EU's green rules will derail trade

MUSCLE FLEXING. Tough days lie ahead for global trade and climate talks. EU has brushed aside WTO and UNFCC

Ajay Srivastava

In the first seven months of 2023, the EU introduced five regulations on climate change and trade. These will make EU richer by $500-800 billion annually through the sale of emission allowances, collection of fines, etc., once the regulations are implemented in full.

The EU needs money to continue to provide substantial subsidies to its firms and farmers. For instance, the European Green Deal alone aims to raise €1 trillion in the next 10 years, with €503 billion coming from the EU budget. The new regulations can provide full share of the EU budget. Table 1 shows some of the EU subsidy programmes.

EU's hypocrisy knows no limits as it distributes billions of dollars of subsidies to its farmers and industry, while empowering itself to investigate subsidies given by other countries.

Let us now discuss the EU's five new regulations and their impact on business and trade. Table 2 captures the core details of each regulation.

One, the Deforestation Regulation (EUDR) will shake up trade in agricultural goods. The regulation requires firms to ensure that the product exported to the EU has been grown on land which has not been deforested after December 31, 2020. The new rules will apply to large firms w.e.f. December 2024 and small firms in June 2025.

The regulation will initially affect trade of meat, oil cake, soya beans, palm oil, coffee, leather hide, skin, paper, paperboard, and wood furniture. The EU will expand the product list soon. Foreign exporters would be required to invest in expensive due diligence and share farm level data with the EU. The EU provides significant subsidies to its farmers, the EUDR will make imports costly and thus will help EU firms. It is not WTO compatible and a non-tariff barrier.

Two, Carbon Border Adjustment Mechanism (CBAM). This will allow the EU to charge a tax on the import of steel, aluminium, cement, fertiliser, hydrogen, and electricity from January 1, 2026. By 2023 CBAM will tax all industrial products. The process will start from October 1 this year, when Indian exporters must share firm-level emission data with the EU. The UK, Canada, Japan, and the US are also bracing to levy similar import taxes.

EU distributes billions of dollars of subsidies to its farmers and industry, while empowering itself to investigate subsidies given by other countries

EU's major subsidy and incentive programmes to support its firms

TABLE 1

EUs programme	Date of introduction	Target sector	Beneficiaries
European Green Deal Investment Plan	2020	Energy	Firms in renewable energy, energy efficiency etc., **Budget: €1,000 billion for 2020-30**
Horizon Europe	2021	R&D	Businesses, research organisations, and universities working on innovative projects, **Annual budget: €95 billion**
European Regional Development Fund (ERDF)	1975	SMEs	SMEs located in less developed regions of the EU, **Annual budget: €54 billion**
Digital Europe Programme	2021	Digital	Businesses, research organisations, and universities developing digital technologies, **Annual budget: €8 billion**
Common Agricultural Policy (CAP)	1962	Agriculture	Farmers with land or livestock, **Annual budget: €60 billion**

EU's new regulations

TABLE 2

EUs programme	Date of Introduction	Compliance from	Target sector	Impact
Deforestation Regulation	May-23	Dec-24	Agriculture	High compliance cost for export of agriculture products to EU
Carbon Border Adjustment Measure	May-23	Jan-26	Industry	20-35% additional cost for export of industrial products to EU
Shipping in Emissions Trading System	Apr-23	Jan-27	Shipping	3-4% increase in price of export and import products
EUs Foreign Subsidies Regulation	Jul-23	Oct-23	Foreign subsidies	EU takes over the task of WTO to investigate foreign subsidies
Supply Chain Due Diligence Act	Jan-23	Jan-23	Global supply chains	Higher compliance cost, supply chain disruption in few cases

Developed countries account for about 60 per cent of global imports and have an average industrial tariff of 2-3 per cent. CBAM will translate into a 20-35 per cent carbon tax over and above import duties. Imagine the disruption in trade in industrial goods with import taxes going up 10 times. CBAM will divide the world into two parts: CBAM-charging countries and the rest of the world. This will disrupt the existing global supply chains and increase trade costs.

Three, inclusion of shipping in the EU's Emissions Trading System (ETS). The EU parliament included shipping in the ETS on April 18, 2023. As a result, EU will start charging a CBAM-like tax from EU's outbound and inbound shipping companies from January 1, 2027. The EU ETS will initially cover large ships of 5,000 gross tonnes and above but will later cover smaller ships. The compliances will generate revenue for the EU but result in 3-4 per cent increase in the price of export and import products.

To reduce emissions, ships need to switch from using bunker fuel to low-carbon fuels like LNG and ammonia. The shipping sector must also invest in optimising hull design, using efficient engines, etc. The International Energy Agency estimates a $1.5 trillion expenditure to achieve net-zero emissions from global shipping by 2050. India's shipping sector must set aside over $100 billion to survive in a low-carbon future.

Four, the EUs' Foreign Subsidies Regulation (FSR). This prohibits foreign subsidies and grants the EU the authority to investigate cases where foreign subsidies distort competition within the EU. The FSR covers financial contributions from non-EU governments to firms operating in/exporting to the EU. The EU Commission is investigating the PLI scheme, and a decision is expected soon.

Firms must notify M&A and public procurement transactions to EU authorities above a certain value. For M&A, the FSR kicks in if the value of the merging companies' assets exceeds €500 million or if the value of foreign subsidies exceeds €1 million. For public procurement-related transactions, the threshold values are €250 million or if value of foreign subsidies exceeds €4 million.

Five, German Supply Chain Due Diligence Act (SCDDA). It prohibits forced labour and other labour law violations by German and foreign firms doing business with Germany with supply chains extending within and outside Germany. The law applies to firms with more than 3,000 employees. The firms must implement new due diligence processes and extensive compliance measures, resulting in higher costs. However, the law could also could help workers from being exploited. In India, it is crucial to raise awareness of labour laws among workers and employers and establish efficient complaint-handling mechanisms.

The law may result in few surprises for Germany. Germany may give up sourcing cobalt, a key component for batteries, from Congo mines, where human rights issues, including child and forced labour, are prevalent. Germany may have to halt the import of industrial goods from China due to concerns regarding the treatment of Uyghurs.

Though the European Union (EU) does not have the economic or military clout of the US or China, it always was miles ahead than the rest on introducing new regulations. Tough days are ahead for global trade and climate talks. EU has become the first one to dump both the WTO and UNFCC and began taking unilateral measures.

The writer is founder, Global Trade Research Initiative, a research group focussed on technology, climate and trade