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Research Institute for Sustainability (RIFS)

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Creating a Climate-Just Carbon Border Adjustment Mechanism

Considering impacts on third countries in the
scheme's evaluation

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POTSDAM



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The recommendations in this policy brief are based on a workshop with civil society stakeholders and EU representatives on the topic of “The EU’s Carbon Border Adjustment Mechanism and its implication for a Just Transition: the case of South Africa”. The workshop was jointly organised by the Cape Town and Brussels Offices of the Heinrich Böll Foundation and the IASS (now RIFS). Additional data was collected through expert interviews in the second half of 2022.

Introduction

The EU's Carbon Border Adjustment Mechanism (CBAM) is expected to launch in October 2023, with reporting obligations only. The scheme aims to ensure that European efforts to reduce greenhouse gas emissions do not induce so-called 'carbon leakage', which could occur if companies based in the EU relocate carbon-intensive production to countries with less ambitious climate standards or increase imports of carbon-intensive products to the EU.

The mechanism will require companies importing certain products to the EU to offset embedded GHG emissions by purchasing CBAM certificates, thus ensuring that the carbon price of imported products is equivalent to that of products made by European producers under the EU Emissions Trading Scheme (ETS).

CBAM's effectiveness and impact will be evaluated by the EU towards the end of its phase-in period. This evaluation will likely lead to adjustments in the mechanism's design and will be followed closely by third countries considering the introduction of similar instruments.

Economies and sectors dependent on exports to the EU will be both more exposed and vulnerable to the mechanism. In this policy brief we explore the views of stakeholders in South Africa, the EU's largest trading partner in Africa, and consider measures necessary to ensure that CBAM addresses issues of justice and sustainability. In particular we identify three key recommendations for European policymakers:

■ **Message 1:**
Strengthen engagement with civil society in vulnerable countries

Participation opportunities for third country stakeholders should be made accessible and inclusive by addressing the needs of civil society. This includes formal mechanisms within the EU's institutional structure to facilitate consultations, regional stakeholder evaluation roundtables, and online platforms adapted for target groups to provide information and foster participation.

■ **Message 2:**
Enable targeted impact studies by local researchers

The EU should facilitate country-level studies by local researchers in the Global South on the impacts of the CBAM. This support should include financial resources and technical assistance to better understand the policy implications for trade partners. The studies should inform a science-based and context-dependent evaluation of the mechanism.

■ **Message 3:**
Address and engage with the climate justice implications of the CBAM

EU communications should address CBAM's expected and observed impacts on trade partners and the implications for climate justice. The mechanism's distributional impacts should be considered in a special report and measures likely to be effective in mitigating or offsetting disproportionate effects should be integrated into the scheme.

The mechanism in brief

The adoption of the European Green Deal was accompanied by concerns that its ambitions could be undermined by carbon leakage; that is, the relocation of carbon-intensive industries such as cement and steel production to countries with less stringent climate standards. This would cause European industries to lose market shares or be driven out of business, with EU emissions sinking but global emissions rising. The spectre of carbon leakage was previously addressed by granting energy- and emissions-intensive industries free allowances under the EU Emissions Trading System (ETS). CBAM will ensure that European polluters pay and that goods imported into the EU are subject to an equivalent carbon levy.

Under an agreement reached by the European Parliament, Council, and Commission in December 2022 the scope of the CBAM will initially be limited to certain emissions-intensive goods, and the Commission will subsequently assess whether further products should be included in the scheme, with the aim of extending CBAM to all goods covered by the ETS

by 2030. During the three-year phase-in period, the Commission will also review the methodology for tracking indirect emissions. The phase-in of the full mechanism will be coordinated with the phase-out of EU ETS free allowances to ensure that goods are not double protected and that the mechanism conforms to WTO rules.

The CBAM phase-in period begins in October 2023. For the duration of the transitional period, companies will only have reporting obligations relating to direct emissions. Businesses will not be required to purchase CBAM certificates until the mechanism is fully implemented in 2027, parallel to the phase-out of free allowances under the EU ETS and the Commission’s review of the CBAM “including an assessment of progress made in international negotiations on climate change, as well as the impact on imports from developing countries, in particular the least developed countries (LDCs)” (European Parliament, 2022a).

Products covered in the phase-in period	Iron and steel
	Cement
	Aluminium
	Fertilizers
	Electricity
	Hydrogen
	Some downstream or precursor products: screws, bolts, similar items of iron or steel
Potential additions (to be assessed before the end of the phase-in period)	Organic chemicals and polymers
	More downstream products

Figure 1:
The mechanism’s initial scope

The CBAM aims to facilitate the further decarbonisation of European industry while incentivising trade partners to follow suit. Given that the EU is a key export market for many countries, the mechanism is expected to spur efforts by governments and firms to accelerate decarbonisation – both for direct production emissions and indirect emissions stemming from energy used in the production of goods, which will be included under certain conditions.

