Policy Brief: Carbon tax or carbon trap? India's fight to control its green transition

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Executive Summary

The European Union (EU) and India currently navigate a critical moment in which their geopolitical and economic strategies must align to successfully address climate change. India's foreign policy is guided by the fundamental principle of strategic autonomy, ensuring it will not be coerced into positions that compromise its interests. While India actively seeks a deeper partnership with Europe for technology transfer, diversified capital, and resilient supply chains, this relationship is being tested by a single, complex mechanism: the Carbon Border Adjustment Mechanism (CBAM). Europe is hoping that India will align with its green standards, but CBAM continues to be perceived as a trade barrier disguised as climate action.

India's perspective on CBAM

For the EU, CBAM is an attempt to prevent carbon leakage and promote cleaner global manufacturing by imposing a carbon tariff on imports from Emissions-Intensive-Trade-Exposed (EITE) sectors, including iron and steel, cement, aluminium, and fertilisers. However, from India's perspective, the mechanism appears discriminatory and unfair. Indian industry argues that the measure overlooks the principle of "Common but Differentiated Responsibilities" (CBDR), imposing the same carbon cost universally regardless of a country's development status or existing climate commitments.

While India's overall exposure to CBAM-affected exports accounts for only 0.2% of its GDP, the impact is highly concentrated. The iron and steel sector alone constitutes 90% of these exports to the EU, making this specific industrial backbone particularly vulnerable. The central friction is not environmental – it is about economic sovereignty and the collection of tax revenue. If India were to impose no domestic carbon pricing, the revenue from the carbon tax would accrue entirely to the EU. This potential outflow could reduce India's GDP by 0.02 to 0.03% between 2026 and 2030. For a developing economy striving to lift millions out of poverty, every fraction of GDP growth is significant.

Adding to this challenge is the vast price gap: The EU's carbon price typically averages €60–€80 per tonne, while India's indicative domestic price sits around €5–€10 per tonne. This disparity may prevent meaningful deductions, leaving Indian exporters disadvantaged and uncompetitive.

How India is responding

India's chosen response to CBAM follows a clear strategic principle: It will not compromise domestic development or surrender tax collection rights. This approach has led to the development of a domestic carbon pricing mechanism, initiated by India to retain control over its fiscal and development trajectory. The optimal policy response involves implementing a domestic carbon tax. This step reduces adverse effects on GDP and household income while allowing India to technically comply with CBAM by starting with a lower tax rate, consistent with its status as a developing country.

By imposing this moderate domestic tax, India shifts the financial flow and ensures revenue retention:

- In scenarios involving domestic carbon pricing alone, India could generate carbon tax revenue equivalent to about 1% of its GDP by 2030;
- Even in a hybrid model where rates are halved and revenue is split, India retains revenue equivalent to 0.5% of its GDP.

This revenue is critical because it stays in India rather than flowing to Brussels. It can be recycled to subsidise the greening of the economy or redistributed to affected industries and households.

India is already preparing the ground through the proposed Carbon Credit Trading Scheme (CCTS). Implementing a robust CCTS will enable Indian businesses to demonstrate low-carbon manufacturing processes, thereby attracting lower CBAM charges. Crucially, the CBAM challenge is being framed as something bigger: A catalyst for India to accelerate its net-zero transition on its own terms.
Carbon pricing incentivises cleaner production, and analysis shows that, while carbon-intensive industries decline, non-CBAM sectors – such as renewable electricity exports – increase, coinciding with India's massive domestic expansion of clean power (India has reached 235.7 GW of non-fossil fuel capacity as of June 2025).

Utilising the TTC to reduce friction

If Europe wishes to convert its economic weight into strategic influence with India, it must engage with the logic of India's autonomy. The EU must recognise that India's balancing act is a feature rather than a flaw of its strategy. For the partnership to work, Europe must move beyond declarations to concrete deliverables. The EU–India Trade and Technology Council (TTC) provides the institutional platform, but it must deliver substance, particularly focusing on areas of strategic wiring, such as clean-tech supply chains and trusted digital standards, which cannot be disrupted by political "noise".

Recent Indian statements suggest a set of priorities centred on clear recognition and institutional safeguards. These priorities can be grouped as follows:

- Aligning standards: Europe must provide technical assistance and policy guidance to help align India's CCTS with CBAM verification standards;
- Reducing trade friction: Drawing on India–EU experience with Mutual Recognition Agreements (MRAs) in highly-regulated sectors such as pharmaceuticals and medical devices, extend similar cooperation to conformity assessment and carbon-reporting in CBAM-covered industries like steel and aluminium, so that Indian exporters are not subject to duplicate testing and certification;
- Institutionalising transparency: A dedicated India–EU Climate and Trade Working Group under the Free Trade Agreement (FTA) negotiations to ensure transparency on CBAM's implementation;
- Ensuring fairness: Negotiate a "rebalancing mechanism" (similar to those considered in other agreements) that would allow India to seek compensation or adjustment if future EU climate measures significantly undermine the benefits of the trade deal.

The conflict is not about India's refusal to engage in climate action, as India is already one of the few major economies on track to meet its Paris Agreement commitments. The issue centres on how climate action gets implemented and who controls the policy process.

By supporting India's domestic carbon mechanisms and recognising its development priorities, the EU can ensure that CBAM acts as a true environmental incentive rather than an economic tariff. The broader focus should be on building resilient value chains together, and the objectives align: Europe requires diversified supply chains that are not entirely dependent on China, and India needs access to technology and capital to accelerate its industrial transition. However, this requires a partnership that respects India's strategic autonomy and recognises that engagement must be voluntary, reciprocal, and on equal terms.

Ways forward

Success in this partnership requires Europe to recognise that India operates differently: It possesses scale, ambition, and options. India will engage with CBAM, but only on terms that protect its economic sovereignty and development trajectory. The TTC framework must also deliver tangible results: This requires MRAs that reduce trade friction, technology partnerships, and transparent mechanisms that ensure climate measures do not become disguised protectionism.

For India, the challenge is to demonstrate that its domestic carbon pricing mechanisms are robust, transparent, and genuinely driving decarbonisation. This builds credibility, strengthens the case against punitive tariffs on Indian exports, and positions India as a responsible stakeholder in global climate action while maintaining control over its own economic policy. The EU–India relationship will ultimately be defined not by how well India aligns with European priorities, but by whether both sides can build a framework that respects autonomy while advancing shared goals. Europe's green transition imperative meets India's strategic autonomy, and the space between them is where a genuine partnership can be built.

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