

A robust CBAM design to unlock climate-friendly industry investments at EU scale

A climate contribution (excise) with CBAM is aligned with developments in other ETS files: EU ETS is combined with free allocation AND Carbon contracts for difference are funded through climate contribution at EU scale.

Objective:

- **Leakage concerns** are addressed for exports and imports along the value chain
- **Incentives** are provided for material producers and all actors along the supply chain
- **Coverage** is expanded to broader set of materials and indirect emissions
- **Perspective** is clear for investors, resolving international uncertainties and declining ETS cap
- **Benefits for society** are realised
- **Contribution** to global climate action is delivered at home and supported abroad

How does it work?

- **A climate contribution (excise) with CBAM** using standardised carbon intensity values derived from benchmark rates for each material is levied on EU production of materials and imported materials (also as part of products).ⁱ Duty suspension scheme ensures that climate contribution is not due on exported materials, also as part of products.
- **EU ETS is combined with free allocation** at benchmark rate of best available conventional technology for period of transition to climate neutrality. Allocation is only granted to firms that implement transition strategy with clear milestones.
- **Carbon contracts for difference funded through climate contribution** are granted to new installations to cover incremental production costs of climate neutral technologies. Contracts respond to level of carbon price reflected in international material prices.

How does it achieve the objectives?

Avoids carbon leakage concerns on exports, value chain and from resource shuffling

- Conventional production obtains free allocation at benchmark level of conventional technology during transition period to climate neutrality.ⁱⁱ
- Liability for payment of climate contribution is imposed on domestic production and imports of materials including as part of products, but it is not due on exports.ⁱⁱⁱ
- Incentives for resource shuffling are avoided, because standardised values are applied.

Incentivises investments in all mitigation options

- Conventional installations incentivised by EU ETS to improve carbon efficiency.
- Material efficiency, substitution and recycling are incentivised by climate contribution.
- Clean production processes obtain carbon contracts to cover incremental costs.

Allows for coverage of broader set of materials and of indirect emissions

- WTO case for climate contribution: It replicates established principles of excise charges.
- ASCM case for free allocation: Avoid double charging of ETS and climate contribution.^{iv}
- Administrative effort of climate contribution is moderate (see EU Impact assessment).^v
- Standardised values allow for coverage of basic chemicals.
- Excise structure allows to also include indirect emissions in standardised values.

Provides a credible perspective for investors

- Limiting free allocation to existing installations during transition period to climate neutrality provides clarity and ensures sufficient allowances are available with declining EU ETS cap.
- EU scale funding overcomes current limitations of carbon contracts for difference to countries with sufficient public budget: to unlock climate-friendly industry investments at EU scale.
- Implementation is predictable, because Climate contribution serves environmental integrity of EU ETS and is hence adopted without unanimity voting in EU Council (Article 192.1 TFEU).^{vi}

Benefits to society are realized

- Windfall profits will be avoided, because free allocation is linked to current and not historic production volumes. This avoids the pass-through of opportunity costs.
- The carbon price will decline, because also material efficiency and recycling will respond to the price signal, therefore reducing the price level necessary to reach climate targets.
- Cost increases for final consumers will be moderate and equal to case of full auctioning and CBAM or global carbon pricing. 40 Euro/year or 0,3% cost increase for poor households, 0,4% for rich households, less with improved material efficiency.^{vii}

Contributes to global climate action

- Builds on global experience and was jointly developed with international partners.^{viii} Could provide successful example and blue-print for inclusive industry transition in third countries.
- Puts EU in good position to convene carbon pricing club, possibly with other CBAM designs. Free allocation and CCfD would then be reduced by agreed carbon price levels.
- Complements measures to encourage global action (sustainable finance, product carbon requirements) and to support partner countries (climate alliances, climate finance).

ⁱ Free allocation would be directly linked to production volumes, so as to avoid partial cost pass-through and windfall profits <https://www.repository.cam.ac.uk/bitstream/handle/1810/299473/cwpe1988.pdf>

ⁱⁱ See CBAM support study for DG TaxUD for evaluation and of performance of excise option. https://clustercollaboration.eu/sites/default/files/news_attachment/Final%20report%20CBAM%20study_0.pdf. The impact assessment assumes free allocation and excise is not at best available conventional technology but at average carbon intensity of sector, reducing incentives for emission reductions, revenues and performance in addressing carbon leakage risks.

https://ec.europa.eu/info/sites/default/files/carbon_border_adjustment_mechanism_0.pdf

ⁱⁱⁱ Economic and legal considerations <https://www.e-elgar.com/shop/gbp/including-consumption-in-emissions-trading-9781800376847.html>

^{iv} Analysis of WTO-ASCM compatibility <http://hdl.handle.net/10419/234455>

^v Estimated compliance are 23-45 mio € and enforcement costs >13 mio € per year, higher but of the same order of magnitude as other CBAM options. See CBAM support study for DG TaxUD:

https://clustercollaboration.eu/sites/default/files/news_attachment/Final%20report%20CBAM%20study_0.pdf

^{vi} Analysis of legal basis <http://onlinelibrary.wiley.com/doi/10.1111/reel.12131/full>

^{vii} Analysis of distributional impact <https://www.sciencedirect.com/science/article/pii/S0921800921002263>. 60 €/t CO₂ prices are assumed. Absolute effect lower in lower-income countries, relative effect higher.

^{viii} Concept builds on Chinese ETS pilots and Korea ETS, and was developed by coalition of international think tanks. <https://climatestrategies.org/publication/inclusion-of-consumption-of-carbon-intensive-materials-in-emissions-trading-an-option-for-carbon-pricing-post-2020/>