Policy Brief on The Implications of CBAM on Egypt

INTRODUCTION

On September 11, 2023, LYNX Strategic Business Advisors organized a roundtable discussion on the implications of the European Commission's Carbon Border Adjustment Mechanism on Egyptian exports to the European Union. This event was held in collaboration with Fertiglobe, a national private sector producer of fertilizers. The event was part of the LYNX Forum series on evolving economic and public policy affairs, aiming to foster discussions and collaboration between government and non-government stakeholders on developing policies and regulations that enhance Egypt's investment climate and strengthen the role of the private sector in the economy.

The LYNX Forum's main discussants included Dr. Mahmoud Mohieldin, the UN Climate Change High-Level Champion for Egypt and the UN Special Envoy on Financing the 2030 Agenda, Mr. Essam El Naggar, the Chairman of the Egyptian General Organization for Export and Import Control, Ambassador Omar Abou Eish, the Secretary General of the Permanent Secretariat for the Implementation of the Egypt-EU Association Agreement at the Egyptian Ministry of Foreign Affairs, Ambassador Mohamed Nasr, Director of the Department for Environmental Affairs, Climate Change and Sustainable Development at the Egyptian Ministry of Foreign Affairs, Mr. Vicente Hurtado Roa, Head of the Energy and Green Taxation Unit at the European Commission, Mr. Ayman Refaie, Head of the Carbon Credits Department at the Egyptian Environmental Affairs Authority, in addition to representatives of 35 companies operating in Egypt's fertilizers, cement, iron and steel, aluminum, electricity, and hydrogen sectors, as well as several of Egypt's development partners. This edition of LYNX Forum was moderated by Mr. Moataz Yeken, LYNX's Senior Economic Consultant.

The LYNX Forum witnessed an interactive discussion between Egyptian and European stakeholders on the new CBAM mechanism. The European Commission's executives presented CBAM as an environmental policy that adds to ongoing efforts to decarbonize the global economy, while the Egyptian side criticized the policy, considering it as a protectionist trade measure, rather than a climate one.

This Policy Brief highlights the CBAM mechanism and its features. Subsequently, it outlines the implications of this mechanism on Egyptian exports to the EU. Thereafter, it highlights the efforts undertaken by the Government of Egypt regarding monitoring and reporting carbon emissions in the manufacturing sector. Finally, the Policy Brief offers brief policy recommendations for the GoE, and private sector players impacted by CBAM.

DEFINITION, FEATURES, AND IMPLEMENTATION

Definition

The Carbon Border Adjustment Mechanism (CBAM) is a policy introduced by the European Union (EU) with the declared objectives of:

Preventing carbon leakages, which refers to the risk of carbon-intensive industries relocating their production outside the EU to avoid the costs associated with the EU's climate policies, while at the same time enjoying accessibility to European markets. By implementing CBAM, the EU intends to maintain the effectiveness of its climate policies and prevent such leakage.

Contributing to global decarbonization efforts and supporting the EU's goal of achieving climate neutrality by 2050. According to the EU, the new mechanism aims to encourage other countries to adopt more ambitious climate policies by creating an economic incentive for them to reduce their carbon emissions.

CBAM is intended to complement and reinforce the EU Emissions Trading System (ETS), which is the primary tool for reducing greenhouse gas emissions within the EU. It focuses on carbon-intensive sectors and aims to create a level playing field between EU industries subject to carbon pricing and their international competitors, by disincentivizing the importation of final products that produce a high level of carbon emissions during the manufacturing process.

DEFINITION, FEATURES, AND IMPLEMENTATION

Features

As demonstrated above, CBAM is a policy geared towards reinforcing the EU ETS, by ensuring the closure of loopholes for carbon-intensive industries and equalizing the playing field between manufacturers operating within the EU and outside of the EU. According to European Commission officials, CBAM is built on four key elements:

Mirroring the EU's carbon pricing by applying a similar mechanism to imports entering the EU. This means that imported goods will be subject to a carbon price based on their carbon content.

