

Research Briefing

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# Carbon Border Adjustment Mechanism



## Summary

- 1 What is a Carbon Border Adjustment Mechanism (CBAM)?
- 2 EU Carbon Border Adjustment Mechanism
- 3 UK Government plans for a UK CBAM
- 4 International trade considerations
- 5 Global cooperation
- 6 Further Reading

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# Contents

<b>Summary</b>	<b>4</b>
Further reading	6
<b>1 What is a Carbon Border Adjustment Mechanism (CBAM)?</b>	<b>7</b>
1.1 What does a CBAM achieve?	7
1.2 How does it work?	8
<b>2 EU Carbon Border Adjustment Mechanism</b>	<b>10</b>
2.1 Design of EU CBAM	10
2.2 Implications of EU CBAM for the UK	13
<b>3 UK Government plans for a UK CBAM</b>	<b>20</b>
3.1 Policy development	20
3.2 Design	20
3.3 Views on UK CBAM	22
3.4 Comparison with EU CBAM	23
<b>4 International trade considerations</b>	<b>27</b>
4.1 Compliance with global trade rules	27
4.2 Effect on developing countries	33
<b>5 Global cooperation</b>	<b>38</b>
<b>6 Further Reading</b>	<b>40</b>
Effectiveness of CBAMs	40
UK CBAM	40
EU CBAM	40
Trade considerations	41
United States	41

## Summary

A Carbon Border Adjustment Mechanism (CBAM) is a mechanism implemented by governments to account for the carbon cost of producing imported goods, with the ultimate aim of reducing greenhouse gas emissions and supporting global progress towards net zero.

Goods produced in different countries can be subject to different regulatory regimes. Some countries, such as the UK, apply regulations to make sure that domestic producers take steps to mitigate and reduce the carbon emissions they produce.

In December 2023, the UK Government [announced the UK would implement a CBAM](#). It will consult on the design of a UK CBAM during 2024. Based on the Government's announcements, UK CBAM will be similar to EU CBAM but there are differences in terms of timescale and scope.

## How is the UK reducing its carbon emissions?

Under the [Climate Change Act 2008](#), the UK has set targets for national emissions reductions up to 'net zero' emissions in 2050. [Reaching net zero](#) means total greenhouse gas emissions would be equal to the emissions removed from the atmosphere. The Government has set out strategies and policies which seek to decarbonise sectors in line with these targets.

To reduce emissions of carbon dioxide in line with climate change commitments, the UK applies a carbon price to certain domestic products to reflect the amount of carbon dioxide emitted during production. This is done through the UK Emissions Trading Scheme (ETS). This replaced the EU Emissions Trading System from 1 January 2021, following the UK's withdrawal from the European Union (EU), [The ETS scheme limits the volume of emissions produced each year](#) from industrial activity, by charging businesses that emit significant amounts of carbon dioxide.

## Why isn't emissions trading enough to reduce carbon emissions?

Emissions trading schemes risk simply moving production of carbon intensive goods to new locations or "pollution havens", where producers may be subject to less stringent regulations. This is commonly referred to as "[carbon](#)

leakage”, as although production may have moved, the same volume of emissions is still produced.

## What is a Carbon Border Adjustment Mechanism (CBAM)?

A CBAM aims to ensure equal treatment of domestic and imported goods by applying a charge to carbon emitted during the production of imported carbon-intensive goods, such as aluminium, cement, iron and steel. Its aim is to prevent carbon leakage.

## Are there design challenges to a CBAM?

CBAMs require information on emissions embedded in products to be collected, reported and verified so that the applicable carbon tariff can be applied by customs authorities when the goods are brought into the country. This process can create administrative costs in the exporting country. Any economic impact is likely to be concentrated in countries and regions where carbon-intensive industries are concentrated.

To be consistent with world trade rules, CBAMs must be designed to not treat imported goods less favourably than the same goods produced domestically. CBAMs must also consider any charge already applied to goods in the exporting country, to avoid imported goods being charged twice for their carbon emissions.

## What implications does the EU CBAM have for the UK?

The first CBAM in the world was the EU CBAM, which is currently in a transition period and will be fully operational from 1 January 2026.

EU CBAM has implications for the UK. If a charge has already been paid under the UK ETS, any difference between that charge and a higher EU CBAM charge would be payable. The reporting obligations will apply to imports from the UK even if no charge is required. The economic impact of those obligations within the UK is uncertain. There is also uncertainty as to how EU CBAM will apply to Northern Ireland under the Windsor Framework.

EU CBAM does not apply to exports from non-EU countries that participate in the EU ETS or have an ETS linked to the EU ETS (Norway, Iceland, Liechtenstein and Switzerland).

## Global cooperation

The [Government has said carbon leakage is best solved](#) by working together at the global level, rather than by adopting unilateral CBAMs, but that work takes time. [A recently launched 'Climate Club'](#), co-founded by Germany and Chile, represents an attempt to pursue global cooperation on carbon leakage.

## Further reading

- Commons Library briefing, [The UK's plans and progress to reach net zero by 2050](#), November 2023.
- Commons Library briefing, [Northern Ireland Protocol: The Windsor Framework](#), March 2023.
- Commons Library briefing, [The UK emissions trading scheme](#), May 2021.

# 1 What is a Carbon Border Adjustment Mechanism (CBAM)?

A Carbon Border Adjustment Mechanism (CBAM) applies a charge to carbon emitted during the production of imported carbon-intensive goods, such as aluminium, cement, iron and steel. This is to ensure the carbon price of imports is equivalent to the carbon price of domestic production, so that domestic climate objectives are not undermined.

## 1.1 What does a CBAM achieve?

To reduce emissions of carbon dioxide in line with climate change commitments, the UK EU and other nations [apply a carbon price](#) to certain domestic products to reflect the amount of carbon dioxide emitted during production.<sup>1</sup> This is explicit, through placing a charge on the activity, or implicit, by applying emissions reduction regulations, which then result in costs to producers.<sup>2</sup>

The UK system for applying a carbon price is its [Emissions Trading Scheme \(ETS\)](#), which is similar to the [EU Emissions Trading System \(EU ETS\)](#). They both work on the ‘cap and trade’ principle: a cap is set on the total amount of greenhouse gases that can be emitted, and the cap is gradually reduced so that emissions decrease over time. Within the cap, companies may trade emission allowances (the amount of carbon dioxide that production can result in). If they choose to continue to emit, they will need to buy allowances. Conversely, companies that choose to reduce their emissions can sell any surplus allowances they may own.<sup>3</sup>

An ETS can mean that the domestic cost of producing goods is higher than the cost of importing goods from countries that do not impose a charge on carbon emissions. Within both the UK ETS and EU ETS, the main way of counteracting this competitive disadvantage is to allocate emission allowances in some sectors for free.<sup>4</sup> In evidence from a range of

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<sup>1</sup> Our World In Data, [Which countries have put a price on carbon?](#), 14 October 2022, (accessed 1 March 2024).

<sup>2</sup> Environmental Audit Committee, [Greening Imports: a UK carbon border approach](#) (PDF), 4 April 2022, HC 737.

<sup>3</sup> European Commission, [What is the EU ETS?](#), (accessed 26 January 2024).

<sup>4</sup> European Commission, [Free Allocation](#), (accessed 26 January 2024).

stakeholders, the Environmental Audit Committee was told that [measures such as free allocation weaken the incentive](#) for decarbonisation.<sup>5</sup>

A CBAM is a different approach to the same issue but without weakening the incentive to decarbonise. It aims to ensure equal treatment of domestic and imported goods by applying a charge to carbon emitted during the production of imported carbon-intensive goods. This is to avoid what is known as “carbon leakage”.

[Carbon leakage](#) is the movement of production and associated emissions from one country to another, due to different levels of decarbonisation effort through carbon pricing and climate regulation.<sup>6</sup> Carbon leakage can lead to physical production moving to another country with less stringent mechanisms in place to account for the environmental costs of carbon emissions, “offshoring” emissions to create “pollution havens” of high carbon emissions and low levels of regulation. It can also happen through substitution, as domestic consumers choose cheaper imports produced with higher emissions over more expensive domestic goods. This can undermine emissions reduction efforts.<sup>7</sup>

The [Government has said that the best solution to carbon leakage is to work in partnership](#) is to work in partnership with other countries to develop a global approach. It did also note that making progress on international solutions takes time.<sup>8</sup> In the absence of international progress, the EU and UK have decided to establish CBAMs.

A CBAM is not a revenue-raising measure. [Researchers at the University of Sussex have published a paper asking if a CBAM could “fill the UK’s fiscal gap”](#). They conclude that revenues from both EU CBAM and UK CBAM are likely to be small and that a successful CBAM would raise no revenues as it would have prompted other countries to decarbonise at the same price.<sup>9</sup>

## 1.2

## How does it work?

There is no commonly agreed design of a CBAM. So far, the only CBAM in place is the scheme set up by the EU (see section 2 of this briefing), although the UK recently announced plans for its own CBAM (see section 3).

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<sup>5</sup> Environmental Audit Committee, [Greening Imports: a UK carbon border approach](#) (PDF), 4 April 2022, HC 737, para 12.

<sup>6</sup> LSE Grantham Institute on Climate Change and the Environment, [What is carbon leakage? Clarifying misconceptions for a better mitigation effort](#), 8 December 2021, (accessed 16 February 2024).

<sup>7</sup> HMG, [Factsheet: UK Carbon Border Adjustment Mechanism](#), 18 December 2023, (accessed 22 January 2024).

<sup>8</sup> HMG, [Factsheet: UK Carbon Border Adjustment Mechanism](#), 18 December 2023, (accessed 22 January 2024).

<sup>9</sup> Centre for Inclusive Trade Policy (CITP), [Will the CBAM fill the UKs fiscal gap?](#), CITP briefing paper 10, 12 February 2024.



The principle of the EU CBAM is that the carbon price paid on imports of cement, iron and steel, aluminium, fertilisers, electricity and hydrogen is equivalent to the carbon price of domestic production. These sectors are carbon-intensive and at most risk of carbon leakage.

