

# UK STEEL

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## UK CBAM: CREATING A LEVEL PLAYING FIELD WITH ROBUST CARBON LEAKAGE PROTECTION



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# INTRODUCTION

As a Carbon Border Adjustment Mechanism (CBAM) is a complex policy tool, careful consideration must be given to its design to guarantee a robust policy with minimal risk of circumvention, strong carbon leakage protection, and simplicity of administration for governments and industry alike to aid the trade of goods. This paper outlines a number of design elements that the UK steel sector believes are imperative in order for the UK CBAM to work for the UK steel industry and deliver on its underpinning policy intent.

The steel industry is highly trade and carbon intensive. In 2022, 22.2% of all steel produced globally was traded across borders, but in markets outside of China, this climbed to 39%. The UK exported 40% of its steel production and imported 55% of its direct requirements. Whilst specialised and high-value steels are increasingly being produced, market requirements and economies of scale mean that the vast majority of steel made in even developed economies is commoditised and available from a broad range of sources. There is, therefore, intense competition, which keeps steel prices and margins low. This puts the UK steel industry at significant risk of 'carbon leakage', where the steel production and associated emissions move "from one country to another due to different levels of decarbonisation effort through carbon pricing and climate regulation, such as the UK Emissions Trading Scheme (ETS)"<sup>1</sup>. This scheme and other climate change policies add costs to UK steel

production, which are not faced in other countries, harming the industry's ability to compete in both domestic and international markets, putting operations in the UK at risk, and ultimately driving deindustrialisation within the UK.

The UK Government has announced its intention to introduce a UK CBAM, which offers the opportunity to provide a level playing field between imported steel and domestically produced steel in terms of carbon pricing while also creating an incentive to decarbonise production. A CBAM introduces a carbon price on imported products if those products have not faced any carbon price or faced a lower carbon price than that prevailing in the UK, ensuring a level playing field on carbon costs and mitigating the risks of deindustrialisation. Meanwhile, the UK CBAM would enable trade across borders and continue to facilitate steel imports.

<sup>1</sup>UK Government (2023), Addressing carbon leakage risk to support decarbonisation: Consultation, <https://www.gov.uk/government/consultations/addressing-carbon-leakage-risk-to-support-decarbonisation>, 30 March 2023



## **IN DETERMINING THE KEY CBAM DESIGN PRINCIPLES, THIS PAPER PROPOSES THAT THE UK CBAM MUST:**

- 1.** Be brought forward to 2026 to minimise the risk of trade barriers and trade diversion.
- 2.** Delayed inclusion of scope 2 emissions, until complete decarbonisation of the electricity grid.
- 3.** Cover all UK ETS sectors to minimise the risk of material substitution and ultimately cover complex products where CBAM materials make up a substantial part to avoid value chain circumvention.
- 4.** Be linked to the UK ETS and be based on weekly average ETS prices.
- 5.** Place the reporting and compliance obligation on the importer, and the data must undergo robust verification, with a rigorous and uncompromising penalty system supporting it.
- 6.** Have robustness tests built into the CBAM to ensure it provides sufficient carbon leakage protection.
- 7.** Be based on actual, verified emissions data. Any default values must be time-limited and based on the highest global emissions intensity to minimise the risk of emissions and CBAM compliance costs being undervalued, which would only benefit most carbon-intensive producers.
- 8.** Obtain mutual recognition with EU CBAM to enable frictionless trade with our largest trading partner.
- 9.** Exempt non-EU exports from UK ETS costs to avoid disadvantaging trade to non-EU markets.
- 10.** Be enforced by HMRC to ensure rigorous enforcement by a government body with existing customs experience. HMT and the UK ETS Authority can be responsible for the general policy development.
- 11.** Earmark the revenue for industrial decarbonisation.
- 12.** Extract insights and lessons learned from the EU CBAM.

# DESIGN PRINCIPLES

While a UK CBAM will be intricate and have many specific policy elements, the principal design elements are outlined below.

## IMPLEMENTATION TIMELINE

The UK CBAM implementation should be brought forward to 2026 to minimise the risk of trade barriers and trade diversion. The European Union (EU) is in the process of implementing its CBAM, with cost-related measures coming into effect from 2026. As the UK Government has stated its intention to apply the UK CBAM on 1st January 2027, this timeline gap will bring about potentially detrimental impacts.

The implementation of Scope 2 emissions within the UK's Carbon Border Adjustment Mechanism (CBAM) should not commence on January 1, 2027, but should be delayed until complete decarbonisation of the electricity grid. Its implementation should align with the European Union's adoption of the same measure.

### Trade barriers

In 2022, the UK exported 3.4m tonnes of steel, of which 2.6m tonnes went to EU member states, constituting 75% of exports. As the UK and EU Emissions Trading Schemes are not linked, EU and UK steel producers face different carbon prices. In 2026, EU free allowances will be reduced by 2.5%, and the UK Government plans to implement its reforms to free allocation. This will result in importers of UK-made steel having to buy EU CBAM certificates, as the legal and cost compliance obligations are on importers. Where the actual cost falls directly or indirectly will be a matter for commercial discussions and agreements with any EU-based customers and will be bespoke to each commercial agreement. However, an additional cost is placed on UK-made steel if imported to the EU market, which will constitute as a disadvantage to the UK steel industry's biggest export market.

Carbon pricing and CBAM costs are, of course, not the only factors impacting steel producers' competitive position (i.e. other factors, such as electricity prices, natural gas prices, raw material costs, etc., also have significant impacts). While UK steel producers would have a commercial advantage in cases of lower UK carbon pricing, all other things being equal, even a modest disparity in prices could provide a significant advantage to competitors, given the intense competition within the steel industry.

