emissions (from the production of electricity consumed); (b) production methods; (c) carbon price paid in the country of origin, etc. Penalties of €10-50 would apply for each tonne of unreported embedded emissions.

Beginning 1 January 2026, importers into the EU will need to buy CBAM certificates to account for price differences in embedded emissions between the EU and country of export. The World Bank recently published its CBAM Exposure Index, measured by multiplying a country's export share by the difference between the exporter's emission intensity and the

EU average of the same for a CBAM product, scaled by an assumed carbon price of \$100 per tonne (a recent high in per tonne price of CO₂ in the EU market). By this assessment, there will be a relative decrease in competitiveness of Indian exports.

Curbing emissions is a given. We do not have the luxury of quibbling on that. It is the EU's demand for equivalence in the pricing of emissions that is problematic, particularly given the fact that countries have agreed to differential emission reduction obligations, reflected as Nationally Determined Contributions (NDCs) under the Paris Agreement. This, in turn, is rooted in the principle of the UN Framework Convention on Climate Change that developed countries with historically high emissions have higher obligations than developing countries. Developed countries also had to ensure climate finance for developing countries to the tune of \$100 billion annually by 2020, which remains unfulfilled.

At a practical level, the EU's CBAM would work as follows: Even if aluminium or steel products exported from India to the EU have resulted in exactly the same emissions had these been produced in the EU, a price differential for emissions would be demanded that's loaded against Indian exports. The CBAM only allows for subtracting the price for CO₂ that has already been paid in India; but the gap with the EU price will also have to be paid. This effectively amounts to our exporters paying for the EU's climate transition, upending the principles of the Paris Agreement.

It is not as though emissions are free in India. India's regulatory mechanisms of renewable purchase obligations (RPO) under the Electricity Act and specific energy consumption (SEC) norms under the Energy Conservation Act, as well as a coal cess of ₹400 per tonne on domestic and imported coal are all emission charges. The government is also working towards a Carbon Credit Trading Scheme (CCTS), which is expected to accelerate our adoption of market-based price discovery for emissions. Nevertheless, carbon prices in India and the EU are unlikely to converge, since the determination of a carbon price is linked to the emission-reduction obligations of each country; these differ.

Another crucial fact is that there are no agreed principles for the measurement of and accounting for the price of emissions. The World Bank estimates that over 70 carbon pricing initiatives exist the world over. In an op-ed in the Financial Times in October 2021, World Trade Organization Director General Ngozi Okonjo-Iweala noted that the most straightforward solution would be a global carbon price aligned with the Paris Agreement. That observation was rooted in a basic approach to equity and fairness, since the Paris Agreement is an acknowledgement by 195 countries (including EU members) that there is no one-size-fits all approach to emission reductions. The WTO's efforts so far have not resulted in any clarity on carbon pricing. Reports indicate that a presentation by Okonjo-Iweala earlier this year proposed a scheme whereby countries would be split into four categories based on their development status and historical emissions, with less developed countries paying the lowest carbon price (placed at \$27 for every tonne emitted) and the wealthiest paying the most (estimated at \$181 per tonne). This was suggested as a basis to calculate the

equivalence of various climate policy measures across the world. The principle behind such a sliding scale appears to be correct; however, WTO members are yet to achieve clarity on carbon pricing. In theory, if differential prices lie at the heart of assessing equivalence, the EU's CBAM would have to give up using the EU benchmark as its price.

The EU's CBAM is just the first unilateral measure adopted to address competitiveness concerns arising from emission-related obligations that affect trade; others are likely to follow. Governments and businesses need to work towards a clear solution to the problem of carbon pricing. We must ensure that events do not overtake us along our path of sustainable development.