The EU CBAM seeks to achieve its objective by linking the CBAM charge to the carbon price set by the EU ETS.<sup>10</sup> The President of the European Commission, Ursula von der Leyen, explained if a supplier came to the EU market with a “dirty product”, they would “have to pay a price as if... [they] were in the Emissions Trading System in the European Union.”<sup>11</sup>

As set out in more detail in section 2 of this briefing, EU CBAM is designed so companies buy CBAM certificates priced in line with the EU ETS, declare the emissions embedded in their imports and then surrender the amount of CBAM certificates corresponding to their emissions. Any amount due would be the difference between any carbon price already paid and the carbon price applicable under the EU ETS. Even where no amount is due, a company would need to have declared their embedded emissions.<sup>12</sup>

The proposed UK CBAM takes a similar approach but has differences in the scope of covered products and emissions, and in how it would charge a carbon price (see section 3). Consultation on the precise design of the UK CBAM is due in 2024.<sup>13</sup>

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<sup>10</sup> European Commission, [Carbon Border Adjustment Mechanism](#) (accessed 22 January 2024).

<sup>11</sup> Ursula von der Leyen, [Speech: High-level event on carbon pricing organised by the Carbon Pricing Leadership Coalition and Canada](#), COP26 in Glasgow, 2 November 2021.

<sup>12</sup> European Commission, [Carbon Border Adjustment Mechanism](#) (accessed 22 January 2024).

<sup>13</sup> HMG, [Factsheet: UK Carbon Border Adjustment Mechanism](#), 18 December 2023, (accessed 22 January 2024).

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## 2 EU Carbon Border Adjustment Mechanism

In May 2023, the EU adopted [Regulation 2023/956 establishing a Carbon Border Adjustment Mechanism](#) (the “EU CBAM”) to put a price on greenhouse gas emissions from imports at the same level as products manufactured in the EU. In adopting its CBAM, the EU became the first jurisdiction to extend its domestic carbon price to imported emissions generated outside its borders.

The imports in scope of EU CBAM are selected products in the following sectors:

- cement
- iron
- steel
- aluminium
- fertiliser
- electricity and
- hydrogen.

A carbon price will be applied to those imports equivalent to the price faced by domestic producers operating in those sectors under the EU ETS.

Reporting obligations began on 1 October 2023. Importers will be required to pay for embedded emissions from 1 January 2026.<sup>14</sup> EU CBAM will apply to imports from the UK, and so embedded emissions from goods originating in the UK need to be reported.<sup>15</sup>

### 2.1 Design of EU CBAM

Following a transition period ending on 31 December 2025, importers will have to register to import goods within scope of EU CBAM. They can purchase CBAM certificates, which will be priced according to the average weekly cost borne by EU producers under the EU ETS. Importers will have to surrender

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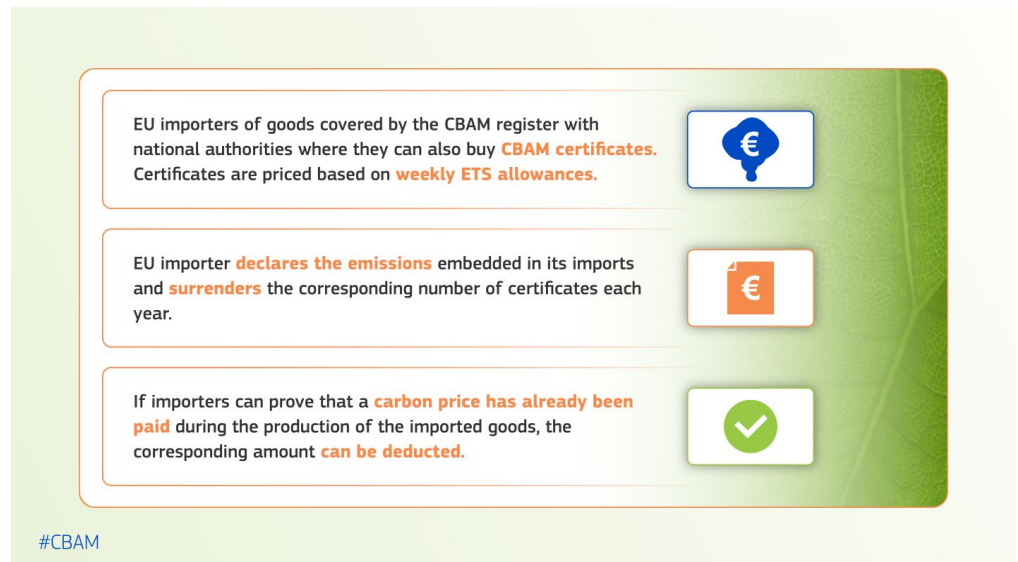
<sup>14</sup> European Commission, [Carbon Border Adjustment Mechanism](#), (accessed 22 January 2024).

<sup>15</sup> European Commission, [CBAM Questions and Answers](#) (PDF), updated 31 January 2024.

certificates at the end of the year equivalent to the amount of carbon embedded in their imported products within scope of CBAM. They will be reimbursed for any excess certificates. If a carbon price on an imported good has already been paid, fewer (or potentially zero) certificates would be surrendered.<sup>16</sup>

The design is set out in the diagram below.

### EU CBAM Description



European Commission, [Carbon Border Adjustment Mechanism](#) (accessed 22 January 2024)

The mechanism will apply to imports from non-EU countries, except four countries covered by the EU ETS or equivalent agreements (Iceland, Liechtenstein, Norway and Switzerland). There are provisions for other third countries to be exempted from applying CBAM to their imports of electricity into the EU, but subject to several conditions, including alignment with EU legislation in the areas of environment, climate, competition and energy. The regulation also requires the European Commission to explore the possibility of concluding agreements that take into account the carbon pricing mechanism of third countries.<sup>17</sup>

### What are the rules for the transition period?

While the full provisions of the regulation will not apply until 1 January 2026, reporting obligations have already come into force. This means importers must now report direct and certain indirect emissions embedded in their products, as well as any carbon price due in the country of origin.<sup>18</sup> The

<sup>16</sup> European Commission, [Carbon Border Adjustment Mechanism](#), (accessed 22 January 2024).

<sup>17</sup> [Regulation \(EU\) 2023/956, 10 May 2023](#).

<sup>18</sup> Emissions arising from the generation of electricity used to produce the goods to which the Regulation applies. From 1 January 2026, EU CBAM's scope is limited to direct emissions for iron/steel, aluminium and hydrogen, and importers of cement and fertilisers will have to declare both direct and indirect emissions.

details are set out in a [Commission Implementing Regulation](#).<sup>19</sup> This includes information about how emissions should be reported and the basis for calculating embedded emissions. The penalty for failure to comply is a charge of €10 to €50 per tonne of unreported emissions.<sup>20</sup>

Until the end of 2024, companies will have the choice of calculating their emissions in three ways:

- full assessment according to the detailed EU method set out in the implementing regulation;
- assessment based on an equivalent method; or
- assessment based on default reference values (only until July 2024).<sup>21</sup>

From January 2025, companies may only use the EU method.

The European Commission has laid out default reference values to represent the average emission intensity of a particular product. They have been set to help companies report emissions if they have insufficient data or capability to calculate the precise emissions intensity of their products.<sup>22</sup>

The Commission must review the EU CBAM Regulation and report before 31 December 2025, with a view to expanding the scope of products and embedded emissions included in the system.

## Changes to the EU Emissions Trading System

Alongside EU CBAM, the EU made changes to its Emissions Trading System (ETS). The amount of EU ETS free allowances available to sectors covered by the CBAM will be gradually reduced over a nine-year period between 2026 and 2034. During this time, EU CBAM will apply only to the proportion of emissions that does not benefit from free allowances under the EU ETS. This is to remain compliant with world trade rules (see section 4 of this briefing).<sup>23</sup>

For further information on the design of EU CBAM and how it will be applied, see the [European Commission's Q&A factsheet on the CBAM](#) (PDF).<sup>24</sup>

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<sup>19</sup> [Commission Implementing Regulation \(EU\) 2023/1773, 17 August 2023](#).

<sup>20</sup> [Commission Implementing Regulation \(EU\) 2023/1773, 17 August 2023](#).

<sup>21</sup> Default reference values will continue to be allowed for electricity given the difficulties of measuring the emissions embedded in electricity.

<sup>22</sup> European Commission, [DEFAULT VALUES FOR THE TRANSITIONAL PERIOD OF THE CBAM BETWEEN 1 OCTOBER 2023 AND 31 DECEMBER 2025](#) (PDF), 22 December 2023.

<sup>23</sup> [‘Fit for 55’: Council and Parliament reach provisional deal on EU emissions trading system and the Social Climate Fund](#), Council of the European Union, 18 December 2022, (accessed 26 January 2024).

<sup>24</sup> European Commission, [CBAM Questions and Answers](#) (PDF), updated 31 January 2024.

## 2.2

## Implications of EU CBAM for the UK

EU CBAM has implications for the UK by virtue of the Windsor Framework (previously known as the Northern Ireland Protocol) and the application of the CBAM to imports from non-EU countries.<sup>25</sup>

### Windsor Framework

To maintain an open border on the island of Ireland, the [Windsor Framework](#) requires Northern Ireland (NI) to align with a list of EU single market legislation governing the trade in goods. This guarantees that goods placed on the market in NI meet the same standards as those placed on the rest of the EU Single Market.<sup>26</sup>

There is a mechanism in Article 13(4) of the Framework to add new EU Acts to the list of applicable laws. In [a letter to the European Scrutiny Committee](#), the Minister of State for Energy Security and Net Zero (Graham Stuart MP) confirmed the Government's understanding that the Commission would propose the EU CBAM Regulation be added to the Windsor Framework. This would require a joint EU-UK decision in the Withdrawal Agreement Joint Committee.

If the EU proposed the addition and the UK declined, the EU may adopt 'appropriate remedial measures', which are undefined.<sup>27</sup> In its most recent comment on the matter, the Government said the EU had not made such a proposal, and the Government had not set out its own position on adding the regulation to the Windsor Framework.<sup>28</sup> At the time of writing, there has been no update on either the EU or UK approach.

A UK Government Minister should not normally agree to a Decision of the Joint Committee to add a new EU law to the Windsor Framework without an indication the Northern Ireland Assembly supported the application of that EU law by passing an Applicability Motion.<sup>29</sup> This would require cross-community support.

