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# The European Carbon Border Adjustment Mechanism debate: key policy implications and political challenges as viewed from Spain

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## EXECUTIVE SUMMARY

The current system to internalize the cost of negative externalities caused by industries' CO<sub>2</sub> emissions in the European Union is based on a market of emissions allowances that contemplates several exemptions whenever goods are exposed to high-emitting, low-price carbon competition. This pricing system is proving to be incomplete: by mitigating (partially or completely) the carbon price through free allowances, it decreases or eliminates the incentive to reduce carbon emissions. Thus, although the price per allowance (corresponding to 1 emitted ton) within the system has been around 30€-35€ in recent years, the effective price in Spain putting together all taxes and mechanisms was estimated by the OECD at less than 15€ in 2015.

To help closing this gap in Spain and around the whole continent, the European Commission proposed last July a Carbon Border Adjustment Mechanism (CBAM hereafter) devoted to tax imported products based on their carbon content, hence subjecting them to the same carbon price as European products and reducing the risk of leakage. Sectors initially contemplated are electricity, aluminum, fertilizer, iron and steel products, as well as cement, although the Commission hopes to enlarge the scope in coming years.

However, we foresee four major policy roadblocks to improve the current system through the CBAM proposal, that will undercut its efficacy from the outset.

→ Inapplicability over real emissions: the verification of all the production steps of imported products is nearly impossible. The degree of specificity demanded by the current proposal grants a hard-to-foresee number of loopholes and gives room for tactics aimed at 'dodging the bullet' of carbon pricing. This process will be particularly curbersome for trading/commerce SMEs, prominent within the Spanish firm ecosystem. Simultaneously, importers will still be able to use at least two strategies for reducing the apparent emissions embedded in their products:

1. Resource shuffling: certifying as low-emission products those exported to the EU+NAFTA area and leaving the non-certifiable ones for domestic or third-country markets.
2. Sending their products to Europe through indirect routes to benefit from less severe conditions set by other countries. Here, the work of matching to the smallest detail the new CBAM system with existing third-country systems will be crucial. Any asymmetry, which is almost certain to arise due to broader geo-political considerations involved in any negotiation of this caliber, will increase the availability of this strategy. The car industry in Spain is particularly exposed to this and the former risk, given its intricate structure and current reliance on iron and steel imports.

- Non-verifiable values. A large extent of the values proposed by the Commission when real emissions won't be verified consist of resorting to default averages (either the average of emissions of the exporting country or, more likely, the average of the 10% top emitters within the EU). Both benchmarks offer plenty of room for non-European producers above both averages, placing virtually no incentive for them to move down. Furthermore, those at or right above the average might be tempted to even raise their current emission level, producing the opposite effect, e.g. the cement sector, quite prominent in Spain.
- Lack of exemption for exporters. The CBAM proposal does not exempt exporters from paying the carbon price. This cannot be done under WTO rules, since it would be considered an "unfair subsidy". If cleaner, but less competitive, European products end up being priced out of international markets, carbon leakage is once more a likely outcome, since demand (and thus production) will be bound to shift towards more competitive, albeit less clean, products. Again, metal-based manufacture (e.g. cars, machinery) and cement production might be of particular worry for Spanish interests.
- Shifts within the value chain. The application of the CBAM to only some basic material sectors may create a shift in imports towards manufactured products incorporating these basic materials while not having to pay the carbon price through resource shuffling or other alternative strategies. These manufactured products typically hold higher value-added. In consequence, an eventual shift would result in a reduction of European income vis a vis the current course, potentially damaging complexly integrated sectors such as car and machinery production.

From a political standpoint, the critical problems to carry on the CBAM implementation fall under two different categories:

- Inflation effects. Carbon pricing, even when limited in scope, will likely produce a price raise. Inflation related to energy transition is finding a prominent role in import-dependent countries such as Spain. Through these channels, voters are slowly but steadily building a link on their mind between price increases and decarbonization. Any new element with the potential to reinforce this link should be carefully considered from a political standpoint, adding provisions to minimize the potential price impact and balance it out, especially for low-income households that could be disproportionately affected by it. Another alternative would be to pass first the Social Fund, as an umbrella to protect consumers against the negative effects of the CBAM or the ETS extension.
- Trade & local industry effects. The removal of free allowances pair with the lack of some form of export exemptions could end up expelling comparatively less emitting EU-originated products from global markets. According to current estimates, among the sectors included in the current scope of the CBAM, iron, steel, and cement (precisely those that could have the greatest impact on Spanish production dynamics) account for by far the largest share of free allowances. Other sectors such as ceramics or paper (also concerned for the future) are more affected by this situation.

This implies that the implementation of a policy that runs the risk of producing side effects without significantly achieving its main objective, such as the CBAM in its current design, could serve as a spur to precisely these skeptical perspectives on decarbonization.

The coalition that supports them in countries such as Spain brings together small and medium-sized entrepreneurs with semi-skilled workers who could find in this message a point of connection.

It is therefore urgent to put on the table proposals that maximize the desired effect while minimizing the side effects. In that sense, the current CBAM proposal would particularly benefit from extra attention to the differential impacts on the targeted industries, especially the workers who occupy them.

Even more important is to ensure that it much more sharply reduces the risk of carbon leakage throughout the value chain (something that might be better addressed by domestic carbon prices coordinated at the global level). A failed policy of costs without benefits could jeopardize the legitimacy of future policies needed to ensure decarbonization.

