Manufacturing sector: CBAM implementation from 1 January could prove disruptive for the manufacturing sector | Credendo

The Carbon Border Adjustment Mechanism (CBAM) is an EU environmental measure aiming at encouraging global decarbonisation and supporting the EU's climate goals, while protecting the EU's industry competitiveness. The measure ended its transitional phase (i.e. when only reporting of embedded emissions is due) on 31 December 2025 to enter its definitive phase on 1 January 2026 (i.e. when registering and purchasing of CBAM certificates becomes mandatory).

How does the CBAM work?

Under the CBAM, **EU importers are required to pay a carbon price on certain imported goods (from non-EU countries), equivalent to the price that EU producers pay under the EU Emissions Trading System (EU ETS)**. Importers must report the (direct and indirect) embedded greenhouse gas emissions on their imports, purchase corresponding CBAM certificates and surrender them to cover these emissions. The system aims to prevent "carbon leakage" (a situation where companies move their production outside the EU to avoid the costs associated with climate policies) and level the playing field for domestic producers by ensuring that imported goods are not cheaper due to lower carbon costs abroad.

The emissions targeted by the CBAM are those embedded in the following seven products: **cement, electricity, hydrogen, fertilisers, aluminium, iron and steel,** and 180 downstream products with a high carbon leakage risk and a high share of steel and/or aluminium content, such as car components, garden tools and washing machines.

In parallel, while the CBAM becomes fully operational, the EU's emissions trading system (EU ETS) will remain in place for some time. The EU ETS includes the granting of free allowances, or "permits to pollute", to heavy industries (such as cement, steel, glass, pulp, some chemicals, basic pharmaceuticals, etc.) to avoid carbon leakage. However, those free allowances will be progressively phased out from 2027 until 2034. The goal is that in fine all companies pay for their emissions, via the CBAM in the case of importers, or via the EU ETS in the case of EU-producing companies.

The European Commission **intends to broaden the scope of the CBAM** to include **by 2030** all sectors currently under the EU ETS (notably glass, chemicals and plastics, ceramics, pulp and paper, oil refining products, etc).

General impact at EU level

Broadly speaking, the combination of the CBAM with the phasing out of free allowances of carbon permits will involve **large additional environmental costs** for heavy polluting sectors in the EU and their client sectors domestically and abroad. Some executives say they could prove quite disruptive. Importers who persist in importing without registering under the scheme may be subject to penalties that are up to five times greater than those imposed by the EU ETS.

For at least two years, some revenue of the new tax will go to a fund that compensates exporters competing with lower-cost, higher-emission producers, helping reduce the impact on those exporters.

General impact for non-EU countries

Since imports from (non-EU) countries with an equivalent carbon price will be exempted from the EU's CBAM, countries such as China, Brazil, Mexico, Türkiye, Colombia and Japan have either introduced or tightened their domestic carbon pricing schemes this year, partly to avoid their exporters being heavily hit by the EU charge.

The UK manufacturing sector (and the steel industry in particular) is very worried about the UK's decision to introduce its carbon border tax in 2027 – a full year after the EU's version. This timing gap creates a "dumping risk", as Asian and Middle Eastern producers may want to divert high-emission steel away from the EU market to avoid CBAM charges, targeting the UK instead.

The mechanism has also triggered geopolitical tensions, as developing countries view it as protectionist, and led to debates at COP30 about "unilateral trade-restrictive measures".

Sectoral risks at EU level

- **Steel**

While the **industry is already under heavy pressure** from the global demand downturn, the flooding of cheap Chinese goods and the impact of high US tariffs, steel appears to be amongst **the most vulnerable sectors since its GHG emissions are largely covered by free allowances**. While in a first stage the CBAM is expected to improve the level-playing field and somehow protect the sector, the progressive phasing out of free allowances will push costs in the medium to long term, as the greening of this industry is very costly and remains technologically limited.

In the short term, the risk for EU producers is that extra-EU countries circumvent CBAM "taxes" by selling into Europe products made from their "clean" installations, while selling their higher emission steel into their domestic and non-EU markets.

All clients of the EU steel industry (mainly in the automotive and construction sectors) are expected to experience an immediate increase in their input prices. Protectionist measures in discussion at the EU level are likely to add to this concern.

- **Cement**

The EU cement industry is another highly impacted sector. It is estimated that the **carbon price could account for more than 50 % of the production costs by 2030**. Despite this, the cement industry has been supportive of the implementation of the CBAM as planned.

- **Electricity sector**

While EU electricity producers already pay for EU ETS permits without free allowances – and taking into account increasing electricity prices within the EU –, applying the CBAM to the power sector could fragment the pan-European power market, which relies on cross-border flows with non-EU countries (notably Norway, the UK, the Western Balkans). Indeed, cross-border flows may dry up and the EU's access to non-EU capacity during emergencies could be lost. **This could represent a threat to security of supply and price stability**. The Bruegel think tank warned last November that the current electricity policy "risks undermining security of energy supply, while the climate benefits are unclear".

- **Chemicals and other manufacturing industries**

While at this stage only fertilisers (ammonia and nitric acid) and hydrogen are covered by the CBAM, the European Commission is assessing the possibility of extending the CBAM to additional sectors, such as chemicals, plastics and organic basic materials. As a result, **those products could be included in the CBAM as soon as 2027**.

Chemical companies have expressed severe concerns about the CBAM's economic impact and argue to maintain free ETS permits for the industry as long as the CBAM does not demonstrate its actual efficiency.

Analyst: Florence Thiéry – f.thiery@credendo.com