

Boundaries Between Climate Change Response and Trade Protectionism

Proactive Carbon Emission Reduction Efforts as Climate Change Response

Climate change response is the preeminent challenge facing the international community. Many countries are setting up policies and strategies with sustainability as their top priority while striving to reduce their carbon emissions. Currently, 132 countries and 822 companies¹⁾ have declared net zero²⁾ commitments. In addition to making such declarations, influential manufacturers with substantial electricity consumption are joining the RE100³⁾ initiative. Environmental sustainability is a global issue. As such, merely eliminating or relocating certain sources of pollution cannot provide a fundamental solution; instead, the issue requires a global solution where concerted efforts by all nations must be coupled with technological innovations.

In recent years, the European Union(EU) announced the Carbon Border Adjustment Mechanism(CBAM) to reinforce carbon emission reductions in EU and non-EU countries. The CBAM aims to prevent carbon leakage⁴⁾ and ensure that both EU and non-EU companies compete on the same playing field in Europe. The EU has long been highly concerned with environmental issues, introducing stringent environmental regulations and taking a wide array of actions to transition to a low-carbon society. However, careful observation is required to assure that environmental regulatory policies aimed at protecting the environment, such as CBAM, do not lead to trade friction with other countries.

Carbon emission reduction is closely related to international trade and commerce. An enormous amount of carbon is emitted during the production of goods and their transportation from source to consumer. Hence, a common system of a large economic union such as CBAM can be effective in terms of enabling comprehensive management beyond the limits of national environmental regulations. However, since CBAM presupposes the possession of carbon emission reduction technology, there is a reasonable possibility that it may act as a trade barrier against other countries that lack such technology. Furthermore, since carbon-intensive industries, such as metal and chemical industries, are generally government-designated key industries, the CBAM is not immune to the accusations that it is merely a tool of trade protectionism that provides such industries in the EU with additional benefits and competitive advantages.

1) Net Zero Tracker (as of February 2023)

2) **Net zero** is an ideal state where a maximum reduction of greenhouse gas (GHG) emissions and a maximum reabsorption of CO₂ from the atmosphere reduce the net GHG emissions to zero.

3) **RE100** is a voluntary initiative by major global companies committed to the goal of obtaining 100% of their electricity from renewable sources by 2050.

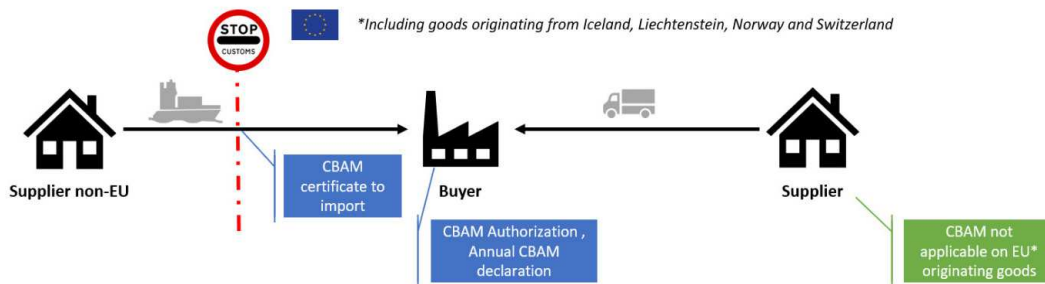
4) **Carbon leakage** refers to a situation where companies relocate their production facilities to countries with lenient environmental policies to circumvent carbon emission restrictions.

Thus, the CBAM may serve as a technological barrier to developing countries, with additional import tariffs potentially forfeiting their price advantage.

What is the EU's Carbon Border Adjustment Mechanism (CBAM)?

In December 2022, the EU reached a provisional agreement on the CBAM, a measure that imposes tariffs on imports from countries with lax environmental regulations. A key part of the "Fit for 55"⁵⁾ package, the CBAM is a new technological regulation aimed at promoting carbon reduction. It requires importers to submit CBAM certificates priced according to the volume of carbon emissions pertinent to their imported items that exceed the relevant standards. By imposing import tariffs that is similar to the carbon price paid by companies in the EU for emissions above a certain threshold, the mechanism seeks to pressure all companies to reduce their emissions equally; not only to the ones within the EU, but also including products produced out the EU under relatively less stringent environmental regulations.

