

Geopolitical Implications of the EU's Carbon Border Adjustment Mechanism

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Introduction

The Paris Agreement is an outcome-focused environmental treaty, which aims to keep the global average temperature increase below 2 degrees Celsius, preferably 1.5, compared to pre-industrial levels (United Nations, 2021). However, it does not prescribe how signatories should achieve this outcome. The targets and measures are voluntary and vary widely across countries. Numerous industrialized countries — including European and Nordic nations — have implemented emissions reduction policies in the absence of concerted global action. Such disproportionate emissions-reduction efforts may lead to the relocation of economic activity to countries that do not have or have less-stringent climate policies leading to limited reductions in global emissions — carbon leakage.

To prevent this and encourage decarbonization outside of its borders, on July 14, 2021, the European Commission (EC) released a regulatory proposal for a carbon border adjustment mechanism (CBAM) (European Commission, 2021d). The draft CBAM regulation proposes an emissions tax payable on certain emission-intensive goods imported by the European Union (EU).¹ In this chapter, we explore reactions to the draft CBAM regulation by public and private stakeholders within the EU and its main trading partners in the affected sectors (China, Russia, and Turkey) on the regulation's design, feasibility and fairness. We argue that the CBAM proposal is the EU's attempt to use its normative power² to incentivize climate policy reforms in third countries.³

¹ Affected industries are aluminum, cement, energy, fertilizers, and iron and steel. A full list of emissions covered by the draft regulation for each individual industry is published by the EC (European Commission, 2021a). For all five industries, the focus is on carbon dioxide (CO₂) but fertilizers also include nitrous oxide and aluminum includes perfluorocarbon (PFC) emissions.

² See Manners, 2002; Pace, 2007.

³ "Third countries" are neither in the EU nor the European Economic Area which includes Iceland, Liechtenstein and Norway. Switzerland would also be exempt from a CBAM because it has a bilateral trade agreement with the EU.

The CBAM would affect the EU's trading partners differently; the regulation will initially apply to a select number of emission-intensive industries at high risk of carbon leakage. Although the EU states the CBAM is a measure to prevent carbon leakage, the geopolitical implications of the CBAM for the EU may be significant since the EU is the main market for emission-intensive goods from major exporters like China and Russia. We rely on international trade statistics to identify the EU's trading partners that would be most affected by the CBAM and to guide the focus of our discussion on the geopolitical implications of the proposal.

In the next section, we outline the specifics of border carbon adjustment (BCA) regulations before discussing the details of the EU's CBAM. We then present our conceptual framework. The framework relies on the concept of normative power (Manners, 2002) to explain the CBAM's potential role in incentivizing climate policy reforms in third countries. In light of the debate around the EU's normative power, we discuss the geopolitical implications of the CBAM. We conclude that the EU needs to initiate bilateral conversations with its main trading partners on the framing and purpose of this regulation in order to prevent retaliatory actions and an erosion of trust by its trading partners.

Purpose of Border Carbon Adjustments

Uncoordinated actions to reduce global emissions and the transboundary nature of greenhouse gas (GHG) emissions mean differences in environmental regulations may undermine achieving the Paris Agreement target. The outcome of these differences in regulations is of particular concern for parties to the Paris Agreement, like the EU, implementing ambitious emissions-reduction regulations. More strictly regulated firms in countries with stringent emissions-reduction regulations may scale back production as they lose competitiveness in domestic or global markets compared to less strictly regulated firms or relocate to countries with weaker or no environmental standards. The resultant increase in emissions would in part offset the emissions reduction in strictly regulated countries, leading to a cross-border carbon leakage. Leakage is central to the policy debate on unilateral emission regulations; particularly for emissions-intensive and trade-exposed industries where emission-intensive inputs represent a significant share of total production costs.

In response to such concerns, a border carbon adjustment (BCA) is a policy option to level the playing field in international trade. As a duty on emission-intensive goods, a BCA discourages

imports. As an alternative to globally coordinated measures, a BCA, although complicated and costly to design and implement, limits carbon leakage by shifting part of the economic burden to countries with less stringent emission-regulations.⁴ BCAs are also a coercive tool to incentivize or pressure trade partners to adopt more-stringent environmental policy.

