The Carbon Border Adjustment Mechanism and implications for South African and European Union trade

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The CBAM overview

- The CBAM is an EU climate measure aimed at preventing the **risk of carbon leakage**. CBAM will impose a carbon **tax on embedded greenhouse gases** of carbon intensive products imported into the EU.
- Function in parallel with EU Emissions Trading Scheme (ETS) and will mirror the ETS
  - It will gradually replace the current mechanisms used to address carbon leakage particularly free allocations
- Proposed implementation date January 2023 with a transitional period between 2023 and 2026
    - During the transitional period, burden will be **administrative** rather than financial.
    - After importers will have to purchase digital CBAM certificates, price corresponding to the carbon price paid under ETS
    - Once the CBAM becomes operational in 2026, **reduction of and eventual phase out** of free allowances in sectors covered by the CBAM progressively by 2035
- Current scope covers direct emissions from electricity and 29 product categories from the **cement, fertilisers, steel and aluminium** sectors.
- Importers from countries that have a carbon price may claim a reduction in the number of CBAM certificates
- CBAM is under review within the EU, final version may differ from current proposal

CBAM impact on SA

Iron and Steel (Excluding ferro-alloys and scrap)

Risk/Exposure: High

- Exports to the EU accounted for about 15% of total South African iron and steel exports
- Current production methods are primarily dependent on coal (primary production) or coal-based electricity (for secondary production).
- In 2019, South African steel production and steelmaking was more emissions-intensive than the world average

Aluminium

Risk/Exposure: High

- 40% of South Africa's aluminium exports go to the EU
- While South Africa's primary aluminium production carbon intensity is lower than the global average, key risk is coal-powered electricity
- If scope is expanded to include indirect emissions, SA aluminium faces significant risk
- 88% of its carbon footprint is from electricity

Chemicals/Fertiliser and Cement

Risk/Exposure: Marginal

- Chemicals/fertilisers: exports of inorganic fertilisers account for less than 1% of exports to the EU.
- Cement: exports to the EU are insignificant

Proposed amendments of the CBAM

- European Parliament and Council are currently reviewing the proposed CBAM
- The Environment, Public health and Food Saftey (ENVI) + other committees submitted recommendations
  - Shorting the transition period by one year – implementation date Jan 2025
  - Phasing out of free allocations by December 2028
  - Extension of scope to include polymers, organic-basic chemicals and hydrogen
  - Inclusion of indirect emissions and downstream products
  - Ultimate product coverage should cover all products covered by the EU ETS
  - Recognition of explicitly carbon pricing policies only
  - CBAM proceeds to assist least developed countries

WHAT ARE THE MITIGATION MEASURES FOR SOUTH AFRICA?

In **its current form,** the CBAM does not appear to pose serious short-term risks to small enterprises, however if implemented the proposed amendments will place South African industries at **significant risk**

Short-term measures:

- Transitional period the burden is administrative rather than financial. Supporting importers with the reporting requirements will be crucial.
- A domestic carbon reporting system lead by the Department of Forestry, Fisheries and the Environment, could ease the administrative burden of South African firms

Medium to Long-term measures:

- *Accelerating the decarbonisation of carbon-intensive industries* by increasing renewable energy in production processes and investing in energy-efficient technologies
- *Decarbonising South Africa's electricity system* by increasing renewable energy in the national
- Introducing more *ambitious climate-change policies*
- *Reforming South Africa's carbon tax* to reflect global carbon pricing. Increasing the South African carbon price to stimulate heavy emitters to reform their business models and operations.

CONCLUSION

- The legislative process for the CBAM has not been concluded
- CBAM is currently under review and the proposed recommendations could change the final CBAM significantly
- South African exporters to the EU will need to prepare for a boarder CBAM, shorter transitional period and inclusion of indirect emissions
  - if indirect emissions are included, South African exporters will face additional risks as the country is heavily reliant on coal for its electricity and liquid fuels
- It is important to monitor the policy and legislative processes in the EU carefully to assess the potential impact and implications for production and trade
- South Africa should have contingency plans in place to respond to EGD regulations and requirements
- South Africa should also fast-track its journey towards a net-zero carbon economy as other countries could follow the EU in introducing border carbon taxes