Addressing companies directly, rather than countries, focusing on the actual carbon content of the products imported to the EU, instead of taking into consideration the levels of carbon emissions in the countries of production.

Complying with international trade rules, particularly those set by the World Trade Organization (WTO). The EU argues that the CBAM targets companies rather than countries, adding that the carbon pricing is based on the actual carbon content of imported goods.

Focusing on carbon-intensive sectors such as cement, iron and steel, aluminum, fertilizer, electricity, and hydrogen. These sectors are selected based on criteria such as the risk of carbon leakage, the coverage of CO2 emissions in ETS sectors, and practical feasibility.

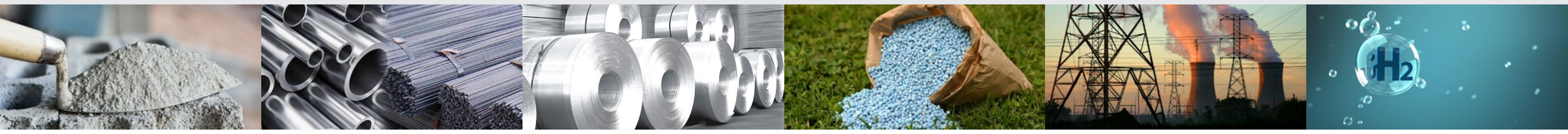
DEFINITION, FEATURES, AND IMPLEMENTATION

Implementation

The European Commission states that the implementation of CBAM will follow a gradual and phased approach to ensure that businesses are afforded the requisite time to adapt to this new policy. The initial, and therefore transitional phase, before the full implementation of CBAM, will begin in October 2023 and is expected to last until December 2025. It will involve the implementation of monitoring and reporting requirements. Additionally, during this phase, businesses will learn about their roles, tasks, and duties to be fulfilled. The Commission believes that the information collected during this phase will support efforts to refine the mechanism for its full implementation from 2026 onwards.

As announced by the European Commission, CBAM will focus at an initial stage on 6 carbon intensive sectors, where the risk of carbon leakage remains high and where it is practically feasible to implement the new policy mechanism. These sectors are:

1. Cement industry
2. Iron and steel manufacturing industry
3. Aluminum industry
4. Fertilizer industry
5. Power generation
6. Hydrogen production



With regard to reporting obligations on businesses, companies importing goods into the EU will be required to submit reports on the carbon content of their imported goods. These reports shall include the following details:

- Quantity and type of the imported goods
- Country of origin
- Company information
- Production routes and parameters, specifically direct and indirect embedded emissions
- Contextual information
- Carbon price paid in the country of production

The European Commission reaffirmed its readiness to provide guidance and support to different companies to support their efforts to comply with CBAM, through training, guidance documents, templates, an information portal, and an IT reporting interface. The Commission stressed that it seeks to facilitate the reporting process, while ensuring consistency and accuracy of the information provided.

CBAM will undergo a review in 2025, which may lead to the expansion of its scope to include indirect emissions and exports. From January 2026 onwards, the full implementation of CBAM will take place, including the phase-out of free allocation for industries covered by the mechanism.

Revenues generated through CBAM will be used to support climate action, such as financing the EU budget, climate finance for developing countries, and reducing the contributions of Member States to the EU budget.

IMPLICATIONS OF CBAM ON EGYPT

Concerns have been raised by developing countries and exporting companies to the EU regarding CBAM. One main concern is that the mechanism does not consider the priorities and conditions of climate and development action in these countries. Additionally, it may not effectively reduce emissions in sectors such as fertilizers, cement, iron, steel, and hydrogen. The tax may also impact the activities of companies operating in these sectors, which in turn can affect the economies of developing countries.

