



# Evaluation of the European Commission's CBAM proposal

September 9, 2021

ERCST event

**Andrei Marcu**  
**Michael Mehling**  
**Aaron Cosbey**

---

**ERCST**

Roundtable on  
Climate Change and  
Sustainable Transition

# ERCST Guide to the EU CBAM – Table of Contents

## 1 INTRODUCTION AND OVERVIEW

- 1.1 ABOUT THIS GUIDE
- 1.2 OUR APPROACH
- 1.3 STRUCTURE

## 2 CONTEXT AND EVOLUTION OF THE CBAM

- 2.1 POLITICAL AND ECONOMIC CONTEXT
- 2.2 HISTORY OF THE EUROPEAN DEBATE
- 2.3 INTERNATIONAL REACTIONS AND DEVELOPMENTS

## 3 GUIDE TO CBAM DESIGN ELEMENTS

- 3.1 OBJECTIVES AND PRINCIPLES
- 3.2 POLICY MECHANISM
- 3.3 COVERAGE OF TRADE FLOWS
- 3.4 GEOGRAPHIC SCOPE
- 3.5 SECTORAL SCOPE
- 3.6 EMISSIONS SCOPE
- 3.7 DETERMINATION OF EMBEDDED EMISSIONS
- 3.8 CALCULATION OF THE ADJUSTMENT
- 3.9 USE OF REVENUE
- 3.10 ADMINISTRATION AND GOVERNANCE
- 3.11 TIMELINE AND SEQUENCE

## 4 CONCLUSIONS

# 1. Objectives and Principles (I)

- **Article 1.1** and Recital **Paragraphs 4.1 – 4.3** of the proposed CBAM Regulation.
- CBAM aims to **address the risk of carbon leakage**, so as to fight climate change by reducing GHG emissions in the EU and globally.
- Among the sub-objectives: stable framework for low-carbon investment; provide incentives for third-country producers.
- Ancillary effects: **revenue generation; strengthening joint global climate action.**

# 1. Objectives and Principles (II)

Environmental Benefit	Competitiveness Benefit	Technical & Administrative Feasibility	Legal Feasibility	Political & Diplomatic Feasibility
Prevention of leakage, enabling of climate ambition, are major environmental benefits.	A related benefit, if leakage is prevented, can be preservation of competitiveness. But the two goals are not always in harmony.	Objectives and principles have no major implications for technical and administrative feasibility.	The objective of leakage prevention is arguably the only one that stands a chance of passing a GATT Article XX challenge.	The objective of leakage prevention is arguably the least controversial politically and diplomatically.

- Identifying **prevention of leakage** as a general objective makes sense from a legal and political/diplomatic perspective; also serves environmental objectives. Ancillary benefit: **preserves competitiveness**.
- Identifying **revenue generation** and **global action** as ancillary benefits also makes sense – raises the issues and signals to trading partners, without explicitly wedding the regime to those ends.
- The environmental benefits of leakage protection, and the benefits of a stable regime that incentivizes investment in low-carbon technologies, depend on effectiveness of the regime, but it won't come into full effect until 2035.

## 2. Policy Mechanism (I)

- **Articles 20 to 24** of the proposed CBAM Regulation
- **Evolution** from 'Carbon Border Tax' to EU ETS **companion** policy
- System of notional '**certificates**' from an uncapped pool
- Certificate priced based on the **average closing price of EUAs** on the common auction platform for each calendar week
- **Not tradable** and only bankable within limits, but competent authorities will **repurchase** a certain share of annual purchase

## 2. Policy Mechanism (II)

Environmental Benefit	Competitiveness Benefit	Technical & Administrative Feasibility	Legal Feasibility	Political & Diplomatic Feasibility
Policy mechanism has no major implications for environmental benefit	As a complement to the EU ETS rather than an internal tax or charge, the CBAM faces greater risk if its covers exports	Implementation as a complement to the EU TS is more complex than defining a fixed price	CBAM as a complement to the EU ETS is easier to pass than a tax	Policy mechanism has no major implications for political and diplomatic feasibility

