

UK Steel – Spending Review Submission 2024

About UK Steel

UK Steel is the trade association for the UK steel industry. It represents all the country’s steelmakers and a number of downstream steel processors.

Introduction

- **Steel is a key driver of economic growth and supply chain resilience**
- **Steel is central to the UK’s decarbonisation journey**
- **The UK is in a prime position to lead green steelmaking as one of the biggest generators of steel scrap in the world**
- **The sector employs 33,700 people directly in the UK and supports a further 42,000 in supply chains, with a median steel sector salary of £37,315, which is 26% higher than the UK national median and 35% higher than the regional median in Wales, and Yorkshire & Humberside, where its jobs are concentrated**
- **The steel industry directly contributes £1.8 billion to UK GVA and supports a further £2.4 billion, while directly contributing £3.4 billion to the UK’s balance of trade.**

Steel is a foundation industry, literally the building block of our society, feeding into everything from construction to transport, critical national infrastructure, defence, energy pipelines, wind turbines, household goods, food packaging, and medical, industrial, and agricultural equipment. Steel is the bedrock of the UK’s supply chains and is fundamental to the future of the UK economy, our economic resilience and national security. The industry supports thousands of jobs and communities both directly and indirectly along the supply chain, particularly in Wales, South Yorkshire and the Northeast of England.

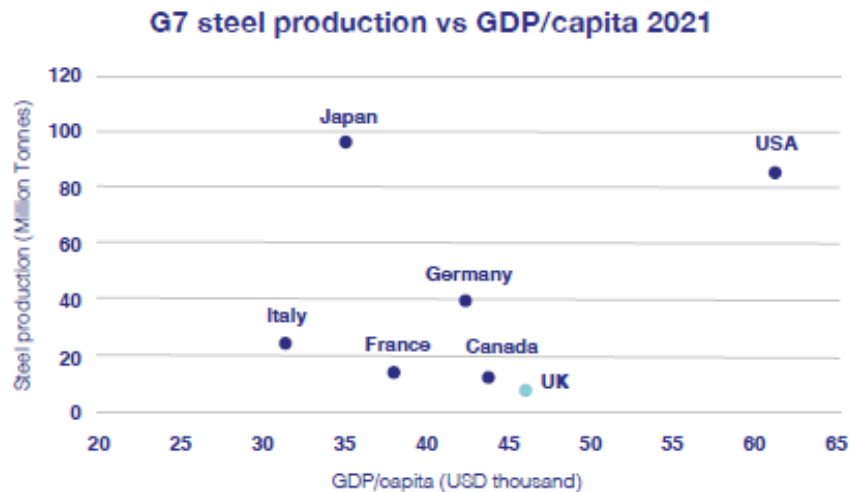
Steel is not only a driver for growth and a major employer in the regions where it is located, but it is also at the heart of a low-carbon economy. Steel is not only infinitely recyclable but also critical to all low-emission energy generation and every single technology required for a Net Zero future.



Source: McKinsey (2021), Critical raw materials for strategic technologies and sectors in the EU, A foresight study, European Commission, Mar 9, 2020; The role of critical minerals in clean energy transitions, IEA, May 2021

Despite the clear advantages of a strong steel sector, the UK steel sector has faced an uncompetitive business environment, driven by persistently high electricity prices. Combined with the unprecedented growth in steel produced in developing economies, fuelled by state subsidies, it has become increasingly difficult to compete in a global market for steel riddled with distortions and excess steelmaking capacity. The landscape remains challenging for the UK steel sector amid a weak economic climate and lack of a clear operating framework that will ensure a competitive business landscape and a level playing field with our competitors.

The UK is an outlier in terms of its steel production relative to the size of its economy and relative to the size of its manufacturing base, which creates significant risks for its economic resilience. France, which is comparable to the UK in terms of GDP, population, and size of its manufacturing sector, produces around double the amount of steel. The UK's steel production has contracted at one of the fastest rates in the world over the last 50 years, second only to Venezuela. If the steel industry in the UK were to continue to contract, the UK would be unique in being by far the largest economy and steel consumer to be almost completely reliant on imports.



