On The Borderline:
The EU CBAM and its place in the world of trade

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1. Overview of CBAMs
2. Reasoning for and against CBAMs
3. Why is the EU proposing a CBAM & outline of the EU proposal
4. Economic and environmental impacts
5. Questions around the legality
6. Potential political and diplomatic implications
7. Alternatives to CBAMs
Economic impacts

- Modelling by Cambridge Econometrics’ E3ME
- Various scenarios
- Economic minor but positive for the EU (around 0.2 - 0.4 of EU GDP) by 2050, compared to baseline
- Could create around 600,000 jobs by 2050 across sectors
- Impacts on global GDP (and countries outside the EU) are very small but generally positive
- GDP in Russia would be adversely affected

Time profile of impacts in EU CBAM scenarios, GDP difference (%) from baseline in EU27
Environmental impacts

• Reduction on global CO2 emissions (around 10 MtCO2 by 2050, or about 0.023 per cent)

• A slight increase in the EU emissions due to increase industrial activity.

• ETS fail scenario
Emissions reduction impact would be considerable, around 912 (MtCO2) by 2050

CO₂ emission impacts, difference from baseline (MtCO₂) by 2050
CBAM basic impacts by 2050
(50% assumption electricity imports; revenue recycling)

- CBAM cost increase towards EU members: +6.5%
- Import price increase: +50%
- Imports decrease from outside EU: -2.2%
- Exports to EU decrease: 0%
- Lower production outside of EU: 0%
- Lower GDP outside of EU (emitters): 0%
- Lower emission levels (higher intensity): -12.0 Mt
- Higher within EU emission levels (lower intensity): +2.1 Mt
- Lower emission levels globally: -9.9 Mt
- Investment within EU increases: +0.9%
- Production within EU increases: +1.1%
- GDP within EU increases: +0.4%

Note: prices, trade, production and investment for impacted sectors; GDP and emissions for whole economy. 51, 50% electricity, revenue recycling.
<table>
<thead>
<tr>
<th>Basis for adoption</th>
<th>The rules of conduct</th>
<th>Justification</th>
<th>Remedies</th>
</tr>
</thead>
<tbody>
<tr>
<td>ie whether it is a global treaty or an agreement among only a few States or unilateral action</td>
<td>ie which rules may be breached by the CBAM - ie questions over whether the measure would cause undue restrictions to market access and/or discriminatory treatment</td>
<td>ie rules that could justify a violation of a rule of conduct (legal defences, typically the general exceptions clause in Article XX of the GATT)</td>
<td>ie the ability of a State to adjust a measure to bring it into compliance with a rule of conduct or a justification, but also the margin of manoeuvre left by rules on remedies to keep a course of action</td>
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The proposed EU CBAM would be treated as a **unilateral** measure (from outside the EU, the EU is seen as a single entity).

The proposed EU CBAM would likely be regarded as a regulation **equalising the effects of another regulation** affecting the internal sale of a product (ie the EU ETS), rather than as a tax.

A judgement as to whether domestically produced goods (eg steel) and imported goods would be **deemed to be alike** (regardless of their carbon content). If the goods are deemed to be alike, the specific **details of the carbon equalisation methodology** would determine whether it would be regarded as **discriminatory**.

There is a fair chance that the measure may amount to a breach of both the National Treatment and the Most Favoured Nations clause, but it could still be justified.

**The EU CBAM may be justifiable on the grounds that, as a measure to reduce GHG emissions, it would mitigate climate change and protect human life or health or as a measure relating to an exhaustible natural resource (a stable climate system) adopted in conjunction with domestic restrictions – the ETS.**

However, there is an open question as to whether the EU CBAM is ‘less trade restrictive’ than reasonably available alternative measures.

**It may also be seen as ‘imposing’ the EU carbon price on other countries.**
Political and diplomatic considerations - within the EU

- Must be seen as a part of a bigger political agenda of the EU Green Deal
- Subject to lengthy inter-institutional negotiations between the Council, Parliament and the Commission
- Final proposal will be shaped by the EU political economy – and possibly foreign pressures – and will likely to look very different to the current one
- Member State views still being formed – diverse, subject to change and even internally divided (e.g. producers v users of materials)
Political and diplomatic considerations - International

- Options available to third countries: retaliation, negotiation, litigation against the EU
- Can be bilateral or multilateral AND symmetrical or asymmetrical (examples)
- Response options not mutually exclusive and may be explored simultaneously
- Responses will likely be influenced by the current relationship with the EU, and country level factors (such as presence / absence of ETS or carbon price)
- Countries that rely heavily on the EU markets for their exports but are unlikely to qualify for an exemption likely to respond more aggressively
- Examples of Ukraine, the UK, the US and Russia discussed in more detail
- Litigation unlikely until the EU CBAM becomes a law, but retaliation may take place sooner
If not CBAM, then what?

- CBAM legally complicated and potentially politically difficult

- Other options
  - so-called climate clauses in bilateral or multilateral trade agreements
  - multilateral processes under the WTO or OECD convenership
  - the development of new approaches under the Trade and Environmental Sustainability Structured Discussions (TESSD)
  - the formation of so-called climate clubs

- Could be used in conjunction with, or instead of, an EU CBAM

- Could potentially be much more effective in driving decarbonisation than the sole use of carbon pricing and equalisation measures in the EU

- However, practical challenges to implementation are considerable and the extent of their true potential has not yet been systematically assessed
Conclusions

• The politics of the current EU CBAM proposal make WTO dispute likely, but not necessarily successful.

• If the EU is found to be in violation of the trade rules, the measure can be brought into compliance without retrospective penalties being payable.

• The risk of retaliation and loss of reputation are greater than the risk of litigation.

• Standardised mechanisms to measure carbon content will be needed to fairly implement a CBAM → could enable other climate policies (esp demand side)

• EU CBAM may be necessary to improve the political acceptability of ambitious climate policy and high carbon price (and for the EU to achieve its 2050 target).

• A well-designed EU CBAM could incentivise trade partners to implement more ambitious climate policies, thus removing the need for it.
Thank you!

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