



Trade Hot Topics

A Special Focus on Trade, Environment and Climate Change

The EU's Carbon Border Adjustment Mechanism: Implications for Commonwealth Countries

Brendan Vickers, Salamat Ali and Kimonique Powell*

1. Introduction

The increasing frequency and intensity of climate-related disasters and extreme and unpredictable weather around the world have highlighted the urgency of tackling the climate crisis. Indeed, the Intergovernmental Panel on Climate Change's sixth assessment report warns that unless there is a rapid and large-scale reduction in greenhouse gas emissions, limiting global warming to a 1.5°C threshold will be beyond reach (IPCC, 2021). Climate change caused by mostly human activities is an existential threat affecting all countries and people, although its consequences and the responses vary. The 2015 Paris Agreement requires the Parties to submit voluntary climate action strategies in Nationally Determined Contributions (NDCs), which are framed and guided by the United Nations Framework Convention on Climate Change (UNFCCC) principle of common but differentiated responsibilities and respective capabilities. Many countries, and even some subnational entities, have set ambitious emissions targets (Stock, 2021). However, global disparities in carbon pricing and varying climate policies and environmental and

pollution controls have raised concerns in some advanced economies about competitiveness and potential 'carbon leakage'¹ of their energy-intensive, trade-exposed (EITE) industries.

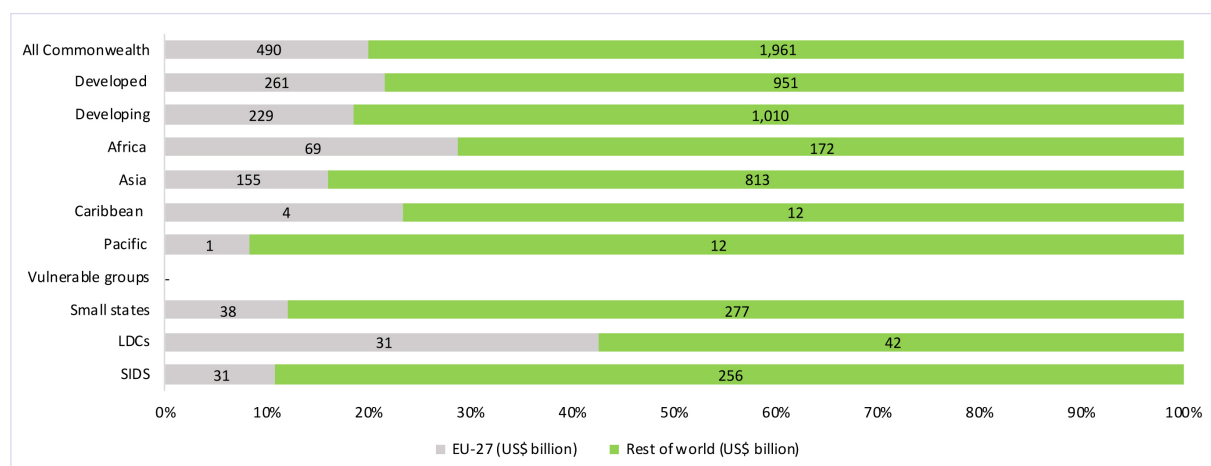
Border carbon adjustments (BCAs), whereby taxes on the embodied carbon of imports could be imposed at the border, have been discussed and debated for several decades, although none has been implemented to date. The recent decision of the European Commission (EC) to propose a Carbon Border Adjustment Mechanism (CBAM) under the European Green Deal, as well as the prospect of similar schemes in Canada, Japan and the United States,² therefore calls for greater scrutiny about the design, coverage, compatibility with World Trade Organization (WTO) rules and implications of BCAs, especially for Commonwealth member countries that export energy-intensive goods to the European Union (EU) (see Box 1). The EU has identified five sectors — energy, iron and steel, fertilisers, aluminium and cement — for the CBAM's initial implementation phase. Although this mechanism could potentially incentivise foreign producers to decarbonise their industries, there is also the risk

* Brendan Vickers is Head of Section, Salamat Ali is Trade Economist and Kimonique Powell is Assistant Research Officer in the International Trade Policy Section, Commonwealth Secretariat, London. The authors are grateful to Ian Parry and Sam Lowe for reviewing the draft and providing constructive comments. Any views expressed are those of the authors and do not necessarily represent those of the Commonwealth Secretariat.

1 Carbon leakage occurs if businesses in certain industry sectors or sub-sectors transfer production to other countries with less stringent emission constraints or if imports from these countries replace equivalent but less greenhouse gas emissions-intensive products due to the differences in climate policy.

2 The United States is discussing BCA legislation while Canada and Japan have initiated consultations on BCAs. While the focus of this *Trade Hot Topic* is on the EU's CBAM, the insights are likely to also be relevant for BCAs introduced by other countries in the future.

Figure 1: Commonwealth countries merchandise trade exposure to the EU market



Source: Commonwealth Secretariat using data from World Integrated Trade Solution (WITS).

Note: The numbers in each bar indicate the value of merchandise exports in 2019.

that it could unfairly penalise developing countries' exports because most do not yet have carbon pricing mechanisms and have differential responsibilities for mitigating emissions (Lowe, 2021; UNCTAD, 2021). The additional cost could also transmit forward and backward to other sectors, affecting their export competitiveness. Moreover, if the CBAM were, at a later date, amended to take into account indirect emissions embedded in exports, there could be further adverse effects on the supply chains of a number of products.

This issue of *Commonwealth Trade Hot Topics* examines the structure and orientation of Commonwealth countries' CBAM-related exports to the EU to determine their level of exposure to this potential carbon pricing mechanism. The analysis is based on the Commonwealth countries' trade flows in 2019³ for the goods specified in Annex I of the Regulation of the European Parliament and of the Council establishing the CBAM (European Commission, 2021a).