However, countries and firms are not equally equipped to adapt to the demands of CBAM by

decarbonising economic activities and tracking emissions. Canadian companies, for example, have more experience with carbon tracking and can muster more public resources to support implementation than enterprises in Morocco or Vietnam. In response, developing countries – particularly large emerging economies like South Africa and China – argue that the CBAM violates the spirit of the Paris Agreement’s differentiated responsibilities for developed and developing countries. This, in turn, has implications for the EU’s reputation as a climate actor and for international negotiations generally (Weko 2022).

Perceptions of the CBAM: Discussions with South African civil society

Studies on how non-EU stakeholders perceive the planned CBAM suggest that the mechanism has met with a mixed reception. On the one hand, some actors have framed the CBAM as a protectionist measure, leading to concerns that the mechanism will be rejected initially. At the same time, CBAM has pushed the subject of climate goals up the political agenda ahead of its introduction and has prompted businesses to become more involved in climate discussions (Holovko et al. 2021; Konrad Adenauer Stiftung 2021).

The EU can only benefit from engaging with perceptions and perspectives from non-EU stakeholders and cooperating with civil society in third countries. This would help the EU by building trust with countries in the Global South, advancing global cooperation, and forging coalitions for climate action.

This policy brief is informed by the views of South African actors, but its insights are of relevance to issues that will arise more broadly in relation to the CBAM. On climate topics, the country coordinates negotiating positions and interests both as part of the BASIC group (Brazil, South Africa, India, China) and as part of the G77 plus China countries (Global South countries). As is the case with many other countries, South Africa is highly reliant on coal for its energy supply and a significant share of its exports to the EU will fall within the scope of the CBAM.

The recommendations put forward in this policy brief are based on discussions at a stakeholder workshop that brought representatives from South African NGOs, think tanks, labour unions, and academia together with EU officials. This input was supplemented by in-depth interviews with four key experts on climate policy in the EU and South Africa. Although specific to South Africa, these conversations are important in general to better understand the perspectives and needs of Europe's trade partners.

Stakeholder discussions revealed both concerns about the possible impacts of the mechanism and positive views about the possibilities and opportunities it could hold. Stakeholders were apprehensive that the mechanism might compel export-oriented companies to accelerate decarbonisation measures to a degree that would undermine the broader economy by eliminating low- and unskilled employment opportunities, whether directly in exporting companies or in energy production and supply (e.g. coal workers). Participants also criticised that CBAM is based on unequal power structures and might disproportionately affect countries that are yet to make significant progress in the transition to a low-carbon economy, but which are only responsible for a fraction of the historical emissions of the EU and the countries of the Global North.

At the same time, CBAM was also seen by some civil society actors as an opportunity to push for more ambitious domestic climate policy. In the past, activists found it difficult to bring about change in climate and energy policy in South Africa, due in no small part to the economic interests of elites. The CBAM is expected to propel climate issues and decarbonisation to the top of the national agenda and lend momentum to South Africa's energy transition. In addition, it could increase the power of 'green' lobbies by benefitting actors and companies that want to decarbonise and adapt to climate change. The CBAM can serve both as an additional economic incentive for industrial decarbonisation, but also as an argument to convince politicians to adopt policies promoting the reduction of industrial carbon emissions. Civil society actors also saw the CBAM as an opportunity to increase regional cooperation by joining forces to make a stronger case for the decarbonisation of the region and for green industries sharing knowledge and finding joint strategies to deal with CBAM formalities and adapting to the scheme.

Four key opportunities to address concerns relating to the mechanism were identified in discussions with stakeholders: inclusive consultation and clear communication on the mechanism as it evolves; capacity-building measures that help affected stakeholders to adapt to this new regulatory environment; action to (re)build trust between the EU and countries of the Global South, which has been shaken by the failure to uphold climate finance promises and the debate on vaccine equity during the Covid-19 pandemic; and increased financial support by the EU using CBAM revenues for decarbonisation efforts in the countries of origin.

To address the issues highlighted by stakeholders at the workshop and in the interviews, we identify three key opportunities for action. In order to increase the inclusiveness of the policy process, we recommend that the EU involves stakeholders and civil society of third countries in the CBAM evaluation, and assesses and considers local contexts. This would also generate more knowledge about the measure and could be connected with capacity-building measures. Additionally, we recommend that the EU strengthens the importance of climate justice considerations in its communication and evaluation of the scheme. This would respond to the demand for more mutual trust by addressing justice issues. Finally, the EU should consider which measures, for example redistributing financial flows, could make the CBAM an instrument for climate justice.

