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**MEMO**

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## **Questions and Answers: Carbon Border Adjustment Mechanism (CBAM)**

### **Why is the EU putting in place a Carbon Border Adjustment Mechanism?**

The EU is at the forefront of international efforts to fight climate change. The European Green Deal set out a clear path towards realising the EU's ambitious target of a 55% reduction in carbon emissions compared to 1990 levels by 2030, and to become a climate-neutral continent by 2050. In July 2021, the Commission made its [Fit for 55 policy proposals](#) to turn this ambition into reality, further establishing the EU as a global climate leader. Since then, those policies have taken shape through negotiations with co-legislators, the European Parliament and the Council, and many have now been signed into EU law. This includes the EU's plan for a Carbon Border Adjustment Mechanism (CBAM).

As we raise our own climate ambition and less stringent environmental and climate policies prevail in non-EU countries, there is a strong risk of so-called 'carbon leakage' – i.e. companies based in the EU could move carbon-intensive production abroad to take advantage of lax standards, or EU products could be replaced by more carbon-intensive imports. Such carbon leakage can shift emissions outside of Europe and therefore seriously undermine EU as well as global climate efforts. The CBAM will equalise the price of carbon between domestic products and imports of a selected number of products and ensure that the EU's climate objectives are not undermined by production relocating to countries with less ambitious policies. The CBAM is therefore a climate measure that should support the EU's increased ambition on climate mitigation by preventing carbon leakage and, while ensuring WTO compatibility.

The European Parliament and the Council of the European Union, as co-legislators, signed the final CBAM Regulation on 10 May 2023. The provisions underpinning the CBAM, and its operational features will now progressively enter into force and application.

### **How will the CBAM work?**

Designed in compliance with World Trade Organization (WTO) rules and other international obligations of the EU, the CBAM system will work as follows:

- As from the CBAM's entry into force in 2026, EU importers will buy carbon certificates corresponding to the carbon price that would have been paid, had the goods been produced under the EU's carbon pricing rules.
- Conversely, once a non-EU producer can show that they have already paid a price for the carbon used in the production of the imported goods in a third country, the corresponding cost can be fully deducted for the EU importer.
- The CBAM will therefore help reduce the risk of carbon leakage by encouraging producers in non-EU countries to green their production processes.

To provide businesses and other countries with legal certainty and stability, the CBAM will be phased in gradually and will initially apply only to a selected number of goods at high risk of carbon leakage: iron, steel, cement, fertiliser, aluminium, hydrogen and electricity generation. In a transitional phase, a reporting system will apply as from 1 October 2023 for those products with the objective of facilitating a smooth roll out and to facilitate dialogue with third countries. Importers will start paying the CBAM financial adjustment in 2026.

Carbon Border Adjustment Mechanisms are already in place in some regions around the world, such as California, where an adjustment is applied to certain imports of electricity. A number of countries such as Canada and Japan are planning similar initiatives. In addition, the IMF and the OECD have recently carried out work to study how such measures could support international efforts to reduce greenhouse gas emissions. In the [communiqué following their meeting of 9-10 July 2021](#), G20 Finance Ministers also mentioned the need for closer international coordination on the use of carbon pricing mechanisms and the work of setting up a Climate Club has been since ongoing.

Finally, as an EU own resource, revenues from CBAM will contribute to the EU's budget, as laid out in the December 2020 Interinstitutional Agreement on budget and own resources.

### **Isn't carbon leakage already addressed by the Emissions Trading System?**

The EU's Emissions Trading System (ETS) is the world's first international emissions trading scheme and the EU's flagship policy to combat climate change. It sets a cap on the amount of greenhouse gas emissions that can be released from industrial installations in certain sectors. Allowances must be bought on the ETS trading market, though a certain number of free allowances is distributed to prevent carbon leakage. That system has been effective in addressing the risk of leakage, but it also dampens the incentive to invest in greener production at home and abroad. The CBAM will progressively become an alternative to this. Under the EU's revised ETS, however, the number of free allowances for all sectors will decline over time so that the ETS can have maximum impact in fulfilling our ambitious climate goals. Furthermore, for the CBAM sectors, the free allowances will gradually be phased out as from 2026 as the CBAM financial adjustment is phased in according to a gradual schedule.

To complement the ETS, the CBAM will be based on a system of certificates to cover the embedded emissions in products being subsequently imported into the EU. The CBAM departs from the ETS in some limited areas, however, in particular since it is not a 'cap and trade' system. Instead, the CBAM certificates mirrors the ETS price.

Once the full CBAM regime becomes operational in 2026, the system will adjust to reflect the revised EU ETS, in particular when it comes to the reduction of available free allowances in the sectors covered by the CBAM. This means that the CBAM will only begin to apply to the products covered gradually and in direct proportion to the reduction of free allowances allocated under the ETS for those sectors. Put simply, until they are completely phased out in 2035, the CBAM will apply only to the proportion of emissions that does not benefit from free allowances under the EU ETS, thus ensuring that importers are treated in an even-handed way compared to EU producers.

## **How will the CBAM work in practice?**

The CBAM will mirror the ETS in the sense that the system is based on the purchase of certificates by importers. The price of the certificates will be calculated depending on the weekly average auction price of EU ETS allowances expressed in € / tonne of CO<sub>2</sub> emitted. Importers of the goods will have to, either individually or through a representative, register to take part in the CBAM and buy CBAM certificates.