Among the newly presented 'Fit for 55' policy package proposed by the European Commission in July 2021, the Carbon Border Adjustment Mechanism occupies a prominent role as the critical innovation tasked with the need to reduce CO<sub>2</sub> emissions globally. The mechanism aims to improve the current European Emission Trading System by establishing a levy on emissions at the European trade border. Given its declared importance, however, the CBAM is severely underrepresented outside the 'Brussels bubble' public debate. Spain is no exception: on the contrary, the European proposal has received a stark low degree of attention. This is particularly surprising for a country that has put green transition at the core of its short (see e.g. the Spanish recovery plan) and long-term (see e.g. España 2050) policy goals. In the present brief, we intend to contribute to spark debate on the CBAM implications for Spain and for the whole EU. To do so, first we briefly explain our view on the current system to regulate emissions and its gaps leading to the need of a new set of mechanisms. We then proceed to evaluate the proposed CBAM from a policy and a political economy perspective, pointing to its crucial shortcomings on both fronts and taking a Spain-flavored point of view.

# Why we need a CBAM: The European ETS and the risk of leakage

## The current system

The European Emissions Trading System (EU ETS) is the system in place in the European Union to control CO<sub>2</sub> emissions. The following emitting sectors are included in the system:

- Fossil fuel energy sources, plants and refineries over 20MW of installed capacity, plus all coal-based sources and plants
- Iron, steel and aluminum production
- Cement, lime, gypsum and mineral fiber production
- Glass production
- Pulp, paper and cardboard production
- Ceramics, tiles and bricks production
- Chemical industries, esp. acid and bulk chemical products
- Specific gas production for technical purposes
- Aviation transport within the European Economic Area

Under this system, all installations belonging to the abovementioned sectors must surrender a number of allowances equivalent to the CO<sub>2</sub> emitted per year. These allowances can be obtained in three ways:

- Receiving them directly from the EC (free allowances). This option is only available for some sectors at risk of carbon leakage (see below).
- Buying them in centralized auctions, organized by Member States, under conditions set by the European Commission (which sets an annual reduction rate of the

allowances supplied, in order to comply with overall reduction targets).

- Buying them in the secondary market. Currently three markets articulate the exchange: EEX in Leipzig (which publishes Carbix, the benchmark price index), ECX in London, and EXAA in Vienna.

If the emitter exceeds the allowances it possesses, it must pay a penalty (100€/tCO<sub>2</sub>), and in addition buy the allowances needed. If emissions are lower than the allowances, the allowances not needed may be sold in the secondary market.

The price of the allowance is set by the auctions and the secondary market and is determined by the interaction of the supply of allowances (those put in circulation by the European Commission) and the demand for allowances (which in turn depends on the emissions of the sectors). The price is therefore dynamic and market-based. However, the Commission introduced in 2015 a mechanism to ensure that prices would not be too low or too high: the Market Stability Reserve (MSR). The MSR removes allowances from, or feeds them into the market, if certain conditions are met. To some extent, the MSR acts as a cap and floor regulation over carbon market prices.

Therefore, any industry in Europe belonging to the sectors mentioned would be exposed to these (partially regulated) carbon prices, and would pass them through the value chain, creating an incentive along this chain to reduce carbon emissions. However, that creates an unfair advantage to imported products (not subject to carbon prices) or to other countries' products in international markets. This can also result in carbon leakage: the fact that carbon emissions may increase globally if carbon-intensive non-European products benefit from this regulation and increase their production, by becoming more competitive than the cleaner European industry.

The solution adopted by the European Commission to address this risk of carbon leakage was to allocate some allowances freely to some sectors, those considered to be at risk. There are two proxy indicators for this:

- **CCI or Carbon Cost Intensity** = the cost of acquiring emission allowances over total costs; the higher this weight, the more risk (more incentive) there is to shift production.
- **TI or Trade Intensity** = the trade exposure measured as the proportion of trade with non-EU countries over total turnover; the more exposure the greater the risk of leakage by displacement.

Until 2020, if a sector (a) exceeded 30% on both indicators or (b) if CCI>5% and simultaneously TI>10%, it was classified as a carbon leakage sector. But from the beginning of 2021, the indicators (CCI and TI) have been replaced by a new, single indicator. TI gets multiplied by sector emissions intensity (CEI), corresponding to kgCO<sub>2</sub> x € gross value added. Whenever

TlxCEI > 20%, then the sector is considered at risk of leakage. This indicator is inevitably more restrictive than the previous setup. Also, if the annual output varies above or below 15% from year to year, the free allowances are adjusted accordingly.

However, even if at risk of leakage, an installation may not receive freely all the allowances needed. The number of free allowances is benchmarked by the 10% most efficient installations in each sector in Europe (there are currently 52 specific benchmarks), which is redefined each year. This is to incentivize carbon efficiency (although only up to a certain limit since industry as a whole has no incentive in reducing the benchmark).

