

INTERNATIONAL TRADE HAS A CARBON PROBLEM

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New Mangalore Port handling the export of steel cargo to African and European countries.
Photo: Special Arrangement

The European Union's [\(EU\) key climate law, the Carbon Border Adjustment Mechanism \(CBAM\)](#), has spooked India. New Delhi fears that CBAM will cripple the export of its carbon-intensive products to the EU. While India's exports may be limited to aluminium, iron, and steel, and affect only 1.8% of its total exports to the EU, India has reportedly decried CBAM as being protectionist and discriminatory. There is also talk of challenging the CBAM at the World Trade Organization (WTO)'s dispute settlement body. This debate brings to the forefront the inter-linkages between trade and the environment. While the international trade regime allows countries to adopt unilateral measures for safeguarding the environment, environmental protection should not become a smokescreen for trade protectionism. The CBAM needs to be viewed from this standpoint.

In 2005, the EU adopted an important climate change policy known as the Emissions Trading System (ETS). Now in its fourth stage, 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. However, the EU's concern is that while it has a mechanism for its domestic industries, emissions embedded in products imported from other countries may not be priced in a similar way due to a lack of stringent policies or due to less stringent policies in those countries. This, the EU worries, 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. Furthermore, the EU also apprehends the phenomenon of 'carbon leakage', that is, 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 addressing this quagmire, and, thus, levelling the playing field for the EU industries. Under the CBAM, imports of certain carbon-intensive products, namely cement, iron and steel, electricity, fertilizers, aluminium, and hydrogen, 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.

A cornerstone principle of WTO law is non-discrimination. Thus, countries are required to accord equal treatment to 'like' products irrespective of their country of origin (most-favoured nation

treatment) and to treat foreign-made 'like' products as they treat domestic ones (national treatment principle). While the CBAM's design is origin-neutral in appearance, it may, in its application, discriminate between goods from different countries on account of an inadequate carbon pricing policy, or due to onerous reporting requirements that importers would be subject to.

A key consideration in all this may be whether the carbon-intensive products to which the CBAM applies are 'like'. While steel products may appear similar, the process by which electric arc furnaces produce steel is less carbon-intensive than the steel produced in blast furnaces, for instance. Being products that are not 'like', the rules on non-discrimination would have little application in such a case. Accordingly, the debate on CBAM reignites a long-standing debate in international trade law circles: must processes and production methods be relevant for comparing products? Traditionally, the answer to that in WTO jurisprudence has been no, and, on that account, as commentators have noted, the CBAM violates WTO law for discriminating between EU and foreign products covered by CBAM based on the embedded emissions.

However, even if the EU's CBAM is discriminatory, there could be a claim for justifying it 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, first, they fall under one of the listed policy grounds, and second, if they satisfy the requirements of the introductory clause of Article XX, known as the chapeau. One of the listed policy grounds in Article XX is 'conservation of exhaustible natural resources'. CBAM would fall under this category. However, it is doubtful if it would satisfy the chapeau, which inter alia requires that countries do not apply measures in a manner that results in arbitrary or unjustifiable discrimination between countries where the same conditions prevail. As commentators argue, the CBAM only considers 'explicit' carbon prices, not 'implicit' costs (non-price-based costs) borne by products originating in certain countries. Accordingly, it arbitrarily or unjustifiably discriminates between countries where the same environmental conditions exist.

Editorial | [Green crosshairs: On the impact of the European Union's Carbon Border Adjustment Mechanism](#)

Finally, CBAM is also an important issue in the ongoing India-EU free trade agreement negotiations. India should work with the EU to secure gains on CBAM and ensure smooth onboarding for Indian exporters to maximise the benefits of a bilateral deal, even as the possibility of a WTO challenge remains open.

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