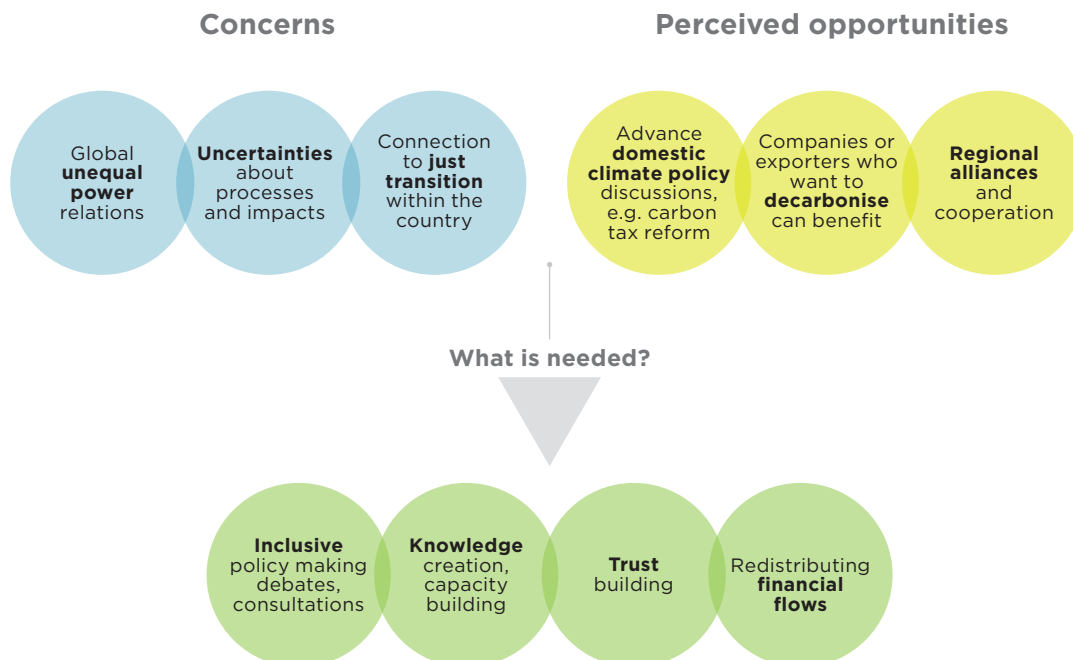


Figure 2: Concerns, challenges and solutions identified in conversations on the planned EU CBAM with actors from South African civil society. Source: IASS/authors

Strengthen engagement with civil society in vulnerable countries

A key finding of the stakeholder workshop and expert interviews is the need to make relevant consultation processes more inclusive and accessible.

The EU has committed to ensure the participation and inclusion of all affected stakeholders when designing policies (see, for example, the EU's Better Regulations Guidelines, European Commission 2021). Where relevant, this should also be the standard for policy assessment and evaluations. However, existing mechanisms for participation in the CBAM policy process are not easily accessible for civil society actors in the Global South. Overall, actors from the Global South were clearly underrepresented in the open online consultations that allowed everyone to have their say on the CBAM: In consultation round 1, only 3 of 224 responses were from actors in countries in the Global South (= 1.3%) (European Commission 2020a), in consultation round 2, just 13 of 617 responses were from the Global South (= 2.1%) (European Commission 2020b).

Accessibility could be improved by establishing formal mechanisms, including a unit within the European Union's institutional structures that is tasked with facilitating the consultation of external governments and stakeholders in relevant policy development processes as well as the subsequent evaluation of their efficacy and impacts. There should be a particular focus on involving civil society actors, who usually command fewer resources and therefore struggle to engage with existing consultation opportunities.

Thus, the EU would be well advised to institutionalise consultations as part of the proposed CBAM authority in order to ensure that their findings inform evaluation and decision-making processes. This would include, for example, open calls for participation in discussions about policy design that are publicised with country-specific strategies to reach actors

affected by the mechanism. These new open calls would build on and supplement the existing "Have your say" initiatives.

Here, the EU can use its experience in organising stakeholder consultations that include civil society actors, such as the "domestic advisory groups" frequently established in partner countries to provide relevant insights for the negotiation of free trade agreements. This experience provides a blueprint for the development of similar participative formats to accompany the evaluation of the CBAM. These formats should be developed in consultation with representatives of civil society from the Global South to ensure their accessibility and suitability for effective and responsive policy development. In some cases, it will be necessary to actively facilitate the participation of civil society actors and support their efforts to overcome barriers and engage with the process without hindrance.