In the absence of ETS linking, CBAM declarants would face significant administrative costs when calculating the "taxable value" of carbon. They would also have to submit regular CBAM reports, including information on the total quantity of each type of goods, the total embedded emissions, the total indirect emissions, and the carbon price due in a country of origin, taking into account any rebate or other form of compensation available. CBAM declarations will also have to include copies of verification reports as well as the total number of CBAM certificates to be surrendered, taking into account the carbon price paid in the country of origin for the declared embedded emissions. In combination, the collective impact could pose a threat to the UK steel sector's ability to export to our largest trading partner.

### Trade diversion to the UK

When facing EU CBAM costs, steel with relatively higher embedded CO<sub>2</sub> emissions currently exported to the EU from other third countries or jurisdictions with lesser carbon compliance costs could be diverted to more open markets like the UK, which would likely negatively impact the market and depress domestic prices.

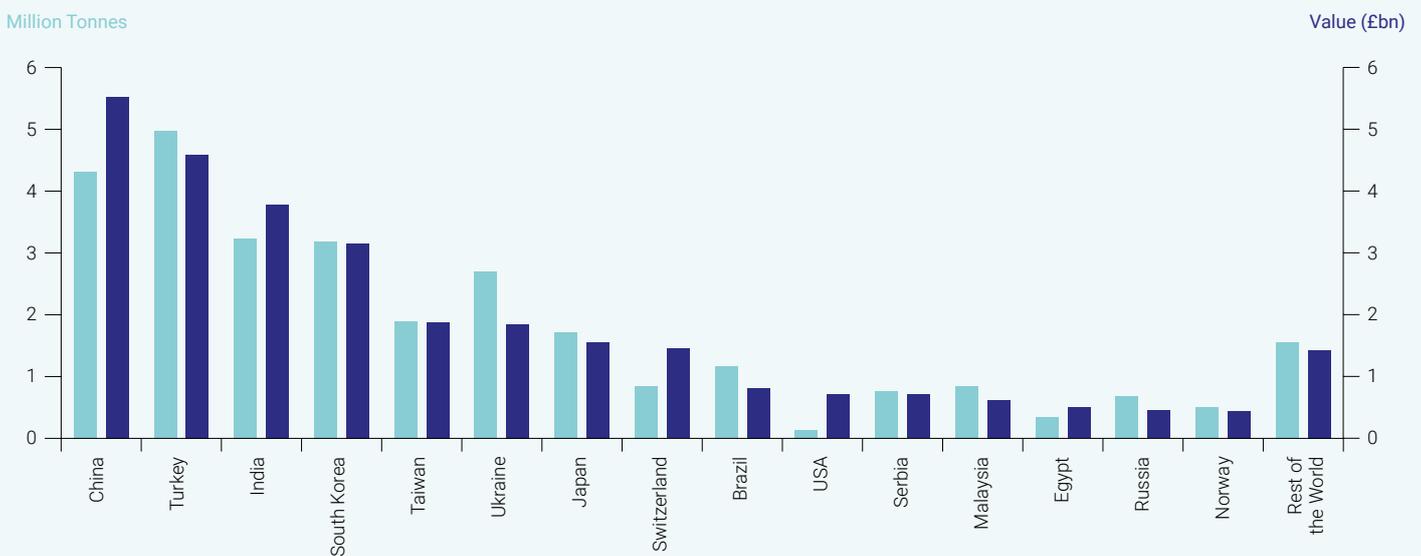
As CBAM compliance obligations will fall on steel which has not faced carbon costs already, not all steel is at risk of diversion, nor will the compliance obligation be significant if emissions are low. Steel produced in a low-emission EAF or produced in countries with somewhat equivalent carbon pricing is less likely to be diverted. Steel produced via high-emission blast furnaces (BF-BOS) or high-emission Direct Reduced Iron (DRI) or produced in countries with no or negligible carbon costs are at higher risk of being diverted to other open markets. In 2022, 28.8m tonnes of steel was exported to the EU. Of this, 22,033 tonnes originated from Canada and New Zealand, both of which have comparable carbon prices (£30-40/tCO<sub>2</sub>e). Furthermore, an estimated 6.3m tonnes of steel exported to the EU was produced via EAF and would be at a reduced risk of trade diversion, as its emissions would generally be lower. It is estimated that 22.5m tonnes of steel currently imported into the EU have faced no or negligible carbon costs and are produced via high-emission

BF-BOS or DRI production routes. When exposed to an EU CBAM compliance cost, this 22.5m tonnes of steel would be at higher risk of being diverted to other open markets<sup>2</sup>. Even if just 10% of this were to be diverted to the UK, that would result in a 45% increase in UK imports, corresponding to around 80% of the UK market.

Of the 15 highest exporting countries to the EU, only South Korea and Japan apply a carbon price to their steel industries, although at significantly lower levels than the UK

(£12.00/tCO<sub>2</sub>e and £10.39/tCO<sub>2</sub>e, respectively, at the time of writing compared to £35/tCO<sub>2</sub>e in the UK). Canada and New Zealand, the only two countries with somewhat comparable carbon pricing, only make up 0.08% of the tonnes of steel exported to the EU. The vast majority of the steel exported to the EU faces no significant carbon price and will face CBAM compliance costs when entering the EU. Over 90% of global steel production has not faced a comparable carbon price to the UK or EU ETS, demonstrating the risk of trade diversion.

