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Thought Leadership

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## Carbon Border Adjustment Mechanisms (CBAM): Implications for the South African Export Market

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### From the Paris Agreement to the European Union CBAM

At the 21st United Nations Climate Change Conference (COP21), the Paris Agreement was adopted with the overarching goal of limiting the global average temperature increase to well below 2°C above pre-industrial levels and to pursue efforts to limit it to 1.5°C above pre-industrial levels. [1] This legally binding agreement permits countries to set their own ambitious targets.

In line with its commitment to cut greenhouse gas (GHG) emissions by 55% by 2030 in comparison to 1990 levels, the European Union (EU) launched a series of legislative proposals

July 2021 under the "Fit for 55" initiative. A crucial component of this package is the Carbon Border Adjustment Mechanism (CBAM) Regulation.<sup>[2]</sup>

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### **Addressing Carbon Leakage with CBAM**

The EU aims to lead global efforts in combatting climate change and addressing potential carbon leakage concerns through the implementation of this regulation. <sup>[3]</sup> Carbon leakage occurs when emission reduction efforts in one country, leads to increased emissions in another, due to industries relocating to areas with less stringent policies.

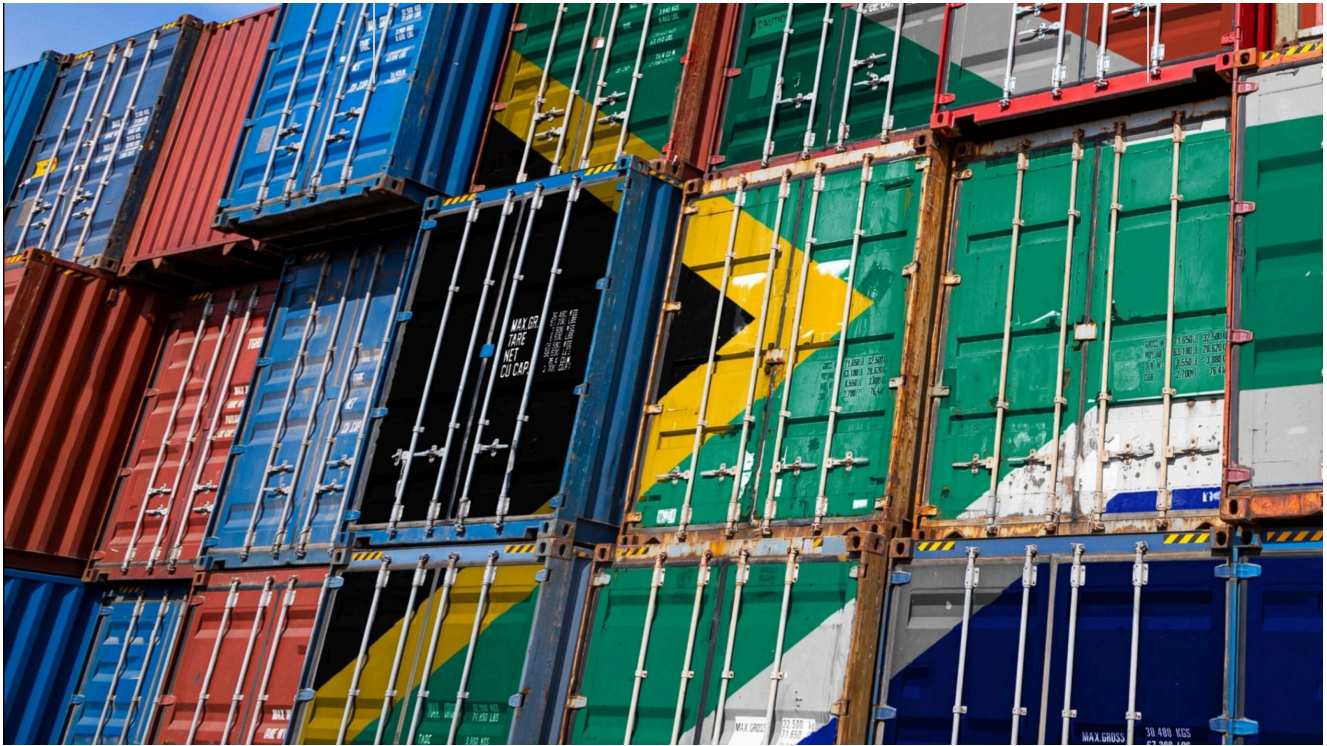
The CBAM is intended to mitigate carbon leakage by imposing a carbon border tax on the embedded GHGs of carbon-intensive products being imported. This measure equalises the carbon price between EU products and imports, ensuring that importers face similar conditions to EU manufacturers and that the EU's climate objectives are not undermined by carbon leakage.