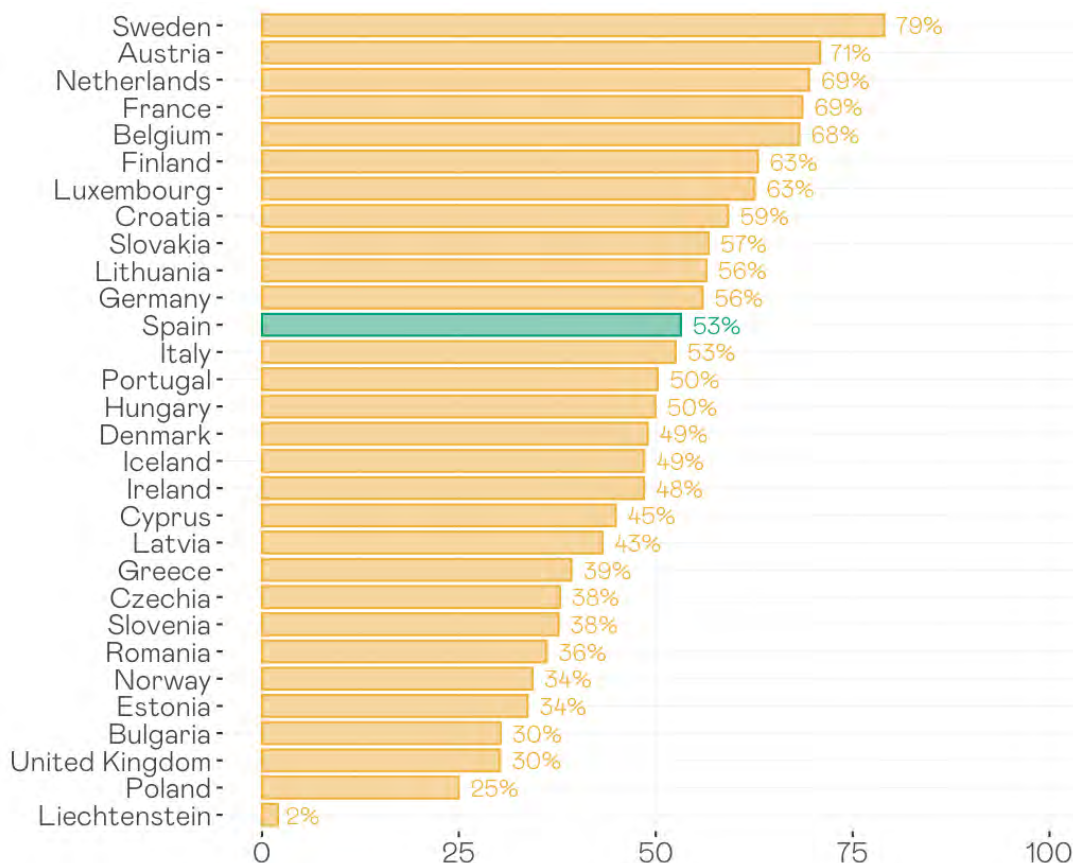
## Implications for Spain

Up to 2020, a bit above half of all the allowances (free + auctioned + sold) for Spanish installations fell under the “free” category.

Graph 1.

### Share of free allowances over total of free, auctioned and sold allowances

Within the EU ETS system, 2020



Source: Data from the European Environment Agency | EsadeEcPol

Historically, among the biggest countries in Continental Europe the share has remained around 50%, very much in parallel with Italy and Germany. France displays a somewhat higher degree of allowances, showing more exposure (as estimated by the current formula) to carbon leakage, while Polish industries have ended up with the lowest share of free allowances across all the system (except for micro-countries like Lichtenstein).

Graph 2.

