

## UK STEEL – SUBMISSION TO THE CONSULTATION ON THE INTRODUCTION OF A UK CARBON BORDER ADJUSTMENT MECHANISM

**Date:** 13<sup>th</sup> June 2024

**To:** [cbampolicyteam@hmrc.gov.uk](mailto:cbampolicyteam@hmrc.gov.uk)

### About UK Steel

UK Steel, a division of Make UK, is the trade association for the UK steel industry. It represents all the country's steelmakers and a large number of downstream steel processors.

### Submission to the consultation on the introduction of a UK carbon border adjustment mechanism

#### General comments:

UK Steel welcomes the consultation on the introduction of a UK Carbon Border Adjustment Mechanism (UK CBAM), which we have advocated for since 2021. A CBAM is vital to ensuring a level playing field on carbon costs, ensuring that imported steel products face similar carbon taxation as domestic producers. This will not only minimise the risk of carbon leakage, but also help create a supportive business environment which will support the steel industry in investing in new, lower-emission steel manufacturing.

In April 2024, UK Steel published its report<sup>1</sup> on the key design principles of a UK CBAM, which put forward 12 recommendations for the Government when creating the carbon border policy. We were pleased to see that several of these align with the Government's proposals within the consultation, such as basing the CBAM cost on UK ETS prices, placing the reporting and compliance obligation on the importer, enforcement by HMRC, and avoiding CBAM certificates. However, on several principles, the Government has proposed a different direction than what was suggested by the steel industry. While several of these are covered by consultation, a few are not, and we would therefore reiterate these here below. Where topics are covered by consultation, we will address those in response to the consultation questions.

#### Bring the CBAM forward to 2026 to minimise the risk of trade diversion and trade dynamics

The UK CBAM implementation should be brought forward to 2026 to minimise the risk of trade diversion and, ultimately, carbon leakage and deindustrialisation. 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 1<sup>st</sup> January 2027, this timeline gap will bring about potentially detrimental impacts.

#### *Trade diversion to the UK:*

When facing EU CBAM costs, steel with higher embedded CO<sub>2</sub> emissions currently exported to the EU from other countries 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 while driving carbon leakage and deindustrialisation.

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 countries with somewhat equivalent carbon pricing or produced in a low-emission EAF is less likely to be diverted. Steel produced via high-emission blast furnaces (BF-BOS) or high-emission Direct Reduced Iron

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<sup>1</sup> UK Steel (2024), *UK CBAM: Creating a Level Playing Field with Robust Carbon Leakage Protection*, <https://uksteel.org/uk-cbam>

(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, this 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 £45/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.

We are concerned that HMT and HMRC are underestimating the EU CBAM charges, which high-emission steel will face in 2026 when exported to the EU. While the EU is reducing free allocations by only 2.5% in 2026 for the sectors within the EU CBAM, the EU is also reforming the EU ETS benchmarks, which will lead to a significant decrease in free allocation for the EU steel market. Based on the most recent information on the EU ETS benchmark reforms, it is suggested that BF/BOF producers will be 25.5% short in 2026<sup>3</sup>. Add to this the 2.5% reduction in free allocations for CBAM sectors, and BF/BOF producers will receive 27.4% fewer free allocations than their emissions. EU importers of steel will face a significant CBAM charge and will be at high risk of trade diversion. This is demonstrated in the scenario below:

A non-EU steelmaker exports to the EU market:

- EU steel installation produces 30,000t of steel, with annual emissions of 54,000tCO<sub>2</sub>, i.e. 1.8tCO<sub>2</sub>/t
- EU installation receives 39,200 free allowances covering 72.6% of emissions, paying a carbon price on the remaining emissions
- Non-EU steel installation also produces 30,000t of steel, with annual emissions of 54,000tCO<sub>2</sub>, i.e. 1.8tCO<sub>2</sub>/t
- Non-EU steel installation pays no carbon price
- An average EUA carbon price of €75/tCO<sub>2</sub>

If importing 20,000t of steel from non-EU steelmakers to the EU, the likely cost would be:

- Liable emissions: (Emissions of installation – emissions covered by free allocation for EU producers under EU ETS) \* (total tonnes):  $(1.8-1.3)*20,000 = 10,000$
- EU CBAM obligation: The liable emissions multiplied by the average weekly UKA price equals the CBAM obligation:  $10,000*€75 = €750,000$

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<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.

<sup>3</sup> Preliminary free allocation: 1.335 EAU/t crude steel and a carbon intensity: 1.793 kg CO<sub>2</sub>/t crude steel results in a free allocation shortage of 25.5%. Source: Eurofer.

- 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 €750,000 would be the CBAM cost
- The additional CBAM cost per tonne of steel would therefore be:  $\text{€}750,000/20,000 = \text{€}37.5/\text{tonne}$  of steel.

