Carbon Border Adjustment Mechanism (CBAM)

Mains: *GS-III – Economy & Environment*

Why in News?

As a climate policy tool, CBAM helps reduce global emissions, and also poses significant challenges for developing countries such as India.

What is Carbon Border Adjustment Mechanism (CBAM)?

- **CBAM** – It is *price-based and quantifiable*, directly linking market access for carbon-intensive products to carbon emissions.
- **Goal** – To prevent carbon leakage by imposing a *carbon-linked charge on imports* based on their embedded emissions.

> ***Carbon leakage*** *– When companies move production of carbon-heavy goods to countries with weaker climate rules to avoid strict emission limits or costly compliance in their home country.*

- **Proposed In** – July 2021 by the European Union (EU) & entered its definitive phase from January 1, 2026.
- **Distinction from Traditional NTMs** – CBAM is structurally distinct from traditional *non-tariff measures (NTMs),* such as product standards.
- While NTMs affect market access *through compliance requirements* and are *largely qualitative*, with scope for interpretation,
- **Impact on Exporters** – Even if exporters comply with the product quality standards in destination markets, the carbon intensity of production is likely to raise export costs and thereby constrain market access.
- Additionally, investing in cleaner energy and transitioning toward carbon-neutral production is significantly more expensive than complying with conventional product quality standards, especially in the short run.
- **Shift in Global Trade Rules** – Market access and export growth are no longer determined by tariffs alone.
- As global trade becomes more tied to carbon rules, a country's advantage now depends not just on efficiency and price, but also on how carbon-efficient its production processes are.

How the CBAM affected India's trade?

- **Applicability of CBAM** – Even as India pursues bilateral trade negotiations with the EU, CBAM will still apply, making carbon-intensive exports to Europe costlier.
- **Market Access Beyond Tariffs** – Market access, therefore, is increasingly being shaped not only by tariffs but also by compliance with carbon-emission standards.
- **Impact on Various Sectors** – Its effects may also extend beyond targeted sectors through global price shifts and the gradual adoption of similar policies by other developed countries.
- **Immediate Impact** – India's *steel and aluminium sectors* are likely to face the most immediate impact, given their dependence on European markets and carbon-intensive production processes.
- Although the carbon levy will formally be paid by EU importers, part of the burden is likely to *shift to exporters* through tighter contracts and stricter supplier selection.
- As European buyers increasingly prefer low-emission suppliers, Indian exporters face a choice to absorb higher costs now or adopt greener production to secure future market access.
- In the short run, *compliance costs could shrink profit margins* and hurt export competitiveness despite ongoing free trade agreement negotiations.
- **Indirect Impact** – As a major *net importer of fertilizers*, India may face indirect price pressures through global price transmission.
- **Key fertilizer exporters** to the EU — Egypt, Russia, Morocco and China — are *also major suppliers of fertilizers to India*.
- As these suppliers face higher carbon-compliance costs, part of the burden is likely to be passed on through higher global fertilizer prices.
- India's fertilizer import bill is therefore likely to increase, jeopardising the agricultural sector, farm profitability and high food prices.
- **Structural Shift** – CBAM signals a structural shift in global trade, as other developed countries consider adopting similar carbon tariff compliance policies.
- Developing countries like India face constrained market access unless they improve carbon efficiency.

What need to be done to overcome the challenges?

- **Domestic Strategy** – Countries such as India must adopt a two-pronged strategy of domestic reform and effective international negotiation.
  - Greater investment in clean energy and
  - Stricter implementation of carbon policies are essential to improve firms' carbon efficiency.
- **Domestic Push for Fertilizer** – Reducing the import dependence of emission-intensive and more expensive goods such as fertilizers, through
  - Higher domestic production and
  - Better implementation of the soil health cards scheme and
  - The promotion of balanced and need-based application of fertilizers is equally important.
- **International Strategy** – Internationally, India must *negotiate for equitable treatment* of developing countries so that the short-run costs of carbon compliance can

be eased through a phased transition.
- India must also seek transitional support and technology transfer to ensure a level playing field in trade agreements with developed countries.

What lies ahead?

- The challenge is not merely adapting to carbon-constrained trade regimes, but ensuring that the transition does not undermine growth and sustainability.

Reference

The Hindu | Tariffs to carbon, the new rules shaping India’s trade