



# CBAM

## The EU's Solution to Carbon Challenges

Climate change is one of the most critical issues of our time, influencing economies, ecosystems, and societies across the globe. As a response, nations and regions are implementing strategies to limit greenhouse gas emissions and drive a transition toward sustainability. Among these, the European Union's (EU) Carbon Border Adjustment Mechanism (CBAM) stands out as a robust measure to address carbon leakage, incentivize global decarbonization, and ensure fair competition. More than just a policy, CBAM represents the EU's commitment to extending its environmental standards globally.

This article details the design and objectives of CBAM, its connection to the EU Emissions Trading System (ETS), its role in addressing carbon leakage, and the timeline for its implementation. It also highlights the opportunities and challenges CBAM presents for businesses and policymakers.

### What is CBAM?

CBAM, governed by Regulation (EU) 2023/956, introduces a carbon price on specific imported goods, aligning the cost of imported products with their greenhouse gas (GHG) emissions during production. Initially focusing on carbon-intensive industries like steel, cement, aluminum, hydrogen, fertilizers, and electricity, CBAM targets sectors integral to global supply chains but often associated with high energy consumption and emissions.

At its core, **CBAM serves as both a regulatory framework and an incentive system to promote cleaner production methods.** Its objectives include:

1. **Preventing Carbon Leakage:** As the EU tightens climate regulations and increases carbon costs for domestic industries, there is a risk that businesses may relocate production to countries with less stringent environmental rules. This relocation, known as carbon leakage, undermines global climate goals. CBAM addresses this issue by ensuring that imports face equivalent carbon costs to those borne by EU manufacturers.
2. **Encouraging Global Decarbonization:** By imposing carbon costs on imports, CBAM motivates producers outside the EU to adopt cleaner technologies and practices. This creates a ripple effect, potentially influencing global supply chains to prioritize sustainability.
3. **Creating a Level Playing Field:** CBAM eliminates the unfair pricing advantage that goods from regions with weaker environmental policies might otherwise have. EU manufacturers, who already bear the costs of carbon pricing under the ETS, can compete on an equal footing with imports.
4. **Driving Innovation in Low-Carbon Solutions:** The financial implications of CBAM incentivize industries to invest in greener technologies, fostering innovation across sectors. This aligns with broader goals of achieving net-zero emissions and advancing sustainable development.

### The Relationship Between CBAM and the EU ETS

CBAM is closely tied to the EU ETS, the cornerstone of the EU's carbon pricing framework introduced almost 20 years ago, in 2005. The ETS operates under a "cap-and-trade" principle, setting a cap on total emissions for key sectors, including power generation and heavy industries. Companies within these sectors are allocated emission allowances, which they can trade depending on their actual emissions.

While the ETS has proven effective in reducing emissions within the EU, it does not account for the emissions embedded in imported goods. This limitation exposes EU industries to competition from carbon-intensive imports, undermining the ETS's impact. **CBAM addresses this gap by aligning the carbon costs of imported products with the ETS allowance prices.**

**Importers under CBAM must purchase certificates corresponding to the embedded emissions of their goods. The price of these certificates is directly linked to the ETS,** ensuring consistency in carbon pricing across domestic and imported products. This integration not only strengthens the ETS but also creates a unified framework to support decarbonization efforts within and beyond the EU.

### The Necessity of CBAM

The implementation of CBAM reflects the EU's broader climate ambitions, which include achieving net-zero emissions by 2050. However, ambitious climate policies come with risks. Without CBAM, the EU's stricter regulations could inadvertently disadvantage its industries, leading to economic losses and higher global emissions.

**CBAM addresses the following Key Challenges:**

1. **Limiting Production Relocation:** Carbon leakage occurs when businesses shift production to countries with weaker environmental policies to avoid carbon costs. This relocation undermines domestic industries and global climate goals. CBAM prevents this by equalizing the cost structure between EU and non-EU producers.