The EU's main motivation in proposing the CBAM is to prevent the risk of carbon leakage by equalizing the cost of carbon between imported and domestically-produced goods. The CBAM would cover mainly CO₂ emissions (direct and indirect) embedded in imported goods to make trading partners face an emissions price similar to what they would face if they produced the same goods in the EU. The EU is not the only jurisdiction considering a BCA. Notably, as Droege and Fischer (2020, p. 30) point out "nearly every example of draft climate legislation circulating in the US Congress includes BCA." The state of California has a BCA that applies to emissions from electricity imported from other U.S. states (McWilliams & Tagliapietra, 2021). In 2020, Canada also announced its intentions to explore the potential for a BCA and released an initial assessment report in August 2021 (Department of Finance, 2020). If the EU adopts the CBAM, it will apply to imports into the EU27, the European Economic Area (EEA) and Switzerland.⁵

Cornerstones of the EU's Draft CBAM Proposal

The CBAM is part of the broader "Fit for 55" climate plan which aims to reduce the EU's net emissions at least 55% below 1990 levels by 2030 through a set of proposals that is supposed to deliver on the EU's climate goals from the European Green Deal, formulated in 2019 (European Commission, 2019).⁶ The EC, as the executive branch of the EU, pledged to achieve net zero

⁴ The limit to leakage is only partial, as a BCA protects domestic production's internal market share from lower-cost imports (where the cost difference is from less stringent environmental policy elsewhere). A complimentary tool that protects domestic firms' international and domestic competitiveness is an output-based pricing system, which provides an output subsidy to emissions-intensive and trade exposed production, mitigating the costs of environmental policy. See Droege & Fischer (2020).

⁵ According to the draft proposal (European Commission, 2021d), the CBAM will apply to imports into EU27 (Austria, Belgium, Bulgaria, Croatia, Republic of Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain and Sweden), the members of the European Economic Area (EU27 plus Iceland, Norway and Liechtenstein) and Switzerland. Note that the UK is no longer part of the EU and there is no clear indication if the UK (plus Northern Ireland) will be exempt at this point.

⁶ According to the EC, the European Green Deal will "transform the EU into a fair and prosperous society, with a modern, resource-efficient and competitive economy where there are no net emissions of greenhouse gases in 2050 and where economic growth is decoupled from resource use" (European Commission, 2019, p. 2). The Green Deal is a holistic policy program focusing on areas including climate, energy, agriculture, industry, environment and oceans, transport, finance and regional development, and research and innovation.

emissions by 2050 (European Commission, 2021c). The CBAM is one element among 13 policies presented in the “Fit for 55” plan. Details on many of these measures and policy objectives remain vague since the EC has not yet released the corresponding amendments. However, as highlighted in the documents issued by the EC, the CBAM would reduce the risk of carbon leakage and ensure a level playing field for EU industries by equalizing the price of emissions between domestic products and imports in select industries.

Initially, the CBAM will have restricted coverage and apply to five industries with a relatively higher exposure to emissions pricing and international trade: aluminum, cement, fertilizer, iron and steel, and electricity generation. The emissions from these accounted for about 55% of all industrial emissions in the EU27 in 2020 (European Commission, 2021b). Iron and steel production is the highest emitter at 30% of industrial emissions. Aluminum emits the least amount in terms of direct emissions due to its reliance on electricity. The EC (European Commission, 2021b, p. 43) states, “looking at total CO₂ equivalent emissions, CBAM sectors together with electricity generation accounted for nearly 40% of emissions in 2020.”

Since the CBAM covers direct and indirect emissions of imports, it complements the internal emissions-pricing scheme of the EU, namely the EU ETS. For the industries subject to the EU ETS, total emissions are capped and industrial facilities buy or receive allowances that cover their emissions. Although the allowances are in principal purchased through competitive auctions, some industries have received free allowances to adjust for competitiveness pressures from non-EU producers; the amount of free allocations is declining over time (Dobson & Winter, 2018). Under the draft CBAM proposal, the auction price of the ETS allowances determines the price of CBAM certificates and when ETS free allowances are eliminated in 2035, the CBAM will apply to all of the industries currently covered by the ETS.⁷

Determining emissions embedded in imports will depend on the chosen mechanism. Under the EU ETS, the covered facilities are subject to a price based on their actual emissions and for fair treatment, the scope of the CBAM may be the same. However, this entails a significant administrative cost on both the importers and the implementing bodies in the EU. Establishing a

⁷ The EU ETS covers emissions from the following industries: electricity and heat generation; energy-intensive sectors including oil refineries, steel works, and production of iron, metals, cement, lime, glass, ceramics, pulp, paper, cardboard, acids and bulk organic chemicals; and commercial aviation within the EEA. It also includes nitrous oxide (N₂O) from production of nitric, adipic and glyoxylic acids and glyoxal; and PFCs from production of aluminium (European Commission, 2021a).

default average emission-intensity value for each industry or product is another option considered by the EU, which would reduce the costs associated with the management of the system and the accuracy of the CBAM as a tool to level the playing field. The EU envisions a transitional phase until 2026 to navigate the tradeoffs between the objectives and the proposal design. An outstanding question is to what extent the EU member states can come to an agreement during negotiations in the European Parliament (EP). Conflict and debates about the CBAM proposal are likely to emerge during the time-consuming negotiations⁸ between the EC and the EU member states (Imeri & Barzilska, 2021). This means that the EU's current proposed dates may not be realistic from an administrative and practical perspective given the lengthy legislative processes.

