Challenges and Opportunities of the EU Carbon Border Adjustment Mechanism (CBAM) for the Western Balkan Countries

1 Introduction: What is the EU CBAM and how does it work

What is the purpose of CBAM?

The EU Carbon Border Adjustment Mechanism (CBAM) is designed to create a level playing field for European producers obligated to buy emission allowances under the EU Emissions Trading System (ETS) and their non-European competitors. It will replace free allocation as the primary instrument for carbon leakage protection. By putting an equal price on the greenhouse gases (GHG) embedded in carbon intensive goods entering the EU, it is meant to push EU industry to decarbonization whilst avoiding carbon leakage, incentivize emission reductions by third-country importers and, thereby, contribute to a reduction of global carbon emissions in line with the Paris Agreement.

What products and emissions are covered?

CBAM currently covers the products, emissions and scopes shown in the table below. The list can be expanded to cover additional products. The current list would be subject to a review prior to the start of the regular phase. The review will include a timetable setting out their inclusion by 2030**.**

Products[1]	Greenhouse Gases	Emissions covered
Cement, incl. various types of it and cement clinkers	CO_2	Direct and indirect[2]
Electricity	CO_2	Direct and indirect
Nitrogen-based fertilizers	CO_2 and N_2O	Direct and indirect
Iron and steel, incl. some final products like railway infrastructure, pipes, building structures, containers, screws and bolts	CO_2	Direct
Aluminium, incl. some final products like plates and sheets, pipes, building structures, containers, wires and cables	CO_2 and perfluorocarbons	Direct
Hydrogen	CO_2	Direct

Table 1. Products, emissions and scopes covered by the EU CBAM

How does CBAM function and when will it come into force?

The EU CBAM Regulation (2023/956)[3] came into force in May 2023, initiating a two-year transition phase that started on October 1st 2023. During this period, importers of certain industrial raw materials and goods from third countries must submit quarterly reports detailing the emissions associated with these products. No financial obligations arise during the transition phase.

[1] For Combined Nomenclature codes see Annex I of the CBAM Regulation.

[2] Direct emissions are emissions resulting from the production process within the system boundaries referred to in the implementing act adopted pursuant to Article 7(7) of the CBAM Regulation (Scope 1); indirect emissions are emissions resulting from the production of electricity consumed in the production processes of goods within the system boundaries.

[3] Regulation (EU) 2023/956 of the European Parliament and of the Council of 10 May 2023 establishing a carbon border adjustment mechanism, https://eur-lex.europa.eu/eli/reg/2023/956/oj

From the regular phase, which begins on January 1st 2026, importers of CBAM goods must be authorized as CBAM declarants to acquire and surrender CBAM certificates for the embedded emissions. The price of certificates will be calculated depending on the average auction price of EU ETS allowances of the previous week. CBAM will be phased in gradually and in an inverse proportion to the phase-out of EU ETS free allowances. As a result, it will be fully implemented by 2034. CBAM puts a price on carbon emissions but does not apply any decreasing cap on them. As CBAM is not a market, carbon certificates are neither tradeable nor bankable and they are cancelled as soon as they are surrendered for compliance.

What countries are affected? Are exemptions possible?

While CBAM applies to all countries outside the EU ETS[4], there are two ways for EU trading partners to (partially) avoid it according to the CBAM regulation:

- Article 2 (6): If a trading partner has implemented a domestic carbon price in the relevant sectors, this price will be deducted from the CBAM levy. However, to completely avoid CBAM, such a carbon pricing system would need to be established by 2025 and the carbon price should correspond to the current price of EU ETS allowances.

- Article 2 (7): If a country's electricity market is integrated with the EU's and fulfils a set of additional criteria (such as setting a 2050 climate neutrality goal, adopting the EU acquis on electricity, renewables and environment as well as introducing carbon pricing for electricity), the country's electricity sector will be exempt from any CBAM obligation. However, an exemption can be revoked if the country has not shown sufficient compliance with the above conditions or took action incompatible with the EU climate and environmental legislation, e.g. provided public support for new generation capacity that emits more than 550 g CO_2/kWh of fossil fuel-based electricity (i.e. new coal plants).

