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UK ETS Authority Free Allocation Review Carbon Leakage Consultation

Free Allocation for CBAM Sectors: Export Leakage Workshop

Joint consultation of the UK Government, the Scottish Government, the Welsh Government and the Department of Agriculture, Environment and Rural Affairs for Northern Ireland

February 2025

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Workshop introduction

- The purpose of this workshop is to gather feedback on the proposals relating to free allocation for CBAM sectors, in the Free Allocation Review consultation launched on 16 December.
- It is hosted by the UK ETS Authority, made up of the UK Government, Welsh Government, Scottish Government and Department of Agriculture, Environment and Rural Affairs in Northern Ireland.
- This workshop will be recorded for note-taking purposes but will not be distributed to stakeholders.
- Please use the chat function to raise any clarification questions or points. We will ask some questions after the presentation to structure the discussion.
- Separate workshops will cover the proposals on the carbon leakage list.
- For an overview of the proposals in the consultation, you can watch a recording of the overview webinar in January [here](#).

What are the proposals in the consultation?

The UK Government has committed to introducing a CBAM in 2027, the Authority is considering how Free Allocation policy could be adjusted to reflect the reduced risk of carbon leakage for given sectors and to increase the effectiveness of the CBAM as a leakage mitigation policy.

The Authority is **minded to adjust Free Allocations for CBAM sectors**. The consultation includes questions on how the adjustment should take place, focused on:

- Parameters for the adjustment,
- Extent of the adjustment,
- Technical implementation of the adjustment

The Authority is also seeking views on assessment criteria that should be considered in reaching a final decision.

Carbon leakage refers to the movement of production and associated emissions from one country to another due to different levels of decarbonisation effort through carbon pricing and climate regulation. As a result of carbon leakage, the objective of decarbonisation efforts – to reduce global emissions – would be undermined.

Free Allocations for CBAM Sectors

Parameters for Adjustment



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When applying an adjustment to Free Allocations for CBAM sectors, the Authority propose to do this gradually to ensure businesses can prepare accordingly and changes to business costs/incentives are phased in. To do this the Authority is considering varying the following parameters (*which can either be applied uniformly to all CBAM sectors or varied by sector*):

- Adjustment start year;
- Adjustment length / end year; and
- Trajectory of adjustment.

Adjustment Start Year

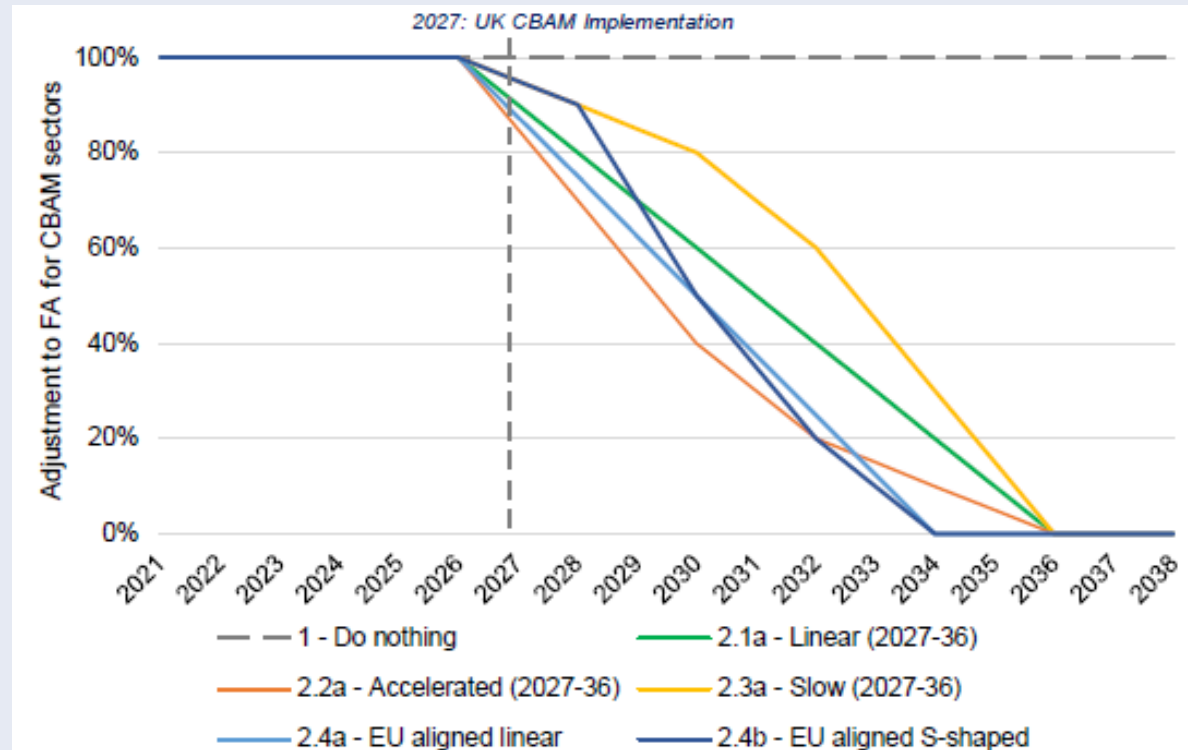
- Not before 2027 as the CBAM will not be in force before this date,
- Some respondents to the 2023 Free Allocation Review consultation called for a delay to the adjustment to ensure the CBAM is fully operational before any reduction in carbon leakage support.

