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As the US and EU swap Climate Policies: What's Next for Businesses?

Charles Gong, a tax partner from Deloitte China, shares his observations and advisories on climate policies in the U.S. and EU, helping you to identify the key points and adjust your business strategies and strive for sustainable development.

Transcript

Charles: Hello, and welcome to ***Deloitte Taxcast***. I'm Charles, a tax partner of Deloitte China. Today I will present US and EU swap Climate Policies What's Next for Businesses?

On January 1st 2023, the U.S. "Inflation Reduction Act (IRA)" came into effect, and on October 1st, the EU's "Carbon Border Adjustment Mechanism (CBAM)" will take effect. These two pieces of legislation not only directly affect achieving global net-zero emissions but also significantly impact the global industrial pattern and trade rules.

The U.S. IRA aims to combat inflation by lowering energy costs. According to the IRA, the U.S. will invest $369 billion in energy security and climate change over the next decade, accounting for 84% of the total investment. Therefore, the IRA is widely considered as the largest investment in climate spending in U.S. history. Specifically, the IRA includes five measures for climate investment: reducing energy costs, ensuring U.S. energy security and domestic manufacturing, achieving economic decarbonization, maintaining community and environmental fairness, and supporting resilient construction in agriculture and forestry.

In the much-anticipated field of new energy, the IRA provides direct subsidies to consumers who purchase electric vehicles, households that use new energy, and factories that use green energy. This will stimulate the development of the new energy industry from the demand side, expand market share, and provide the impetus for transforming and upgrading the energy structure. However, conditions must be met to qualify for tax subsidies, such as electric vehicles must be assembled in North America, at least 40% of the metals and minerals, such as lithium and cobalt, in the car batteries should be mined and extracted in the U.S. or countries that have signed free trade agreements with the U.S., these conditions will undoubtedly raise the threshold and costs of new energy-related products from other countries to enter the US market. Thus, from a global perspective, to obtain U.S. subsidies, new energy-related industries will invest and produce in the U.S. to be eligible for the subsidy and meet the subsidy's restriction conditions, which therefore triggers adjustments in the global industry, value, and supply chains.

In response to the U.S. IRA, on February 1st, the European Commission announced the Green Deal Industrial Plan, allocating $272 billion from EU funds to promote industrial greening and support member states' efforts to accelerate industrial decarbonization. From a long-term perspective, the release of the U.S. IRA may reduce the demand for U.S. import of new energy-related products from China, such as the procurement and production of photovoltaic components and raw materials for batteries, which may shift from China to North America and Southeast Asian countries. Therefore, it is recommended that Chinese companies accelerate the layout and integration of new energy's upstream and downstream industries and enhance the ownership of the new energy chains to protect their existing competitive advantages.

The CBAM is a core part of the "European Green Deal.", according to such regulation, the EU will impose a carbon tariff on imported electricity, cement, steel, aluminium, fertilizers, and hydrogen products from other regions based on the carbon price in the EU carbon trading market at the same time, for the purpose of creating a fair business environment and reducing the risk of carbon leakage for the EU industries and importers. The CBAM has a transition period from October 1st, 2021, to December 31st, 2025. During this period, importers only need to fulfil the obligation to report the carbon emissions of their products. Still, the report content will serve as the basis for evaluating the future adjustment of carbon tariff policies. From January 1st, 2026, the tariff will be officially imposed, and the carbon price paid in the country of production can be deducted from the carbon tariff.

The CBAM, as the first carbon tariff legislation launched in the context of the global demand for long-term investment in low-carbon production and the expected increase in carbon prices, is considered a benchmark for global carbon pricing policies. It has been reported that countries like the UK, Canada, and Japan may follow suit and introduce similar carbon tariffs. The imposition of carbon tariffs will directly increase the import costs of related products, reduce the total import volume of products, and may significantly reduce the profits of related industries. Regarding trade volume, Russia is affected the most by the CBAM, with China ranking the second. Since the amount of carbon tariff is directly related to the carbon emissions of products, the larger the carbon emissions, the higher the tax payable. Thus, for low-carbon producers, implementing carbon tariffs also means opportunities. Taking steel manufacturing as an example, companies using high-carbon processes, such as blast and converters, will face high carbon tariffs, while those using low-carbon technologies, such as direct reduction of iron, can gain a competitive advantage by paying less or no tax.

At this stage, the overall impact of the CBAM on Chinese companies is containable. However, in the future, the scope of the CBAM will gradually expand, and the carbon tax price might also continue to rise so that the impact of CBAM on trade between China and the EU will be more prominent. It is important for relevant Chinese companies to take carbon inventories and accurately report their carbon emissions, while focusing on green transformation and low-carbon product manufacturing in line with China's dual carbon targets.

It is worth noting that, unlike the EU, the U.S.'s policy responding to climate change is affected by changes in political parties and lacks stability and coherence. The U.S. does not have a national carbon emissions trading market or a unified carbon tax. As a result, its path for climate policies differs from that of the EU. The CBMA imposes taxes on carbon-intensive products, and whoever imports them will pay the taxes, which promotes emissions reduction and a global uniform carbon price. In contrast, the U.S. IRA promotes emissions reduction and energy substitution by providing government subsidies to specific industries. Chinese companies should track and evaluate the impact of different bills, adjust their development plans according to policy requirements and changes, reshape the global market layout, and strive for healthy and sustainable development.

That's all for today. Thank you for tuning into *Deloitte Taxcast*. You may find more episodes via the tax cast portal on Tax and Business Advisory| Deloitte China | Services, reports, and insights. Should you have any questions or topics you would like to learn, please contact me, Charles Gong, or drop us a line via the contact page on the website.

Have a great day!

Host for this episode

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