Source: World Bank and World Steel Association

We welcome the National Wealth Fund and the Government's £2.5bn commitment to the steel industry. It is clear that this Government wishes to revitalise the steel industry, increase investment, and improve the business environment for steel. We believe that this is a great starting point, and in this submission, we call for the Spending Review to include policies which support the UK steel industry to thrive in an increasingly competitive international environment. These policies will enable the UK steel sector to continue supporting economic prosperity and well-paid, highly skilled jobs across the country, providing security of supply for a strategically important product and decarbonising in line with our domestic and international responsibilities.

UK Steel Autumn Statement Priorities

Summary of Priorities:

1. **Bring forward the UK Carbon Border Adjustment Mechanism to 2026**
2. **Continue to establish truly competitive electricity prices for the steel sector**
3. **Abolish the Carbon Price Support Mechanism**
4. **Continued investment in modernisation and decarbonisation of the industry**
5. **Increase funding for research and innovation**

Priority 1: Bring forward the UK Carbon Border Adjustment Mechanism to 2026

The UK Steel industry continues to be significantly impacted by carbon leakage, as it is not only carbon and energy-intensive but also highly trade-intensive. While 25% of all steel produced is traded internationally, this climbs to around 40% in markets outside of China, and the UK exports 40% of its steel production and imports over 60% of its direct requirements. There is, therefore, intense competition, which keeps steel prices and margins low. Carbon price differentials are a key risk factor contributing to carbon leakage. As a result of this risk, the Government will introduce a UK Carbon Border Adjustment Mechanism, which will seek to level the cost of carbon for imported steel to that of domestically produced steel. This has long been a recommendation from UK Steel, and we warmly welcome the policy.

However, delaying the introduction of the UK CBAM to 2027, a year later than the EU CBAM policy, will introduce additional risks of trade diversion of high-emission steel to the UK market, which a 2026 introduction of the policy could avoid. As evidenced in the submission to the June 2024 CBAM consultation, when facing EU CBAM costs, steel with higher embedded CO₂ 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. It is UK Steel's estimation that of the c28m tonnes of steel exported to the EU from around the world, up to 22m tonnes could be at risk of being diverted to other open markets. To put this into context, 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. The existing implementation timeline for the UK CBAM does, therefore, endanger this Government's overall strategy for growth and, separately, its industrial strategy for the steel industry.

Based on current carbon prices and reforms to the EU ETS benchmarks, it is estimated that blast furnace steel exported to the EU would face around €35-40/tonne of steel. As the steel market is very trade intensive, operates on thin margins, and with a background of global oversupply, a price difference of even £5/tonne of steel would be able to make or break a commercial contract. An additional charge of €35-40/tonne of steel would, therefore, 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.

Steel is highly price elastic, so even a year or six months can be sufficient to impact trade flows, as markets are quick to adapt to new price signals. 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 experience has shown that surges in imports can happen very quickly.

Against a backdrop of rising global steelmaking excess capacity and oversupply, coupled with increasing protectionism around the world, the risk of trade diversion is more acute than ever. UK producers have already been suffering an erosion of their market share as a result of this – over the first five months of this year, steel imports into the UK jumped by 17% year-on-year¹ amid a weak demand environment. As a result, the UK's import share has jumped to 68% from 60% in 2023 and 55% in 2022.² Most of these imports come from non-EU origins, from countries like China, India and Vietnam that are dominated by high-emission blast furnaces and the carbon intensity of steel in these countries is only expected to get worse in the short term. The OECD estimated that of the 166m tonnes of global gross capacity additions from 2023 to 2025, blast furnace projects account for 55.4%, of which 50Mt of capacity is in India and 12Mt in China. The most recent estimate for 2024 to 2026 shows continuing capacity expansions in India of 32Mt and an added 30Mt in ASEAN countries.³ This means that in Asia,

