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EU Carbon Border Adjustment Mechanism (CBAM) 101

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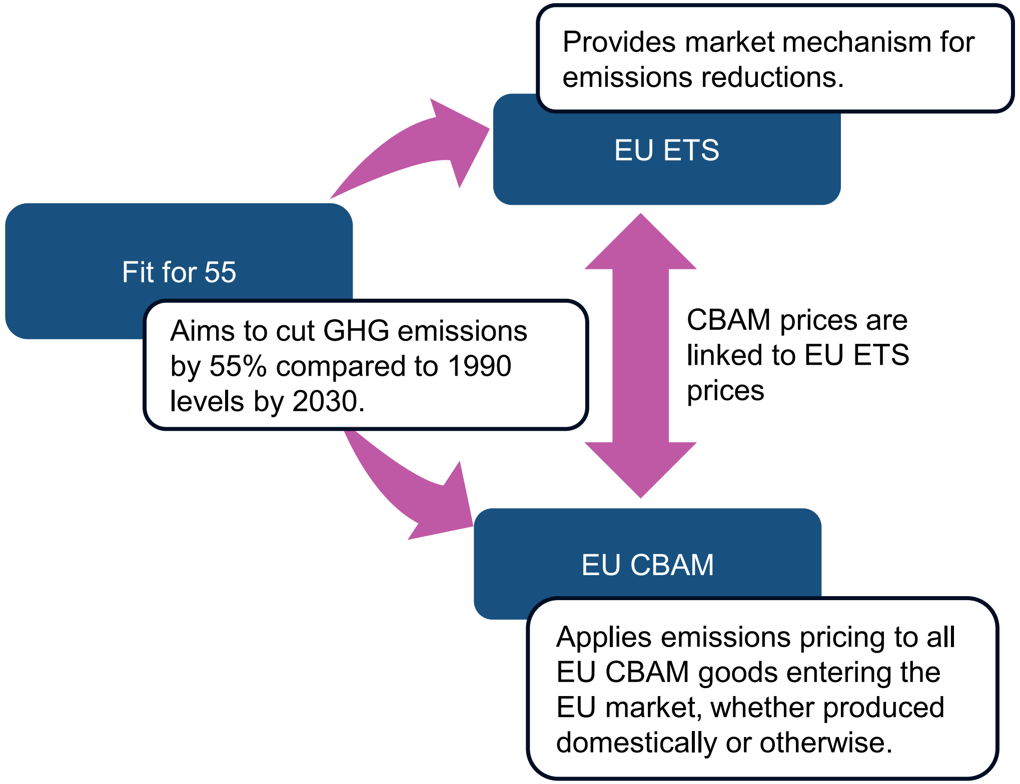
EU CBAM 101

Introduction to EU CBAM

The EU ETS and EU CBAM aim to reduce carbon emissions in Europe over the long term

EU CBAM, EU ETS and Fit for 55 are interlinked



Since the early 1990s, the European Union (EU) has been committed to the reduction of greenhouse gases and has set out a range of emissions goals and policies designed to achieve this, beginning with the ETS in 2005.

EU ETS

- Established in 2005, the EU ETS is a '**cap-and trade**' scheme designed to reduce man-made greenhouse gas emissions (GHG emissions) such as CO_2 by putting a price on emissions.
- In 2021, the ETS was strengthened by increasing the annual emissions reduction rate and phasing out free allowances for key sectors to align with the *Fit for 55* targets.

EU Fit for 55

- The EU Fit for 55 package was introduced in 2021**. It aims to cut GHG emissions by at least 55% by 2030**, when compared to 1990 levels.

As the ETS moves into its next phase, without complementary policies, the current system would have put domestic industries at a disadvantage, as importers of non-EU products would not have to pay equivalent carbon costs. With the implementation of CBAM, the EU aims to address this issue.