The Minister may, however, agree to the adoption of such a decision in the absence of the Assembly passing such a Motion if:

- there are exceptional circumstances that justify the adoption of the decision in the absence of an applicability motion having been passed, or

<sup>25</sup> European Scrutiny Committee, [Windsor Framework: EU Carbon Border Adjustment Mechanism](#) (PDF), 20 June 2023, HC 119-xvii 2022-23, chapter 5.

<sup>26</sup> Commons Library research briefing, CBP 9736, [Northern Ireland Protocol: The Windsor Framework](#).

<sup>27</sup> European Scrutiny Committee, [Windsor Framework: EU Carbon Border Adjustment Mechanism](#) (PDF), 20 June 2023, HC 119-xvii 2022-23, chapter 5.

<sup>28</sup> [Letter](#) from Rt Hon. Graham Stuart MP to Sir William Cash MP, 28 June 2023, (accessed 29 January 2024).

<sup>29</sup> Commons Library research briefing, CBP 9757, [Northern Ireland – The Stormont Break](#).

- the new EU Act would not create a new regulatory border between Great Britain and Northern Ireland.<sup>30</sup>

In its January 2024 [Command Paper, Safeguarding the Union](#) (PDF), the Government confirmed that any proposed addition of the EU CBAM Regulation to the Windsor Framework would be subject to an Applicability Motion.<sup>31</sup>

The Applicability Motion is a unilateral internal procedure within the UK. Professor Steve Peers, a legal commentator, said that the EU's right to adopt appropriate remedial measures if the UK does not agree to add CBAM to the Windsor Framework remains in place.<sup>32</sup>

If the regulation were to be added to the Framework to prevent goods entering the EU single market without paying the CBAM charge, EU CBAM would likely apply to the movement of at least some affected goods from Great Britain to Northern Ireland.<sup>33</sup>

Xinyan Zhao and Dongzhe Zhang, researchers at the Centre for Inclusive Trade Policy, have also argued that goods moved from Great Britain to Northern Ireland, but which risk subsequently entering Ireland, would be subject to CBAM controls when entering Northern Ireland.<sup>34</sup> These would be applied through the 'red lane', which was introduced under the Windsor Framework. All goods passing through the 'red lane' are subject to full customs checks.<sup>35</sup> Zhao and Zhang found that around 1,100 jobs would be vulnerable to disruption by this application of EU CBAM to goods entering Northern Ireland.<sup>36</sup>

[Sam Lowe, a trade expert, highlighted the additional challenge](#) that the EU ETS does not apply to NI under the Windsor Framework except for electricity generation. For other products covered by EU CBAM, the UK ETS applies in NI. Given the price of EU CBAM certificates is based on the EU ETS price, it is unclear how NI would be incorporated into the EU CBAM system.<sup>37</sup>

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<sup>30</sup> Commons Library research briefing, CBP 9757, [Northern Ireland – The Stormont Break](#).

<sup>31</sup> HMG, [Safeguarding the Nation](#) (PDF), January 2024.

<sup>32</sup> EU Law Analysis, [Just Say No? The new 'Stormont Brake' in the Windsor Framework](#), 5 March 2023, (accessed 8 February 2024).

<sup>33</sup> UK in a Changing Europe, [CBAM: what might an EU carbon border adjustment mechanism mean for the UK?](#), 3 August 2021, (accessed 8 February 2024).

<sup>34</sup> Centre for Inclusive Trade Policy, [Where Technical Meets Political: The Complexity of the EU CBAM in Northern Ireland](#), 4 September 2023.

<sup>35</sup> Commons Library research briefing, CBP 9736, [Northern Ireland Protocol: The Windsor Framework](#).

<sup>36</sup> Centre for Inclusive Trade Policy, [Where Technical Meets Political: The Complexity of the EU CBAM in Northern Ireland](#), 4 September 2023.

<sup>37</sup> UK in a Changing Europe, [CBAM: what might an EU carbon border adjustment mechanism mean for the UK?](#), 3 August 2021, (accessed 8 February 2024).

## Application of EU CBAM to the UK

Beyond the question of application to NI and the related challenges, the UK is exposed to EU CBAM as a third country trading in products that fall within the scope of the EU CBAM.

Differences between EU CBAM and the planned UK CBAM are further discussed in section 3 of this briefing.

Based on EU CBAM as adopted in EU law, three broad issues arise for the UK:

- the obligation to assess embedded emissions in UK exports to the EU and report on those,
- whether UK exports to the EU may face a charge, and
- the risk that carbon-intensive products from other countries will be diverted on to the UK market to avoid the EU CBAM.<sup>38</sup>

### Monitoring and reporting obligations

The monitoring and reporting obligations are now in force, meaning importers of affected products from the UK must report the emissions embedded in those products every quarter. The first report was due on 31 January 2024.

In a [letter about EU CBAM to the European Scrutiny Committee \(PDF\)](#), the Government said it was involved as an observer on the EU's CBAM expert group where the details of the monitoring and reporting obligations were agreed. Allowing the use of existing monitoring systems until the end of 2024 was welcomed by the Government.<sup>39</sup>

In its original [Explanatory Memorandum to Parliament on the draft EU CBAM Regulation \(PDF\)](#) in October 2021, the Government said that additional administrative costs caused by the CBAM that would apply to UK businesses “would be proportionate to the relevant industrial concentration within UK regions.” According to the UK Government, the Welsh Government had indicated these costs and their impact were of particular interest.<sup>40</sup> [Similar burdens have been identified in Scotland](#) in research undertaken on behalf of ClimateXChange, a research organisation funded by the Scottish Government.<sup>41</sup>

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<sup>38</sup> European Scrutiny Committee, [Windsor Framework: EU Carbon Border Adjustment Mechanism \(PDF\)](#), 20 June 2023, HC 119-xvii 2022-23, chapter 5.

<sup>39</sup> [Letter](#) from Rt Hon. Graham Stuart MP to Sir William Cash MP, 28 June 2023, (accessed 29 January 2024).

<sup>40</sup> The National Archives, [Explanatory Memorandum for Proposal for a Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism \(PDF\)](#), Submitted by the Department for Business, Energy and Industrial Strategy, 29 October 2021, (accessed 16 February 2024).

<sup>41</sup> ClimateXChange, [Understanding the impacts of emission trading systems and carbon border adjustment mechanisms on Scottish business \(PDF\)](#), March 2022.

This assessment was supported by [a recent paper from Dongzhe Zhang, a researcher at the Centre for Inclusive Trade Policy](#), analysing the economic significance of the EU CBAM in the UK. Zhang argued the administrative burden of applying EU CBAM would be likely to push up the costs of UK exports. This could suppress demand for UK exports and potentially reduce employment. Workers in Wales, Yorkshire and The Humber, North East, West Midlands, East Midlands and Scotland were found to be disproportionately vulnerable to the EU CBAM. According to the research, the most vulnerable sections of the workforce are males and workers aged 50 to 64 years.<sup>42</sup>

### Applying an EU CBAM charge to imports from the UK

According to UK trade statistics, iron, steel and electricity are the most exposed UK industries to EU CBAM.<sup>43</sup>

The trade association of the UK energy industry, [Energy UK](#), has expressed [concern](#) about electricity's inclusion within EU CBAM, noting that it is difficult to assign a precise value for the carbon content of electricity, which is why EU CBAM uses default values for the carbon content of electricity.<sup>44</sup> These represent the average emission factors of the electricity produced from fossil fuels in the country of origin, based on data from the International Energy Agency (IEA).<sup>45</sup>

Energy UK notes that electricity in Great Britain is produced from a mixture of renewable sources and fossil fuels, including gas, but that any single unit of electricity cannot be distinguished according to its source.<sup>46</sup> It argues that all exports of electricity from Great Britain will be considered as being from fossil fuel sources, potentially discouraging renewable generation. As such, it is concerned about the impact of EU CBAM on the generation of renewables in Great Britain and on the further deployment of offshore wind in the North Sea.<sup>47</sup>

The [minutes of the third meeting of the EU-UK Trade Specialised Committee on Goods](#) record the UK as noting “that there were still significant technical issues for electricity requiring resolution for [EU] CBAM to be operable”.<sup>48</sup>

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<sup>42</sup> Centre for Inclusive Trade Policy [The economic significance of the EU CBAM in the UK](#), 19 February 2024.

<sup>43</sup> HMG, [Overseas Trade Statistics Customs Table](#), 2023, (accessed 6 February 2024).

<sup>44</sup> Energy UK, [UK-EU Energy and Climate Cooperation: Why heightened engagement is imperative for Net Zero](#) (PDF), May 2023 .

<sup>45</sup> European Commission, [DEFAULT VALUES FOR THE TRANSITIONAL PERIOD OF THE CBAM BETWEEN 1 OCTOBER 2023 AND 31 DECEMBER 2025](#) (PDF), 22 December 2023.

<sup>46</sup> Northern Irish electricity would be treated separately as NI forms part of a distinct Single Electricity Market on the island of Ireland.

<sup>47</sup> Energy UK, [UK-EU Energy and Climate Cooperation: Why heightened engagement is imperative for Net Zero](#) (PDF), May 2023.

<sup>48</sup> HMG, [Minutes of the third meeting of the EU-UK Trade Specialised Committee on Goods](#), 25 January 2024, (accessed 16 February 2024). The EU-UK Trade Specialised Committee on Goods has been established under the UK-EU Trade and Cooperation Agreement to monitor the implementation of the trade agreement.



Hydrogen was included in the scope of EU CBAM during the negotiation of the regulation between the European Parliament and Council of the EU, having been excluded from the [original draft regulation proposed by the European Commission](#). Commenting on the inclusion of hydrogen, the Government said the impact of EU CBAM on low carbon hydrogen trade and the associated hydrogen technologies and services across the value chain is being assessed.<sup>49</sup>

For all imports into the EU of EU CBAM goods from the UK, a charge would apply where the UK ETS price was lower than the EU ETS price. Based on carbon prices in early 2024, UK companies would be liable to pay a CBAM charge for imports of the affected products into the EU from 1 January 2026.<sup>50</sup> The charge would be the difference between a higher EU ETS price and a lower UK ETS price.

