

The [European Union](#) is fast-tracking the road to a **greener future** as EU institutions reach provisional agreements on the Carbon Border Adjustment Mechanism (“CBAM”) and the EU Emissions Trading System (“ETS”). After round-the-clock negotiations between EU officials, the “Fit for 55” legislative package with the ultimate goal of reaching carbon neutrality by **2050** is now being finalized. What are the implications for non-EU countries?

EU's Climate Action

Recognizing the threats of climate change, the European Union adopted a range of **climate laws**, which includes the ETS and the [CBAM](#), as part of the revolutionary “Fit for 55” legislative package. In contrast to the Emissions Trading System, a directive only EU member states have implemented since 2005, CBAM is extraordinary as it also concerns countries outside the EU's borders. Following the implementation of the ETS, which established strict emissions trading rules within the EU, the phenomenon of “carbon leakage” became evident - companies moved their production outside the EU to avoid paying the carbon price.

The CBAM emerged in response to this occurrence and will impose a levy on **CO2 emissions** embedded in goods imported into the EU single market. Other than this, its primary role is to establish, on paper, a level playing field, foster competition, and create a “polluter pays” principle across the board. In this respect, the [ETS](#) and CBAM are two complementing systems, working hand in hand.

CBAM is likely to create a tectonic shift in international trade with far-reaching implications for businesses and economies worldwide, especially developing countries that rely heavily on exports to the EU. Unless they adapt, they fear facing significant challenges, including a less favorable competitive position of their products in the EU internal market, which may significantly affect their overall economies.

Adoption Process

Due to its importance, **potential clashes** with international trade rules, and disagreements between EU member states, the adoption of CBAM could have been more routine and straightforward. Nevertheless, despite the delay, geopolitical events, and numerous challenges this revolutionary climate regulation brings, it is finally here to stay.

The EU Commission presented its proposal for CBAM Regulation on 14 July 2021. and the EU Council reached a general approach to the proposed regulation on 15 March 2022. The fact that the EU Parliament voted its position from the second attempt on 22 June 2022 after the vote resulted in a fiasco, the plenary session speaks volumes about the rocky road of legislative procedure. Trilogue negotiations between the co-legislators started on 11 July

2022. They ended on 13 December 2022, when the EU Council and the **EU Parliament** reached provisional agreements on the CBAM and ETS. The provisional agreement must get approval from the representatives of the EU governments and the EU Parliament's environment committee meeting in January 2023 before being finally approved by the EU Council and the EU Parliament.

CBAM Scope

CBAM will initially cover a range of specific products imported into the customs territory of the EU in some of the most carbon-intensive sectors: Iron and steel, including a limited number of downstream products such as screws, bolts, and nuts (i.e., products that consist of 100% metal), cement, fertilizers, aluminum, electricity, hydrogen, and precursors (i.e., agglomerated iron ores, ferromanganese, ferronickel, ferrochromium, kaolinite, and other kaolinite clays).

The price of CBAM certificates will be calculated based on embedded emissions, but the scope will be extended to indirect emissions under certain conditions. Compared to the earlier proposals of the EU Commission and the EU Parliament, it is noticeable that certain goods remained outside the scope of CBAM. Still, the scope has now added hydrogen, indirect emissions, downstream products, and precursors. The scope of **CBAM** will be assessed before the end of the transitional period. It may then expand to products such as organic chemicals and polymers, with the overall aim for the scope to include all goods covered under the EU ETS by 2030.

CBAM Entry into Force

CBAM will start to apply as early as October 2023, with a transitional period that will last until the end of 2025. During this period, importers will not be obliged to pay the CO₂ levy. They will receive free CBAM certificates, but they must report their **CO₂ emissions** to the competent EU authority. After the transitional period between 2026 and 2034, free CBAM certificates will gradually phase out, with purchased certificates representing a more significant share each year. Finally, after 2034, CBAM will be fully implemented as there will be no free CBAM certificates, and everyone operating in the EU will have to pay for the CO₂ emissions embedded in imported goods.

CBAM Chain Reaction

So now it is up to the EU's global trading partners to take the necessary steps. The CBAM import levy will apply in proportion to the carbon price already paid in the country of origin. In other words, there will be no double charging.

Therefore, the EU's trading partners must decide whether to pay CBAM or establish

their own carbon pricing system.

In this sense, CBAM is also a unique mechanism that aims to encourage countries to introduce carbon pricing systems like the ETS. In this regard, the EU's CBAM should create a chain reaction, where national CBAMs will ensue, and the original CBAM will become the "golden standard" for international green trade.

What to expect?

CBAM will have substantial ramifications for businesses and economies throughout the world. Companies must make strategic decisions such as reducing emissions, switching to green technology, and carbon offsetting and include these considerations along their supply chains.

The economies of the [Western Balkans](#) are likely to be among the most affected, as more than 80% of the region's exports are to the EU, with significant exposure in the directly affected sectors. One major change is that in the transitional period (October 2023 - December 2025), impacted companies will have to measure, monitor, and report their CO₂ emissions. This provision means that businesses must prepare by building effective mechanisms for measuring their emissions well in advance to gather accurate data and submit their reports.

After the transitional period, companies will have to start buying a part of CBAM certificates, whereby one CBAM certificate is equivalent to one ton of emitted CO₂. The price of one CBAM certificate will equal the price of one ETS allowance, which currently amounts to EUR 85. Due to ambitious **climate goals**, this price is likely to increase further in the coming years.

For companies worldwide, this will translate into additional costs for their businesses. Companies will face multiple fines if they avoid paying the carbon price and continue selling their products to the EU market. Repeated violations may result in a complete ban on imports.

In conclusion...

CBAM is likely to contribute to a broader battle to reduce the effects of **climate change**. Still, it will bring numerous challenges in international trade, especially in terms of compliance with the rules of this unique regulation. There is a low level of awareness amongst governments and businesses of the critical changes that are about to take place, and they need to prepare to face the **challenges ahead**. The adaptation needs to be swift, as there is little time left.

There is, however, a system of checks and balances in place. Following the transitional period, the EU Commission will conduct a thorough and complete analysis of CBAM's

progress in international negotiations on [climate change](#) and the impact on developing countries' exports. Nevertheless, the **transition** to carbon neutrality continues, and CBAM will be integral to the overall formula.

Source: [CEE Legal Matters](#)