



The Carbon Border Adjustment Mechanism (CBAM) faces several issues and challenges, both legal and practical

Authors: Kenneth Tombs, Chair; Rafael Molho, Deputy Chair; Supply Chain Business Council

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What is CBAM?

The EU's Carbon Border Adjustment Mechanism (CBAM) aims to ensure an equitable approach to imports, by ensuring importers into the EU pay a price for carbon emissions, equivalent to that paid by EU producers. CBAM phases in from 2023-2025, with full implementation by 2026. Initially targeting carbon-intensive goods like cement, iron, steel, aluminium, fertilizers, electricity, and hydrogen, importers must report emissions and eventually purchase CBAM certificates. This measure aligns with the EU Emissions Trading System and supports global decarbonisation efforts.

Summary

From the perspective of smaller businesses, the introduction of CBAM presents both challenges and opportunities. Here we summarise our conclusions:

Challenges:

1. Increased Compliance Costs

Smaller businesses may face significant financial and administrative burdens in complying with CBAM regulations. The need to measure, report, and verify the carbon content of their products can be costly and resource-intensive. This could be particularly challenging for businesses with limited budgets and personnel (SAIS Review) (MDPI).

2. Competitive Disadvantages:

Small businesses often lack the economies of scale that larger corporations possess. The additional costs imposed by CBAM could make it harder for them to compete, both within the EU and in international markets. This might lead to reduced market share and profitability for smaller firms (SAIS Review) (MDPI).

3. Complex Supply Chains:

Many small businesses rely on complex and often global supply chains. Ensuring that all parts of the supply chain comply with CBAM requirements can be daunting. This complexity can lead to higher operational costs and logistical challenges (MDPI).

4. Increased Trade Costs:

CBAM will likely increase the cost of exporting goods to the EU for countries with less stringent climate policies. This is because exporters will need to purchase CBAM certificates, reflecting the carbon price paid by EU producers (CSEP) (MDPI).

5. Shift in Global Trade Patterns:

Countries with higher carbon footprints in their production processes might see a decrease in their exports to the EU. Conversely, countries with lower carbon emissions may gain a competitive edge in the EU market (SAIS Review) (MDPI).

6. Incentives for Greener Practices:

CBAM may incentivise non-EU countries to adopt greener technologies and stricter environmental regulations to maintain access to the EU market. This could lead to a global push towards more sustainable production methods (CSIS) (Cato Institute).

7. Potential Trade Disputes:

The implementation of CBAM could trigger trade disputes and retaliatory measures from countries that view it as a protectionist measure. These disputes may escalate within international trade forums like the World Trade Organization (WTO) (SAIS Review) (MDPI).

8. Impact on Developing Economies:

Developing economies, which often rely on carbon-intensive industries, may be disproportionately affected. They might face significant economic challenges in adapting to the new requirements, potentially leading to decreased exports and economic hardship (SAIS Review) (MDPI).

Opportunities:

1. Market Differentiation:

Compliance with CBAM could provide smaller businesses with a unique selling point, particularly in markets where consumers are increasingly environmentally conscious. By showcasing their commitment to sustainability, small businesses can differentiate themselves from competitors (SAIS Review).

2. Innovation Incentives:

The need to reduce carbon emissions could drive innovation within smaller businesses. Investing in green technologies and sustainable practices can lead to long-term cost savings and open new business opportunities. Early adopters of such practices may also benefit from potential government incentives and subsidies (MDPI).

3. Enhanced Supply Chain Relationships:

The need for greater collaboration and transparency in supply chains can strengthen relationships with suppliers and customers. By working closely with partners to meet CBAM requirements, smaller businesses can build more resilient and sustainable supply chains (SAIS Review).

Strategic Responses:

1. Leveraging Support Programs:

Small businesses should actively seek out support programs and funding opportunities offered by their governments and industry associations, to ease the transition to CBAM compliance. These programs can provide financial assistance, technical support, and training (MDPI).

