Including products further down the value chain in the EU CBAM

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Andrei Marcu
Aaron Cosbey
Michael Mehling
Sara Svensson

ERCST
Roundtable on
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Sustainable Transition

Including products further down the value chain in the EU CBAM

- Current CBAM includes imports of primary goods, and only a few semi-finished products.
- Only including primary goods in the CBAM can lead to higher costs for downstream EU producers of semi-finished or finished products (due to increased input prices ETS and CBAM)
- The European Commission is mandated to release a report by the end of 2024 identifying further downstream products for CBAM coverage, and the final decision on product inclusion will be made in 2025.

What do research and policy positions say?

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- Downstream industries have voiced concern in several statements:
  - Consensus that cost increases for raw material inputs will affect competitiveness
  - Complexity of downstream products requires careful assessment of solutions
  - Ideally decide on extension before the transitional period ends
- Think tank and academic research confirms some concerns:
  - Sandbag: Impacts very specific to products and their value chains, not always large
  - ERCST: CBAM might raise cost of semi-finished aluminium products by 10-13%
- European Commission Impact Assessment:
  - Affirms existence of winners and losers across downstream goods
  - 5-15% of all manufacturing value added in commodity groups at risk of carbon leakage
  - Negative output effects can be mitigated by extending CBAM downstream

High-level principles to guide extension decision

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- Principle 1: Prevention of Carbon Leakage Should Drive Extension

  Protect the competitiveness of downstream producers not for its own sake, but to ensure that emission reductions within the EU are not offset by increases elsewhere

- Principle 2: Use Objective Metrics and Leakage Risk Formula

  Align the methodology for determination of CBAM coverage with the existing leakage risk criteria applied under the EU ETS

- Principle 3: Conduct Comprehensive Assessment of Leakage Risk

  Take a comprehensive approach that accounts for the cumulative impacts of carbon costs across the value chain, as well as substitution effects across value chains

- Principle 4: Consider Future Trends and Projections

  Markets for affected goods are evolving rapidly, particularly with the transition toward low-carbon technologies and industrial decarbonization

Additional Considerations: Complexity and administrative burden

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- **In general, the risk of leakage shrinks as we go further down the value chain, and the administrative burden and complexity increase.**

  Most embodied carbon comes from upstream at the level of basic products, and the value of that carbon relative to the price of a product shrinks as more value is added. So risk of leakage also shrinks. Also, the further down the value chain the more non-price considerations matter; products are branded, differentiated. Need to find a balance: is the pain worth the gain?

- Administrative burden

  This is a challenge for CBAM administrators. Adding more products means more methodologies, more default values, more importers and transactions. CN 7326 (other items of iron & steel) includes 15 product categries at 8-digit level, each covering many distinct goods.

- Complexity

  This is a challenge for CBAM reporters, foreign producers. The further downstream a good is, the more upstream stages (inputs) for which the declarant must try to obtain data. In some cases suppliers do not have or will not furnish that data.

Additional Considerations: Complexity and administrative burden

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- The CBAM Regulation explicitly establishes three criteria by which to decide on inclusion:
  - Whether the sector is a large aggregate emitter of GHGs
  - Whether the sector is significantly exposed to carbon leakage
  - The need to balance broad product coverage in terms of greenhouse gas emissions, while limiting complexity and administrative burden
- Inherent dificulties vs transitional pains

  Eventually more suppliers will furnish data, as they develop accounting systems and their concerns over confidentiality are addressed. But the inherent basic complexity of covering more goods will not diminish over time.

Additional Considerations: Methodology and Sectoral Competition

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- Methodological challenges

  Organic chemicals and refinery products were not included in the CBAM's initial coverage because of methodological challenges: single facilities produce many products; how to allocate emissions? This may be resolved in time, though no solution is perfect.

- Competition across sectors

  One of the several reasons aluminium was included in the CBAM's initial coverage was the fact that steel was covered. The two are substitutes in some end uses, so to cover one but not the other would distort competition across sectors. This becomes less relevant a consideration further down the value chain, as specialized products have fewer substitutes.

Key takeaways

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- The CBAM and its operationalization becomes increasingly complex, once we start looking at concrete aspects. There are not always easy choices and solutions - that is, there is sometimes a need to act, but acting within the CBAM leads to very complex and potentially expensive solutions.

- If the CBAM is not expanded to cover more downstream goods in some sectors, there is a risk that they will be subject to significant loss of competitiveness and resulting carbon leakage.

- Expansion brings a risk that goods not at risk of leakage will be covered; the further downstream in any value chain we go, the less the value of cumulative carbon costs relative to the total value of the good, and therefore the less risk of leakage.

Key takeaways

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- The decision on coverage needs to be guided by objective criteria, with prevention of leakage as the primary goal.
- While the objective measure of leakage risk should be primary, administrative burden and complexity of compliance should also figure into coverage decisions. These tend to be higher the further down the value chain coverage is extended. This complicates the decision process, moving us away from straightforward objective criteria.
- Where solutions within CBAM are too difficult, we may need to look at options that are inconsistent with WTO rules, or that involve changes to EU climate policy.