During the COP26, Frans Timmermans (Vice President of the EC) explained that the EU “will increasingly create a space across the planet where countries will take comparable measures to decarbonize their economies which will make the CBAM not necessary or only in a limited way” (Timmermans, 2021). This could imply the formation of a “climate club” in which countries agree on cap emissions or the EU could grant exemptions from the CBAM to countries that implement a national mechanism to price or cap emissions. The more countries adopt climate policies to limit emissions, the less likely a CBAM will be necessary to prevent carbon leakage (Burke, 2021). However, the reactions of industry proponents and third countries that we discuss in this chapter show the CBAM's implementation is uncertain.

The Normative Power of the EU and its role as a “Climate Leader”

The concept of normative power (Manners, 2002) illustrates the EU's external relations, which are influenced by a set of normative principles and shared beliefs that form the core of the EU's self-understanding and are codified in the assembled framework of EU legislations and laws.⁹ Wunderlich (2020, p. 1109) argues that the EU “aims to establish itself by differentiation, that is, as a different kind of power and a force for collective good”. The EU achieves this through promotion of its universal values and shared interests, alongside the powers of attraction and persuasion toward third countries (Manners, 2002). Based on the European Green Deal, Eckert

⁸ The timeline to finalize the CBAM is currently not predictable. The EC presents policy documents to the heads of states and governments at the European Council summit meetings and at Intergovernmental Conferences. During these events, the Commission presents its institutional position which reflects a pan-European perspective. Individual EU member states discuss and present their own national positions at the EP.

⁹ The EU's “normative basis” builds on five core norms: peace, liberty, democracy, rule of law, and respect for human rights (Manners, 2002, p. 242).

(2021, p. 2) identifies several environmental and social norms that the EU aims to “diffuse” through policy reforms in third countries: climate neutrality, zero pollution, a circular economy and a “just transition both inside the EU and globally.”

Pace (2007) presents several mechanisms whereby the EU exerts political and economic pressure on third countries: dialogue, bilateral contractual relations (or politically binding agreements), and specific policy initiatives in key functional areas like energy. The literature discusses the role of the EU as a “global climate leader” in climate change mitigation policy (Parker et al., 2017; Parker & Karlsson, 2017; Torney, 2019). Parker and Karlsson (2017) emphasize that throughout the last two decades, the EU spearheaded several initiatives (like the 20-20-20 targets¹⁰) and continues to be a main supporter of the Paris Agreement.

In recent years, scholars have examined the EU’s leadership position on climate change initiatives and its capability to induce reforms in third countries after key events like the introduction of the Green Deal in 2019 (Lütz et al., 2021; Weko, 2021). Currently, the EP proposes that the EU “may conclude agreements with third countries with a view to take account of carbon pricing mechanisms and carbon reduction measures of equivalent efficiency other than carbon pricing mechanisms” (European Parliament, 2021, p. 21).

In this chapter, we argue that, as reflected by the reactions to draft proposal, while the CBAM may induce emissions-reduction strategies in third countries, its success in incentivizing climate policy adoption relies on the normative power of the EU. Figure 1.1 presents a timeline of the key events that shaped the reactions to the CBAM.

¹⁰ In December 2008, the EU adopted its climate and energy package that targeted reducing GHG emissions by 20% compared to 1990 levels, to increase energy efficiency within the EU by 20% and to have 20% of its energy consumption from renewable sources. The year for all of these targets to be achieved was 2020 (Peña & Rodríguez, 2019).

