

# Unworkable Solution: Carbon Border Adjustment Mechanisms and Global Climate Innovation

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# Free-Ridership and Climate Ambition

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## PROBLEM

Ambitious national **policies to reduce carbon emissions** may put domestic producers of carbon-intensive goods at a competitive disadvantage when trading with partners that have less stringent policies.

**Carbon leakage**, in which production shifts across borders to avoid carbon pricing or regulation, could undermine national climate ambitions.



# Climate Innovation and International Trade

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- Trade policy can foster much-needed innovation
- Clean tech benefits from economies of scale, access to wider markets, increased product-use specialization, clustering, and global firm-level competition
- Dramatic decline in solar-PV prices over last 40 years is key example
- Without a climate-friendly trade regime, **dirty-but-cheap products** are likely to continue to undercut **clean-but-expensive alternatives**

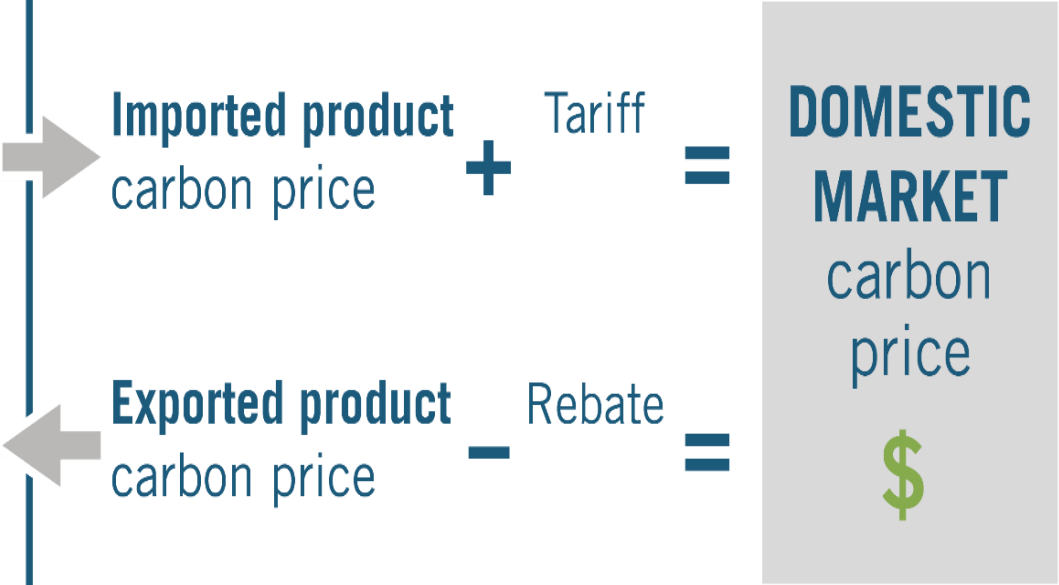
# CBAMs: Current Trends & Reactions

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- Carbon border tariffs associated with carbon pricing since 1990s
- EU proposed CBAM alongside ETS in July 2021
- Reaction from Russia, China, US, Australia and others
- EU industry skeptical of CBAM preferring export rebates and continued free allowance allocation

