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Trade, Labor and EU Law Perspectives

Crossing the carbon border to trade with the EU

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Striving to become the first climate neutral continent globally, the European Union announced the European Green Deal to decouple economic growth from resource use with just and inclusive transition. With the aim to reduce greenhouse gas emissions (GHGs) by at least 55% by 2030, an Open, Sustainable and Assertive Trade Strategy was communicated by the European Commission on 18 February 2021. In furtherance, the proposal for a carbon border adjustment mechanism (CBAM) was likely to see the light of day. On 10 March 2021, the European Parliament adopted a resolution towards a WTO-compatible EU CBAM. As a much-needed measure for implementing the EU's climate goals and for its green pandemic recovery, the CBAM was initiated in the form of a legislative proposal for the second quarter of this year. The EU held sustainability as the central point for moving forward. The EU's approach to using trade as a powerful tool to promote sustainable development and help fight climate change is laudable, though international trade has always been viewed as an impediment to tackle environmental problems effectively. In this context, we attempt to draw the potential effects of global trade due to the proposed CBAM.

The CBAM Resolution

To avoid carbon leakage and achieve the climate commitments of the Paris Agreement, the CBAM has been chosen by the EU as part of the Green Deal. While its design and structure are still not known, the resolution provides valuable insights into the CBAM. The first question that comes to our mind is whether such a measure would be compatible with the World Trade Organisation (WTO) rules. Clearly, as an answer to this, the very title of the resolution includes 'a WTO-compatible EU CBAM', ostensibly an indication that the EU would like to respect international rules while implementing CBAM. Although this does not mean that the measure would fully fit in the WTO Rules, it is evident that the EU has been trying to build and enforce a CBAM compatible with the WTO Rules and the EU Free Trade Agreements (FTAs). On account of Article XX of the General Agreement on Tariffs and Trade (GATT), the WTO members can implement measures that are necessary to protect human, animal or plant life or health (paragraph b) or natural resources (paragraph g). On the other hand, in the resolution, the EU admits that it will accept a third country CBAM if it implements a higher carbon price (p. 4). The EU also stressed that the proposed measure should not be misused as a tool to enhance protectionism, unjustifiable discrimination or restriction (p. 5).

What will be its scope?

Since the GHG emissions from the imports to the EU have constantly been rising, though its domestic emissions have considerably reduced, the CBAM will monitor the GHG content of the imports (p. 5). The measure is expected to cover all imports of the products and commodities under the EU Emissions Trading System (ETS), including the power sector and energy-intensive industrial sectors like cement, steel, aluminium, oil refinery, paper, glass, chemicals and fertilisers (p. 6).

The different forms it can take

Ranging from tax instruments to mechanisms using the EU ETS, the proposed measure would complement by revising the EU ETS and not lead to overlapping and double protection of the EU industry (p. 6). In addition to the above measure, the European Commission is requested to propose more ambitious and binding norms and standards on products placed on the EU market to ensure low carbon and resource-efficient manufacturing. Therefore, as portrayed by the Inception Impact Assessment, some of the CBAM instruments 'could include a carbon tax on selected products – both on imported and domestic products, a new carbon customs duty or tax on imports, or the extension of the EU ETS to imports' (p. 2).

Possible effects on international trade

Under this system, the meaningful carbon pricing will reflect the carbon content of the imports (p. 6). We can identify the potential effects, from the resolution, for the different economies based on their development status. One could anticipate a special treatment for the Least Developed Countries (LDCs) and the Small Island Developing States (SIDSs) (p. 5). Hence, it may be favourable for the LDCs' products that enter the EU without duties or quotas under the Everything But Arms (EBA) scheme. Contribution of the CBAM revenue to climate finance the LDCs and the SIDS, as proposed, will support them to develop clean and green technologies (p. 9). On the other hand, an ETS-equivalent charge will be applied to the imported goods' carbon emissions of the EU domestic and foreign producers (p. 8). However, as the resolution only focuses on equally applying the measure to all the countries, except for differential treatment for the LDCs and SIDSs, it cannot be discerned whether the developing countries' challenges will be considered.

Some changes that could be seen in the trade framework at an international level are as follows: First, keeping in mind the climate goals as the main guiding principles of trade policy, the Paris Climate Agreement will be an essential element in all future agreements, with a Trade and Sustainable Development (TSD) Chapter, of the EU. The FTAs might be adjusted for that purpose. Second, the EU's trade and climate initiative at the WTO will intensify efforts to develop a global framework for carbon pricing, for instance, through the Environmental Goods Agreement. Indeed, the EU offers full support for establishing international CO2 pricing in line with Article 6 of the Paris Agreement. Third, the adopted trade strategy would require necessary climate diplomacy with other countries and subsequently lead to amendments in their respective climate policies.

In conclusion, the EU invites cooperation and concerted actions from all the countries to succeed in the globe's climate neutrality. Considering the constraints of the inequivalent climate policies of the different countries and the prevailing economic inequality, the EU is expected to come up with a legislative framework that accommodates everyone. Whether the CBAM will measure up to its laudable goals will depend on the structure and design of the CBAM. An equally important question is whether the CBAM could satisfy the rigours of international trade rules under the WTO, especially relating to border tax adjustment.

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