2. The Commonwealth's trade with the EU

Collectively, the EU is the Commonwealth's second largest export market after the United States and accounts for about one fifth of its global exports. Two Commonwealth countries, Cyprus and Malta, are also EU members, while the United Kingdom (UK), the largest economy in the Commonwealth, has a Trade and Cooperation Agreement (TCA) with the bloc. Most other members benefit from the EU's Generalised System of Preferences (GSP) – namely, Standard GSP, GSP+ and Everything but

Arms (EBA) for least developed countries (LDCs) – or reciprocal trade agreements, including Economic Partnership Agreements with the African, Caribbean and Pacific countries.

Many Commonwealth countries rely heavily on the EU market. In 2019, around 20 per cent of the Commonwealth's total merchandise exports, worth US\$490 billion, was destined for the EU.⁴ Dependence on this export market varies widely by region,⁵ ranging from 8 per cent for the Pacific members, which are all small island developing states (SIDS), to about 30 per cent for African members, on average (Figure 1). For 10 Commonwealth members, the EU market share ranges from 40 per cent (for Seychelles) to more than 60 per cent (for Antigua and Barbuda and Bangladesh). Collectively, Commonwealth LDCs sent around 43 per cent of their total exports to the EU in 2019, reflecting the significance of this market.

Regionally, Commonwealth Asian members were the largest merchandise exporters to the EU in value terms, contributing around US\$155 billion in 2019 (Figure 1). Overall, however, the UK is the single largest Commonwealth trading partner with the EU, followed by India, Canada, Malaysia and South Africa in that order. These five countries account for around three quarters of the Commonwealth's total EU-bound exports (Table A1). This significant trade with the EU suggests that any changes to its trade policies, including the introduction of the CBAM, could affect several Commonwealth countries' trade patterns.

³ These trade flows were not affected by the COVID-19 pandemic.

⁴ This includes exports to the EU-27 from the UK, which was still part of the EU-28 until 31 December 2020.

⁵ Geographical remoteness from the market and structure of trade largely explain this varying level of reliance on the EU market.

3. Implications of the CBAM for Commonwealth countries

In March 2021, the EU Parliament passed a non-binding resolution in support of a WTO-compatible CBAM. This was followed on 14 July with a legislative proposal by the EC for a CBAM as part of the 'Fit for 55' package of legislation designed to implement the EU's new greenhouse gas emission reduction target of 55 per cent below 1990 levels by 2030 (IEPP et al., 2021). Box 1 outlines the broad scope of the proposed CBAM.

Worldwide, merchandise exports in the sectors covered by the EU's CBAM proposal accounted for about 6 per cent of global exports (US\$1.1 trillion of \$18.5 trillion) in 2019. Around one third was destined for the EU (\$383 billion), suggesting that implementing this measure will affect a wide range of countries, including many Commonwealth members.

In 2019, Commonwealth countries accounted for about 11 per cent of global CBAM-related exports (US\$113 billion of \$1.1 trillion). Overall, these energy-intensive goods from Commonwealth countries comprise a slightly smaller share of merchandise exports than the world average (5 per cent against the global average of 6 per cent). However, the small size and inherent vulnerabilities of many Commonwealth economies, especially small states and LDCs, means CBAM implementation could potentially affect their post-COVID-19 recovery prospects. Moreover, in future, the EU's CBAM could expand to include other sectors, increasing the share of goods exposed to these measures.

Box 1: What is the EU's CBAM?

The CBAM system envisages pricing carbon at the border for specified imports in five sectors according to the emission intensity of goods production processes. The Regulation proposes six types of carbon pricing mechanisms, including border taxation of imports, excise taxation at a retail stage or surrendering of equivalent carbon permits issued under the EU emission trading system (ETS), which is the preferred option.

The CBAM will initially apply to five sectors: energy, iron and steel, fertilisers, aluminium and cement. However, its scope could be extended later to

include indirect emissions and other goods and services.⁶ One way to price carbon is by using actual emissions in producing countries, rather than EU emission allowances. The importer would have the opportunity to seek reductions based on individual carbon footprints and the carbon price paid in the country of production.

Once implemented, the CBAM will have a transitional period of three years, from 1 January 2023 to 31 December 2025, in which reporting obligations⁷ aimed at collecting data and raising awareness will apply. A phase-in period of 10 years will commence from 2026 during which free allowances under the EU ETS will be gradually withdrawn. Importing firms in the EU can either pay the carbon tax at the border or buy CBAM certificates in advance and surrender the equivalent amount to border authorities.

According to the Regulation, the EU will engage with third countries whose trade could be affected by these measures and explore the possibilities of dialogue and cooperation with regards to implementing specific elements of the mechanism. Agreements about carbon pricing methodologies/system and alternatives to the CBAM could be concluded with third countries.

Source: Regulation COM (2021) 564 of the European Parliament and of the Council.

