Carbon Border Adjustment Mechanism (CBAM): one more addition to the EU green trade package

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On 18 April, the European Parliament adopted the CBAM, an unprecedented carbon border adjustment charge, which takes into account the greenhouse gas emissions embedded in imported goods of emissions-intensive sectors with a high risk of so-called "carbon leakage". Carbon leakage takes place when, for reasons of costs related to climate policies in the EU, businesses transfer their production plants to other countries outside the bloc with less costly climate policies (see our briefing from July 2021). The initiative is part of the 2030 Climate and Energy "Fit for 55" legislative package under the European Green Deal, an ambitious plan to reduce greenhouse gas emissions by at least 55% until 2030 compared to the levels of 1990.

Overview

In essence, the world´s first CO2 "tariff" is set up to ensure equivalent carbon pricing for both imports and domestic products. EU importers of carbon-intensive products will have to buy carbon certificates corresponding to the same carbon price that is paid by manufacturers established in the EU under the EU Emissions Trading System (*ETS*) (text available here).

The CBAM covers a wide range of products, namely: iron, steel, cement, aluminium, fertilisers, electricity, hydrogen, and a number of downstream products which make intensive use of iron, steel or aluminium (e.g. screws, tubes, railway tracks). In addition, the emission criteria takes into account not only direct emissions, but also, for certain products, indirect emissions - related to the production of electricity which is consumed during the production processes of the goods.

The scheme will be phased in gradually from 2026 until 2034 at the same pace and proportion as the allowances allocated free of charge under the EU ETS are phased out. The rationale behind offsetting these two schemes is to ensure a level playing field for all suppliers (domestic and exporters) of the listed products and ensuring that all stakeholders provide a monetary compensation for the impact of their high emissions to climate change. By assuring an equivalent regulatory burden between EU products and imported products, the EU reduces its exposure to disputes before the WTO for potential violation of the General Agreement on Tariffs and Trade (GATT), particularly non-discrimination obligations.

Also, the environmental effect intended with such framework is that, if companies have to pay more for their carbon footprint, they will have the proper incentives to reduce emissions by investing in more sustainable production processes or products (for example using green hydrogen in steel production or in fertilizers), or alternatively, pass-on the higher production costs to consumers by increasing prices. Higher costs and prices have the ultimate effect of reducing emissions by dropping output or demand.

The Regulation still needs endorsement by the European Council, which is expected any day now. The obligation on purchasing the CBAM certificate will start from 1 January 2026. During the transitional period, the importers will only have to report the emissions embedded in their imports without any financial payments. At the same time, the European Commission will adopt implementing acts enabling Member States and their respective customs authorities to apply the Regulation. In addition, the Commission is assigned to collect data for the purpose of further specifying the methodology for calculation of indirect emissions.

Is there room to extend the scope of products covered by CBAM?

One may not rule out that the list of products covered CBAM is extended in the near future. The Regulation expressly contains a provision mandating the Commission to present, until the end of 2025, a report to the European Parliament and to the Council with a technical assessment on whether to extend the scope of the Regulation to (i) indirect emissions of additional goods, (ii) emissions in the transport of certain goods, (iii) other goods at risk of carbon leakage, special attention given to organic chemicals and polymers, (iv) other input materials (precursors).

Key takeaways

The CBAM contains two major points of attention. Firstly, since the importer will be allowed to claim a reduction in the number of CBAM certificates to be surrendered corresponding to the carbon price already effectively paid in the country of origin, it remains to be seen in the implementing acts how this offsetting mechanism will be designed and what will be the criteria. A second point of concern relates to the reporting obligation: How to fairly account for emissions related to the production of imported goods, particularly considering different production processes and energy sources in a given country.

Stakeholders have a year and a half to adapt their business models and administrative procedures to comply with the new framework. It is also a moment to strategically reflect on how the Regulation will impact their cost structure and, ultimately, their competitive position in the EU market.

BLOMSTEIN and its ESG team will continue to closely follow developments related to the CBAM. We are at your disposal at any time to answer questions on the practical implementation as well as on the scope of application of these measures. Please do not hesitate to contact Anna Huttenlauch, Roland Stein, Bruno Galvão, Jasmin Mayerl or Carolina Vidal.