

# Climate Investment Update

## EU proposes carbon border tax

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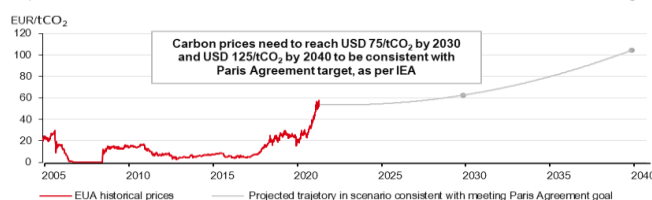
- ◆ EU rolls out world-first carbon tariff policy draft alongside a raft of other climate measures
- ◆ The CBAM is potentially a strong climate tool but its implementation is full of challenges
- ◆ We think the proposal will boost international decarbonisation plans by increasing the pressure to raise climate ambitions

**Carbon border tax:** The European Commission(EC) unveiled its [work programme for its climate neutrality law](#) on 14 July 2021. Along with the bloc's carbon market revamp and effort sharing regulation update, it proposes a carbon border adjustment mechanism (CBAM) – essentially a carbon border tax. The CBAM will be imposed on **iron & steel, aluminium, cement, fertilisers and electricity** in a transition phase which will be soft-launched from 2023. The mechanism could be extended to other sectors after full implementation in 2026. The importers will be taxed on the carbon emission embedded in their goods based on the EU carbon price. The EC expects to raise about **10 billion euros a year** from the CBAM for the EU's budget and own resources. We believe the CBAM will accelerate multilateral decarbonisation and initiate the international race on climate ambitions despite international criticism.

**Challenge ahead:** The proposal is expected to kick-start a series of domestic and international discussions and debates over the year. Referring to the previous resolution results on CBAM, we believe the proposal is likely to be approved by the European Council and Parliament. Nevertheless, the EU will face pressure from its trading partners such as China, Russia and US, which have publicly criticised the CBAM previously. It could even face challenges via the WTO which would make the implementation schedule difficult, in our view.

**Climate game changer:** The CBAM incentivises countries that have bold climate rules or credible carbon pricing schemes. We expect more countries to tighten their climate policies and consider similar initiatives to protect their domestic industries in response to the CBAM. In tandem with the release of the proposal, Canada, Japan, UK and US are examining the feasibility of introducing a carbon border tax.

**Chart 1: Projected carbon price to be consistent with the Paris Agreement goal**



Source: Datastream, HSBC, IEA

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## Key takeaways

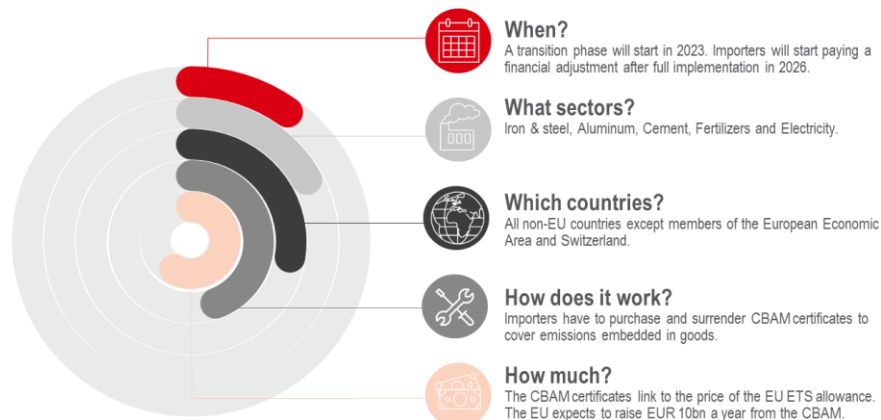
With an aim to increase climate ambitions, the EU proposed the “Fit for 55” package as a key component of the EU Green Deal and the 2050 carbon neutrality pledge. The CBAM could reduce carbon leakage in the EU’s Emission Trading System (i.e. carbon-intensive companies moving to third countries to avoid being subject to climate rules) and also protect selected European industries from foreign competitors that are not subject to stringent climate policies.

**Table 1: Summary of the “Fit for 55” package**

Carbon pricing	Climate target	Emission rule
Revamp of EU Emission Trading System	Update of Effort Sharing Regulation	Update of EU clean car standard
Update of Energy Taxation Directive	Update of Land Use Change Regulation	New infrastructure for alternative fuels
New CBAM	Update of Renewable Energy and Energy Efficiency Directive	More sustainable aviation fuels
		Cleaner maritime fuels

Source: EU, HSBC

## Highlight of the EU Carbon Border Adjustment Mechanism



Source: EU, HSBC

## Good move in raising climate ambitions...but the devil is in the detail

In our view, the CBAM can be recognised as one of the most effective and strongest instruments to **promote multilateral decarbonisation and climate ambitions**. However, we think the implementation of the CBAM will be challenging and economically impactful.

With the complexity and controversy of the CBAM, we believe there will be a number of discussions between EU member states and extensive dialogue with its trading partners. The target timeline of launching the transition phase of the mechanism by 2023 is therefore likely to be subject to delays, in our opinion. Besides, we anticipate the CBAM will have **cost impacts** on those EU sectors that heavily rely on imported goods covered in the mechanism, such as **construction** and **automotive**. The foreign suppliers might pass the carbon cost onto them and the **cost might increase down the value chain** eventually.

The CBAM will offer **compensation to importers for the carbon price paid to their origin’s regulators**. We expect the more countries are likely to consider the introduction of emission constraints in different means including carbon pricing mechanisms and carbon border levies to protect their domestic industries from the CBAM and carbon leakage.

The CBAM and other climate targets will make their way through the EU system this year and through 2022.

*This is an abridged version of a report of the same title published on 15 July 2021. Please contact your HSBC representative or email [AskResearch@hsbc.com](mailto:AskResearch@hsbc.com) for more information.*

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