3.1 Commonwealth countries' trade exposure to the CBAM

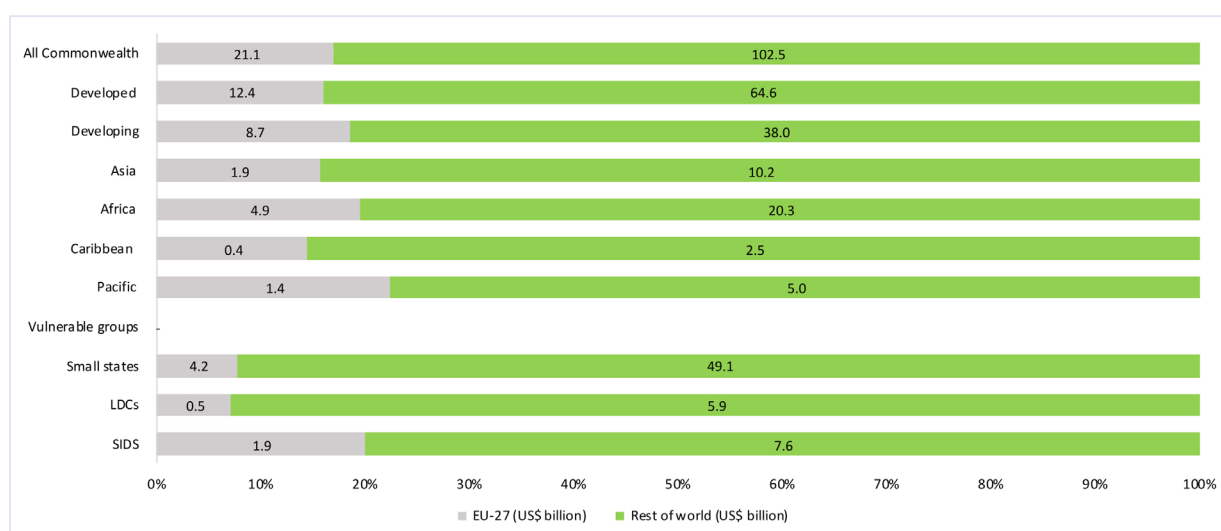
In 2019, Commonwealth countries exported CBAM-related goods worth US\$21 billion to the EU, of which \$12 billion originated in the six developed country members and around \$9 billion in developing countries (Figure 2). This amounts to about 16 per cent of developed countries' exports of these products globally and around 19 per cent for developing country members. The share is slightly higher for Commonwealth SIDS, at 20 per cent, but this is mainly driven by two countries: Trinidad and Tobago and Jamaica. For Commonwealth small states and LDCs, only 8 per cent of their CBAM-related exports were destined for the EU market.

As a share of EU-bound exports, around 5 per cent of exports from developed countries and 4 per cent

⁶ For instance, embedded emissions of transportation services that may risk carbon leakage as well as goods further down the value chain.

⁷ The reporting requirement include quantity of goods, embedded CO₂ emissions and CBAM certificates required to be surrendered after necessary adjustment.

Figure 2: The Commonwealth's CBAM-related trade exposure to the EU, by country group and region



Source: Commonwealth Secretariat using data from WITS for the goods specified in Annex I of the Regulation COM (2021)564 of the European Parliament and of the Council.

Note: This is a clustered column chart, with values ranging from 0 to 100 for each group/region. The numbers on each bar indicate the value of CBAM-related merchandise exports in 2019.

from developing countries could face CBAM charges. However, these shares could rise to around 9 per cent for both developed and developing countries should the coverage of CBAM be extended to other sectors (see section 3.3).

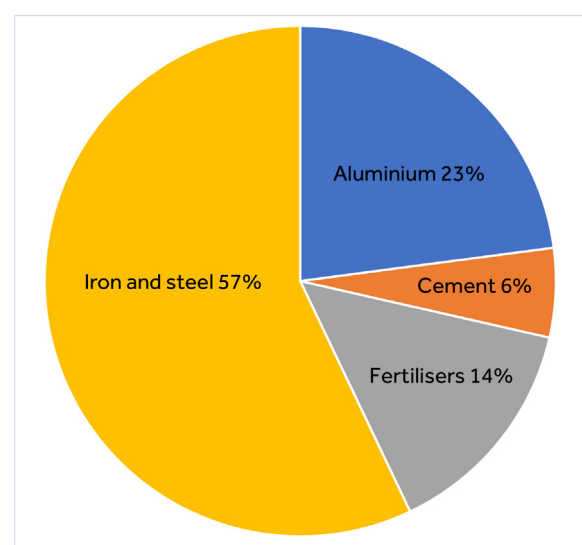
3.2 Sectoral implications of the EU's CBAM

The initial impact of the CBAM would be highly concentrated across a few sectors (Figure 3). The iron and steel sector alone accounts for more than half of Commonwealth countries' CBAM-related exports, followed by aluminium and fertilisers. The share of the cement sector is relatively small, accounting for only 6 per cent.

Iron and steel

Iron and steel is the most exposed sector, accounting for almost 57 per cent (US\$11 billion) of Commonwealth countries' CBAM-related exports. Primary materials of iron and steel (HS72) comprise around two thirds of these exports, while the remaining one third are articles of iron and steel (HS73) (Figure 4). Developed countries (Canada and the UK) are the leading exporters, accounting for almost half of these goods. Among developing countries, India (31 per cent), South Africa (8 per cent) and Malaysia (5 per cent) account for the bulk of iron and steel products exported to the EU. Most Caribbean and Pacific members do not produce these goods and so are largely shielded from the immediate effects of the CBAM (Table A1).

Figure 3: Sectoral composition of the Commonwealth's CBAM-related exports to the EU



Source: Commonwealth Secretariat using data from WITS.

Note: Table 1 contains export value for each sector.

Aluminum

Aluminum is the second most affected sector. In 2019, Commonwealth countries' aluminum exports to the EU were around US\$5 billion, which is almost 23 per cent of their total CBAM-related exports. Overall, the EU absorbed about 18 per cent of the Commonwealth's global exports in this sector. Around half of these exports originated in developed country members, mainly Canada and the UK. Among developing countries, Mozambique (11 per cent), India (11 per cent) and South Africa (10 per cent) are the three largest exporters.