2. Collaborative Approaches:

Forming alliances and cooperatives with other smaller businesses can help share the costs and resources needed to comply with CBAM. Collaborative approaches can also amplify their collective bargaining power and influence in public policy discussions (SAIS Review).

3. Incremental Implementation:

4. Implementing CBAM compliance measures in phases helps manage costs and reduce the up-front and immediate financial impacts. Small businesses should start with their most critical areas, and gradually expand their efforts as they adapt to the new requirements (SAIS Review) (MDPI).

In summary, while CBAM poses significant challenges for smaller businesses, it also offers opportunities for innovation, market differentiation, and stronger supply chain relationships. By leveraging support programs, adopting collaborative approaches, and implementing changes incrementally, smaller businesses can navigate the complexities of CBAM and potentially gain competitive advantages.

The Carbon Border Adjustment Mechanism (CBAM) faces challenges, both legal and practical.

- 1. Trade and Legal Disputes:** CBAM's compatibility with World Trade Organization (WTO) rules is contentious. It risks becoming a protectionist trade measure, potentially violating principles of Most-Favoured-Nation Treatment and National Treatment. The mechanism's reliance on embedded emissions calculations and free allowances for EU producers complicates its alignment with WTO rules (CSEP) (Cato Institute).
- 2. Equity and Fairness:** Developing countries argue that CBAM disproportionately affects them, as they have less capacity to invest in clean technologies compared to wealthier nations. This disparity could hinder their competitiveness and economic development (SAIS Review). Additionally, CBAM's focus on carbon pricing does not account for other significant emissions reduction efforts, such as renewable energy investments (SAIS Review).
- 3. Implementation Challenges:** Ensuring accurate and fair calculation of the carbon content of imported goods is complex. This process requires robust data collection and verification mechanisms, which may be challenging for both importers and exporters. Smaller firms, in particular, may struggle with compliance due to limited resources (CSIS).
- 4. Economic Impact:** The introduction of CBAM could increase costs for imported goods, potentially leading to higher prices for consumers and disrupting international supply chains. This economic impact might prompt retaliatory measures from affected countries, escalating into broader trade disputes (MDPI).
- 5. Technological and Regulatory Gaps:** Countries with less advanced emissions reporting and verification systems might find it difficult to comply with CBAM requirements. This disparity can create an uneven playing field and complicate international trade relations (SAIS Review).

Overall, while CBAM aims to reduce global carbon emissions and level the playing field for EU producers, it poses significant legal, economic, and practical challenges needing to be addressed.

The political reasoning behind the Carbon Border Adjustment Mechanism (CBAM) focusses on carbon leakage; maintaining the competitiveness of EU industries, while promoting global climate action.

- 1. Preventing Carbon Leakage:** One of the main political motivations for CBAM is to prevent carbon leakage, which occurs when businesses transfer production to countries with less stringent climate policies, leading to no reduction in global emissions. By imposing a carbon cost on imports equivalent to that EU producers pay under the EU Emissions Trading System (ETS), CBAM aims to ensure that imported goods do not have a competitive advantage due to lower environmental standards in their countries of origin (CSEP) (SAIS Review).
- 2. Protecting EU Industries:** CBAM intends to level the playing field for EU industries that are subject to strict climate regulations. Without such a mechanism, these industries could be at a disadvantage compared to foreign competitors who do not face similar carbon costs. This protection helps prevent job losses and the relocation of industries outside the EU, thereby safeguarding the EU's economic interests (Cato Institute) (SAIS Review).
- 3. Encouraging Global Climate Action:** By extending carbon pricing to imports, the EU aims to incentivise other countries to adopt similar climate policies. The large size of the EU market means that exporters to the EU have a strong incentive to reduce their carbon footprint to avoid CBAM costs. This can promote broader international efforts to reduce emissions and support the global transition to a low-carbon economy (CSIS) (MDPI).
- 4. Supporting EU Climate Goals:** CBAM is part of the EU's broader "Fit for 55" package, which aims to reduce greenhouse gas emissions by 55% by 2030 compared to 1990 levels. By ensuring that imported goods are subject to similar carbon costs as domestic products, CBAM helps the EU achieve its climate targets more effectively and prevents undermining the EU's internal climate policies (CSEP) (Cato Institute).

