

## Supplementary written evidence from Dr Sanna Markkanen, Cambridge Institute for Sustainability Leadership

### Should the UK implement a CBAM? Why, why not? What are the alternatives?

[Our research](#) on the environmental, economic, legal, diplomatic and political implications of the [EU's CBAM proposal](#) outlines some of the key benefits and potential risks associated with a unilateral CBAM. Many of these would likely apply to a similar proposal made by the UK.

Based on our assessment, and the analytical exercise of examining how the issues we identified as being relevant for the EU could apply to the UK context, I would recommend the UK to refrain from implementing a CBAM unless it becomes a necessity. This would be the case if the rest of the world fails to put in place the required policies to achieve their net-zero targets.

Since 2019, most large economies – including China, India, Russia, the EU and the US – have put in place net zero targets. Many Europe's closest neighbours – such as Ukraine and Turkey – have done the same, as have many populous developing countries – such as Thailand, Vietnam, Malaysia and Indonesia. However, the vast majority of these countries (save the EU and the UK) have not yet developed explicit strategies (such as the UK's Net Zero Strategy) or clear policy frameworks (such as the EU's Fit for 55 package) to map out how these targets are to be achieved, how industry is expected to contribute to these targets, and what support the governments will provide to industries that will need to radically amend their production processes. The lack of clear policy frameworks increases the investment risk in these jurisdictions, especially for capital intensive production. As such, the EU and the UK currently provide a more predictable, and thus lower-risk, investment environment for such operations.

Therefore, the question of whether the UK should or should not implement a CBAM should be made based on a thorough assessment of the policy's potential benefits and disadvantages.

A UK CBAM could, at least in theory, deliver several benefits.

First, it would send a strong message to domestic industry that the government seeks to protect them from some of the cost-implications arising from the phasing out of the free ETS allowances.

Second, a UK CBAM could boost industrial activity in the UK. Our research focusing on the EU suggests that, by 2050, an EU CBAM could result in a minor increase in sectoral output in the sectors covered by the CBAM (most of this impact coming from increased domestic electricity generation, if we assume that 50% of current electricity imports were to be replaced by increased domestic electricity production). However, the EU's emissions would increase slightly as result of increased industrial activity (around 2% per annum by 2050), while global emissions would decline by around 10MtCO<sub>2</sub> per annum by 2050, equivalent to around 0.023% of global annual CO<sub>2</sub> emissions).

Third, if the revenue from the UK CBAM was recycled within the UK, this could generate economic growth and create new jobs. Our analysis shows that an EU CBAM could lead to a minor increase in the EU's GDP, of around 0.2-0.4 % compared to a baseline scenario where the EU achieves climate neutrality by 2050 without a CBAM. The EU CBAM could also create around 600,000 jobs by 2050, primarily as a result of the CABM revenue being used to boost economic activity in the EU (which is one of the most controversial aspects of the EU's current CBAM proposal).

The potential disadvantages, however, are also considerable.

First, a UK CBAM is not compatible with the concept of 'Global Britain' and – unless the revenue from it was recycled in full to support decarbonisation in the Least Developed Countries - clashes with the UK's preferred image as a champion of just transitions both at home and abroad.

Second, there is a considerable reputational risk associated with unilateral implementation of a CBAM. There is a high likelihood that a unilaterally implemented CBAM would be perceived as a protectionist measure by many trade partners and potential trade partners (largely because the expected emissions savings are estimated to be very small), or as an attempt by the UK to impose its preferred carbon control measure, ie carbon price, on countries where this may not be the most suitable approach at the moment.

Third, there is a risk of retaliation, which could be symmetrical or asymmetrical. In other words, disgruntled trade partners may impose measures to control the access of British exports to their jurisdiction, quite possibly focusing on exports that are of particularly high importance to the British economy. Retaliation could take place well before any legislative challenges are put to the WTO, possibly as soon as the UK announced its intention to implement a CBAM.

Fourth, a CBAM does not provide protection to British companies in global markets. Export credits cannot be applied to compensate for the impacts of a regulation (this is not compatible with the WTO rules). In other words, a UK CBAM would protect UK producers against competition from more carbon-intensive imports in the UK market only. Considering that much of the UK's imports in the sectors that could reasonably be covered by an early CBAM come from the EU, where the carbon price is similar to the UK's, the revenue that a CBAM would generate would likely be small, and perhaps even lower than the administrative costs associated with the implementation of the CBAM.

Fifth, a CBAM that is applied only to some materials but not others could cause market distortions (as the cost of some materials increase while the cost of others does not, or as some materials are protected against competition from cheaper imports, while others are not). It would likely increase the material input costs for manufacturers who, if they are not protected by a CBAM (which would be technologically even more complicated than applying a CBAM fairly to basic materials) may feel that basic material producers are protected at their expense.

Finally, as already mentioned, the emissions impact at the global level would likely be very small, as illustrated by our assessment of the EU's proposed CBAM.

It is, of course, undeniable that the 'threat' of a CABM could incentivise other countries to implement carbon pricing regimes, but it is worth asking as to what extent the UK could prompt changes beyond those that are already taking place as a result of the EU's CBAM proposal. Moreover, the recent EU-US steel deal (covering steel and aluminium) is already encouraging other countries to 'join the club', and inclusive multilateral arrangements are generally less contentious than a unilaterally imposed trade control measure.

So, what could the UK do instead of implementing a CBAM?

First, it could 'piggyback' on the EU's CBAM, and gain all of the benefits and none of the downsides by aligning its ETS with the EU ETS, meaning that UK would be exempt from the EU ETS. This would not only mean that there would not no CBAM rate payable – it would also eradicate all admirative fees that would otherwise apply even if the UK carbon price meant that no actual CBAM charge was payable. As an exempt trade partner, the UK could stand to gain from the EU's CBAM as imports from the UK would become more attractive to EU importers than imports from countries such as

Turkey and Russia (Ukraine is seriously considering aligning their ETS with the EU one for this specific reason).

Second, the UK could join the EU-US steel deal. It is currently unclear how exactly this will interact with the EU's proposed CBAM, but the likelihood is that joining a multilateral arrangement would be less politically and diplomatically contentious, and therefore more palatable to existing and potential trade partners, than implementing a unilateral CBAM.

Third, the UK could consider a suite of measures to incentivise businesses to stay, expand and invest in UK based operations. Public sector procurements as one viable instrument was already mentioned in the third panel. However, targeted R&D spending (within the acceptable limits set by the WTO and the EU-UK trade deal) could also support industrial decarbonisation efforts. Business rate cuts or other tax benefits, especially if linked to social targets and the levelling up agenda, could potentially be acceptable (without being regarded as an actionable subsidy) and a powerful tool to support businesses, especially in the less wealthy parts of the UK. Amendments to the energy pricing and taxation (such as those indicated as necessary in the Net Zero Strategy) could incentivise UK's energy intensive industries to switch to cleaner fuels, where physically possible, by removing the cost barrier to doing so. Finally, revisions to certain regulations (such as building regulations) that currently limit the potential size of markets for innovative solutions in certain industries could be amended or repealed to eradicate the disincentive for industrial producers to explore innovative solutions to decarbonise their production. There may also be scope to explore other demand side policies to expand the markets for carbon-neutral or low-carbon materials (such as some of the policy measures we discuss in our [previous report on this topic](#)).

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