Table 1: Commonwealth's CBAM-related exports to the world and the EU (2019)

CBAM sector	HS2	Sub-sector	Exports (US\$ billion)		EU's share (%)
			EU-27	World	
Aluminium	76	Aluminium and articles thereof	4.8	27.7	17.5
Cement	25	Salt, sulphur, earths, stone	1.2	9.4	12.6
Fertilisers	28	Inorganic chemicals	2.6	19.5	13.1
	31	Fertilisers	0.5	9.6	5.0
			3.0	29.1	10.4
Iron and steel	72	Iron and steel	7.4	35.2	20.9
	73	Iron or steel articles	4.7	22.2	21.0
			12.0	57.4	21.0
Grand total			21.1	123.6	17.1

Source: Commonwealth Secretariat using data from WITS.

Papua New Guinea (PNG) also exported aluminium worth \$1 million in 2019. Although its aluminium exports and those of Mozambique (\$1.1 billion) are relatively small in absolute terms, they account for more than 95 per cent of their CBAM-related exports to the EU.

Fertilisers

Fertilisers, including chemicals, have a relatively small share in the total exports of the Commonwealth's developed and developing countries and could be moderately exposed to the CBAM. In 2019, these exports were worth US\$3.1 billion. The shares of developed and developing countries were about 70 per cent and 30 per cent, respectively. Half of these exports originated in Asian members, mainly India and Singapore. Two other moderately exposed Commonwealth developing countries are South Africa and Jamaica, with each exporting about \$100 million of fertilisers in 2019. Among developed countries, the UK was the largest exporter of fertilisers to the EU, followed by Canada.

Cement

Cement is a relatively small sector for Commonwealth exports. In 2019, cement products sold to the EU were only worth US\$1.1 billion. The UK was the leading exporter, accounting for about half of these goods, followed by South Africa (15 per cent) and India (11 per cent). Despite its relatively small size, the sector is quite sensitive to a potential CBAM because the EU absorbs around 13 per cent of the Commonwealth's global cement exports.

3.3 Potential extension of the CBAM to other energy-intensive sectors

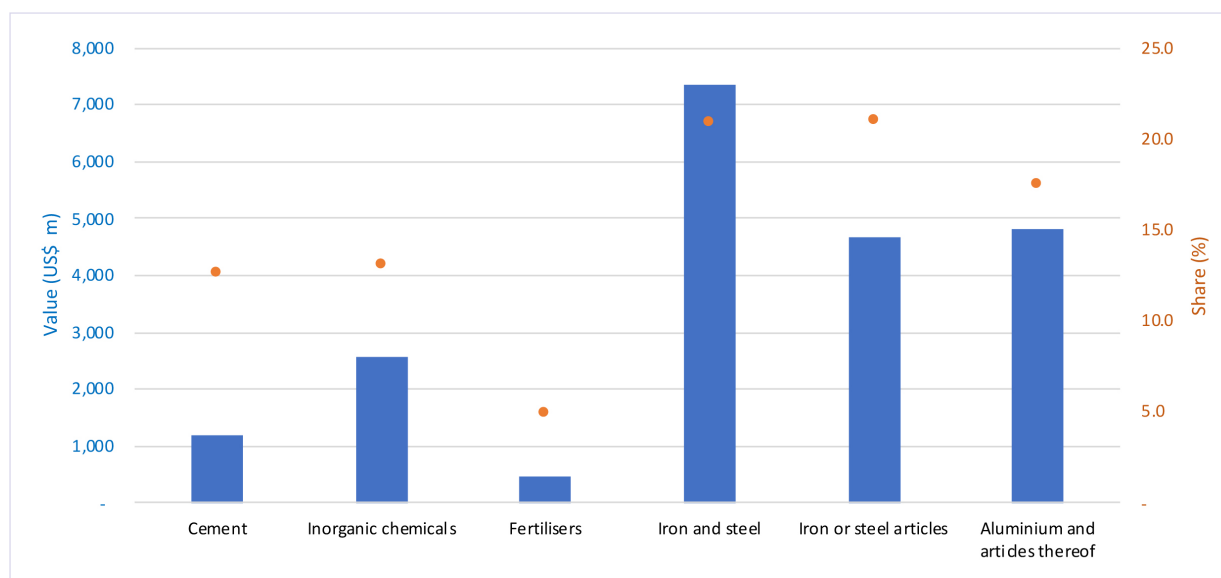
Some recent studies on the CBAM include three additional sectors not currently covered by the

EC Regulation: organic chemicals, glass and glassware, and paper and paperboard (Lowe, 2021; UNCTAD, 2021). Since these EITE industries are vulnerable to competitiveness and carbon leakage, it is likely they could be included in the CBAM at some later stage. All three sectors are extremely important for Commonwealth countries' exports, with those to the EU totalling US\$22 billion in 2019, almost equivalent to the value of trade in the industries covered by the present Regulation. It stands to reason that should the CBAM be extended to include these sectors, the potential value of affected exports could almost double, reaching as much as \$43 billion.

Of these three sectors, organic chemicals (HS19) is the largest product category. In 2019, Commonwealth members' global exports of organic chemicals amounted to US\$61 billion, of which around 15 per cent (US\$16 billion) was absorbed in the EU market, making them highly vulnerable to the CBAM. Half of these exports originated in Asia, mainly India and Singapore. The other moderately exposed Commonwealth developing country is Trinidad and Tobago, contributing about \$500 million in exports. Among developed countries, the UK was the largest exporter of these chemicals to the EU.

In 2019, Commonwealth countries' exports of glass and ceramic products amounted to US\$3 billion. The UK was the leading exporter, accounting for about \$1.1 billion of this total, followed by India (\$435 million), Malaysia (\$135 million) and South Africa (\$50 million). Glass and glassware (HS70) is the largest category followed by ceramic products (HS69). While the value of exports seems relatively small, the EU is the main market and accounts for

Figure 4: Sector level exposure to the EU's CBAM



Source: Commonwealth Secretariat using data from WITS.

