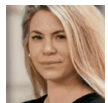


What American Manufacturers Need to Know About the European Union's Carbon Border Adjustment Mechanism



Elena Benaim

Policy Analyst, Carbon Pricing and Clean Energy Supply Chains

Takeaways

On October 1, 2023, the European Union (EU) will enter its transitional phase of a Carbon Border Adjustment Mechanism (CBAM) for a select group of carbon intensive product imports. Here are some of the most important things US manufacturers need to know:

1. CBAM applies to both Importers and Operators (manufacturers) with differing responsibilities for compliance with the regulation. Most US producers will need to comply with the Operators' and not the Importers' requirements. Only the Importer bears the reporting obligations towards the EU.
2. You are considered an Operator if you produce a CBAM-covered good that ends up being imported into the EU. In this case, the Importer will require you to report information on the embedded emissions of these goods. If another Operator integrates your goods as a precursor in the manufacture of other CBAM-covered products, you will be required to report the embedded emissions to this Operator.
3. Both direct and indirect emissions are covered by the CBAM regulation. There are sector-specific calculations required by the EU to report embedded emissions with which Operators must comply.
4. Importers won't face any financial obligations until 2026 when the CBAM becomes "definitive".

Background

In May 2023, the EU adopted a [Regulation establishing a Carbon Border Adjustment Mechanism](#) (CBAM) to level the playing field between companies importing goods from outside the EU and EU companies that are internally subject to a carbon pricing scheme (the [EU Emission Trading System](#), or ETS). The regulation states that in 2026, importers of iron, steel, cement, fertilizers, aluminum, electricity and hydrogen from companies not subject to a carbon pricing scheme will be required to pay a border carbon tax. The CBAM will undergo a transitional period commencing October 1, 2023 that requires every producer and importer of goods from outside the EU to collect and report information related to the embedded emissions of CBAM-covered goods.

More recently, on August 17th, the European Commission published a [Guidance Document on CBAM Implementation for Installations Operators Outside the EU](#). This document, as stated by the Commission, has been written to support stakeholders by explaining the requirements of the [CBAM Regulation](#). More specifically, it provides information on requirements placed on Operators producing CBAM-covered goods outside of the EU for the transitional period.

The impact of the EU CBAM will be determined by the level of carbon intensity of manufacturers in the product's country of origin. The cleaner the product, the more competitive it will be under CBAM regulations. For instance, both the American steel and aluminum industries are among the

cleanest and most energy-efficient in the world and would therefore incur minimal CBAM fees for Importers bringing these goods into the EU. The Inflation Reduction Act will further America's competitive advantage as significant investments are being made to decarbonize manufacturing processes across major industries, as well as providing funding and technical support to manufacturers in the calculation and reporting of the embedded emissions in their products.

Furthermore, many American producers of CBAM-covered goods already report emissions voluntarily to the US Environmental Protection Agency (EPA) and are generating ISO standard, manufacturing facility-specific Environmental Product Declarations (EPDs). The data gathered for the EPDs will be very useful in order to comply with the CBAM reporting requirements.

What American Manufacturers Need to Know About the EU CBAM

The Guidance is an extensive document, written in non-legal terms, accompanied by separate guidance for Importers of CBAM goods and electronic templates that should be used to submit collected emissions and data. These documents are not legally binding but instead are aimed at assisting in the correct interpretation of the proposed regulations to facilitate implementation. Because of the complexity of the CBAM, even the guidance documents are highly technical and must be carefully studied to understand what's required for compliance. As a helpful overview, this memo highlights some of the most important elements of the Guidance for Operators, which is most relevant to US manufacturers (that directly or indirectly) export to the EU.

The Guidance is Divided as Follows:

- **Section 2** Introduction
- **Section 3** Quick Guide for Operators
- **Section 4** The Carbon Border Adjustment Mechanism
- **Section 5** CBAM goods and production routes
- **Section 6** Monitoring and Reporting Obligations
- **Section 7** Sector Specific Monitoring and Reporting
- **Section 8** General exemptions

Below are some of the key issues addressed in the CBAM Guidance for Operators:

Operators and Importers Have Different Responsibilities

There are two different fundamental roles under the reporting obligations. The first role is the Importer, which will directly interact with the EU authorities and will need to ensure that all the information is collected and reported correctly. The second role is the Operator, which is essentially the manufacturer of a good covered by the EU CBAM. Operators are expected to have information on covered goods produced at their facilities (or “installations”). An Importer, or “reporting declarant,” is the entity that imports the goods to the EU and is responsible for meeting the reporting obligations and surrendering CBAM certificates where required. Importers collect embedded emissions data for imported goods from the Operators for use in generating reports and calculating border taxes.

Data on embedded emissions of a covered good must originate from the Operator. So, if you produced a covered steel product at your “installation” and sold it to an entity that imported it to the EU, that Importer will require you to submit data on the emissions of the good to them. The same would hold true if you sold it to a customer who then sold it to an entity that imported it into the EU. Regardless of how many times the product changes hands in between, the Importer will need emissions data that has been provided by the Operator.