The EU is Egypt's largest trading partner. According to the Central Bank of Egypt (CBE), Egypt's total exports to the EU in FY 2021-2022 generated approximately USD 12.556 billion in revenues to the Egyptian market. This accounted for roughly 30% of Egypt's total exports. Thus, the implementation of CBAM will have a major impact on Egyptian companies, and by extension, the Egyptian economy.

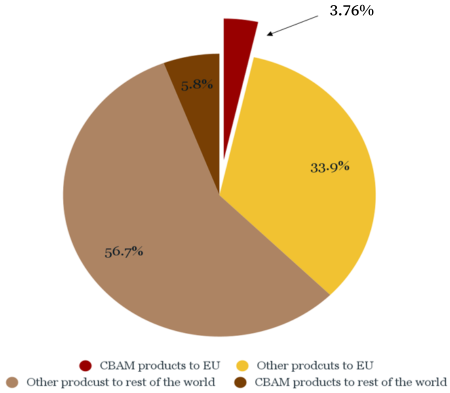
This section highlights the macroeconomic implications of CBAM and will explore the sector-level implications of CBAM on Egypt, as well as the threats CBAM poses to Egypt's sustainable development goals.

IMPLICATIONS OF CBAM ON EGYPT

Macroeconomic Implications

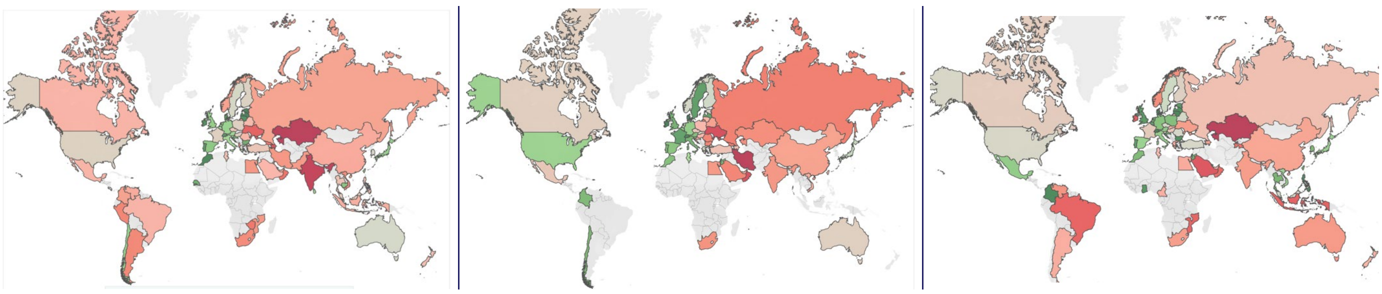
Egypt's exports that fall under the scope of CBAM represent 3.76% of the country's total export volume, which also accounts for nearly 10% of Egypt's exports to the EU. Additionally, exports impacted by CBAM also account for 0.3% of Egypt's GDP.

Furthermore, Egypt's exposure risk to the application of CBAM depends on the country's average share of exports to the EU covered by the new policy mechanism, as well as the carbon intensity of Egypt's economy. Therefore, as previously demonstrated, Egypt's volume of exports to the EU single market increases the risks and possible negative impact on Egypt.



Egypt's CBAM Applicable Exports to EU in 2022

Additionally, the most import source of energy in Egypt is natural gas, which is used in industrial processes and is used to power industrial activities. Therefore, Egypt's reliance on natural gas further increases the risks associated with CBAM's negative impact, since Egypt's economy and industrial sector ultimately rely on a carbon emitting source of energy to fuel its activities. The above-stated conditions demonstrate that CBAM is not merely a customs duty/tax placed on companies in isolation, but rather, it is a tax targeting emerging markets such as the Egyptian economy.