There are numerous civil society initiatives in South Africa that address climate and energy justice issues such as sustainable trade, just transitions, climate finance, and the coal phase-out. Consulting with these groups would grant EU policymakers access to important local context on the impacts of CBAM on marginalised communities, the challenges faced by industry, and where financial support is most needed and effective. Civil society initiatives would equally benefit from this exchange as it would also enable them to communicate their priorities to the South African government and policymakers engaged in the CBAM process. Consultation processes would also help to raise awareness and disseminate knowledge relating to the mechanism and its workings.

Consultation and exchange platforms could be used to build capacities, share best practices, and smooth the mechanism's implementation, advancing efforts

to rapidly decarbonise supply and value chains worldwide. Country-level formats could be complemented by regional stakeholder evaluation roundtables. Representatives of NGOs or think tanks, for example, should be explicitly invited to these formats, with their participation financially supported, if needed. Additional formats exclusively for civil society actors should also be established, such as regular regional meetings to discuss and inform about current issues. Another obstacle noted by participants and interviewees was the challenging nature of legislative texts and policy documents and the complicated institutional

landscape of the EU with its various processes of implementation and evaluation. The creation of a low-threshold online platform could support knowledge building and provide opportunities for informed participation. The platform should give a clear overview of the CBAM, current policy developments, documents and upcoming dates, institutional and decision-making structures, and participation options. Most importantly, all necessary background information should be collected on this platform. Barriers should be dismantled by clearly structuring information and providing translations in different languages.

Enable targeted impact studies by local researchers

The transition period is intended to provide a window for data collection and the evaluation of the mechanism's performance and impacts. If necessary, adjustments can then follow before the scheme becomes fully operational.

Reporting obligations will enter into force on select goods in 2023. This data will provide concrete information on which imports from which countries are affected by the CBAM, and how affected companies are able to handle reporting duties. During the initial transition period it will only be possible to examine which levies would theoretically be due. The exact financial impact can only be estimated and will only become clear when companies are required to pay the financial adjustment following the phase-in period.

However, other information that can only be collected through in-depth country-level studies is also needed: What is the impact on the economic structures and exports of countries? How well can countries adapt to the additional levy? Are certain groups or regions particularly affected? What support would be needed? These insights could be applied to tweak the design of CBAM and improve its efficacy as an instrument to reduce emissions, while at the same time ensuring that it does not impose excessive burdens on companies in the Global South. Equally, the data will enable governments and businesses to better understand the impacts of CBAM and adapt their policies.

Studies of the impacts on certain businesses/sectors can and probably will be conducted by exporting companies themselves. But there is a need for additional research focussing on the deeper implications for the political economy and climate policies of individual countries. These studies should be carried out by local researchers, who are familiar with local

contexts and are thus able to deliver in-depth studies. The EU should provide resources to support these research efforts, as it is also in its interest to understand the scheme's impacts and to detect disproportionately negative impacts.

To facilitate this, a special fund for research on CBAM impacts could be established within the framework of the Horizon Europe research and innovation programme, to which researchers from countries not currently covered by the programme could also apply. Financial and technical assistance should also be provided to joint research efforts on the impacts of CBAM in countries lacking sufficient research infrastructure to conduct such studies alone. This would contribute to broader knowledge transfer and capacity-building efforts and support the development of expertise and institutional capacities necessary for emissions reporting and verification when CBAM comes into full effect. In essence, CBAM liaison offices will be needed at the country and regional levels to facilitate implementation and provide guidance to businesses and state actors.

Country-level studies and ongoing monitoring provide a means to register and address impacts affecting different regions or population groups that may not be discernible in data collected by the reporting system. These include disparate regional impacts of the CBAM in its initial iteration as well as subsequent adjustments or disproportionate burdens affecting marginalised groups. These studies should also seek to pinpoint specific needs for support, for example in public administration or around the introduction of low-carbon technologies. Based on these findings, targeted capacity-building programmes could be developed to help shoulder the administrative burden of tracking emissions.

Address and engage with the climate justice implications of the CBAM

The climate justice implications and distributional impacts of the CBAM are an important issue for many stakeholders and are frequently mentioned by governments of non-EU countries in discussions about the scheme. While the EU is increasing its engagement for climate justice and backed the establishment of a loss and damage facility at COP27, justice considerations do not figure prominently in the EU discourse on the CBAM.