Note: Bars (left axis) indicate the value of Commonwealth countries' exports sent to the EU in 2019 while the dots (right-axis) reflect the EU's share (%) in global exports by sector.

around 11 per cent of the Commonwealth's global exports of these goods.

Like the glass sector, the value of paper and paper products sent to the EU in 2019 was around US\$3 billion, of which \$1.6 billion originated in the UK. The other main exporters were Canada (\$360 million), India (\$173 million) and South Africa (\$107 million). Pulp of wood or other fibrous cellulose (\$400 million) accounts for a small share of these goods, with the majority comprising paper and paperboard products (\$1.6 billion).

4. Issues and concerns regarding the CBAM

The EU's proposed CBAM has triggered some apprehension about how these climate measures and new charges on exports could impact trading partners. Several countries, including Brazil, China, India and South Africa, have voiced concern that the CBAM is trade protectionism disguised as climate action (Bacchus, 2021). Designing a CBAM involves decisions on multiple features (such as sectoral coverage, approaches for measuring embodied carbon, treatment of exports, adjusting for mitigation abroad, how to use the revenues, and whether to exempt LDCs and other vulnerable countries) while trading off environmental, legal, administrative and other considerations (IEEP et al., 2021; Parry et al, 2021). The following section

provides a brief overview of some of the most salient issues.

4.1 WTO compatibility

A major concern is whether the EU's proposed CBAM will be compatible with WTO rules (Box 2). A final decision on this would require legal scrutiny by the WTO's Appellate Body. However, even if the CBAM is found to be incompatible with WTO rules, it will take a long time to get to that decision and will likely lead to the EU tweaking the CBAM, rather than rescinding it. The big concern arises if WTO members go outside of the system and take retaliatory measures anyway.

To comply with WTO rules, the CBAM must adhere to the principle of non-discrimination as set out in the General Agreement on Tariffs and Trade (GATT), specifically Most-Favoured-Nation (MFN) treatment (Article I:1) and National Treatment (Article III:1). Alternatively, the CBAM could qualify as a general exception to the GATT rules (Article XX), providing the EU can demonstrate that the measure is not an arbitrary or unjustifiable discrimination between countries where the same conditions prevail and is not a disguised restriction on international trade. Additionally, it has been suggested that the CBAM could qualify under a more generalised WTO climate waiver.⁹

⁹ A less explored option for the CBAM to comply with the WTO rules is through a climate waiver. A climate waiver from applicable trade rules for national measures that discriminate based on carbon and other greenhouse gases used or emitted in making a product has been long suggested to confront the clash between climate ambitions and trade rules (Bacchus, 2018).

Box 2: What WTO rules would govern the CBAM?

The MFN rule requires that any treatment granted to imported products of one WTO member must be extended unconditionally to like products originating from all other WTO members. This means the CBAM could be inconsistent with the MFN rule if it discriminates among and between products based on their national origin.¹⁰ Therefore, the EU could not, for example, apply the CBAM only to countries with lower emissions-reduction ambitions while exempting countries with higher ambitions (i.e., net zero targets).¹¹ If it did so, the EU would be passing judgement on the extent and quality of other WTO Members' climate actions rather than offering a fair assessment of the emissions from their industrial processes (Bacchus, 2021; Emerson and Moritsch, 2021). This could amount to discrimination as per its MFN obligations.

National treatment requires that the CBAM should not favour domestic production over imports, meaning the EU could violate this obligation if it continues to issue free allowances to some domestic producers under the emission trading system (ETS). The Commission has committed to gradually phase out these free allowances, although some domestic constituents have pushed back and argued that the proposed CBAM does not provide sufficient protection from carbon leakage (Bacchus, 2021). Moreover, WTO rules permit countries to apply import charges and export rebates not exceeding indirect domestic taxes on 'like' domestic products or their inputs – although there is some legal uncertainty regarding whether domestic carbon taxes and ETSs can be viewed as indirect taxes (Parry et al., 2021).

Should the CBAM fail to meet the MFN and national treatment requirements, there are general exceptions under GATT Article XX. This permits members to pursue legitimate domestic policy objectives that may affect international trade providing that such policies are applied in a non-discriminatory manner. Article XX(b) allows measures necessary to protect human, animal

or plant life or health, and Article XX(g) allows measures relating to the conservation of exhaustible natural resources. The CBAM could qualify for an exception under Article XX because it is a climate measure. However, there is the caveat that the CBAM must be considered necessary to achieve the stated environmental goals. That is, there should be no other, less trade restrictive alternative that could achieve the same goal.

To this end, Bacchus (2021) argues that it may be challenging for the EU to prove that its CBAM is necessary because there is at least one alternative that would be less trade restrictive and WTO-consistent, namely a carbon tax. Moreover, the EU would also need to prove that restrictions on imported products are comparable to domestic measures and that it is not being 'applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail' or that it is a 'a disguised restriction on international trade' (GATT Article XX). The burden of proof rests on the EU to demonstrate that it is not imposing its own climate standards on other countries through the CBAM without taking into consideration their own climate measures or taking the views of its trading partners into account through mutual dialogue.

4.2 Administration and compliance

Implementing the CBAM could impose significant compliance costs, even for large enterprises. Firms are required to file an annual declaration. This reporting will include quantity of goods, embedded carbon emissions and CBAM certificates that need to be surrendered after necessary adjustment. If the scope of the CBAM is expanded to cover embedded emissions in other sectors, such as ceramics and glassware, small and medium enterprises could be significantly affected and need assistance to meet these obligations.