Steel **Fertilizers** **Aluminum**

Less CO2 emissions than EU average **Higher CO2 emissions than EU average**

CO2 Emissions Intensity for Selected Products

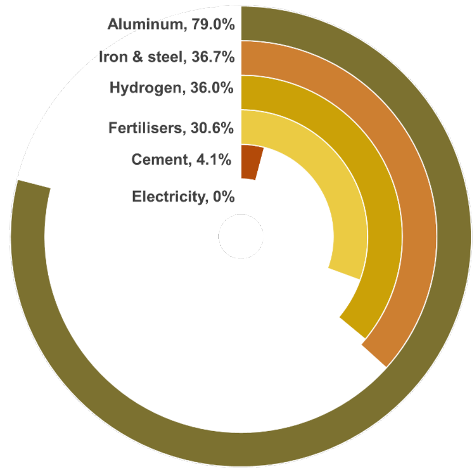
An additional risk associated with the implementation of CBAM and its potential negative impacts on the Egyptian economy, is that CBAM will potentially harm the competitiveness of Egyptian businesses and products. Due to the carbon intensity of Egyptian exports, as demonstrated by the World Bank's CO2 Emissions Intensity Map (displayed above), Egyptian businesses and products will likely struggle to compete in European single market because of CBAM.

IMPLICATIONS OF CBAM ON EGYPT

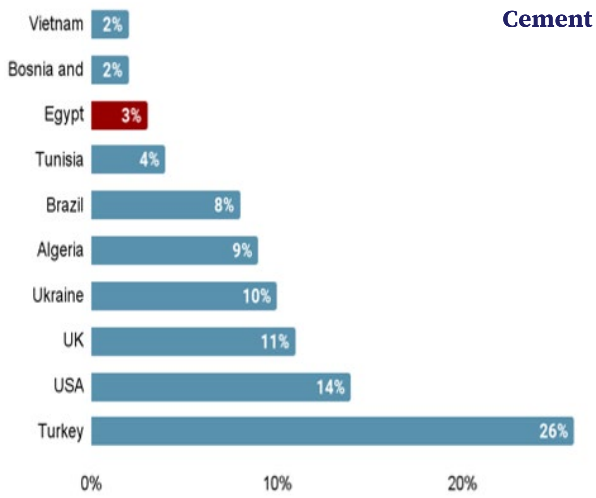
Sector-Level Implications

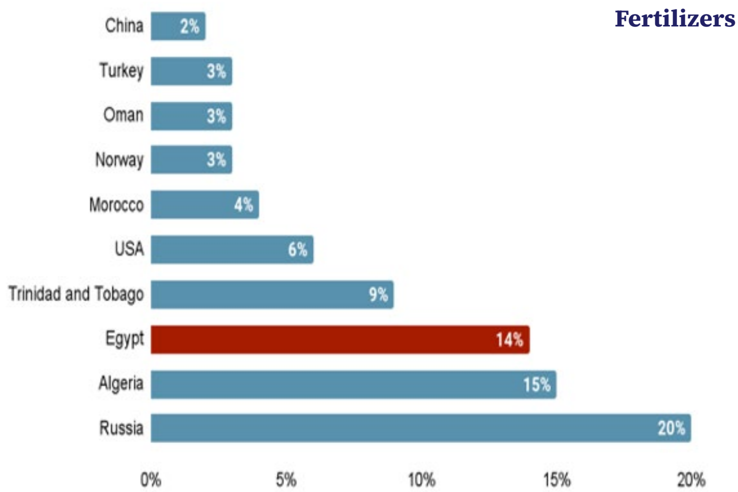
CBAM presents significant challenges to the six targeted sectors in Egypt, in particular, the fertilizer, cement, and aluminum industries.

For example, Egypt was among the top 10 exporters of fertilizers and cement to the EU in 2022, with Egypt accounting for 3% of the total cement exports to the EU and for 14% of the total fertilizers' exports to the EU. Furthermore, around 79% of Egypt's aluminum exports are directed towards the EU market. These factors highlight the threat that CBAM poses to Egypt's cement, fertilizer, and aluminum industries once CBAM is fully enforced.