**Global steel exports to EU (2022)**



Source: ISSB

This is demonstrated in the scenario below:

A NON-EU STEELMAKER EXPORTS TO THE EU MARKET:	IF THE NON-EU STEELMAKER EXPORTS 20,000T OF STEEL TO THE EU, THE LIKELY COST WOULD BE:
<ul style="list-style-type: none"> <li>■ EU steel installation produces 30,000t of steel, with annual emissions of 60,000tCO<sub>2</sub>, i.e. 2tCO<sub>2</sub>/t</li> <li>■ EU installation receives 48,000 free allowances covering 80% of emissions, meaning that 1.6tCO<sub>2</sub> is covered by free allocation and pays a carbon price on 0.4tCO<sub>2</sub>/t</li> <li>■ Non-EU steel installation also produces 30,000t of steel, with annual emissions of 60,000tCO<sub>2</sub>, i.e. 2tCO<sub>2</sub>/t</li> <li>■ Non-EU steel installation pays no carbon price</li> <li>■ An average EUA carbon price of €65/tCO<sub>2</sub></li> </ul>	<ul style="list-style-type: none"> <li>■ Liabe emissions: (Emissions of installation - emissions covered by free allocation for EU producers under EU ETS) * (total tonnes): (2-1.6)*20,000 = 8,000</li> <li>■ EU CBAM obligation: The liabe emissions multiplied by the average weekly UKA price equals the CBAM obligation: 8,000*€65 = €520,000</li> <li>■ Final CBAM cost: EU CBAM obligation – carbon price effectively paid in third country = CBAM cost: As no carbon price has been paid in the non-EU country, the €520,000 would be the CBAM cost</li> <li>■ The additional CBAM cost per tonne of steel would therefore be: €520,000/20,000 = €26/tonne of steel.</li> </ul>

<sup>2</sup>Source: International Steel Statistics Bureau. Note: Canada & New Zealand place somewhat comparable carbon costs between £30-40/tCO<sub>2</sub>e on their steel producers; South Korea and Japan negligible carbon costs at £10-12/tCO<sub>2</sub>e; and South Africa, Chile, Mexico, Kazakhstan, and Colombia almost no carbon costs at £0.7-3/tCO<sub>2</sub>e, with the remaining countries placing no carbon costs on emissions from steel producers. 71% of global steel production is produced via BF-BOF (at an average of 2.32 tonnes CO<sub>2</sub> per tonne of crude steel cast), 7% DRI-EAF (at an average of 1.65tCO<sub>2</sub>/tCS), and 22% Scrap-EAF (at an average of 0.67tCO<sub>2</sub>/tCS). High trade diversion risk is estimated to be BF-BOF/DRI-EAF production in countries with no/negligible carbon costs.

Again, as the steel industry is highly trade-intensive, a cost increase for EU importers of steel with relatively high embedded CO<sub>2</sub> emissions from 3rd countries or jurisdictions could be sufficient to precipitate changes in product supply into the EU and drive some of that steel to more open markets, like the UK, unless equivalent carbon leakage protection is also implemented in the UK. This strengthens the case for bringing forward the implementation of the UK CBAM to match the 2026 full implementation timeline of the EU CBAM in order to avoid harm to the UK steel industry, its decarbonisation efforts, and the UK’s supply-chain resilience and national security.

The Government has stated that reforms to the UK ETS free allocation methodology will be implemented in 2026 alongside potential new market mechanisms, at the same time as further reforms to the UK ETS scope and cap take effect, with the expectation that this will increase the cost of a UK emissions allowance (UKA). The steel safeguards are also set to end by June 2026. The combination of all these policy changes has the potential to cause, as yet unquantifiable, disruption to the UK steel sector. Government must ensure that all of its carbon pricing and leakage policies are introduced and amended with a whole-system approach and counter the potential detrimental impacts of a timeline, scope and pricing gap between measures implemented by the EU and those implemented by the UK. The simplest way to address the timeline gap is for the UK to have its CBAM in place from 2026.

Concerns have been raised that not all sectors would be ready for a 2026 implementation of a UK CBAM, however,

not all sectors need to be fully encompassed within a UK CBAM in lockstep. While there is currently no evidence to suggest a 2026, or earlier, implementation would pose challenges for the steel industry, it could be challenging for HMRC to implement it for some other industries from a practical implementation perspective due to insufficient reliable data and processes information, leading to compliance levels being compromised. However, it is not unreasonable to suggest that timely partnerships with these sectors should offer solutions and support Government efforts to avoid the risks of trade diversion. A differentiated implementation timeline for different products could increase the risk of material substitution (see below), but the risks and potential harm of trade diversion are greater.

Even a year or six months can be sufficient to impact trade flows, as markets are quick to adapt to new price signals. Steel is not only highly trade intensive, but steel trade is also highly price elastic. While there are some specialised products and some particular end-use sectors that will look for specific product characteristics, the vast majority of steel trade is for commodity products like rebar and hot-rolled coil. These are fairly standardised products that are not differentiated on quality but compete primarily on price. These trade flows are, therefore, very responsive to price signals, and past experience has shown that surges in imports can happen very quickly. One of the starkest examples was back in 2013-2015 when imports of rebar into the UK rose exponentially, primarily from China, until the point when an anti-dumping measure was introduced in 2016. In 2014 alone, there was a fivefold increase in Chinese imports just within a year, decimating the domestic producer’s market share.

**Rebar imports into the UK**

	2011	2012	2013	2014	2015	2016
UK total rebar imports (tonnes)	171,719	215,178	290,588	490,802	532,919	348,576
Index total rebar imports	100	125	169	286	310	203
UK rebar imports from China (tonnes)	3	2	47,803	254,583	365,409	44
Rebar imports from China as % of total	0%	0%	16%	52%	69%	0%