The Government has confirmed this to the European Scrutiny Committee:

Where there is a carbon price differential, EU importers will be legally obliged to demonstrate the carbon price paid by the exporters and pay for any difference in carbon price via the purchasing of EU CBAM certificates.<sup>51</sup>

### **Diversion of carbon-intensive products on to the UK market**

In [a blog post about EU CBAM](#) Sam Lowe explained an effective EU CBAM would make carbon-intensive products more expensive to import into the EU. He argued this could lead to foreign exporters making a greater effort to sell their high carbon products to buyers in other markets.

The House of Lords European Affairs Committee also identified the risk of diverting carbon-intensive goods on to the UK market:

There could be serious risks in terms of trade diversion and damage to mutual UK-EU trade if their respective CBAMs on third country trade were to diverge substantially.<sup>52</sup>

The Government told the European Scrutiny Committee it was conducting analysis on the risk of carbon-intensive products being diverted onto the UK market following the introduction of EU CBAM.<sup>53</sup>

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<sup>49</sup> [Letter](#) from Rt Hon. Graham Stuart MP to Sir William Cash MP, 28 June 2023, (accessed 29 January 2024).

<sup>50</sup> At the time of writing, UK allowances were trading at £34.04, EU Allowances at €54.21. Data taken from <https://carboncredits.com/carbon-prices-today/>. (accessed 4 March 2024).

<sup>51</sup> [Letter](#) from Rt Hon. Graham Stuart MP to Sir William Cash MP, 28 June 2023, (accessed 29 January 2024).

<sup>52</sup> House of Lords European Affairs Committee, [The Future UK-EU Relationship](#) (PDF), 29 April 2023, HL 184 2022-23, paragraph 235.

<sup>53</sup> [Letter](#) from Rt. Hon Graham Stuart MP to Sir William Cash MP, 10 May 2023, (accessed 16 February 2024).

## Mitigating the impact of EU CBAM on the UK

According to the European Commission, imports of goods from all non-EU countries are covered by EU CBAM, except non-EU countries that participate in the EU ETS or have an ETS linked to the EU ETS.<sup>54</sup> Among evidence given to the House of Lords European Affairs Committee, the consensus “was that the most realistic way of securing an exemption from [EU CBAM] for the UK would be to link the respective UK and EU Emissions Trading Systems”.<sup>55</sup>

In the [UK/EU and EAEC: Trade and Cooperation Agreement](#), the two Parties agreed to consider linking their emissions trading systems.<sup>56</sup> Commenting on possible linkage, [Sam Lowe and James Low of Flint Global, a political risk consulting firm, noted](#) that linkage becomes more difficult the greater the divergence between the two systems.<sup>57</sup> They noted that, while the two approaches remain broadly similar, the EU ETS is expanding to include buildings and road transport and has a clear plan to phase-out free allowances.<sup>58</sup>

To date, there has been no reported progress, but the Government told the House of Lords European Affairs Committee it remains open to the possibility of linking the two systems.<sup>59</sup>

The Scottish Government, which is part of the UK ETS Authority, has said it “continues to favour consideration of alignment between the UK ETS and the EU ETS”.<sup>60</sup>

Under EU CBAM, the European Commission is required to explore the possibility of concluding agreements that take into account the carbon pricing mechanism of third countries, including the UK. There is no indication that any such work has begun, nor what any such agreements might comprise.

The Government has said it is discussing EU CBAM with the Commission, including in the Trade Specialised Committee on Goods, with the last

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<sup>54</sup> European Commission, [CBAM Questions and Answers](#) (PDF), updated 31 January 2024.

<sup>55</sup> House of Lords European Affairs Committee, [The Future UK-EU Relationship](#) (PDF), 29 April 2023, HL 184 2022-23, paragraph 230.

<sup>56</sup> HMG, [UK/EU and EAEC: Trade and Cooperation Agreement \[TS No.8/2021\]](#), 30 April 2021, (accessed 16 February 2024).

<sup>57</sup> UK in a Changing Europe, [UK and EU Emissions Trading Schemes – drifting in different directions?](#), 11 September 2023, (accessed 20 November 2023).

<sup>58</sup> UK in a Changing Europe, [UK and EU Emissions Trading Schemes – drifting in different directions?](#), 11 September 2023, (accessed 20 November 2023).

<sup>59</sup> House of Lords European Affairs Committee, [Government Response to Report on the Future UK-EU Relationship](#) (PDF), 30 June 2023, paragraph 60.

<sup>60</sup> Scottish Government, [UK Emissions Trading Scheme: Business and Regulatory Impact Assessment](#) (PDF), November 2023.

discussion taking place on 8 November 2023.<sup>61</sup> There has been no public indication that a formal agreement is being explored.

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<sup>61</sup> House of Lords European Affairs Committee, [Government Response to Report on the Future UK-EU Relationship](#) (PDF), 30 June 2023, paragraph 63, and HMG, [Minutes of the third meeting of the EU-UK Trade Specialised Committee on Goods](#), 25 January 2024, (accessed 16 February 2024).

## 3 UK Government plans for a UK CBAM

The UK Government plans to introduce a Carbon Border Adjustment Mechanism (“UK CBAM”) in 2027. This will make importers of carbon intensive goods liable to pay the difference in carbon price between producing these goods outside of the UK regulatory system and producing them within the UK.

### 3.1 Policy development

The Government ran [a consultation on addressing carbon leakage risk to support decarbonisation](#) from 30 March 2023 to 22 June 2023. This covered potential policies to address carbon leakage, including a carbon border adjustment mechanism (CBAM), product standards, and other policy measures to help grow the market for low emission products, as well as emissions reporting that could support the implementation of carbon leakage policy more broadly.

It published an [outcome factsheet of this consultation](#) (PDF) on 18 December 2023, setting out plans to implement a UK CBAM by 2027. Design and delivery of the CBAM will be subject to further consultation in 2024.<sup>62</sup>

Within the UK, competence for the introduction of taxes and duties, such as a CBAM, is reserved to the UK Government.<sup>63</sup> The consultation summary states that the UK Government will, however, “engage extensively with the devolved administrations to ensure the coherence of the wider policy framework”, including UK Emissions Trading System (ETS) free allowances.<sup>64</sup>

### 3.2 Design

The Government has decided it will implement a CBAM by 2027 applying a carbon price to selected imported products from the following sectors:

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<sup>62</sup> HMG, [Factsheet: UK Carbon Border Adjustment Mechanism](#), updated 18 December 2023, (accessed 13 February 2024).

<sup>63</sup> [Scotland Act 1998, Schedule 5, Part 2, Heading A1; Government of Wales Act 2006, Schedule 7A, Part 2, Heading A1; Northern Ireland Act 1998, Schedule 2, paragraph 9](#). In Northern Ireland, it is an ‘excepted’ rather than ‘reserved’ matter.

<sup>64</sup> HMG, [Addressing carbon leakage risk to support decarbonisation: Summary of consultation responses and government response](#) (PDF), 18 December 2023,

- aluminium
- cement
- ceramics
- fertiliser
- glass
- hydrogen
- iron and
- steel.<sup>65</sup>

## Categories of emissions

Emissions can be split into different categories, depending on whether they were directly emitted in an activity or whether they are the result of emissions within the wider value chain. The Greenhouse Gas ([GHG Protocol](#)) categorises these in three scopes, which are in common use:

- Scope 1 emissions are direct emissions from owned or controlled sources,
- Scope 2 emissions are indirect emissions from the generation of purchased energy (electricity, heat, steam and cooling),
- Scope 3 emissions are all indirect emissions, not included in Scope 2, that occur in the value chain of the reporting company (for example, a scope 3 emission could be the transportation of finished products by air by a subsequent business).<sup>66</sup>

In the UK, some companies are required to disclose Scope 1 and 2 emissions in their annual reports in line with the [Streamlined Energy and Carbon Reporting requirements](#). Scope 3 emissions remain largely voluntary, with reporting of [one specific type of scope 3 emissions](#) required for large unquoted companies and LLPs. A [consultation on the costs, benefits and practicalities of Scope 3 emissions reporting](#) in the UK closed on 14 December 2023.<sup>67</sup>

The Government has set out its intention that the UK CBAM will be applied to Scope 1, Scope 2, and select precursor product emissions (emissions that

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<sup>65</sup> HMG, [Factsheet: UK Carbon Border Adjustment Mechanism](#), updated 18 December 2023, (accessed 13 February 2024).

<sup>66</sup> [Greenhouse Gas Protocol website](#), (accessed 16 February 2024).

<sup>67</sup> HMG, [Call for evidence: UK greenhouse gas emissions reporting Scope 3 emissions](#), 19 October 2023 (closed 14 December 2023), (accessed 16 February 2024).

contribute to the formation of greenhouse gases) embodied in imported products, to ensure comparative coverage with the UK ETS.<sup>68</sup>

The importer of any products that fall within the scope of the mechanism will be liable for a charge under UK CBAM. There will be no purchase or trading of emissions certificates. The full scope of products and sectors to be included in the UK CBAM will be subject to additional consultation in 2024.<sup>69</sup>

The carbon price applied under CBAM will adjust for free allowances and other reductions to the carbon price paid domestically (for instance, under the ETS), and will account for explicit carbon prices in other jurisdictions. If there is a discrepancy between the UK carbon price and goods that have already passed through a different CBAM, an adjustment will be made. The Government acknowledges further work is required in setting out the criteria for comparable carbon prices elsewhere in the world to be recognised by the UK CBAM.

There is no reference in the [consultation on addressing carbon leakage risk to support decarbonisation](#) to specific design issues affecting Northern Ireland due to the potential interaction with the EU CBAM (see section 2 of this briefing). Consultation documents on the UK CBAM have not set out how it will interact with other CBAMs.

### 3.3 Views on UK CBAM

The UK Government's summary of its consultation on carbon leakage indicates support for action to tackle carbon leakage and for the government to take measures domestically, such as a CBAM, and internationally.<sup>70</sup>

#### Stakeholders

Following the Government's announcement that it intended to proceed with a UK CBAM, some stakeholders issued supportive statements. The British Chambers of Commerce described the development as "a logical and key enforcement element of lowering carbon emissions in the UK economy and tackling greenhouse gas releases elsewhere in the world".<sup>71</sup>

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<sup>68</sup> HMG, [Factsheet: UK Carbon Border Adjustment Mechanism](#), updated 18 December 2023, (accessed 13 February 2024), and

Commons Library research briefing, CBP 9212, [The UK Emissions Trading Scheme](#).