The Regulation provides for abatement in taxation depending on whether there are existing ETSs in exporting countries and whether the producers are

10 An exception to the MFN rule could be made where discrimination is based on the principle of 'special and differential treatment' for developing countries as per the GATT enabling clause or differentiated responsibilities for developing countries as set out under the Paris Agreement. This is a hotly debated issue, and many scholars believe that some exception should be granted at least to LDCs.

11 This course of action has been widely speculated since the CBAM Resolution was adopted by the European Parliament's Committee on Environment, Public Health and Food Safety in March 2021. The Resolution, which speaks to the EU's disparagement of non-cooperative jurisdiction in international climate negotiations such as COP25, has provided grounds for this speculation (Emerson and Moritsch, 2021).

charged domestically for their carbon emissions. The details of eligibility criteria for exemptions are not clear at this stage. This would require developing equivalence mechanisms and an appeals procedure. There is also no internationally agreed methodology to measure embodied carbon on a product- and plant-specific basis. Default values of emissions could vary by region and country depending on factors such as industrial production structure, geography, natural resources and energy mix. Exports of some countries that have their own domestic carbon price, such as the UK, are unlikely to incur an additional charge when entering the EU, but the importer will still be hit by the costs of proving this.

4.3 Revenue generation and usage

The CBAM is expected to generate additional revenue, which for 2030 is estimated at above €2.1 billion (European Commission, 2021a).¹² The EC envisages this revenue being used to fund the administration and implementation of the CBAM, with remaining revenues allocated to the EU budget as 'own resources', including for financing the recovery instrument NextGenerationEU.¹³

There may be greater political acceptance of this measure and fewer legal risks if the EU committed to allocating substantial CBAM revenues to supporting the low carbon transition in LDCs, SIDS and other climate vulnerable countries (IIEP et al., 2021).¹⁴ This is particularly the case given that developed countries have fallen short of their commitment to mobilise US\$100 billion per year (through public and private sources) to help developing countries fulfil their NDCs. Moreover, some of the revenue could also be designated as Aid for Trade to support producers to comply with the CBAM.

4.4 Treatment of developing countries and LDCs

The EC Regulation currently makes no provision to exempt LDCs from the proposed CBAM. This contrasts with the European Parliament's resolution, which stresses that LDCs and SIDS should be given special treatment because of their specificities and the potential negative impacts of the CBAM on their development. There is a compelling case to exempt imports from LDCs because of their small economic

size, well-defined international status (including in the WTO) and very small contributions to historical carbon emissions (Parry et al., 2021). However, the EU should also strive not to unfairly penalise the exports of other developing countries.

In one approach, Lowe (2021) proposes the EU could justify the full or partial exemption of countries currently covered by its unilateral GSP scheme, which was discussed earlier, and involves 21 Commonwealth members (Table 2). As it does with its trade preferences, the EU should differentiate between LDCs and lower-middle-income countries – offering a full, unconditional exemption to the former and conditional exemptions, including using specific import thresholds, to the latter. These exemptions would be temporary and linked to levels of development. As developing countries' economies grow, or their exporters become more internationally competitive, they will graduate out of the exemptions. Their exports will then be subject to the EU's CBAM unless they have an equivalent domestic carbon price or the specific goods are produced with greater carbon efficiency than EU equivalents (ibid).

Table 2: EU GSP treatment for Commonwealth countries as of 1 January 2021

Standard GSP (5) ¹⁵	GSP+ (2)	EBA (14)
India	Sri Lanka	Bangladesh
Kenya	Pakistan	The Gambia
Nauru		Kiribati
Nigeria		Lesotho
Tonga		Malawi
		Mozambique
		Rwanda
		Sierra Leone
		Solomon Islands
		Tuvalu
		Uganda
		Tanzania
		Vanuatu*
		Zambia

Source: Commonwealth Secretariat using data from European Commission, 2021.

* Vanuatu graduated from LDC status in December 2020.

12 Other estimates suggest this could be in the range of €5-14 billion per year, depending on the final design of the mechanism (IIEP et al., 2021).

13 NextGenerationEU will provide the EU with the necessary means to address the challenges posed by the COVID-19 pandemic and, therein, support investment in the green and digital transitions (Regulation COM (2021)564 of the European Parliament and of the Council).

14 The European Parliament proposal supports use of revenues both for climate action within the EU and for an increase in EU climate finance, particularly to support LDCs and SIDS to undergo an industrialisation process based on clean and decarbonised technologies.

15 https://trade.ec.europa.eu/doclib/docs/2017/july/tradoc_155841.pdf

5. Conclusion and way forward

Collectively, the EU is the second largest export market for Commonwealth countries, absorbing around US\$490 billion in merchandise in 2019. The proposed CBAM could affect 17 per cent of the Commonwealth's global exports in four energy-intensive sectors: iron and steel, aluminium, fertilisers and cement. In the initial phase, around 5 per cent of Commonwealth countries' exports to the EU (US\$21 billion) could be exposed, but this share could rise to around 9 per cent (around \$43 billion) if other goods and services are brought into the fold. Most of these exports originate in a few large developing country members in Asia — India, Singapore and Malaysia — and two developed countries, namely the UK and Canada. In Africa, the two relatively more exposed countries are South Africa and Mozambique,¹⁶ while in the Caribbean region, some exports from Belize, Dominica, Jamaica and Trinidad and Tobago could attract border carbon taxes. Most Pacific SIDS, except PNG, do not export these energy-intensive products to the EU and therefore remain largely spared from these measures.