Source: HMRC

DESIGN PRINCIPLES

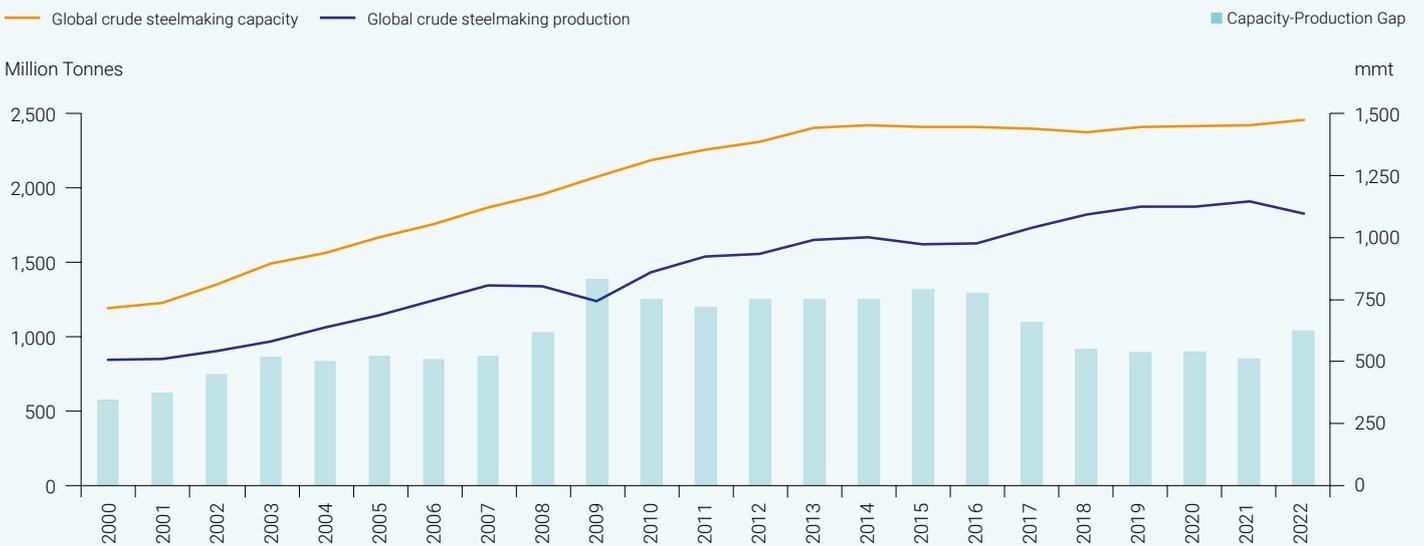
Exporters and importers are fast to react to opportunities in the market and new trade flows emerge on a monthly basis. Another example of surges in imports was observed when steel imports into the UK were not covered by the UK’s steel safeguards. These were imports from countries that did not previously supply the UK but took advantage of the opportunity of benefiting from a safeguard exemption as developing countries that accounted for less than 3% of UK imports for a given product. Within a year, many of these countries were able to increase their market share significantly, with some, such as India and Vietnam, to over 20% in 2021<sup>3</sup>.

The above examples demonstrate that trade flows can change very quickly, and this can have a material impact on

domestic producers and their market share. The pressure is all the more intensified as a result of rising global steelmaking overcapacity against weak steel demand in the UK and abroad. The OECD reported global steelmaking overcapacity at 630 million tonnes in 2022 – this corresponds to 33% of global steel production and is over 60 times the size of the UK market. Much of this is fuelled by state subsidies, for example, in China, India, and the Middle East. Meanwhile, weak domestic demand for steel in China and elsewhere means there is an abundance of surplus and typically high emissions material looking for export markets.

It is therefore strongly recommended that the UK CBAM be brought forward to 2026 to minimise the risk of trade diversion and trade barriers.

**Rising global steelmaking excess capacity heightens risk of trade diversion**



Source: OECD, Latest Developments in Steelmaking Capacity 2023 (data from OECD for crude steelmaking capacity and World Steel Association for crude steel production)

<sup>3</sup>Trade Remedies Service (2022), Tariff Rate Quota Review of Developing Country, Exception Case, SM0016, Recommendation to the Secretary of State, <https://www.trade-remedies.service.gov.uk/public/case/SM0016/submission/0c4eb6bb-a95d-4463-a962-404871dcc1af/>

## SECTOR SCOPE

The UK CBAM should cover all UK ETS sectors to minimise the risk of material substitution and ultimately cover complex products where CBAM materials make up a substantial part to avoid value chain circumvention. The UK CBAM will address carbon leakage but will also create new risks inherent to such a mechanism:

- Value chain circumvention: UK CBAM will apply to basic materials covered by UK ETS rather than end-consumer products, such as cars or washing machines. There is a risk that the manufacturing of finished products will move outside of the UK, with producers able to avoid the CBAM by exporting finished products into the UK. It is, therefore, important that the CBAM is eventually applied to steel in goods as well as semi-finished products and to key downstream steel products, notably processed steel products, as in the EU.
- Material substitution: Should the CBAM not apply to all industrial materials, those not covered would presumably continue to benefit from free allocation as a primary means of carbon leakage mitigation and, as such, would face lower carbon compliance costs than those borne by steel producers. This would risk a shift by existing steel customers and value chains towards other materials not covered by CBAM, e.g. other metals or carbon fibres for

vehicles or paper and plastics for packaging. The material substitution away from steel would lead to overall higher global emissions if substituted for equally carbon-intensive products. The UK CBAM must thus be expanded to as many industrial products as possible, where there is a risk of substitution to avoid unintended consequences.

While it is unlikely that a UK CBAM can cover all industrial sectors and materials from the beginning, it should be an ambition to expand the policy rapidly when it has proven effective and robust. We welcome the current coverage of aluminium, cement, ceramics, fertiliser, glass, hydrogen, iron, and steel, but also note that it should be expanded to all manufacturing sectors in the UK ETS and key downstream products to minimise the risk of material substitution. It should also cover more complex manufacturing products, like vehicles, white goods, construction equipment, semi-finished construction products, and many more, to reduce the risk of value chain circumvention. This should be achieved by covering products where >50% of its components constitute CBAM materials. For example, if the components of a washing machine are more than 50% steel, aluminium, glass, and ceramics, a CBAM compliance cost would be applied when imported to the UK. Over the subsequent years, this should be lowered gradually, largely eliminating the risk of value chain circumvention.