Adjustment length / end year

- Targeting a 10-year adjustment period or a shorter length to ensure reduction is gradual while the CBAM is introduced, minimising reduction in carbon leakage mitigation,
- Potential to align with the EU phase-out date, resulting in a shorter adjustment period

Trajectory of adjustment

- Linear
- Accelerated then slowing,
- Slow then accelerating.



Free Allocations for CBAM Sectors

Extent of Adjustment



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The Authority is considering two options for the extent of adjustment:

- 1) an adjustment to zero, analogous with a phase out of Free Allocations for CBAM sectors,
- 2) a phase down to account for outstanding carbon leakage risk not covered by the CBAM.

As a CBAM will only cover imports, UK exports will continue to have exposure to carbon leakage and may face further consequences to downstream products. **The Authority is mindful of the potential risks which have been highlighted for export leakage protection and will only consider changes to free allocations that will be compatible with WTO rules and other relevant trade law obligations.**

If the Authority decided to phase down Free Allocations to account for outstanding carbon leakage risk, it would be possible to make an amendment to the **Carbon Leakage Indicator equation** for CBAM sectors to account for export leakage risk by calculating trade intensity on the basis of export intensity.

There are a number of risks associated with maintaining Free Allocations for export leakage risk:

- Free Allocations would not be adjusted beyond a certain point, limiting the efficacy of the CBAM and dampening decarbonisation incentive,
- As the industry cap continues to reduce towards 2030 and beyond the number of allowances available will reduce so it is not a viable long-term solution,
- Calculating Free Allocation for export leakage risk would be based on historic data and would not address any issues of over- or under-allocation.

Free Allocations for CBAM Sectors

Technical Implementation of Adjustment



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The Authority is minded to apply the adjustment at installation level, following the calculation of preliminary Free Allocations.

Free Allocations would only be adjusted for sub-installations covered by the CBAM. A mapping for CBAM goods at commodity code level to UK ETS Free Allocation SIC is set out in the Analytical Annex to the consultation, which can be found on gov.uk.

CBAM sector	SIC4 / Industry
Aluminium	24.42 (Aluminium production)
Cement	23.51 (Manufacture of cement)
Fertiliser	20.15 (Manufacture of fertilisers and nitrogen compounds)
Hydrogen	20.11 (Manufacture of industrial gases)
Iron and steel	24.10 (Manufacture of basic iron and steel and of ferro-alloys)
	21.20 (Manufacture of tubes, pipes, hollow profiles and related fittings, of steel)

The Authority is also considering how the adjustment to Free Allocations can be applied and are minded to apply the adjustment at installation level, following the calculation of preliminary Free Allocations.

The Authority is mindful to ensure this reporting can take place in the least administratively burdensome way. One option could be to require operators to disaggregate Free Allocation applications across CBAM and non-CBAM goods through the second stage of Baseline Data Collection (1 April – 30 June 2026).

