PRI PRINCIPLES FOR RESPONSIBLE INVESTMENT

THE EU CARBON BORDER ADJUSTMENT MECHANISM (CBAM)

Investor brief

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An investor initiative in partnership with
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UN environment programme | finance initiative

United Nations Global Compact

About the PRI

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of sustainability and governance-related issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating sustainability and governance-related issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system. For more information, visit www.unpri.org.

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Investor brief: The EU CBAM

Executive Summary

The EU CBAM – the first international mechanism to prevent carbon leakage of its kind – has entered its 'definitive phase' on 1 January 2026, after a three-year 'reporting only' phase. Companies importing CBAM-eligible goods from six sectors (steel, aluminium, cement, fertilizers, electricity, and hydrogen) into the EU now need to pay a cost related to the amount of 'embedded carbon' within these goods. This brief explains how CBAM supports EU carbon pricing, how it works and differs from tariffs, its implementation status, and global carbon markets, climate and trade policy impacts.

CBAM objective and functioning

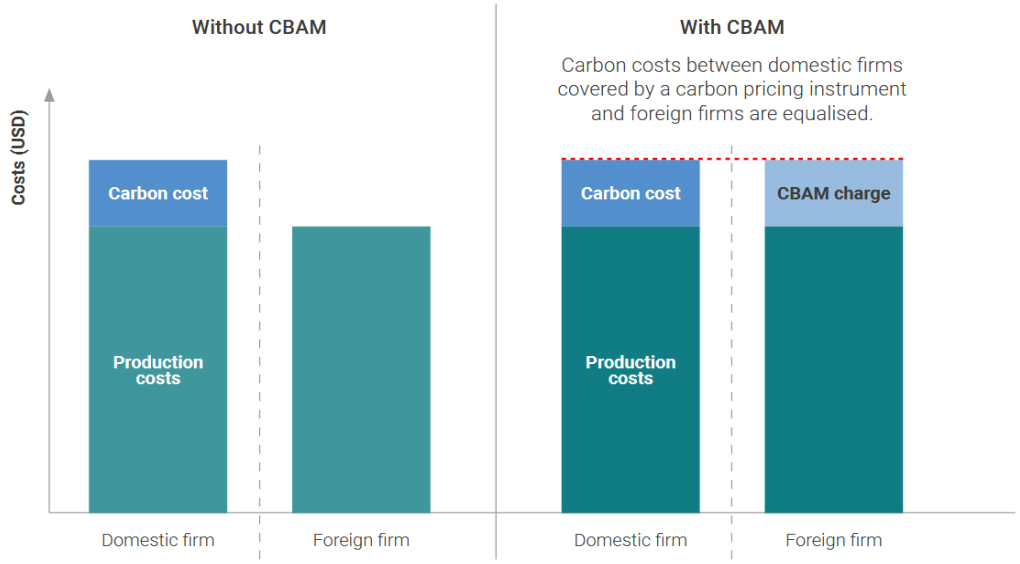
Why a CBAM?

- **The EU Carbon Border Adjustment Mechanism (CBAM) is designed to support carbon pricing in the EU** by providing safeguards for its functioning on the global market. It does this by addressing three key challenges:
  - Carbon leakage – i.e., the outsourcing or offshoring of emissions-intensive manufacturing processes to 'third countries'
  - Pricing signals – i.e., the carbon price set in the EU emissions trading system (ETS)
  - International impacts – on carbon markets, climate negotiations, and trade relations with other countries
- **Accordingly, CBAM's three main objectives are:**
  - Avoid carbon leakage and level the playing field for EU companies covered by the EU emission trading system (ETS), e.g. heavy industry and power plants
  - Strengthen domestic carbon pricing signals for consumers and companies
  - Encourage other jurisdictions to implement their own carbon pricing systems

How does it work?

- **The CBAM introduces a carbon price on EU companies importing emission-intensive goods into the EU.** It currently covers six sectors: cement, iron and steel, aluminium, fertilizers, electricity, and hydrogen. CBAM is phased in incrementally over three stages:
  - **2023–2025:** Reporting only (on 'carbon imports'), no payments required
  - **2026:** Adjustment costs begin at 2.5% of ETS carbon price
  - **2027–2034:** Gradual expansion until CBAM coverage and pricing equals ETS (while simultaneously phasing out free ETS allowances)

- **The price of CBAM certificates is linked to the EU ETS carbon price.** If a producer outside of the EU already is subject to a carbon price 'at home', then this cost is subtracted from CBAM charges for products imported into the EU (see figure below).



