

# THE EU'S NEW CARBON BORDER ADJUSTMENT MECHANISM IN ACTION: IMPACTS ON CANADA AND BEYOND

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As part of its plan to reduce greenhouse gas emissions by 55% by 2030, the European Union (“**EU**”) signed into law a new Carbon Border Adjustment Mechanism (“**CBAM**”) Regulation on May 10, 2023.<sup>[1]</sup>

The CBAM is a trade tool designed to level the playing field for tradable products affected by global climate regulation. It imposes a charge on certain imports of carbon-intensive goods from countries with less stringent emissions requirements.<sup>[2]</sup> The mechanism is part of the EU's broader effort to achieve its ambitious climate targets and to ensure a fair transition to a low-carbon economy. A transitional phase will begin on October 1, 2023 with full implementation scheduled for January 2026.<sup>[3]</sup> The new measures will have important consequences for Canadian exporters of carbon-intensive goods to the EU.<sup>[4]</sup>

## Coverage and Requirements

The Regulation is substantially similar to the EU's original CBAM proposal published in July 2021. It covers the same industries and will function with the same certificate system as originally planned.

The Regulation will implement the following key measures for EU importers and foreign exporters:

- A carbon price will be imposed on carbon-intensive goods entering the EU in the following sectors that are currently covered by the EU's “Emissions Trading System” (“**ETS**”):
  - iron and steel;
  - cement;
  - fertilizer;
  - aluminum;
  - electricity and hydrogen.<sup>[5]</sup>
- Importers must purchase CBAM certificates to offset the carbon content of their goods. The price for CBAM certificates will be based on the prices for intra-EU ETS allowances. The price of ETS allowances fluctuates based on market demand and the EU's climate targets. The ETS price in May 2023 hovered around € 85/tonne (approximately CAD \$123 /tonne),<sup>[6]</sup> which is significantly higher than the 2023

Canadian minimum Carbon Pollution Price of CAD \$65/tonne.<sup>[7]</sup>

- Importers must report their annual CBAM obligations based on the carbon content embedded in the products they import into the EU, and a third-party verifier will confirm the accuracy of these reports.<sup>[8]</sup>
- Products exported from countries that have established domestic carbon pricing schemes, including Canada, will be eligible to receive rebates on the value of CBAM certificates that would otherwise be required, based on the amounts already paid through their own domestic carbon pricing. The EU will establish a framework to assess the equivalency of other countries' carbon pricing policies and rebates will be provided if the domestic carbon pricing is deemed equivalent or partially equivalent to the EU ETS.<sup>[9]</sup>
- The EU will phase-out its free allowances system which allows EU domestic producers to compensate for indirect emissions incurred from greenhouse gas emissions. The phase out will occur in parallel with the phasing-in of the CBAM.<sup>[10]</sup> The new CBAM is designed to ensure that the phase-out of free allowances should “in no case result in more favourable treatment for Union goods compared to goods imported into the customs territory of the Union.”<sup>[11]</sup>

### **Phase-In Timeline**

Starting from October 1, 2023 until December 31, 2025, EU importers will need to comply with a “simplified” CBAM consisting only of reporting obligations regarding the carbon content of imported goods.<sup>[12]</sup> This initial phase is designed to allow the EU to gather data to inform the operation of the program before the full CBAM is implemented.<sup>[13]</sup> The transitional phase will also allow importers, and the foreign exporters who supply them, to gain experience working with the new system and in meeting the administrative requirements. In particular, the determination of the embedded carbon content in products and the amounts of any price reductions based on domestic carbon pricing in the country of export will involve complex calculations.

The permanent phase will begin on January 1, 2026. At that time, EU importers will be required to report the quantity and the embedded CO<sub>2</sub> content of all goods covered by the CBAM, as well as purchase and surrender the requisite number of CBAM certificates for such imports.<sup>[14]</sup>

### **CBAM’s Implications for Global Trade**

The CBAM will impact goods entering the EU from countries with less stringent carbon pricing policies. To adapt to the new CBAM, some countries may choose to enter into bilateral agreements with the EU. Canada would be an obvious candidate for such an agreement, which could assist Canadian exporters by clarifying and standardizing how Canada’s federal carbon pricing regime (and provincial variations) would interface with the CBAM -- particularly in relation to reductions of the value of certificates to be surrendered based on carbon pricing charges levied in Canada.

It is not yet clear whether the EU's leadership on border carbon adjustments will be followed by other countries that export significant amounts of carbon-intensive products. The Canadian Government announced plans to create a border carbon adjustment regime in its 2021 Budget and held a public consultation on the issue in the Fall of 2021.<sup>[15]</sup> However, it has not yet brought forward a proposed regime.

The United States has lagged on climate regulation and is not well placed to implement a CBAM-style regime because of the absence of a domestic carbon pricing regulatory framework. However, there are indicators of interest in the subject matter.<sup>[16]</sup> The United States is currently negotiating a "Green Steel" deal with the EU.<sup>[17]</sup> The agreement, once finalized, will impose higher tariffs on carbon-intensive steel, and will be open to any other interested countries who wish to join and benefit from the agreement.<sup>[18]</sup> More recently, a group of legislators put forward a "Clean Competition Act" which includes proposals for a border tax on carbon-intensive imports.<sup>[19]</sup>

As more countries consider implementing similar measures it remains an open question as to how these new developments will fit into the WTO framework, such as the *General Agreement on Tariffs and Trade*. For a fuller analysis on how border carbon adjustments may face scrutiny under WTO rules, please refer to our earlier memorandum "[A Roadmap for Trade Law Compliant Border Carbon Adjustments](#)."