EU CBAM

The EU Carbon Border Adjustment Mechanism (CBAM) is a policy tool introduced by the EU that puts a price on the carbon emissions embedded in certain imported goods and precursors.

SOURCE: CRU

From 2026, there will be a carbon price on selected goods and precursors on imports to the EU

How does the EU CBAM work?

- EU CBAM reporting declarants must register with the relevant authority and declare the embedded emissions in selected goods and precursors.
- By August 2027, and every year thereafter, reporting declarants will need to surrender certificates covering the previous year's emissions subject to CBAM.
- Emissions subject to CBAM can be calculated using embedded emissions and CBAM benchmark and factor.
- A carbon price paid on the embedded emissions in another jurisdiction can be deducted from the obligation.
- From 2027[(1)], at the end of each quarter, EU CBAM declarants must hold certificates covering at least 50% of the embedded emissions on the goods they have imported since the start of the calendar year.
- EU CBAM may cover a different scope of emissions depending on the sector.

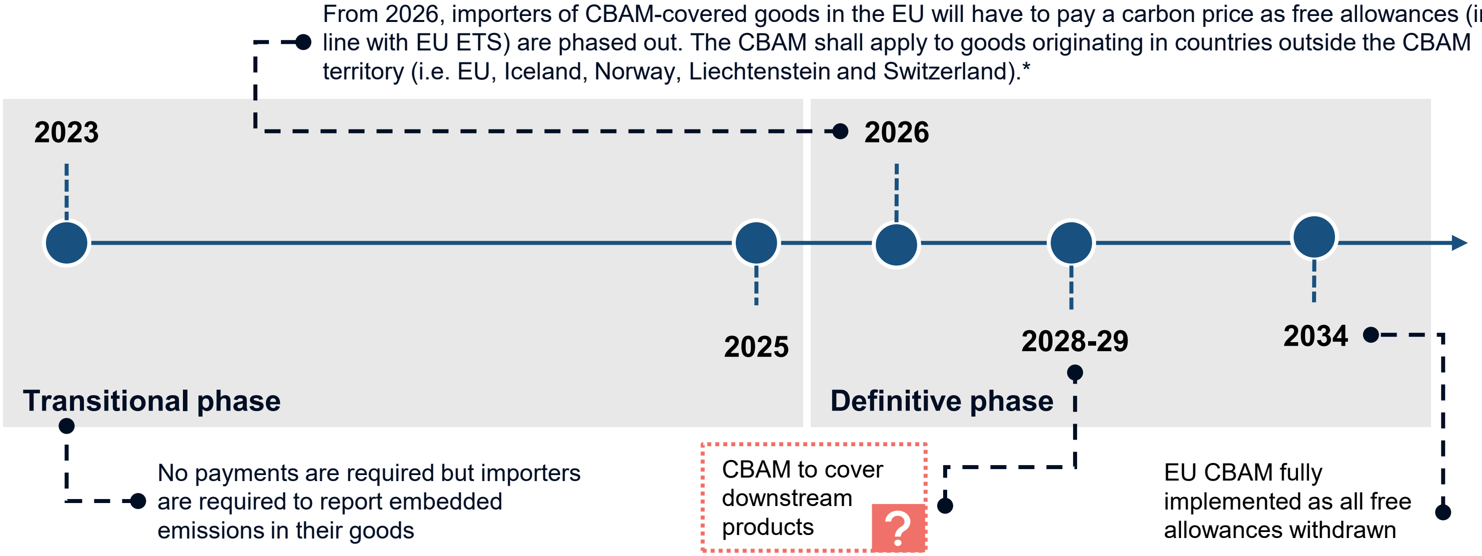
	Scope 1	Scope 2
Cement, fertilizers	√	√
Iron/steel, aluminium, hydrogen	√	Subject to review
Electricity	√	-

Reporting declarants: Refers to the entity responsible for paying carbon costs for imported goods and precursors. As of January 2025, EU CBAM allows non-EU installation operators to upload emissions data directly.