Overall, the political rationale for CBAM is rooted in the need to maintain economic competitiveness, while upholding strong environmental standards and promoting global climate action. If we look back at an equivalent approach taken in the US State of California on car pollution and safety in the 1960's, ultimately this changed the domestic USA markets, in turn globally driving for cleaner and better cars.

How to prepare for CBAM?

EU and non-EU businesses need to take several steps to prepare for the Carbon Border Adjustment Mechanism (CBAM) to ensure compliance and minimise potential financial impacts. Here are some key actions businesses can take:

For EU Located Businesses:

- 1. Assess Supply Chains:** EU businesses should analyse their supply chains to identify which imported goods will be subject to CBAM. This involves understanding the carbon footprint of their suppliers and the countries of origin.
- 2. Engage with Suppliers:** Communicate with suppliers to ensure they are aware of CBAM and encourage them to adopt greener practices. This might include providing support for improving energy efficiency and reducing emissions.
- 3. Calculate Carbon Costs:** Businesses need to estimate the additional costs CBAM will impose on their imports and incorporate these into their pricing strategies and certification. They should prepare for detailed emissions reporting requirements.
- 4. Invest in Low-Carbon Technologies:** Investing in low-carbon technologies can reduce the carbon intensity of products, and potentially lower the financial burden of CBAM. This might also provide a competitive edge in the market.
- 5. Stay Informed on Policy Developments:** Regularly update internal policies and practices to stay in compliance with evolving regulations and guidelines related to CBAM. Engage with industry associations and stakeholders to stay informed about best practices and regulatory changes.

For Non-EU Located Businesses:

- 1. Understand CBAM Requirements:** Non-EU businesses exporting to the EU must understand CBAM requirements, including how the carbon content of their products will be assessed and reported. This involves familiarising themselves with EU carbon pricing mechanisms.
- 2. Emissions Data Collection:** Implement systems to accurately measure and report the carbon emissions associated with their production processes. This includes improving data collection and ensuring transparency in emissions reporting.
- 3. Engage with EU Importers:** Collaborate with EU-based customers to understand their needs and ensure that exported goods comply with CBAM regulations. This could include providing necessary documentation and emissions data.
- 4. Adopt Sustainable Practices:** Invest in cleaner technologies and sustainable practices to reduce the carbon footprint of their products. This can help mitigate the cost impact of CBAM and enhance competitiveness in the EU market.
- 5. Policy Adaptation:** Adjust internal policies and practices to align with CBAM requirements. This might involve training staff on new compliance requirements and adapting business strategies to incorporate carbon costs.

General Preparation Steps:

- **Documentation and Reporting:** Ensure that robust documentation and reporting systems are in place to track emissions accurately. This includes maintaining records of emissions data and verifying compliance with CBAM regulations.
- **Extend Management Systems:** to include a register of key information relating specifically to carbon reporting and data.
- **Financial Planning:** Businesses should conduct financial planning and scenario analysis to understand the potential cost impacts of CBAM, and develop strategies to manage these costs.
- **Seek Expert Advice:** Engage with legal, environmental, and trade experts to navigate the complexities of CBAM compliance and to receive guidance on best practices and strategic adjustments.

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Resources and Tools:

- CBAM Registry: The EU will establish a CBAM registry where businesses can register and report emissions data.
- EU Guidance: Utilise guidelines and resources provided by the European Commission to understand detailed CBAM requirements and compliance processes.

By taking these steps, both EU and non-EU businesses can better prepare for the implementation of CBAM, ensuring compliance while minimising financial and operational disruptions.

