

UK STEEL – SUBMISSION TO THE CONSULTATION ON MOVING THE UK ETS SECOND FREE ALLOCATION PERIOD

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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 moving the UK ETS second free allocation period

Do you agree with the proposal to move the start of the next allocation period to 2027 and treat 2026 as an extension of the current allocation period? Please explain your answer.

We welcome the consultation on moving the UK ETS second free allocation period to 2027 and appreciate the opportunity to provide feedback on this issue. As steelmaking is a very carbon-intensive process, carbon pricing and free allocations significantly impact the industry's ability to operate in the UK and its overall competitiveness. The UK ETS, therefore, has a significant impact on the steel industry's ability to compete, operate, decarbonise, and attract investment. Since 2016, the sector has emitted, on average, around 11.5MT CO₂ annually, with emissions in 2023 of 9.5MT CO₂. In 2022, UK Steel and its members set out a sector vision for how to rapidly decarbonise the steel industry, which has led to bilateral negotiations between the Government and individual steel companies on transitioning to lower-emission steel production. Most recently, Tata Steel UK and the UK Government have agreed on a funding package to switch to electric arc furnace steelmaking, which will reduce scope 1 emissions by 90%. The UK already has four electric arc furnace steel producers, which are still impacted by the UK ETS despite their lower-emission profile.

We strongly support the extension of the current allocation period to 2026 and move the start of the next allocation period to 2027. This is essential to aligning free allocation policies with the introduction of CBAM to avoid gaps in carbon leakage protection and ensure a holistic approach to industrial decarbonisation. This proposal is timely and sensible and will reduce the risk of carbon leakage.

Currently, free allocations play a vital role in protecting the UK steel industry from carbon leakage. It is, therefore, particularly welcome that certainty is provided for another year before the UK CBAM is introduced. At a time when the risk of carbon leakage increases as a result of the EU CBAM introduction, it is only fitting that free allocations are not reduced or altered before another carbon leakage protection can be introduced.

The proposal for an extension to 2027 is very welcome and will hopefully provide the necessary certainty and visibility for the steel industry regarding their free allocations. As free allocations are so vital to the industry, visibility of future free allocations is essential for the industry to plan its operations and future investments. We would therefore encourage the Government to confirm free allocations beyond 2027, 2030, and up to 2050, which will allow the industry the assurance around their future Net Zero investments.

The UK steel industry is still concerned about the risk of trade diversion due to the UK delaying its CBAM to 2027, leaving a 12-month gap between the EU and UK CBAM implementation. Steel with high embedded CO₂ emissions, currently exported to the EU, is at risk of being diverted to more open markets like the UK once the EU's CBAM takes effect, driving carbon leakage and depressing domestic prices. We believe that HMT/HMRC have underestimated how quickly steel trade flows can change, as steel products are fairly standardised and 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. There is, therefore, a significant risk that when facing an EU CBAM charge of up to €40/tonne of steel, high-emission steel will be diverted to the UK.

We would request that the Government ensures the continued protection of the UK steel sector through robust free allocation policies, at least until the CBAM can provide equivalent carbon leakage protection. While UK Steel has been a strong proponent of a UK CBAM policy since 2021, we recognise that CBAMs are new and untested. The robustness of the UK CBAM is unclear, and the policy could be subject to fraud and circumvention and prove incapable of providing carbon leakage protection. Any changes to free allocations should only happen gradually, and any signs that the UK CBAM is not functioning as intended must result in an increase in free allocations. Only then can the UK avoid decarbonisation leading to deindustrialisation.

For further information, contact:

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