<sup>69</sup> HMG, [Factsheet: UK Carbon Border Adjustment Mechanism](#), updated 18 December 2023, (accessed 13 February 2024).

<sup>70</sup> HMG, [Addressing carbon leakage risk to support decarbonisation: Summary of consultation responses and government response](#) (PDF), 18 December 2023.

<sup>71</sup> British Chambers of Commerce, [BCC reacts to UK CBAM announcement](#), 18 December 2023, (accessed 13 February 2024).

The independent climate change think tank, E3G, also welcomed the move.<sup>72</sup> E3G had earlier commissioned polling showing strong support among manufacturers for a UK CBAM.<sup>73</sup>

## UK-wide opposition parties

UK-wide opposition parties are broadly supportive of carbon leakage measures along the lines of a CBAM. The [Labour Party's public statement on UK steel](#) is underpinned by a need to mitigate risks of carbon leakage to ensure that energy-intensive sectors remain competitive, with Labour List (a sympathetic but independent forum commenting on Labour Party news and policy) citing the need to “consider the conclusion of the government’s consultation on a carbon border adjustment mechanism, amongst other approaches”.<sup>74</sup>

Similarly, the Liberal Democrats propose measures to protect “UK businesses from unfair competition by following the EU in introducing a carbon border adjustment mechanism for high-emission products such as metals or chemicals”.<sup>75</sup>

## Concerns raised

There were some concerns expressed in response to the government consultation on a UK CBAM. These included the administrative burdens on importers, circumvention (where importers shift to a product not covered by CBAM where possible), and the passing on of increased costs to consumers.<sup>76</sup>

In June 2023 the [European Scrutiny Committee expressed concerns about the impact](#) a UK CBAM may have on prices paid by consumers “at a time when [UK inflation] is already high.”<sup>77</sup>

## 3.4

## Comparison with EU CBAM

The EU CBAM and UK CBAM are being developed separately, but there are similarities between the two. In the [Government summary of responses to its](#)

<sup>72</sup> E3G, [UK to implement a CBAM by 2027 – E3G reaction](#), 18 December 2023, (accessed 13 February 2024).

<sup>73</sup> E3G, [UK businesses overwhelmingly back carbon border tax](#), 10 November 2023, (accessed 14 February 2024).

<sup>74</sup> Labour, [Labour pledges bright future for UK steel with plan to ‘Get Britain Building’](#), 23 October 2023, (accessed 13 February 2024); Labour List, [Revealed: Full final policy platform set to shape next Labour manifesto](#), 5 October 2023, (accessed 13 February 2023).

<sup>75</sup> Liberal Democrats, [FIQ: Solving the Energy Crisis for the Long-Term \(Policy Motion as passed by conference\)](#), Spring 2023, (accessed 13 February 2024).

<sup>76</sup> HMG, [Addressing carbon leakage risk to support decarbonisation: Summary of consultation responses and government response](#) (PDF), 18 December 2023.

<sup>77</sup> [Letter](#) from Sir William Cash MP to Rt Hon. Graham Stuart MP, 14 June 2023, (accessed 16 February 2024).

[consultation](#) (PDF) on a UK CBAM, it said some responses advocated for “international alignment”, including with the EU CBAM.<sup>78</sup>

## Approach

Both the UK CBAM and EU CBAM will apply a carbon price to imported carbon-intensive goods, with the price defined by the relevant ETS. They also both calibrate implementation with a phasing-out of free allowances under the respective ETS.

The proposed UK CBAM differs from the EU CBAM in that it will not require the purchase or trading of emissions certificates, whereas this is the case with the EU CBAM (section 2.2 of this briefing).<sup>79</sup>

## Scope of products and emissions

The scope of products included in each CBAM differs. Both CBAMs cover: aluminium, cement, fertiliser, hydrogen, iron, and steel. EU CBAM also includes electricity, which the UK would omit, while UK CBAM includes ceramics and glass.

There is some divergence in the type of emissions covered. Both EU CBAM and UK CBAM cover direct (‘Scope 1’) emissions. Under EU CBAM, only indirect (‘Scope 2’) emissions arising from electricity consumed during the production process are included. The proposals for UK CBAM cover indirect emissions arising from heat, steam and cooling, as well as electricity.

The scope of products and emissions considered under the UK CBAM is subject to further consultation in 2024. Similarly, the European Commission will re-consider the scope of EU CBAM’s products and emissions before 2026.

## Timeline

The timeline also differs. The EU CBAM is already in force with most of the design details set out. There is an option for further changes to be made before it becomes fully operational on 1 January 2026. Its effect will increase over the period 2026 to 2034 as EU ETS allowances are phased out.

The UK CBAM, on the other hand, has no legislative status yet, and further design and delivery of the CBAM will be subject to consultation in 2024. The mechanism should be implemented by 2027.<sup>80</sup>

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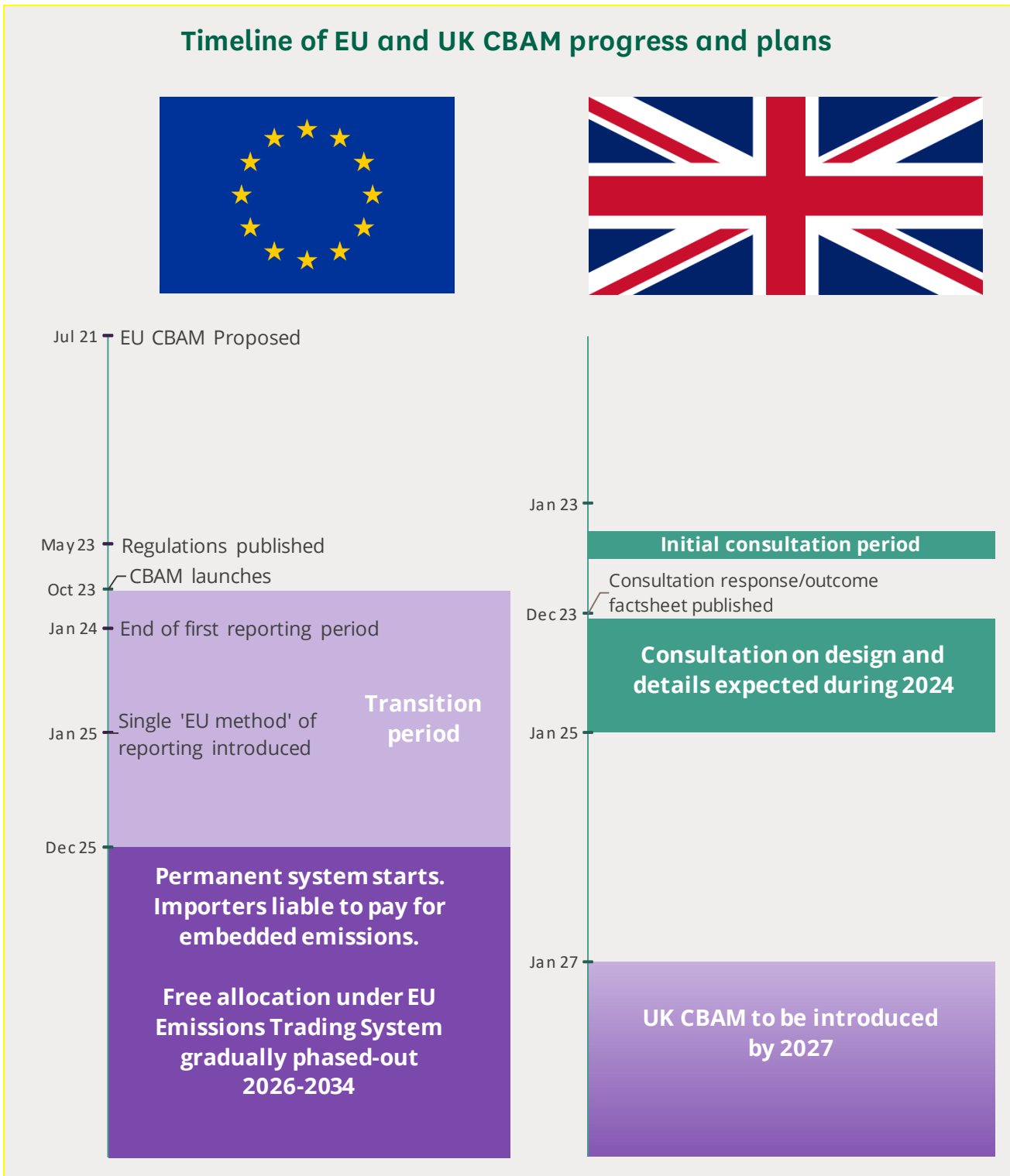
<sup>78</sup> HMG, [Addressing carbon leakage risk to support decarbonisation: Summary of consultation responses and government response](#), 30 March 2023 (updated 18 December 2023), (accessed 13 February 2024).

<sup>79</sup> HMG, [Factsheet: UK Carbon Border Adjustment Mechanism](#), updated 18 December 2023, (accessed 13 February 2024).

<sup>80</sup> HMG, [Factsheet: UK Carbon Border Adjustment Mechanism](#), updated 18 December 2023, (accessed 13 February 2024).



The diagram below sets out the respective timelines.



For an overview and further explanation of the differences between EU CBAM and UK CBAM, see the [UK-EU regulatory divergence tracker for Q4 2023 from UK in a Changing Europe](#).<sup>81</sup>

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<sup>81</sup> UK in a Changing Europe, [UK-EU Regulatory Divergence Tracker Q4 2023](#) (PDF), 24 January 2024, (accessed 1 February 2024), see page 8.

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## 4 International trade considerations

Trade experts and stakeholders have highlighted the ways CBAMs could affect international trade and development, as well as identified the risks to be mitigated. Some have warned carbon border measures could be at risk of breaching World Trade Organisation (WTO) rules if they were demonstrably discriminatory or a form of disguised protectionism.

It is important to note the application of WTO rules to a CBAM is an unclear and untested area. Nevertheless, some experts believe a CBAM can be WTO-compliant, although such compliance would depend on the details of its design.

There are also wider trade issues, such as possible retaliatory action, where trading partners introduce additional import tariffs on goods from countries which have introduced CBAMs. CBAMs could also adversely affect low and middle-income countries who have historically contributed less to global emissions. Opinions diverge on whether their special position should be recognised through exemptions from a CBAM itself, or alongside it, as a policy of targeted support.

