



CBAM sectors statement on ETS and CBAM Dialogues

The current economic context reinforces the case for a watertight CBAM with a cautious free allocation phase out and a tangible export solution

The Emissions Trading System (ETS) and the Carbon Border Adjustment Mechanism (CBAM) represent key elements of the regulatory framework accompanying the transition towards climate neutrality of our sectors – aluminium, cement, fertilizers, steel.

The short-medium term horizon of this transition is more challenging than ever. Skyrocketing energy prices, high inflation, soaring carbon prices and related indirect costs, and raw materials shortages are unprecedented challenges. At present, CBAM sectors are heavily impacted, with unprecedented idling of capacities reaching 70% for ammonia in fertilizers' production, 50% for primary aluminium and around 10% for steel, whilst in a sector like cement, some companies have faced a tripling of their production costs following the electricity price hike.

At the same time, the business case for low carbon investments in Europe is heavily challenged by the different regulatory and financial framework being developed by our trading partners, whose consistency with international trade law is frequently not subject to sufficient scrutiny. For instance, the Inflation Reduction Act will provide financial support for around \$ 370 billion to low carbon investments in USA's industry and energy, with a likely impact on global competition and trade patterns.

Against this background, it is indispensable to achieve the EU's climate ambition for 2030 in a sustainable and socially fair manner. This requires strengthened carbon leakage provisions and measures supporting companies' investments and avoiding disproportionate costs in the short to medium term.

Therefore, we would like to stress the following essential elements in view of the dialogue negotiations on ETS and CBAM.

Why is a cautious approach to the free allocation phase-out for CBAM sectors necessary?

- The CBAM is a new tool which needs to be properly tested before replacing free allocation, even gradually. The transitional period 2023-2025 is not a real test period, since during that period importers will not pay the CBAM levy.
- Moreover, a fast free allocation phase out will expose the EU industry to significantly higher carbon costs, in a context where its cost base is already severely impacted by energy prices. This would inevitably reduce our sector's financial ability to invest in decarbonisation projects by 2030.
- A complementarity between CBAM and free allocation would also ensure a smoother impact on European value chains, since the free allocation phase out would increase the costs of CBAM materials, thus raising the costs of the energy transition to be paid by European citizens and companies in a deteriorating economic environment.

- This would also reduce the initial level of the CBAM levy to be paid by importers, which mitigates the impact on trade flows and facilitates international trade relations.
- ⇒ **For the reasons mentioned above, our sectors believe that the CBAM with actual payments by importers reflecting the price paid by EU domestic producers should complement free allocation at full benchmark levels until its effectiveness is proven. Should such solution not be possible, our sectors urge negotiators to support the Council proposal establishing the phasing out of free allowances between 2026 and 2035, with a slower reduction pace until 2030.**

Why is a tangible export solution necessary and how can it be WTO compatible?

- The current energy crisis clearly shows the inevitable and sizeable impact of unilateral cost shocks on European industry. In the absence of a tangible export solution, phasing out free allocation will expose European exports of CBAM sectors -currently worth € 60 billion¹- to unbearable carbon costs, as it is the case today for energy costs.
- Such situation will undermine the viability of EU exports, with consequences for jobs and investments in the EU. Losing EU exports capacity will also have serious environmental consequences, as the global demand would be met by production from other countries with a much higher carbon footprint, and in any event not subject to a predictable emission reduction trajectory equivalent to the EU ETS.
- Leaving the export solution to possible later measures subject to further assessments will be tardy and redundant. Retaining free allocation only for best 10% installations in the EU is not a tangible, structural export solution for CBAM sectors, as the remaining 90% producers would be exposed to unbearable carbon costs. Similarly, financial support through the Innovation Fund – despite the importance for first-of-a-kind projects for individual companies in the long-term climate neutrality transition – will not help preventing the immediate loss of export markets for entire EU sectors when free allocation is phased out.
- ⇒ **Our sectors believe that a tangible solution for exports can be implemented through several measures, such as retaining benchmark based free allocation or introducing an export adjustment. As demonstrated by multiple opinions by independent law firms, the WTO consistency of such measures needs to be deeply assessed according to their design and details and cannot be disregarded as a matter of principle. Ultimately, the export solution is meant to re-establish a global playing field for European producers subject to unilateral carbon costs while retaining incentives to further decarbonise. EU producers will not be granted any undue advantage over competitors.**

Last but not least, our sectors want to emphasise the need to improve and **strengthen the governance and enforcement of the CBAM**, notably with regards to the role of the central authority, circumvention provisions, default values, the limitation of exceptions and the verification, transparency of data and a review mechanism. These provisions are crucial to reinforce CBAM's watertightness and to ensure it fully meets its intended policy objectives.

¹ Source: Calculations based on Eurostat data by the European Roundtable on Climate Change and Sustainable Transition