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Balancing European competitiveness with export rebates

- **By 2026, CBAM will impose tariffs on the carbon content of imported goods, aiming to prevent carbon leakage and ensure fair competition within EU markets**
- **Proposed export rebates are designed to offset higher domestic carbon costs for EU producers, helping them remain competitive in global markets**
- **But, implementation faces hurdles including compliance with WTO rules, environmental concerns, administrative complexity, and potential trade disputes**
- **Export rebates could influence EU trade relations, especially with key markets like the US and UK, while balancing competitiveness and climate goals**
- **Effective export rebates require transparent calculation methods, non-discrimination, avoidance of double counting, and alignment with emission reduction targets to maintain legitimacy and minimize disputes**

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Introduction

In 2026, the Carbon Border Adjustment Mechanism (CBAM) will be fully implemented. CBAM is a system that places a tax on the carbon emissions associated with goods imported into the EU. Its goal is to reduce carbon leakage and ensure fair competition between domestic and foreign producers within EU markets. However, the current design of CBAM only applies to imports into the EU, which helps protect EU producers in their domestic market but leaves them at a disadvantage when competing internationally due to higher carbon costs. To address this, the European commission has a plan to discuss a proposal on export rebates as a solution to restore the competitiveness of European producers in global markets. This note explores an extended design of CBAM while examining the challenges and potential impacts of including export rebates.

CBAM

The Carbon Border Adjustment Mechanism (CBAM), introduced by the European Union (EU) under its Green Deal, aims to reduce carbon emissions and prevent carbon leakage, which occurs when industries relocate to countries with weaker climate policies. By imposing a tariff on the carbon content of imported goods, CBAM ensures that foreign producers exporting to the EU face similar carbon costs as EU industries, which are subject to the EU's Emissions Trading System (ETS). CBAM has significant implications for global trade and climate policy, as it influences international trade dynamics, encourages alignment with EU standards, and promotes global cooperation on emission reductions. However, challenges exist, including administrative burdens for importers, impacts on trade flows, and concerns over the competitiveness of EU exports due to higher domestic carbon costs. Its phased implementation, started in October 2023, aims to balance environmental objectives with trade considerations and transition impacts. You can read more on CBAM impacts and opportunities in our previous note here.

Concept and importance of export rebates

Export rebates are financial measures or refunds designed to offset the costs associated with domestic carbon pricing policies, such as those under the EU Emissions Trading System (ETS). Within the context of the Carbon Border Adjustment Mechanism (CBAM), export rebates are complementary to its current design and aim to address the competitive disadvantages faced by EU producers in international markets. CBAM imposes a carbon levy on imports to equalize carbon

costs between domestic and foreign producers within EU markets, but it does not account for the higher production costs EU exporters face globally due to stringent domestic carbon pricing. Accordingly, export rebates act as a subsidy for EU exporters, helping them to restore their competitiveness, particularly in sectors with fierce international competition and narrow profit margins.

Challenges and criticisms

As mentioned above, export rebates are being considered as a way to prevent EU exporters from losing market share and to ensure that EU industries remain competitive globally while maintaining ambitious climate policies. That is, export rebates aim to help EU exporters stay competitive globally, but they come with several challenges. One concern is that their implementation must align with international trade rules, especially compliance with World Trade Organization (WTO) regulations. WTO rules prohibit protectionist measures or excessive subsidies that distort competition. For export rebates under CBAM to comply, they must accurately reflect actual carbon costs and avoid discriminatory practices against foreign producers.

Another worry is that these rebates could conflict with the environmental goals of CBAM (Carbon Border Adjustment Mechanism). Supporting exports might lessen the motivation for industries to use cleaner production methods, which could hinder efforts to cut global emissions. However, under the current proposal, these rebates need to be tied to emission reduction targets, which should mitigate this effect.

Another challenge is the complexity of applying and monitoring export rebates. Calculating carbon costs accurately for exported goods while following international trade rules can be difficult, especially for small and medium-sized businesses (SMEs), creating extra administrative work. To address this, the EU commission could set clear standards and simplify processes to ensure compliance.

Additionally, export rebates might lead to trade disputes, as other countries could see them as unfair subsidies. This could result in retaliatory actions, such as tariffs or changes to trade agreements. These tensions are heightened by the current global focus on national interests, with some nations, like the US, stepping back from climate commitments.

Different groups have varied opinions on export rebates. Businesses tend to support them because they help stay competitive globally, especially in industries with tough competition and slim profit margins. Policymakers, however, must carefully balance economic competitiveness with environmental goals while ensuring that export rebates comply with WTO rules to avoid trade disputes. Meanwhile, environmental advocates often criticize export rebates, believing they could undermine CBAM's main goal of reducing global emissions and weaken the EU's role as a climate leader. Finding a way to address these diverse viewpoints will be key to deciding whether and how export rebates should be included in the CBAM framework.

International implications

The question that arises here is which countries could be most affected by export rebates. Certain sectors within European heavy industries (Iron and steel, for example), particularly those at high risk of carbon leakage, have historically received a significant proportion of their emission allowances for free under the EU ETS, helping preserve their international competitiveness. However, this will change as CBAM entered its transitional phase in 2023 and the free allocation of allowances will begin to phase out from 2026 to 2034.