Percentage of Egyptian Exports to the EU for the 6 CBAM sectors in 2022





Top 10 Exporting Countries to the EU for Cement and Fertilizers

Therefore, an assessment of the level of carbon intensity of each of those sectors is critical to ensure the mitigation of the negative impacts of CBAM on the Egyptian market and businesses. Furthermore, the industrial sectors in Egypt will have to increase their technical capacity with regards to monitoring, reporting, and verification procedures of CBAM.

IMPLICATIONS OF CBAM ON EGYPT

Impact on Climate and Development Efforts

Due to the potential negative economic impacts of CBAM, the policy mechanism increases risks regarding the overall sustainable development goals of Egypt. In Egypt's view, the CBAM mechanism does not reflect the agreed principles or established processes within the climate negotiations, which allows for developing countries to benefit from leniency in order to continue their development plans. This leniency takes into consideration that developing economies have historically contributed the least to the increase in carbon emissions. CBAM, while not directly targeting countries, was targeting specific sectors in Egypt and other developing countries.

In 2021, Africa accounted for 3.9 percent of the world's emissions of CO2, with that figure ranging between 3.4% to 3.9% over the last two decades. Consistently, the African continent has contributed the smallest shares of global carbon emissions. The obligations that CBAM places of businesses in developing countries, including Egypt, threaten the development of these economies and consequently threaten the efforts made to increase climate sustainability in these economies.

Additionally, the implementation of CBAM also raises concerns regarding the instability of European energy policies and strategies, which may increase confusion to its trading partners, including Egypt. Rising demand for natural gas from European countries is providing the market with contradicting indications on the policies pursued by the European Commission. This confusion could ultimately impact the ongoing progress achieved by developing countries regarding their energy transition as well the growth of sustainable and alternative energy projects in their economies.

Nonetheless, Egypt may consider CBAM as an opportunity and use it to its advantage. In this regard, Egypt must work on developing climate and development policies and standards, in line with the country's priorities, while maximizing development potential, and increasing competitiveness. To that end, the cooperation between the EU and developing countries on voluntary carbon markets that enable these countries to use carbon credits in reducing emissions, and thus increasing the competitiveness of their products, will be of utmost importance. Furthermore, Egypt must find solutions to localize carbon pricing, turning the challenge of CBAM into an opportunity.

GOE DECARBONIZATION MEASURES

The Government of Egypt (GoE) continues to exert efforts to enhance decarbonization, including the development of the National Climate Change Strategy 2050, the development of renewable energy capacities and green hydrogen production, and the development of a carbon credits framework.