As the steel market is very trade intensive, operates on thin margins, and with a background of global oversupply, it has been the case that a price difference of even £5/tonne of steel would be able to make or break a commercial contract. An additional charge of €37.5/tonne of steel would thus be more than sufficient to divert some steel away from the EU steel market to more open markets, like the UK, unless equivalent carbon leakage protection is also implemented simultaneously in the UK. We do not believe that HMT and HMRC have taken into account the shortfall in free allocation as a result of the altered EU ETS benchmarks from 2026 onwards but instead just focused on the 2.5% CBAM reduction of free allocation. We would therefore encourage the Government to reconsider its assessment of the risk of trade diversion from the EU steel market in 2026 and the potential significant damage it could cause the UK steel industry, driving carbon leakage and deindustrialisation.

Separately, 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.

It is also our assessment that HMT and HMRC are underestimating how quickly steel trade flows can change, 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.

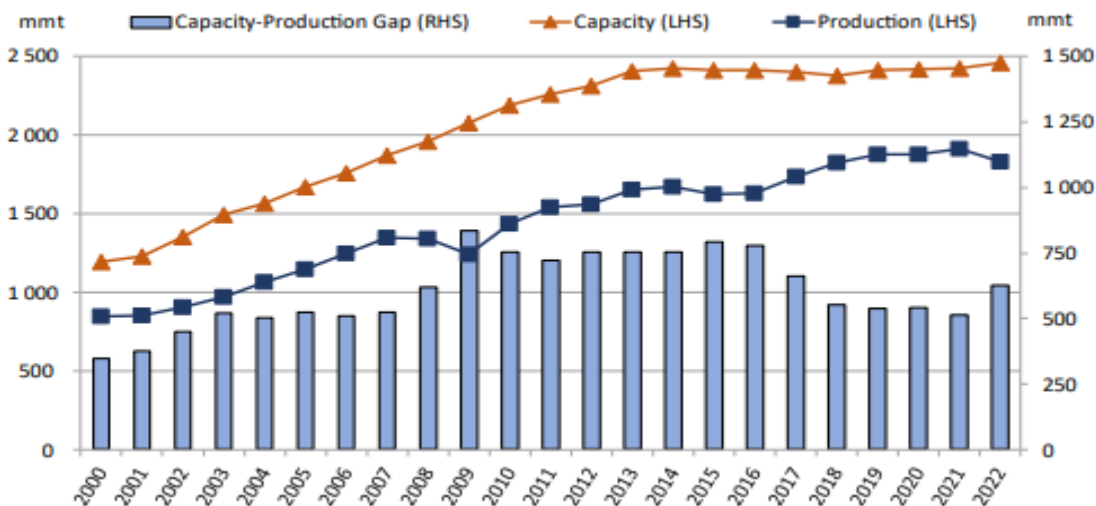
Rebar imports into the UK	2011	2012	2013	2014	2015	2016
<b>UK total rebar imports (tonnes)</b>	171,719	215,178	290,588	490,802	532,919	348,576
<b>Index total rebar imports</b>	100	125	169	286	310	203
<b>UK rebar imports from China (tonnes)</b>	3	2	47,803	254,583	365,409	44
<b>Rebar imports from China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

Source: HMRC

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.

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.

Global crude steelmaking capacity and crude steel production 2000-2022



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

### Carbon Pricing & Trade Dynamics

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 significantly reduced, free allocations for CBAM sectors 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, resulting in additional costs for UK steel exports to the EU market. While carbon pricing and CBAM expenses play a significant role, other factors, like electricity and natural gas prices, of course also affect the business landscape and risk of carbon leakage.

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, accounting for the carbon price paid in the country of origin for the declared embedded emissions. In combination, the collective impact could challenge the UK steel sector’s exports to our largest trading partner.

It is therefore strongly recommended that the UK CBAM be brought forward to 2026 to minimise the risk of trade diversion, carbon leakage, and deindustrialisation. Ultimately, maintaining the existing 2027 implementation deadline will greatly increase the risk of carbon leakage, where production in the UK will decrease while production in countries with lower climate ambitions will increase.

### Export mechanism and mutual recognition EU CBAM

With a UK CBAM in place, if circumstances arose where UK steel producers faced higher carbon compliance costs in the UK, which would increase 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. This would drive carbon leakage, where UK production would fall, while steel production in countries with lower climate ambitions would increase.

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, thus increasing the risk of carbon leakage. It is, therefore, necessary to find an export solution. 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.

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. 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.

Separately, 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 preventing carbon leakage and deindustrialisation 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.



Without an export mechanism, the UK CBAM and any reductions in free allocations would drive deindustrialisation. As such, this type of policy is crucial to preventing carbon leakage.

