UK STEEL – SUBMISSION TO THE CONSULTATION ON EXTENDING THE UK ETS CAP BEYOND 2030

Date: 9th April 2025
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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 extending the UK ETS Cap Beyond 2030

1.1.) Do you agree with the Authority's minded to position, as presented above, that the UK Emissions Trading Scheme should be extended into a Phase II to follow directly on from Phase I? (Y/N) Please explain your answer.

No.

The UK Emissions Trading Scheme aims to support and incentivise the decarbonisation of industrial activities in the manufacturing and power sector. The question of whether to extend the UK ETS beyond 2030 should thus be whether the UK ETS has achieved this and whether it is the right policy tool in the future as well. As the Government's Clean Power Plan aims to decarbonise power production by 2030, the UK ETS would, after 2030, be a scheme primarily focused on the manufacturing sector (albeit with the addition of aviation and new potential sectors). We would question whether carbon pricing is the right policy to decarbonise trade-intensive and energy-intensive manufacturing, whether a policy of carrot over stick would not be better, and whether carbon pricing risks deindustrialisation and reduction of territorial emissions over consumption emissions.

The UK ETS fundamentally does not provide an incentive to decarbonise or reduce emissions for the steel sector. Steel is a global commodity, intensively traded across borders. In 2023, while 23% of all steel produced is traded internationally, this climbs to 39% in markets outside of China, and the UK exports 46% of its steel production in 2023. UK steel import penetration (i.e., the percentage of steel demand supplied by imports) has climbed from around 12% in the 1970s to 65% in 2024 due to a rapid increase in global trade, the removal of tariffs on steel products amongst developed nations, manufacturing supply chain integration across the EU, and a gradual decline in the UK's overall steel production capacity. The UK imports its steel from an increasingly wide range of countries. Whilst the vast majority come from the EU, mainly due to geographic proximity and integrated supply chains, countries such as India, Türkiye, South Korea, China, Vietnam, Brazil, and Taiwan are all major exporters to the UK now – each supplying over 100,000 tonnes a year.

With such high levels of international trade in steel, simple mechanisms such as the UK ETS create an uneven playing field when those countries exporting to the UK have not applied comparable policies. Recouping carbon prices from customers is highly challenging, and almost without exception, customers will instead turn to imported products to keep their costs to a minimum. Without a CBAM, national carbon pricing would be better suited for sectors with no real alternative but to produce the product domestically, where consumers cannot readily turn to imported alternatives.

However, even with a UK CBAM, the UK ETS does not provide an effective incentive to decarbonise integrated steelmaking. When blast furnace steel producers switch to electric arc furnaces, substantially reducing their emissions, they will not continue to receive similar levels of free allowances, which they can sell as part of the investment financing. Instead, the free allocation would be substantially cut as their new free allocations will be based on the EAF benchmarks. The steel industry cannot pass on the cost of carbon to their customers, nor the cost of decarbonisation due to the high trade intensity of the sector, and the UK ETS does not reward them for a switch to electric arc furnaces. The UK ETS fundamentally does not provide an incentive to decarbonise or reduce emissions for the steel sector; instead, it increases the risks of carbon leakage and reduces competitiveness.

The UK ETS allowance prices have also risen substantially compared to carbon costs in the 2010s, while free allocation has dropped (and the Government has consulted on phasing down free allocations for CBAM sectors), increasing overall carbon costs. Discussions on linking the UK ETS and EU ETS is also affecting the price and creating more uncertainty until clarity is provided. Without additional and supportive policies, we fear that the current approach will drive deindustrialisation. The steel industry is in a crisis, with British Steel announcing it will close its blast furnaces, in part due to high carbon costs, the global overcapacity of steel is increasing, and the US has introduced new trade barriers, which will fundamentally threaten global trade patterns. While the UK has now confirmed that it will introduce a CBAM policy in 2027 to ensure a level playing field between imported and domestically produced products, the effectiveness of the policy is unknown. If the UK CBAM is proven ineffective in preventing carbon leakage, the Government cannot continue to apply a domestic carbon price without driving dramatic deindustrialisation and with minimal impact on global emissions.

We would therefore support the comments made by the ETG in its response that "*there is therefore a need for a holistic/joined-up approach from government to ensure that UK businesses can remain internationally competitive. This requires effective measures to tackle carbon leakage, such as continued free allocation and a well-functioning UK CBAM, expanded support for industry to decarbonise and wider support for decarbonisation across the economy.*" We, therefore, cannot recommend extending the UK ETS beyond 2030 before the Government has demonstrated that the UK CBAM works as intended.

2.1) Do you have a preference regarding the length of the post 2030-phase? (Y/N) Please explain your answer.
Yes.
If the Government extends the UK ETS, then the second phase should be 10 years, similar to the first phase, providing stability and predictability for ETS participants.

2.2) Beside the options outlined, are there other durations that should be considered for the length of Phase II? (Y/N) Please explain your answer.
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3.1) Do you agree with the Authority's minded to position to allow banking of allowances between phases of the Scheme? (Y/N) Please explain your answer.
Yes.
If the Government extends the UK ETS beyond 2030, it must allow participants to retain allowances for the second phase. Otherwise, the liquidity of the market would be compromised, and any benefits of decarbonisation would be reduced.

For further information, contact:
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