**Evolution of the share of free allowances over total of free, auctioned and sold allowances**

Within the EU ETS system, 2020

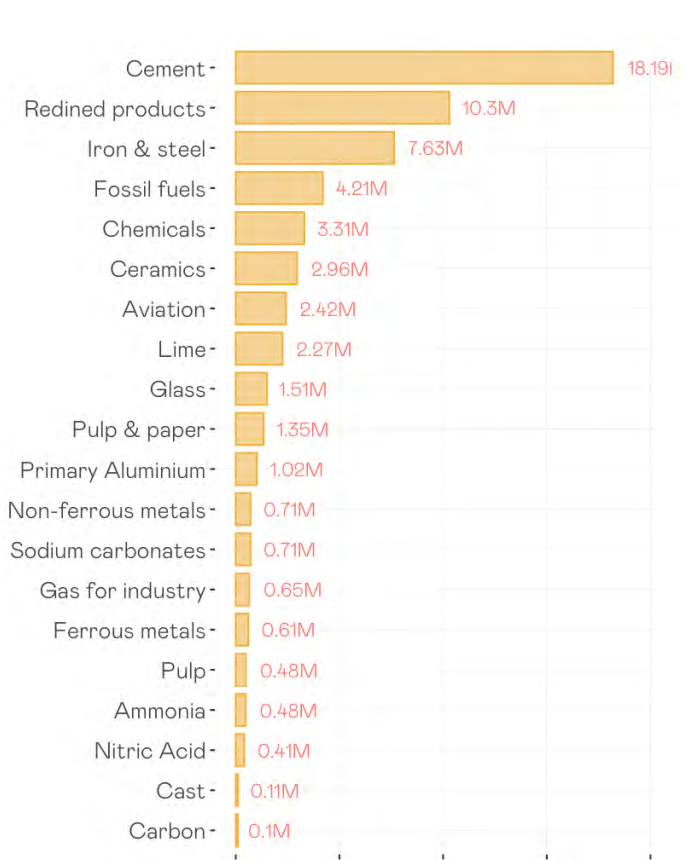


Source: Data from the European Environment Agency | EsadeEcPol

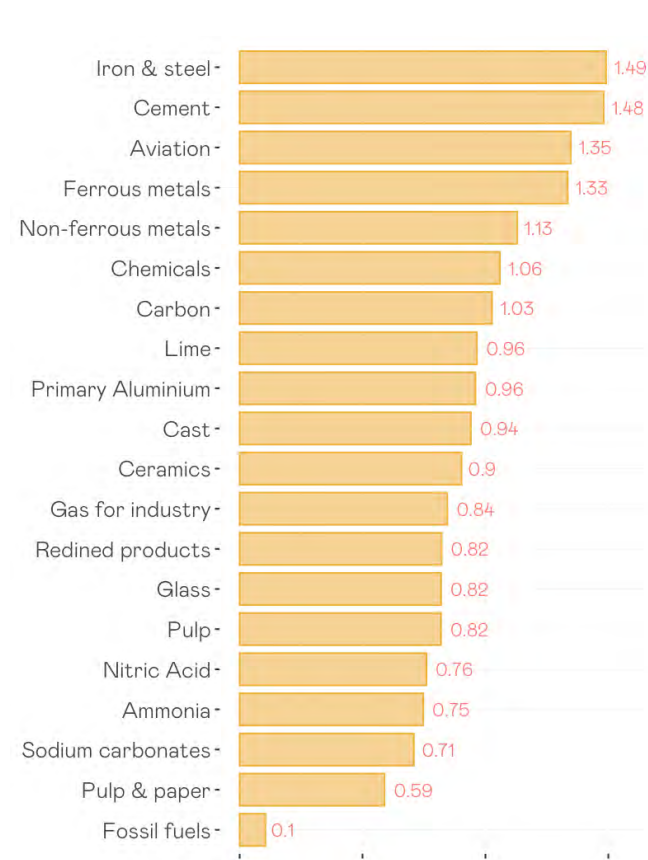
These differences help dimensioning the comparative allocation deficit supported by Spanish industries, giving an idea of how exposed the contemplated sectors to carbon pricing are.

Graph 3.

**Free allowances per sector in Spain**  
tCO2 - Within EU ETS system, 2020



**Per emitted tone**  
tCO2 - Within EU ETS system, 2020



Source: Data from the European Environment Agency | EsadeEcPol

Sector-wise, most of the Spanish free allowances were concentrated in the cement, refinery, steel, iron and fuel industries. Chemical and ceramic sectors also received a significant amount of free allowances.

Furthermore, the steel/iron and cement industries got the highest rate of free allowances per CO2 emitted tone, adding to their respective positions as dominant recipients of extra room justified by the risk of carbon leakage.



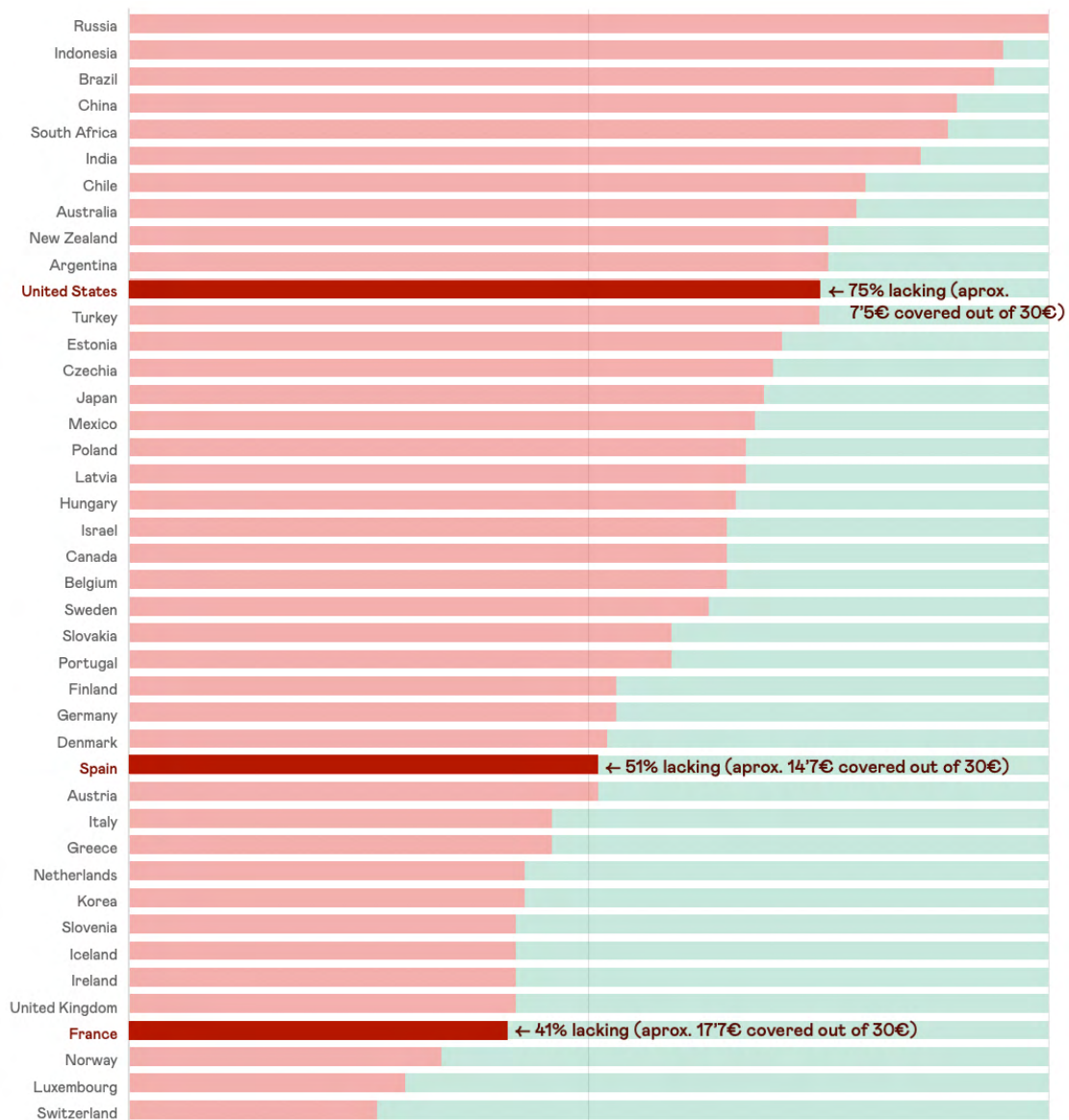
## The problem at hand and the Commission's proposed solution: a new CBAM

The core problem of the current system is that, by mitigating (partially or completely, depending on the installation) the carbon price, it decreases or eliminates the incentive to reduce carbon emissions, and hence does not mobilize the potential for carbon reductions in industry (which represents 25% of European carbon emissions). In Spain, the above graphs give an approximate idea of how big this problem is. The OECD's estimate of carbon pricing gap put forward in 2015 gives a more precise and synthetic idea: using a benchmark value of €30 per ton, Spain would fall 51% short.