¹ UK Trade Info (HMRC)

² ISSB

³ Latest developments in steelmaking capacity and outlook until 2026, OECD, June 2024, [pdf \(oecd.org\)](https://www.oecd.org/)

blast furnaces account for more than 74% of capacity additions. Meanwhile, 89% of blast furnace energy input globally comes from coal.⁴

Steel trade flows have always been able to change very quickly, but the current weak global demand environment, coupled with oversupply, creates alarming conditions for high levels of trade diversion. These conditions were last experienced back in the ‘steel crisis’ years of 2015-2016, resulting in steel plant closures and severe turmoil in the global steel market, including in the UK. Expectations are that we are entering a period that could be even worse.⁵ In this environment, it would be a serious error to underestimate the risk of trade diversion and to expose the UK steel market to an influx of high-emission steel.

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.

Recommendation: Bring forward the UK CBAM to 2026 to avoid damage to the steel industry from the EU CBAM policy.

Priority 2: Continue to establish truly competitive electricity prices for the steel sector

The UK has long had Europe’s highest industrial electricity prices and well above other key industrial competitors. The UK Government has taken a number of actions to reduce industrial electricity prices, but a significant price disparity still persists. For an electro- and trade-intensive sector like steel, this is hugely damaging to both short-term competitiveness as well as long-term viability and ability to attract inward investment. Higher electricity costs naturally increase production costs (electricity costs can represent around 20% of conversion costs⁶), making UK producers less competitive in home and export markets. This lowers the profitability of the UK steel industry while also reducing investment and making decarbonisation more expensive.

An ongoing electricity price disparity will continue to negatively impact the steel industry in numerous ways:

- The steel sector operates on relatively thin margins. Whilst there are increasingly specialised and high-value steels being produced, market requirements and economies of scale mean that the vast majority of steel made even in developed economies is commoditised and available from a broad range of sources. There is, therefore, intense competition, which keeps steel prices and margins low.
- Negatively impacting the decarbonisation process, as it would cost over £90m more to operate an electrified steel sector in the UK than a comparably sized sector in Germany.
- The direct impact of the UK’s high electricity prices is on the steel manufacturers’ international competitiveness. Raw materials such as iron ore and coal are sold in global markets, and there will, therefore, be little difference in the price of iron ore used in, for example, France and the UK. It is where there are national and regional variations in costs that competitiveness issues arise. As steelmakers are competing in an international market, they are unable to pass on any additional costs over and above those faced by their competitors. A consistently higher energy price, therefore, impacts their ability to compete and diminishes their profitability. A price disparity of £16.5/MWh translates into a total additional cost to UK steel producers compared to those in Germany of around £37m per year.

As a result, the previous Government announced the British Industrial Supercharger package to reduce the disparity between UK and European industrial electricity prices. However, it failed to align network compensation levels with those in France and Germany, offering only 60% compensation. The French

⁴ Worldsteel (2021), Energy use in the steel industry, <https://worldsteel.org/wp-content/uploads/Factsheet-energy-in-the-steel-industry-2021.pdf>

⁵ [Top steelmaker Baowu warns Chinese producers face severe crisis \(ft.com\)](https://www.ft.com/content/2021-08-11/top-steel-maker-baowu-warns-chinese-producers-face-severe-crisis)

⁶ Conversion costs - the costs of converting the basic raw materials into steel.

and German governments exempt their steel industries from 85%-90% of network charges, resulting in network charges at around £0.85-2.55/MWh, compared to the UK network charges of 8.58/MWh after the 60% compensation. UK steelmakers will, therefore, face network costs of ten times higher than their nearest competitors, resulting in an ongoing competitive disadvantage. The Government should, thus, increase Network Charges Compensation to similar levels as Germany and France, i.e. 90%, and provide truly competitive electricity prices for the steel industry.