The final CBAM agreement stipulates that the new mechanism should be run by the European Commission in coordination with relevant Member State competent authorities. Therefore, the Commission will be in charge of reviewing and verifying declarations as well as managing a central platform for the selling of CBAM certificates to importers. In order to import goods covered under the CBAM into the EU, importers must declare by 31 May each year the quantity of goods and the embedded emissions in those goods imported into the EU in the preceding year. At the same time, they must surrender the CBAM certificates they have purchased in advance from the Commission.

By ensuring importers pay an equivalent carbon price as domestic producers under the EU ETS, CBAM will ensure no less favourable treatment for products made in the EU and imports from elsewhere.

## **What will happen in the transitional phase?**

Importers will have to report emissions embedded in their goods subject to CBAM without paying a financial adjustment in a transitional phase starting on 1 October 2023 and finishing at the end of 2025, giving time for the final system to be put in place.

This transitional phase, combined with the gradual phasing in of CBAM over time, will allow for a careful, predictable and proportionate transition for EU and non-EU businesses as well as authorities.

Once the definitive system becomes fully operational in 2026, EU importers will have to declare annually the quantity of goods and the amount of embedded emissions in the total goods they imported into the EU in the preceding year, and surrender the corresponding amount of CBAM certificates. CBAM will be gradually phased in as free allowances in the EU ETS are phased-out for these goods over a period of 8 years. In the first years, only the most carbon intensive products will be subject to CBAM. Low-carbon intensive products under the CBAM scope will have nothing to pay when entering the EU since the level of emissions is below the emissions benchmark covered under the EU ETS.

## **Which sectors will the new mechanism cover and why were they chosen?**

The CBAM will initially apply to imports of the following goods:

- Cement
- Iron and Steel
- Aluminium
- Fertilisers
- Hydrogen
- Electricity

These sectors have been selected following specific criteria in particular, due to their high risk of carbon leakage and high carbon emissions which will eventually – once fully phased in – capture more than 50% of the emissions of the ETS covered sectors.

The CBAM will apply to direct emissions of greenhouse gases emitted during the production process of the products covered as well as indirect emissions for a number of products listed in Annex IA of the regulation. The agreement foresees that an analysis will need to be carried out to include indirect emissions in further products in the future. A review of the CBAM's overall functioning during its transitional phase will also be concluded before the entry into force of the definitive system.

At the same time, the product scope will be reviewed to assess the feasibility of including other goods already covered by the EU ETS and susceptible to carbon leakage in the scope of the CBAM mechanism, such as certain downstream products and those identified as suitable candidates during negotiations. The report will include a timetable setting out their inclusion by 2030.

### **How can EU importers ensure that they get the information they need from their non-EU exporters to be able to use the new system correctly?**

The information on embedded emissions for goods subject to CBAM should be communicated to importers registered in the EU by their non-EU producers. In cases where this information is not available as the goods are being imported, EU importers will be able to use default values (even once the definitive system has kicked in) on CO2 emissions for each product to determine the number of certificates they need to purchase. Importers will nevertheless be able to demonstrate actual emissions during a reconciliation procedure and surrender the appropriate number of CBAM certificates accordingly.

### **Imports of goods from which countries will fall under the scope of the CBAM?**

In principle, imports of goods from all non-EU countries will be covered by the CBAM. That said, certain third countries who participate in the ETS or have an emission trading system linked to the Union's will be excluded from the mechanism. This is the case for members of the European Economic Area and Switzerland.

CBAM will be applied to electricity generated in and imported from countries that wish to integrate their electricity markets with the EU until such a point that those electricity markets are fully integrated. At that point, and under strict conditions linked to their implementation of certain obligations and commitments, these countries could be exempted from the mechanism. If that is the case, the EU will revisit any exemptions granted in 2030, at which point those partners should have put in place the decarbonisation measures they have committed to, and an emissions trading system equivalent to the EU's.

### **What are the next steps?**

The CBAM will enter into application in its transitional phase on 1 October 2023, with the first reporting period for traders ending 31 January 2024. The set of rules and requirements for the reporting of emissions under CBAM will be further specified in an implementing act to be adopted by the Commission after consulting the CBAM Committee, made up of experts from EU Member States.

### **How will you engage with third countries and industry going forward?**

When preparing the CBAM proposal, the Commission already consulted stakeholders widely, both through an open public consultation and more targeted consultations. In addition, the Commission engaged in extensive bilateral consultations with public authorities in EU and non-EU countries, business associations, individual companies and NGOs. Targeted consultations were also undertaken with senior managers and associations from the basic materials sectors, manufacturers, NGOs and policymakers.

During this transition period we will continue to work together with industry and our partner countries to increase our mutual understanding of the instrument, to ensure the smooth implementation of the mechanism, find synergies wherever possible, and promote effective methods of decarbonisation globally. This will feed into the evaluation of application of the regulation that the Commission will complete by mid-2025, which will also define the final methodology to be used when CBAM goes live on 1 January 2026.

At the same time, The European Commission fully supports and takes part in discussions on the design and implementation of effective climate mitigation policies worldwide, such as through the Inclusive Forum for Climate Mitigation Approaches (IFCMA) at the OECD, or the Climate Club promoted by G7.

The EU also remains ready to work with low- and middle-income countries towards the decarbonisation of their manufacturing industries. The Union will also support less developed countries with the necessary technical assistance.