### Indirect emissions

As stated below, we do not believe that the UK CBAM should cover indirect emissions at this point. The implementation of indirect emissions should be delayed until the complete decarbonisation of the electricity grid and no sooner than implementation by the EU.

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. 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 direct (scope 1) emissions before later, once effectiveness has been demonstrated, being expanded to cover indirect (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 are not guaranteed.

Due to the functioning of the electricity market based on marginal pricing, indirect costs paid by UK steelmakers in the electricity price are not linked to the actual emissions of the electricity consumption but to the emissions of the marginal electricity producer. Therefore, even if the UK power grid is decarbonising quickly, the indirect carbon costs remain set by the marginal production, which is expected to remain fossil-based at least until 2030, if not beyond. As the Government hasn't presented a clear methodology to make the CBAM effective in tackling this situation, the inclusion of indirect emissions in the CBAM would increase rather than decrease the carbon leakage risk. Consequently, indirect emissions should not be included in the CBAM scope at this stage for steel products.

### Robustness tests

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.. As a policy, a CBAM 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.

### Earmark the revenue for industrial decarbonisation.

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, as outlined in the consultation document. 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.

### Extract insights and lessons learned 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 were 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.

**Question 1: Do you agree that the list of commodity codes in Annex A an accurate reflection of the policy intent described above? Please provide supporting evidence**

Yes. We believe that this is an accurate list of commodity codes which will cover the necessary steel products. However, we would highlight the need to expand the list to cover more complex products containing steel in the future.

As UK CBAM will apply to basic materials covered by UK ETS rather than end-consumer products, such as vehicles or white goods, 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.

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 (see below). 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.

As the Government is not proposing to apply the UK CBAM 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 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 eventually be expanded to as many industrial products as possible, where there is a risk of substitution to avoid unintended consequences.

In the context of the UK CBAM, which aims to prevent carbon leakage and create a level playing field for carbon costs, it's important to recognise that UK and EU steel producers might eventually bear the full carbon costs for their entire production. Meanwhile, steel producers in third countries, where domestic carbon cost schemes are absent, can compete in the UK market by only accounting for carbon costs related to the portion of their production exported to the UK (and the EU).

**Question 2: Are there any relevant commodity codes omitted or any that should be excluded? Please provide supporting evidence.**

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**Question 3: Do you have any concerns on the feasibility of any of the commodity codes in Annex A being within scope of the CBAM? Please provide supporting evidence.**

No, we do not have any concerns about the steel commodity codes in Annex A.

**Question 4: Do you agree that scrap aluminium, scrap glass and scrap iron & steel do not pose a carbon leakage risk and should not be within scope of the CBAM? If not, please provide evidence to support your response.**

We agree with the proposal that scrap iron and steel should not be included in the UK CBAM at present. As the UK CBAM is designed to ensure a level playing field between domestic and international producers, scrap should not be covered by the CBAM as the UK ETS does not cover scrap.

**Question 5: Do you agree that the government's definitions of 'direct' and 'indirect' emissions accurately describe the embodied emissions a CBAM ought to place a carbon price on, in line with those emissions within scope of the UK ETS? If not, please explain why not.**

While we agree with the definition of direct and indirect emissions, we do not believe that the UK CBAM should cover indirect emissions at this point. The implementation of indirect emissions should be delayed until the complete decarbonisation of the electricity grid and no sooner than implementation by the EU.

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. 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 direct (scope 1) emissions before later, once effectiveness has been demonstrated, being expanded to cover indirect (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 are not guaranteed.

Due to the functioning of the electricity market based on marginal pricing, indirect costs paid by UK steelmakers in the electricity price are not linked to the actual emissions of the electricity consumption but to the emissions of the marginal electricity producer. Therefore, even if the UK power grid is decarbonising quickly, the indirect carbon costs remain set by the marginal production, which is expected to remain fossil-based at least until 2030, if not beyond. As the Government hasn't presented a clear methodology to make the CBAM effective in tackling this situation, the inclusion of indirect emissions in the CBAM would increase rather than decrease the carbon leakage risk. Consequently, indirect emissions should not be included in the CBAM scope at this stage for steel products.



**Question 6: Do you foresee any issues with calculating the emissions associated with precursor goods in CBAM goods? Please provide evidence to support your response.**

No.

