

Consultation on the introduction of a UK carbon border adjustment mechanism

June 2024

Background

The Aldersgate Group is an alliance of major businesses, academic institutions, professional institutes and civil society organisations driving action for a sustainable and competitive economy. Our corporate members believe that ambitious and stable low carbon and environmental policies make clear economic sense for the UK. Our members have operations across the UK economy and include companies such as Associated British Ports, CEMEX, Johnson Matthey, National Grid, Suez, Scottish Power, and Siemens.

We develop independent policy solutions based on research and the expertise and diversity of our members. Through our broad membership, we advocate change that delivers benefits to an every-growing spectrum of the economy. The response to this consultation draws on previous Aldersgate Group responses and further input from members.

Questions

- 1. Do you agree that the list of commodity codes in Annex A is an accurate reflection of the policy intent described above? Please provide supporting evidence.**

The Aldersgate Group recommends that a UK CBAM be targeted to as broad a scope of sectors and products that are both proven to be at risk of carbon leakage and required to participate in the UK Emission Trading System (ETS). Future expansion of the UK ETS, for example, energy from waste and maritime shipping, currently under consideration, should be reflected in the sectoral scope of a CBAM if there is a proven risk of carbon leakage. The timelines for including new sectors in ETS and CBAM should be aligned.

Aligning a CBAM as closely as possible with the UK ETS will enable smoother implementation and administration of the scheme. Alignment will also minimise the cost of compliance for industry, which already has a good understanding of how to comply with the UK ETS. It will be important to evaluate CBAM and ETS scope with a regularly defined frequency to ensure that the intent of the policies - to drive decarbonisation in the UK and internationally while maintaining UK competitiveness - is continuously delivered and ambition is raised.

The UK CBAM sector scope deviates from the EU CBAM scope and includes glass and ceramics. For those sectors covered by the UK CBAM but not by the EU CBAM, there is concern about loss of competitiveness, particularly in the EU market, which is a key trading partner. Given the broad sectoral approach proposed, we recommend that the Government engages closely with industry to ensure the policy approach is fit for the different sectors covered and the impact appropriately assessed and considered.

We support the proposal not to include electricity in the UK CBAM sector scope. Electricity is currently not on the UK's carbon leakage list and does not receive any carbon leakage protections such as free allocations under the UK ETS. Moreover, the UK is currently only physically connected to – and therefore can only trade electricity with – the European nations, which are covered by the EU ETS and decarbonisation targets.

Regarding the products that will be covered within sectors, further clarity is needed. Retailers of finished goods that utilise large quantities of CBAM materials have expressed confusion over the rationale for including some specific commodity codes and not others in the proposed design. For example, in the case of ceramics, retailers have questioned why the 6910 series of finished goods is included while the 6912 series is not. Clarity is needed on this, and on whether the Government plans to increase the number of finished goods that falls into the scope of the policy.

The UK CBAM needs to fulfil its purpose to mitigate carbon leakage while minimising unintended consequences or perverse incentives. There are some sector specific concerns regarding the risk of supply chain circumvention with the introduction of a UK CBAM and the phase out of ETS free allowances. For example, filled containers will not be subject to CBAM, which may result in bulk filling for the UK market being moved from the UK, as UK containers potentially become less competitive. This would disrupt the UK supply chain and lose the carbon efficiency gains achieved by transporting goods in bulk and then filling containers domestically. More work is needed to understand the genuine risk of circumvention and other potential impacts to UK supply chains.

Overall, it is important to provide clarity as soon as possible about exactly what products will be covered by the UK CBAM. The Government must consider what information and support would enable businesses to prepare and comply with CBAM to provide a smooth learning curve. The Government should also provide clarity on when further policy review will take place to provide certainty to businesses.

The Aldersgate Group supports the linkage of the UK ETS and CBAM to those in the EU, taking an ambitious approach to ETS reform. A considered approach to linkage will ease compliance for UK companies exporting to the EU, who would not have to produce new documentation of compliance with EU rules. It should also improve liquidity in the UK ETS, as being part of a larger market increases the opportunity for trading allowances; and perhaps most importantly, would exempt UK producers from the EU CBAM.

More broadly, businesses have expressed a concern that CBAM is likely to increase the cost of inputs for material-intensive finished products that will not be covered under a UK CBAM, such as cars or mechanical and electrical plants. This may lead to UK producers of material-intense products being less competitive both in the UK and internationally. In other words, there is a risk that the CBAM, which seeks to address the competitiveness challenge in one segment of the value chain, basic materials, will simply move the challenge downstream (component and final products manufacturing). Considering that these are goods with higher value added, failing to mitigate this risk could have significant adverse economic impacts.