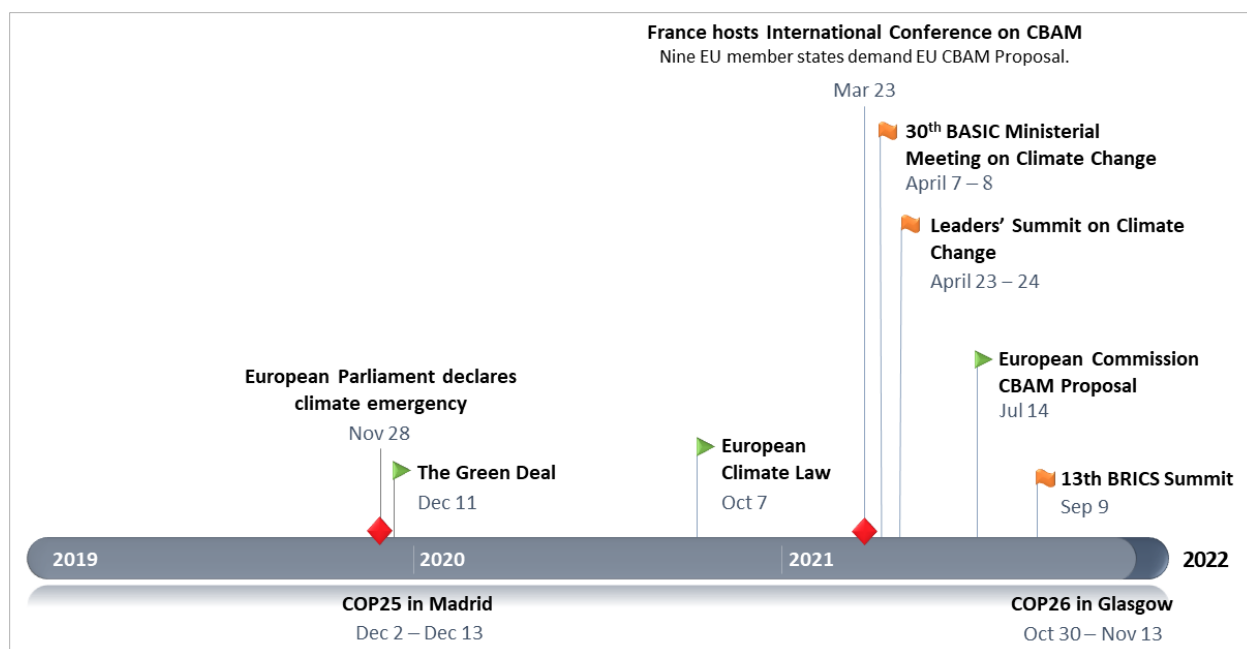


Figure 1.1. Timeline of International Key Events related to the EU Commission's CBAM Proposal 2019–2021.

Source: Prepared by Authors.

While the reactions expressed during these events imply the normative power of the EU, internal and external forces, manifested through the economic interests of public and private stakeholders, compel the EU to deliver concessions to third countries. These concessions undermine the normative power of the EU and the multilateral participation necessary to achieve Paris Agreement targets. Next, we present the reactions to the draft CBAM proposal in the EU and by its main trading partners.

Reactions of the EU member states and industry leaders to the draft CBAM proposal

Since the CBAM is a climate policy with potential impact on trade flows, it is likely to incite intense geopolitical debates among EU members, industry proponents, and the EU's main trading partners. All 27 EU member states are expected to defend their national interests during the negotiations, which will be influenced by the impact on their domestic industries. Several EU member states, like Finland (Kuusi et al., 2020) and France (Ministry for Europe and Foreign Affairs, n.d.), have already commissioned reports on the potential domestic impact of the CBAM, and these reports may indicate the direction of their vote on the proposal in the EC. Another

example is the European Automobile Manufacturers’ Association (ACEA), which announced its expectations for the regulation, like maintaining the industry’s global competitiveness and avoiding retaliation from third countries (ACEA, 2021).

In March 2021, several cabinet ministers from nine EU member states¹¹ published an op-ed calling on the EC to develop a CBAM proposal that ensures non-discrimination and a “good articulation with the EU ETS which could mirror the European carbon market” (Blümel, 2021). On the same day as the op-ed’s release, France held an international conference discussing design and implementation of a potential CBAM. France will inherit the Presidency of the Council of the European Union from January to June 2022, and has declared that developing a governance and implementation framework for the CBAM will be a priority (Ministry for Europe and Foreign Affairs, n.d.). April 2020, France proposed its own expectations for the CBAM (Table 1.1.).

French CBAM Proposal delivered to the European Commission in April 2020
<ul style="list-style-type: none"> • Require those importing goods from outside the EU to acquire specific carbon quotas from a market mirroring the EU Emissions Trading System (EU ETS).
<ul style="list-style-type: none"> • Gradually replace the system of free allocation of ETS allowances following a transitional phase that would run until 2025.
<ul style="list-style-type: none"> • Initially select a limited number of pilot sectors, including the highest-emitting activities and those most exposed to the risk of carbon leakage, such as steel and cement.
<ul style="list-style-type: none"> • Take into account the climate policies of third countries and their level of development in the design of the mechanism.
<ul style="list-style-type: none"> • Provide a solution, in the form of compensations, to the issue of exporting sectors, so as to limit carbon leakage on other markets.

Table 1.1. French CBAM Proposal delivered to the European Commission in April 2020.

Source: Ministry for Europe and Foreign Affairs, n.d.

¹¹ Cabinet ministers from the following EU members authored the op-ed: Austria, Czech Republic, Denmark, France, Lithuania, Luxembourg, Slovakia, Spain, the Netherlands.

As a large economy within the union, Germany's reaction to the CBAM is important for the proposal's success. German industry proponents, like the Federation of German Industries (BDI), argue that central design and implementation questions remain unanswered in the CBAM proposal, such as exemption criteria. Similarly, Chief Executive Wolfgang Große Entrup of Germany's Chemical Association stated that for the EU "it is not enough just to be a role model for the world" but rather, the CBAM must uphold Germany's industrial competitiveness (Kurmayer, 2021). In general, German industry leaders expressed concerns regarding the EU's proposal and that they would prefer the status quo of the EU ETS. EU industry leaders claim that the CBAM "only protects companies within the EU and is associated with considerable legal and bureaucratic hurdles" (Kurmayer, 2021). There is strong internal resistance against the CBAM proposal among EU-based private stakeholders.