Relevant authority: Each member state designates a national authority to implement EU CBAM. These authorities exchange essential or relevant information among themselves.

EU CBAM Certificate: Refers to certificate in an electronic format issued by relevant authorities corresponding to one tonne of embedded emissions in the goods. **The EU CBAM certificate price mirrors EU ETS carbon price.**

Selected goods and precursors: EU CBAM initially **covers six sectors (cement, iron and steel, aluminium, fertilizers, electricity and hydrogen);** however, the European Commission has recently announced plans to broaden CBAM scope to include certain downstream products (and implement other anti-circumvention methods), but it is not clear exactly what this will cover and when it would be implemented.



DATA: CRU, European Commission. Note: (1) As per EU notification dated 26 Feb 2025, starting year of obligation to hold minimum number of EU CBAM certificates was changed to 2027 from 2026. Reporting declarants will still be required to surrender CBAM certificates covering 100% of their emissions in 2026 by 31 May 2027. *The UK government and the EU have agreed to link up their emission trading schemes, with the UK most likely being exempt from EU CBAM regulations.

EU CBAM aims to mirror EU ETS, which sets carbon pricing for pollutants based in 27 EU Member States plus Norway, Iceland and Liechtenstein

How does the EU ETS work?

- The EU Emissions Trading System (EU ETS) directly contributes to managing the EU's carbon budget – which is derived from its emission reduction targets - by placing a cap on emissions from covered sectors in the form of allowances.

- **The cap on emissions is reduced annually to ensure that the EU is in line with its carbon budget trajectory.** As a result, a fixed number of emission allowances are made available each year, with one allowance giving the right to emit one tonne of CO_2e . **Within the cap, allowances are either made available freely or auctioned off.** Businesses can then compete to buy allowances.

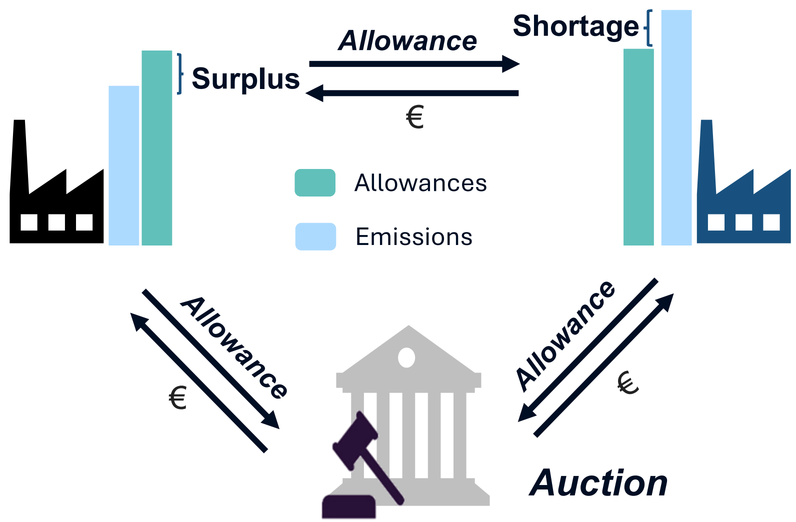
- The EU ETS carbon price is determined by the supply and demand for allowances, with businesses buying and selling these as the overall cap declines (*see figure on right*).

    - Those that emit more than their free allocation of allowances will have to cut emissions, bid for allowances in an auction or buy allowances from another producer.

    - Those that emit less than their free allocation of allowances can either keep allowances for next year or sell them to another emitter at a profit.

- Free allowances have been provided to sectors at risk of carbon leakage, but **as free allowances phase out under EU ETS, all emitters regardless of location will eventually pay the full carbon price**.