Source: NZAOA, Position on Governmental Carbon Pricing

- **While CBAM costs – legally and administratively – are paid by EU importers** by purchasing and surrendering CBAM certificates, economically, non-EU exporters may ultimately bear part of the cost indirectly. For example, exporting companies may lower their prices to help EU buyers remain competitive or invest in cleaner production to reduce embedded emissions (and thus the required certificates).

How CBAM differs from tariffs

- **CBAM is not a tariff, but a carbon pricing equalisation mechanism** applied at the EU border to match the EU ETS. It can raise costs for CO2-intensive products imported into the EU; however, that cost is reduced if the exporter already paid a carbon price for the product 'at home'.
- **Key differences between CBAM and tariffs are** their respective (i) purpose, (ii) basis for cost, (iii) uniformity of rates, and (iv) WTO compliance.

	Tariff	CBAM
Purpose	Trade protection, revenue	Environmental, create level playing field: align carbon costs of imports with EU ETS
Basis for cost	Value of goods	Embedded CO_2 emissions in goods
Uniform tariff?	Yes – same duty for each sector/ product category	No – varies by product, producer's actual emissions, and home carbon price
WTO compliance	Often challenged	Designed to be WTO-compliant (non-discriminatory, tied to climate rules)

CBAM implementation and status quo

- **The CBAM entered into force on 1 January 2026,** after significant revision as part of the EU's 'Omnibus I' simplification package. The simplified text reduces CBAM's scope while ensuring continued climate ambition.
- By only requiring EU companies that import of at least 50 tons of 'embedded carbon' in CBAM-eligible goods to declare, it is expected to exempt ~90% of previously covered companies, while still covering 99% of imported emissions.
- **Additional measures to address carbon leakage** and close loopholes were introduced in December, including:
  - Adding products to CBAM coverage (including goods like car doors or washing machines) to address the risk of downstream carbon leakage
  - Applying additional anti-circumvention safeguards
  - Simplifying the rules for electricity imports
  - Establishing a 2-year Temporary Decarbonisation Fund using CBAM revenues

Impact on international carbon markets

- **CBAM has been criticised by other countries as setting up an unfair trade barrier.** Major EU trading partners like Brazil, India and China have suggested CBAM may breach WTO rules, while Russia has initiated a formal dispute.
- **In international climate negotiations, unilateral trade measures have long been controversial** – especially for developing countries – while the EU views them as part of its climate policy toolbox. At COP30, trade was included in the formal summit outcome, establishing annual trade dialogues for the next three years to discuss the economic impacts of such measures.
- **At the same time, many countries are implementing and expanding their own carbon markets.** These national markets reduce costs related to CBAM: any carbon price paid domestically is credited against CBAM, and if it matches the EU ETS price, no additional cost applies. In the long term, the EU aims to align global carbon prices, potentially eliminating the need for CBAM altogether.
  - ***China,*** the world's largest GHG emitter with 25% of global emissions, is extending its ETS system beyond the power sector, to cover around 60% of domestic carbon emissions by 2027.
  - ***Japan*** shifted its 'Green Transformation' GX-ETS from a voluntary to a compliance scheme, potentially developing Asia's second-largest emissions-trading system.
  - ***Brazil and Turkey*** have both approved laws for carbon markets last year.
  - The ***UK*** government will implement a CBAM by 2027 to mitigate carbon leakage risk for industrial sectors covered by the UK ETS, and negotiations have begun with the EU on how to closely integrate both mechanisms.

  - ***India*** has launched its Carbon Credit Trading Scheme (CCTS) for nine carbon-intensive sectors, with trading to begin this year.
  - In the ***United States,*** thirteen states (30% of US population and more than 36% of GDP) have active carbon pricing programs.
- **According to the World Bank, there were 80 national or subnational systems** (37 emissions-trading schemes and 43 carbon taxes) that cover 28 per cent of global emissions and raised $102bn in 2024.
- **The formal launch of the Coalition on Compliance Carbon Markets at COP30** highlights growing momentum to align carbon pricing globally. Led by Brazil and supported by countries including China, the UK and the EU, the voluntary initiative provides a platform to promote ambitious and fair carbon pricing, share best practices and lessons learned on carbon accounting and measurement, reporting and verification (MRV), and progress toward long-term market interoperability.

