

EIUG Response to the Consultation on Carbon Leakage

Introduction

1. The Energy Intensive Users Group (EIUG) is an umbrella organisation that represents the interests of energy intensive industrial (EIs) consumers. Its objective is to achieve fair and competitive energy prices for British industry. It represents manufacturers of steel, chemicals, fertilisers, paper, glass, cement, lime, ceramics, and industrial gases. EIUG members produce materials which are essential inputs to UK manufacturing supply chains, including materials that support climate solutions in the energy, transport, construction, agriculture, and household sectors. They add an annual contribution of £29bn GVA to the UK economy and support 210,000 jobs directly and 800,000 jobs indirectly around the country.
2. These foundation industries are both energy and trade intensive and continue to invest in the UK. To compete globally, EIs need secure, internationally competitive energy supplies and measures to mitigate the risk of carbon leakage. However, inward investment, growth and competitiveness have been hampered for years by UK energy costs being higher than those abroad. This has increased the risk of carbon leakage and deterred investments in decarbonisation. In some cases, investment, economic activity, emissions and jobs have relocated abroad, leading to a subsequent increase in imports, decrease in productivity and reduction in UK GDP.
3. This response focuses on those questions from the consultation of most interest to EIs. Furthermore, the responses to questions are subject to the Government's response on tiering of free UK ETS allowances. The UK ETS Authority published a consultation with this proposal on 18 December 2023, but has not published its response yet. When this consultation closes it will be nearly a year since consultation with the tiering proposal closed. This causes policy uncertainty and is bad policy-making.
4. The majority of EIUG members prefer to continue to use the existing Carbon Leakage List, this is because they consider the quality of the UK data for their sectors – in terms of accuracy and reliability – too poor to justify a change to a carbon leakage list based on UK data. Those who prefer a list based on UK data, such as the cement and lime sector, find their sectoral data used to determine their risk of carbon leakage generally accurate.

CARBON LEAKAGE INDICATORS

1. Do you agree with the data sets used to calculate emissions intensity and trade intensity? If you do not, please explain why and suggest alternative data sets.

6. The EIUG recognises that the data used to calculate emissions intensity and trade intensity are probably the best available from public sources, but are far from accurate for some sectors. The NERA report already recognises this and takes additional steps to estimate intensity data with fall back options. In particular, the ONS data in the ABS and APS do not necessarily reflect reality in some sectors. Additionally, some companies registered under certain SIC codes, also this does not reflect reality.

8. Furthermore, many stakeholders have tried to reproduce their CLI figures based on these data sources, but have often not been able to. Reproducibility of statistical indicators is a necessary condition for their faithfully measuring the reality they have been designed to represent. The CLI figures are therefore not particularly reliable. This is not the case for the cement sector though. The MPA was able to reproduce the analysis, and the sector believes it is an accurate representation of their carbon leakage risk.

9. Due to the inaccuracy and unreliability of the data sets, the EIUG cautions for overreliance on these data sets and recommends an additional qualitative assessment for those sector who are borderline or so-called edge cases, the European Commission has as offered for the current EU ETS based list (see also DESNZ's EBRs scheme), if the Authority were to move to a carbon leakage list based on UK data.

10. Finally, though the EIUG recognises that the Department wants to use the most recent data to inform the calculation of risk of carbon leakage, including the Covid-years may not be the most representative years.

2. Do you agree with the fallback approaches which have been used where gaps have remained in the trade and emissions intensity data sets? If you do not, please explain why and suggest alternatives.

11. The EIUG recognise the logic behind the fallback approach, but cautions about using proxy data sources as they make the statistics less valid. Again, DESNZ should use more qualitative assessment to correct the increase in risk the CLI not being accurate due to use of proxy data sources.

3. Do you agree with the methodology used to update the Carbon Leakage List threshold values i.e. 0.14 and 0.74, determined on the basis of Option A described above? If you do not, please explain why and suggest an alternative methodology.

12. The EIUG agrees with the threshold values, but does not agree with the stated position not to offer a second-stage qualitative assessment. As state above, the EIUG recognises that the data sources proposed are the best available but are from accurate or reliable for some sectors. The EIUG therefore urges to supplement the quantitative methodology with a qualitative assessment for those sectors that are on the edge or have certain unique features not captured by the quantitative methodology and/or due to poor data quality.