Global Implications of the CBAM – Reactions from the EU's Main Trading Partners

The draft CBAM proposal also sparked significant reactions from the EU's main trading partners. As shown in Table 1.2., the EU's biggest trading partners in the five potentially affected sectors are China, Russia and Turkey. The draft CBAM proposal lacks detail on crucial design elements, such as crediting trade partners' climate action. Nevertheless, the potential CBAM immediately prompted strong reactions from several third countries (Gläser & Caspar, 2021); see Table 1.3.

In a joint statement responding to the CBAM, China, South Africa, Brazil, and India expressed "grave concern". These four countries argue that BCAs are, in general, discriminatory according to the principles of Equity and Common but Differentiated Responsibilities and Respective Capabilities¹² (Republic of South Africa, 2021). Under these principles, industrialized countries should be championing emission reduction strategies by also supporting developing and least-developed countries.

¹² These principles are outlined in the United Nations Convention on Climate Change from 1992: "The Parties should protect the climate system for the benefit of present and future generations of humankind, on the basis of equity and in accordance with their common but differentiated responsibilities and respective capabilities. Accordingly, the developed country Parties should take the lead in combating climate change and the adverse effects thereof" (United Nations, 1992, p. 4).

EU Imports' County of Origin for CBAM-affected Industries				
Aluminum	Norway	Russia	China	United Arab Emirates
	3116	2425	1546	1171
	18%	14%	9%	7%
Cement	Turkey	Colombia	Ukraine	Belarus
	106	26	24	22
	35%	9%	8%	7%
Electricity Generation	Switzerland	Russia	Serbia	Norway
	710	613	478	473
	21%	19%	14%	14%
Fertilizer	Russia	Egypt	Algeria	Morocco
	1492	450	421	355
	34%	10%	10%	8%
Iron and Steel	China	Russia	Turkey	Ukraine
	4876	4749	4283	2726
	14%	13%	12%	8%

Table 1.2. Main Sources of Imports (Import Value (in million €) and Share of Total Industry Imports by value, 2019)

Source: Trade data for 2019 is from Eurostat Comext “EU trade since 1988 by HS2,4,6 and CN8” Available from:
<https://ec.europa.eu/eurostat/web/international-trade-in-goods/data/focus-on-comext>

CBAM Criticisms by the EU's Main Trading Partners		
Protectionism	Revenue Generator	Unilateral decision-making
<ul style="list-style-type: none"> • Allegedly protectionist and a trade barrier under a climate pretext. • Competitiveness of domestic industry. 	<ul style="list-style-type: none"> • CBAM revenues could be seen as income for the overall EU budget. • Funds from less affluent countries redirected into the EU. 	<ul style="list-style-type: none"> • The EU failed to consult with third country trading partners. • Accusation of acting on a unilateral basis.

Table 1.3. Main Criticism of the CBAM by the EU's main trading partners.

Source: Adapted from “Less confrontation, more cooperation”. Gläser, A. and Caspar, O. (2021). *Germanwatch – Policy Brief*. Available from: <https://germanwatch.org/en/20355>

Furthermore, although the EU claims the CBAM was designed in compliance with WTO rules, commentators state that an EU CBAM may not be. Scholars emphasize that a CBAM may be considered protectionist by the EU’s trading partners and thus contradict WTO rules, in particular the General Agreement on Tariffs and Trade (Kolev et al., 2021). Therefore, EU trading partners may impose retaliatory measurements against the EU in order to express their discontent with such policies. This could also prompt judicial challenges, if third countries formally complain to the WTO against the CBAM (Mehling, 2019).

Before examining the individual reactions of China, Russia and Turkey to the EC’s proposal, we discuss the countries’ respective emissions reduction policies. This provides important context for their current climate change mitigation objectives, which will form a basis for their negotiations with the EU (Table 1.4).