National Climate Change Strategy 2050

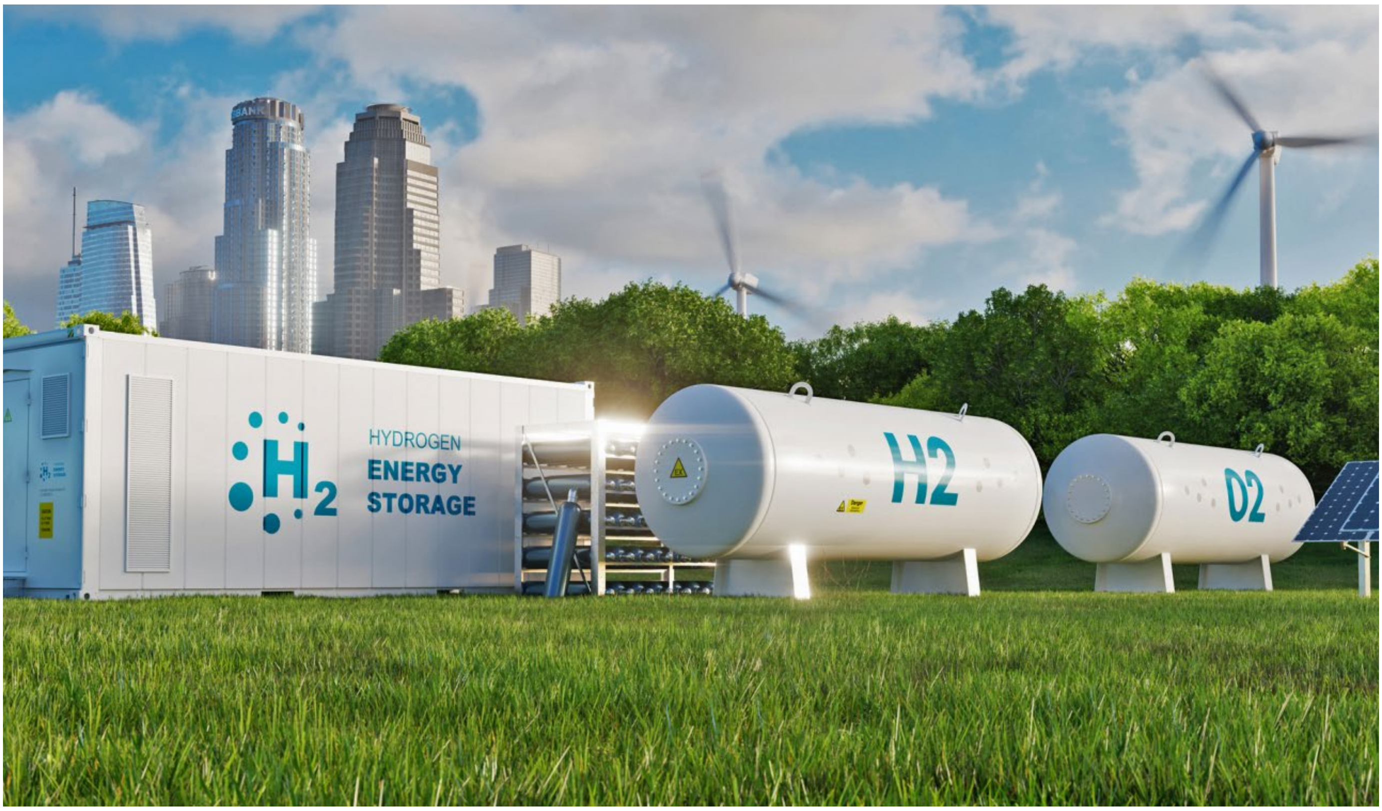
In 2022, the GoE launched its National Climate Change Strategy 2050 to support global climate sustainability efforts and mitigate the climate related risks that threaten the country. This strategy aims to achieve sustainable and low-emission economic growth, while enhancing Egypt's resilience and adaptive capacity to climate through effective climate change action governance and management, as well as the development of climate financing infrastructure.

The strategy outlined 8 strategic goals, including:

1. Ensuring integrated planning between the different public sector strategies,
2. Integrating climate actions into national planning,
3. Integrating sustainability criteria and green recovery into planning and budgeting,
4. Integrating climate adaptation and resilience measures in infrastructure projects,
5. Benefiting from finance opportunities afforded under the United Nations Framework Convention on Climate Change (UNFCCC), the Paris Agreement, and other climate-related sources,
6. Capitalizing on existing infrastructure to implement new climate related projects,
7. Fostering market competition and green job creation,
8. Strengthening international cooperation.

GOE DECARBONIZATION MEASURES

Development of Renewable Energy and Green Hydrogen



Egypt has taken significant steps to support the growth of renewable energy power generation capacities and the development of a low-carbon hydrogen economy. These two sectors, other than being included in the CBAM applicable sectors, are also critical with regard to the decarbonization of other industrial activities.

On renewables, the GoE issued the Renewable Energy Law no. 203/2014, the new Electricity Law no. 87/2015, as well as the Investment Law no. 72/2017 to attract further investments in this sector. Furthermore, the GoE launched the Integrated Sustainable Energy Strategy 2035, which sets an ambitious target of 42% renewable energy in Egypt's power mix by 2035. Additionally, other regulatory measures have also been implemented, such as the development of feed-in-tariffs and the development of net-metering regulations.