Graph 4.

### Carbon pricing gap in OECD and G20 countries

% covered and lacking according to approved measures for carbon pricing on each country, with the benchmark of 30€ per tone; 2015



Source: Data from OECD Effective Carbon Rates estimation, 2018 | EsadeEcPol

Since the proportion of free allowances within the EU ETS system has not significantly changed, and since overall green fiscal pressure remained at 1,9% in Spain in 2019 according to Eurostat, nearly matching the 1.6% estimate cited by Rubio (2015) coming from the same original source, we can take this value as a rough but informative indicator. Moreover, the Spanish carbon pricing gap nearly matches that of Germany (53%) and Italy (46%) but is significantly superior to the French (41%) gap, indicating that at least for those countries the current system might be producing a less functional equilibrium. Same goes for the Netherlands or Luxembourg, both above Spain on their shares of free allowances but below it in terms of carbon pricing gap vis a vis the OECD's benchmark, probably reflecting the effect of additional pricing instruments.

To help closing these gaps, the European Commission has put forward the introduction of a Carbon Border Adjustment Mechanism (CBAM), which would tax imported products based on their carbon content, hence subjecting them to the same carbon price as European products and reducing the risk of carbon leakage (the price channel for leakage would remain). The tax would be based on the EU ETS: the price of the CBAM would be set by the ETS allowance price. This would make free allocation redundant, and the proposal includes accordingly its phase out.

As explained by Dumitru et al (2021), by its nature, the CBAM would in principle affect EU importers of non-EU products (except EFTA, which are already in the ETS). Sectors initially affected are imports of electricity, aluminum, fertilizer, iron and steel products, as well as cement (scope 1). It focuses on direct emissions from the production process, although it considers potential future extensions to electricity used in the process (scope 2) and others (scope 3) after 2035 (Dumitru et al, 2021).

The emissions verification process is anticipated to be particularly complicated, requiring a series of justifications and documentation for each product that shows the attributable emissions (Dumitru et al, 2021). These evaluations are bound to be a matter of debate between European authorities, exporters and importers. There is an alternative option available to companies: resorting to default values that can be based on one of the following: (a) the average in the country of production; (b) in the absence of relevant data to fulfill (a), the average of the worst 10% within the EU for the considered sector (Dumitru et al, 2021). For electricity, "the default value considered in the current draft is the average European electricity emissions" (Linares, 2021).

The final price established by CBAM certificates will be corrected for carbon prices borne by the producer in its country of origin: e.g., UK, China and South Korea already have ETS-type systems (Dumitru et al, 2021).

# Major roadblocks to improve the EU ETS system through the current CBAM-based proposal

## Policy-wise, the European CBAM will lack effectiveness

Although in theory a CBAM would achieve a reduction in the risk of leakage, and the restoration of the carbon price signal in European value chains, our concern is that the proposal made by the EC will not do the job, due to at least four crucial shortcomings.

**Inapplicability over real emissions.** Although in theory the CBAM should be applied over real emissions, this is quite difficult to achieve: the verification of all the production steps of imported products is nearly impossible. The degree of specificity demanded by the current proposal grants a hard-to-foresee number of loopholes and gives room for tactics aimed at ‘dodging the bullet’ of carbon pricing. This process will be particularly curbersome for trading/commerce SMEs: as argued by Cornago (2021), small and medium-sized firms “are less likely to have the resources to professionally certify the carbon content of their entire supply chain” or to comply with the requirement of having enough funds to “cover the predicted cost of purchasing CBAM certificates for the current and forthcoming year” as stated by the draft. Spain has one of the more atomized company ecosystems within Europe, and thus is bound to disproportionately suffer from these administrative burdens.

Complexity is not the end of the problem: simultaneously, within the proposed framework importers will still be able to use several strategies for reducing the apparent emissions embedded in their products:

- Resource shuffling: certifying as low-emission products those exported to the EU+NAFTA area and leaving the non-certifiable ones for domestic or third-country markets. If the shuffling is substantial enough, it might leave the total amount of emissions unscathed.
- Sending their products to Europe through indirect routes to benefit from less severe conditions set by other countries. Here, the work of matching to the smallest detail the new CBAM system with existing third-country systems will be crucial. Any asymmetry, which is almost certain to arise due to broader geo-political considerations involved in any negotiation of this caliber, will increase the availability of this strategy. The car industry in Spain is particularly exposed to this and the

former risk, given its intricate structure and current reliance on iron and steel imports. Furthermore, Spain might even become a port of entry for a significant share of these goods, given its privileged position within widely connected Southern European value chains along with Italy.

**Non-verifiable values.** A large extent of the values proposed by the Commission when real emissions cannot be verified consist of resorting to default averages. Furthermore, their likely outcome will be a paradoxical benefit for most high-emitting importers, while some European producers are bound to lose.

