



# The CBAM Regulation leaves several open questions regarding implementation

## Introduction

The Carbon Border Adjustment Mechanism (CBAM) regulation has been published in the Official Journal of the European Union after formal approval by the co-legislators, and will enter into force on the 1st October 2023.

When the proposal was released in 2021, it was hailed as one of the cornerstones of the decarbonisation policies and of a global level playing field for industries.

It quickly became entwined with EU climate diplomacy, being heralded as a policy meant to encourage other regions to endorse robust climate-friendly policies, such as carbon markets and/or a carbon tax.

However, the war in Ukraine and the unprecedented energy crisis - that massively hit industries with devastating curtailments - have distorted the political balance and agendas of the European Union and its Member States.

Clearly, the world has changed and is less about interdependency, open global trading, and trust in markets, and more about national-driven policies, protectionism, and unilateralism: CBAM must respond to the new reality.

A robust CBAM that helps the industry remain competitive means a workable and defensible export solution at the WTO level and firm application of the anti-circumvention rules. This needs to be reflected in the review report to be submitted by the European Commission by the end of 2025.

Furthermore, along with an ambitious climate/environmental agenda, the EU must implement a strong industrial policy to sustain investments and allow the industry to remain competitive.

In order to contribute to a watertight CBAM, AEGIS Europe is looking forward to collaborating with the European Commission in the transition phase and adoption of the secondary legislation to come.



## What's at stake?



### Jobs and contribution to EU economy

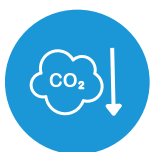
The pressure currently exerted on businesses in our sectors, which are contributing to 4.55% of EU value added and are to a large extent SMEs, is unprecedented. European exports are also at risk - without an appropriate measure for exports, they will be less competitive vis-à-vis products originating in non-EU countries with laxer climate ambitions and without similar carbon emission controls, such as China. This carbon leakage would not only lead to increased global emissions but could also endanger 1.7 million direct jobs, and potentially hundreds of thousands more as the effects would trickle down to other manufacturing industries.



**1.7 mln directly employed people**



**4.55% of EU value added (EUR 549 billion)**



### A Greener production model

The European manufacturing industry is probably the cleanest globally and constantly invests in decarbonisation technologies at levels unmatched in other parts of the world. But if low carbon production in the EU becomes even more uncompetitive, more market opportunities will go to heavy polluters based outside of the EU. Less income means fewer investments into research and innovation.



### Climate change mitigation ambition

As European industries face higher regulatory costs than their competitors in third countries, an ineffective CBAM in replacing current measures to avoid carbon leakage will lead to more closures, curtailments, and relocation to countries where production costs are lower but more carbon-intensive. European production is already the least carbon-intensive globally. Therefore, a CBAM that does not entail a real export solution and not benefit from a the application of strong anti-circumvention measures and fraud-proof verification tools, will lead to the replacement of European production, thereby increasing global emissions and jeopardising the EU's climate ambitions.





## Our considerations

# 1 The CBAM implementation requires further clarification

The CBAM Regulation will enter into force on 1 October 2023, and for a three-year period importers will be subject to reporting obligations only. As of January 2026, ETS free allowances will phase-out at the same pace as CBAM will gradually phase-in [1], and the process will be fully completed by the end of 2034. However, while the timing and percentages are well established, uncertainties relating to the implementation phase still remain: for instance, it is not yet clear what precise information will have to be declared as of October 2023 and as of January 2026, or which kind of information will be required.



# 2 The EU must introduce WTO-compatible export adjustments alongside the gradual phase-out of free allowances

CBAM needs to include a WTO-compatible export solution to avoid carbon leakage and the replacement of EU low-carbon products with high-carbon alternatives on global markets, which would undermine the competitiveness of EU industries and lead to an overall increase in global emissions [2].

However, while recourse to the Innovation Fund represents valuable support to decarbonisation projects, it is not an adequate solution to address carbon leakage risk in relation to exports for the entire EU industry, in terms of magnitude and feasibility. For AEGIS Europe members, direct exports amount to over 300 billion euros annually [3].