### 4.1 Compliance with global trade rules

WTO rules aim to support economic growth and development of its members by bringing certainty in trade relations and prescribing non-discriminatory, transparent and predictable terms for trade. The WTO General Agreement on Tariffs and Trade (GATT), which covers trade in goods, aims to reduce barriers to trade such as tariffs, quotas and other restrictions. It sets rules for non-discriminatory trade practices between countries and treating domestic and imported products similarly.<sup>82</sup>

Various countries have been critical of CBAM and questioned the mechanism's compatibility with WTO rules of fair and equitable trade. Some, particularly China, have suggested they would initiate a legal challenge to the EU CBAM at the WTO.

Some trade experts, including OECD researchers and trade experts Prof. Joost Pauwelyn and Dr. David Kleimann, have demonstrated that, depending on the design of CBAMs, they could be compatible with WTO rules, including

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<sup>82</sup> WTO, [GATT \(PDE\)](#), Article XI

exemptions applicable to health and environmental measures. This has also been suggested by witnesses to the Environmental Audit Committee, including the British Standards Institution. See the Committee's report [Greening imports: a UK carbon border approach](#).<sup>83</sup>

## Which rules apply?

### National treatment and most favoured nation principle

The GATT principle of 'national treatment' prohibits discrimination against imports compared with equivalent domestic products. For example, applying an emissions tax on imported steel could be problematic if combined with issuing free carbon allowances to domestic steel producers.<sup>84</sup>

The 'Most Favoured Nation' (MFN) principle, which is central to the rules-based trading system supported by the GATT, prohibits WTO members from treating equivalent imports differently depending on their country of origin, for example by applying different emissions levies to the same type of cement or steel when imported from different countries.<sup>85</sup> Exemptions to the MFN principle are permitted for goods from countries with a free trade agreement and from developing countries.

### Tariff bindings and other trade restrictions

Under the GATT, countries also agree to a maximum ("bound") tariff for each product which is imported. For goods, these bindings refer to ceilings on customs tariff rates. If a CBAM is designed as a customs duty, the imposition of an additional tariff could therefore exceed this agreed maximum.<sup>86</sup> Generally, countries can change national tariff bindings, but only if other WTO members agree to it. If no agreement is reached, it could lead to a legal challenge at the WTO.

GATT also bans restrictions on trade "other than duties, taxes or other charges", for example import quotas, import or export licences or other measures.<sup>87</sup>

Offering domestic producers an export rebate or a subsidy compensating for their domestic carbon costs could be challenged under the WTO's Agreement on Subsidies and Countervailing Measures (ASCM).<sup>88</sup>

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<sup>83</sup> Environmental Audit Committee, [Greening imports: a UK carbon border approach: Government response](#), Fifth Report of Session 2021-22, HC 737, 4 April 2022, pp19-25

<sup>84</sup> WTO website, [Principles of the trading system](#), (accessed 26 January 2024)

<sup>85</sup> WTO website, [Principles of the trading system](#), (accessed 26 January 2024)

<sup>86</sup> OECD, [Climate Policy Leadership in an Interconnected World. What Role for Border Carbon Adjustments?](#) 23 December 2020, para 38

<sup>87</sup> [GATT](#), Article XI

<sup>88</sup> OECD, [Climate Policy Leadership in an Interconnected World. What Role for Border Carbon Adjustments?](#) 23 December 2023, paras 48, 49

## Compatible design options

In research commissioned by the European Parliament, international trade experts Prof. Joost Pauwelyn and Dr. David Kleimann have analysed potential approaches to carbon border measures in light of the WTO rules and outlined compatible design principles and risks.

To avoid a breach of the principle of national treatment, a carbon tax adjusted at the border would be easier to align with WTO rules. Pauwelyn and Kleimann argue a CBAM as a border tax could meet the “level playing field” requirement by applying an import charge equivalent to an internal tax. This could be achieved by charging imports with an equivalent carbon price to the one paid by domestic producers on a similar domestic product or input. The tax should also avoid discriminating against imports or different sources of imports. However, if found in breach, it could possibly be justified on environmental grounds (see the following section).<sup>89</sup>

As opposed to a product-specific charge, a general duty on imports from countries that do not charge for emissions would be the most vulnerable to challenge at the WTO, Pauwelyn and Kleimann write. If such a duty were conditioned on the overall policy of a country rather than embedded carbon on a specified imported product, this could be seen as coercive, and contrary to the GATT prohibition on arbitrary discrimination between countries and disguised restrictions on trade.<sup>90</sup>

## Environmental exemptions

Even if a CBAM was considered to breach some of the above rules, GATT health and environmental exceptions could be used as a justification for the measure by demonstrating that it is:

- “necessary to protect human, animal or plant life or health” or relating to the conservation of exhaustible natural resources and “made effective in conjunction with restrictions on domestic production or consumption”<sup>91</sup>, and
- does not discriminate arbitrarily between countries in similar conditions or can be seen as a disguised restriction on international trade.<sup>92</sup>

## Is a legal challenge likely?

The application of WTO rules to a CBAM is still an unclear and untested area. Regardless of the warnings expressed by some countries, various trade

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<sup>89</sup> [GATT](#), Article II 2 (a); Joost Pauwelyn and David Kleimann, [Trade Related Aspects of a Carbon Border Adjustment Mechanism. A Legal Assessment](#), Briefing for European Parliament International Trade Committee, April 2020, pp6,12

<sup>90</sup> A general measure would likely be in breach of the so-called chapeau of the health and environmental exception in [GATT](#), Article XX. As above, p12

<sup>91</sup> [GATT](#), Articles XX(b) and XX(g)

<sup>92</sup> This is the so-called chapeau of GATT Article XX; OECD, [Climate Policy Leadership in an Interconnected World. What Role for Border Carbon Adjustments?](#) 23 December 2023, paras 51-54

experts believe a CBAM can be designed to be WTO-compliant and compliance would depend on the details of any such measures. Not least, they would have to be “sufficiently linked to health or environmental concerns” rather than be justified on the grounds of maintaining international competitiveness of domestic producers and protecting them from imports.<sup>93</sup>

Alongside others, international trade experts Ieva Baršauskaitė and Alice Tipping, of the International Institute for Sustainable Development, say the tensions around CBAM suggest “that it is a question of when, not if” it is challenged under the WTO dispute settlement system. Whether a country brings a case would depend on various factors including political ones.<sup>94</sup>

However, it is worth noting that at present the WTO dispute settlement mechanism is not functioning because of the absence of its Appellate Body – the permanent court of the WTO. Further details are in section 2.2 of [the Commons Library briefing on the challenges and opportunities of the World Trade Organization](#).<sup>95</sup>

Similarly, scholars have warned that even before a formal dispute at the WTO, countries could retaliate and use WTO provisions to justify restricting access to their markets for imports from countries which have introduced CBAMs.<sup>96</sup>

### Current WTO rules not tailored to address climate change

As a wider issue, scholars question the fitness of WTO rules, which were designed thirty years ago to promote trade flows and non-discrimination in trade, to adequately respond to policies focussed on climate change.<sup>97</sup> Baršauskaitė and Tipping argue WTO disputes are not a substitute for “a meaningful international discussion on difficult new issues at the intersection of trade and climate change” and urge countries to cooperate on CBAM and carbon pricing standards (see section 5 of this briefing).<sup>98</sup>

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<sup>93</sup> Joost Pauwelyn and David Kleimann, [Trade Related Aspects of a Carbon Border Adjustment Mechanism. A Legal Assessment](#), Briefing for European Parliament International Trade Committee, April 2020, pp 6,12

<sup>94</sup> Ieva Baršauskaitė and Alice Tipping, IISD, [Border Carbon Adjustments. Priorities for international cooperation](#), August 2023; OECD, [Climate Policy Leadership in an Interconnected World. What Role for Border Carbon Adjustments?](#) 23 December 2023, paras 133-134

<sup>95</sup> Commons Library research briefing, CBP-9942, [World Trade Organization: Challenges and opportunities](#), section 2.2

<sup>96</sup> Cambridge Institute for Sustainability Leadership, [On the Borderline: The EU CBAM and its place in the world of trade](#) (PDF), October 2021, p15

<sup>97</sup> Emily Jones, Christopher Adam, [New frontiers of trade and trade policy: digitalization and climate change](#), Oxford Review of Economic Policy, Volume 39, Issue 1, Spring 2023

<sup>98</sup> Ieva Baršauskaitė, Alice Tipping, IISD, [Border Carbon Adjustments. Priorities for international cooperation](#), August 2023

## The UK aspires to design a WTO-compliant CBAM

The Environmental Audit Committee has outlined expert suggestions on how to increase compliance of the prospective UK CBAM with WTO rules and prevent challenges from trade partners, including:

- designing the CBAM ‘first and foremost with the UK’s climate objectives in mind, and for the purpose of effectively reducing carbon emissions’;<sup>99</sup>
- ensuring that ‘the carbon price applied to imports [is] no greater than that applied domestically’;<sup>100</sup>
- ensuring that the CBAM can ‘only be applied to sectors where domestic producers are subject to a carbon price’;<sup>101</sup>
- ‘limiting the CBAM to the most carbon-intensive goods which are at the highest risk of carbon leakage [to] underline the environmental objective of the tool’;<sup>102</sup> and
- allocating revenue generated by the CBAM ‘towards schemes that have similar objectives to the mechanism itself [...] i.e. decarbonisation’.<sup>103</sup>

The Government has said it would design any UK CBAM measures to comply with its international obligations including WTO commitments and the UK’s bilateral or regional trade agreements. It also said it is focussed on reaching agreement with trade partners on methodological issues, such as carbon accounting.<sup>104</sup>

The Government added it recognises least developed and low-income countries in particular “may lack the capacity, technological resource and infrastructure to comply with measures”. It will therefore consider the development issues and use financial and technical assistance to these countries to mitigate their problems.<sup>105</sup>

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<sup>99</sup> Environmental Audit Committee, Written evidence Zero Carbon Campaign ([CBM0002](#))

<sup>100</sup> As above

<sup>101</sup> Environmental Audit Committee, Written evidence Green Alliance ([CBM0025](#))

<sup>102</sup> Environmental Audit Committee, Written evidence Third Generation Environmentalism (E3G) ([CBM0018](#))