# EMISSION SCOPE

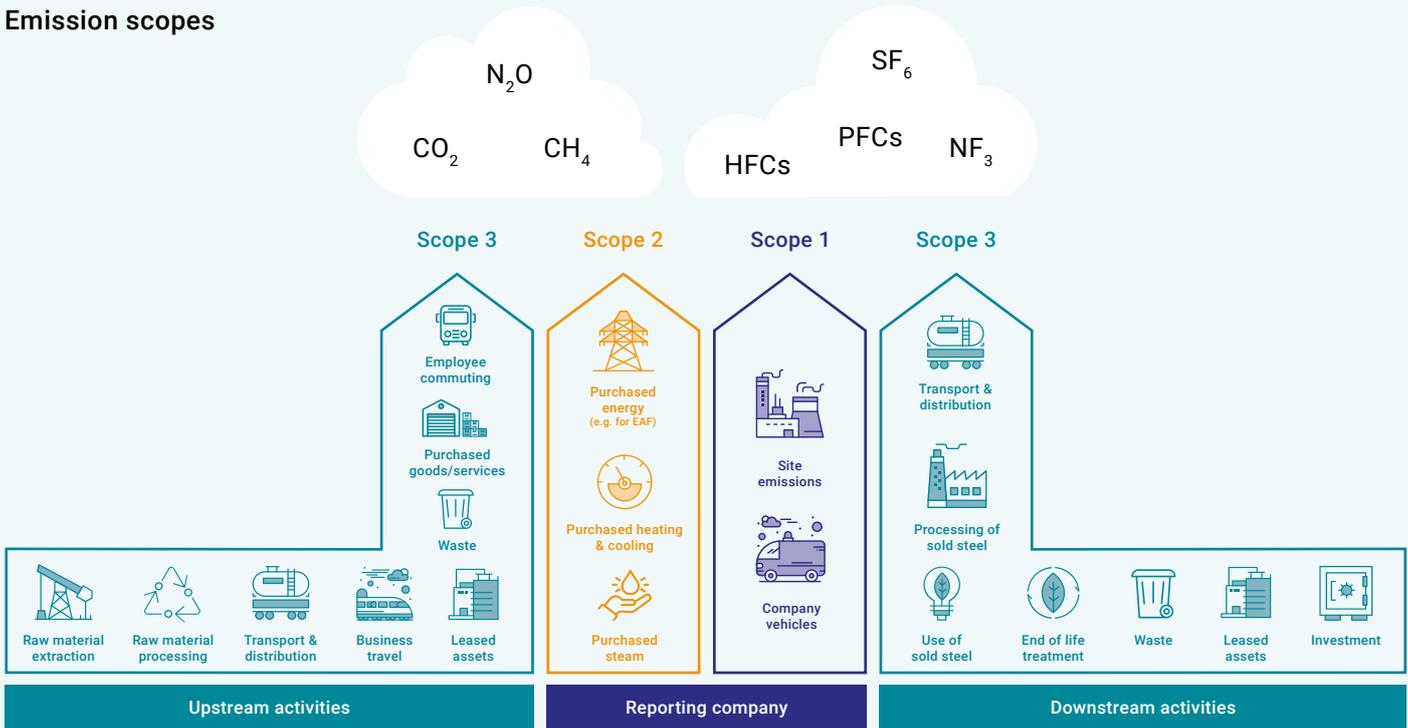
The UK CBAM must cover scope 1 and 2 emissions to reduce the risk of circumvention and imports of high-emission steel, but the implementation of scope 2 emissions should be delayed until complete decarbonisation of the electricity grid and no sooner than implementation by the EU.

A company's greenhouse gas emissions are categorised into three scopes. The GHG Protocol Corporate Standard describes these as such: "Scope 1 emissions are direct emissions from owned or controlled sources. Scope 2 emissions are indirect emissions from the generation of purchased energy. Scope 3 emissions are all indirect emissions (not included in scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions"<sup>4</sup>.

The Government has stated that the UK CBAM "will be applied to Scope 1, Scope 2 and select precursor product emissions embodied in imported products to ensure comparative coverage with the UK Emissions Trading Scheme"<sup>5</sup>.

However, as CBAM policies are new and untested, and the robustness of the policy is unclear, it should be implemented gradually to ensure that it can actually prevent carbon leakage. As detailed below, there will be a clear incentive to misreport, underreport, and falsify data to minimise and avoid any CBAM costs. The UK CBAM should, therefore, initially only apply to scope 1 emissions before later, once effectiveness has been demonstrated, being expanded to cover scope 2 emissions. If the CBAM is extended to scope 2 emissions too soon, it may increase the risk of carbon leakage if the CBAM's robustness and effectiveness aren't guaranteed.

## Emission scopes



Source: GHG Protocol, UK Steel

<sup>4</sup>Greenhouse Gas Protocol, FAQ, [https://ghgprotocol.org/sites/default/files/standards\\_supporting/FAQ.pdf](https://ghgprotocol.org/sites/default/files/standards_supporting/FAQ.pdf)

<sup>5</sup>UK Government (2023), Addressing carbon leakage risk to support decarbonisation: Summary of consultation responses and government response, <https://www.gov.uk/government/consultations/addressing-carbon-leakage-risk-to-support-decarbonisation>, 18 December 2023

## DETERMINING THE CBAM COMPLIANCE COST

To create a level playing field on carbon pricing, the UK CBAM should be linked to the UK ETS and should be based on weekly average ETS prices. While the Government has confirmed the link to the UK ETS, it has not yet decided how this link will be established. The EU CBAM certificates “will be calculated depending on the weekly average auction price of EU ETS allowances expressed in €/tonne of CO<sub>2</sub> emitted”<sup>6</sup>. A similar principle should be applied to the UK CBAM.

