

## RIFS-Blogpost

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# Three Challenges for the CBAM's Transitional Phase

**In 2021, as part of the European Union's "Fit for 55" initiative to reduce European greenhouse gas emissions by 55% by 2030, the European Commission proposed a cross-border carbon pricing mechanism targeting imports of carbon-intensive products: the Carbon Border Adjustment Mechanism (CBAM). While the EU established an internal carbon pricing scheme as early as 2005 with its Emissions Trading Scheme (ETS), other countries are still in the early stages of designing or implementing similar schemes. Differences in carbon policy design and regulatory regimes across different countries have led to concerns about "carbon leakage", whereby efforts to reduce greenhouse gas emissions in one country result in the relocation of economic activities and associated emissions to countries with less stringent policies. The CBAM aims to create a level-playing field by charging an additional fee on carbon intensive goods entering the European single market.**

On 1 October 2023, the EU's Carbon Border Adjustment Mechanism (CBAM) entered into effect, beginning with a transitional phase that will run through to 2026. This provides a two-year learning phase during which stakeholders, including the European Commission, can gradually adjust to the new terms of trading established by the CBAM. The calculation of direct and indirect carbon emissions, quarterly CBAM reporting and monitoring requirements are among the new elements introduced by the mechanism.

The introduction of the world's first carbon border tariff presents challenges across three areas. First, establishing the new regulatory framework and guiding its implementation represents a considerable administrative challenge for the Commission; secondly, companies exporting to the EU will need to develop institutional capacities and adapt to the new rules of the game; and finally, ensuring the traceability of carbon-intensive goods is likely to present significant challenges due to the complexity of the information and the regulatory scheme's requirements.

## **1 Putting CBAM on track**

Following a long and dynamic legislative process, the Commission must now prove the technical feasibility of the mechanism. While experience gained through the European ETS is undoubtedly a valuable resource, the implementation of the CBAM will pose challenges for EU institutions, national authorities, and businesses both within and outside the EU, which will all need to adjust their practices to the requirements of the new scheme.

The Commission will operate a transitional registry that will facilitate efforts to monitor companies' compliance with quarterly reporting obligations under CBAM. It will also mediate between the so-called competent authorities of member states, which are responsible for implementing and enforcing

**! Zum Aktualisieren der Textelemente, Zitation markieren und dann F9 drücken !**

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CBAM and provide access to the registry. These responsibilities are generally assumed by government ministries or environmental agencies in member states.

The rules of the game will also change for EU importers, who are required to consult with the operators of installations producing goods covered by the CBAM in order to report on the quantity of goods imported, total embedded emissions, indirect emissions, and the carbon price due in a country of origin for embedded emissions.

## **2 Developing reporting capacities outside the EU**

The transitional phase provides exporters from developing countries with the opportunity to scale up their institutional capacities in order to deal with CBAM when it enters into full operation in 2026. The transitional phase provides a margin of flexibility as exporters of goods to the EU adjust to the CBAM's requirements and develop capacities to calculate and report emissions generated during the production of carbon-intensive goods (embedded emissions) and electricity.

Through to 1 January 2025, companies exporting to the EU can choose from three reporting options: (a) full reporting according to the new methodology (EU method); (b) reporting based on equivalent third country national systems; and (c) reporting based on reference values. From 1 January 2026, all companies exporting to the EU will be required to comply with the mechanism's requirements.

This flexibility allows exporters to use a wide variety of methods to calculate their relevant emissions. Nevertheless, the reporting requirements for carbon-intensive goods under CBAM are likely to exceed existing regulatory resources in many countries. Competent national authorities and companies will need to boost available capacities in order to facilitate the mechanism's smooth implementation. And while several developing countries have expressed intent to adopt carbon pricing schemes, few have done so to date.

## **3 Traceability and transparency in reporting carbon-intensive goods**

In addition to the explicit goals of preventing carbon leakage and establishing a level-playing field, CBAM could pave the way for improved carbon traceability. The focus on carbon-intensive goods during the transitional phase provides an opportunity to overcome the lack of transnational regulatory agreement and gain experience in the technical operation of a cross-border carbon pricing mechanism.

The CBAM Transitional Registry, which will be superseded by a permanent registry on 1 January 2026, is a standardised and secure electronic database and an interface for the submission of CBAM reports by importers of goods covered by the mechanism such as cement, iron, steel, aluminum, fertilizers, electricity and hydrogen. There are concerns that importers could seek to undermine transparent reporting requirements by exploiting the option to declare estimated values when sufficient data on product-embedded emissions or their calculation are unavailable. The reporting requirements have also caused disquiet among exporters, who fear that disclosing emissions could impact competitiveness and lead to disputes with suppliers over embedded carbon emissions.

Finally, although the Implementing Regulation advises that CBAM reports "may be checked" for the purpose of ensuring compliance, it grants declarants considerable flexibility. It is unclear at this time to what extent countries will adopt the CBAM methodology for calculating carbon emissions in their domestic regimes. Overall, a harmonized international regulatory approach will be crucial for effective and transparent traceability. During the transitional phase states and stakeholders will likely need to allocate additional resources in order to enhance capacities ahead of the mechanism's full implementation. All stakeholders involved in the process will need additional capacities to navigate the technical challenges. However, the implementation of the CBAM marks a milestone in international regulatory carbon pricing.