How to Identify CBAM Goods

As an Operator, you should first establish which goods are being produced by your production facility (or “installation” as the guidance refers to it) under the scope of the CBAM.

- Draw up a list of all goods and precursors at your installation, both produced at your installation and precursors obtained from outside the installation.
- Check and compare the full range of goods produced against the product specifications given in Annex I to the [CBAM Regulation](#)¹ and compare the Combined Nomenclature (CN) Codes.
- From this comparison, establish which of the listed goods produced by the installation are within the scope.

Section 5 of the guidance, particularly starting at 5.3, provides specific information for each sector and details which precursors need to be identified. Since precursors can be a complex topic, it can be helpful to pay particularly close attention to how they impact compliance. If you are a producer of steel, which falls under the scope of the CBAM (Annex II – CN code – 72–) and your product is sold into the EU, you will be contacted at some point by the Importer and asked to provide data in line with CBAM’s reporting obligations. This rule equally applies to situations when your product (steel) is sold – as a precursor – to another company in the US, which uses it,

for example, to produce pipes (CN code – 7304) and later exports them to the EU. Also, in this case you will be contacted by the Importer and asked to provide relevant data, even if you don't ship your products directly to the EU. Whether you are producing a CBAM-covered precursor at your installation or purchasing it externally to incorporate into your goods, you as an Operator should be prepared with the required information on that precursor's embedded carbon.

Transitional vs Definitive Period

The EU is implementing the CBAM in two consecutive phases, or “periods”. The current CBAM Regulation and accompanying Guidance only apply to the transitional period.

- **The Transitional period (October 1, 2023 through December 31, 2025):** This phase is designed as a “learning phase”, during which CBAM Importers will report a set of data (gathered from operators), including emissions embedded in their goods. Importers will not have to pay a financial adjustment for these embedded emissions in the transitional period. However, if an Importer fails to submit the required quarterly CBAM reports or if submitted reports are incorrect or incomplete, penalties could apply. Penalties range between €10 – €50 for each ton of unreported emissions – with higher penalties applied if multiple incorrect reports are submitted in a row.
- **The Definitive period (starting January 1, 2026):** Commencing January 2026, the CBAM will start its definitive period, meaning importers of CBAM goods will be obligated to purchase and surrender certificates for the embedded emissions of their imported goods unless they can prove that they are subject to a carbon pricing system mirroring the EU ETS. The CBAM financial obligations will be implemented in parallel with the phaseout of the allocation of free allowances under the EU ETS, which were put in place to support the decarbonisation of the sectors covered by CBAM. As such, the CBAM financial obligations will rise gradually and only at the end of the definitive period (2034) will the full price be applied. The schedule for the border tax rates is: 2026: 2.5%, 2027: 5%, 2028: 10%, 2029: 22.5%, 2030: 48.5%, 2031: 61%, 2032: 73.5%, 2033: 86%, 2034: 100%.

Which Emissions to Report

Operators need to account for both direct emissions and indirect emissions. **Direct emissions** are the emissions from the production processes of goods, including emissions from the production of heating and cooling consumed during the production process. **Indirect emissions** are from the production of electricity, consumed during the production process of goods.

Section 6 of the Guidance outlines how an Operator should report direct and indirect emissions of a good and of its precursors; it explains the concept and the needed calculations for embedded emissions.

Conclusion

Commencing October 1, 2023, US manufacturers producing CBAM-covered goods that are directly or indirectly imported to the EU will be required to comply with the requirements outlined in the CBAM transitional phase Regulation.

US manufacturers are well positioned to compete for EU business under the transitional CBAM Regulation.

- US producers are already amongst the cleanest and most efficient in the world.
- Many US producers currently generate and report direct and indirect emissions data to the US EPA.
- A rapidly increasing number of US producers are generating EPDs which account for much of the data necessary to comply with the EU CBAM reporting requirements.
- The Inflation Reduction Act (IRA) and the Bipartisan Infrastructure Law (BIL) will further strengthen US competitiveness by providing billions of dollars to support producers in decarbonizing their manufacturing processes and providing financial and technical support to generate ISO-standard EPDs.

For more information on the full suite of funding, tax credits, financing, technical assistance, and other tools being offered by the federal government to help US manufacturers reduce their emissions and stay competitive in markets around the world, Operators should review this page on the Department of Energy's website.

If you are interested in more information about EPA's grant funding opportunities in support of emissions reporting and EPD generation, you can find it [here](#).

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ENDNOTES

1. The Combined Nomenclature (CN) classification system defines the essential characteristics of goods and is used to identify those sector goods in scope for the CBAM.

The CN 'product specification' classification system comprises two parts, firstly a numerical 4, 6 or 8-digit numbering system, reflecting different levels of product disaggregation, and secondly a short text description of each product category giving its essential characteristics. The first 6 digits are identical to the Harmonised System (HS) classification used in international trade and the remaining 2 digits are EU-specific additions.