**Question 7: Do you foresee any difficulties with the government's proposal to use product level default emissions values calculated in line with global average emissions weighted by the production volumes of the UK's key trading partners? Please outline.**

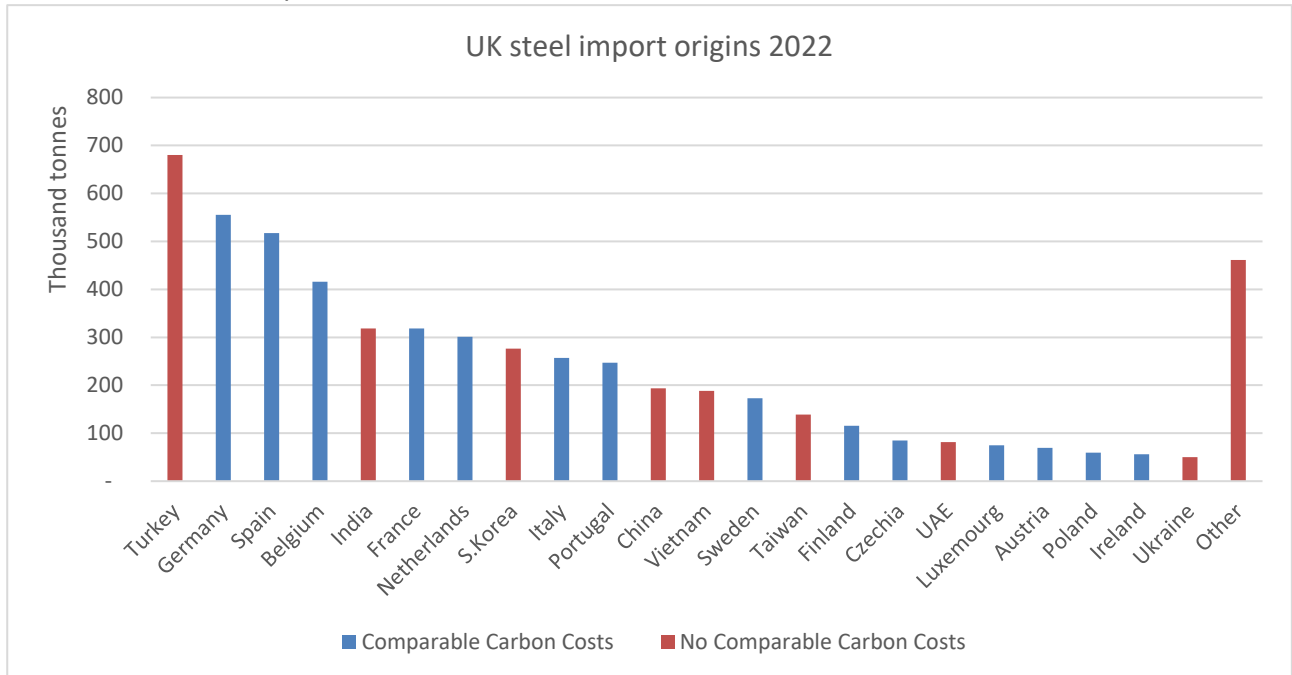
Yes. We are very concerned about the Government's proposal to allow the use of default values, as these would undervalue the emissions and CBAM compliance costs, which would only benefit the most carbon-intensive producers.

The Government has set out key principles for the CBAM, stating that the UK CBAM must ensure a comparable carbon price is paid on imported emissions and domestic emissions while not placing a burden on importers or imports that is higher than on domestic producers. By allowing the use of default values, the Government is breaking with both those principles, as it would allow imported higher-than-average-emission steel to pay a lower price than what it would have paid if produced domestically. It would also exempt imported steel from having to report its accurate emission profile, which is required of domestic steelmakers under the UK ETS MRV regime. As such, the availability of default value allows imported steel to pay less than domestic producers while facing a lower administrative burden than UK producers. At its heart, a CBAM is aimed at creating a level playing field between domestically produced and imported industrial products, ensuring they face similar carbon pricing and climate change obligations. Default values will undermine this key principle and, as described below, will also threaten the environmental integrity of the policy.

In particular, the values must reflect the most carbon-intensive technologies and products since only in this way will importers have an incentive to declare their actual emissions and avoid benefitting from using the default values without declaring the actual emission data, where the most carbon-intensive products benefitting the most from the use of default values. Appropriate default values are of crucial importance for the effectiveness of the CBAM in preventing the risk of carbon leakage. This element is particularly relevant in the steel industry, as the carbon intensity varies significantly.

Should the Government still allow the use of default values, then these must be carefully considered to ensure the environmental integrity of the scheme. The UK imports its steel from an increasingly wide range of countries. Whilst the majority come from the EU, primarily due to geographic proximity and integrated supply chains, countries such as Turkey, India, South Korea, China, Vietnam, and Taiwan are all major exporters to the UK now – each supplying over 100,000 tonnes a year and with Turkey providing as much as 680,000 tonnes in 2022 – 12% of imports and 6% of total demand.

