

UK CARBON BORDER ADJUSTMENT MECHANISM

EIUG POSITION PAPER

Introduction and issue

1. This position paper sets out the changes that HMT should make to improve the design of the UK carbon border adjustment mechanism (CBAM). The EIUG supports long term, effective carbon leakage mitigation, requiring continuation of both UK ETS free allocation and a well-designed CBAM, taking into account sector specific issues to help fulfil that role. At the moment, energy intensive industries captured by the UK emission trading system receive a certain volume of free ETS allowances, but Government intends to reduce their allocation over time, exposing these industries to an increasing risk of carbon leakage. Both the UK and EU have recognised this risk and are working on introducing a CBAM for a number of sectors.
2. In the view of the EIUG, as it currently stands, the design of the UK CBAM does not meet the quality of a minimum viable product. It risks failing to achieve its objective and undermining support for other manufacturing sectors to be included in the future.

UK Carbon Border Adjustment Mechanism

3. The UK CBAM aims to ensure that highly traded, carbon intensive products from jurisdictions outside the UK face a comparable carbon price to that paid by UK manufacturers, so that UK decarbonisation efforts lead to a true [reduction in global emissions](#) rather than simply displacing carbon emissions overseas, called carbon leakage. In practice, the CBAM will place a carbon price or tariff on the emissions embodied in imports of specified goods in the following sectors; aluminium, cement, fertiliser, hydrogen and iron & steel.

Default values

4. The current CBAM design applies a single tariff to each CBAM sector, making no distinction between the carbon-intensity of the different products manufactured in each sector. The embodied carbon and trade exposure can vary significantly per product, country and process. For example, in case of steel, there is a significant different between steel manufactured via an electric arc furnace compared to steel manufactured in a blast furnace – the latter being far more carbon-intensive. Government has chosen the current CBAM sectors because those manufacturers produce relatively homogenous goods, ie similar product and production process and therefore similar carbon-intensity. Yet for a few sectors, such as steel and fertilisers, they are markedly different and the EU has reflected this in its CBAM design. HMT should do the same and differentiate the tariff per product and process where they are markedly different.
5. Furthermore, HMT has considered basing sectoral default values in the UK on the “global average”, with this global average being based on a weighted average carbon-intensity of import volume to the UK and global production. Yet, emission intensity can vary substantially per jurisdiction. For example, China has a higher carbon intensity than the EU. As the HMT consultation on the CBAM already identified the key trading partners for CBAM sectors, it would not be beyond the capacity of HMT and HMRC to include different carbon values for the key trading partners of the UK, as the EU has done.

The direct impact of indirect emissions

6. HMT has made changes to its original CBAM design by excluding indirect emissions from its scope until at least 2029 to reflect the continuation of the schemes to compensate certain energy intensive industries for the indirect emission cost due to the UK ETS. However, cement and hydrogen are currently not eligible for this scheme and therefore leave domestic cement manufacturers exposed to an estimated £30 million that most non-EU importers can avoid. HMT and DBT should align their

policies as part of the upcoming review of the EII compensation schemes and included cement and hydrogen production.

Sectoral Scope

7. The UK CBAM currently applies to a limited number of basic products and other raw inputs only with the specified sectors. This poses several risks:

Circumvention: Importers can bypass the UK CBAM by switching from basic products to finished or semi-finished goods that contain the same material, but fall outside its scope. Importers might reorganise supply chains to route more down-stream products from overseas, allowing high-emission primary products embedded in downstream goods to enter the UK with no carbon adjustment applied. The European Commission has already proposed extending its CBAM to 180 downstream products.

Material substitution: If the scope of the UK CBAM does not cover substitute materials over time, the current primary materials in scope will face higher carbon costs, creating an incentive for consumers to switch away from these primary materials to alternative ones, such as carbon fibres for steel in vehicles.