- **The price of EU CBAM certificates is pegged directly to the EU ETS carbon price.** For imports from 2027 onwards, the price will be based on the weekly average of EU ETS auction prices. For the first financial year (imports in 2026), a special procedure has been proposed to calculate the price using the quarterly average of the ETS price for the relevant quarter.



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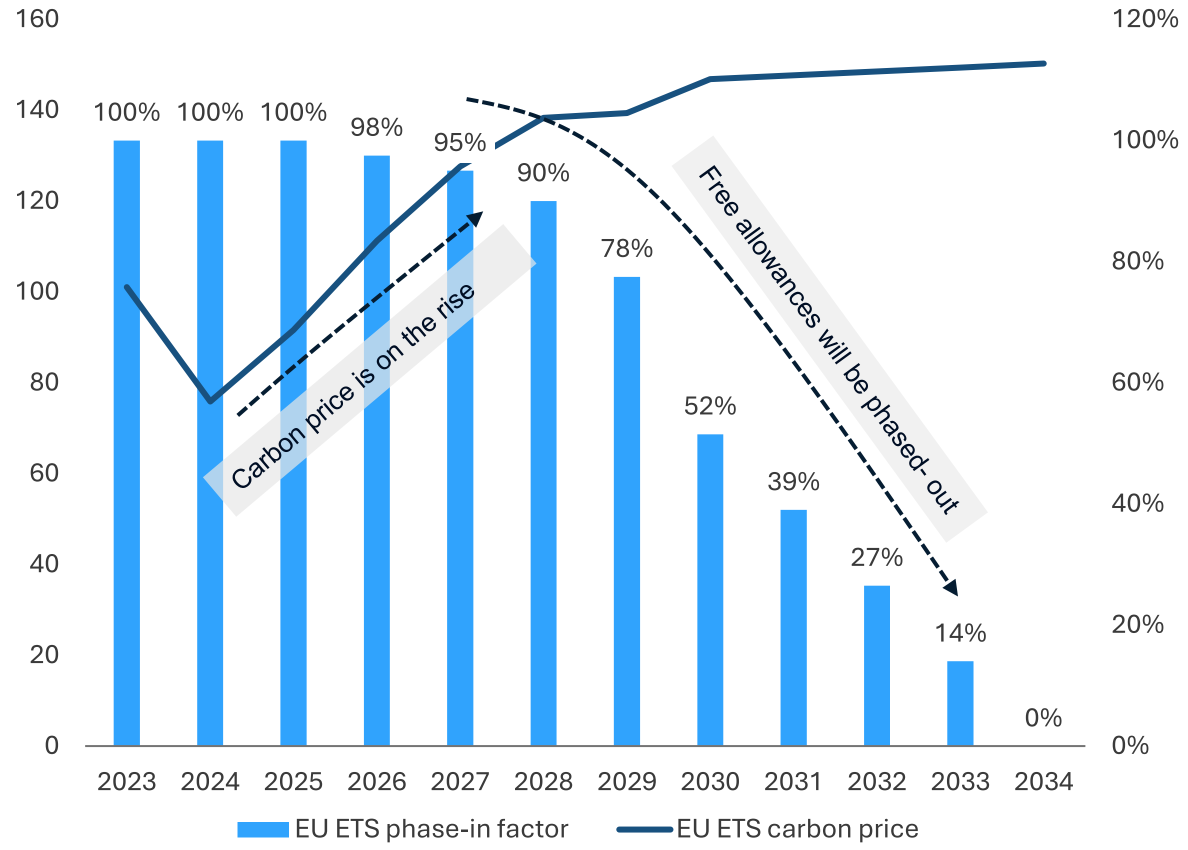
Sectors covered under EU ETS

- **Power Generation** (e.g., coal, gas, and oil power plants)
- **Heavy Industry** (e.g., steel, cement, chemicals, aluminium, glass, oil refineries)
- **Maritime Shipping** (included from 2024)