- **Policy mechanism** has relevance for **administrative** and **legal feasibility**
- Legal basis identified in the Explanatory Memorandum as Article 192(1) TFEU, which would allow for **qualified majority voting**
- Adjusting for a **regulatory policy** makes it risky to to adjust for **exports**
- Although certificates as such are **not tradable** or **fungible** with EUAs, declarants may still **hedge with EUAs**, potentially affecting EU ETS market
- No hedging possible within these constraints

### 3. Coverage of Trade Flows (I)

- **Articles 1, 2 and 4** of the proposed CBAM Regulation
- Proposed CBAM would only cover **imports** into the customs territory of the EU
- No adjustment for **exports**, but continued – albeit declining – **free allocation** to covered producers
- Most participants in the **stakeholder consultation** had called for exploring the “possibility to **grant a rebate** to EU exporters”

### 3. Coverage of Trade Flows (II)

Environmental Benefit	Competitiveness Benefit	Technical & Administrative Feasibility	Legal Feasibility	Political & Diplomatic Feasibility
Coverage of imports only offers the relatively greatest environmental benefit due to maximum emissions coverage	Coverage of imports only levels the playing field in the domestic market, but not in international markets	Due to data gaps and limited jurisdiction, coverage of imports is relatively more complex to implement than coverage of exports	Coverage of imports only offers the strongest case under Article XX GATT because it expands the scope of carbon pricing	Relatively more controversial than coverage of exports; excluding exports does not meet demands of some domestic stakeholders

- Omitting exports likely to result in export-related leakage, but **net environmental effect unclear** due to expanded coverage of carbon pricing
- Coverage of imports only avoids **WTO legal risk** that would arise from preferential treatment of domestic goods conditional on export performance
- Different views on WTO and export rebates
- **Administrative, political and diplomatic trade-offs** (e.g. risk of pushback) to be seen



## 4. Geographic Scope (I)

- **Articles 2, 3 and Annex II** of the proposed CBAM Regulation
- Proposed CBAM covers **all countries**, with exemptions for countries **linked** or **integrated into** the EU ETS, and **special territories**
- Temporary exemptions may be provided for imports of **electricity** from countries that become **coupled** with the EU electricity market
- No exemption for **LDCs** and **SIDS**, as recommended by the **European Parliament** and several stakeholders

# 4. Geographic Scope (II)

Environmental Benefit	Competitiveness Benefit	Technical & Administrative Feasibility	Legal Feasibility	Political & Diplomatic Feasibility
<p>Limited exemptions have little effect on the environmental benefits of the proposed CBAM</p>	<p>Wide geographic scope levels the playing field for all important competitors; countries integrated into or linked with the EU ETS already have equivalent carbon price in place</p>	<p>Broad coverage – including of LDCs with reduced MRV capacities of producers – may increase administrative burden</p>	<p>Selective exclusion of countries risks violating the MFN principle in Art. I GATT</p>	<p>Extension of geographic scope to least developed countries likely to be perceived as unfair, potentially spilling over to other political processes</p>

- Limited exemptions strengthen **environmental benefits** of the CBAM
- Where exemptions are granted, however, **WTO law violation** possible
- Not excluding **LDCs** and **SIDS** is likely to face political opposition

## 5. Sectoral Scope (I)

- **Articles 1, 2 and 30** as well as **Annex I** of the proposed regulation
- Proposed CBAM would cover a total of 30 goods in **cement, nitro-gen fertilisers, iron & steel, aluminium, and electricity** sectors
- **Downstream coverage** of basic materials based on leakage risk
- Coverage of electricity follows separate rules
- **Review** of sectoral scope due by the end of the transition period with a view to **expanding the list** of covered goods

# 5. Sectoral Scope (II)

Environmental Benefit	Competitiveness Benefit	Technical & Administrative Feasibility	Legal Feasibility	Political & Diplomatic Feasibility
High environmental benefit from leakage prevention in covered and downstream sectors, but may expose uncovered sectors, sub-sectors	Competitiveness benefit from protection of covered and downstream sectors, but may expose uncovered sectors, sub-sectors	Limited choice of sectors and sub-sectors increases feasibility	The proposal's choice of sectors does not give rise to legal issues	Should not cause major controversy

- Limited product coverage lessens overall impact and administrative **burden**, but also reduces the environmental and economic **benefits**
- **Expansion** possible to chemicals, refinery products, and pulp & paper
- Some covered sectors had **resisted** being included in the CBAM scope
- Special treatment for electricity – what is the purpose/target?