Taking up these issues and identifying potential challenges would enable the EU to engage with affected countries and develop plans to tackle or mitigate existing and emerging inequalities. Acknowledging justice issues, showing the will to deal with them, and proposing and implementing solutions counteracts the risk of masking power inequalities and can enable the EU to co-develop solutions. It is vital that the EU responds to the legitimate concerns of third countries: What impacts are to be expected for which countries? What are the policy options to cushion losses for countries with weaker economies? Which of these options does the EU want to implement and why? Open and inclusive discussions on climate justice, with effective follow-through, would help to regain the trust of non-EU stakeholders and governments.

Early action to address emerging climate justice issues would benefit countries likely to be especially burdened by the mechanism and build acceptance by preparing the ground for nuanced discussion of CBAM's purpose and ability to accelerate and support decarbonisation processes globally. Possible measures to address justice concerns include: capacity building and support programmes to facilitate reporting and decarbonisation at enterprise-level, financial support for countries particularly affected by the CBAM, and measures to promote decarbonisation in LDCs.

Contributing more to climate finance outside its borders would also help maintain the EU's overall legitimacy as an international climate actor. Therefore, revenues derived from the mechanism should be dedicated to European climate finance. The increase in support for decarbonisation efforts in least developed countries should be at least commensurate with revenues generated by imports from LDCs, as proposed by the European Parliament (ERCST, 2022). Decarbonisation initiatives in developing countries should also be supported in order to advance the objectives of the CBAM. A central concern raised in stakeholder consultations is the identification of the most urgent needs for decarbonisation support and tech transfer in industries in the Global South to ensure that funds are used efficiently. An annual report from the European Commission/CBAM authority on the contribution to decarbonisation of industries in LDCs, as proposed by the European Parliament, is advisable.

During the transition period the Commission should prepare a special report on the mechanism's climate justice implications in order to establish an overview of the issues at stake and signal its willingness to engage with countries. This report should not only highlight the challenges, but also identify options to reduce potential harmful impacts. In addition, low-threshold communication formats (online) should be developed that address the CBAM's climate justice implications globally and at country-level. It is also important that power relations and distributional impacts are covered in depth in an evaluation report to be prepared following the transition period, preferably in a section dedicated to climate justice.

Finally, these reports must be followed by action. The measures identified as most effective in avoiding or offsetting disproportionate effects must be integrated into the scheme in order to support countries in their efforts to transition to a low-carbon future.

Outlook

The CBAM should ensure that the EU can pursue its decarbonisation plans without fear of carbon leakage. At the same time, it will provide an emissions reduction incentive for countries outside the EU. However, in its current form the mechanism disregards the disparity in the resources that countries can muster in order to decarbonise their industries and energy systems. Leaving justice questions unaddressed means that the current iteration of the CBAM would in all likelihood disproportionately impact vulnerable countries, which will face immense challenges tracking emissions and pursuing rapid economic and structural change.

To avoid this and to ensure that the CBAM achieves its goal of preventing carbon leakage, it is necessary to gain a clear understanding of its impacts across different regions and countries. Stakeholders, including civil society actors outside of the EU, can play

an important role in evaluating and improving the CBAM. Opportunities for their involvement should be expanded and made accessible. There is a need for targeted and contextualised research on the impact of policies at the local level. Moreover, clear and open communication from the EU on expected and observed distributional impacts and how climate justice is being considered in the evaluation of the CBAM is necessary.

With countries like Canada and the United Kingdom also considering the introduction of carbon border tariffs, the EU CBAM is likely to stand as a blueprint for the development, implementation and evaluation of future mechanisms. In light of this, it is especially important that the voices of stakeholders and civil society actors from third countries be included in the course of CBAM's evaluation. ■

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Research Institute for Sustainability (RIFS)

The Research Institute for Sustainability (RIFS) conducts research with the aim of investigating, identifying, and advancing development pathways for transformation processes towards sustainability in Germany and abroad. The Institute was founded in 2009 as the Institute for Advanced Sustainability Studies (IASS) and has been affiliated with the Helmholtz Centre Potsdam - GFZ German Research Centre for Geosciences under its new name since 1 January 2023 and is thus part of the Helmholtz Association. Its research approach is transdisciplinary, transformative, and co-creative. The Institute cooperates with partners in science, political and administrative institutions, the business community, and civil society to develop solutions for sustainability challenges that enjoy broad public support. Its central research topics include the energy transition, climate change and socio-technical transformations, as well as sustainable governance and participation. A strong network of national and international partners and a Fellow Programme supports the work of the Institute.

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