2 Status Quo: Possible CBAM Impacts on Companies in the Western Balkan Countries (WB6)

What impact can CBAM have on WB6?

Companies from Albania and Kosovo are likely to be less affected: Albania mainly relies on hydropower for its power production and industry and therefore has a rather low carbon intensity of electricity. According to the World Bank Relative CBAM Exposure Index, it might even gain competitiveness in comparison to the average EU producer of the goods it exports.[5] Kosovo's exports to the EU are minimal, constituting only about 1 % of its GDP.

Bosnia and Herzegovina, Montenegro, North Macedonia and Serbia are likely to face a more significant impact, as CBAM exports to the EU account for between 4 and 6 % of their GDP. Since they still heavily rely on coal for their electricity generation, the carbon intensity of the fossil share of the electricity sector (1 – 1.1 t CO_2/MWh) is considerably above the EU average.[6]

Bosnia and Herzegovina and Serbia mostly export electricity, aluminium as well as iron and steel to the EU, so that the exporters from these sectors are going to be the ones most affected by CBAM. In Montenegro, mostly electricity and aluminium exporters will be affected. In North Macedonia, the most affected exporters will be from the iron and steel as well as electricity sectors. In all countries, existing and planned coal assets will most

[4] In addition to the EU member states, Iceland, Norway, Liechtenstein and Switzerland are exempted from CBAM as they have either adopted EU ETS or linked their own ETS to it.
[5] The index measures the additional cost of CBAM certificates for exporters compared to the average EU producer, , adjusted by the proportion of exports to the EU market. It assumes a carbon price of $100 per metric ton and takes into account emissions costs for EU producers. Relatively clean exporters therefore can gain competitiveness compared to EU companies. https://www.imf.org/-/media/Files/News/Seminars/2023/9th-joint-imf-WBG-WTO-trade-conference/session-23-maliszewska.ashx
[6] https://bankwatch.org/wp-content/uploads/2022/12/2022-12-05_The-Western-Balkan-power-sector.pdf

likely become unprofitable after the CBAM phase-in due to limited export opportunities to the EU and higher production costs.[7]

What measures can WB6 take to minimize the impact of CBAM? Where do they stand on the implementation of these measures?

To minimize the costs of CBAM, the WB6 could introduce carbon pricing either for all CBAM goods or at least the electricity sector (in addition to fulfilling the other requirements of Article 2 (7)). In both cases, the revenues of national CO_2-pricing would be higher than those of CBAM since all enterprises would be subject to it and not just EU importers. If we assume a moderate carbon price of 50 Euro per tonne, the WB6 countries would collect 2.8 billion Euro annually from producers of fossil-fuel-based electricity alone.[8] The revenue would stay in the countries and could be used to finance decarbonization or just transition projects.

What is the status on introducing carbon pricing in the WB6?

So far, only Montenegro has introduced a national cap and trade scheme in 2020. Whereas it marks considerable progress in comparison to the other WB countries, it only effectively encompasses one coal plant[9] and has a price of 24 Euro per tonne CO_2 – well below the EU ETS price. The other WB countries have either made public statements on considering carbon pricing or have started with establishing legal basis for its introduction, but the work ongoing has not been publicly visible.

Whereas most WB countries have considered introducing national carbon pricing,[10] which would allow them to keep the revenues in the country and avoid additional coordination burden, the Energy Community has been advocating for a regional ETS. It argues that a regional system would ensure that emissions are reduced where it is cheapest to do so, while allowing to avoid issues of low liquidity of allowances, which is a problem smaller WB countries might encounter. It would also significantly reduce the administrative costs of setting up and implementing the ETS.

What is the status on electricity market coupling and implementing other requirements of Article 2 (7)?

Whereas Article 2 (7) is often interpreted as automatically applying to WB6, none of the countries actually has electricity market coupling with the EU yet. As of February 2024, only North Macedonia and Serbia have submitted their drafts of new Energy Laws to the Energy Community Secretariat (EnCS) and only Serbia has managed to create an intraday and day-ahead electricity market.