As the UK is a smaller territory than the EU, CBAM certificates should not be necessary. Instead, CBAM compliance should align with and be integrated into other customs cost compliance systems (i.e. costs applied and paid at the same time as any other import taxes or duties). CBAM compliance costs must be applied if goods are imported into a freeport area to avoid the scenario where goods are imported into freeport areas, further processed into a product not in scope of CBAM, and then officially enter UK customs territory as a different good.

If the Government is considering introducing CBAM certificates

to demonstrate compliance, then the UK CBAM certificate should be paid when steel is imported into the country, and the obligation should fall on the importer (see below) rather than the end-consumer to minimise fraud and deception. The CBAM certificates should only be valid for three months to avoid speculation and gaming of the system, and reselling should not be possible. In this case, as an example, an importer could buy UK CBAM certificates six weeks ahead of the CBAM good being imported and surrender them at the point of import, but if they chose not to import the products after all, the CBAM certificates could not be resold. Unlike UK ETS allowances, purchasing CBAM certificates will not impact the UKA/CBAM price, as it is not traded in a market of limited permits. It would, therefore, not be appropriate to allow a more extended validity period, as this would create an incentive to purchase CBAM certificates when the UKA price was low and resell these years later when the UK ETS cap has been lowered further and prices increased. However, CBAM certificates would not be necessary in the UK, as CBAM goods entering the UK would not be traded to other member states, as with the EU CBAM.

## IMPORTER OBLIGATIONS, PENALTIES, AND ROBUSTNESS TESTS

The reporting and compliance obligation should fall on the UK importer, and the data must undergo robust verification, with a rigorous and uncompromising penalty system supporting it. It is furthermore crucial that robustness tests are built into the CBAM to ensure it provides the intended carbon leakage protection.

The CBAM obligation should apply when the steel product enters the UK customs territory, certifying that the UK importer pays the effective UK carbon price per tonne of CO<sub>2</sub>e at the point of compliance, as per the section above on determining the compliance cost. Industry, steel consumers, and the Government require reliable, trustworthy data on the embodied emissions of steel products for the CBAM to be effective. Only robust verification of emissions data can ensure credible data. The Government has considered two options: (1) establishing an independent regulator to certify third-party organisations to verify emissions data, as under the UK ETS, or (2) relying on foreign manufacturers to self-verify. To establish a level playing field and an effective UK CBAM, emissions data must only be accepted when subject to a rigorous system of monitoring, reporting and verification, identical to the UK ETS. The reporting and compliance obligations should be as onerous as the

EU CBAM to minimise the risk of trade diversion.

The Government should create a rigorous, expeditious, and uncompromising penalty system to respond to fraudulent reporting, lack of data, or circumvention. As carbon prices will increase and consequently the CBAM compliance costs, so will the financial rewards for underreporting embedded emissions or fraud, which can only be counteracted with a robust penalty system.

Finally, the UK should incorporate robustness tests in the UK CBAM, similar to what the EU has introduced, assessing the degree of circumvention, fraud, effectiveness, sector scope, etc.. While a CBAM is a fundamental policy tool to address carbon leakage and create a level playing field on carbon pricing, it is still an untested, unproven, and novel policy that has yet to be introduced anywhere globally. If fraud and circumvention are widespread and the UK CBAM proves incapable of providing carbon leakage protection, the Government must be prepared to step in with substitute carbon leakage measures (such as increased free allocations). It is therefore necessary that UK CBAM robustness tests be created and conducted on a regular basis for the first many years of the scheme’s introduction.

<sup>6</sup>EU Commission (2023), Carbon Border Adjustment Mechanism, [https://taxation-customs.ec.europa.eu/carbon-border-adjustment-mechanism\\_en](https://taxation-customs.ec.europa.eu/carbon-border-adjustment-mechanism_en)

## DEFAULT VALUES

The UK CBAM should be based on actual, verified emissions data. Any default values must be time-limited and based on the highest global emissions intensity to minimise the risk of emissions and CBAM compliance costs being undervalued, which would only benefit the most carbon-intensive producers.

When imposing a price on emissions associated with imported products, it must be determined which reporting and values will be accepted. In general, there are two approaches:

1. Independently verified emissions data by a recognised body, where importers are required to submit accurate emissions data, or
2. Default values which aim to estimate the carbon content of products as accurately as practicable based on process-, product- and country-level values, internationally recognised datasets, and/or values derived from UK emissions data<sup>7</sup>.

If the Government follows industry recommendations to bring forward the UK CBAM to 2026, optional default values could be introduced for the first 12 months to maintain trade openness, where importers do not have access to robust data supported by monitoring, reporting and verification. Should default values be made available, it will be vital not to substantially under- or overestimate the carbon emissions, but especially to create an incentive to report accurate emission

data and prevent incentives for high-emission products. The Government could also consider introducing voluntary reporting from 2025 onwards with default values.

Any default value should be based on global steelmakers with the highest emissions intensity to ensure an accurate CBAM cost for the most carbon-intensive producers and encourage others to provide reliable data. If default values are based on the 10% worst UK emitters or the global average, high-emission steel or steel with unreliable data will face a lower CBAM compliance cost, and their emissions will be underestimated. To avoid benefitting the high-emitting steel producers, any default values must be based on the highest global emissions intensity.

However, should the Government retain the existing 2027 implementation timeline, there would be no need to introduce default values, as importers and market participants will have been reporting to the EU CBAM for 12 months, or 36 months, if including the transition period. To ensure trust in the UK CBAM, emissions data should only be accepted when subject to a rigorous monitoring, reporting and verification (MRV) system, similar to what domestic producers face when complying with the UK ETS. This follows the principle of a level playing field. It would not be reasonable for UK steel producers to undergo a demanding and thorough MRV process under the UK ETS, but importers can avoid this by relying on default values unrelated to their production.

