

The EU Carbon Border Adjustment Mechanism (CBAM)

Overview

In 2023, the European Union adopted the Carbon Border Adjustment Mechanism (CBAM) as part of its Emissions Trading System (ETS) and the EU Fit for 55 package.¹ This strategy aims to achieve a 55% reduction in emissions by 2023, compared to the 1990 levels. Since the introduction of the ETS, carbon prices from EU-produced goods have become more expensive, increasing the risk of carbon leakage, or the relocation of customers to countries with lower emission reduction requirements.² CBAM puts a fair price on the production of carbon intensive goods from import countries by equalizing the price of goods imported into the EU and EU domestic products to reduce the risk of carbon leakage and Green House Gas emissions. The goal is to level the playing field for EU producers and EU importers while encouraging cleaner production. This also ensures that the EU's climate objectives stay at the forefront of this policy.³

Transitional Phase (2023-2026)

While CBAM was adopted in May 2023, the transitional period officially began in October and will last until 2026. The transitional phase allows for the gradual introduction of regulations for import countries and a smooth process for the EU. CBAM will apply to all entities that import goods into the EU. While the list is set to expand in the coming years, it first targets goods with the highest risk of carbon leakage including iron and steel, cement, fertilizers, aluminum, electricity, and hydrogen. Starting January 31, 2024 companies must submit quarterly reporting requirements. Until 2025 there is some lenience on the specifics of these reports however, each report must include the total energy use, the embedded emissions, the

country of origin, and the carbon price paid in the country of origin for the emissions contained in those goods. Additionally, importers must require their manufacturers to provide independently verified information on these embedded emissions.⁴ The transitional phase is meant to serve as a time for companies to adjust to these regulations and comply with the requirements of CBAM.

Future and Post 2026

CBAM will enter the 'definitive phase' in 2026, where only registered declarants will be allowed to import CBAM goods. For companies to import goods, several criteria need to be approved. This is done to ensure that all companies adhere to CBAM regulations. Quarterly reporting obligations will become annual and yearly reports will be due beginning May 31, 2027, for the year prior.⁵

Possible Downfalls

If not all organizations are aware of how CBAM will affect them, there could be a slight shift in the effectiveness of international trade. It is unclear if CBAM will benefit different regions of the world and successfully reduce carbon emissions globally. If not implemented properly, opponents argue that instead of lowering carbon emissions, CBAM will increase carbon leaking and decline the efficiency of the global market.⁶ However, so far, the slow implementation of CBAM allows companies to adjust accordingly. In a global sense, CBAM is also an incentive to drive decarbonization technologies⁷. Several other countries such as the US, and the UK plan to implement their own carbon border adjustment. The EU's CBAM plan, along with support from other countries can prove to be a lasting change in trade and decarbonization.⁸