As contracting parties of the Energy Community, the WB6 adopted several key documents that constitute a cornerstone for fulfilling the other requirements of Article 2 (7), including the Electricity Integration Package (legal basis for market coupling), Energy Community Treaty (assuming an obligation to apply EU acquis on energy, renewables, environment and competition), Sofia Declaration on the Green Agenda (commitment to carbon neutrality by 2050). However, the transposition of these goals and policies into national legislation has not been completed yet and is marked by delays.

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[7] https://static.agora-energiewende.de/fileadmin/Projekte/2021/2021_01_EU_Balkan_Green_Deal/A-EW_251_CBAM_WB-6_WEB.pdf

[8] The 2015 to 2020 annual average CO2 emissions from fossil fuel power and heat generation in the Western Balkans amounted to 56.783.333 tonnes, according to the International Energy Agency, https://www.iea.org/data-and-statistics/data-tools/energy-statistics-data-browser?country=SERBIA&fuel=CO2%20emissions&indicator=CO2EleBySource

[9] Since the Kombinat Aluminijuma Podgorica (KAP) and the Niksic steel mill that were initially part of the Montenergo's ETS are now virtually closed, the scheme mainly focuses on the Pljevlja coal plant.

[10] https://balkangreenenergynews.com/bih-to-prepare-co2-taxing-system-by-2026/; https://balkangreenenergynews.com/serbia-proposes-national-co2-pricing-system-instead-of-regional-ets/; https://balkangreenenergynews.com/which-western-balkan-countries-intend-to-introduce-carbon-tax/; https://balkangreenenergynews.com/bih-to-prepare-co2-taxing-system-by-2026/;

3 Outlook: Transforming the CBAM Challenge into an Opportunity

Climate and environmental benefits: While CBAM poses challenges to industries with high energy and carbon intensity, it also offers an opportunity for WB6 countries to decarbonize their industries and advance environmental policies, yielding co-benefits such as cleaner air and water.

Accelerated EU integration: The consistent implementation of key elements of the EU acquis into national legislation has already enabled closer cooperation with EU institutions, regular feedback and financial support. It also requires streamlining administrative and legislative processes in the WB6. This could accelerate the countries' EU accession processes.

Economic resilience and energy security: A coordinated phase-out of coal power, including halting plans for new plants, would help to avoid revenue losses from declining EU exports, uncontrolled layoffs and stranded assets. A consistent legal framework for decarbonization and investments in renewable energy would ensure energy security, enable profitable exports to the EU and create high-quality jobs. All WB6 countries could significantly profit from accelerating the deployment of wind and solar energy. For North Macedonia alone, IRENA estimates the potential for almost 60 % renewables in the power sector by 2030, whereas for Serbia it estimates a share of 46 %.

Carbon pricing revenues for efficient and just transition: Introducing a carbon pricing mechanism for the industry and power sectors, whether through a CO_2 tax or an emissions trading system, is the most effective option for the WB6 countries to respond to CBAM, encourage decarbonisation and use revenues to support the affected industry or to finance social compensation. Coordinated price levels – either through national schemes or a regional ETS – would help address carbon leakage concerns. Moving forward as a group would allow the WB6 countries to build capacity faster and share expertise on implementation. However, for carbon pricing to be effective, existing fossil fuel subsidies need to be phased out and power markets need to be reformed.

Benefiting from EU support: The EU provides substantial financial and technical support for the region's energy transition, including through the Instrument for Pre-Accession Assistance (IPA III) and investments in the framework of the Western Balkans Guarantee Facility. In addition, the Platform Initiative for the Western Balkans and Ukraine, launched in 2020 to support coal regions in their transition, could be modernised to include robust funding mechanisms and territorial just transition plans.

While the road to decarbonisation presents challenges, it also offers the WB6 nations a transformative opportunity to make strides toward cleaner energy, stronger economies, and closer integration with the European Union – ultimately paving the way for both environmental and economic resilience.

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