## 6. Emissions Scope (I)

- **Article 7 and Annex III** of the proposed regulation
- Proposed CBAM would cover direct emissions from the production of covered goods (**scope 1**), as well as emissions embedded in input goods (**selected scope 3**), but **not scope 2**.
- **Scope 2** dealt with by **compensation for indirect carbon costs** – a separate regime from the CBAM
- It's **not clear which scope 3 emissions would be covered** – details left to a definition of project boundaries in the implementing legislation

## 6. Emissions Scope (II)

Environmental Benefit	Competitiveness Benefit	Technical & Administrative Feasibility	Legal Feasibility	Political & Diplomatic Feasibility
Unclear whether coverage for emissions embedded in inputs will leave risk of downstream leakage	Unclear whether coverage for emissions embedded in inputs will leave risk of downstream competitiveness impacts	Coverage of direct emissions is straightforward. Unclear how complex it would be to cover emissions embedded in inputs.	No legal issues with coverage of direct emissions. Coverage of emissions embedded in inputs risks creating different treatment for imported goods vis-à-vis domestic goods.	Unclear whether treatment of emissions embedded in inputs will create political and diplomatic controversy.

- **Coverage of direct emissions** is straightforward, mirrors domestic ETS regime.
- Sectors with **large scope 2 emissions** welcome non-coverage.
- **Proposed coverage of emissions embedded in input goods** makes sense in principle as protection against leakage, competitiveness impacts in downstream sectors.
- **Critical questions unanswered** about the nature of the scope 3 coverage – raises potential issues in legal feasibility, technical and administrative feasibility.

## 7. Determination of Embedded Emissions (I)

- **Articles 7 and 10**, as well as **Annex III** of the proposed regulation
- For **goods, actual data is requested**. Default is sectoral average in country of export. If default not possible, average of EU 10% worst.
- **Foreign operators can register**, and record actual (verified) emissions intensity data in database, usable by importers.
- For **electricity, average values of price-setting sources** in countries, groups of countries, or regions of export. If no average value calculated, EU weighted average of emissions from fossil fuel generation. Restricted provisions for using actual data – prevents **resource shuffling**.

# 7. Determination of Embedded Emissions (II)

Environmental Benefit	Competitiveness Benefit	Technical & Administrative Feasibility	Legal Feasibility	Political & Diplomatic Feasibility
<p>Basis in actual data (for goods) creates incentives for foreign decarbonization. Provisions to avoid resource shuffling (for electricity) seem effective.</p>	<p>Use of national averages for default values allows free ride for those foreign firms that are worse than average.</p>	<p>May be difficult to determine, keep current, national sectoral averages for all goods in all trading partners. But national data may be “voluntarily” supplied.</p>	<p>Basis in actual data probably helps in Art XX challenge (unless request found too onerous)</p>	<p>Could work if regime facilitates provision of national data by foreign governments. But might be controversial if there’s disagreement over data.</p>

- **A request for actual data** is probably legally a gold standard, though it could be found to be too onerous a requirement (overly trade-restrictive).
- Not clear under what conditions it would be impossible to calculate actual national averages, in which case the punitive default is used. May punish small economies with poorly developed regimes for emissions reporting.
- **Strong incentives for exporting governments to provide national data to the EU.** Helps individual firms, avoids application of punitive default.



## 8. Calculation of the Charge (I)

- **Articles 9, 21, and 31** of the proposed regulation
- Proposed CBAM price would equal **average of EU ETS closing prices**, calculated weekly.
- **Credit** against that price would be granted for any (verified) **carbon price paid in country of export. National agreements** can be negotiated. **No credit for non-price policies.**
- The price would be **further adjusted to account for any free allowances** received by the covered sectors in the EU.