On the development of green hydrogen, the GoE is developing a national strategy for the development of low-carbon hydrogen. Additionally, the GoE has taken concrete steps to develop several green hydrogen pilot projects, including signing 9 framework agreements at COP27, at a potential investment of USD 83 billion. Subsequently, the Cabinet of Ministers approved measures to expand the scope of the Investment Law to include green hydrogen projects, as well as approve a draft law to incentivize investments in green hydrogen projects. A National Council for Green Hydrogen, chaired by the Prime Minister, has been formed to oversee Egypt's efforts to develop its hydrogen potential and implement its national strategy, with membership of all concerned public sector entities.

GOE DECARBONIZATION MEASURES

The Development of a Carbon Credits Framework

Egypt continues to develop a carbon credits framework, which will be instrumental in localizing carbon pricing related revenues, instead of "generating carbon related financial profits to the EU. In August 2023, the Financial Regulatory Authority (FRA) issued carbon credit verification and certification standards, an important building block for the development of a carbon credit credits regulatory framework.

Furthermore, the Egyptian Stock Exchange (EGX) announced in 2022 the development of Africa's first voluntary carbon market, which allows companies developing carbon reducing projects to sell certified carbon credits to companies wishing to offset their carbon footprint.

The Enhancement of Carbon Reporting and Testing for Exports

The development of effective and accurate carbon reporting and testing mechanisms is critical for Egypt to mitigate the potential negative implications of CBAM, as well as to implement local carbon pricing schemes. The General Organization for Export and Import Control (GOEIC) is exerting efforts to ensure that Egyptian exports can meet the evolving environmental standards and requirements.

As part of these efforts, GOEIC is working on developing its monitoring laboratories at air, sea, and land ports, including enhancing their infrastructure, equipment, and technical expertise, to ensure that efficient and effective carbon and environmental monitoring and reporting tools are accessible to the Egyptian private sector. Additionally, GOEIC has also established laboratories to examine and test biodegradable plastic products destined for export. These laboratories have obtained an international accreditation. GOEIC is also planning to establish a unit for the issuance of environmental and carbon emission reductions certificates to support carbon credits trading.

POLICY RECOMMENDATIONS

LYNX recommends that the GoE's approach to mitigating the negative impact of CBAM on Egyptian exports to the EU, focus on the following collective measures:

Enhance coordination efforts between GoE and the private sector to assess and seek to mitigate the challenges emanating from CBAM on the targeted sectors. This will enable the GoE authorities to convey industry concerns in discussions with the EU, particularly within the institutional framework for the implementation of the Egypt-EU Association Agreement. This will also allow for the development of tools and mechanisms that help mitigate the negative impacts of CBAM on the Egyptian private sector.

Build consensus among various national stakeholders on CBAM trade related matters. This is a prerequisite for further negotiations with the EU on relevant measures to mitigate the risks on national industries from CBAM. And despite EU claims, the GoE should lead further negotiations and discussions on the relevance of the CBAM in the context of WTO.

Accelerate the development of the carbon credits framework, allowing the carbon emission reduction expenditures to remain in Egypt rather than become a source of revenue for the EU, while meeting the requirements of the new EU regulations.

Enhance carbon emission monitoring and reporting capacities to support the development of a domestic carbon credits framework, as well as support the competitiveness of the Egyptian private sector while exporting to the EU.

Continue supporting the development of renewable energies, green hydrogen, and alternative sustainable fuel sources to support the Egyptian private sector in its decarbonization efforts.

Prioritize emission reductions initiatives in national development planning and strategies, including relevant financial and technical support to green transformation and decarbonization.

Enhance efforts on capacity building, strengthen local green transformation expertise, to enable the Egyptian private sector to implement decarbonization efforts by utilizing local capacities and thus save time and cost.

LYNX

STRATEGIC BUSINESS ADVISORS

info@lynxegypt.com
www.lynxegypt.com

4 Latin America Street, Garden City, Cairo

(+2) 0227944331