Simplified illustration of EU CBAM process



(Source: EY2021, The EU-CBAM)

The CBAM will initially include cement, electricity, fertilizers, steel, and aluminum⁶⁾, and the scope will gradually expand, starting with sectors that are carbon-intensive and whose emissions are relatively easier to measure. Beginning in October 2023, importers will be required to calculate and report carbon emissions of the CBAM targeted products. Then, once the mechanism goes into full effect in 2026, importers will be obliged to purchase CBAM certificates. Countries with a cap-and-trade system will be partially or fully exempted based on the cost of emissions under the carbon pricing system in the country of origin.

Climate Change Response and Ways to Promote Trade in Developing Countries

Appropriate environmental regulations can serve as an incentive for carbon reduction. However, the CBAM does not include any provision of necessary technological support to developing countries, suggesting that the system does not recognize gaps between

5) **Fit for 55** is a set of climate change response legislation aimed at cutting EU carbon emissions by at least 55% of 1990 levels by 2030.

6) HS codes: cement - 2523 10 00, 2523 21 00, 2523 29 00, 2523 90 00; electrical energy - 2716 00 00; fertilizers - 2808 00 00, 2814, 2834 21 00, 3102, 3105; iron and steel - 72, 7301, 7302, 7303 00, 7304, 7305, 7306, 7307, 7308, 7309, 7310, 7311; aluminum - 7601, 7603, 7604, 7605, 7606, 7607, 7608, 7609 00 00

developing and developed economies although such gaps are generally acknowledged by international conventions. Currently it is almost impossible for developing countries to keep pace with developed countries on the path to carbon neutrality, considering not only abatement technologies but also industrial restructuring. Against this backdrop, adequate support measures must be put in place to ensure that developing economies are not left out of the market.

According to the 2021 UN Comtrade database, the largest share in terms of trade prices of France's CBAM imports were fertilizers (HS 3102, 3105) from Egypt and Morocco, followed by steel (HS 72, 7308) from Ukraine, India, Tunisia, and Vietnam. Aluminum (HS 252310, 252329) were imported from Morocco and Cameroon, and cement (HS 252310, 252329) from Morocco and Vietnam. From a French perspective, the proportion of CBAM imports from developing countries (those listed on the 2021 DAC List of ODA Recipients) out of total CBAM imports can be seen as rather insignificant, at less than 4%. However, from the perspective of Egypt, France was one of the top five among 46 importers of Egyptian fertilizers (HS 3102) in 2021. According to a 2021 report published by the Institute for European Environmental Policy (IEEP), fertilizer (HS 310210) exports to the EU accounted for 39% of Egypt's total fertilizer exports, 31% of its total EU exports, and 4% of its total exports in 2019.

In terms of sheer numbers or proportion of total exports, CBAM targeted products may not account for much. It is also true that the implementation of such mechanism may merely mean that a developing country needs to change its export destinations without having to experience a reduction in its export volume. However, if a regulatory mechanism like the CBAM acts as a trade barrier, it will be seen as cutting off the green/carbon ladder, rather than the ultimate solution to climate change.

Tackling climate change, a global challenge, requires both carbon neutrality and technical and financial support for industries needed for economic development in developing countries. Furthermore, it is necessary to encourage developing countries to participate in climate change adaptation by establishing various institutional support systems⁷⁾ that can complement technical and financial support. Above all, trade-related regulations must be thoroughly examined to ensure they do not lead to trade tensions. In light of this, Aid for Trade⁸⁾ and other realistic support measures that comprehensively consider multiple fields, such as the environment and trade, need to be expanded or newly established.

7) Korea is also preparing various support measures, such as a green finance system, in addition to technology and financial support, to mitigate the impact on businesses and to accelerate the transition to a green economy.

8) **Aid for Trade** is a WTO initiative launched in 2005 to promote trade expansion and economic growth for developing countries by providing official development assistance (ODA) targeting capacity building with regard to trade.

[References]

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