It is worth recognising that by increasing the cost of energy-intensive material inputs, CBAM could indirectly incentivise material efficiency and material substitution, therefore resulting in less carbon intensive final products in the international supply chain. The Government should seek to understand the impact (opportunities and challenges) domestically of CBAM along the value chain and consider what support and other enabling policies, such as green public procurement and mandatory product standards, would enable decarbonisation along the value chain, including for carbon intensive final products.

- 4. Do you agree that scrap aluminium, scrap glass and scrap iron & steel do not pose a carbon leakage risk and should not be within scope of the CBAM? If not, please provide evidence to support your response.**

Scrap aluminium, scrap glass and scrap iron and steel do not pose a carbon leakage risk and the use of scrap has a net emissions benefit. Greater certainty around supply availability and quality of scrap would support industry to make the shift towards more circular and lower carbon production models. The Government should be seeking to strengthen scrap supply chains domestically and internationally.

Beyond CBAM, an enabling policy environment for industrial decarbonisation is essential to provide investor confidence. Some key enablers include developing an industrial strategy with decarbonisation at its heart, developing new business models for electrification and ensuring access to grid connections, increasing certainty regarding the future cost and availability of CCS and low carbon hydrogen, and supporting demand side measures such as mandatory product standards and green public procurement.

- 5. Do you agree that the Government's definitions of 'direct' and 'indirect' emissions accurately describe the embodied emissions a CBAM ought to place a carbon price on, in line with those emissions within scope of the UK ETS? If not, please explain why not.**

We agree with the approach to include direct emissions and indirect embodied emissions (covering electricity, heat steam and cooling) in CBAM goods, including those emissions embodied in any relevant precursor goods at a point further up the value chain. The emissions scope and measurement under a CBAM should be as closely aligned as possible with the methodology used in the UK ETS. This means all scope 1, 2, and 3 emissions that face a carbon price under the UK ETS should be included in the UK's CBAM. This approach takes account of the fact that the UK's electricity grid has a lower carbon intensity than most.

CBAM must fulfil its purpose to ensure imported goods are subject to a comparable carbon price to that incurred by domestic-based production. This includes ensuring UK-based industry is neither at an advantage or disadvantage compared to non-UK producers.

The UK CBAM must reflect the compensation provided for indirect costs in the UK ETS. For example, some Energy Intensive Industries (EIIs) receive compensation for the indirect impact of the UK ETS on their electricity prices. To ensure they do not receive

unequal insulation from these costs, a CBAM must account for this differential in the carbon price paid.

Given the substantial amount of industrial decarbonisation policy (UK ETS and associated compensation scheme) already in place and the urgency to put in place a UK CBAM, we are supportive of the Government's proposed self-assessment tax model, which is more compatible with existing compensation schemes. In comparison, the EU CBAM certificate model would be more complex to implement alongside existing Carbon Price Support or the EII compensation scheme. We also agree that importers should be familiar with the self-assessment tax model and HMRC is familiar with enforcement, both of which should contribute to a smoother initial implementation of the UK CBAM.

However, deviation from the EU CBAM approach does create an additional administrative burden on businesses operating across both jurisdictions. The Government must make the UK process clear for importers and allow as much time as possible for preparation. The Government should also consider what support may be needed to ensure compliance. Where possible the Government should maximise alignment with the EU CBAM to reduce the burden on businesses operating across both jurisdictions. The Government should review the effectiveness of the self-assessment tax system over time and should explore whether to phase in an alternative system that is still compatible with other industrial decarbonisation policies.

The UK CBAM must fulfil its purpose to prevent carbon leakage with minimised trade barriers and supporting the acceleration of decarbonisation internationally. UK companies exporting to the EU will need to comply with the EU CBAM and should the UK carbon price be lower than the EU's, domestic industries will be obliged to pay a top-up, with this revenue going to the EU, not the UK. Cooperation on carbon pricing across borders will accelerate progress on emission reductions and reduce negative impacts on UK companies. The Government could consider undertaking negotiations with the EU for UK exemption from the EU CBAM.

The Aldersgate Group continues to call for the linkage of the UK and EU ETS and CBAM schemes. Considering the compliance burden and the other advantages of linking the UK ETS and CBAM to those in the EU, including reducing trade barriers and increased liquidity in the carbon market, there is a strong case for future linkage. We strongly support the UK CBAM and ETS being set up in such a way that future linkage remains possible. The obligatory review in 2025 of the Trade and Cooperation Agreement between the UK and EU, affirms a joint commitment to achieve economy-wide climate neutrality by 2050 and includes opportunities to expand cooperation. The review may provide an opportunity to start examining the linkage of the UK and EU's ETS and CBAM schemes.