<sup>103</sup> Environmental Audit Committee, Written evidence Zero Carbon Campaign ([CBM0002](#))

<sup>104</sup> Department for Energy Security and Net Zero, HM Treasury, [Addressing carbon leakage risk to support decarbonisation : Consultation](#) (PDF), p60

<sup>105</sup> As above

## The EU insists on compatibility

The EU CBAM has been the focus of questions around compatibility with trade rules.<sup>106</sup> It has been argued that countries which are more reliant on fossil fuels and exports to the EU are more likely to oppose the EU CBAM.<sup>107</sup>

Top exporters of CBAM-covered products to the EU include Russia, China and Turkey, followed by the UK.<sup>108</sup>

To alleviate concerns of trade partners, the European Commission has expressly stated its objective is to ensure CBAM is WTO-compatible.<sup>109</sup>

However, in previous discussions, some of the EU's trade partners have raised various WTO-compliance issues. China and Russia have claimed the EU is using the climate agenda to introduce protectionist policies. Various countries are concerned about the emergence of a two-tier system with cleaner products being exported to the EU.<sup>110</sup> Brazil, South Africa, India and China have said applying EU carbon pricing to developing countries goes against the Paris Agreement's principle of Common but Differentiated Responsibilities and Respective Capacities.<sup>111</sup> Steel producers in Ukraine have urged the EU to recognise their compliance with EU requirements under the EU-Ukraine Association Agreement and offer an exemption. Turkish producers have called for EU financial assistance to support their industries' adjustment to the EU CBAM.<sup>112</sup>

While the EU CBAM has raised concerns internationally, it has not yet been formally challenged at the WTO.

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<sup>106</sup> WTO Committee on Trade and Environment, [Report of the meeting held on 16 and 20 November 2020 \(WT/CTE/M/70\)](#), 17 March 2021

<sup>107</sup> Chatham House, "[Which countries are most exposed to the EU's proposed carbon tariffs?](#)", 20 August 2021; Carboncredit.com, [EU's Carbon Border Adjustment Mechanism \(CBAM\) Faces Significant Opposition](#), 8 June 2023

<sup>108</sup> Maryla Maliszewska, Maksym Chepeliev, Carolyn Fischer, Euijin Jung, World Bank, [How developing countries can measure exposure to the EU's carbon border adjustment mechanism](#), World Bank Blogs. The Trade post, 13 June 2023

<sup>109</sup> European Parliament Research Service, [EU carbon border adjustment mechanism](#) (PDF), 12 April 2023, p3

<sup>110</sup> "[How global trade could fragment after the EU's tax on 'dirty' imports](#)", Financial Times, 9 January 2024

<sup>111</sup> "[BASIC nations oppose EU's plan to impose a 'carbon border tax'](#)", Times of India, 10 April 2021

<sup>112</sup> European Parliament Research Service, [EU carbon border adjustment mechanism](#) (PDF), 12 April 2023, p6



## 4.2

### Effect on developing countries

Many stakeholders have raised the issue of adverse effects CBAMs could have on developing countries and the Least Developed Countries (LDCs) and asked for a careful consideration of effects on particular trading partners.<sup>113</sup>

Witnesses to the Commons Environmental Audit Committee have said that among LDCs the CBAM has an image of a protectionist trade measure.<sup>114</sup> China and Russia have labelled the EU CBAM as a “green” trade barrier.<sup>115</sup>

#### Uncertainty and administrative burden

Specific issues have been raised by countries, trade experts and stakeholder organisations.

Exporters in the covered sectors (such as steel, aluminium, cement and fertilizers) in developing countries’, where many of which are fundamental to the countries’ heavy industry and export income, will experience increased uncertainty about their export markets due to CBAMs.<sup>116</sup>

Firms will also have to bear the administrative burden of CBAM-compliance. It’s been argued, for producers of ‘green goods’ in these countries, the administrative costs to demonstrate for CBAM purposes that their production is low carbon could become too high and they could cease exporting.<sup>117</sup>

Various countries are concerned about cleaner products being exported to the EU and other countries with a CBAM whereas those with a larger carbon footprint would go to poorer countries with weaker climate regulation. They stress that less developed economies have arguably less capacity to decarbonise than developed economies.<sup>118</sup>

According to the World Bank, which has assessed countries’ exposure to the EU CBAM, in absolute terms, major exporters Russia, China, Turkey and Ukraine, are the most exposed to the levy. However, by the World Bank’s relative exposure index, the countries losing most in competitiveness would be those for whom the EU is a key destination of a significant portion of their exports of the same good, and their exports have a relatively larger carbon

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<sup>113</sup> The [developing country status at the WTO](#) is based on self-declaration rather than specific requirements; this includes major economies as China, India and South-Africa. The United Nations (UN) classification determines the status of an LDC.

<sup>114</sup> Environmental Audit Committee, ‘[Greening imports: a UK carbon border approach](#)’, Fifth Report of Session 2021-22, HC 737, 4 April 2022, para 38

<sup>115</sup> “[China urges EU to ensure new carbon tariff complies with WTO rules](#)”, Euractiv, 15 September 2023

<sup>116</sup> Ieva Baršauskaitė and Alice Tipping, IISD, [Border Carbon Adjustments. Priorities for international cooperation](#), August 2023, p2

<sup>117</sup> Environmental Audit Committee, ‘[Greening imports: a UK carbon border approach](#)’, Fifth Report of Session 2021-22, HC 737, 4 April 2022, para 38

<sup>118</sup> “[How global trade could fragment after the EUs tax on ‘dirty’ imports](#)”, Financial Times, 9 January 2024

footprint). By this measure the most affected countries include Zimbabwe as a major exporter of iron and steel to the EU, Ukraine, which exports large quantities of fertilizer, and Mozambique, for which the EU is the main destination of aluminium exports.<sup>119</sup>

Another issue is that at present there is no common international standard for calculating the embedded carbon footprint of goods arriving at the border. Experts say measuring actual emissions of an exported product would be preferable and most fair as opposed to a broader, sector-based or a country-specific emissions benchmark. But such calculations are, as a rule, very complex and hard to get right.<sup>120</sup>

The EU has been the first to adopt a standard for its CBAM and serves as a test case. See section 2.2 above for the EU's approach, which roughly gives importers a choice between a product-specific calculation or equivalent calculation, and a default reference value.

## Is an exemption from CBAM viable?

Generally, two approaches have been offered to solving the developing countries' and LDCs problem:

- an exemption for certain countries from CBAM or a carbon price reduction on certain imports from developing countries, or
- an equal carbon price for all countries, supplemented by targeted support to decarbonise industries in developing countries.

Various stakeholders, including trade scholars, environmental non-governmental organisations (NGOs) and campaign organisations such as the Trade Justice Movement, have supported the idea of treating least developed countries differently for CBAM purposes.<sup>121</sup> They highlight that it would be unreasonable for poorer countries with lower historical emissions to bear the

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<sup>119</sup> The World Bank experts measure a country's exposure to the EU CBAM for any particular good in absolute terms—reflecting the total potential cost of certificates for its exporters—and in relative terms—reflecting the effect of the policy on their competitiveness in EU markets. A comparable index for UK trade is not available at this time.

Maryla Maliszewska, Maksym Chepeliev, Carolyn Fischer, Euijin Jung, World Bank, [How developing countries can measure exposure to the EU's carbon border adjustment mechanism](#), World Bank Blogs. The Trade post, 13 June 2023

<sup>120</sup> Emily Jones, Christopher Adam, [New frontiers of trade and trade policy: digitalization and climate change](#). Oxford Review of Economic Policy, Volume 39, Issue 1, Spring 2023, p7; Ieva Baršauskaitė and Alice Tipping, IISD, [Border Carbon Adjustments. Priorities for international cooperation](#), August 2023, p3; Environmental Audit Committee, Written evidence Zero Carbon Campaign ([CBM0002](#)); Citizens' Climate Lobby UK ([CBM0007](#)); Trade Justice Movement ([CBM0016](#));

<sup>121</sup> Environmental Audit Committee, '[Greening imports: a UK carbon border approach](#)', Fifth Report of Session 2021-22, HC 737, 4 April 2022, para 39

same costs as developed countries, which have historically contributed a larger share of cumulative carbon emissions.<sup>122</sup>

In 2021, considering a possible EU CBAM, the European Parliament urged the European Commission to grant LDCs special treatment that would take account of the potential negative impacts of the CBAM on their development.<sup>123</sup>

It's also been noted the guiding principle of international climate negotiations, "common but differentiated responsibilities and respective capabilities" deserves attention. Under the Paris Agreement, for example, a country's national circumstances can be considered when making its climate commitments, which implies that developed countries carry a larger responsibility for addressing climate and environmental issues than developing countries. The latter might argue the CBAM policy of treating all countries the same runs counter to the Paris Agreement's bottom-up, nationally determined contributions, and could push them to cut emissions more than what they have pledged.<sup>124</sup>

However, researchers at the Atlantic Council Global Energy Center, an American international affairs think tank, argue that treating developing countries as a homogenous group is not justified and a tailored approach is preferable:

Carbon border adjustments would have a highly varied impact on developing countries, and the impact will depend a great deal on how the policy is designed; for instance, an exemption for very poor countries is conceivable. But broadly speaking, a carbon border adjustment will be positive for some developing countries, will impact others negatively, and some will see little or no effect.<sup>125</sup>

At the same time, the approach of differentiated treatment carries risks. Industry organisations have told the Environmental Audit Committee that, with exemptions in place for some countries, others could look to re-route their exports through these countries. Moreover, without additional support

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<sup>122</sup> Sam Lowe's analysis for the Centre for European Reform, [The EU's carbon border adjustment mechanism: how to make it work for developing countries](#), 2021

<sup>123</sup> European Parliament, , Texts adopted, 10 March 2021, para 8

<sup>124</sup> Randolph Bell, Richard Morningstar, Elena Benaim, [Carbon border adjustment: a powerful tool if paired with a just energy transition](#), Atlantic Council Global Energy Center, in OECD: Development matters, 27 October 2020; Environmental Audit Committee, Written Evidence Dr Alice Pirlot (Research Fellow at Oxford University Centre for Business Taxation) (CBM0031); Sam Lowe, Centre for European Reform, [The EU's carbon border adjustment mechanism: how to make it work for developing countries](#), 2021

<sup>125</sup> Randolph Bell, Richard Morningstar, Elena Benaim, [Carbon border adjustment: a powerful tool if paired with a just energy transition](#), Atlantic Council Global Energy Center, in OECD: Development matters, 27 October 2020

LDCs could be left with the traditional, more carbon-intensive production methods.<sup>126</sup>

Trade expert Sam Lowe notes that applying different rates to different countries would complicate the mechanism. Determining the origins of a product could add an additional level of complexity, because it requires taking into account the origins of inputs and the level of processing done on goods in a particular country.<sup>127</sup>

### Targeted support

If developing countries are not exempt from CBAM, their varied position could be recognised through a policy of targeted support, alongside a CBAM.<sup>128</sup> This would potentially involve technical and financial assistance to the LDCs, and close consultation with trading partners in low- and middle-income countries on the design of a CBAM.<sup>129</sup>

Barsauskaite and Tilley say careful consideration should be given to the use of CBAM revenues. They argue a share should be diverted to support developing countries, considering that some may require assistance more than others. Therefore, criteria should be adopted to help prioritize the use of CBAM revenues.<sup>130</sup> These revenues are currently estimated to [reach USD 80 billion per year by 2039](#) for EU CBAM, depending on carbon price and emissions intensity.