The principles of EU carbon pricing include

- **Polluter Pays Principle:** Entities emitting greenhouse gases (GHGs) must bear the costs associated with their emissions.
- **Market-Based Mechanisms:** Use of the EU Emissions Trading System (ETS) to create a market for carbon allowances, promoting cost-effective emissions reductions.
- **Cap-and-Trade System:** Setting a cap on total emissions and allowing trading of emission allowances to provide flexibility in how reductions are achieved.
- **Progressive Reduction Targets:** Gradual reduction of the emissions cap to achieve long-term climate goals.
- **Fairness and Transparency:** Ensuring a fair and transparent system where all participants understand the rules and can compete on a level playing field.
- **Revenue Recycling:** Using revenues from carbon pricing to support green initiatives, mitigate impacts on vulnerable populations, and fund climate adaptation projects.
- **Innovation Incentives:** Encouraging investment in low-carbon technologies and sustainable practices through predictable carbon pricing signals.
- **Linkage with International Systems:** Collaborating with other carbon pricing mechanisms globally to enhance the effectiveness of climate action.
- **Monitoring, Reporting, and Verification (MRV):** Implementing rigorous MRV processes to ensure accurate tracking of emissions and compliance with regulations.

These principles help ensure that carbon pricing in the EU is effective, fair, and aligned with broader climate objectives.

Could CBAM trigger trade wars to follow should right wing governments being elected to major trading economies?

While CBAM aims to reduce global carbon emissions and level the playing field for EU producers, its introduction amidst a political climate of more extreme right-wing governments, could trigger trade wars. The likelihood of such conflicts depends upon how the carbon duties are perceived and implemented, as well as the diplomatic efforts made to address concerns from major EU trading partners. Effective communication, cooperation, and intellectual support for affected countries will be key to mitigating these risks

Here are some factors that could contribute to this outcome:

Factors Contributing to Trade Wars

1. Protectionism Perception:

Right-wing governments often prioritise national interests and economic protectionism. They may view CBAM as a protectionist measure that unfairly targets their industries, leading to heightened tensions and retaliatory trade policies (CSEP) (Cato Institute).

2. Economic Nationalism:

These governments might adopt a more aggressive stance in defending their economic sovereignty. Measures perceived as external interference, such as CBAM, could provoke strong responses aimed at protecting domestic industries, potentially escalating into trade disputes (SAIS Review) (MDPI).

3. Retaliatory Tariffs:

Countries affected by CBAM might impose retaliatory tariffs on EU goods, sparking a cycle of retaliations that could evolve into broader trade wars. This scenario is more likely with governments that adopt hardline stances on trade (MDPI).

4. International Legal Disputes:

Right-wing governments could challenge CBAM at the World Trade Organization (WTO), leading to protracted legal battles. If the WTO rules against the EU or if countries perceive the WTO's decisions as biased, it could further strain international trade relations (CSIS) (Cato Institute).

Historical Context and Precedents

1. Past Trade Disputes:

Previous trade disputes, such as those involving steel and aluminium tariffs under the US Trump administration, show how protectionist policies can quickly lead to retaliatory measures and broader trade conflicts. Similar dynamics could unfold with CBAM if it is perceived as discriminatory (Cato Institute) (MDPI).

2. Climate Policy as a Trade Issue:

The intersection of climate policy and trade is becoming increasingly contentious. CBAM, which links carbon pricing to trade, exemplifies this trend and could exacerbate existing tensions if not managed diplomatically (CSIS) (SAIS Review).

Potential Mitigations

3. Diplomatic Engagement:

To avoid trade wars, the EU could engage in diplomatic negotiations with major trading partners to explain the rationale behind CBAM and explore collaborative approaches to carbon pricing and emissions reductions (CSIS).

4. Support for Affected Economies:

Providing financial and technical support to help developing countries and other affected economies transition to lower-carbon production methods could reduce resistance and mitigate the risk of retaliatory measures (SAIS Review) (MDPI).

5. WTO-Compatible Adjustments:

Ensuring that CBAM is designed to comply with WTO rules can help pre-empt legal challenges and reduce the perception of protectionism. Transparent and fair implementation will be crucial in this regard (CSEP) (Cato Institute).

For further reading and detailed guidelines, refer to

[European Commission CBAM page](#)

[MDPI on CBAM challenges](#)

[Why CBAM](#)

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