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OPINION | EU border tax will hit steel and other exports hard - manufacturers have no time to lose

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Photo: Getty Images

For South Africa, exports to the EU of iron, steel and aluminium will be the categories that are initially hardest hit. Crucial steps must be taken by businesses and policymakers to adapt - and this must happen soon, says Duane Newman.

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The European Union (EU) has launched its Carbon Border Adjustment Mechanism (CBAM), which will make it more costly and complicated for African firms that export to the EU.

The CBAM, which came into force on 1 October this year, is an import tariff on carbon-intensive goods from abroad. It is applied as an import tax paid by the importer when products enter the EU.

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The tax is assessed on the amount of greenhouse gas emissions embedded in goods being exported to Europe.

The aim is to standardise the price of carbon between EU products and imports, to ensure that EU manufacturers are not disadvantaged by imports from countries that do not impose the same severity of carbon tax.

Initially, the carbon-intensive sectors to be covered by the CBAM will be aluminium, cement, electricity, fertilisers, iron and steel and hydrogen.

For South Africa, exports to the EU of iron and steel and aluminium will be the categories that are initially hardest hit.

At a later stage, the inclusion of additional sectors - including the organic chemicals and polymers sectors - will also be considered.

From 2026, CBAM tax will be paid and phased in, meaning that imports into the EU will face a similar tax burden as for goods made by European companies.

Critics expressed concern in response to EU consultations before the CBAM was launched at the fast pace at which the EU has proceeded.

South Africa’s Trade, Industry and Competition Department (dtic) submitted a lengthy response to the request for comments, voicing several concerns about CBAM.

It criticised "the unilateral imposition of the EU’s CBAM and other measures under the Green Deal that pose a threat to our sustainable development and climate change mitigation action imperatives and those of fellow African and other developing countries, including addressing inequality, unemployment and poverty eradication.

"CBAM has the effect of transferring the burden of climate action onto developing economies, and places undue and unjust burdens on our country and industries."

In a research paper in February 2023 entitled The European Union’s Carbon Border Adjustment Mechanism and Implications for South African Exports, South African research body Trade & Industrial Policy Strategies (TIPS) noted a potentially high impact on SA exports, particularly the iron, steel and aluminium sectors.

"This is primarily due to the use of coal-powered electricity and coal as feedstock in these sectors," TIPS noted.

A negative CBAM impact will also affect exporters from the rest of Africa, and there is a strong likelihood that other jurisdictions - including the UK, Japan and Canada - will soon impose their own equivalents of the CBAM.

London School of Economics Professor Dave Luke has suggested the CBAM may reduce African exports to the EU by up to 5.7%, equivalent to a US\$16-billion reduction in GDP.

Initially, the CBAM will be levied on direct emissions – reflecting the emissions that were generated in their production. However, in December it was agreed to extend the CBAM to indirect emissions, i.e. emissions from bought-in electricity. We do expect that emissions in bought-in raw materials and components will also be included.

What must be done to mitigate impact

African manufacturers will need to consider where they source their components and raw materials.

It could mean they might need to change their current suppliers or ensure that those suppliers

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Rand - Yen	0.13	+0.0%

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Company Snapshot

adopt greener production methods.

Exporters, therefore, will need to consider not only what they produce, but what they produce it from.

There wasn't much time to prepare for the new EU border tax, and companies are scrambling to assess how quickly they can decarbonise before the January 2026 date when the CBAM will actually be paid.

The EU believes the introduction of the CBAM will have both direct and indirect impacts on businesses trading into the EU. A holistic approach across value chains is required to effectively map and mitigate the impacts of the regime.

Barbara Creecy, South Africa's Minister of Forestry, Fisheries and the Environment, told a panel session at President Cyril Ramaphosa's 2023 Investment Conference that as new green legislation comes into effect there is a "transition risk".

She noted that CBAM would likely constrain SA's auto sector, adding that a "lower carbon growth trajectory" would be important.

TIPS noted that the CBAM would impose compliance costs. Exporting firms will not only have to account for, report and verify the embedded emissions in their products, but the CBAM will eventually require third-party verifiable carbon audits - which can be costly even for large firms.

TIPS suggested that the administrative burden on exporters could be eased if governments were to introduce domestic carbon reporting systems.

It advocated the decarbonising of industries and the electricity system, and the introduction of more ambitious climate change policies.

As the CBAM aims to achieve equivalence between the carbon tax burden on EU-manufactured products and imports into Europe, it would be mitigated if exporting countries were to bring their own carbon tax regimes in line with those of the EC.

There is an additional argument that we should be reforming South Africa's carbon tax to reflect global carbon pricing, which will be critical to ensure that the country's carbon-intensive products reflect at least the EU price of carbon.

In other words, the higher carbon tax is paid in South Africa and not in the EU.

Any failure to wake up and act could be extremely costly.

Duane Newman, EY South Africa Tax Partner.

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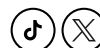
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