Outlook and geopolitical implications

- **Three key issues will shape CBAM's impact on global carbon pricing and trade:**
  - Recognition of how carbon has effectively been paid in the country of origin, and how this will apply to emerging economies
  - How well CBAM supports EU industrial competitiveness
  - Enabling interoperability among CBAMs worldwide

  The use of CBAM revenues may also influence international acceptability; currently, the EU is planning on using them domestically, in part to support EU-based exporting companies.
- **In Asia, the climate architecture is evolving rapidly towards pricing and integrity standards,** with China and the EU emerging as co-leaders in setting standards. Other countries like Singapore and Australia have an opportunity to work as 'honest brokers' and credible intermediaries to align policies for an emerging global carbon pricing ecosystem. Brazil has emerged as a leader on establishing and aligning compliance carbon markets in the LATAM region.
- **Some commentators see China evolving as the world's first ElectroState,** with the EU following as a distant second, challenging existing geopolitical power structures of competing PetroStates like Russia, Saudi Arabia, and the United States. This view sees PetroStates depend on coordinating pricing power and reaping fossil revenues, while ElectroStates are betting on technology leadership, industrial decarbonisation, and circular innovation by ramping up renewable energies and electrification. Trading partners with high renewable energy shares will benefit from CBAM implementation due to relatively lower 'embedded' carbon emissions.
- **For the EU, industry decarbonisation, innovation, and strong cleantech are key for its Clean Industrial Deal competitiveness strategy,** to strengthen economic resilience and green value chains, and increase (circular) material and (renewable) energy security. The ETS has proven to be one of its most effective policy tools,

halving carbon emissions since 2005 in sectors covered (mainly power and heavy industry). CBAM is a logical extension of this strategy, attempting to future-proof carbon pricing dynamics and incentivise 'green competitiveness' while avoiding carbon leakage.

- **CBAM rewards countries, companies, and investors** for using energy and materials efficiently, adopting cleaner technologies, and shifting towards circular production models, thus integrating efficiency into the cost of goods sold. This can help drive a structural and climate-focused shift in global trading. For emerging markets, it creates challenges for carbon-intensive materials and manufacturing sectors while incentivising innovation, modernisation, and efficient management of resources.

Further reading

- Carbon brief (Oct 2024), Q&A: Can 'carbon border adjustment mechanisms' help tackle climate change?
- Columbia/SIPA Center on Global Energy Policy (May 2025), PetroStates and ElectroStates in a World Divided by Fossil Fuels and Clean Energy
- Environmental Finance (Jan 2026), Europe's carbon tax turns emissions into a competitive weapon
- FT (Jan 2026), Climate action faces key tests in 2026
- FT (Oct 2025), EU makes fresh push for global carbon pricing ahead of 2026 levy
- IETA (June 2025), Evolution of Global Response to EU CBAM
- Net Zero Asset Owner Alliance (May 2024), Updated Position on Governmental Carbon Pricing
- OECD (Mar 2025), What to expect from the EU Carbon Border Adjustment Mechanism?
- SCMP (Nov 2025), COP30: China to join Brazil-led coalition seeking improved carbon trading rules
- World Bank (2025), State and Trends of Carbon Pricing 2025

Annex

Different economic transition policy approaches in PetroStates and ElectroStates

	PetroStates (United States, Saudi Arabia, Russia)	**ElectroStates (China, EU)**
Focus and Dominant Asset	*Molecules* (fossil fuels: oil and gas)	*Electrons* (electrified systems & critical minerals)
Export Products	Oil, Gas, LNG	Solar panels, EVs, batteries, grid tech (mostly China)
Vulnerabilities	Erosion of fossil fuel demand (energy transition)	Mineral dependency, intermittency issues, continued fossil fuels reliance, trade backlash, overcapacity
Strategy	Expand fossil fuel production and exports to maintain geopolitical leverage.	Build dominance over electrified systems—solar, wind, grids, batteries, EVs.
Geopolitical Leverage	Supply control, pricing power	Tech standards, green supply chains
Mindset	Energy security through *control of resources* and *price influence*.	Energy security through *electrification*, *technological leadership* and *supply chain control*.
Tactics	• Weaponizing supply (Russia). • Dominating OPEC+/market coordination (Saudi Arabia, Russia). • Using tariffs and trade coercion (United States, Trump administration with LNG).	• Owning critical minerals processing and battery manufacturing (China). • Setting clean tech standards (EU: taxonomy, CBAM, etc.). • Massive renewables and grid investments (both).
Leadership Mode	State-driven: price coordination, cartel logic, export leverage, trade tools	State-led: industrial policy, techno-economic scale, green value chains

Source: Columbia/SIPA (2025), PetroStates and ElectroStates