Status of Emissions-Reduction Policies			
Jurisdiction	China (NATIONAL ETS)*	Russian Federation – Sakhalin	Turkey
Status	In Force (since mid-2021)	Under Development	Under Consideration
Total GHG emissions	12,301 Mt CO ₂ e (2014)	2220.1 Mt CO ₂ e (2018)	520.9 Mt CO ₂ e (2018)
GHG Reduction Target	CO ₂ peak before 2030; neutrality by 2060.	Emissions will not exceed 70% of 1990s levels by 2030.	Up to 21% reduction from 2021 levels by 2030.
GHG covered	CO ₂	No information available.	No information available.
Sectors	Power sector. In the long-term, expected to cover nine industries: power, cement, aluminum, iron and steel, nonferrous metals, petroleum refining, chemicals, pulp and paper, and aviation. There is no specific timeline for this expansion.	No information available.	No information available.
Point of Regulation	Expected to cover both direct and indirect emissions from power generation.	No information available.	No information available.
Number of entities	The regional ETS pilot covered power sector entities, which may also fall under the national ETS. These entities are transitioning into the ETS national market.* Estimate: 2,225 facilities (2021).	No information available.	No information available.
Cap	No absolute cap on emissions. The cap is adjusted ex-post based on actual production levels. Monitors intensity, meaning a regulated plant receives more permits if it produces more output. The national ETS is estimated to have a cap of over 4,000 MtCO ₂ /year for 2021.	No information available.	No information available.
Permit Allocation	Free allocation based on four distinct fuel-based benchmarks: conventional coal plants below 300MW; conventional coal plants above 300MW; unconventional coal plants; and natural gas. Entities will receive allowances at 70% of their 2018 output multiplied by the corresponding benchmark factor. Allocation will be adjusted later to reflect actual generation in 2019 and 2020. The National Measures clarify that auctioning may be introduced at a later point in time which has not been determined.	No information available.	No information available.

* China has the following regional ETS pilots: Beijing; Chongqing; Fujian, Guangdong, Hubei, Shanghai, Shenzhen, Tianjin.

Table 1.4. Status of Emissions Trading Systems in China, Russian Federation, and Turkey.

Source: Adapted from “Comparing ETS – China-Russia-Turkey”. *International Carbon Action Partnership (ICAP)*, 2021. Available from: <https://icapcarbonaction.com/en/ets-map>

China

China faces significant exposure to the CBAM, since the EU is China's biggest trading partner. In 2020, 14% of China's total trade (imports and exports) was with the EU. The EU is China's largest source of imports and second largest export market following the US, particularly for iron and steel. In 2020, the EU was the destination of the 15% of China's total exports while China sourced about 13% of imports from the EU. However, China's ETS may alleviate the CBAM's effect on Chinese exporters. The national ETS, which came into force in 2021, regulates more than 2,200 power facilities and covers around 40% of China's CO₂ emissions (Kardish et al., 2021). China's 14th Five-Year Plan (2021-2025) is scheduled to expand the ETS to include iron, steel and aluminum production before 2025; however, a definitive date for implementation is not set (Liu, 2021). This could mean that Chinese exporters may be exempt or face a lower EU border adjustment.

Average allowance prices in China ranged from USD 3.28 to USD 12.62 in 2020 while the EU ETS prices averaged at \$28.28 during 2020. With this difference, the EU may not exempt China from a potential CBAM, unless the EU gives China special treatment based on its developing country status (González, 2019). According to WTO rules, countries can declare themselves as a "developing" or "developed" country; however, other WTO members can challenge this self-declaration (World Trade Organization, 2021).

During the Leaders' Summit on Climate Change on April 22, 2021, Chinese President Xi Jinping delivered a speech outlining Chinese expectations on global actions against climate change. He reinforced that any action taken by individual countries must be based on multilateralism and comply with international law. Furthermore, he stated that "developed countries need to increase climate ambition and action, and at the same time help developing countries and support them in financing, technology, and capacity building" (Ministry of Foreign Affairs of the People's Republic of China, 2021).

Accordingly, after the EU published its CBAM proposal, Liu Youbin, a spokesperson for the Chinese Ministry of Ecology and Environment, commented that the EU's CBAM is a unilateral measure and undermines WTO rules in addition to eroding trust in the global community (Reuters, 2021). This means that the EU can expect significant resistance from China to its proposal. China may reject the EU's CBAM proposal based on its potential non-compliance with WTO rules. This

indicates resistance against the EU and may undermine its normative power to induce emissions-reduction measures in China.

However, (Hübner, 2021) surveying various public and private stakeholders, including academics and NGOs from China, finds the prevailing opinion among Chinese stakeholders is the CBAM will not significantly affect trade. The rationale is China's national ETS (see Table 1.4.) would qualify as an equivalent emissions-reduction measure, allowing China to make a strong case at the WTO if CBAM disputes were to escalate. Hübner (2021) emphasizes that to avoid an escalation or retaliation against the EU, open communication and early bilateral engagement between the EU and China will be crucial for China to accept the CBAM.

Russia

The EU is Russia's biggest trading partner and accounts for about 34% of Russia's global trade. Like China, Russian exporters face substantial exposure to the impacts of the CBAM since the EU is also Russia's largest export market. In 2020, 33% of Russian exports went to the EU, followed by 14% destined for China. The EU sources most of its iron and steel and fertilizers from Russia and also represents the largest export market for Russia in these industries. Different from China and Turkey, Russia also has significant exposure to the CBAM through its electricity exports to the EU (Makarov, 2021). However, the industries covered by the CBAM comprise a relatively small share (7.6% in 2019) of Russia's exports to the EU by value (Kardish et al., 2021) which is predominantly oil and natural gas. In 2020, Russia was the origin of 26% of the EU's oil imports and 40% of natural gas imports.