Separately, the Government provides compensation to some steelmakers for the indirect impact on electricity prices caused by the UK ETS and carbon price support mechanism (CPS). UK Steel analysis finds that the CPS increases wholesale prices by £7.56/MWh, while the UK ETS increases prices by £17.43/MWh. The Government also recognises this, stating that “*carbon pricing through the UK ETS and CPS will have a knock-on effect on the wholesale electricity price and increase retail electricity prices in the short to medium term*”⁷. The Government has, therefore, compensated electro-intensive industries for this impact on electricity prices since 2013/14. The Departmental budget for these schemes will run out at the end of this fiscal year and will need to be extended to prevent carbon leakage and deindustrialisation.

Finally, additional actions must be taken to reduce wholesale prices for EIs and steelmakers. While the previous Government considered a number of options through the Review of Electricity Market Arrangements (REMA), it has taken forward locational marginal pricing (LMP) as a proposal. From the Government’s own analysis, it is clear that LMP will increase wholesale prices for steelmakers due to the existing locations, with wholesale prices varying by as much as £13/MWh across the UK in 2050 under LMP. This postcode lottery would hugely damage the steel industry’s competitive position, create uncertainty around future investments, and increase the cost of decarbonisation. UK Steel is therefore urging the Government to drop LMP within the REMA process. Instead, a number of different options should be considered to reduce wholesale prices for EIs, for example, such as a UK ARENH tariff as implemented in France or the introduction of green power pools.

Recommendation: Increase network charging compensation to 90% in line with France and Germany.

Recommendation: Extend the compensation for the indirect costs of the UK ETS and the CPS mechanism for a further five years.

Recommendation: Discount LMP within the REMA process, and instead consider other policy options to reduce wholesale electricity prices.

Priority 3: Abolish the Carbon Price Support Mechanism

The UK’s Carbon Price Support mechanism is currently increasing the UK’s carbon price unnecessarily compared to the EU. Most UK steel companies today receive near-full compensation for pass-through costs from power generators in industrial electricity prices. However, not all benefit from this, and many Energy-Intensive Industries (EIs) are not eligible for the ETS/CPS compensation, resulting in higher electricity prices and a price differential with many European countries. This will remain a problem until either the UK removes the CPS or expands the compensation for the indirect cost of carbon in electricity prices to more EIs.

The original purpose of the Carbon Price Floor mechanism was to provide a stable minimum carbon price in the UK, to drive investment within the power sector and later to drive out coal. With the EU ETS price remaining well below projections in 2013 and 2014, the UK total carbon price quickly became 4-5 times higher than the EU’s and contributed significantly to the electricity price disparity between the UK and the continent. In order to minimise this impact on industrial competitiveness, HMT froze the CPS rate at £18/tCO₂ in the 2014 Budget, assuming the EU price would remain low for the remainder of the decade. The previous Government had aimed to phase out the CPS to keep the total carbon price above £25/tonne of CO₂ to ensure that coal generation was phased out. UK ETS prices have not been below

⁷ UK Government (2024), Compensation for the indirect costs of the UK ETS and the CPS mechanism: guidance for applicants, <https://www.gov.uk/government/publications/uk-emissions-trading-scheme-and-carbon-price-support-apply-for-compensation/compensation-for-the-indirect-costs-of-the-uk-ets-and-the-cps-mechanism-guidance-for-applicants>

£30/UKA at any time since it was created, with current levels around £40/UKA. Furthermore, the last coal generation is expected to close this September.

Additionally, the UK has now introduced its own ETS with a cap consistent with Net Zero and minimum auction price, making a separate top-up tax unnecessary, and the UK ETS prices have remained much higher than the intended total carbon price. The new Government can use this opportunity to remove a tax aimed at topping up an EU scheme and, thereby, reducing the impact on energy-intensive industries.