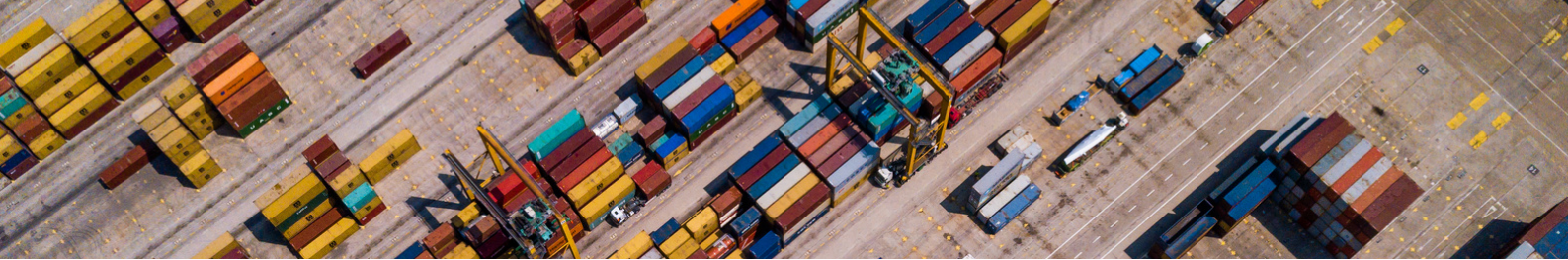
By 2025, the Commission must assess the risk of carbon leakage for goods produced in the EU intended for export to non-EU countries, and present a legislative proposal to address that risk in a manner that is compliant with WTO rules and taking into account the decarbonisation of EU installations [4].

[1] The envisaged timeframe for the phase-out of ETS free allowances is the following: 2026: 2.5%; 2027: 5%; 2028: 10%; 2029: 22.5%; 2030: 48.5%; 2031: 61%; 2032: 73.5%; 2033: 86%; 2034: 100%.

[2] The Commission itself in its Impact Assessment confirmed that withdrawal of ETS free allowances under CBAM would decrease EU exports - see Commission Staff Working Document Impact Assessment Report Accompanying the document Proposal for a Regulation of the European Parliament and of the Council establishing a carbon border adjustment mechanism, 14 July 2021, part 1/2 page 65.

[3] Source: Eurostat, year 2022

[4] Recital 52a and Article 27(2) of the CBAM Regulation.



## 3 Loopholes in the CBAM Regulation must be addressed to prevent circumvention

The CBAM regulation is complex and legally uncertain on some aspects. The Commission, which will play a key role in the implementation phase, needs to ensure the effective application of these provisions. For instance, it should also tackle practices like resource shuffling, which implies allocating low carbon production only to the EU with no positive effect on the overall CO<sub>2</sub> emissions. Furthermore, when the envisaged methodology for calculating emissions allows for individual assessments of the carbon footprint in addition to the default value, then such individual values (much lower than the default ones) would become an incentive for exporters to circumvent. Nonetheless, the Regulation does not cover and address all practices of circumvention [5].

## 4 Extension of the CBAM emission and product scope must be preceded by an impact assessment and industry consultations

CBAM will initially cover iron and steel, refineries, cement, aluminium, electricity, organic basic chemicals, hydrogen, and fertilisers [6] and, according to the Regulation, all ETS sectors (covered by Directive 2003/87/EC) are to be included in the CBAM scope by 2030. For further expansion, the Commission shall consult the relevant stakeholders to identify other precursors for upstream or downstream products to be considered for inclusion [7].

However, for some ETS sectors with very specific value chains, products, and global trade flows, a CBAM cannot effectively address carbon leakage and reduce emissions: the one-size-fits-all strategy does not reflect the complexity of European industry. An in-depth impact assessment and industry consultation are required, and in case inclusion is considered feasible, a transition should be considered as well.