6. Do you foresee any issues with calculating the emissions associated with precursor goods in CBAM goods? Please provide evidence to support your response.

The challenges associated with calculating emissions associated with precursor goods (or CBAM goods scope 3 emissions) are well documented. Companies use different calculation and allocation methodologies and data can be costly and slow to collect,

inaccurate or unavailable. In addition, verification mechanisms are not currently well established. The complexity of supply chains can increase these challenges (see World Economic Forum, 2023 White Paper on Emissions Measurements in Supply Chains). The UK CBAM proposal does not include a transitional period, unlike in the EU where reporting started in 2023 and full operation will start in 2026. The lack of a transitional phase may make it more administratively challenging for businesses and increase risk of poor compliance initially. This can be mitigated by ensuring the UK CBAM design, implementation and timelines are clear as soon as possible to allow businesses to prepare. Lessons should be learnt from the implementation of the EU CBAM; for example, ensuring information is correct, clear and accessible, online portals are operational and helpline advice is accessible.

One significant deviation between the EU and UK CBAM is the year gap between them becoming fully operational: 2026 and 2027, respectively. This gap may provide an opportunity for the UK to learn from the implementation of the EU CBAM and adjust plans accordingly. However, there is a risk of carbon intensive products being diverted to the UK from 2026 in response to the EU CBAM, potentially undermining the competitiveness of UK domestic producers. If the UK carbon price, and therefore the CBAM rate, remains lower than the EU this will be an ongoing issue. The risk of high-carbon products being diverted to the UK needs to be mitigated. Wider policy levers, such as product standards, may be relevant to consider. In the longer term, linking the UK ETS and CBAM to those in the EU could navigate this problem and should be examined as part of the commitment to create a scheme that effectively fulfils its intended purpose for decarbonisation whilst minimising the burden for businesses operating in both the UK and EU.

Urgent clarity is needed on the alignment between the UK ETS and UK CBAM. Businesses need to know how the UK ETS will develop over time, particularly around the phase out of free allowances.

7. Do you foresee any difficulties with the Government's proposal to use product level default emissions values calculated in line with global average emissions weighted by the production volumes of the UK's key trading partners? Please outline.

We support the use of default values being applied in cases where importers cannot provide accurate, independently verified emissions data. We also support the use of product level default emissions values. Setting default values at the sector level would not sufficiently account for the variation of emissions at the product level. The use of default values increases the feasibility of the CBAM initially, and we would welcome review and evolution over time to ensure carbon leakage continues to be avoided. Future approaches could include moving to a jurisdiction-based default values system or a data-based model with a date set for default values to be phased out.

The default values must be set at a sufficiently high level to incentivise importers to provide data and encourage other countries to set up carbon pricing. It may be

necessary for the default value to increase over time to continue to incentivise monitoring, reporting and verification (MRV) and avoid carbon leakage.

We understand the intent of weighting by production volumes of the UK's key trading partners to make the average more accurate for key trading areas. However, businesses are concerned that this weighting could lead to the EU skewing the global average down due to the generally lower carbon intensity of EU production. This creates a risk that importers of high carbon goods will opt to use the default values and not be incentivised to undertake MRV. These higher carbon CBAM goods could outcompete domestically produced goods as they will not face an accurate carbon price at the border. If default rates are not set correctly this could lead to the UK CBAM not fully fulfilling its purpose to mitigate carbon leakage.

A possible alternative model would be a tiered system for default values which would maintain the environmental integrity and deliver on feasibility. A pragmatic number of tiers could be set, and countries sorted into these tiers based on average emissions intensity. The tiers could then have corresponding default values.

Another alternative model, to better protect against carbon leakage from the UK, could be to set the default values on the product CO₂ intensities that reflect the higher end of the end of UK production. For example, the values could be based on the average from the 10% least carbon efficient installation in the UK ETS. In this case, default values would evolve over time as UK industry decarbonises.

Once set, we encourage the Government to set a specified time and frequency for the review and evaluation of the level default values are set at. Trade patterns and the carbon intensity of production will change over time, default values need to reflect this. The Government needs to clarify how often default values will be updated during the initial period of 2027-2030 and beyond.