# 8. Calculation of the Charge (II)

Environmental Benefit	Competitiveness Benefit	Technical & Administrative Feasibility	Legal Feasibility	Political & Diplomatic Feasibility
Credit for foreign carbon prices, adjustment for free allowances, are in line with environmental objectives.	Credit for foreign carbon prices, adjustment for free allowances, has neutral impact on competitiveness.	Challenging to arrive at agreement on the <i>effective</i> foreign carbon price. Crediting for non-price policies would arguably have been unworkably difficult.	Proposed credit and adjustments are probably necessary for successful Article XX defence.	Proposed credit and adjustments are probably necessary to avoid major push-back from trading partners. Partners will push for crediting for non-price policies.

- **Not crediting for foreign carbon price, not adjusting for free allowances**, would be legally and politically/diplomatically a non-starter.
- **Determining foreign carbon price will not be straightforward.** *Effective* price will account for free allowances/carbon tax breaks, offset policies, other distinctive regime elements. There are no details on the national agreements: what do they refer to and what is taken into account?
- **No credit for non-price policies** will be problematic for major trading partners with no carbon prices, but would have been technically/administratively extremely challenging.

## 9. Use of Revenue (I)

- CBAM will not generate revenue in the transitional period 2023 - 2025.
- Revenue will be **generated as of 2026** and will be **collected nationally** by competent authorities.
- Overall, CBAM revenues are expected to more than exceed administrative costs.
- The proposed regulation includes **no provisions regarding the use of this revenue**, besides a reference in the explanatory memorandum specifying that “most revenues generated by CBAM will go to the **EU budget**”, thereby contributing to the EU’s own resources.
- The proposed CBAM regulation does not include any articles setting out the principles or provisions regarding the earmarking of revenues for specific purposes e.g. for climate purposes domestically or abroad, or for covering incurred administrative and compliance costs. It thus also remains **agnostic with respect to the extent to which the revenues will be retained domestically or sent abroad**.

# 9. Use of Revenue (II)

Environmental Benefit	Competitiveness Benefit	Technical & Administrative Feasibility	Legal Feasibility	Political & Diplomatic Feasibility
No earmarking of revenues entails no constraints in their use, leading to optimal decision-making	No earmarking of revenues entails no constraints in their use, leading to optimal decision-making	Revenues accruing to EU budget without having to define revenue allocation rules to multiple uses nor carry out a process to award funding for projects entails minimum administrative burden	Not allocating a share of revenue to minimize the transaction cost of foreign producers and promote mitigation efforts, likely weakens the case under Article XX GATT and increases the risk of legal challenges under international law	CBAM might be perceived as a domestic revenue raising tool, decreasing its acceptance by international partners, likely increasing diplomatic pushback

- The absence of earmarking scores well in terms of environmental and competitiveness effectiveness as it does not introduce constraints that can lead to non-optimal decision-making. It is also technically and administrative less complex.
- On the other hand, the absence of earmarking might come at the cost of reducing legal, political & diplomatic feasibility, as CBAM might be perceived as a revenue raising tool rather than a tool to address carbon leakage.
- Stronger contestation and potential for challenges under WTO increased

# 10. Administration and Governance (I)

- Majority of **day-to-day administrative** tasks delegated to ‘**Competent Authorities**’ (CAs) in **Member States**. For instance:
  - Reviewing and approving applications for authorisation of declarants to import covered goods (Art. 5, 17)
  - Administering the system of CBAM declarations (Art. 6, 19)
  - Establishing a national registry of declarants that contain data regarding their CBAM certificates (Art. 14, 16)
  - Administer most aspects of the system of notional CBAM certificates that need to be purchased and surrendered by importers (Art. 20, 22, 23 and 24)
- **Customs authorities** charged with **implementing responsibilities**, i.e. ensuring that goods are imported by authorised declarants (Art. 25)
- **European Commission**:
  - Holds a **subsidiary role** in the administration of CBAM, where it “shall assist the competent authorities in carrying out their obligations” under the regulation and “**coordinate** their activities”.
  - Elaboration and adoption of **implementing acts** under several proposed provisions (e.g. Art. 5, 6, 7, 8, 9),
  - Operation of a **central database** for the registration of information of **third country installations** (Art. 10, 14).
  - Charged with acting as the ‘**central administrator**’, tracking the purchase, holding, surrender, re-purchase and cancellation of CBAM certificates and ensuring coordination between national registries (Art. 15),
  - Determining and publishing the **price of CBAM certificates** (Art. 21).