Monitoring and Evaluation

8. If HMT sticks to the current design, it risks the UK CBAM failing to meet its objective to equalise carbon costs between domestic manufacturers and imports is high. It will therefore be crucial that HMRC and HMT monitor trade flows and take measures quickly if unintended consequent emerge.
9. The EIUG proposed including a statutory requirement in the draft legislative provisions for HMT to conduct post implementation reviews and report to Parliament. As the CBAM is a new and complex tariff with potential unforeseen consequences, the standard HMT line 'we assess

the effectiveness of every tax as part of the normal Budget process' is wholly inadequate and shows a naivety inconsistent with good policy-making. The EIUG calls on HMT to set out its monitoring and evaluation strategy for the UK CBAM.

Carbon Leakage in the Export Market

10. The UK CBAM is an import-only policy that imposes carbon pricing on imported products entering the UK market. However, as Government withdraws free ETS allowances for the total production of a UK manufacturer, it means that the proportion of its production that it exports will be exposed to carbon pricing, putting the business at a competitive disadvantage relative to manufacturers abroad who do not face an equivalent carbon price. This results in reduced manufacturing in the UK and the replacement of UK-manufactured products in export markets with products from countries with lower or no carbon pricing. This is called carbon leakage in the export market.
11. The Commission for Carbon Competitiveness has published a [report](#)¹ on this issue. It believes taking action on carbon leakage in the export market is vital to maintaining the competitiveness of UK industry, and that it can be done in line with our international trading obligations. The Commission has made the following recommendations:
- Maintain long-term free allowances under the UK ETS for products destined for the export market;
 - Make the case for export support with conviction regardless of WTO challenges brought by other nations – and be willing to see it through;
 - Show leadership to support UK manufacturing;
 - Adopt a comprehensive approach to tackling carbon leakage;
 - Apply carbon leakage mitigations to all manufacturing sectors.
12. The EU has recognised that leaving exports exposed to carbon pricing is problematic and is actively discussing options to address it. The UK

¹ [Commission for Carbon Competitiveness \(2025\), *Carbon Leakage in the Export Market*, London.](#)

ETS Authority has also recognised it as an issue, but – unlike the EU – has made no commitment to address it. The EIUG strongly recommends the Government to publicly commit to addressing this issue as well and start to work up options how to address it.

Linking of the Emission Trading Systems

13. With regards to the EU CBAM, the current design of the UK CBAM is in several aspects materially weaker to the EU CBAM. This risks that, when the UK Government and the EU agreed to link their respective emission trading systems, traders might circumvent the EU CBAM via the UK with its weaker CBAM. This would undermine the integrity of the EU's single market and the EIUG therefore thinks that the EU CBAM is likely to remain in place for imports from the UK until the European Commission has assessed the UK CBAM as equivalent.
14. From a business perspective, this means that one of the benefits of linking the emission trading systems falls away, as we see ETS linking and mutually recognition of the EU and UK CBAMs as connected. Linking the emission trading systems whilst keeping the CBAMs in place for trade between the UK and EU is wholly suboptimal and the EIUG therefore encourage HMT to adopt product, process and trading partner specific default values as the EU has done (see earlier section). We also recommend HMT officials to have in depth discussions with the European Commission and get a formal opinion from it, as part of the Government's effort to build closer relations with the EU.

Recommendations

15. HMT's current design of the UK CBAM is ineffective to mitigate the risk of carbon leakage and unlikely to be deemed equivalent to the EU CBAM. The EIUG believes HMT still has time to introduce changes and makes the following recommendations to HMT to strengthen the UK CBAM to what it should look like in the first place:

- Introduce default values per product, process and key trading partner where the carbon intensities are markedly different, just like the EU has done;
- HMT and DBT to align the UK CBAM and compensation for indirect emission costs due to the UK ETS, as part of the upcoming review of the EII compensation schemes;
- Set out publicly the process and timetable to expand the UK CBAM to other products, mirroring the EU CBAM;
- HMT to publish a monitoring and evaluation strategy for the UK CBAM;
- Government to adopt the recommendation from the Commission for Carbon Competitiveness to address carbon leakage in the export market;
- HMT officials to have in depth discussions with the European Commission and get a formal opinion of UK CBAM equivalence, as part of the Government's effort to build closer relations with the EU.

Arjan Geveke

Director EIUG

director@eiug.co.uk