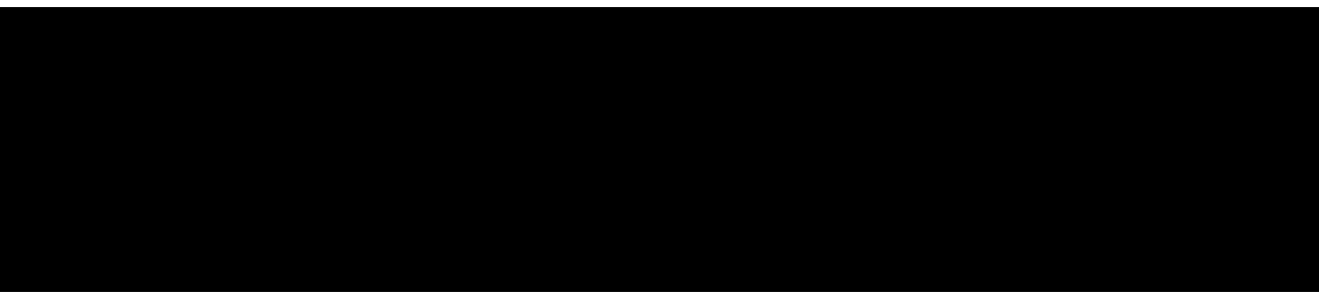
## Sources of UK Steel Imports 2022



Source: International Steel Statistics Bureau.

Over 90% of the world’s steel production faces no carbon pricing, with only comparable carbon pricing in the European Union, Switzerland, Canada, and New Zealand. It is, therefore, highly likely that a considerable proportion of imported steel will not have faced comparable carbon pricing. In 2022, the UK imported 5.6 million tonnes of steel, of which 40% were from countries without comparable carbon pricing. Some countries (like South Korea and South Africa) have carbon schemes, which are priced at considerably lower levels, and imports from these countries constitute 6% of overall imports. If the Government makes default values available, it would, therefore, be expected that up to 34% of the imported steel would use the default values.

Should default values be made available, it will be vital not to substantially under- or overestimate the carbon emissions and to create an incentive to report accurate emission data and prevent incentives for high-emission products. We do not support basing the default values on global averages, which will significantly distort the default values to benefit high-emission steel. WorldSteel estimates that the average CO<sub>2e</sub> emissions per tonne of crude steel cast are 1.91 tCO<sub>2</sub>/tCS, but the carbon intensity of steelmaking varies substantially across countries, technologies, and sites.



If the Government used the global average of 1.91 tCO<sub>2</sub>/tCS for default values, then importers of the most carbon-intensive steel would have their CBAM obligations underestimated by almost half. Basing the default values on global averages will only provide a significant CBAM discount to those importing steel products with carbon intensity above the global average. As such, half of the world’s steel would thus have its emissions underestimated and its CBAM obligations reduced if exported to the UK. The UK Government is thereby

designing a CBAM, where it will explicitly favour higher emission steel, with the most carbon intensive steel receiving the biggest discount.

To reflect the huge range in carbon intensity of steel production, any default values 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. Default values should be based on the 10% highest carbon-intensity steel production to avoid benefitting the high-emitting steel producers. If this is not possible, then a large mark-up must be applied.

As is clear from the table above, there are significant variations between steel production technologies, which will create issues if default values are based on the overall average rather than on the technology route, like the UK ETS benchmarks. We are very concerned that the Government is considering applying a single rate for all steel imports, regardless of production route. This would threaten the environmental integrity of the UK CBAM by allowing the import of high-emission steel to face a lower CBAM cost than even the BOF average emissions, let alone the actual emissions of the plant producing the steel. As there are such significant differences between the different production routes, the Government must consider basing any default values on the benchmark methodology, which differentiates between steel production technologies. Otherwise, imported high-emission steel will have its emissions and CBAM liability underestimated, and the Government would have designed a policy which only favours the most carbon-intensive steel production. The preferred option is there to have CBAM rates based on the benchmarks, where any default values applied are calculated on the basis of the “worst performers”. As such, the EAF steel rate should be based on the worst-performing EAF producers to create a clear incentive to declare actual emissions. Likewise, a BOF CBAM rate is based on the worst-performing BOF producers.

The Government could have been considered default values due to its potential concerns about the impact on developing countries. However, as China produced 54% of the world’s steel in 2023, and India produced 7% (while planning significant increases to their production capacity), global steel production is dominated by “developing” countries. UK Steel production today makes up just 0.3% of the world’s steel production. While China and India are technically classified as developing countries, their steel production far outweighs the UK steel industry. If the Government is concerned that a CBAM would have negative impacts on developing countries, it could make default values available to the ‘least developed countries’ category. We support the Government’s efforts in ensuring that any UK climate policy does not disadvantage the least developed countries, but this concern should not be extended to all developing countries, which today make up the majority of global steel production.