Subject to determining an appropriate methodology to implement this disaggregation, the Authority is minded to ensure that only Free Allocations mapped to CBAM goods are adjusted, ensuring that any non-CBAM goods retain their carbon leakage mitigation through Free Allocation

Free Allocations for CBAM Sectors

Assessment Criteria



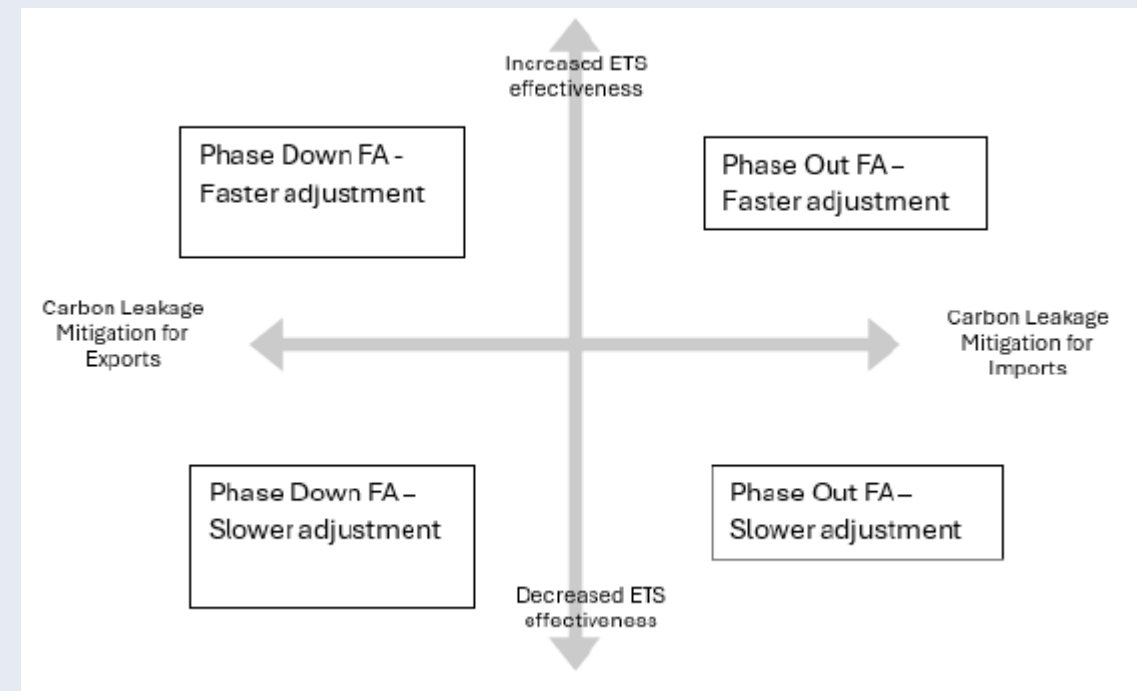
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In order to come to a final decision on the methodology for Free Allocation adjustments, the Authority is considering the following assessment criteria:

- Mitigating carbon leakage risk for imports;
- Mitigating carbon leakage risk for exports;
- Impact of a Free Allocation adjustment on ETS effectiveness;
- Technical feasibility of the adjustment methodology; and
- Affordability to government of the final policy choice

The Authority will ensure any changes are in line with WTO rules and wider trade law related obligations. Therefore, an assessment criteria which falls outside the scope of the above weightings is WTO compatibility.



Questions for Discussion

1. Do you agree with the Authority's minded to position to adjust Free Allocations for CBAM sectors?
2. Do you think the Authority are considering the correct parameters for adjustment and do you have a preference for the start year, adjustment length or trajectory?
3. Do you agree with the considerations the Authority will take into account when determining the extent of the adjustment to free allocations and do you have a preference on whether the adjustment should be to a zero or a non-zero amount?
4. Do you agree with the Authority's minded to position that free allocations should only be adjusted for goods covered by the UK CBAM?
5. Do you agree with the assessment criteria that has been put forward for consideration by the Authority?

Next Steps



Consultation closes: 10 March 25

You can submit written responses to the consultation via citizen space, which is available here:
<https://www.gov.uk/government/consultations/uk-emissions-trading-scheme-free-allocation-review-carbon-leakage>

Or you can submit via e-mail here: ukets.consultationresponses@energysecurity.gov.uk

If you have any further queries, please contact us at the following mailbox:
emissions.trading@energysecurity.gov.uk