# 10. Administration and Governance (II)

Environmental Benefit	Competitive-ness Benefit	Technical & Administrative Feasibility	Legal Feasibility	Political & Diplomatic Feasibility
Limited impact	Limited impact	Measured approach in terms of sharing of responsibilities between the EU and MSs, following similar setup as in the EU ETS, and allowing to capitalise on national authorities past experience	Limited impact	Decentralized approach respects Member State competences and the principle of subsidiarity

- The set-up whereby national competent authorities play a key role mirrors to a large extent the set-up used in the EU ETS, allowing Member States to capitalize on their experience in managing the EU ETS.
- The administrative setup of CBAM has limited implications for the environmental and competitiveness benefits of CBAM, or the degree of its legal feasibility. In terms of technical/admin. feasibility, it has little bearing on the overall required administrative effort but significant bearing on how this is shared between MSs and the EU.
- Decentralized approach respects Member State competences and the principle of subsidiarity

# 11. Timeline and Sequence (I)

- As proposed, the CBAM takes a mostly measured approach in terms of implementation timeline:
- Payment obligations for importers do not begin until 2026, following a **transitional period**;
- **Free allocation will be phased out gradually**, prorating the initial payment obligation for importers.
- Similarly, the proposed CBAM takes a prudent approach in terms of initial sector/product scope (**small number of sectors included initially**), as well as emissions scope (only direct emissions are covered, with a review to **decide the inclusion of Scope 2 emissions due in 2026**).

# 11. Timeline and Sequence (II)

Environmental Benefit	Competitiveness Benefit	Technical & Administrative Feasibility	Legal Feasibility	Political & Diplomatic Feasibility
Reduced environmental benefit compared to CBAM without transitional period, or CBAM with immediate phase out of free allocation.	Transitional period with (some) free allocation safeguards competitiveness better than the immediate phase-out of free allocation	Gradual introduction of CBAM allows time to develop systems and methodologies, and to gain experience during the transitional phase	Gradual introduction of CBAM allows partners to adjust to requirements, minimising chances of legal challenges	Gradual introduction of CBAM strengthens its political feasibility, in the EU and internationally

- Gradual introduction of CBAM strengthens its political, legal and technical feasibility, and competitiveness benefits: the transitional phase will provide sufficient time for regulated entities to adjust to requirements, and authorities to set up administrative systems and obtain experience with their operation. Moreover, the transitional period signals to partners that CBAM is not a revenue raising instrument. Similarly, the gradual transitioning from free allowances to CBAM safeguards competitiveness and will allow time and resources to develop methodologies that will ensure equivalent carbon pricing between domestic and imported goods.
- This is however at the cost of foregoing part of the environmental benefits during the transitional period, during the period of gradual phase out of free allocation, and more generally until subsequent reviews of the CBAM expand its scope and impact.



# ERCST survey on CBAM proposal

- ERCST survey to collect stakeholder reactions to the proposed provisions of the CBAM proposal, and BCAs more widely.
- Closing date: 20 September 2021
- Link: [https://ec.europa.eu/eusurvey/runner/ERCST\\_CBAM\\_survey](https://ec.europa.eu/eusurvey/runner/ERCST_CBAM_survey)