It is also worth noting that if the UK makes default values based on global averages available, then it would increase the risk of high-emission steel exported to the EU being diverted to the UK market, thereby driving carbon leakage. As the EU is currently not planning on allowing the use of default values (although potentially allowing up to 20% to use default values), high-emission steel would face a higher CBAM cost in the EU than in the UK, as the proposed default values based on global averages would naturally be lower than the higher-than-average-emission steel. This would unsurprisingly create an incentive to dump high-emission steel in the UK, where it would face a discounted CBAM liability, as opposed to the EU market. This would undermine the environmental integrity of the UK CBAM and drive carbon leakage.

Finally, should the Government retain the existing 2027 implementation timeline, we do not see the need for 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 comparable carbon price paid on imported emissions and domestic emissions while not placing a burden on importers or imports that is higher than on domestic producers. 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.

**Question 8: Are there alternative approaches to default emissions values the government ought to consider which neither undermine the environmental integrity of the CBAM nor are punitive in nature? If so, please provide detailed evidence.**

As outlined above, we believe that imported steel should face similar requirements as domestically produced steel, following the key principles set out by HM Treasury and HMRC that the CBAM should not place a burden on importers or imports that is higher than on domestic producers. This would mean that imported steel should have to report their actual emissions under independently verified scrutiny. The European Union is currently planning to require verified, accurate emission data for their CBAM reporting, although potentially allowing up to 20% to use default values. As the UK and EU steel markets are very integrated, it would not be punitive to require genuine emission data for the purpose of the UK CBAM when our largest trading partner requires the same.

In the case, where the Government still wishes to make default values available, then a significant mark-up must be applied. This would reflect the risk that high-emission steel would benefit from default values and create a clear incentive to provide accurate, verified, and audited emissions data. As outlined above, the range of emissions per tonne of crude steel is exceptionally large, and it would thus undermine the environmental integrity of the CBAM if the government created default values which specifically favoured the most carbon-intensive productions. To ensure the environmental integrity of the policy and sufficient carbon leakage protection, any default values used must be based on the most carbon-intensive producers. This also reflects the approach in the UK ETS benchmarks (a scheme to which the UK CBAM will be linked), where free allocations are based on the 10% most efficient and least carbon-intensive steel plants. Steel plants in the UK ETS are, therefore, penalised if they cannot perform as well as the 10% most carbon-efficient plants by receiving fewer free allocations. Basing the default values on the 10% most carbon-intensive plants would similarly incentivise more carbon-efficient plants to make their actual and verified emissions available to importers while ensuring that the most carbon-intensive plants did not benefit from too low default values.

**Question 9: Do you have views on how a percentage based mark-up (in addition to global average emissions weighted by production volumes of embodied emissions intensities of the UK's key trading partners) could impact the use of default values and actual reported emissions data? Please outline.**

As outlined in our answer to question 7, it would not be appropriate to use a global average, as the global average would benefit the most carbon-intensive production. If default values are to be made available, then a mark-up must be placed added to this. Considering the global average emission intensity of 1.91 tCO<sub>2</sub>/tCS, then it would be appropriate to add 50-75% to this average as a minimum. This would still provide importers of the most carbon-intensive steel a significant discount. The preferred option would be to base the default values on the 10% of most carbon-intensive plants, as outlined above. However, as we are urging the Government to create several CBAM rates for the imports of steel products, additional consideration must be given to the mark-ups applied to each rate. [REDACTED]

[REDACTED]

[REDACTED] It is vital that any default value made available does not underestimate the carbon emissions of imported steel and thus the CBAM liability.

Any calculations of default values must be conducted alongside industry, with transparency and clarity in mind. We would urge the Government to publish, in detail, which emission data it will use for default values and its calculations while inviting industry and stakeholders to engage and provide feedback on this.

**Question 10: Do you have any initial views on the considerations and/or aims of a future review into the use and functionality of default values? Please outline.**

While the CBAM is a new and novel policy, and Government may be of the view that default values would ease the introduction of the new reporting requirements on importers, it would not be appropriate to allow the continued use of default values. These must be temporary and time-limited while the market adapts to monitoring, reporting, and verifying their GHG emissions. The European Union is only allowing default values to be used in the initial reporting period before they are either not available or only available to a smaller proportion of imported products. The UK should not adopt a more lenient approach than our closest and largest trading partner. As such, we propose that if the Government wishes to permit the use of default values, then these are only made available for the first year of the scheme's operation, and in no scenario are they available after 2030.

**Question 11: Do you foresee any issues with a liable person acquiring and providing to HMRC details of emissions embodied in CBAM goods at the end of the accounting period (should they choose to)? Please outline.**

No.