Iron and steel and aluminium are the two most highly exposed sectors in the Commonwealth to the CBAM as they account for around three quarters of its total CBAM-related exports to the EU. Fertilisers is the third most exposed sector: around 10 per cent of the Commonwealth's global fertiliser exports are sent to the EU, and this share could rise significantly if the scope of the CBAM extends to organic chemicals in the future. There is also the potential for trade diversion in these products. Once the CBAM is implemented, countries with more advanced carbon emission mitigation measures in place could potentially erode the market share away from Commonwealth countries in these energy-intensive products.¹⁷

The EU's proposed CBAM and the prospect of similar policies by Canada, Japan and the United States, as well as growing pressure for countries to achieve net zero by 2050, raise important questions about the linkages between climate strategies and trade policies. It is imperative that the EU engage in dialogue and outreach with countries that may be affected by this measure to examine its impacts and how best they can be addressed. Moreover,

while BCAs could provide an incentive for trading partners to pursue decarbonisation, it should also take into account the differential responsibilities and respective capabilities of countries under the Paris Agreement to mitigate emissions. Some countries exporting to the EU may have carbon pricing policies in place, while others may wish to pursue regulatory approaches for mitigation.¹⁸ For the UK, the TCA commits both Parties to maintaining effective carbon pricing and to work toward linking their ETSs (which would effectively guarantee that they have the same basis for national carbon pricing) (Lydgate, 2021).

To alleviate the direct and indirect effects of future BCAs on their economies, Commonwealth countries should start thinking about adapting their production processes in energy intensive sectors, while developed countries should provide financial and technological assistance to support a low-carbon transition in small states, LDCs and countries in sub-Saharan Africa. Overall, the prospect of BCAs points to the need for greater multilateral cooperation on carbon pricing and greater coherence and mutual supportiveness between the multilateral trade and environmental regimes to tackle climate change. Significant global conferences, notably the 26th Conference of the Parties (COP26) of the UNFCCC and the WTO's 12th Ministerial Conference, are opportunities for Commonwealth countries to provide leadership and advocate globally for greener growth and recovery from the pandemic as well as additional support for the smallest and most vulnerable countries to pursue their NDCs and the Sustainable Development Goals (SDGs).

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16 South Africa exports iron and steel to the EU while Mozambique exports aluminium.

17 If the EU enacts the CBAM, there is also a possibility that high carbon products that would otherwise have ended up on the EU market will 'deflect' into other markets. This could lead to political pressure in third countries to introduce their own CBAM equivalents.

18 The EU position is that if regulatory measures do in fact lead to a lower carbon intensity of production, then this will already be accounted for when importers are calculating the real amount of embedded carbon in imports.

Emerson, C and S Moritsch (2021) 'Making Carbon Border Adjustment Proposals WTO-Compliant'. KPMG briefing document. <https://assets.kpmg/content/dam/kpmg/xx/pdf/2021/03/making-carbon-border-adjustment-proposals-wto-compliance.pdf>

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7. Appendix

Table A1: Commonwealth countries' CBAM-related exports, by county, region and sector

Region/ group	Economy	Total merchandise exports			CBAM-related total exports				CBAM related exports to the EU, by sector							
		(US\$ million)		EU share (%)	(US\$ million)		EU share (%)	(US\$ million)				Share (%)				
		World	EU-27		World	EU-27		Cement	Fertilisers	Ironand steel	Aluminium	Cement	Fertilisers	Ironand steel	Aluminium	
Developed economies	Australia	291,087	20,320	7.0	14,855	305	2	85	69	100	50	28.0	22.6	32.9	16.5	
	Canada	461,048	39,027	8.5	31,796	1,516	5	41	765	303	406	2.7	50.5	20.0	26.8	
	Cyprus	3,457	2,047	59.2	185	77	42	8	12	48	9	10.8	15.1	62.1	12.0	
	Malta	4,333	2,140	49.4	85	64	75	16	13	29	6	24.7	20.4	46.1	8.8	
	New Zealand	41,478	4,014	9.7	1,143	62	5	2	1	21	38	3.7	1.0	34.5	60.8	
	United Kingdom	411,125	193,675	47.1	17,941	9,679	54	466	1,260	6,135	1,818	4.8	13.0	63.4	18.8	
		1,212,527	261,223	21.5	66,006	11,702	18	618	2,120	6,636	2,327	5.3	18.1	56.7	19.9	
	Botswana	4,868	1,036	21.3	91	0	0	0	-	0	-	56.6	0.0	43.4	0.0	
	Cameroon	5,439	2,310	42.5	94	86	91	0	0	0	85	0.1	0.1	0.3	99.6	
	Eswatini	3,445	139	4.0	28	0	1	-	-	0	0	0	0.0	0.0	6.7	93.3
Africa	Ghana	15,553	2,780	17.9	210	106	50	0	0	1	104	0.0	0.0	1.3	98.7	
	Kenya	5,009	1,473	29.4	143	2	1	0	0	1	1	3.1	6.7	43.7	46.6	
	Lesotho	1,145	354	30.9	3	0	0	-	-	0	-	0.0	0.0	100.0	0.0	
	Malawi	888	247	27.9	4	0	3	0	-	0	0	1.3	0.0	98.6	0.1	
	Mozambique	6,035	1,828	30.3	1,321	1,125	85	47	-	5	1,072	4.2	0.0	0.5	95.3	
	Namibia	4,473	1,328	29.7	583	32	5	13	18	1	0	42.0	56.2	1.7	0.0	
	Nigeria	56,216	23,775	42.3	455	12	3	0	0	4	7	0.3	0.4	37.2	62.1	
	Rwanda	781	81	10.3	6	0	1	0	0	-	0	25.5	0.0	7.4	67.1	
	Sierra Leone	729	333	45.6	15	3	18	0	0	0	2	1.4	1.4	84.9	12.4	
	South Africa	117,137	30,764	26.3	10,727	1,826	17	188	197	965	476	10.3	10.8	52.9	26.0	
	Tanzania	4,486	459	10.2	225	0	0	0	0	0	0	61.1	0.1	34.2	4.6	
	The Gambia	167	22	13.3	6	0	1	-	-	0	0	0.0	0.0	99.3	0.7	
	Uganda	3,129	451	14.4	65	2	2	1	-	0	0	94.9	0.0	1.7	3.4	
	Zambia	8,123	405	5.0	438	14	3	0	0	0	14	0	0.7	99.3	0.0	
Asia	Mauritius	2,542	943	37.1	160	7	5	1	2	0	4	8.1	33.9	6.8	51.2	
	Seychelles	683	286	41.8	6	1	10	0	-	0	0	62.7	0.0	36.7	0.6	
		240,850	69,013	28.7	14,578	3,215	22	252	217	995	1,750	7.8	6.8	31.0	54.4	
	Bangladesh	46,951	27,015	57.5	106	2	2	0	0	1	0	2.4	1.7	77.1	18.8	
	Brunei Darussalam	6,737	6	0.1	63	0	0	-	0	0	0	0.0	8.9	77.9	13.2	
	India	292,395	56,373	19.3	23,274	4,771	20	256	207	3,754	555	5.4	4.3	78.7	11.6	
	Malaysia	332,072	33,302	10.0	11,667	769	7	10	14	564	181	1.2	1.9	73.4	23.5	