Think tanks such as the Overseas Development Institute, the Atlantic Council and others argue that attention should be paid to fair transition policies to support countries reliant on exports of particular CBAM goods, such as Mozambique and other African countries, as they are expected to experience the most adverse effects from CBAM.<sup>131</sup>

An August 2020 article by the Centre for Strategic and International Studies, [How can Europe get carbon border adjustment right?](#), highlights the importance in setting the cost of carbon at the right level so as to produce a mechanism effective at reducing emissions but that does not unduly penalise poorer countries:

There exists, in other words, a sweet spot. Set the carbon price too high and you splinter the world trading system—one world becomes low carbon, another becomes high carbon, with limited trade between them. Set the price

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<sup>126</sup> Environmental Audit Committee, 'Greening imports: a UK carbon border approach', Fifth Report of Session 2021-22, HC 737, 4 April 2022, para 39; "[How global trade could fragment after the EU's tax on 'dirty' imports](#)", Financial Times, 9 January 2024

<sup>127</sup> Sam Lowe, [Should the EU tax imported CO2](#), 24 September 2019

<sup>128</sup> Environmental Audit Committee, 'Greening imports: a UK carbon border approach', Fifth Report of Session 2021-22, HC 737, 4 April 2022, para 39

<sup>129</sup> Environmental Audit Committee, 'Greening imports: a UK carbon border approach', Fifth Report of Session 2021-22, HC 737, 4 April 2022, paras 39-40

<sup>130</sup> Ieva Baršauskaitė and Alice Tipping, IISD, [Border Carbon Adjustments. Priorities for international cooperation \(PDF\)](#), August 2023, p2

<sup>131</sup> Jodie Keane, [Overseas Development Institute. Carbon Border Adjustment Mechanisms: clarity needed on support for adjustment](#), 2 October 2023

too low and it becomes a modest cost that is absorbed into final prices without much decarbonization impact.<sup>132</sup>

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<sup>132</sup> Centre for Strategic and International Studies, [How can Europe get carbon border adjustment right?](#), August 2020

## 5 Global cooperation

Global fragmentation of carbon border measures could be costly, not only for developing countries, but any producers in countries introducing their own CBAMs. This is because in absence of a common global standard, different methods to calculate emissions content of goods are used. Trade experts Ieva Baršauskaitė and Alice Tipping have argued this fragmentation would lead to a radical adjustment of supply chains with some suppliers redirecting exports.<sup>133</sup>

As set out in section 4.2, there are concerns about diversion of trade or the emergence of a two-tier system for trade in cleaner goods among the developed economies and more carbon-intensive goods in the less developed ones.

In December 2023, the UK Government confirmed its view that carbon leakage is best solved by working together at the global level, but that such work takes time:

the best solution to carbon leakage is an international one. The UK and many others around the world are working to reduce carbon leakage risk by pushing for ambitious climate action. But progress on international solutions takes time.<sup>134</sup>

Similarly, the Director General of the World Trade Organization said in 2021 that a global approach was required to avoid the risks arising from fragmented unilateral approaches.<sup>135</sup>

[Sam Lowe, a trade expert](#), noted that countries may respond in two ways to EU CBAM. The first is to develop their own similar, but unilateral, schemes. The second is to forge some sort of ‘climate club’ (see below).

There are signs that, in the absence of a global consensus, countries are moving ahead unilaterally, while also considering co-ordination. The UK has already set out its plans for a CBAM based on the same principles as the EU CBAM. Other countries, including Canada and Australia, are reportedly also

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<sup>133</sup> Ieva Baršauskaitė and Alice Tipping, IISD, [Border Carbon Adjustments. Priorities for international cooperation](#), August 2023, p3

<sup>134</sup> HMG, [Factsheet: UK Carbon Border Adjustment Mechanism](#), updated 18 December 2023, (accessed 13 February 2024).

<sup>135</sup> Financial Times, [‘Ngozi Okonjo-Iweala: Adopting a global carbon price is essential’](#), 14 October 2021.

considering similar mechanisms.<sup>136</sup> India is reported to be developing its own carbon tax in response to EU CBAM.<sup>137</sup>

In the USA, various ideas have been discussed but nothing, to date, has been approved. Proposals for a carbon border tax from two Democratic senators were summarised in a February 2023 article by the independent think tank, the American Action Forum (AAF).<sup>138</sup> In March 2023 Forbes reported that Republican Senator Bill Cassidy had proposed an American CBAM in a debate.<sup>139</sup>

At the same time, there are efforts for a more coordinated approach. [A 'Climate Club' was launched](#) (PDF) on 1 December 2023 at the COP 28 Climate Summit in Dubai, having been co-founded by Germany and Chile. It has 36 members including the UK, USA, EU and Turkey. As set out in [the Climate Club's 2024 Work Programme](#) (PDF), part of its focus will be to cooperate on carbon leakage measures, with upcoming specific work on measuring emissions intensity.<sup>140</sup>

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<sup>136</sup> Financial Times, '[How global trade could fragment after the EUs tax on 'dirty' imports](#)', 9 January 2024, (accessed 5 February 2024).

<sup>137</sup> [India weighs local tax options to avoid EU carbon levy – minister](#), Reuters, 2 November 2023 (accessed 20 November 2023).

<sup>138</sup> American Action Forum, [U.S. Carbon Border Adjustment Proposals and World Trade Organization Compliance](#), 8 February 2023

<sup>139</sup> Forbes, [Bipartisan Carbon Border Adjustment Mechanism - A Political Unicorn?](#), 15 March 2023

<sup>140</sup> Climate Club, [Climate Club Work Programme 2024](#) (PDF), 27 October 2023.

## 6 Further Reading

### Effectiveness of CBAMs

Several articles have examined CBAMs in the context of their potential to address carbon leakage and reduce carbon emissions:

- Energy Economics, [Why carbon border adjustment mechanisms will not save the planet but a climate club and subsidies for transformative green technologies may](#), volume 122 June 2023
- Energy Policy, [Alternative carbon border adjustment mechanisms in the European Union and international responses: Aggregate and within-coalition results](#), volume 174, March 2023
- United Nations Environment Programme, [Position paper on Governmental Carbon Pricing](#), June 2022

### UK CBAM

- The Commission for Carbon Competitiveness, [Fixing the Carbon Leak](#), July 2023
- UK Trade and Business Commission, '[UKTBC Evidence Report: CBAM and Net Zero](#)', November 2023

### EU CBAM

- UK Government, [Summary of European Commission guidance on the EU CBAM for UK exporters](#), 17 January 2024
- European Parliament Research Service, [EU carbon border adjustment mechanism](#), 12 April 2023
- European Parliament Research Service, [EU carbon border adjustment mechanism: Implications for climate and competitiveness](#), 24 March 2023



## Trade considerations

Several commentators and academics have analysed the EU CBAM and proposals for CBAMs in other countries in the context of implications for international trade. See:

- Centre for Inclusive Trade Policy, Emily Lydgate, [A trade strategy to support domestic decarbonization and environmental objectives](#), 4 April 2023
- Oxford Review of Economic Policy, Volume 39, Issue 1, Spring 2023 [Special on trade and climate change & digitalisation]:
  - Emily Jones, Christopher Adam, [New frontiers of trade and trade policy: digitalization and climate change](#)
  - [Trading in the era of carbon standards: how can trade, standard setting, and climate regimes cooperate?](#) Aik Hoe Lim, [Kateryna Holzer](#)
  - [From theory to practice: determining emissions in traded goods under a border carbon adjustment](#), [Michael A Mehling](#), [Robert A Ritz](#)
  - [The political economy of carbon border adjustment in the EU](#), [Michael Jakob](#)
  - [Competition, trade, and sustainability in agriculture and food markets in Africa](#), [Simon Roberts](#)
- Sam Lowe, [Most Favoured Nation: CBAM Dominoes - by Sam Lowe \(substack.com\)](#) 16 December 2022
- Cambridge University Press, [Reconciling the Climate/Industrial Interplay of CBAMs: What Role for the WTO?](#), 18 July 2022
- Emily Lydgate, [Addressing UK greenhouse gas emissions through trade policy](#), Centre for Inclusive Trade Policy blog, 29 June 2022 (contains link to full report for Committee on Climate Change)

## United States

For further reading and commentary on United States measures see:

- Forbes, [Bipartisan Carbon Border Adjustment Mechanism - A Political Unicorn?](#), 15 March 2023


- E&E News, [Carbon border fee gains traction, but hurdles remain](#), 4 May 2022
- Foreign Affairs, [Green Gridlock How to Fix the U.S.-EU Disconnect on Climate](#), 25 April 2023
- UK Trade Policy Observatory, [Trade policies and emissions reduction: establishing and assessing options](#) (PDF), June 2022
- CED Policy Brief, [US and EU Proposals for Carbon Border Adjustment Mechanism](#) (PDF), December 20, 2022
- E3G, [US perspectives on Carbon Border Adjustment Mechanisms](#) (PDF), September 2021

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