The CBAM proposal has provoked a discussion in the Russian government about carbon reduction measurements. According to Bank of Russia economists Morozov et al. (2020), Russia is one of the countries greatly affected by the full CBAM implementation. Unlike China, Russia's national emissions-reduction strategy is underdeveloped, providing it no leverage in negotiations with the EU over an exemption from the CBAM. However, although the details remain obscure, there are plans to expand the efforts to monitor emissions (Climate Action Tracker, 2021).

Prior to COP26, Russian government officials signed a document that allowed President Vladimir Putin to announce that Russia aims to reach net-zero carbon emissions by 2060 but with no details on a specific timeline (The Moscow Times, 2021). In response to the EU's CBAM proposal, Maxim Reshetnikov, the Russian Minister of Economic Development, criticized the lack

of clarity in August 2021. He also stated “at present, there are a number of contradictions with the rules of the WTO and international climate change agreements” (Karpukhin, 2021). Reshetnikov also claimed that the CBAM would “perpetuate the gap between industrialized and developing nations. That is, those that have already achieved peak energy consumption and possess energy-effective technologies, and the others, which have not achieved this level yet” (Karpukhin, 2021).

The 13th BRICS¹³ summit on September 9, 2021 resulted in the New Delhi Declaration in which state leaders, including Vladimir Putin, declared that “it is critical that all WTO members avoid unilateral and protectionist measures that run counter to the spirit and rules of the WTO” (BRICS, 2021). Opposing the CBAM, Russia condemned the proposal as a unilateral measure that should be considered protectionist. Reshetnikov stated “if we take a close look at the WTO agreements, we will see that, according to our estimates, the EU’s CBAM contradicts them, in particular, such basic principles as ‘national treatment’ and ‘most-favored nation status,’ the introduction of import restrictions and many other things. In other words, we have solid grounds to put forward grievances. It is hoped that these disagreements will be settled and major disputes will be avoided” (Karpukhin, 2021).

From a normative perspective, it is unlikely that Russia will be pressured into adopting emissions reduction measures that align with the EU’s current ETS. Previous work has indicated that economic trade sanctions, imposed by both the EU and US, have not changed Russia’s foreign policy approach towards Crimea (Michalski & Nilsson, 2019). In the same manner, it remains to be seen how negotiations between Russia and the EU will evolve over the CBAM and if the EU has the ability to leverage environmental policy reforms within Russia.

Turkey

In addition to the current policy discussion, historical political dynamics affect the geopolitical implications of the CBAM for Turkey-EU relations. In 1987, Turkey formally applied to join the European Economic Community (now EU) and became eligible to join the EU in 1999 (Emerson, 2004). Accession negotiations, based on 35 negotiation chapters, began in 2005 (Directorate for EU Affairs, 2019). The unresolved Cyprus question, the ongoing dispute between Turkey and Cyprus after the Turkish military invasion and occupation of the northern third of Cyprus in 1974,

¹³ BRICS is a consortium of five emerging economies (Brazil, Russia, India, China and South Africa) cooperating on matters of the economy, society, education and other policy domains.

has stalled negotiations. Furthermore, the EU often considers Turkey as a “buffer” at its external border, and financially supports Turkey to prevent asylum-seekers from North Africa and the Middle East from entering the EU (Saatçioğlu, 2020).

The EU’s CBAM proposal, which would affect Turkey most in the cement, iron and steel sectors (see Table 1.2.), could further aggravate political tensions between both jurisdictions. Currently, Turkey does not have a domestic ETS in place¹⁴. However, since 2012, the country has been evaluating opportunities to achieve emissions mitigation targets (ICAP, 2021). The Turkish government is working closely with the EU on meeting EU accession requirements in the energy policy domain. Policy sectors under negotiations are also called “negotiation chapters”. The negotiation chapter on EU energy policies includes three principles: competitiveness, security of supply, and sustainability (Directorate for EU Affairs, 2019). The negotiation chapter on energy has not yet been opened; however, from a Turkish perspective, it is seen as a policy domain in which they can achieve a “high level of compliance” with EU regulations and directives (Directorate for EU Affairs, 2019).

With Turkey, the EU’s normative power manifests itself through potential EU membership. However, negotiations have already taken more than a decade and accession requirements may change, especially in the face of accelerated climate change and corresponding EU environmental policy. At the same time, the EU’s normative power to induce policy reforms in Turkey is greatly influenced by its dependency on Turkey preventing asylum-seekers from entering the EU in an irregular manner (Gürkan & Coman, 2021).