13. An example in case, is the industrial gases sector. Some installations in this sector manufacture gases crucial for the chemical and steel sectors. They are therefore co-located and integrated with chemical and steel installations, as the gases are costly to transport, but are operated by different companies in order to increase efficiency.

14. This sector is included on the EU ETS carbon leakage list but not on the UK ETS list because of the low trade intensity. However, as these gases are crucial to manufacture certain chemical and steel, the industrial gases companies will pass on the cost of UK ETS allowances to the companies in these sectors if they are no longer eligible for free allowances, thereby increasing the cost for those sectors already high on the UK carbon leakage list. A loss of free allowances for the industrial gases sector would exacerbate the exposure to the risk of carbon leakage of the chemical and steel sectors. This unique feature between the industrial gases sector and the chemical and steel sectors is not captured by the data for the quantitative methodology. A reliance on the quantitative methodology only would therefore undermine the policy objective to mitigate the risk of carbon leakage.

4. Do you agree with the Authority's preliminary list of Carbon Leakage Indicator values?

5. If you do not agree with the Authority's preliminary list of Carbon Leakage Indicator values, please explain why and suggest any additional data (that meets the assessment criteria). If you do not agree and would like to propose an alternative methodology or data set which does not meet the assessment criteria, please explain why this data should be used.

15. The majority of the EIUG does not agree with the Authority's preliminary list of carbon leakage indicators due to the inaccuracies and unreliability of UK data. The minority either agrees with using the new UK list, such as the MPA, or cannot offer a sector wide opinion.

16. Individual EIUG members will submit their responses to the consultation with the data issues and additional data specific for their sector.

5. Do you agree with the Authority's minded to position to take an 'additive' approach to the Carbon Leakage List, should new data provided through this consultation change the current Carbon Leakage Indicator values? If you do not agree, please explain why and suggest an alternative approach.

17. The EIUG advocates an additive approach in the form of a qualitative assessment to allow sectors new data to proof the risk of carbon leakage.

7. Are there any other facts or matters that you would like the Authority to take into account before making a final decision on the Carbon Leakage List?

18. Yes, the Authority should take into account that it has not responded to the consultation proposal on tiering yet. A decision on this could have fundamentally changed stakeholder responses to the questions in this consultation.

8. On the basis of the information presented in this Chapter do you think we should update the Carbon Leakage List to be based on UK data or do you have a preference to continue to use the existing Carbon Leakage List? Please explain your answer.

19. On the basis of the information presented, the majority of EIUG members prefers to continue to use the existing Carbon Leakage List, because the quality of the UK data – in terms of accuracy and reliability – is too poor to justify a change to a carbon leakage list based on UK data. The minority either agrees with using the new UK list, such as the MPA, or cannot offer a sector wide opinion.

20. If the Authority does decide to change to a Carbon Leakage List based on UK data then the EIUG strongly recommends supplementing the proposed quantitative methodology with a qualitative methodology for those sectors that are on the edge or have certain unique features not captured by the quantitative methodology and/or due to poor data quality.

FREE ALLOCATION OF CBAM SECTORS

20. The EIUG would like to point out that the objective of the CBAM is not to incentivise decarbonisation, but to level the playing field in terms of exposure to carbon pricing between goods manufacturing and consumed domestically and goods imported that are not exposed to the same carbon price, to mitigate the risk of carbon leakage.

9. Do you agree with the Authority's minded to position to not take forward the 'do nothing' option? If you do not agree, please explain your reasoning.

21. The EIUG agrees with the Authority minded to position only for those sectors eligible under the UK CBAM. However, the Authority should not phase out the allocation of free ETS allowances until Government has evaluated and proven its effectiveness. Any change to free allocation, if the UK CBAM is not effective, will increase to the risk of carbon leakage again.

Furthermore, once allowances are reduced, the trajectory should not go faster than the EU's and care needs to be taken to avoid impacts within sectors that have large export exposure, such as refining and chemicals.

22. If the ETS Authority determine that it cannot retain allocation of free ETS allowances for those sectors in the UK CBAM, then it should have regard to the volume of imports that are subject to CBAM; less volume means less risk to 'ETS Effectiveness' from retaining free allocation. As CBAM rates will be applied by sector, not all CBAM sectors would need to have their allocation of free ETS allowances reduced at the same rate or trajectory.

