International trade has a carbon problem

Why in news?

The talks on the Carbon Border Adjustment Mechanism (CBAM) at the WTO's dispute settlement body has brought to the forefront the inter-linkages between trade and the environment.

What is CBAM?

- The Carbon Border Adjustment Mechanism (CBAM) is an initiative of European Union (EU) to prevent carbon leakage from extremely carbon intensive imports.
- Under CBAM, duties will be imposed on imported goods based on the carbon expended in producing them.
- The duty imposed is an equivalent cost on imports to level the playing field between foreign and domestic producers.

Why EU wants CBAM?

- The EU has stringent emission control mechanisms like Emissions Trading System (ETS) for its domestic industries.
- The EU's concern is that emissions embedded in products imported from other countries is not be priced in a similar way and would put its industries at a disadvantage.
- To tackle this, the impacted industries in the EU had so far been receiving free allowances or permits under the ETS.
- The EU also apprehends the phenomenon of 'carbon leakage' due to the application of ETS.
- European firms operating in carbon-intensive sectors might possibly shift to those countries that have less stringent GHG emission norms.
- CBAM is aimed at levelling the playing field for the EU industries.

Cement, iron and steel, electricity, fertilizers, aluminium, and hydrogen are few carbon-intensive sectors to be covered under CBAM.

How does CBAM work?

- Under the CBAM, imports of certain carbon-intensive products, will have to bear the same economic costs borne by EU producers under the ETS.
- The price to be paid will be linked to the weekly average of the emissions priced under the ETS.
- However, where a carbon price has been explicitly paid for the imported products in

their country of origin, a reduction can be claimed.

Why CBAM is not in line with WTO principles?

- Non-discrimination is a cornerstone principle of WTO law. Countries are required to accord equal treatment
  - To 'like' products irrespective of their country of origin (MFN treatment) and
  - To treat foreign-made 'like' products as they treat domestic ones (national treatment principle).
- **Inconsistency -** The CBAM violates WTO law for discriminating between EU and foreign products covered by CBAM based on the embedded emissions.
- Also the question of whether carbon-intensive products to which the CBAM applies are 'like' arises.
- For example, the process by which electric arc furnaces produce steel is less carbon-intensive than the steel produced in blast furnaces.
- The CBAM does not considers 'implicit' carbon borne by products originating in certain countries.
- **Way out -** The discrimination of CBAM could be justified under the General Exceptions clause given in Article XX of the General Agreement on Tariffs and Trade (GATT).
- Under Article XX, measures taken by countries that otherwise violate GATT obligations are permitted if,
  - They fall under one of the listed policy grounds, and
  - They satisfy the requirements of the introductory clause of Article XX, known as the chapeau.
- CBAM would fall under the 'conservation of exhaustible natural resources', one of the listed policy grounds in Article XX.

What are India's concern towards CBAM?

- India has criticized CBAM as being protectionist and discriminatory policy.
- The EU's Carbon Border Adjustment Mechanism (CBAM), has spooked India that it will cripple the export of its carbon-intensive products to the EU.
- CBAM is an important issue in the ongoing India-EU free trade agreement negotiations.
- To know more about India's Concerns on CBAM, Click here.

What should India do with CABM?

- India should work with the EU to secure gains on CBAM.
- India ensure smooth onboarding for Indian exporters to maximise the benefits of a bilateral deal.
- India can also consider the possibility of a WTO challenge as it remains open.

Quick Facts

Emissions Trading System (ETS)

- In 2005, the EU adopted the Emissions Trading System (ETS), a climate change policy.
- The ETS is a market-based mechanism that aims at reducing greenhouse gas (GHG) emissions by allowing bodies emitting GHG to buy and sell these emissions amongst themselves.

Reference

1. The Hindu - International trade has a carbon problem

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