

CARBON BORDER ADJUSTMENT MECHANISM - ENVIRONMENT

NEWS: Carbon tax has been one of the sticking points in the India-UK trade pact.

WHAT'S IN THE NEWS?

Signing of India–UK Free Trade Agreement (FTA)

- India and the United Kingdom signed a long-awaited Free Trade Agreement (FTA) on **May 6, 2025**, after nearly **three years of complex negotiations**.
- The agreement aims to enhance trade, investment, and economic cooperation between both countries, but finalisation was delayed due to differences over carbon-related trade measures.
- One of the key issues that hindered progress was the **UK's proposed Carbon Border Adjustment Mechanism (CBAM)**, which has significant implications for Indian exports.

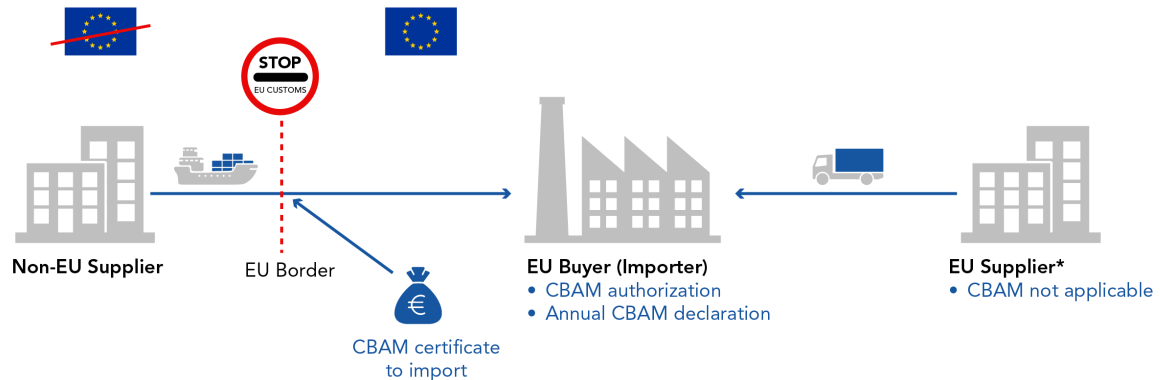
UK's Carbon Border Adjustment Mechanism (CBAM)

- The CBAM is a form of **carbon pricing policy** proposed by the UK to reduce carbon emissions by imposing **carbon taxes on imported goods** with high carbon footprints.
- As per the **draft legislation**, CBAM will apply from **January 1, 2027**, and will cover sectors like **aluminium, cement, fertilisers, hydrogen, iron, and steel** — all known for high emissions during production.
- The CBAM mirrors similar efforts by the **European Union**, intending to create a **level playing field** for domestic industries that follow stringent emission norms, by taxing more polluting imports.

India's Concerns and Rebalancing Mechanism Proposal

- India raised strong objections to the CBAM, arguing that it disproportionately affects **developing countries** and undermines principles of **climate justice**.
- In response, India proposed a “**rebalancing mechanism**”, which was included in the **general exceptions chapter** of the FTA text.
- This mechanism would allow India to **seek compensation** for losses incurred due to CBAM and **shield itself from potential legal disputes** at the **World Trade Organization (WTO)**.

EU Carbon Border Adjustment Mechanism simplified illustration



* Including goods originating from Iceland, Liechtenstein, Norway, and Switzerland
Source: The Conference Board, 2022

WTO's General Exceptions Clause

- International trade agreements such as the **General Agreement on Tariffs and Trade (GATT)** include a chapter on **‘general exceptions’**, allowing member states to implement trade-restrictive measures under certain conditions.
- These exceptions are permitted for reasons such as **protecting public health**, **conserving natural resources**, or **addressing climate change**, even if they violate general trade obligations.
- India’s invocation of this clause is a **strategic legal move** to balance trade liberalisation with environmental and equity concerns.

CBAM as a Carbon Pricing Tool

- According to the **World Bank**, a carbon tax is a type of **carbon pricing** that assigns a direct cost to greenhouse gas emissions, either by taxing the emissions themselves or the carbon content of fossil fuels.
- CBAMs are designed to **prevent “carbon leakage”**, where industries shift production to countries with **lax emission norms**, thus defeating global emission reduction goals.
- By taxing carbon-intensive imports, CBAMs encourage **global alignment of climate policies**, but they also risk becoming **barriers to trade**, especially for **developing economies**.

Impact on India and Other Developing Countries

- Developing nations like India argue that CBAMs **violate the principle of Common But Differentiated Responsibilities (CBDR)** enshrined in the **United Nations Framework Convention on Climate Change (UNFCCC)**.
- This principle recognises that while all countries share responsibility to fight climate change, **developed nations bear a larger burden** due to their historical emissions and greater financial and technological capacity.
- Indian leaders, including Finance Minister **Nirmala Sitharaman** and Commerce Minister **Piyush Goyal**, have publicly called CBAMs **unfair** and a **form of green protectionism**.

Trade Dependency on EU and UK

- India's economic exposure to Europe is significant, with over **15% of its merchandise exports** directed toward the **European Union**.
- In 2022–23, India exported goods worth **\$75 billion** to the EU, many of which fall under CBAM-targeted sectors like **steel and cement**.
- Imposition of CBAM by the UK or EU could **reduce price competitiveness** of Indian exports in European markets, affecting jobs and industrial growth.

India's Domestic Response – Carbon Credit Trading Scheme (CCTS)

- To build a domestic framework aligned with climate action, India launched its **Carbon Credit Trading Scheme (CCTS)** in **2023**.
- The scheme aims to create a market for trading **carbon credits**, helping energy-intensive industries reduce emissions in a **cost-effective manner** while fulfilling India's **Paris Agreement commitments**.
- CCTS differs from Western models by focusing on **emission intensity reduction** (emissions per unit of output), rather than absolute emission cuts — a more **suitable model for a developing economy**.

Operational Readiness and Draft GEI Rules 2025

- The CCTS is **not yet operational**, pending the finalisation of regulatory mechanisms.
- On **April 16, 2025**, the **Ministry of Environment, Forest and Climate Change** released the **Draft Greenhouse Gases Emissions Intensity (GEI) Target Rules, 2025**.
- These rules will establish **sector-specific emission targets** and create a **compliance mechanism** to monitor and verify reductions.

Dual Mechanism of CCTS – Compliance and Offset

- Under CCTS, there are two main tracks:
 - **Compliance Mechanism:** Obligated entities (like major polluters) must reduce emissions below the prescribed intensity levels and will be rewarded with **Carbon Credit Certificates**.
 - **Offset Mechanism:** Voluntary participants (non-obligated entities) can implement emission reduction or carbon sequestration projects and receive credits which can be traded.
- This dual mechanism is expected to **catalyse investments in green technologies** and provide **economic incentives for decarbonisation** across industries.

Conclusion: A Balanced Climate-Trade Strategy

- India's approach in the FTA negotiations — seeking a **rebalancing clause** while launching its **domestic carbon market** — reflects a **balanced strategy** to engage with global trade and climate regimes.
- It underscores India's effort to protect **trade competitiveness**, promote **equity in climate action**, and strengthen its **climate-resilient economy** in the years ahead.

Source: <https://indianexpress.com/article/upsc-current-affairs/upsc-essentials/knowledge-nugget-carbon-tax-cbam-upsc-uk-india-trade-fta-9986151/>