

The EU's border tax poses major challenges for Indian businesses

The compliance burden will be heavy and we must ponder how carbon pricing here can lighten it



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Th EU's Carbon Border Adjustment Mechanism (CBAM) requires all EU imports to bear the same cost for each tonne of carbon dioxide (CO₂) emitted as those being produced in the EU. Initially confined to six sectors—iron and steel, aluminium, cement, fertilizers, electricity and hydrogen—it will eventually expand its coverage.

For India, the immediate impact is on two sectors: aluminium and steel. The EU is a major destination for these, accounting for about 27% of India's aluminium and 38% of steel exports.

The CBAM's current phase, which runs till 31 December 2025, is focused on detailed data reporting of both direct and indirect emissions. The former are those generated during the production processes of CBAM goods, including of relevant precursors. Indirect emissions cover the production of electricity that is consumed during the production of CBAM goods.

CBAM levies commencing 1 January 2026 will focus only on direct emissions. Their impact on aluminium from India is expected to be in the range of 7-10% ad valorem duty. However, when indirect emissions are included, the impact could potentially be over 70%, effectively closing the EU as a market for Indian aluminium exports. This is because in India, aluminium smelters run on coal-fired electricity. Greener sources of producing aluminium by

way of hydro or gas-based electricity account for far fewer emissions. But shifting to renewable energy is a challenge in India, given the need for round-the-clock power, constraints on the availability of alternative sources such as hydro, gas and nuclear energy, and unviable battery-storage options.

There is also a significant ripple effect of the CBAM, even in the current 'report only' phase. Non-EU customers are demanding CBAM declarations from Indian manufacturers as further value is added to imports from India in these countries and supplied to EU markets. While the Indian government has indicated that it would be seeking waivers from the EU for Indian MSMEs, there is no mechanism within EU's CBAM regulation for this.

Despite the EU's attempt to extol the virtues of CBAM—that it will nudge countries to decarbonize production—the reality is different. The EU's system penalizes imported emissions at its own rates. If product A produced in the EU and product B made in India each yields the same quantity of CO₂ emissions (say, 10 tonnes), CBAM requires the importer of product B to pay EU authorities the difference in price-per-tonne of CO₂ paid in India and that determined by the EU for its producers. Not only will this make such imports less competitive, ironically, it will result in reverse financing of the EU's carbon budget by developing countries.

While there are larger questions about how this upends the balance achieved under the UN Framework Convention on Climate Change (UNFCCC) and potentially flouts WTO rules, pressure is building up on businesses to put in place mechanisms to comply. At a basic operational level, clarity is needed on several aspects.

Arriving at a carbon price in India: India does not have an explicit price for CO₂ right now, but its regulatory framework addresses CO₂ emissions in ways that place an implicit price on emissions. This includes Renewable Purchase

Obligations (RPOs) by electricity distribution licensees (the compliance trajectory for which has steepened), energy efficiency by notified industries (aluminium and steel included), a coal cess, taxes on mining, etc. Most businesses have sustainability plans. We need a clear methodology for assessing the resultant implicit price of CO₂. While it is unclear whether the EU will allow adjustments based on such implicit carbon price assessments, it could mitigate the price burden of CBAM.

Data privacy and protection: At the end of the reporting period, the EU will have access to a minefield of installation-level emissions data from all over the world. Most of this is business sensitive data, access to which necessarily needs to be restricted.

Alignment of the CBAM with India's CCTS: India is in the process of developing its own carbon credit trading system (CCTS), which can be an important framework for carbon pricing in India. Whether it subsumes or subsists with existing mechanisms (such as RPO targets) remains to be seen. It would be useful to consider ways in which this can align with the CBAM, and whether this can simplify compliance.

Addressing these, however, are only stop-gap arrangements. The UK will also shortly start implementing its version of the CBAM, largely along EU lines. Both the UK and EU CBAMs may nullify the benefits of any tariff reduction and market access under free-trade agreements being negotiated with India. While the immediate impact may be on aluminium and steel, CBAM's applicability to other sectors will raise risks for Indian businesses.

Certainty and predictability are needed for both the climate and business climate. Mechanisms like CBAM arm-twist countries to follow only one jurisdiction's vision aligned with its own industrial interests. Such unilateralism does a disservice to both climate justice and economic logic.

These are the authors' personal views.