



COVID-19, GREEN TRANSITION, NATURAL RESOURCES, SOCIAL PROTECTION

## EU climate tax could benefit oil exporters

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### In energy-intensive sectors, a carbon border tax could shift the geography of investment.

For a **green** coronavirus recovery, an effective global **price** on carbon remains as important as ever before. However, until governments can agree on the severity of the risk posed by climate change, a global tax on greenhouse gas emissions seems a remote prospect. Nonetheless, the “carbon border adjustment mechanism” that the EU is **considering** could have similar effects on capital allocation – albeit on a smaller scale.

The EU's ambitious new climate goals will require emissions reductions not only in the energy sector, but also in energy-intensive sectors such as heavy industries, metals, petrochemicals, cement, and fertilizer. To ensure a level playing field between EU companies and foreign firms not subject to EU emissions targets, the EU may implement a border tax on carbon-intensive imports. The combination of high carbon taxes within the EU and a carbon border tax would present energy-intensive industries with a new set of locational choices.

To reduce emission costs, energy-intensive EU companies could either buy clean energy produced within the EU, import clean energy from elsewhere, or relocate production to regions with abundant low-cost clean-energy resources. Non-EU companies seeking to avoid a border tax on their exports to the EU would similarly need access to local or imported clean energy, or would relocate production to places where low-cost clean energy is available. Companies in sectors that can electrify production would look for access to low-cost, clean electricity. Companies in sectors that are hard to electrify, such as steel, cement, and other sectors requiring high-temperature industrial heat, would seek to locate production in places that produce clean hydrogen at a favourable cost.

Currently, hydrogen is almost entirely produced from fossil fuels, and hydrogen production each year generates CO2 emissions equivalent to those of Indonesia and the United Kingdom combined, according to the **IEA**. However, a sufficiently high price on carbon, or an equivalent EU carbon border tax, would ensure the competitiveness of clean technologies for hydrogen production.

“Green” **hydrogen**, produced by electrolysis with energy from renewable sources, and “blue” hydrogen, produced from natural gas where the resulting CO2 is captured and stored underground, are both part of the EU hydrogen **strategy**. Hydrogen can generate industrial heat beyond what is possible with electricity, and is a means of storing energy. Since it can readily be converted back to electricity, hydrogen can solve the intermittency challenges associated with solar and wind. This is crucial for industrial processes such as the smelting of metals, which depend on a steady supply of energy.

Part of the additional clean energy required to meet EU emissions targets will come from within the EU. European companies could also increase clean-energy imports from outside Europe. However, a substantial increase would face logistical obstacles – at least in the short term. Hydrogen imports expensive to transport, and a significant increase in electricity imports would require the development of new power transmission infrastructure. The outcome could therefore be a combination of clean-energy imports and industry relocation.

For countries with abundant clean energy resources, and access to capital to develop these resources, there would be several implications:

First, there could be a greening of already existing energy-intensive industries. By shifting energy use to clean electricity and clean hydrogen, companies could repurpose existing industrial facilities for the low-carbon economy, thereby avoiding a border tax on exports to the EU.

Second, relocation of energy-intensive companies, to places with low-cost clean energy, could provide these areas with opportunities for industrialisation. That would be particularly relevant for countries that have a reasonably educated workforce, geographic proximity to the European market, and access to sector-specific industrial feedstock. For example, low-carbon petrochemicals will continue to require oil and gas for feedstock, even as companies shift energy use to renewables.

Third, there could be a growing market for the export of clean electricity and clean hydrogen not only to Europe, but also to supply energy-intensive companies elsewhere in the world that wish to export to the European market.

Oil and gas-exporting countries in the Middle East could be beneficiaries of a price on carbon, for several reasons. These countries have some of the best solar energy resources in the world, access to capital, as well as sizeable petrochemical, metals, and fertilizer sectors. If applying carbon capture and storage, companies in the region might produce more “**blue**” **hydrogen** from natural gas, or they could produce “green” hydrogen with electricity from local renewable energy sources – which for now remains more expensive. By converting to clean energy, the region's energy-intensive industries could produce low-carbon final products – for example petrochemicals, steel, aluminium, and fertilizer – which may trade without being affected by a carbon border tax.

Several countries in the region have struggled to establish a non-oil private sector able to compete in export markets, and have found it challenging to attract foreign direct investment outside industries based on oil and gas. The region's low cost clean energy could present opportunities for low-carbon industrialisation and exports, based on new comparative advantage.

Many countries that rely on fossil fuels are rightly concerned about the economic and fiscal implications of the clean-energy transition. The precipitous fall in demand resulting from the COVID-19 pandemic has exacerbated such concerns. Predictions about the effects of carbon pricing on these economies are subject to uncertainties about future costs and viability of new technologies, and about the role of oil and gas. Future costs of transporting energy and final products will also play a role, as could potential retaliatory measures to a border tax. Nonetheless, fossil fuel-exporting countries with clean energy resources may find it in their interest to consider potential positive effects of a price on carbon, as well as the negative ones.

This blog was previously published in *Le Monde*, [click here to read it](#).

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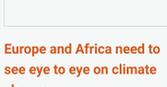


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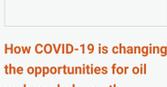
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