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CBAM: An (im)perfect tariff

Europe's export of carbon pricing is a valuable initiative
that could use some improvements

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Introduction

- **With the EU ETS the EU has a pricing system for CO2 emissions**
- **To protect the competitive position of European companies against non-European competitors, some companies now receive free emission allowances**
- **In order to phase out free allowances (Fit-for-55) without harming competitiveness, the European Commission has introduced a Carbon Border Adjustment Mechanism (CBAM)**
- **CBAM prices CO2 emissions from products produced outside Europe**
- **While CBAM works well for many companies, there are still some shortcomings that the EC could adjust to make it a good working tool for all companies:**
 - **CBAM does not take into account Europe's exports to other continents**
 - **The marginal cost of companies receiving fewer free allowances increases by 100%, while non-European companies can resource higher cost prices for the European market**
 - **And CBAM applies only to some raw materials, but not if they have already been incorporated into a product**

The European Union (EU) has several policy measures to address issues such as meeting climate targets. One of these measures is the pricing of CO2 emissions through the EU Emissions Trading Scheme (EU ETS). This system was established in 2005 to encourage companies to become more sustainable through pricing. A measure that has been welcomed by industry and has so far proved to work well.

Because CO2 prices are not applied everywhere, companies that do fall under such a scheme experience a competitive disadvantage. Therefore, many of the sectors covered by the EU ETS currently still receive free allowances to remain competitive with similar producers in many non-European countries. Some sectors simply take longer to become sustainable than others. Nevertheless, the European Commission (EC) wants to get rid of these free allowances and has come up with a measure called *the Carbon Border Adjustment Mechanism (CBAM)* to maintain the level playing field and counter leakage risks.

The CBAM imposes a tariff on the cost price of goods, thereby also pricing the emissions released during production outside the EU. This includes various product groups, namely iron and steel, fertilisers, cement, aluminium, electricity, and hydrogen. CBAM has been introduced in three phases to replace these free allowances, while phasing them out. As the share of free allowances decreases, the cost of CO2 emissions increases. The CBAM scheme applies to importers of CBAM goods produced outside the EU. As a result, products not produced in the EU are priced for emissions as much as European goods consumed within the EU.

While at base CBAM is a good idea to implement a tariff on goods produced outside the EU, thereby protecting European industry and at the same time extending the positive impact of European climate policy to global climate policy, there are also areas for improvement. For instance, CBAM focuses only on imports of commodities covered by the tariff into the EU and does not take exports into account. It also does not take into account the fact that the cost price calculation for a product produced outside the EU is different from one produced within the EU. Furthermore, it charges a tariff on raw materials, but not on products imported that incorporate these raw materials. We describe these and some other shortcomings in this report.

Finally, we come up with some recommendations that would improve the functioning of the CBAM and keep the actual goal - a level global playing field for European producers as well as encouraging sustainability through pricing - intact.

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