- For the contemplated industrial products, the proposed default value is the average of emissions of the exporting country. In absence of that, which will frequently arise due to the lack of reliable data on sector-level emissions across the world, the average of the 10% higher emitters in Europe will be used as a replacement proxy. Both benchmarks offer plenty of room for non-European producers above both averages, placing virtually no incentive for them to move down. As a matter of fact, it might be argued that those at or right above the average might be tempted to even raise their current emission level, producing the opposite effect. By comparison, high-emitting EU+EFTA producers stand to lose since they will have to pay the full cost of their emissions. This should be particularly worrisome for those sectors displaying a high degree of internal emissions inequality across plants, e.g. the cement sector, quite prominent in Spain (the country remains one of the top five European cement producers).
- For electricity, the default is the average of European emissions: by virtue of the aforementioned logic, this might end up benefiting high emitters, while comparatively damaging those European producers emitting above average, which would not be competitive. In the case of Spain, that would mean that the electricity imported from Morocco (generated from coal) would pay less for its CO<sub>2</sub> content than the electricity generated from natural gas combined cycles (since the European CO<sub>2</sub> average is lower than the combined cycle emissions), hence becoming unfairly competitive, and resulting in the leakage of emissions.

**Lack of exemption for exporters.** The CBAM proposal does not exempt exporters from paying the carbon price. This cannot be done under WTO rules, since it would be considered an “unfair subsidy”. If cleaner, but less competitive, European products end up being priced out of international markets, carbon leakage is once more a likely outcome, since demand (and thus production) will be bound to shift towards more competitive, albeit less clean, products. Again, metal-based manufacture (e.g. cars, machinery) and cement production might be of particular worry for Spanish interests, potentially damaging complexly integrated sectors such as car and machinery production.

**Shifts within the value chain.** Finally, the application of the CBAM to only some basic material sectors may create a shift in imports towards manufactured products incorporating these basic materials while not having to pay the carbon price through resource shuffling or other alternative strategies. These manufactured products typically hold higher value-added. In consequence, an eventual shift would result in a reduction of European income vis a vis the current course.

Last but not least, there are potential fiscal implications at the EU level, since a potentially derived issue of all four factors is that, if the CBAM can be avoided at the border, the funds that might be collected (and on which the Commission counts on to pay for NextGenEU funds put forward to ensure the post-pandemic recovery, among other forthcoming projects) may not materialize to its expected level.

Taking all elements into account, on paper it looks like the current CBAM proposal might not produce significant reductions in carbon emissions globally but might damage the competitiveness of European producers while trying. Shall this scenario be realized; Europe would end up suffering the side effects without getting the expected benefits of the cure. At the very least, a more careful evaluation of both negative and positive effects is needed to ensure that the proposal sustains a cost-benefit evaluation.

## Politically, the CBAM exacerbates a complex network of cleavages

It will be precisely these “side effects” that will emerge on the political road to making CBAM a reality. To be implemented, the new system needs a majority of Member States (as Linares (2021) points out, “it was not chosen to establish an equivalent tax, which might seem simpler, because this would require unanimous approval by the Council, contrary to ETS-related measures, which only require a majority for approval”). At the same time, and as any other ordinary piece of new legislation within the European Union, it also has to be approved by an absolute majority of the European Parliament.

In this process, we expect internal political cleavages to become more exacerbated, articulating themselves around three sets of costs that are part of the debate already, but that will gain strength as MEPs and country delegates are forced to adapt their positions to the perceptions and realities of their constituencies. This will be true as well for Spain, which could come to play a role of considerable influence in the process but will need to better articulate its positions in order to do so.

