

EU Carbon Border Adjustment Mechanism (CBAM) – what do businesses in the Middle East need to know?

January 2023



In brief

After several months of negotiations, the European Parliament and EU Council have reached a historic agreement on Carbon Border Adjustment Mechanism (CBAM)* that will apply to the import of certain product groups to the EU starting October 1, 2023.

CBAM is one of the elements of the EU Green Deal, the goal of which is to reduce GHG emissions by 55% by 2030. CBAM is aimed at equalizing the price of carbon paid for EU products operating under the EU Emissions Trading System (ETS) and imported goods.

During the transitional phase of CBAM (October 1, 2023 – December 31, 2025), there will only be a requirement for the quarterly reporting of the greenhouse gas footprint of certain products imported to the EU (including direct and indirect emissions). Starting 2026, there will also be a requirement to purchase CBAM certificates to cover the GHG footprint, and the price of CBAM certificates would be linked to carbon prices at the EU ETS. CBAM would represent an additional cost related to export to the EU market, which would in the end of the day be shared with the exporter or producer and could influence their marketing strategy. There are expectations that other countries may also implement measures similar to CBAM.

In detail

1. Product groups included in the scope of CBAM

Starting October 1, 2023, CBAM will apply to EU imports of iron & steel, aluminium, electricity, certain fertilisers, cement and hydrogen, as well as certain precursors (i.e. cathode active materials) and a limited number of downstream products such as screws and bolts. There is no materiality threshold. For example, if a Middle East producer exports 50 tons of fertilisers or steel to the EU - the producer would have to comply with CBAM requirements.

For organic chemicals and polymers, which were previously included in draft CBAM regulation approved by the EU Parliament in July 2022, the implementation was postponed and decisions with this respect will be taken during the interim period (by 2026). Inclusion of polymers and organic

**Please note that the final text of CBAM regulation is not available yet, this news alert was prepared based on the previous version of the July 2022 document, the press releases and press conference upon reaching the CBAM agreement on December 13, 2022.*



It's a very strong message to the rest of the world and I can't imagine that other regions will not follow with the similar mechanisms. That would be the best response to EU CBAM.



Mohammed Chahim, Rapporteur

chemicals into the CBAM scope would be very important for Middle East producers, since many oil and gas downstream products would be in scope (i.e. high density polyethylene, low density polyethylene, normal alpha olefins, hexen, methanol, ethylene, ethylene dichloride, vinyl chloride monomer and others.)

Furthermore, by 2030, the scope of CBAM is expected to extend to all product groups covered by EU ETS or to the list of products with a risk of carbon leakage (i.e. crude petroleum and petroleum products, inorganic basic chemicals, industrial gases, synthetic rubber, non-ferrous metals and others). The EU shall also assess the methodology for indirect emissions and the possibility to include more downstream products. Currently there are no indications of plans to extend CBAM scope to LNG or natural gas.

Taking into account the plans to extend CBAM product scope, its influence on the Middle East producers would significantly increase over the next several years.

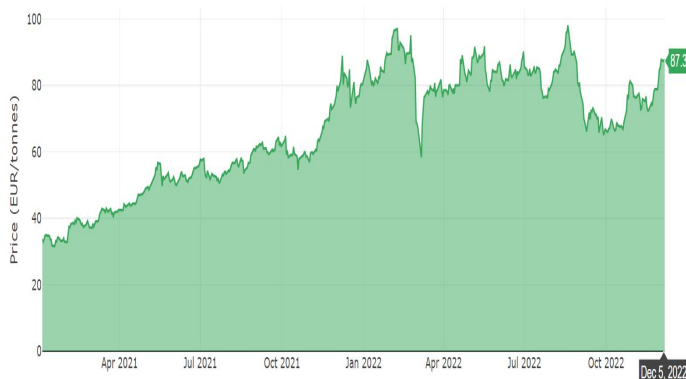
2. Reporting obligations and CO2 price

In the interim period, starting October 1, 2023, the importer of products to the EU would be required to provide quarterly reporting on GHG emissions embedded into the imported products. Reporting should be provided within 30 days from the end of the quarter.