Table A1: Commonwealth countries' CBAM-related exports, by county, region and sector (contd..)

Region/ group	Economy	Total merchandise exports			CBAM-related total exports				CBAM related exports to the EU, by sector							
		(US\$ million)		EU share (%)	(US\$ million)		EU share (%)	World	(US\$ million)				Share (%)			
		World	EU-27		World	EU-27			Cement	Fertilisers	Iron and steel	Aluminium	Cement	Fertilisers	Iron and steel	Aluminium
Asia continued	Pakistan	24,702	9,610	38.9	708	66	9	708	51	1	12	3	76.3	1.5	17.6	4.6
	Sri Lanka	11,673	3,884	33.3	104	10	10	104	2	4	2	3	19.0	36.7	16.3	28.0
	Maldives	274	92	33.7	6	0	0	6	-	-	0	-	0.0	0.0	100.0	0.0
	Singapore	253,008	24,370	9.6	3,856	88	2	3,856	0	27	51	10	0.3	30.2	57.7	11.8
		967,811	154,653	16.0	39,785	5,706	14	39,785	318	252	4,384	752	5.6	4.4	76.8	13.2
Caribbean	Antigua and Barbuda	174	125	71.6	3	0	2	3	0	-	0.0	0.0	13.3	0.0	78.1	8.6
	Barbados	319	108	33.8	39	0.0	0.1	39	0	-	0.0	-	9.4	0.0	90.6	0.0
	Belize	285	164	57.5	4	1	23	4	0	0.0	0.8	0.0	3.3	0.5	96.0	0.2
	Dominica	47	7	14.1	4	2	46	4	1	-	0.3	0.1	78.2	0.0	17.9	3.8
	Grenada	34	9	26.9	1	1	63	1	0	0.0	0.7	0.0	0.6	0.1	98.5	0.8
	Guyana	1,405	266	18.9	28	1	2	28	0	0.2	0.2	0.1	0.5	46.1	30.1	23.3
	Jamaica	1,329	319	24.0	766	220	29	766	0	219.7	0.3	-	0.0	99.8	0.2	0.0
	St Kitts and Nevis	77	12	15.2	1	0.0	2	1	-	-	0.0	0.0	0.0	0.0	23.2	76.8
	Saint Lucia	51	9	16.8	6	0.1	2	6	-	0.0	0.1	-	0.0	30.2	69.8	0.0
	St Vincent*	169	18	10.5	1	0.1	9	1	-	-	0.1	-	0.0	0.0	100.0	0.0
The Pacific	The Bahamas	1,444	563	39.0	81	2.2	3	81	0	0.8	1.3	0.1	1.5	36.2	58.3	4.0
	Trinidad and Tobago	10,710	2,162	20.2	2,278	235	10	2,278	0	219.4	15.0	0.1	0.0	93.5	6.4	0.0
		16,044	3,761	23.4	3,212	461	14	3,212	1	440	19	0.4	0.3	95.5	4.1	0.1
	Fiji	662	61	9.2	4	0.0	0.5	4	0	-	0.0	-	54.2	0.0	45.8	0.0
	Kiribati	92	0.1	0.1	1	-	-	1	-	-	-	-	-	-	-	-
	Nauru	35	3	7.9	11	0.1	0.6	11	-	-	0.1	-	0.0	0.0	100.0	0.0
	Papua New Guinea	11,822	972	8.2	13	2	13	13	-	-	0.0	2	0.0	0.0	1.7	98.3
	Samoa	39	2	4.0	1	0.0	0.0	1	0	-	0.0	-	44.7	0.0	55.3	0.0
	Solomon Islands	701	89	12.6	1	0.0	2.5	1	-	-	0.0	0	0.0	0.0	89.7	10.3
	Tonga	16	0.4	2.6	0.2	0.0	6.8	0.2	-	0	0.0	-	0.0	23.7	76.3	0.0
All Commonwealth	Tuvalu	19	1	2.8	0.1	0	56	0.1	-	-	0.0	0	0.0	0.0	99.7	0.3
	Vanuatu	170	2	1.4	0.3	0	4	0.3	0	-	0.0	-	79.2	0.0	20.8	0.0
		13,557	1,129	8.3	31	2	6	31	0	0	0.2	2	1.1	0.2	8.9	89.8
		2,450,789	489,779	20.0	123,613	21,086	17.1	123,613	1,190	3,030	12,035	4,832	5.6	14.4	57.1	22.9

*St Vincent and the Grenadines
Source: Commonwealth Secretariat using data from WITS.

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