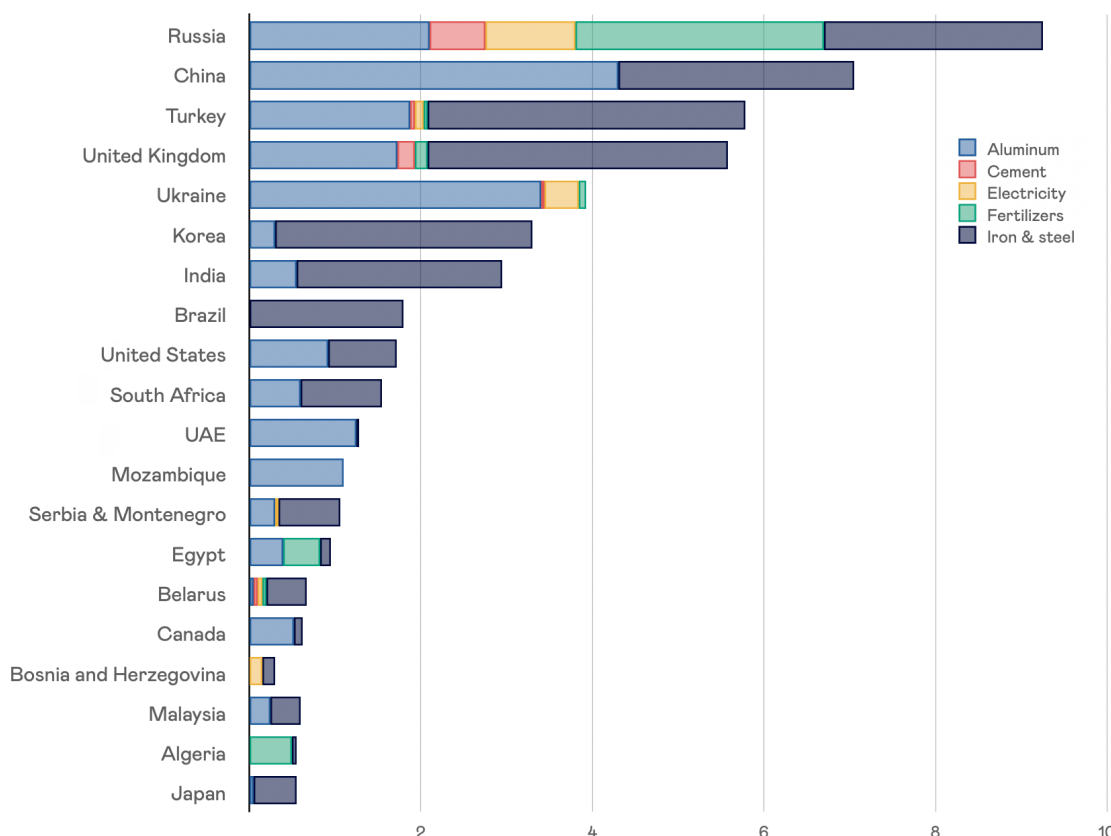
**Inflation effects**

Carbon pricing, even when limited in scope, will likely produce a price raise as expected by most macroeconomic models (e.g. McKibbin et al. 2014). Inflation related to energy transition has recently found its place among the top political debates at the heart of the EU (e.g. Armstrong, 2021), occupying a prominent role in import-dependent countries such as Spain (see for instance Linares, 2021). Through these channels, voters are slowly but steadily building a link on their mind between price increases and decarbonization. Any new element with the potential to reinforce this link should be carefully considered from a political standpoint, adding provisions to minimize the potential price impact and balance it out, especially for low-income households that could be disproportionately affected by it. Another alternative would be to pass first the Social Fund, as an umbrella to protect consumers against the negative effects of the CBAM or the ETS extension.

**Trade effects**

Increasing barriers to worldwide trade flows is the greatest fear associated with CBAM: after all, the mechanism essentially constitutes a cost increase for free movement of goods, designed to better internalize a negative externality. The fear starts with the EU’s main trading partners, listed below.

Grapt 5.  
Exports  
(billion \$) to  
UE27 affected  
by the European  
Commission’s  
CBAM proposal;  
2019



Source: Data from an UNCTAD estimation, based on UN COMTRADE figures | EsadeEcPol

Metals account for most of the concern within the sectors covered, especially in Russia, China and Turkey. This list is completed by exporters in energy-intensive sectors. The aluminum sector is also concerned about being included in the pilot phase of the CBAM, because of the difficulty to address indirect costs of the ETS through electricity prices.

But the fear goes on to affect EU exporters. As stated above, neither the current CBAM proposal nor others floated contemplate export exemptions from the carbon price, since these would be considered forbidden subsidies under the WTO rules: proving the environmental benefit of these exemptions would be very difficult. The lack of some form of exemptions could end up expelling comparatively less emitting EU-originated products from global markets. From a political economy perspective, countries containing these (in the case of Spain, the cement sector is a strong exporter among those covered initially by the CBAM proposal – others such as ceramics or paper are also concerned for the future) are more affected by this situation. It should be mentioned here that even some (not all) environmentalist organizations, and a majority of the European Parliament, defend the exemption to exports, if they actually result in cleaner products traded in international markets.

On the import side, Bulgaria, Lithuania, Latvia and Slovenia have high shares of total imports exposed and their impact on GDP is also expected to be high; Ireland, Italy or Spain have high exposure measured by imports but low measured by GDP. More specifically, Spain's exposure is not distant from that observed at the general European level. Steel and iron imports from China and Turkey are of particular importance, especially on the car manufacturing sector. The automotive industry remains a crucial part of the Spanish industry. There is a latent fear of a CBAM negatively affecting car-related value chains that is being well captured by Eurofer (European Steel Association) and its Spanish members (see next section).

These rough preliminary measures are only one possible approximation of direct exposure, because there is also indirect exposure: what can be expected from countermeasures at the hands of other trading partners? This might be particularly sensitive for large EU exporters, such as Germany, but also for Spain and its core export segments with components falling under the currently proposed scope (cars, vehicle parts and, to a lesser extent, trucks and aircrafts).

The possible negative effects on the value chain, not yet politically articulated, could be felt not only by employers, but also by workers. Plants in affected segments (from metalworking to automotive) have high levels of union organization focused on the defense of jobs. Politicians oriented to this constituency may eventually come under pressure from below if a fear of a blow to trade flows is triggered, especially from the center-left majority formations (the social-democratic PSOE, part of the S&D group in the European Parliament) but also from the center-right (the liberal-conservative PP, part of the European People's Party). At least in the Spanish case, it is therefore much more likely that this roadblock is connected to a framework of damage to local industry. Not surprisingly, Spain played an important role during the up to its current point process to ensure that the European regulatory language on decarbonization included references to "fair" processes.

