The Big Picture: Carbon Border Tax

Why in News

- At the recent **G-20 ministerial meeting on environment and climate change in Italy**, developing countries, including India, are expected to raise their concerns over the **European Union's (EU's)** recent proposal on the **first of its kind "Carbon Border Tax".**
    - Yet to be legally formalised, the tax plan could come into force from 2026.

Key Points

- **Imposing Carbon Levies:** The measure is designed to **protect European industries from competitors abroad** who are not subjected to the same **carbon** levies.
    - A transitional phase from 2023-25 will see importers monitoring and reporting their emissions.
- **Similar Proposals from USA:** In the **United States**, the Democrats have proposed their own version of a tax on imports from countries that lack substantial climate policies as part of a $3.5 trillion budget plan.
    - However, this proposal is far less detailed than the EU's plan.
- **Previous Policy of EU:** A decade ago, European officials wanted to charge foreign airlines taking off and landing in Europe for the carbon pollution they produce.
    - But the EU scrapped the idea after heavy pressure from the United States and **China.**
- **Emissions Trading System of EU:** The 27 EU member states have much stricter laws to control **Greenhouse Gas (GHG) emissions** in the form of the **'Emissions Trading System'** that caps how much GHG individual industrial units can emit.
    - The industries that fail to cap their emissions can buy 'allowances' from those who have made deeper cuts.
- **Carbon Pricing Instruments:** As per the **World Bank**, about 64 carbon pricing instruments such as emissions trading schemes or taxes are in use around the world.
    - However, they cover only 21% of global greenhouse gas emissions.

European Union and Carbon Border Tax

- **Disincentivize Carbon Extensive Goods:** The idea behind the tax is to disincentivize companies outside the European Union that are exporting to the EU four carbon extensive goods: steel**,** cement**,** fertilizers **and** aluminium.
- **Digital Certificates:** Under the proposal, importers will be **required to buy digital certificates representing the tonnage of carbon dioxide emissions** embedded in their imported goods.
- **Causes Behind Imposing Carbon Tax:**
    - **EU and Climate Change Mitigation:** The EU has declared to cut its carbon emissions by

at least 55% by 2030 compared to 1990 levels. Till date, these levels have fallen by 24%.

        - However, emissions from imports contributing to 20% of the EU's CO_2 emissions are increasing.
        - Such a carbon tax would incentivise other countries to reduce GHG emissions and further shrink the EU's carbon footprint.
    - **Carbon Leakage:** The Emissions Trading System of the EU makes operating within the region expensive for certain businesses.
        - The EU authorities fear that these businesses might prefer to relocate to countries that have more relaxed or no emission limits.
            - This is known as **'carbon leakage'** and it increases the total emissions in the world.
- **Benefit for Certain Countries:** Countries that have already introduced carbon trading systems in their own countries will be benefitted by this initiative.
    - These industries of these exporting countries can claim a rebate equal to the amount of tax that they have already paid.
- **Worst Affected Countries:** The countries to be worst affected will be Russia**,** Britain**,** Ukraine**,** Turkey **and** China which collectively export large amounts of fertilizer, iron, steel and aluminum to the European Union.
    - The United States sells significantly less steel and aluminum to Europe, but could also see an impact.

Issues with the New Tax

- **Response of the BASIC Countries:** The **BASIC (Brazil, South Africa, India and China) countries'** grouping had opposed the EU's proposal in a joint-statement terming it **"discriminatory"** and against the principles of equity and **'Common but Differentiated Responsibilities and Respective Capabilities' (CBDR-RC).**
    - These principles acknowledge that richer countries have a responsibility of providing financial and technological assistance to developing and vulnerable countries to fight climate change.
- **Impact on India:** The EU is India's third largest trading partner. By increasing the prices of Indian-made goods in the EU, this tax would **make Indian goods less attractive for buyers and could shrink demand.**
    - The tax would create **serious near-term challenges for companies** with larger greenhouse gas footprint.
- **Non-Consensual with Rio Declaration:** The EU’s notion of having a uniform standard all over the world for the environment is **not borne out by the global consensus contained in the Article 12 of the** Rio Declaration which says that the standards applicable to developed countries cannot be applied to developing countries.
- **Change in the Climate-Change Regime:** The greenhouse content of these imports would also have to be adjusted in the greenhouse gas inventories of the importing countries which essentially implies that GHG inventories would have to be reckoned not on the production basis but at the point of consumption basis.
    - This would turn the entire climate change regime upside down.
- **Protectionist Policy:** The policy can also be regarded as a disguised form of protectionism.
    - Protectionism refers to government policies that restrict international trade to help domestic industries.
        - Such policies are usually implemented with the goal of improving economic activity within a domestic economy.

Way Forward

- **Maintaining India-EU Relations:** India must also not forget that the EU is its second largest buyer and currently, India has surplus in both trade and services with the EU.
    - The EU is a market that India needs to nurture and protect.
    - India should talk to the EU bilaterally to ensure that its exports with the latter are protected either through an **Free Trade Agreement** or by other means and if there are adjustments and standards that India needs to meet then it should look forward to fulfilling it.
- **Playing Wise:** India is not an exporter of cement or fertilizers to the EU and on steel and aluminium too, it is relatively smaller than other countries.
    - India is not the target of this policy of the EU, the target is Russia, China and Turkey which are large emitters of carbon and major exporters of steel and aluminium to the EU.
    - There is little reason for India to be at the forefront of the opposition. It should rather talk directly to the EU and bilaterally settle the issue.
- **Preparing While Protesting:** China has always followed the policy of 'Keep Preparing While Protesting'.
    - It is talking about protesting against the carbon border tax. But side by side, it has already started its own carbon trading system also claiming it to be the largest.
    - If the EU in future imposes this tax, India will be badly affected by it if it doesn't set up its own carbon trading system.
        - India shall not be caught off guard in 2026 if the tax is imposed, it shall prepare for the best as well as the worst.
- **Reshaping the Climate Mitigation Policies of India:** India may not have a carbon trading system but its energy taxes if converted into carbon equivalents would rank as very high.
    - India already has measures of climate change mitigation in the country, it just needs to convert them, devise them in ways which are compatible with important markets of India.
- **Collective Persuasion:** The BASIC countries and other significant developing countries shall follow the policy of collective persuasion at the global meetings for finding alternatives for climate change mitigation rather than implementing such a policy.

Conclusion

- A mechanism like Carbon Border Tax for charging imported goods at borders may spur adoption of cleaner technologies.
    - But if it happens without adequate assistance for newer technologies and finance, it would rather become disadvantageous for the developing countries.
- As far as India is concerned, it must assess the advantages and disadvantages that it is likely to face with the imposition of this tax and talk to the EU with a bilateral approach.