The Cambridge Security Initiative

RUSSIAN ECONOMY UNPREPARED FOR EU CARBON TAX SHOCKS

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Nearly 50 per cent of Russia's state revenue is from fossil-fuel exports, but a European Union (EU) carbon border tax (CBT) proposal could stop a third of those by 2030. A CBT would aim to end competitive advantages enjoyed by exporters offering cheaper goods that do not include pollution-reduction costs. Since Russian finished exports have the world's second-highest in-built CO_2 emissions, any CBT stands to cause significant economic shocks in Russia.

Carbon, in every sense, is a growing security threat to Russia, with renewables now economically viable, de-carbonisation costs dropping, divestment increasing, and America set to overtake Russia and Saudi Arabia in oil exports by 2025. Producers with decaying extraction infrastructure, like Russia, face further problems because 're-gas' tankers are allowing more countries to benefit from global liquid natural gas (LNG) markets. As a result, producers seek to extract as much as possible, which drops prices further—something Russia is already experiencing, but also exploiting in order to damage the rival U.S. energy sector.

While the Russian presidential adviser on climate change believes the CBT would actually be a good trigger for needed Russian reforms, Moscow recently announced more tax breaks for fossil fuels. Russia is three years away from 'peak oil' in existing fields, yet has no coherent strategy to diversify its energy sector. In fact, its 2019 energy security doctrine identifies global de-carbonisation/'greening' trends and U.S.-led sanctions (blocking Russian access to foreign investment and technology) as top threats. The country has ratified the Paris Agreement on climate change but largely to set itself apart from America's withdrawal from it. Russia has not committed to emissions cuts, in fact lately dropping plans for voluntary targets and fines, after industry lobbying. Meanwhile, infrastructure and other costs from record floods, forest fires, and permafrost melt linked to climate change are already hundreds of billions of roubles a year.

OUTLOOK

All 27 EU member-states and the European Parliament must approve any CBT proposal; challenging, since previous efforts to agree unanimously on tax issues have failed. Expect Russia to both lobby openly and act covertly to block, or at least delay, approval—mainly by targeting countries 'softer' on Russia. It will also keep undermining shale and other alternative energy sources, and relying on corruption to keep export markets 'stable'. Russia will keep seeking longer-term supply contracts to tie in customers and keep out renewables.

Should a CBT come into force, it could well resemble an import tax: Russian exporters will have to buy EU carbon allowances, increasing product prices and making EU goods more competitive. Critics point out that such an approach would break World Trade Organization (WTO) rules forbidding discrimination between domestic and foreign producers. One indicator that the EU may favour this approach, once public consultations end late this year, is that officials are already working on an adjustment mechanism to align an EU CBT with WTO rules.