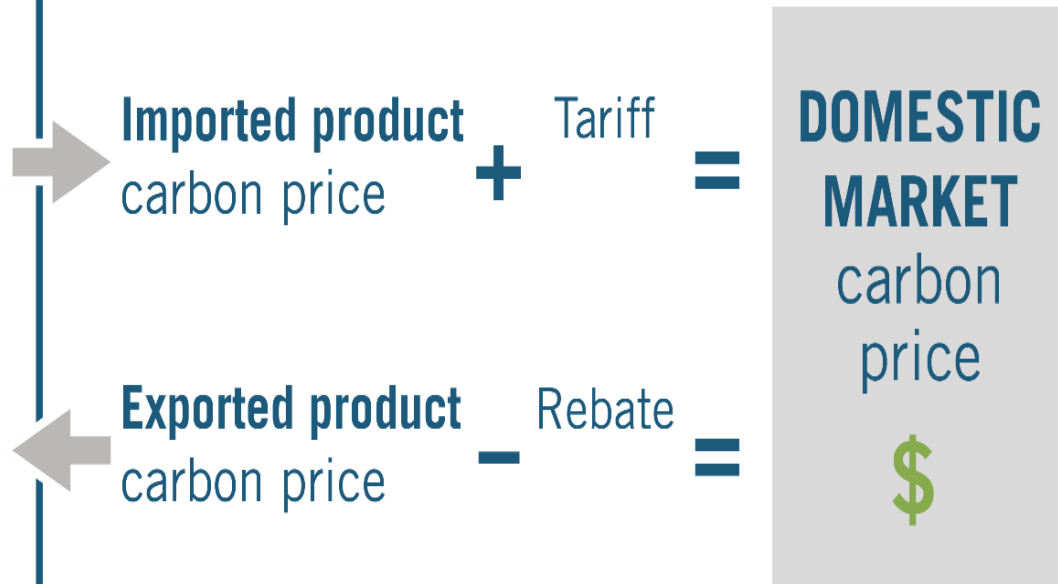
# CARBON BORDER ADJUSTMENT MECHANISM

A CBAM **adds a tariff** to imports equal to the carbon price domestic manufacturers face. An **export rebate** allows domestic manufacturers to be competitive in international markets.



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## CHALLENGES & DRAWBACKS

- **Counting and verifying carbon content:** Varies by production method, time, and place, making product verification difficult
- **Setting prices:** Difficult to accommodate non-pricing climate policies and to determine total CBAM costs
- **Risk of indirect carbon leakage:** Leads to import of finished products not covered by CBAM
- **Compatibility with WTO and climate agreements:** Likely a discriminatory tariff under WTO trade rules and violate existing climate agreements
- **Stymie climate innovation:** Unlikely to spur necessary innovation to deploy climate tech globally

# CBAMs and Climate Innovation

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- CBAMs, as an international extension of domestic carbon pricing, have **limited ability to spur innovation**
- Hard-to-abate sectors such as cement, iron & steel, and chemicals require more than just a demand-pull to drive technology innovation
- Segmentation of domestic industries **lowers innovation incentive**
- Uncertainty as to longevity of CBAM undermine incentive to invest in climate tech innovation
- Innovation goes to gaming system rather than decarbonization tech

# Climate Innovation Club: A CBAM Alternative

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- A club-based approach, rather than a go-it-alone carbon tariff, is **better suited to the global trading regime** and accommodates different national strategies
- Club-members agree to basic criteria for entry, negotiate accountability and verification requirements
- Non-club members face a flat tariff/quota on imports
- Aim is to **spur ambition, climate innovation, and cross-border trade**, not punish producers at the margin



## CLIMATE INNOVATION CLUB

Nations with ambitious, transparent, and **enforceable climate targets** could join and would benefit from open international trade. Rules would be flexible to deal with each nation's unique legislative, regulatory, and market-based ways to address climate change.



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## ADVANTAGES

- Emphasizes the **importance of innovation** necessary to avert the worst consequences of climate change and allows for the flow of innovative technologies across borders
- Reduces international **trade friction**
- **Keeps out dirty producers** by applying a flat tariff
- Drives increasingly **ambitious climate targets** and spurs private and public investment in hard-to-abate sectors



