Africa Trade Policy Programme
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Addressing carbon leakage risk to support decarbonisation A consultation on strategic goals, policy options and implementation considerations

Question 4.1: What specific challenges for countries at differing stages of development to the UK, in particular least developed and low income countries would the government need to consider in the future design of any carbon leakage measures? Please explain your reasoning.

Developing and lower-income countries will face four main challenges undermining their capacity to adhere to the UK carbon border adjustment mechanism. The following answer is based specifically on the experiences and context of developing and least developed African countries.

1. The proposed measure is likely to impact lower income countries more substantially than developed economies, undermining their development pathways

To extrapolate the results for an African Climate Foundation and London School of Economics and Political Science assessment of the EU CBAM and its impacts on African countries (here: Implications for African Countries of a Carbon Border Adjustment Mechanism in the EU), the proposed measures are likely to affect African countries more substantially than developed economies and other developing regions. This is for two reasons: firstly, African countries have less modernised production and energy systems that are more carbon intensive. Secondly African countries tend to have higher concentrations of the UK (and the EU) in their exports owing to historic relationships.

As a result, the tariffs implied by carbon border measures imply both higher tariffs for African countries (relative to others elsewhere in the world) and a greater consequence of those tariffs on total exports from African countries. For instance, the tariff implied by the EU CBAM at €87/tonne amounts to 11.3% for Africa's iron and steel (on average) compared to 6.3% for iron and steel from China or 7.6% for iron and steel from India. Aluminium from Africa (on average) would similarly face an import tariff of 8.5% compared to 3.7% for aluminium from China, under the EU CBAM at €87/tonne. The UK CBAM will create equivalent competitive disincentives for African countries.

The result is that African countries are estimated to be more substantially negatively impacted by the imposition of the UK (and EU) CBAM than any other region. The challenge is further extenuated by the products likely to be covered by the CBAM. These concern industrialised sectors that entail positive spillover effects for the rest of the economy, including the employment of skilled labour, tax revenues and domestic supply linkages. This can be considered as effectively "more valuable" than trade in traditional African exports, like petroleum oils, because it better contributes to a pathway for sustainable industrialisation and development. Undermining that "more valuable" trade is particularly worrying.

2. Difficulties in transitioning to less carbon intensive production

Less developed countries face inherent challenges in modernising production processes and energy generation and so are likely to continue to face adverse competitive implications as a result of the proposed measures. Access to capital for financing production upgrades in such countries is typically much more expensive (owing to real and perceived risk premiums for doing business) making investments in improved and greener production processes more expensive. Skilled labour and know-how is further from the world frontier in green technologies, making it less available and requiring further human capital investments. General business environment deficiencies undermine investments in updated green technologies. These challenges collectively make it more difficult, time-consuming and expensive for businesses in such developing countries to adjust their economies to account for carbon border adjustment measures, compared to equivalent businesses in more advanced countries.

3. Difficulties in addressing non-tariff barriers

Less developed countries have long struggled with the challenges of meeting product standards set in more developed country markets. Even when these less developed countries are commercially competitive, producers frequently have their exports denied or delayed due to challenges with standards. The challenge owes to relative deficiencies in capacities to meet those standards, but also in other instances merely to prove that standards have been met. In many least developed countries, accredited standards bodies are not present, and expertise must be flown in from developed countries to provide certification (for instance of carbon emissions) at great expense. This is particularly burdensome for smaller-scale producers, which tend to dominate in such countries. The challenges in measuring, monitoring, documenting and certifying carbon emissions will be more challenging in developing countries, relative to wealthier ones, making the regime more penalising for these countries.

4. Complexities of adherence to differing equivalent regimes

The above challenges are compounded when less developed countries are required to adhere to a complex web of standards and reporting requirements for different destination markets. By developing an independent UK system, rather than a multilateral or plurilateral system, the UK risks complicating business decisions to the extent that differences in the UK system require both changes in business processes and reporting in those countries for exporters seeking to target different markets. This is particularly challenging for smaller scale businesses in developing countries.

Question 4.2: How can the government best support countries at differing stages of development to the UK, in particular least developed and low income countries? Please explain your reasoning.

Five main avenues for support:

1. Provide differentiated standards of stringency for developing, LDC countries, or designated regions

The UNFCCC framework established the principle of "common but differentiated responsibilities" in regard to the substantial proportionate share of GHG emitted by large historic emitters, like the UK, compared to less historically culpable GHG emitters. Differentiated standards of stringency within the proposed measures can help to fulfil these commitments. The International Monetary Fund (IMF) proposal for instance has been for an international carbon price floor of $25/tonne for low-income countries, $50/tonne for middle-income countries and $75/tonne for high-income countries.

2. Provide longer transition periods to the full implementation of the measures for developing, LDC countries, or designated regions

A secondary means of accounting for the particular difficulties of less developed countries in adhering to carbon border measures is to provide longer transition periods before such measures are fully implemented in such countries. Doing so can help such less capable countries to make the investments and industry changes needed to account for the new measures. Longer transition periods can be combined with lower standards of stringency.

3. Match implementation of the measures with legal commitments to provide substantial technical and financial assistance to lesser developed countries

Developing countries need considerable financial and technical support both for their technical adherence to the measures (including monitoring and reporting of carbon emissions) and investing in the transition to cleaner production technologies. At a minimum, revenues generated by the carbon border adjustment mechanism should be legally committed to less able developing countries to assist them in transitioning to upgraded, greener production technologies, energy sources, and administrative monitoring systems to aid adherence to the proposed mechanism.

4. Develop a multilateral or plurilateral approach to accounting for carbon emissions in trade

Less developed countries, in which smaller businesses predominate, are disproportionately negatively impacted by the proliferation of multiple and overlapping trade regimes such as would be created were the UK, EU, Canada and others to create independent carbon border measures. The UK could mitigate such impacts and ensure a simplified common trading system for the treatment of carbon emissions in trade, through developing a common plurilateral system (for instance with the EU, Canada, Japan and other interested countries) or more preferably through a common multilateral framework.

5. Do not undermine regional groupings when applying country-differentiation to derogations from the proposed measures

There can be a tendency in trade policy to aggregate countries by analytical groupings, such as “developing countries” and “least developed countries,” as is the case in the WTO. The reality of trade is that least developed countries usually participate in regional value chains involving inputs into, and from, leading regional countries. For instance, Lesotho supplies textile inputs to South Africa’s automobiles sector. Even if granted exceptions or leniencies to requirements under carbon border measures, least developed countries can still be impacted indirectly through their linkages to regional leaders. A regional approach to derogations can help to respect such linkages, for instance by carving out a longer transition period or lower carbon price for the African continent or sub-regional groupings such as east Africa.