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What should a carbon border measure look like?

A carbon border adjustment measure can support a clean industrial transition globally if it's designed properly and fairly. It must replace all current EU pollution handouts and its revenues must be used wisely to drive innovation and to provide climate finance to countries that most need it.

The EU Commission is preparing the law to put a carbon price on imports to the EU. The stated goal is to increase climate action within and outside the EU. In addition, the CBAM would also ensure that European industry remains competitive and avoid European production being moved overseas ('carbon leakage'), which would theoretically risk increasing overall emissions. In this context, it's worth remembering that in reality the there is no evidence detected for
the occurrence of carbon leakage as defined by the ETS Directive.

A key condition for introducing a carbon border adjustment measure is that it replaces all existing forms of industry protection within the EU, such as free pollution permits and government subsidies to compensate for higher electricity cost ('indirect cost compensation'). Failing that, it would not be a climate tool, but merely protectionism which also would not go down well with the World Trade Organisation.

Assuming - as the Commission has also stated - that the above condition is met, we can look at how this measure should be designed and implemented. Below we summarise certain key elements which are discussed more in detail in our recent response to the European Commission's public consultation and in [this briefing](#).

Bringing imports under the EU carbon market

A tariff would be the most straightforward way to price pollution at the border. But this would be politically extremely difficult, not least because decisions on taxation require unanimity among the 27 EU member states. Therefore, the more realistic option would be to make foreign producers or importers buy pollution permits under the EU carbon market.

The permits should be cancelled immediately when a product enters the EU single market (as opposed to on an annual basis). This might prompt some to call for more allowances on the market ("adjusting the cap"). However, that would not be needed, nor be a good idea, since the market is already significantly oversupplied.

Bringing imports under the EU carbon market while maintaining the cap unchanged would increase demand for allowances and therefore strengthen the carbon price - a key to incentivising innovation and more emission reductions. It would also ensure that foreign companies and EU producers are treated equally.

Ideally, the carbon intensity of each product would be measured and accounted for as it enters the European market and would then be priced for its verified emissions. Alternatively, each product should be priced according to a performance benchmark that reflects the carbon intensity of the average EU producer of that good. This would ensure that importers are charged with a price that is as close as possible to what their European counterparts pay.

Importantly, as a climate tool, the measure should target the worst polluters, as opposed to sectors considered to be at the highest risk of carbon leakage. This means that initially, steel, cement and bulk chemicals should be covered, as these three sectors account for almost 60% of industrial emissions under the EU carbon market.

While a well-designed carbon border measure can drive global climate action, the EU must be sensitive towards countries' need to develop, just as it needs to recognise the relative impacts of carbon prices which can be much higher for low-income countries.

For this reason, Least Developed Countries (LDCs) and Small Island Developing States (SIDS) should be exempted from carbon border measures, as should countries that have similar climate policies in place.

A climate finance tool…

The revenues from the carbon border measure should go in full to fund further climate action.

Part of them could be distributed to developing countries as climate finance contributions. The rest could be directed to EU funds such as Innovation Fund and Modernisation Fund. This way, they would support climate-neutral breakthrough technologies and innovative industrial processes and further develop renewable energy capacity in the EU.

…that complements climate diplomacy

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As also declared by the European Commission, climate diplomacy and dialogue with Europe's trading partners are a crucial part of the carbon border measure exercise.
The measure should not be handled as a punitive tool or an attempt to shield European industries while they continue to pollute business-as-usual. Its goal must be to build collaborations and to encourage trading partners to adopt more ambitious climate policies. This could help drive a clean transition of industry globally, a key condition for the world to meet the Paris Agreement climate goals.