2. **Reinforcing Global Climate Leadership:** By encouraging non-EU producers to adopt greener practices, CBAM extends the EU's influence in climate action. It aligns with the Paris Agreement's objectives, fostering global collaboration toward emission reductions.
3. **Boosting Domestic Competitiveness:** CBAM protects EU industries from unfair competition posed by cheaper imports produced under less stringent environmental standards. This protection enables EU manufacturers to remain competitive while adhering to high sustainability benchmarks.
4. **Accelerating Green Investments:** The financial implications of CBAM encourage industries to invest in cleaner technologies and processes. This not only supports the EU's green transition but also positions businesses as leaders in the global push for sustainability.

## How CBAM Works: A Phased Implementation

CBAM's introduction is designed to ensure a gradual transition for industries and stakeholders. **The mechanism's rollout includes three key phases:**

1. **Transitional Phase (October 2023 – December 2025):** during this phase, importers must report the emissions embedded in their goods but are not required to purchase CBAM certificates. This period allows stakeholders to familiarize themselves with reporting requirements and refine methodologies for calculating emissions. Transparency and data collection are prioritized.
2. **Full Implementation (Starting January 2026):** from 2026, CBAM will require importers to purchase certificates reflecting the embedded emissions of their goods. The cost of these certificates will align with ETS allowance prices, ensuring consistency in carbon pricing.
3. **Phase-Out of Free Allowances (2026–2034):** CBAM will coincide with a gradual reduction in free allowances under the ETS. By phasing out these allowances, the EU ensures that industries covered by CBAM are treated equitably, without compromising environmental integrity.

This phased approach reflects the EU's commitment to balancing environmental goals with economic realities. It provides industries with the time needed to adapt while maintaining momentum toward decarbonization.

## Challenges and Considerations

While CBAM represents a significant step forward, its implementation poses challenges for businesses and policymakers.

### For Industries:

- **Data Collection and Reporting:** companies must accurately measure and report the emissions embedded in their products according to CBAM regulation. This requires engagement with suppliers, investment in emissions monitoring systems, and collaboration with third-party verifiers.
- **Financial Implications:** the cost of CBAM certificates will impact importers, particularly those relying on carbon-intensive supply chains. Industries must assess and adapt their procurement strategies to mitigate these costs.
- **Supply Chain Transparency:** CBAM necessitates a clear understanding of supply chain emissions, encouraging businesses to prioritize transparency and sustainability in their operations.

### For Policymakers:

- **International Cooperation:** aligning CBAM with World Trade Organization (WTO) rules and addressing potential trade disputes will require ongoing dialogue with global partners.
- **Technical Challenges:** policymakers must ensure that CBAM's implementation is seamless and minimizes administrative burdens for stakeholders.

## Opportunities for Businesses

CBAM can be seen not just like a regulatory requirement, but also as an opportunity for businesses to lead in the green transition. Companies that proactively reduce emissions and adopt sustainable practices will benefit in several ways:

- **Competitive Advantage:** businesses that invest in cleaner technologies can position themselves as market leaders, gaining an edge over competitors with carbon-intensive operations.
- **Access to New Markets:** adhering to CBAM standards can open doors to environmentally conscious markets, enhancing brand reputation and customer trust.
- **Long-Term Savings:** while the initial costs of adopting greener technologies may be high, they often lead to significant long-term savings through improved efficiency and reduced carbon costs.

## A Broader Vision

CBAM is a cornerstone of the EU's strategy to combat climate change. By extending carbon pricing beyond its borders, it reinforces the EU's commitment to a sustainable future while fostering global collaboration. As CBAM evolves, it is likely to influence climate policies worldwide, encouraging other regions to adopt similar mechanisms or align with the EU's standards.

For businesses, CBAM underscores the importance of integrating sustainability into core operations. Those that embrace the green transition will not only comply with the mechanism but also thrive in a low-carbon economy.

In conclusion, CBAM exemplifies the EU's ability to balance environmental responsibility with economic resilience. By addressing carbon leakage, promoting fair competition, and encouraging global emission reductions, CBAM sets a precedent for climate policy in the 21st century. As the world grapples with the urgency of climate change, mechanisms like CBAM offer practical solutions to foster a sustainable, competitive, and decarbonized global economy. ■