**Question 12: Do you agree that verification of emissions should be performed by any body accredited by accreditation services which are part of the International Accreditation Forum (IAF), like UKAS in the UK? If not, please explain why not.**

Yes, we support this position. However, we urge the Government to continue to monitor the quality of data reported and the risks of misreporting and fraud. As carbon prices will increase and consequently the CBAM compliance costs, so will the financial rewards for underreporting embedded emissions or fraud.

**Question 13: Would the market respond adequately to provide for the accreditation of verifiers by accreditation services and the verification of emissions independent verifiers?**

Yes. We believe that the market can deliver this. However, the Government must be mindful of the clear financial incentive to understate and underreport GHG emissions and thus must create the necessary scrutiny regime of reported data.

**Question 14: Noting that the government is still developing policy in this area, do you have any initial views on the monitoring, reporting and verification (MRV) rules for the UK CBAM? Please outline.**

A key principle of the UK CBAM must ensure a comparable carbon price is paid on imported emissions and domestic emissions while not placing a burden on importers or imports that is higher than on domestic producers. As such, the MRV rules for the UK CBAM must mirror the UK ETS MRV rules to ensure a level playing field. A less stringent UK CBAM MRV regime would be inappropriate and threaten the environmental integrity of the policy.

**Question 15: Do you foresee any difficulties in obtaining an accurate weight for CBAM imported goods? If so, please specify the difficulties, why they will arise and any suggestions you might have for dealing with those concerns.**

No.

**Question 16: If a liable person was required to arrive at the weight of the goods themselves, how would they do that? Please explain how CBAM products that you import are weighed. For example, is the weight arrived by means of a calculation or is it physically weighed?**

This is not a problem for the steel industry, where weight is a common market measure and tool.

**Question 17: Is there a UK industry standard weight for the CBAM good you import? If so, please give details.**

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**Question 18: Do you agree that the CBAM rate calculation set out a fair reflection of the price paid in the production of goods in UK? If not, please explain why not.**

No. While we support the direct link to the UK ETS, we do not believe that the single rate for the entire steel industry is an appropriate approach, as this significantly distorts the CBAM rate payable by importers. As evidenced in answer to question 7, the carbon intensity of steel production varies significantly across sites, countries, and, crucially, production technologies. [REDACTED]

[REDACTED]

This is also evidenced in the UK ETS benchmark methodology, where there are broadly three steel benchmarks: BOF (made up of Coke, Sinter, and Hot metal benchmarks), EAF carbon steel, and EAF high alloy steel (although some steel producers will use the fuel and heat benchmarks). As such, free allocations are based on production route benchmarks rather than an overall average iron and steel benchmark, which would significantly overallocate EAF producers and underallocate BOF producers. If the Government applies a single iron and steel CBAM rate, it will substantially penalise EAF-produced steel while providing a large discount to importers of BOF steel. This again threatens the environmental integrity of the scheme but also diverges from the principle of a level playing field between domestically produced and imported steel.

There would not be a need for individual separate product-level CBAM rates, but instead, benchmark-based CBAM rates, where the rates are based on production routes, i.e., separate rates for EAF carbon steel, EAF high alloy steel, and BOF-produced steel. This would ensure that imported steel would not face a higher burden than domestic producers while ensuring the environmental integrity of the UK CBAM. Information on production routes is widely available on any steel traded in the global market, and introducing three separate CBAM rates for the steel industry would not create additional burdens on importers.

**Question 19: Does setting a CBAM rate for each sector on a quarterly basis strike the right balance between tracking the UK ETS market price and giving importers certainty for financial planning? If not, please explain why not.**

Setting a quarterly rate is an acceptable frequency, but as explained in the answer to question 18, there should not be a single rate for the steel sector, but instead three.

**Question 20: Are there any other considerations for setting the UK CBAM rate not set out above? Please outline.**

We would urge HM Treasury and HMRC to reconsider the proposal for a single rate for the steel industry, considering the wide variation within the emission profiles of the different production routes, and instead base the rates on the production routes established within the UK ETS benchmarks, which were developed by experts from industry, Government, regulators, and NGOs over several decades. Adopting an oversimplified rate for the entire steel sector would provide a large discount to importers of the most carbon-intensive steel while overcharging the import of the lowest-emission steel. While the balance between accuracy and complexity of burdensome administration is recognised, and it is understandable why the Government wishes to simplify the CBAM as much as possible, a single rate does not strike the right balance. Instead, three rates for the steel sector should be introduced, which would ensure both a more accurate CBAM charge to importers while avoiding the complexity of product-level rates.

**Question 21: Are there explicit carbon pricing policies which do not align with our criteria which should be recognised by the UK? Please outline.**

We recognise that not all carbon pricing schemes have an explicit carbon price as within the UK ETS, with the Australian scheme being a prime example of this.