## Key Takeaways

The EU's newly adopted CBAM will have significant implications for the global trade of carbon-intensive goods. Canadian businesses in the affected sectors will need to adapt to these changes and develop systems to comply with this regulatory regime to maintain exports to the EU market. As a starting point, Canadian exporters should consider the products they are currently selling to the EU and determine their CO<sub>2</sub> content and carbon-intensity to better understand how the CBAM will specifically impact their sales, costs and prices. This may also help to identify competitive advantages and growth opportunities relative to other countries exporting to the EU that impose no or lower domestic carbon pricing charges than Canada (e.g. the US and China, among many others). For Canadian policy-makers, the to-do list may include development of a bilateral agreement with the EU related to its CBAM and decisions about whether and how to proceed with a Canadian border carbon adjustment regime.

[1] "EU climate action: provisional agreement reached on Carbon Border adjustment Mechanism (CBAM)" *European Council* (December 13, 2022). [Online](#); *Regulation (EU) 2023/956 of the European Parliament and of the Council of 10 May 2023 establishing a carbon border adjustment mechanism*. [Online](#).

[2] "Carbon Border Adjustment Mechanism" *European Commission*. [Online](#).

[3] "Carbon Border Adjustment Mechanism" *European Commission*. [Online](#).

[4] This is our latest bulletin on border carbon adjustments. Click [here](#) and [here](#) to read our previous bulletins.

[5] *Regulation (EU) 2023/956 of the European Parliament and of the Council of 10 May 2023 establishing a carbon border adjustment mechanism.* [Online.](#)

[6] EC, *Regulation (EU) 2023/955 of the European Parliament and the Council of 10 May 2023 establishing a carbon border adjustment mechanism*, [2023] OJ, L 130/66 at 56. [Online.](#)

[7] Canada's carbon price will progressively increase to CAD \$170/tonne by 2030, see "Update to the Pan-Canadian Approach to Carbon Pollution Pricing 2023-2030" *Government of Canada.* [Online.](#)

[8] *Regulation (EU) 2023/956 of the European Parliament and of the Council of 10 May 2023 establishing a carbon border adjustment mechanism.* [Online.](#)

[9] *Regulation (EU) 2023/956 of the European Parliament and of the Council of 10 May 2023 establishing a carbon border adjustment mechanism.* [Online.](#)

[10] "Carbon Border Adjustment Mechanism" *European Commission.* [Online.](#)

[11] EC, *Regulation (EU) 2023/955 of the European Parliament and the Council of 10 May 2023 establishing a carbon border adjustment mechanism*, [2023] OJ, L 130/66 at 56. [Online.](#)

[12] "EU climate action: provisional agreement reached on Carbon Border Adjustment Mechanism (CBAM)" *European Council* (December 13, 2022). [Online.](#)

[13] "EU climate action: provisional agreement reached on Carbon Border Adjustment Mechanism (CBAM)" *European Council* (December 13, 2022). [Online.](#)

[14] "Carbon Border Adjustment Mechanism" *European Commission.* [Online.](#)

[15] "Consultation on border carbon adjustments" *Government of Canada* (last modified February 1, 2022). [Online.](#)

[16] For example, a US Senator has introduced a bill that, if passed, would implement a border carbon adjustment mechanism in the US, see "Whitehouse and Colleagues Introduce Clean Competition Act to Boost Domestic Manufacturers And Tackle Climate Change" *Sheldon Whitehouse, United States Senator for Rhode Island* (June 8, 2022). [Online.](#)

[17] "FACT SHEET: The United States and European Union to Negotiate World's First Carbon-Based Sectoral Arrangement on Steel and Aluminum Trade" *The White House* (October 31, 2021). [Online.](#)

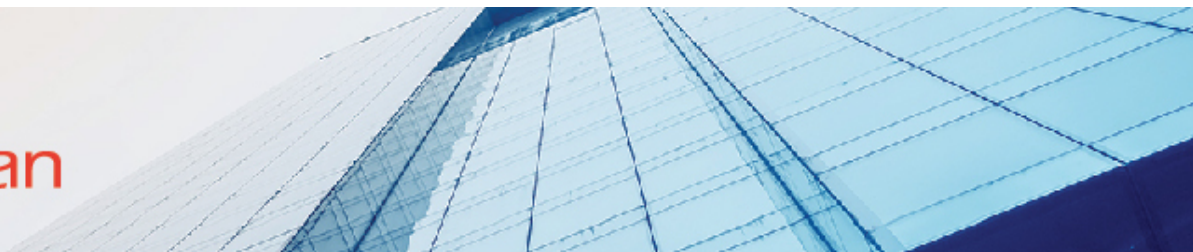
[18] "FACT SHEET: The United States and European Union to Negotiate World's First Carbon-Based Sectoral Arrangement on Steel and Aluminum Trade" *The White House* (October 31, 2021). [Online.](#)

[19] "Whitehouse and Colleagues Introduce Clean Competition Act to Boost Domestic Manufacturers And Tackle Climate Change" *Sheldon Whitehouse, United States Senator for Rhode Island* (June 8, 2022). [Online.](#)

by [Neil Campbell](#), [Talia Gordner](#), [Lisa Page](#) and Adelaide Egan (Articling Student)

### **A Cautionary Note**

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against



making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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