The CBAM could have a significant impact on EU-Turkey trade. Similar to China and Russia, the EU is by far Turkey’s largest trading partner. In 2020, 33.4% of Turkey’s imports came from the EU and 41% of the country’s exports went to the EU. Turkey supplies more than one third of the EU’s cement imports. In addition to cement, Turkey is also the third largest source of iron and steel for the EU after China and Russia. The EU is also the largest market for Turkey’s exports in both industries. Turkish public and private sectors work closely with the European Bank for Reconstruction and Development (EBRD) to enable an environment for a “scaled-up domestic carbon market” (European Bank for Reconstruction and Development, 2021). For this, the EBRD has three instruments at its disposal: policy dialogue; support for Turkish banks to develop carbon

¹⁴ Turkey has signed a bilateral customs union agreement with the EU. However, Turkey is still considered a “third country” and the CBAM would apply to its importers.

market services; and carbon asset development processes. For example, through its “Mid-size Sustainable Energy Financing Facility (MidSEFF) Carbon Market Development Support Programme”, the EBRD supported the Sena hydropower plant consisting of two run-of-river hydroelectric generators, expected to generate 68 GWh per year of renewable energy.

Similar to Russia, without an ETS in place, the CBAM could significantly affect Turkish producers exporting to the EU. During COP26, Turkey’s chief negotiator evaluated the CBAM as a “very big threat” because of the high share of Turkish exports that go to the EU (Weise, 2021). In contrast, the general secretary of the Turkish Steel Producers Association noted, “as Turkish mills are already investing in green steel, I don’t think that the CBAM will have a significant effect on our exports to the EU” (Can, 2020).

Timmerman (2021) argues that the potential launch of the CBAM encourages Turkey to ratify the Paris Agreement on October 5, 2021 through a memorandum of understanding with the World Bank. Although it could be argued that the Turkish ratification is a result of the EU’s normative power, other dynamics must also be considered. Because of this ratification, Turkey will receive \$3.2 billion in loans from Germany and France for its domestic clean energy transition (Weise, 2021). Furthermore, Turkey unilaterally announced that it would implement the Paris Agreement as a “developing country,” despite its “developed country status” in the UN (Lo & Farand, 2021). Therefore, as Timmermans (2021) suggests, even though the CBAM is at a proposal stage, it has already delivered policy responses and reforms in third countries.

Conclusion

The EU’s CBAM proposal is a mechanism to help meet its climate goals in the “Fit-for-55” package. The EU’s CBAM is likely an intentional strategy to initiate discussions about aligning emissions prices across the globe. The EU’s CBAM could represent a first move toward a global “climate club” with exclusionary effects for third countries (Bierbrauer et al., 2021). One important — and outstanding — policy design question facing the EU is the grounds for exemptions from the CBAM. The EU has not released specific exemption criteria, and these criteria are likely to be part of ongoing negotiations.

The CBAM represents a collective effort of nine EU member states, who formally requested the EC deliver a proposal (Blümel, 2021). However, as this chapter discusses, while some individual EU member states and their governments are supportive, domestic industry

leaders and some of the EU's main trading partners have expressed concerns. Industry leaders within the EU raised concerns that the CBAM may diminish their competitiveness and result in lost export sales. Third countries raised three main concerns, arguing that the CBAM proposal is a protectionist measure; it is a revenue generator to enhance the EU's budget; and that the EU's decision-making process is unilateral, which goes against the WTO principles of multilateralism and international cooperation.

Our analysis focused on the reactions of China, Russia and Turkey — the EU's main trading partners in the five sectors (aluminium, cement, electricity, fertilizers, and iron and steel) initially covered by the CBAM. We outline industry and government reactions and show a general apprehension towards the EU's CBAM proposal due to the above-mentioned criticisms. At the same time, however, EC spokesperson Frans Timmermans claims that the CBAM incentivizes policy reforms in third countries (Timmermans, 2021). He uses the example of Turkey, which ratified the Paris Agreement in October 2021 in an effort to become exempt from a potential CBAM.

The CBAM proposal reflects the EU's normative power: its ability to influence political reforms in third countries. At the same time, however, internal and external resistance against the EC's CBAM proposal remains and will force the EU to deliver concessions throughout negotiations which may weaken the EU's position as a global climate leader. Nevertheless, the EC's proposal is considered ground breaking in the sense that it reflects the first international carbon levy and thus, currently spearheads the international discourse on BCAs. Thus, the EU maintains its position as a normative power in matters of climate change and takes on the role of a climate leader (Torney, 2019).

The CBAM is simultaneously a domestic policy tool and a political tool for the EU to exert pressure on third countries to increase their emissions reduction efforts. In order for the CBAM to be widely accepted by the international community, the EU needs to start bilateral negotiations with third countries to prevent trade wars, retaliation and erosion of trust in the global community.

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