In countries where data collection is not possible currently, lower carbon producers could be placed at a disadvantage if the default value is higher than their own emissions intensity. The Government should seek to understand the extent of this negative impact so that any adverse impacts on low-income countries are limited. To reduce adverse impacts on low-income nations, the UK should understand where and how to deploy support to improve MRV capabilities, alongside wider support including the use of international climate finance to drive low carbon capacity building.

10. Do you have any initial views on the considerations and/or aims of a future review into the use and functionality of default values? Please outline.

We strongly support the commitment to review the model for determining default values. We acknowledge the need to allow time for businesses and governments in other jurisdictions to facilitate a transition towards accurate monitoring, reporting and verification (MRV) and therefore, accept the approach to keep, once set, the initial model until the end of 2030. However, it will be important to provide clarity on how the

model for default values will change and ensure that any new approach sets default values at a level which protects against risk of carbon leakage, incentivises greater MRV and decarbonisation internationally.

We would encourage consideration of default values becoming more punitive over time or making their use time limited to better incentivise MRV and decarbonisation internationally.

12. Do you agree that verification of emissions should be performed by any body accredited by accreditation services which are part of the International Accreditation Forum (IAF), like UKAS in the UK? If not, please explain why not.

High quality emissions data will drive decarbonisation and help deliver a level playing field. Verification by an accredited partner is vital to ensure monitoring and reporting of emissions is as accurate as possible. An improved system for emissions monitoring, reporting and verification (MRV) will in turn help support wider decarbonisation as emissions data is needed for other policy mechanisms, such as mandatory product standards and green public procurement.

14. Noting that the Government is still developing policy in this area, do you have any initial views on the monitoring, reporting and verification (MRV) rules for the UK CBAM? Please outline.

Monitoring, reporting and verification (MRV) enables carbon accounting along the value chain and can ultimately drive action to decarbonise. A UK CBAM should aim to align as closely as possible with the model for emissions MRV used under the UK ETS. As with the ETS, the Government should explore the viability of sufficiently accurate technologies for emissions MRV at appropriate points in the value chain.

The Government should seek international alignment on MRV rules and methodologies as this will help deliver a level playing field, facilitate international transferability and reduce the compliance burden on businesses operating across multiple jurisdictions.

The Government should seek to understand the MRV capabilities of SMEs and low-income countries and where possible provide support.

18. Do you agree that the CBAM rate calculation set out a fair reflection of the price paid in the production of goods in UK? If not, please explain why not.

We do not agree that the CBAM rate calculation sets out a fair reflection of the price paid in the production of goods in the UK. The UK CBAM rate applied to the embodied emissions should reflect explicit carbon pricing in the UK and adjust for free allowances and other reductions to the carbon price paid domestically. Although we understand the desire to reduce the additional burden on importers to familiarise themselves with a large number of product level CBAM rates, product level rates would be a more accurate reflection of the carbon price paid domestically than the proposed sector level approach due to sub-sector differences.

The CBAM rate needs to act as a deterrent for carbon leakage. While feasibility is a key factor, particularly initially, businesses are concerned that sector level rates will not reflect the carbon price being paid domestically and therefore fully align with the CBAM purpose to tackle carbon leakage. The Government should consider a methodology for CBAM rates that takes account of key sub-sector differences. The UK ETS uses a methodology to identify 52 product level benchmarks, the UK CBAM could apply a similar differentiating methodology and have 52 product level rates.

Should the Government make any changes to existing or new carbon pricing or adjustment policy in the future, it would need to consider whether or how these changes should be included in the calculation of the UK CBAM rate. In the case of free allowances under the ETS, the Government needs to urgently provide a clear plan on the phase out of free allowances and how it will work with the UK CBAM as this will give businesses the time needed to prepare.

19. Does setting a CBAM rate for each sector on a quarterly basis strike the right balance between tracking the UK ETS market price and giving importers certainty for financial planning? If not, please explain why not.

The Aldersgate Group agrees that the price applied by a CBAM should track the prevailing UK ETS price throughout the year. Measuring prices against the UK ETS at frequent intervals will take into account the fact that ETS emissions allowances both fluctuate in price and are traded throughout the year. The frequency of setting the CBAM rate should be reviewed at a specified future date to explore if the frequency is suitable, and if not it should be updated.

20. Are there any other considerations for setting the UK CBAM rate not set out above? Please outline.

A UK CBAM should aim to align as closely as possible with the UK ETS, meaning that it should follow the same model for emissions MRV and should seek to align as closely as possible on pricing. UK ETS and CBAM alignment will enable smoother implementation and administration of the scheme in its early years and minimise the cost of compliance for businesses.

