



**The Coalition
of Finance Ministers
for Climate Action**

How low- and middle-income countries can prepare for carbon border adjustment mechanisms: emerging analytical support available for Ministries of Finance

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**A contribution to the 'Compendium of Practice from a Global Community of Ministries
of Finance and Leading Organizations: Economic analysis and modeling tools to assist
Ministries of Finance in driving green and resilient transitions'**

Topic: Addressing the climate policy questions facing Ministries of Finance:
the economic and fiscal impacts the green transition

June 2025

Access the full Compendium at www.greenandresilienteconomics.org

This contribution was prepared at the request of, and with guidance from, the Ministry of Finance of Denmark as Lead of the Coalition's Helsinki Principle 4 initiative 'Economic Analysis for Green and Resilient Transitions' and its Steering Group, with input from its Technical Advisory Group. The views, findings, interpretations, and conclusions expressed are those of the authors. While many Coalition members and partners may support the general thrust of the arguments, findings, and recommendations made in this contribution, it does not necessarily reflect the views of the Coalition, its members, or the affiliations of the authors, nor does it represent an endorsement of any of the views expressed herein by any individual member of the Coalition.

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Starting in 2026, the European Union's Carbon Border Adjustment Mechanism (CBAM) will impose a levy on imported non-EU products that adjusts for the differences between the EU Emission Trading System (ETS) carbon price and the carbon price paid in the producing countries. Governments around the world are trying to understand how the CBAM will impact their exports and what policy responses they should take to mitigate potential negative effects. Importantly, the CBAM has also generated renewed interest in domestic carbon pricing and markets, for their potential to reduce tariff exposure and support domestic resource mobilization and the green transition.

Yet many Ministries of Finance, particularly in low- and middle-income countries (LMICs), do not have clear models or information on how CBAM and other carbon pricing mechanisms will affect their economies, or what possible policy responses are and their likely benefits and costs. Global climate, tax, and trade experts Kimberly Clausing and Catherine Wolfram, together with the African Tax Institute, the Climate Action Platform for Africa, and the Jameel Poverty Action Lab, are building an informal community of practice bringing together LMIC governments, researchers, and policy experts to share knowledge and experience that can help LMICs prepare for the oncoming CBAM and generate models and analysis that support them in designing effective policy responses.

For example, Clausing and Wolfram are working with the UK's International Growth Centre and the Government of Mozambique to more accurately model the likely impacts of the EU CBAM on their aluminum exports and to estimate the benefits and costs of different policy options in response. Using data from aluminum smelters throughout the world, their research will consider how the EU CBAM will impact countries' comparative advantage and the resulting trade patterns. Under some scenarios, green exporters may gain from CBAMs and carbon pricing, since the European price may increase by more than the levy, whereas other exporters may face costs associated with reorienting their trade toward other markets (if the levy exceeds the green price premium). Countries such as Mozambique will have incentives to decarbonize their production and to adopt complementary policies. Such policy responses could include carbon pricing regimes of different scopes, efforts to spur decarbonization in CBAM-impacted industries (such as aluminum) and accompanying complementary tax policies.

Developing countries are projected to bear higher costs of climate change despite having lower emissions, and they often lack sufficient fiscal space to undertake significant mitigation efforts. Countries designing CBAMs should consider incorporating measures that limit their potential negative effects on low-income countries, whether exempting the lowest-income countries (who emit very little) from tariffs and/or setting tiered carbon tariff floors that are lower for low-income countries.

There are already signs that the EU's approach is increasing other countries' climate ambitions, with Australia, Canada, Japan, and the UK considering similar border adjustments. To prepare for the EU and other potential CBAMs, MoFs should:

1. Analyze their exposure to oncoming tariffs using models that incorporate general equilibrium effects (e.g., price changes in commodities regulated by CBAM), the potential for market shifting, and their relative competitiveness under CBAM compared with other countries
2. Model the benefits and costs of a range of policy responses such as greening industry and domestic carbon pricing as a source of new revenue that can also reduce tariff exposure, and proactively pursue the policy mix that best meets their economic and climate goals
3. Build domestic carbon monitoring and reporting systems to avoid getting assigned a default carbon intensity by the EU, particularly in countries with a greener production and/or energy mix. Some countries may find the CBAM opens up new opportunities rather than imposing costs.

Government agencies interested in joining the community of practice should contact Claire Walsh (cwalsh@povertyactionlab.org).

Further reading

Clausing, Kimberly A., and Catherine Wolfram (2023) Carbon Border Adjustments, Climate Clubs, and Subsidy Races when Climate Policies Vary. *Journal of Economic Perspectives* 37(3), 137–162.

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