Recommendation: Remove the CPS completely.

Priority 4: Continued investment in decarbonisation and capabilities of the industry

Decarbonisation is a necessity for the steel sector's viability, and governments around the world are partnering with industry to achieve this. UK Steel has published a roadmap⁸ for how to decarbonise and the steel sector is committed to investing in reducing 80% of its emissions by 2035 and achieving Net Zero steel production by 2050. Our industry further needs to invest in broadening its manufacturing capabilities to be able to supply into a broader range of strategic energy and defence infrastructure, bolstering the UK's supply chain resilience. Our sector wants to work hand-in-glove with Government to achieve these aims through matched investment and a wider enabling environment that will develop economic and social prosperity for our nations and strengthen our national security.

Significant progress is being made to invest in electric arc furnaces, but there is more to be done. For example, enabling the sector to replace natural gas with hydrogen, which would be contingent on both availability and competitive pricing of hydrogen. Furthermore, there is an opportunity to develop the UK steel sector's production capabilities in areas where there are strategic dependencies on foreign supply chains, for example, certain types of plate for wind turbines and naval vessels.

The Government has already set out a clear ambition to support the steel industry in decarbonising its production while minimising the impact on jobs and local economies. While the Government is negotiating with Tata Steel and British Steel, a broader industrial strategy must be pursued. Especially considering the need for additional infrastructure, grid connections, scrap availability, hydrogen infrastructure, energy efficiency funding, CBAM, Mandatory Product Standards, support for decarbonising heat, and R&D funding.

Recommendation: Provide match-investment funding with UK steel producers to supercharge their journeys towards decarbonisation and build up our domestic capability, protecting jobs and improving our national security.

Priority 5: Increase funding for research and innovation

The UK boasts some of the best research and innovation expertise, which we must capitalise upon and grasp the opportunity to become global leaders in low-emission steelmaking.

As the Government has announced the National Wealth Fund, which will support investment in manufacturing and strategic industries, it can accelerate innovation and industrial decarbonisation through a steel-specific Green Steel Fund. The funding currently available to the steel sector for energy efficiency and R&D is limited and spread very thinly across a number of sectors, while the application process is too onerous. Meanwhile, the UK's £225m share of the European Research Fund for Coal and Steel, which was a key R&D resource, ceased to be available but was never replaced. According to the terms of the EU Withdrawal Agreement (Article 145), the approximately £180m UK share of this fund will be returned in five annual instalments from June 2021. This money was provided by a levy on UK steel and coal companies over the course of our membership of the European Coal and Steel

⁸ UK Steel (2022), Net Zero Steel: A Vision for the Future of UK Steel Production, <https://www.makeuk.org/about/uk-steel/net-zero-steel---a-vision-for-the-future-of-uk-steel-production>

Community and can provide up to 100% funding in the field of steel, as it is industrial funds. As this was industry-funded, it should be returned to the steel industry for R&D purposes.

The Government's commitment to provide £2.5bn in funding for the steel industry could not only help decarbonise the steel industry but also improve its energy efficiency and boost innovation. Already, UK steelmakers support over £214m in active UKRI research programs, tangibly demonstrating their strong and ongoing commitment to R&D. A more ambitious and targeted funding programme, and crucially one that is also less onerous, would drive results at the required pace and ensure that technologies are commercially available for the Government's mission-led economic priorities and the Net Zero transition. This should also be combined with developing and investing in the skills needed for the future in areas such as automation, digitalisation and the hydrogen economy.

A dedicated Green Steel Innovation Fund should cover investments in a) Energy efficiency (including heat recovery), b) CO₂ emissions reduction (from steelmaking and adjacent processes), c) Circularity and resource intensity (such as water reduction and scrap recovery), d) Hydrogen deployment.

Recommendation: Establish a ringfenced Green Steel Innovation Fund to support R&D in green steelmaking.

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