## EXPORTS AND THE IMPACT OF HIGHER CARBON COMPLIANCE COSTS

For non-EU exports, the UK CBAM must exempt exports from ETS costs on UK manufactured goods to avoid penalising trade to non-EU markets. Given that the UK currently exports 40% of its steel production, it is imperative to identify an effective export strategy. The EU is by far our most important trading partner, receiving 75% of the UK's steel exports, and therefore, facilitating frictionless trade should be a key priority. While the UK has many competing geopolitical aims in negotiating with the EU, the UK Government should be seeking to link its carbon schemes or negotiate mutual recognition with the EU CBAM so UK producers can avoid reporting against EU CBAM.

As outlined above, the steel industry is highly trade-intensive, with high levels of imports and exports. Even with a UK CBAM in place, if circumstances arose where UK steel producers faced higher carbon compliance costs in the UK, increasing

their operating costs, there would be a deterioration in their ability to compete in the global market, affecting the 40% of UK produced steel which is currently exported.

Careful consideration should be given to how reforms to the UK ETS scheme and higher carbon compliance costs could impact UK producers' ability to compete in export markets. It is, therefore, imperative to identify and incorporate an effective approach to the treatment of goods subject to carbon prices which are exported from the UK. Roughly 30% of steel produced in the UK is exported to the EU, and a further 10% of domestic production is exported to non-EU markets. Should the EU CBAM be implemented as currently envisaged, its cost methodology will take account of the carbon 'effectively' paid in the UK for goods exported to the EU. However, for the remaining 10% of UK production exported to RoW markets, there is no consideration of the carbon price paid in the UK.

<sup>7</sup>UK Government (2023), Addressing carbon leakage risk to support decarbonisation: Consultation, <https://www.gov.uk/government/consultations/addressing-carbon-leakage-risk-to-support-decarbonisation>, 30 March 2023

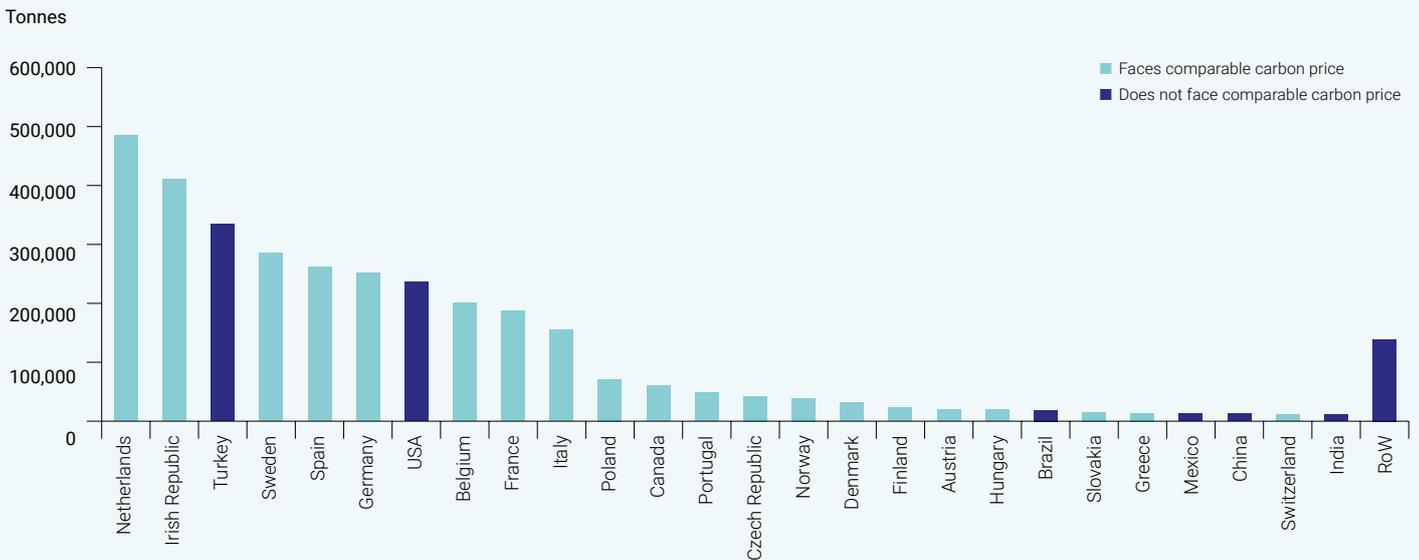
These products tend to be higher-value products, and while the percentage of UK production they constitute may appear modest, their significance lies in the substantial impact they have on the sector’s profitability and the sustainability of operations in the UK. Lower production would impact overall plant efficiency, with higher capacity utilisation tending to result in improved metrics, including (i) lower emissions; (ii) reduced energy consumption; (iii) lower input costs; and (iv) decreased overall production costs; per tonne of steel. A decrease in production levels will consequently compromise productivity and efficiency, negatively affecting each plant’s, and the industry’s, competitiveness in the long run.

The chart below shows that the UK exports to many non-EU countries without a comparable carbon price. While 30% of UK production is exported to the EU, the steel exported to countries without an equivalent carbon price is valued at £1.4bn annually.

As the UK CBAM is established, barriers to trade must be removed by (1) linking the UK ETS and EU ETS to exempt UK-made products from the EU CBAM and (2) exempting UK exports to non-EU countries from ETS costs. This will level the playing field between green, low-emissions UK-manufactured products and competitors in third countries and jurisdictions which do not face a carbon price. This exemption is crucial for promoting the competitiveness of UK production and products where sustainability has been prioritised, and investment has been made in reducing carbon emissions. Without such a measure, the CBAM’s effectiveness in mitigating carbon leakage risks would be significantly compromised.