The timing of export rebates will influence their impact on EU exports to other countries. If introduced alongside CBAM, rebates could help EU exporters maintain competitiveness in global markets by offsetting the higher production costs caused by domestic carbon pricing. However, if introduced later, after free allowances are phased out, EU exporters may face increased production costs, potentially reducing their competitiveness in international markets. This could impact trade relations with major export destinations like the US, UK, and other countries that are key export markets of the EU for iron and steel, aluminium, and other CBAM covered sectors, as illustrated in the left graph below. These sectors are characterized with high competition and low profit margins which make them very sensitive to trade disruptions.

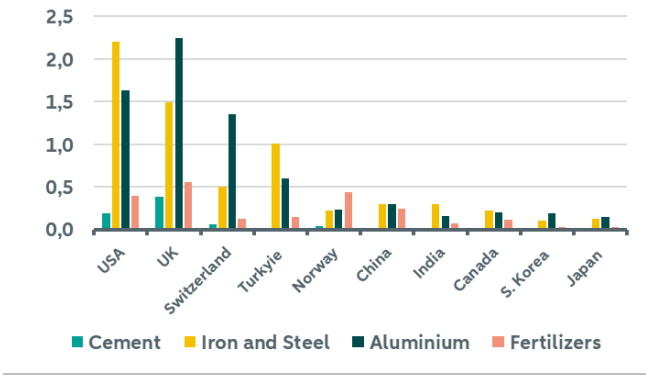
Similar to imports, export rebates should be attributed to the differential in carbon pricing between the EU and its trading partners. That is, markets with similar or higher carbon prices compared to that in the EU would not be subject to export

rebates eliminating the potential of trade tensions and disputes. For example, this could be the case if the EU and UK carbon markets became linked together.

However, these rebates are being considered at a moment that trade and geopolitical frictions grow between nations. At the same time, some nations are hesitating to follow their climate promises, while the United States openly doubts the idea of global warming which put additional challenges on substantiating a case for these rebates.

EU exports in CBAM covered sectors (2024)

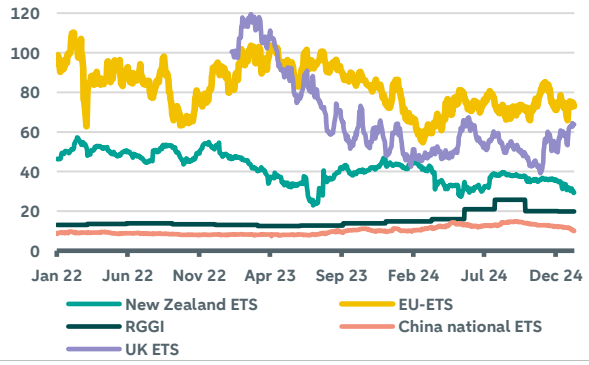
EUR (billion)



Source: UN comtrade, ABN AMRO Group Economics

Comparison between major ETS markets

$/tCO2



Source: Bloomberg, ABN AMRO Group Economics

Accordingly, the design of export rebates should align with international trade rules which require a focus on several key factors such as: Compliance with WTO principles, particularly the principles of non-discrimination and the prohibition of subsidies that distort trade; Transparent and accurate calculation methods which strengthen the legitimacy of rebates and reduce the risk of disputes; Non-Discrimination which ensures fairness and prevents discriminatory practices that could lead to trade disputes; Environmental integrity by linking rebates to evidence of progress in reducing emissions or investing in low-carbon technologies; Avoidance of double counting, which could lead to criticism of unfair trade practices by other countries; Engagement with international partners, which can help address concerns and align rebate designs with global trade norms.

Impact on carbon prices

The impact of export rebates on carbon prices could be two-fold. On the one hand, rebates might reduce demand for EUAs by lowering compliance obligations for EU exporters, depending on the specific design and implementation of the rebate system. However, this impact should be mitigated under the current EU proposal which link export rebates to achieving emission reductions. On the other hand, export rebates could boost international competitiveness, encouraging higher production to meet global demand. While this could lead to increased emissions and demand for allowances, the extent of the impact would depend on whether industries adopt cleaner technologies and production methods in line with EU climate goals. Moreover, this increase is weakened if environmental safeguards are embedded in the rebate system to prevent emissions growth. Careful design of export rebates is essential to balance economic competitiveness with environmental integrity.

Conclusion

The full implementation of the Carbon Border Adjustment Mechanism (CBAM) in 2026 signifies a pivotal step in the EU's climate strategy, aiming to tackle carbon leakage and promote fair competition. However, the mechanism's current design leaves EU exporters at a disadvantage in global markets due to higher domestic carbon costs. Export rebates offer a potential solution to restore competitiveness while maintaining ambitious climate goals, but their implementation must overcome challenges related to compliance with WTO rules, environmental integrity, and trade fairness. By designing export rebates that are transparent, non-discriminatory, and linked to emission reductions, the EU can balance economic competitiveness with environmental objectives, ensuring CBAM's success as a tool for global climate leadership.

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