23. This is especially important for hydrogen which has very limited imports. The table below, taken from HMT's 2024 CBAM consultation, states that only £4M of hydrogen was imported into the UK in 2023.

Table 1. CBAM imports by sector³⁰

Sector	Total value of CBAM sector imports (£m)	Proportion of total (%)	Proportion from countries linked to the EU ETS (%) ³¹
Aluminium	4,510	22.0	70.4
Cement	491	2.4	N/A ³²
Ceramics	1,163	5.7	67.0
Fertiliser	1,035	5.1	56.5
Glass	1402	6.8	62.2
Hydrogen	4	0.0	98.6
Iron & steel	11,873	58.0	62.9
Total	20,477	100	63.2

HMRC Import origin data (2023); Totals may not add up due to rounding.

24. Hydrogen imports are not expected to increase, as low-carbon hydrogen will be converted to a carrier molecule for transportation, such as ammonia. As a result, the only impact from reducing free allocation for hydrogen will be further loss of competitiveness of UK industry and an increase in the risk of carbon leakage.

10. Do you agree with the parameters of adjustment that have been identified by the Authority? If not, please explain your reasoning and any other parameters which should be considered.

22. The parameters of adjustment identified by the Authority are not the key ones. The key one is effectiveness of the UK CBAM. Until the Government has evaluated its effectiveness, the proposals to adjust the free allocation are running ahead of itself. Its effectiveness is a necessary condition for any future change in free allocations.

13. Do you agree with the considerations the Authority will take into account when determining the extent of the adjustment to free allocations? If not, please explain your answer.

23. The EIUG fundamentally disagrees with the Authority's argument not to make an adjustment to CLI values for CBAM sectors and recalculate Free Allocations from 2027 on this new basis.

24. With regards to WTO compliance, the Government currently already provides free allocations to companies exposed to the risk of carbon leakage that export. After application of the UK CBAM, the Government could withdraw – depending on the CBAM's effectiveness – the volume of free allowances proportionate to the production of a company that is consumed domestically since the UK CBAM focuses on imports only.

UK ETS Authority perceived risks	EIUG view
Free Allocations would not be adjusted beyond a certain point, meaning that the efficacy of the CBAM would always be limited. This could dampen the carbon price signal and the incentive to decarbonise for those sectors receiving Free Allocations.	Irrelevant, as the objective of the CBAM is to level the playing field in terms of carbon pricing. Whether the CBAM is high or low for domestics or imports does not impact on its efficacy. Furthermore, this argument is based on theoretical economics in a closed economy and is not how businesses make decisions, as ignores the option for sectors not to invest in decarbonisation and move the capital abroad.
Maintaining Free Allocations for CBAM sectors to cover export leakage risk could be problematic towards 2030 and beyond, when the number of	Not maintaining Free Allocation for CBAM sectors to cover export leakage risk could be problematic towards 2030 and beyond, as it increases the

allowances available under the cap and industry cap will be very limited, and there would be no long-term solution to the diminishing number of allowances as we move to a net zero ETS.	exposure to UK carbon pricing that imports probably do not face, deterring investments, dampening economic growth and increasing the risk of carbon leakage. Decarbonisation by de-industrialisation would be no long-term solution for the UK to achieve its Net Zero objective.
In order to maintain the certainty required for ETS operators, we would also still need to calculate Free Allocations based on export leakage on the basis of historic data and set the level over a period of time. This would not address the issues of over- or under-allocation and it would mean that Free Allocations are still not a perfect carbon leakage mitigation measure.	Correct, but that is the same as the situation now with allocation of free allowances for domestic and export production. Having a somewhat imperfect carbon leakage measure is still better than have no carbon leakage mitigation measure.

18. Do you agree with the assessment criteria that has been put forward for consideration by the Authority? If not, please explain your answer and provide other assessment criteria for consideration.

25.The EIUG suggests that the following assessment criteria should be added for consideration:

- **Effectiveness of the UK CBAM:** if the UK CBAM is not as effective as expected and free allocation are withdrawn then the policies fail on their objectives to mitigate the risk of carbon leakage. The UK CBAM's effectiveness is a necessary condition for any assessment to change free allocations;
- **Contribution to economic growth:** this is the Government's key objectives and should therefore also be included in the assessment criteria.

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