

What is Carbon Border Adjustment Mechanism and how will it operate? 2/48/21



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The European Green Deal and net zero carbon emissions are hot topics in Europe and globally, with implications for Latvia's environmental protection policy, particularly affecting companies that produce or import iron and steel, cement, fertilisers, aluminium, and electricity.

The Carbon Border Adjustment Mechanism

Europe has announced its 2030 commitment to cut carbon emissions by 55% compared to the 1990 levels and to become a net zero continent by 2050. However, if only Europe adopts stringent policies on cutting carbon emissions, the proposed measures might not achieve great results because some companies will want to shift their carbon-intensive production to third countries with less stringent environmental and climate policies. Alternatively, EU products might be replaced by imports of more carbon-intensive goods.

Climate change is a global problem that needs global solutions. To minimise attempts at shifting carbon emissions outside Europe, the European Commission has proposed to adopt from 2023 the Carbon Border Adjustment Mechanism (CBAM) – a system that, in line with the WTO rules and other international commitments, will ensure that the EU importers purchase carbon certificates for the carbon price that would be payable had the goods been produced according to the EU carbon price-setting rules. If a third-country producer is able to prove that he has already paid the price for the carbon used in producing the imported goods in a third country, the costs will be deductible for the EU importer. The CBAM will help mitigate the risk of carbon emissions shift, prompting third-country producers to make their production processes less harmful to the environment.

To provide companies and other countries with legal certainty and stability, the CBAM will be phased in gradually. It will initially apply only to certain goods at high risk of carbon emissions shift: iron, steel, cement, fertilisers, and aluminium, as well as electricity production.

How will the CBAM work in practice?

The CBAM will slightly resemble the EU emissions trading system because the importers of goods at risk of carbon emissions shift will have to purchase certificates. The price of certificates will be computed depending on the weekly average quota auction price expressed in euros per tonne of emitted CO₂. To purchase CBAM certificates, the importers themselves, or with the help of a representative, will have to register with the government agency responsible for administering certificates. This institution will also be responsible for selling CBAM certificates to the importers.

To import into the EU any goods covered by the CBAM, the importers will have by 31 May each year to report the quantity of goods imported into the EU in the previous year and the amount of emissions arising in the production of those goods. At the same time, the importers will have to surrender to the government agency responsible for administering certificates the CBAM certificates they purchased from it earlier.

So the EU emissions trading system will see the importers pay the same carbon price as the local producers, and the CBAM will ensure equal treatment of goods produced in the EU and imports from other countries, as well as preventing the shift of carbon emissions.

During the transition period from 2023 to the end of 2025, the importers will have to report emissions embedded in the goods but will not yet have to pay any financial adjustment. This will provide time for setting up the final system. This transition period, together with a gradual implementation of the CBAM, will allow EU and third-country companies as well as institutions to carry out a careful, predictable and reasonable transition over time. Once the final system is up and running in 2026, the EU importers will each year have to report the total goods they imported into the EU in the previous year and the relevant embedded emissions, and will have to surrender an appropriate number of CBAM certificates.

So the CBAM is expected to apply to imports of cement, iron and steel, aluminium, fertilisers, and electricity. Initially the CBAM will apply to direct GHG emissions arising in the production of those goods. By the end of the transition period, the European Commission will evaluate the operation of the CBAM, assess whether its scope should be expanded to include more products and services, and assess whether this should include “indirect” emissions (i.e. from electricity consumed to produce the goods).

Although the CBAM is to cover importation from all third countries, those that either take part in the EU emissions trading system or have an emissions trading system linked to the EU, i.e. EEA members and Switzerland, will be excluded from the CBAM. The CBAM will apply to electricity produced in countries that have not yet integrated their electricity markets with the EU.

It is important to note that revenues generated by the CBAM as the EU’s potential own resources will represent contributions to the EU budget.