EU Carbon Border Adjustment Mechanism – Explained

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Carbon Border Adjustment Latest News

- The Government of India is reportedly preparing a scheme to bear **90% of the compliance cost** incurred by MSMEs exporting to the European Union under the **Carbon Border Adjustment Mechanism (CBAM)**.

Carbon Border Adjustment Mechanism (CBAM)

- The **Carbon Border Adjustment Mechanism** is a carbon pricing mechanism introduced by the **European Union (EU)** to prevent **carbon leakage**, the relocation of carbon-intensive industries to countries with less stringent climate regulations.
- Under CBAM, importers of certain goods into the EU must purchase **CBAM certificates** corresponding to the embedded carbon emissions generated during the production of those goods.
- The mechanism aims to ensure that imported products face a carbon cost similar to that imposed on producers within the EU under the **EU** **Emissions Trading System** **(EU ETS)**.
- The **transitional phase** of CBAM began in **October 2023**, focusing on emissions reporting, while the **financial obligations came into effect from January 1, 2026**.

- CBAM currently applies to carbon-intensive products such as:
    - Iron and steel, Aluminium, Cement, Fertilisers, Electricity and Hydrogen
- The scope is expected to expand gradually to include additional sectors.

How CBAM Works

- Exporters selling covered products to the EU must report the **embedded emissions** generated during production.
- These emissions include:
    - Direct emissions from manufacturing processes
    - Indirect emissions from electricity consumption (for specified sectors such as cement and fertilisers)
- EU importers are required to purchase CBAM certificates based on these verified emissions.
- If exporters fail to provide actual emissions data, the European Commission applies **default emission values**, which are subject to progressively increasing **mark-ups**:
    - 10% in 2026
    - 20% in 2027
    - 30% from 2028 onwards
- These higher default values significantly increase compliance costs and reduce the competitiveness of exporters unable to accurately measure and report emissions.

Challenges for Indian MSMEs

- Although CBAM is often viewed as a carbon tax, experts note that the **largest burden for MSMEs is compliance rather than taxation**.
- To comply with the regulation, exporters must establish systems for:
    - Carbon accounting
    - Emissions measurement and monitoring
    - Third-party verification
    - Digital reporting
    - Data management and documentation
- According to industry estimates, **each MSME may incur compliance costs of Rs. 15-20 lakh** merely to meet CBAM reporting requirements.
- Unlike large corporations, MSMEs often lack:
    - Technical expertise
    - Financial resources
    - Dedicated sustainability teams
    - Digital infrastructure for emissions reporting
- Since many of these expenses are **fixed costs**, they do not decrease with lower production or export volumes, placing smaller exporters at a competitive disadvantage.

Government’s Proposed Support Scheme

- Recognising the disproportionate burden on small exporters, the Central Government is working on a scheme to **reimburse 90% of CBAM compliance costs** for eligible MSMEs. The proposed support is intended to help exporters:
    - Develop carbon accounting systems
    - Obtain third-party verification
    - Build reporting infrastructure
    - Continue accessing European markets
- The initiative follows unsuccessful attempts by India to secure special concessions for small industries during negotiations with developed countries.

Impact on Indian Exports

- India is the **world's second-largest producer of crude steel and primary aluminium**, making CBAM particularly significant for the country's manufacturing sector.
- According to a recent **Indian Council for Research on International Economic Relations (ICRIER)** working paper:
    - Iron and steel exports to the EU could decline by nearly 24%, making it the most affected sector.
    - India's overall global exports of iron and steel may decline by 5.7%.
    - Fertilisers, aluminium, and fabricated metal products are also expected to face substantial impacts.
- The report further notes that while CBAM is likely to adversely affect India's exports to the EU, its impact on global carbon emissions is expected to be **limited**, as emission reductions will depend on the technologies and production processes adopted by exporting countries.

Implications for India

- CBAM presents both challenges and opportunities for India's manufacturing sector.
- **Economic Challenges**
    - Increased compliance costs for exporters
    - Reduced competitiveness of MSMEs in European markets
    - Pressure on labour-intensive export sectors
    - Additional burden due to the UK's proposed CBAM from **2027**
- **Strategic Opportunities**
    - Adopt cleaner production technologies
    - Improve energy efficiency
    - Strengthen carbon accounting systems
    - Enhance global competitiveness through sustainable manufacturing
- The mechanism may also accelerate India's transition towards low-carbon industrial production, particularly as global markets increasingly prioritise environmental standards.

Way Forward

- To minimise the impact of CBAM, India should adopt a comprehensive strategy by:
    - Providing financial assistance for MSME compliance

- Expanding technical support for carbon accounting and emissions reporting
- Strengthening domestic carbon measurement and verification infrastructure
- Encouraging the adoption of cleaner production technologies through targeted incentives
- Continuing bilateral negotiations with the EU to address concerns of developing countries while ensuring market access for Indian exporters

- Such measures would help Indian industries remain competitive while aligning with global climate commitments.

Source: IE