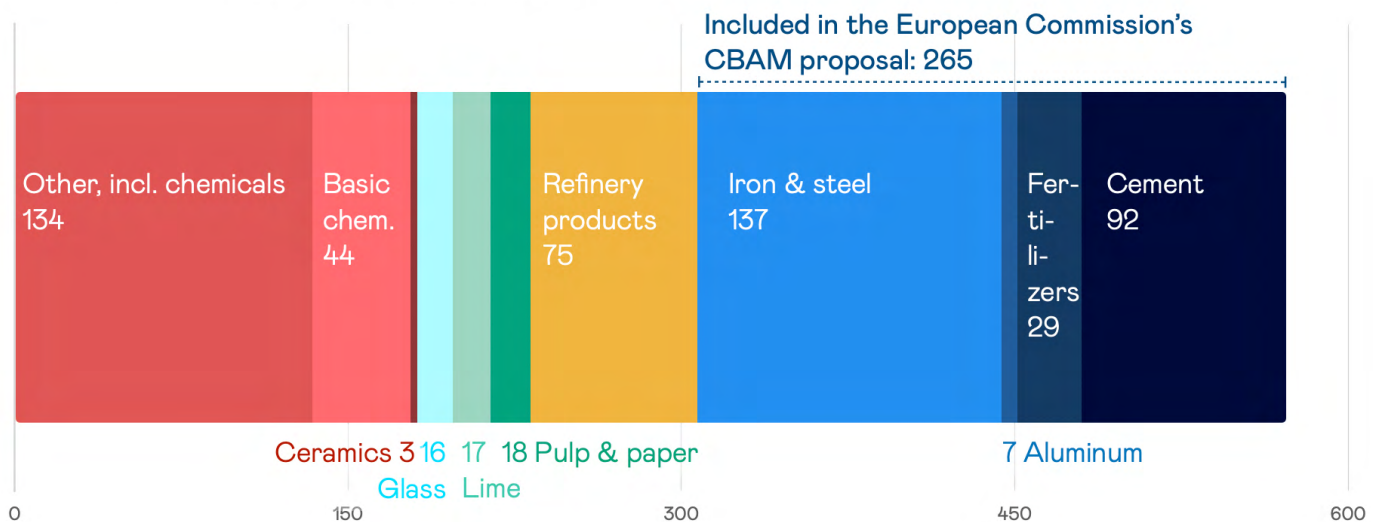
**Effects on local industries**

The policy translation of all these concerns has been an insistence on maintaining the free allowances that so many sectors now enjoy under the current EU ETS scheme. Eurofer itself, together with Cembureau (the European cement employers’ association) and the chemical associations CEFIC or Fertilizers Europe have been adamant in this demand. BusinessEurope articulated it back on the 8th of March, right before the European Parliament voted for its policy framework: “We must ensure our companies’ competitiveness by maintaining existing measures, like the free allowances under the EU ETS, at least as long as the new [CBAM] is in a testing phase and has not yet proven its effectiveness”.

The European center-right (the EPP group in the Parliament) picked up the baton from the employers to water down the demand for a “rapid and eventual complete phasing out” of free allowances, some members of other parties whose constituencies might perceive an eventual negative impact found this change potentially useful, as the introduction of a slow and gradual process for phasing out free allowances might buy them political time.

Graph 6.

**Number of emission allowances to be distributed for free for each sector in 2021**  
within the EU ETS framework



Source: Data from the European Commission compiled by Sandbag | EsadeEcPol



According to estimates by the think tank Sandbag, among the sectors included in the current scope of the CBAM, metal and cement (precisely those that could have the greatest impact on Spanish production dynamics) account for by far the largest share of free allowances. It is therefore to be expected a node of resistance to faster implementations to put a price on emissions in the semi-coordinated triangulation between direct workers, employers, local politicians and the European level.

On the other side are politicians tied to rather urban, tertiary sector voters, willing to assume the eventual price-in of carbon dioxide externalities and, above all, not particularly exposed to the direct real or perceived costs of any new regulations (indirect, inflation-related costs might end up affecting them as well, but to a lesser extent). New left formations, urban social democrats and centrist liberals make up this group. S&D's spokesman in the September 2021 meeting with the with the European Commission's Director General for Taxation and Customs Union (TAXUD) on CBAM stated that "we should not, already at this stage, start limiting the scope or the possibilities we have around CBAM because, I believe other regions will follow with similar legislation". Furthermore, one of the most sophisticated initiatives for carbon pricing has come from the office of Spaniard Luis Garicano (Ciudadanos, Renew Europe). In his detailed proposal (Garicano, 2020) the MEP goes for a markedly more ambitious scope, including under the CBAM all sectors that are currently under the EU ETS. In fact, Garicano himself and his group partner Pascal Canfin (France) submitted a public letter to the European Commission after the publication of their CBAM proposal. In it, and among other criticisms (such as the administrative burden on companies or the suboptimal use of average country-level indicators to determine CBAM taxation levels) they underline the (in their view) narrow scope both in the abundance of sectors not included and in the amount of space left for those that are in the system to remain de facto under free allowances until the end of this decade. However, it should be noted that Garicano's proposal is implemented upon the use of basic materials, not carbon emissions, hence losing its environmental edge (and also benefiting high-emitters).

The contrast of these positions with those of the members (Spanish and from other nations) of the parliamentary groups more to the right of the EP establishes the parameters of the new confrontation in the political axis of decarbonization. The ECR group, to which Vox belongs, has insisted on underlining precisely the above-mentioned costs associated with the CBAM, minimizing the need to correctly value in the market the effects of emissions.

This implies that the implementation of a policy that runs the risk of producing side effects without significantly achieving its main objective, such as the CBAM in its current design, could serve as a spur to precisely these skeptical perspectives on decarbonization. The coalition that supports them in countries such as Spain brings together small and medium-sized entrepreneurs with semi-skilled workers who could find in this message a point of connection.

It is therefore urgent to put on the table proposals that maximize the desired effect while minimizing the side effects. In that sense, the current CBAM proposal would particularly benefit from extra attention to the differential impacts on the targeted industries, especially the workers

who occupy them. Another critical issue in this regard is the use of the revenues potentially generated by this policy. Trade unions and industry demand that they are used to accelerate innovation in industry and support a just transition. Even more important is to ensure that it much more sharply reduces the risk of carbon leakage throughout the value chain (something that is much better addressed by domestic carbon prices coordinated at the global level). A failed policy of costs without benefits could jeopardize the legitimacy of future policies needed to ensure decarbonization. Paradoxically, therefore, a more ambitious and effective proposal to put a price on emissions (eventually and hopefully at a global level or at least among the major trading partners, as in a climate club) could, if it incorporates the necessary fairness and compensation mechanisms, prove more politically sustainable in the long run.

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