Moreover, incorporating this exemption aligns with the broader objective of fostering a global transition towards environmentally sustainable practices. By encouraging the export of green, low-emission goods without imposing additional ETS costs, the UK can position itself as a leader in environmentally responsible production, setting a positive example for other nations to follow.

### UK steel exports by destination, 2022



Source: ISSB

## GOVERNMENT ADMINISTRATOR

HMT and the UK ETS Authority should be responsible for evaluating the scheme and the general policy development, while HMRC should be responsible for customs-related cost elements (as it does with other import taxes and duties). Collecting and verifying emission data can be a joint responsibility between HMRC and the existing UK ETS auditors and regulators. This would reduce duplication,

administrative costs, and general burdens for business. Due to the severe harm to the UK steel industry, the tolerance for circumvention and fraud is extremely low, and HMRC must be fully equipped and resourced to implement and enforce the policy, ensuring the emissions data have been subject to a rigorous system of monitoring, reporting and verification.

## CBAM REVENUE STREAM

With over 90% of the world not applying a comparable carbon price to the UK ETS, establishing a UK CBAM will likely create a revenue stream. Some have estimated that this could be several billions every year, and the UK should earmark the CBAM revenue for industrial decarbonisation. Considering the scale of investment required by, and with, individual

companies, the need to support and accelerate deployment of CCUS and hydrogen infrastructure, and ongoing support for industry, combined with the impact on consumers, the Government should ensure a steady revenue stream to fund the necessary scale and speed of industrial decarbonisation the UK requires.

## INSIGHTS GAINED FROM THE EU CBAM

As the EU implements its CBAM policy, the UK can extract valuable insights and lessons learned from this process to minimise any disruption to industry and trade. By dissecting the EU's approach, the UK could discern effective strategies, potential challenges, overarching implications, and practical knowledge, which can contribute to developing robust and effective carbon border adjustment policies.

The UK steel industry can point to several recommendations to improve on the EU CBAM implementation:

- **Timely implementation:** A key theme of reported issues has been a lack of timely implementation and late publishing of critical documents. This includes guidance only being published a month before the transition period began, default values being published a month before the reporting deadline, member states only establishing the CBAM competent authorities a month before the reporting deadline, and the IT register not being opened less than a month before the deadline. This has resulted in an unnecessary chaotic and disruptive implementation, which could easily have been avoided if the Commission and Member States had prepared better.
- **Accessibility:** The EU Commission has not established a helpdesk or provided a route where steel exporters can clarify the guidance and ask questions. This has led to needless confusion and uncertainty. The UK should provide some form of service desk in the implementation period to assist importers and minimise trade disruption.

- **Template and IT platforms:** The EU Commission published a template spreadsheet to assist importers and their suppliers in gathering data and complying with the EU CBAM, which the UK could use as a starting point for the development of a template bespoke to UK requirements. However, the EU template had to be updated several times as errors were identified, and crucially, it did not match the information requested on the IT platform. The UK should ensure a timely template is issued, which has been tested prior to publication and is entirely compatible with the IT systems that will be recording, processing, and analysing relevant information. The UK should also invite importers and steel industry representatives to test and interact with the appropriate IT platforms to increase intuitiveness, accessibility, and user-friendliness.
- **Transition period:** Representatives from the steel producers have expressed significant concern about the UK's plans not to have a transition period or initial voluntary reporting period. If this was not available for the EU CBAM, they believe it would have led to substantial misreporting, under and overreporting of emissions, under and overpayment of CBAM compliance costs, high levels of non-compliance, and disruption to trade. So, while the EU had specific reasons for implementing a transition period, which does not apply to the UK (e.g. lack of granular data on trade flows and customs records at an EU level, lack of supranational IT systems), it also provided UK steelmakers with valuable practice in reporting the necessary emission and trade data. The earlier the reporting regimes are established and tested, the greater success there will be in having measures and effective processes in place to avert trade diversion to the UK. The UK should, therefore, implement voluntary reporting ahead of the CBAM being implemented.



# CONCLUSION

The implementation of a UK CBAM is a crucial step toward improving the competitiveness and sustainability of the steel industry amid the challenges posed by carbon pricing differentials. The intricate design principles outlined in this report emphasise the need for a well-considered and timely approach to the introduction of the UK CBAM.

The significance of aligning timelines with the EU CBAM implementation cannot be overstated, as the potential trade barriers and risks of trade diversion highlighted underscore the urgency for synchronicity. If necessary, a staged implementation should be adopted for different products, where measures are introduced for steel in line with the EU CBAM timeline, recognising the potential practical challenges that may exist for some industries and products while also emphasising the importance of minimising the risk of material substitution. Similarly the inclusion of scope 2 emissions must be delayed until the decarbonisation on the UK grid, and aligned with the EU CBAM scope.

Addressing sector scope and determining CBAM compliance costs are critical components, requiring careful consideration and a commitment to comprehensive coverage to ensure the effectiveness of the policy. This report recommends a diligent and robust reporting and

compliance system, emphasising the importance of credible emissions data verified through a rigorous monitoring, reporting, and verification process. Considerations must be extended to exported products, which, in anticipation of expected higher domestic carbon compliance costs, should be exempted from ETS costs to maintain and potentially enhance UK products' competitiveness in global markets.

The recommendations presented in this report aim to guide the UK Government in crafting a comprehensive, effective, and adaptive UK CBAM policy that not only protects against carbon leakage but also promotes sustainable industrial practices. The careful consideration of these principles is essential for ensuring the successful integration of the UK CBAM into the broader landscape of climate policies, safeguarding the steel industry's future, and contributing to a global shift toward a low-carbon economy.

UK Steel is the trade association for the UK steel industry and champions the country's steel manufacturers.

We represent the sector's interests to government and promote our innovative, vibrant and dynamic industry to the public.

**Together, we build the future of the UK steel industry.**

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