Although CBAM reporting obligation is with the EU party, the compliance burden on the exporter/ producer would be significant too due to the necessity to prepare the data on greenhouse gas emissions.

It should be noted that CBAM reporting requires GHG data per product and not per installation. Verification should not be required during the interim period, however starting 2026 verification requirements would come into force.

Starting 2026, the CBAM declarant (an EU entity) would be required to purchase the CBAM certificates, as well as provide quarterly reports on embedded GHG emissions and annual CBAM declarations. The price of the CBAM certificates will be linked to the weekly average carbon price in the EU ETS. Currently the EU ETS price exceeds 85 Euro per ton of CO₂. The price of CO₂ has risen significantly in the last 2 years - in the beginning of 2021 the price was around 34 Euro per ton of CO₂.



The introduction of CBAM would be phased-in in parallel to the phase-out of the free allowances in the EU ETS. It means that CBAM will apply only to the proportion of emissions that do not benefit from free allowances under the EU ETS in the same industry in a specific year.

Annual CBAM declaration would include information on the GHG emissions of imported products, on CBAM certificates purchased and surrendered as well as on “explicit carbon price” paid abroad, including carbon taxes and carbon quotes.



3. What if carbon emissions data would not be available?

In case the data on actual embedded emissions for the producer would not be available (or reliable), one of the options would be to use default emissions data, which would be based on emissions of 10% of the least efficient producers in the EU in the relevant industry. For Scope 2 the default energy mix would be based on the fossil fuel energy mix in the EU (which might be more carbon-intensive than the actual energy mix in the Middle East)

4. Developments in other jurisdictions

As noted during the press conference after the CBAM agreement was reached by the EU Council and European Parliament, CBAM is a very strong message to the rest of the world on carbon border taxation, and it is expected that other jurisdictions would follow with similar measures.

In the US there is a draft Clean Competition Act (CCA), the earlier version of which was issued in July 2021 and the later in July 2022. There are significant differences between the CCA and CBAM, some of them outlined below. CCA includes 25 sectors, such as petroleum, natural gas, fertilisers, iron & steel, glass paper and others. The proposed carbon price is 55 USD per ton of CO₂ with an increase each year. The tariff would be payable on the difference between the actual emission and the US baseline emissions.

CCA proposal is still at early stages of discussions. Apart from that, there is information on draft conceptual proposals in the US regarding import tariffs on steel and aluminum based on how much carbon the producing country's industries emit.



The takeaway

How will CBAM influence your business?

If your company exports carbon intensive products to the EU that are included in the (initial or expected extended) scope of CBAM (i.e. iron & steel, fertilisers, hydrogen, organic chemicals, polymers, petroleum products, non-ferrous metals, non-organic chemicals, etc.) we would recommend you consider:


- The potential financial impact of CBAM on your exports (based on various scenarios)
- The potential effect on your marketing strategy
- The commercial opportunities if your products are less carbon-intensive and are “greener” than the industry average
- The preparation for greenhouse gas reporting, which might require an update or the development of GHG methodology, the development of internal processes, IT-systems for GHG accounting, product footprint tracking and CBAM reporting

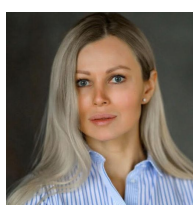
Immediate steps recommended in order to get ready for the new reporting requirements starting from October 1, 2023 include:

- Checking if the product codes of exported goods are included in CBAM scope
- Reviewing your current methodology of GHG (greenhouse gas) calculations, assess if there is enough detail on CO2 emissions per product and if the methodology would allow to meet the CBAM requirements
- Diagnostics of IT systems for GHG calculation (if any), if there is possibility to provide data needed for CBAM based on the existing systems
- Developing of roadmap for preparation to CBAM reporting, which taking into account the above steps could include development or update of GHG calculation methodology, development of internal processes, choosing and implementation of IT-systems (both for the producer and EU reporting entity), performing “dry run” reporting.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your PwC contacts or:

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