

The Carbon Border Adjustment Mechanism (“CBAM”) – the European Union’s Next Climate Action Step

As a result of ongoing discussions, the European Parliament and the Council of the European Union [announced](#) on December 13, 2022, that a provisional agreement had been reached to implement a European Union (“EU”) Carbon Border Adjustment Mechanism (“CBAM”) beginning on October 1, 2023. The CBAM, the first of its kind, is designed to mitigate the risks of “carbon leakage” — the relocation of facilities outside of the EU to circumvent emissions limits only to then ship goods back into the original EU markets — and is essentially a carbon levy applied on imports of products in the iron and steel, cement, aluminium, fertilizer, hydrogen, and electricity sectors. The CBAM is touted as a key part of the EU’s aim to achieve climate neutrality by 2050.

The European Commission first introduced the CBAM in July 2021 as part of its “Fit for 55” in 2030 package — a series of interconnected and comprehensive proposals designed to ready the EU’s policies (climate, energy, land use, transportation, and taxation) to reduce net greenhouse gases (“GHGs”) by at least 55% by 2030, as compared to 1990 levels.

Per the EU legislative process, the CBAM now needs to be confirmed by ambassadors of the EU member states and by the European Parliament. Both the European Parliament and the Council of the European Union will then have to formally approve the agreement before CBAM comes into force.

As noted, the CBAM currently targets the imports of carbon-intensive industries, although it does extend to “some precursors and a limited number of downstream products”¹ (e.g., screws and bolts and other similar articles in the iron and steel industries). Given the scope of these industries, this program will impose additional costs on imports of many different products into the EU. While the focus is on “embedded” emissions (those occurring upon manufacture), indirect emissions are also set to be included in the future applicable regulations. The CBAM incorporates a transition period during which extending its scope to other goods at risk of carbon leakage, and additional downstream products, will be assessed. The goal is to include all goods covered by the EU’s Emissions Trading System (“EU ETS”) by 2030. Assessment of the methodology for indirect emissions is also to be considered.

The CBAM is designed to work in parallel with the EU ETS — the world’s largest carbon market — based on a cap and trade system. Fundamentally, the CBAM will obligate companies importing into the EU to purchase CBAM certificates to pay the differential between the country of production’s carbon price (or lack thereof) and the price of carbon allowances in the EU ETS. Such CBAM certificates cannot be traded. In addition, similar to the EU ETS, a period of free certificate allocation is expected. The CBAM is designed to ensure that global climate efforts are not undercut by companies relocating manufacturing operations to countries outside of the EU with less ambitious climate policies and to create an incentive for EU trading partners to regulate CO₂ emissions as well.

The CBAM will take effect on October 1, 2023, but will be phased in gradually. Initially, a simplified version of the CBAM will apply with reporting obligations only, the aim being to collect data. Starting in 2026, a levy will be imposed on importers of covered goods (which may have been expanded by that time) tied to the weekly average EU ETS allowance price, which, as of December 1, 2022, traded above 80 EUR.

The EU hopes that the CBAM will be fully compatible with international trade requirements, although legal challenges are likely to occur given the controversial nature of the levy.

Although the CBAM is a EU-based policy, its implications extend far beyond the bloc's borders. For example, with the implementation of the levy, the EU hopes to strengthen the climate policies of non-EU countries. In addition, companies producing goods outside the bloc seeking access to EU markets will need to perform detailed emissions analyses and assess opportunities to reduce emissions regardless of policy developments, or otherwise risk losing market-share. Implementation of the CBAM is likely to also intensify efforts to decarbonize GHG-intensive industries subject to the levy, such as steel and cement production.

¹ Press Release, Council of the EU, *EU Climate Action: Provisional Agreement Reached On Carbon Border Adjustment Mechanism (CBAM)* (Dec. 13, 2022), <https://www.consilium.europa.eu/en/press/press-releases/2022/12/13/eu-climate-action-provisional-agreement-reached-on-carbon-border-adjustment-mechanism-cbam/>.

Questions

1. Please make a summary of the text, including as many details as possible.
2. As explained on the text, how does the CBAM certification work?
3. What are your views on this mechanism? In your opinion, are there any other measures that countries could apply to mitigate climate change?