**Question 22: Are there other recognised forms of evidence which a liable person could provide? Please outline.**

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**Question 23: Are there additional considerations or processes that might facilitate the provision of information on the overseas carbon price from producer to liable person, including by mutual agreement with other jurisdictions? Please outline.**

When considering mutual recognition with other jurisdictions, the Government should again prioritise to negotiate a linkage between the UK ETS and EU ETS, as this would benefit both domestic producers and importers of steel. Not only would this permit UK producers to avoid reporting against EU CBAM, but UK importers would also not have to report against the UK CBAM for steel imported from the EU.

**Question 24: For operators overseas, do you foresee challenges providing the evidence for importers to comply with the measure? Please outline.**

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**Question 25: Do you foresee challenges with referencing the overseas carbon price on a quarterly basis? Please outline.**

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**Question 26: Do you have views on what types of third parties would be appropriate to verify overseas carbon price? Please outline.**

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**Question 27: Do you have views on how the government could decrease the burden on the liable person to evidence an overseas carbon price? Please outline.**

As there are a limited number of carbon schemes globally, HMRC could monitor these and maintain a database on global carbon prices. This would reduce the burden on importers of having to evidence carbon prices, especially considering that many importers will have to evidence the same carbon prices.

**Question 28: Do you agree that where a CBAM good has been subject to multiple carbon prices, the total carbon price can be offset from the UK CBAM liability? If not, please explain why not.**

Yes.

**Question 29: Do you foresee any difficulties with the arrangements for where the tax point arises, including which rates will apply? Please explain where you have any difficulties with the proposed policy.**

We foresee one potential issue in situations where steel is imported into a customs special procedure such as a freeport or customs warehouse, where they are further process into finished goods not liable for the CBAM tax. We would be concerned if new manufacturing plants would be located in freeports and imported high-emission steel, which is then used to make vehicles, white goods, or semi-finished construction products to avoid CBAM liability. This would encourage value chain circumvention and lead to higher overall global emissions.

**Question 30: Do you foresee any risks with our proposal to base the CBAM liability on the CBAM good which is processed into a non-CBAM good before it is released into free circulation? Please explain the risks.**

We welcome this proposal and believe that it should also apply to a customs special procedure such as a freeport or customs warehouse.

**Question 31: Do you agree that the proposal for designating the liable person is appropriate or are there likely to be unintended consequences? If you do not agree, please explain your reasons.**

Yes.

**Question 32: Do you agree that there should be a minimum threshold below which a person should not be required to register for the CBAM? If not, please explain why not.**

Yes, we agree that a minimum threshold could be applied.

**Question 33: Do you agree that an annual value of £10,000 is an appropriate level at which to set the minimum threshold? If not, please explain where you think it should be set and your reasoning.**

We are concerned that the proposed level would exclude around 60 per cent of potential registrations, which would indicate that it has been set too high. If the Government proceeds with the proposed limit, it should be carefully monitored to ensure it is not exploited to avoid the CBAM liability and that too much product is not placed on the UK market without facing similar carbon taxation as UK producers.

**Question 34: Do you agree with the tests set out in Figure 15 for assessing whether a person has met the minimum threshold? If not, please explain how you think the threshold should be assessed.**

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**Question 35: Do you consider the registration and deregistration requirements set out above to be appropriate? If not, please specify why not.**

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**Question 36: Do you foresee any difficulties with the arrangements set out for completing and submitting returns, including the content required on the return? If so, please specify the difficulties and why they would arise.**

No.

**Question 37: Do you think that allowing 5 months from the end of the first accounting period until returns are due allows sufficient time for a liable person to obtain data about the carbon content of their CBAM goods? If you think a different period should operate, please explain why.**

Yes.

**Question 38: Do you agree with the proposal to move to quarterly accounting period from 2028 and, if not, why not?**

If the Government proceeds with implementing the UK CBAM in 2027, then we would agree that the quarterly accounting period can start in 2028. However, as we have strongly recommended that the UK CBAM be moved forward to 2026, it would be most appropriate for the quarterly accounting period to start in 2027.

**Question 39: Do you foresee any difficulties in moving to a system of four fixed accounting periods a year from 2028, with returns/payments generally due a month later? If so, please explain your concerns and any suggestions for dealing with those concerns.**

No. But again, we would argue that this should be moved forward one year.

**Question 40: Do you consider that HMRC's approach to enforcement powers and penalties is appropriate? If not, please specify why.**

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, as stated above, 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.. As a policy, a CBAM 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.

**Question 41: Do you have any other concerns or suggestions around potential compliance risks? Please outline.**

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**For further information, contact:**

Frank Aaskov, Energy & Climate Change Policy Manager, 07872 190965, [faaskov@makeuk.org](mailto:faaskov@makeuk.org)