**Thank you**

---

**ERCST**

Roundtable on  
Climate Change and  
Sustainable Transition

Design element	Proposed design in EC proposal
<b>Trade flow coverage</b>	Only imports to the EU are covered. There are no export rebates, but free allocation of EU ETS allowances is maintained (and gradually phased-out by 2035, see below).
<b>Policy instrument</b>	‘Notional ETS’ without a cap, whereby importers of covered products have to surrender CBAM certificates (priced on the basis of EU ETS allowances, see below) equal to the embedded emissions in their imports.
<b>Effect on free allocation of EU ETS allowances</b>	<p>The CBAM is put forward as an alternative to free allocation of EU ETS allowances in the covered sectors, and would therefore replace free allocation over time. To allow producers, importers and traders to adjust to the new regime, the reduction of free allocation will be implemented gradually while the CBAM is phased-in.</p> <p>Sectors covered by the CBAM will eventually stop receiving free allocation. The Commission proposes a 10-year transition period before free allocation is fully phased-out. The share of free permits for the sectors affected will still be 100% in 2025, and will gradually decline by 10 percentage points each year to reach zero in 2035.</p> <p>During the period when free allocation is maintained, the CBAM will only apply to those emissions above the free allocation received by domestic producers. The methodology for calculating the reduction in the number of CBAM certificates to be surrendered by importers to reflect free allocation will be determined by implementing acts.</p>
<b>Geographical scope / exemptions</b>	Countries that are part of or linked to the EU ETS (currently Iceland, Liechtenstein, Norway and Switzerland) are exempted. Some special territories of the EU are also exempted. Additional exemptions may be provided for imports of electricity from countries that fulfill certain conditions.
<b>Sectoral/product scope:</b>	Five sectors are to be covered initially: cement, steel, electricity, aluminium, fertilizers. Covered products within these sectors include both ‘simple’ goods (i.e. primary materials) and more ‘complex’ goods (i.e. semi-manufactured goods that use primary materials as inputs). The European Commission can add products /sectors to the list through delegated acts.

<b>Emissions scope</b>	Only direct emissions (Scope 1) are covered, including emissions attributed to covered goods and those embedded in input goods deemed to be within the system boundaries of the production process. Indirect emissions from electricity (Scope 2) are not covered, though a review will make recommendations in 2026 on whether to include these going forward.	
<b>Determination of embedded emissions</b>	<p>For products:</p> <ul style="list-style-type: none"> <li>▪ Based on actual emissions at installation level verified by accredited verifiers, with fallback default values set at the average emission intensity of each exporting country for each of the goods, increased by a mark-up (to be determined in implementing acts).</li> <li>▪ When reliable data for the exporting country cannot be applied for a type of goods, the default values shall be based on the average emission intensity of the 10 per cent worst performing EU installations for that type of goods.</li> <li>▪ During the initial transitional phase (2023-2025), where importers may not yet be able to produce the data required on actual emissions, default values could also apply.</li> </ul>	<p>For electricity:</p> <ul style="list-style-type: none"> <li>▪ Based on third country-specific default values that correspond to the average CO<sub>2</sub> emission factor in tonnes of CO<sub>2</sub> per MWh of price- setting sources in the third country</li> <li>▪ Where third country-specific default values have not been determined, the calculation will be based on a default value set at the average CO<sub>2</sub> intensity of electricity produced by fossil fuels in the EU.</li> <li>▪ A different (lower) default value can be established for a third country that demonstrates, based on reliable data, that the average CO<sub>2</sub>e emissions factor of price-setting sources in the country is lower than the default value that represents the CO<sub>2</sub> emissions factor from EU fossil fuel-based generation.</li> <li>▪ If a set of certain conditions are collectively met (e.g. declarant has concluded a power purchase agreement with a producer of electricity located in a third country), a declarant can opt for declaring actual emissions.</li> </ul>
<b>Level of adjustment (CO<sub>2</sub> price):</b>	The level of adjustment will mirror the average auction price of EU ETS allowances each week. Crediting of policies in the country of origin will only recognize explicit carbon pricing policies (e.g. a carbon tax or ETS), with prices paid deducted from CBAM.	
<b>Use of revenues</b>	The CBAM will not generate revenue in the transitional period from 2023 to 2025. Revenue generated as of 2026 will be collected nationally by competent authorities, and the intent is that most of it will accrue to the EU budget. No mention of earmarking of revenues for specific purposes (e.g. for climate purposes domestically or abroad).	
<b>Implementation timeline</b>	<ul style="list-style-type: none"> <li>▪ 2023-2025: transitional CBAM entailing no financial adjustments</li> <li>▪ 2026: Full implementation of the CBAM</li> </ul>	