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## POLICY MEMO

# How the introduction of the carbon price will shape the energy future of Bosnia and Herzegovina

**Carbon (CO<sub>2</sub>) pricing** is a fiscal instrument that governments use to encourage companies and other emitters to switch to renewable energy sources and adopt new technologies to reduce emissions, to achieve national and international climate goals.

There are two main types of carbon pricing: emissions trading systems (ETS) and CO<sub>2</sub> taxes. The CO<sub>2</sub> tax directly determines the price of CO<sub>2</sub> emissions, while the ETS sets the upper limit of CO<sub>2</sub> emissions in certain sectors, requiring a permit for each ton of CO<sub>2</sub> emitted. The choice of a combination of instruments and modalities for charging carbon emissions depends on political goals and circumstances and is only one of the necessary instruments for achieving national and international climate goals. CO<sub>2</sub> price helps shift the burden of damage onto those who are responsible for it and who can reduce it.

### Why is this instrument relevant for Bosnia and Herzegovina?

The European Emissions Trading System (EU ETS) was introduced in 2005 and will be further strengthened and expanded soon, supported by the new Energy Tax Directive and the Carbon Border Adjustment Mechanism (CBAM). CBAM is introduced as a fee/duty on carbon emitted during the production of carbon-intensive product groups (iron and steel, cement, fertilizers, aluminum, electricity, and hydrogen), which is paid upon import into the EU from 2026.

### How to avoid paying CBAM?

According to the CBAM regulation, there are two ways of exemption from CBAM. The first refers to countries that meet certain conditions for the establishment of their emissions trading system and are compatible with the EU ETS. The second exception implies the integration of the markets of the countries to which CBAM is applied into the EU process supported by the Energy Community.

The essential difference between CBAM and the EU ETS is that in the case of CBAM, the fee is paid by the importer from the EU and that income goes to the EU budget, while in the case of the ETS, the income remains in the country that introduced that system, and that money used specifically for investing in cleaner technologies.

### Initial assessments of CBAM's impact on the BiH economy

According to the report of the State Regulatory Commission for Electricity from 2022, 64 percent of electricity in BiH is obtained from coal-fired thermal power plants. Electricity, together with cement, iron

and steel, aluminum, and artificial fertilizers, makes up almost a third of Bosnia and Herzegovina's exports, with exports to the EU in these industries accounting for around 10 percent of GDP in 2022. Preliminary projections show a drop in exports from the affected industries of Bosnia and Herzegovina in the range of 11 to 25 percent, which depends on the level of the carbon price and is equivalent to roughly 1.1 to 2.5 percent of GDP, according to International Monetary Fund estimates. It is expected that Bosnia and Herzegovina, next to Montenegro, will have the greatest exposure to CBAM in the region.

### Emission trading in Bosnia and Herzegovina until 2026?

Bosnia and Herzegovina, together with other countries in the region, chose the option to introduce a price for CO<sub>2</sub> by 2026 through the establishment of the Emissions Trading System, to avoid the effects of CBAM and generate domestic revenues (not EU revenues) that would be used to support the transition to renewable energy and the reduction of CO<sub>2</sub> intensity in the relevant sectors.

The introduction of this mechanism is defined by the international obligations of Bosnia and Herzegovina, such as the Paris Agreement on the Roadmap to Decarbonization of the Energy Community (of which BiH is a member) and the Sofia Declaration (which BiH accepted). The Secretariat of the Energy Community supervises and assists members in the preparation of plans and strategies for CBAM and the introduction of national/regional ETS systems, especially in the electricity sector. Montenegro is the only one in the region that since 2020 has successfully implemented an emissions trading system that includes the energy and industry sectors at a price of about 25 percent of the average price of the EU ETS.

### Next steps and future challenges

BiH, like most countries in the region, has established a framework for monitoring, reporting, and verification (MRV) of emissions, which is one of the essential prerequisites for the establishment of the ETS. Also, Bosnia and Herzegovina has prepared a road map for emissions trading and has begun to consider options and plan the implementation of various elements of the trading system and accompanying legislation to timely determine the prices and scope of this tax.

The application of ETS or CBAM will have the greatest impact on the competitiveness of electricity production from coal - mines and thermal power plants, as well as other products covered by this policy. Almost half of CO<sub>2</sub> emissions come from thermal power plants. BiH exports 25 percent of the total electricity produced, although most of the thermal power plants in BiH are expiring or have already expired. Also, the draft of the National Energy and Climate Plan does not envisage new thermal capacities and overlooks a 20 percent reduction in emissions from thermal power plants by 2030. Decisions related to the introduction of the ETS must inevitably follow direct strategic decisions related to the future of electricity production from coal in BiH, considering such perspectives. A wider professional and public debate about the main elements of this design, as well as a detailed analysis of the various aspects of the changes, is still to take place.