NATIONAL UNIVERSITY OF LESOTHO | WORLD TRADE ORGANIZATION | WTO CHAIRS PROGRAMME

Policy Brief: Climate and Trade: Unlocking Solutions through International Trade

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Introduction

The Carbon Border Adjustment Mechanism (CBAM) is a policy tool introduced by the European Union (EU) to address carbon leakage and ensure that climate policies do not disadvantage European industries in the global market. By imposing a carbon price on imports of certain goods, CBAM aims to create a level playing field between domestic and foreign producers and incentivize global reductions in greenhouse gas emissions. This policy brief explores the CBAM in detail, its potential implications for the African continent, and its specific impact on Lesotho.

1. Definition

The Carbon Border Adjustment Mechanism (CBAM) is designed by the European Union to prevent carbon leakage— where companies transfer production to countries with less stringent climate policies, undermining global efforts to reduce emissions. By placing a carbon price on imports of certain high-emission goods, CBAM ensures that foreign producers face similar carbon costs as their European counterparts. This policy aims to:

- Protect the European industry by preventing carbon leakage, CBAM protects European industries from unfair competition.
- Encourage global climate action by incentivizing non-EU countries to adopt more ambitious climate policies.
- It also encourages technological innovation and cleaner production methods both within and outside the European Union.

CBAM applies to imports of goods that are at risk of causing carbon leakage due to their high carbon intensity. Initially, CBAM targets sectors such as steel, cement, aluminum, and fertilizers. Key elements of the mechanism include:

- Carbon pricing: importers must purchase CBAM certificates equivalent to the carbon emissions embedded in their products.
- Benchmarking: The European Union establishes benchmarks for carbon intensity, which importers must meet to avoid excessive costs.
- Reporting Requirements: Importers must report the emissions associated with their products to ensure transparency and accuracy in carbon pricing.

CBAM is a tool that supports global climate goals by encouraging reductions in carbon emissions and promoting cleaner technologies. It will initially apply to imports of certain highly carbon intensive products that present the most significant risk of carbon leakage. These products are cement, iron and steel, aluminum, fertilizers, electricity and hydrogen. With this extension of the scope of application, CBAM will eventually capture – when fully introduced – more than 50% of the emissions of the sectors covered by the current European carbon pricing mechanism. The objective of this first phase is to serve as a pilot and learning periods for all interested parties (importers, producers and authorities) and to collect useful information on implied emissions to refine the methodology of the final period.

The mechanism may be expanded to cover additional sectors, influencing global trade dynamics and climate policies.

2. Global Impact of CBAM

The introduction of CBAM has multiple economic implications:

- Trade dynamics: CBAM may affect trade flows to the European Union by increasing the cost of carbon-intensive imports. Countries heavily reliant on exporting these goods may face reduced demand or higher costs to enter the economic block.
- Competitive advantage: firms in non-EU countries with higher carbon footprints may struggle to compete with European companies that benefit from stricter domestic climate policies.
- Investment flows: CBAM may incentivize investment in low-carbon technologies and cleaner production processes globally.

CBAM aims to enhance global environmental standards to tackle climate change by:

- Encouraging cleaner production: the mechanism motivates firms worldwide to adopt greener technologies to avoid additional costs.
- Supporting global climate goals by promoting emission reductions, CBAM supports international climate agreements such as the Paris Agreement and the adoption of carbon pricing worldwide.

3. Effect of CBAM on African Economies

African economies are very diverse, with varying levels of industrialization, production trends, energy generation and carbon emissions. Key sectors impacted by CBAM include in Africa in general:

- **Agriculture**: a significant sector in many African countries, agriculture would be highly vulnerable to CBAM. Although agriculture is not included in phase one of CBAM, European authorities have stated it may be included in the future.
- **Mining and metals**: many African countries are major exporters of minerals and metals, including Lesotho, which are among the sectors targeted by CBAM.
- **Manufacturing**: The manufacturing sector in Africa, though less developed than in other regions, may still be impacted by changes in global demand and pricing.

The economic effects of the introduction of CBAM in the trade flows of African economies is important. Some countries reliant on exports of carbon-intensive goods may experience reduced revenues or increased costs due to CBAM. Some African industries may even face challenges in maintaining competitiveness in the covered sectors due to the additional costs associated with the newly introduced CBAM requirements. On the other hand, CBAM may encourage African industries to invest in cleaner technologies to remain competitive.

African countries may adopt various strategies to mitigate the impacts of CBAM:

- Strengthening their climate policies: implementing and enhancing national climate policies can help align with European standards and reduce the risk of carbon leakage.
- Promoting green technologies: encouraging investment in low-carbon technologies can help African industries stay competitive, like renewable energy or energy efficiency.
- Diversifying economies: reducing reliance on carbon-intensive sectors can help African economies adapt to global changes in trade dynamics.

3. Lesotho and CBAM

Lesotho is a small, landlocked country with a predominantly agricultural economy. Key economic sectors include:

- **Agriculture**: Agriculture is still the main source of income for many Basotho, contributing significantly to the country's GDP. Lesotho's agricultural exports may be affected by changes in global trade dynamics resulting from CBAM. While agriculture is less carbon-intensive, the broader economic effects may influence the sector.
- **Manufacturing**: Lesotho has a growing manufacturing sector, including textiles and apparel. Lesotho's textile industry, which is a significant source of employment and export revenue, may face challenges due to CBAM. The cost of compliance and competition with EU producers could impact the industry.
- **Mining**: The country has some mining activities, although they are not as extensive as in other African nations. Lesotho's mining sector may also be affected by CBAM if future expansions or changes in production practices increase carbon intensity.

Policy Recommendations for Lesotho:

- Developing climate strategies: Lesotho should enhance its national climate policies to align with European requirements and reduce vulnerability to CBAM.
- Investing in green technology: promoting green technologies in key sectors can help Lesotho maintain competitiveness and adapt to global market changes.
- Diversifying economic activities: reducing reliance on carbon-intensive sectors and investing in sustainable industries can help mitigate the impacts of CBAM.

4. Conclusion

The Carbon Border Adjustment Mechanism represents a significant step in addressing carbon leakage and promoting global climate action. While its primary focus is on protecting European industries and encouraging cleaner production globally, the mechanism has far-reaching implications for economies worldwide, including Lesotho. By understanding the potential impacts of CBAM and adopting appropriate strategies, Lesotho can navigate the challenges and opportunities presented by this policy tool, contributing to a more sustainable and equitable global economy.