### **Implementation of EU CBAM**

The CBAM regulation entered a transitional phase on 1 October 2023, until December 2025. During this period affected companies will have administrative obligations rather than financial ones, requiring importers to report only direct emissions embedded in their products.<sup>[4]</sup>

At this stage, the regulation affects a list of products amounting to 42 groups of goods, across electricity, cement, fertilisers, iron and steel, aluminium, and hydrogen sectors.<sup>[5]</sup> Additional products deemed to be at high risk will be assessed for inclusion, before the end of the transition phase in 2025. These include additional products covered by the European Union Emission Trading System (EU ETS), such as organic chemicals, polymers and related downstream products. The transition period will also be used to develop the methodology for calculating indirect emissions.

At the end of the transition phase in 2025, importers of goods into the EU will need to declare the quantity of imports they have made, and their embedded GHG emissions annually, and then purchase an equivalent number of CBAM certificates. This is referred to as the definitive phase. The price of CBAM certificates will align with the weekly average auction price of the EU ETS expressed in €/ton of CO<sub>2</sub>. It is important to note that the free allowances currently awarded under the EU ETS will progressively be phased out by 2034, to level the carbon price for both EU producers and EU importers.



South Africa exports high carbon-intensive products to the EU, making it particularly vulnerable to CBAM regulations.

### **The Vulnerability of South Africa's Export Market to CBAM**

In 2022, the EU accounted for 21% of total national exports. With the introduction of CBAM, the costs of South African goods into the EU will increase, reducing their competitiveness and potentially the overall value of future exports to the EU. This will have significant impacts on key sectors of the South African economy that are unable to rapidly, competitively and effectively reduce the carbon-intensity of their products.

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### **Similar Climate Trade Measures from other Countries**

Other countries, including Japan, the UK, Canada and USA have started introducing Border Adjustment Mechanisms with a similar intent to the EU CBAM.

The USA, South Africa's second largest trade partner, at 11% of total national exports, introduced four bills related to climate and trade in 2023 alone.

While the specifics of these bills may change as they progress through the US Congress, these

Another major South African trade partner that has introduced a similar mechanism is the United Kingdom.

The UK government recently undertook a consultation on the introduction of its CBAM, with submissions closing on 13 June 2024.

Liable parties under the UK CBAM will be required to submit a CBAM return, and then pay any liability at the end of each accounting period (as opposed to buying

These range from submitting reports of emissions associated with the goods before passage is granted under the **PROVE IT Act**, to paying fees on some goods whose emissions exceed that of the same goods produced in the US, under the **Foreign Pollution Fee Act**. [6]

The UK CBAM will also allow free allocations. The first accounting period is set to be 1 January to 31 December 2027 and will subsequently be made quarterly from 2028, with a one-month deadline to file the return and pay.



### How Should South Africa Respond?

The likelihood that EU policymakers might provide an exemption for South Africa, as an upper-middle-income country, seems implausible.[7] South African policymakers can pursue legal or political routes to negotiate possible alterations in the CBAM's design that could ease South Africa's vulnerability. Some of the possible opportunities would include:

- Negotiating a slower CBAM phase-in period to allow South Africa to adapt to its production processes, develop and implement policies that align with global ambitions, and build capacity in sectors that are most vulnerable.
- Negotiating for indirect emissions to be excluded from the CBAM design. Indirect emissions can be complex to calculate and monitor as they involve emissions from sources not owned or directly controlled by the company, such as those from purchased electricity, transportation and distribution.
- Seeking a more favorable assessment of the default emissions intensity of South African (and other) producers.

were made during the design of CBAM to ensure it aligns with WTO rules.<sup>[8]</sup>

In parallel to this process, South African firms are encouraged to refine their GHG emission accounting systems through the development of an appropriate Monitoring, Reporting and Verification (MRV) system. This includes advancing low carbon strategies and financing within industrial processes and business models, to adapt to the introduction of border carbon adjustments. This option has short-term financial implications but presents opportunities in the longer term.

### Long-Term Considerations



Global trends are moving towards greater accountability for emissions, making it critical for South Africa to enhance its competitiveness in international markets.

This includes adopting long-term policy interventions that could assist in reducing South Africa's trade exposure, including through supportive measures in relation to industrial policy, energy policy, trade policy and fiscal policy.

These policy measures can play a key role in driving green led industrialisation (including within hard-to-abate sectors impacted by border carbon adjustments) advancing the pace of renewable energy implementation at scale and promoting South Africa's trade related competitiveness across current and future markets.

As the NBI has long emphasised, climate change is an economic issue of high significance. South Africa must act swiftly to address the risks and the opportunities presented by climate change.

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[8] PCC (n7)



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