## The WTO compatibility of a CBAM with free allowances & export adjustments

An EU ETS system incorporating a CBAM, continued free allowances, and a new export adjustment mechanism can be WTO consistent. To ensure WTO compatibility, export adjustments must be an integrated but independent component of the EU ETS and apply to EU products exported to third countries with lower climate ambitions. A [legal study](#) commissioned by AEGIS Europe has identified the two most probable legal pathways that a WTO-compatible export adjustment could take:

1. **Extending free allowances to EU exports (de facto export adjustments)**
2. **Granting refund/credit for allowance obligations on exports (de jure export adjustments).**

Export adjustments should be kept in place until third countries align their climate policies to the EU to prevent carbon leakage. [8]

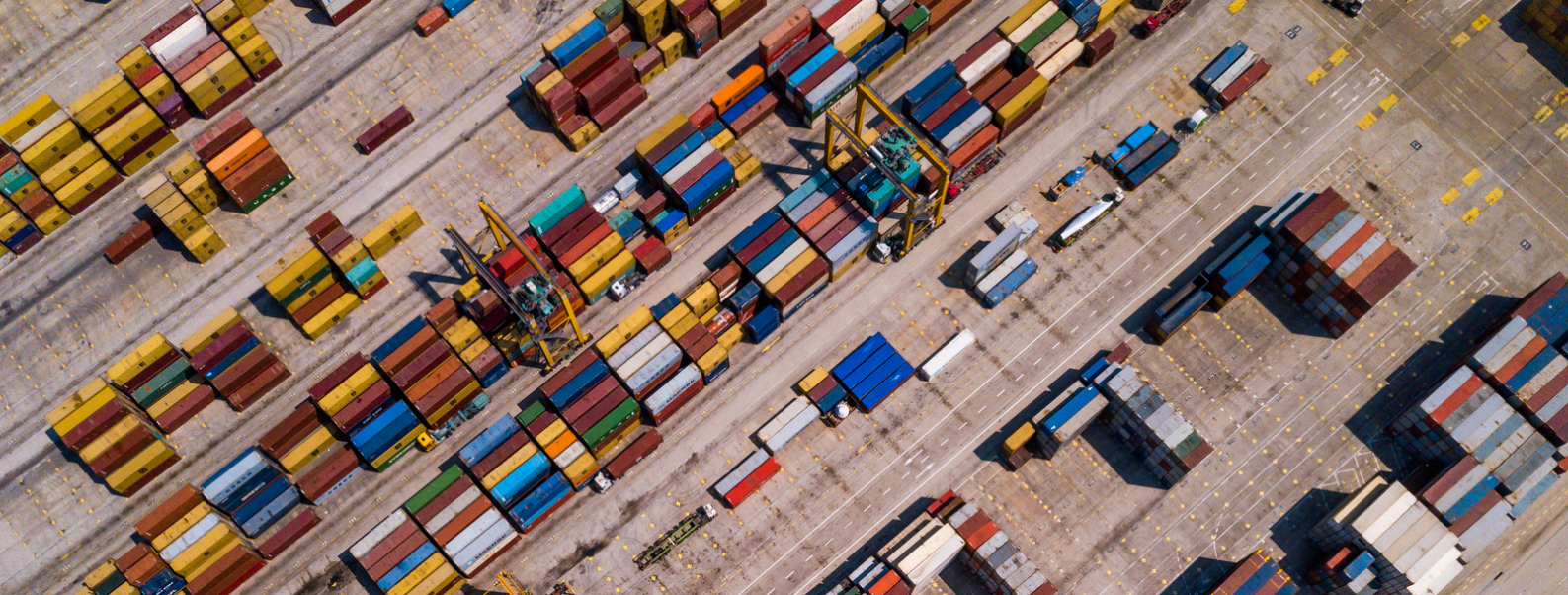
[5] Recital 52a and Article 27(2) of the CBAM Regulation.

[6] Recital 30 and Annex I of the CBAM Regulation.

[7] Recital 52b of the CBAM Regulation; Article 30(1) and (2a) of the CBAM Regulation

[8] Based on WTO Consistency of "Export Adjustments" in the context of the EU emissions trading system, King & Spalding, Nctm, 2022





## About AEGIS Europe

AEGIS Europe is an industry alliance that brings together more than 20 European trade associations and companies committed to manufacturing in the EU on a truly level playing field ensured by a rules-based free and fair international trade. Our members collectively generate an annual turnover of €530-550 billion and provide for around 1.7 million direct jobs.

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