Plans for adjustment at the border should be set out as early as possible with a clear roadmap for how it will interact with the UK ETS and free allocation, outlining the trajectory for the reduction of free allocation. This will provide a clear investment signal for industries covered under both systems.

To ensure the UK ETS and CBAM continue to effectively fulfil their intended purpose for decarbonisation while minimising the burden for businesses, the Government should consider the extent and rationale for differing trajectories in the UK ETS and CBAM from the EU schemes and ensure linkage of the schemes remains possible.

We continue to call for the linkage of the UK ETS and CBAM to those in the EU, taking an ambitious approach to ETS revision. A considered approach to linkage will ease compliance for UK companies exporting to the EU, who would not have to produce new

documentation of compliance with EU rules. It should also improve liquidity in the UK ETS, as being part of a bigger market increases the opportunity for trading allowances; and perhaps most importantly, exempts UK producers from a future EU CBAM. Moreover, as the UK's biggest trading partner, removing trade barriers with the EU, particularly between Northern Ireland and the Republic of Ireland, is beneficial for UK producers and consumers.

23. Are there additional considerations or processes that might facilitate the provision of information on the overseas carbon price from producer to liable person, including by mutual agreement with other jurisdictions? Please outline.

The UK must use its influence on the global stage to support international cooperation on carbon leakage mitigation. This includes working with other nations to establish common carbon pricing and emissions reporting methodologies and driving international action.

24. For operators overseas, do you foresee challenges providing the evidence for importers to comply with the measure? Please outline.

Where possible, the Government should minimise the complexity and cost of collecting this data to avoid creating barriers to small and medium-sized enterprises (SMEs) and manufacturers in lower income countries, who may have more difficulty with data collection and reporting. It may also be necessary to provide specific support to SMEs and manufacturers in lower-income countries to ensure they can comply with the requirements.

The EU has introduced a CBAM, and other jurisdictions including Australia, Canada and China are considering introducing CBAMs. The Government should design the UK's carbon leakage mitigation measures in a way that maximises future interoperability with international schemes. The UK should use its influence on the global stage to support international cooperation on carbon leakage mitigation and where possible maximise the interoperability for businesses. Working with other countries to create complementary or linked policy frameworks for measuring and pricing the lifecycle emissions of various products will allow for more efficient cooperation on industrial decarbonisation, while also benefitting manufacturers across the globe.

27. Do you have views on how the Government could decrease the burden on the liable person to evidence an overseas carbon price? Please outline.

Maintaining interoperability between UK, EU and global initiatives and technical criteria will be important to ensure high compliance with the UK's CBAM. The UK should continue to use diplomatic opportunities, such as active engagement in the G7 and G20, to advocate for greater ambition in global carbon pricing systems.

28. Do you agree that where a CBAM good has been subject to multiple carbon prices, the total carbon price can be offset from the UK CBAM liability? If not, please explain why not.

We agree with this approach.

32. Do you agree that there should be a minimum threshold below which a person should not be required to register for the CBAM? If not, please explain why not.

We support an approach that maximises compliance and ensures that the UK CBAM is fulfilling its purpose. Therefore, an approach to setting a threshold that minimises avoidance is important.

33. Do you agree that an annual value of £10,000 is an appropriate level at which to set the minimum threshold? If not, please explain where you think it should be set and your reasoning.

Plans for a UK CBAM should be set out as early as possible with a clear roadmap for how it will be implemented. The Government should provide a decision on the threshold as soon as possible to give certainty to businesses on what is expected and time to prepare. This threshold should also be reviewed at a specified date in the future to ensure it is still set at the appropriate level over time.

37. Do you think that allowing 5 months from the end of the first accounting period until returns are due allows sufficient time for a liable person to obtain data about the carbon content of their CBAM goods? If you think a different period should operate, please explain why.

Businesses must have clarity and certainty on the UK CBAM design and implementation as early as possible ahead of the introduction date to give the maximum time for preparation.

40. Do you consider that HMRC's approach to enforcement powers and penalties is appropriate? If not, please specify why.

Enforcement by HMRC will ensure rigorous enforcement by a government body with existing customs experience. The model proposed, based on self-declaration, needs to be properly enforced. Data should be provided to border officials so that declarations can be checked. When live, some testing at the border will be required to randomly check imports and investigate where the declared CO₂ for a product sits outside of an expected range.

The supply of quality, transparent, and easy to understand data will be of utmost importance to operating a UK CBAM. Greater transparency in UK trade data to enable cross-checks of any default values should also be introduced. The power to enforce suitably large fines for deliberate misreporting of data should exist to help deter anyone trying to game the system.