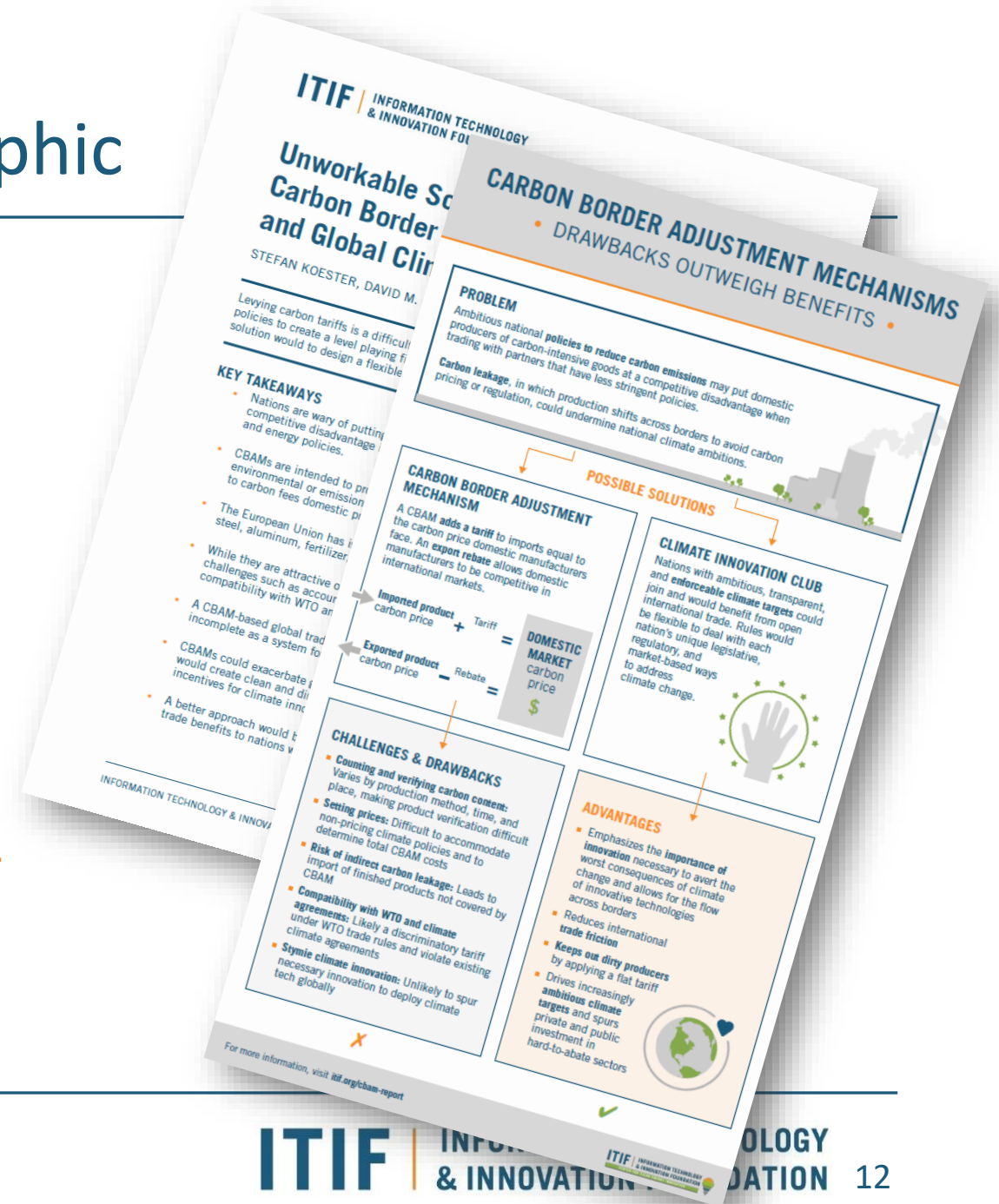
# A Clean Steel Club: A Possible Steppingstone

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- Economy-wide club-based approach is best, a sectoral approach has fewer veto points
- **Steel is a good industry to start** - carbon intensive, trade exposed, globally traded, and processes well understood
- Clean steel club members would meet some minimum criteria
- Non-club members would face a flat-tariff on imported steel
- Club members could **adopt minimum procurement requirements for clean steel**
- Knowledge sharing across club member states to further clean steel tech

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- Report Available at <https://itif.org/publications/2021/09/20/unworkable-solution-carbon-border-adjustment-mechanisms-and-global-climate>
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# Thank You!

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