SOURCE: CRU

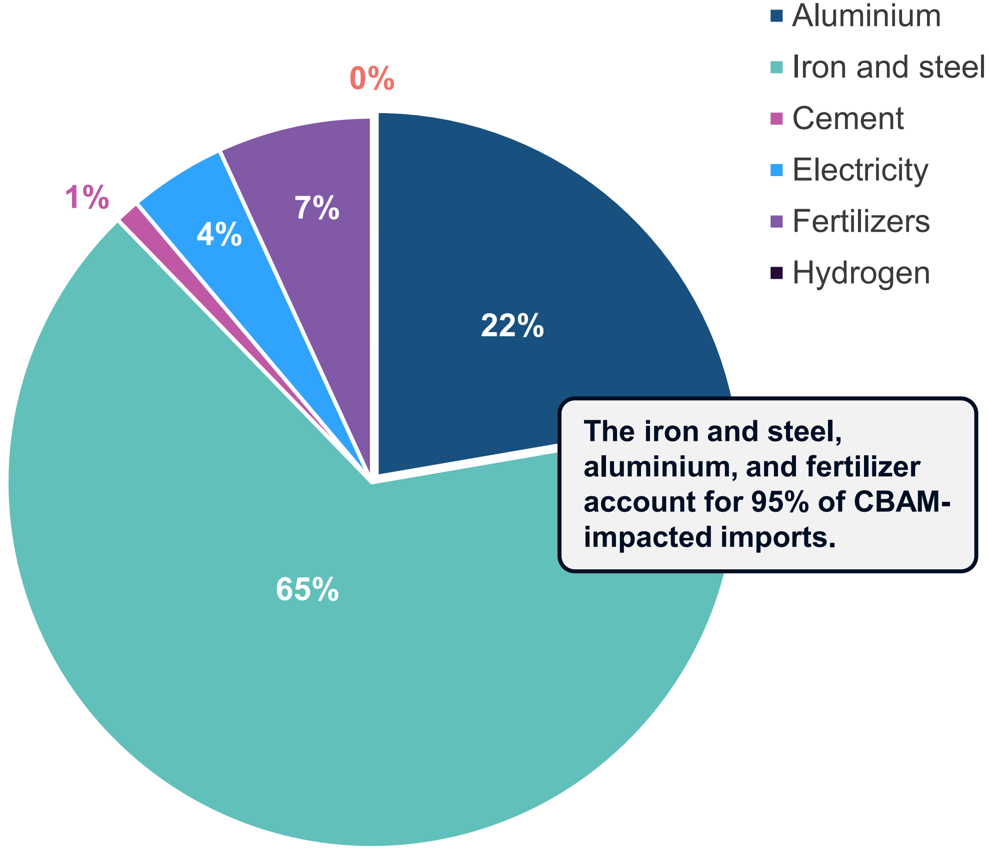
EU long-term carbon price is set to rise – aluminium, steel and fertilizers account for 95% of the EU CBAM impacted imports

LHS: EU ETS long-term carbon price, Real 2024, €
RHS: EU ETS free allowances phase out, %



DATA: CRU

Share of goods covered by the six sectors affected by the EU CBAM (by value)



Team – coverage on CBAM bolstered by expertise across several teams

Sector-specific knowledge in CRU's steel, aluminium and fertilizers teams…

Steel

Chris Asgill

Head of Steel

Matt Watkins

Principal Analyst

Aluminium

Paul Williams

Head of Aluminium

Alex Christopher

Senior Analyst

Fertilizers

Chris Lawson

Head of Fertilizers

Charlie Stephen

Nitrogen & Hydrogen Analysis Lead

…is strengthened by an in-depth understanding of the energy transition and carbon policy.

Mark Jeavons

Head of Economics & Sustainability

Frank Eich

Principal Analyst

CRU is also able to provide bespoke consulting services on CBAM:

Kaitlin Gebbie

Senior Consultant

Ibrahim Yucel

Principal Consultant