

UK STEEL – SUBMISSION TO CALL FOR EVIDENCE ON ‘TRADE AND THE ENVIRONMENT’

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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 Call for Evidence on Trade and the Environment

Introduction:

1. Balancing the principals of global free trade with our climate and environmental responsibilities is an increasingly fraught policy challenge, and one the steel sector sits at the epicentre of. The body of rules and agreements governing the global trading system have not fundamentally changed since the establishment of the General Agreement of Tariffs and Trade (GATT) in 1948, a time when man's impact on the natural world was far smaller, man-made climate change was not in anyone's thoughts, and the idea of internalising the environmental costs of industrial activity would have only been found at the fringes of political and policy thinking. The arguments in support of free trade were most famously articulated by Adam Smith in the Wealth of Nations:
2. *"In every country it always is and must be the interest of the great body of the people to buy whatever they want of those who sell it cheapest. The proposition is so very manifest that it seems ridiculous to take any pains to prove it..."*¹
3. There can be no doubt that the basic premise of this argument still holds true. Free trade has been the engine of growth and prosperity for every single country that has embraced it. However, as our impact on the environment has grown, not least in relation to climate change, there is an increasing need to update this principle and add necessary caveats to ensure it meets the competing demands of the modern world.
4. "The great body of the people" does not merely have an interest in having the maximum choice of goods at the cheapest available upfront cost. As we increasingly understand, the price we pay for products upfront is often not the whole cost but merely a down payment with the remaining cost to be paid for at a later date usually by someone else. Externalities like CO₂ emissions, air, land, and water pollution are all too often not factored in – but they must ultimately be paid for by someone: taxpayers, people in other countries, or future generations. Whilst certainly a debateable and overly simplistic view, until we became widely aware of climate change one could argue that local environmental impacts were just that, local and therefore not of concern except to those that were directly impacted by them. It was up to national governments to look after their local environments and if they chose not to and were able to produce good more cheaply as a result then that was their decision and to our benefit.
5. However, today with our understanding of climate change this view no longer holds. Emissions released to produce goods in one country ultimately have an environmental cost that impacts everyone. The concept of the 'cheapest price' considered by Adam Smith can no longer be thought of in such simple terms, we must instead increasingly think of it as 'the cheapest price with environmental costs reflected'. Many countries, including the UK, are increasingly reflecting the costs of climate change through carbon pricing and other climate change policies. However, in the vast majority of countries carbon pricing is either non-existent or nascent in its development. For example, whilst the UK currently has a carbon price approaching £90/tonne, China's current price is closer to £7.50², and Australia has no carbon price at all. If fully exposed to those prices, UK steel producers' production costs would increase by up to £180/tonne of steel (around a 50%

¹ Adam Smith (1776) *An inquiry in the Nature and Causes of the Wealth of Nations*. Chapter 3.

² <https://www.scmp.com/business/china-business/article/3162702/chinas-emissions-trading-market-likely-see-expansion-rising>

production cost increase), Chinese producers by £15/tonne and Australian producers' costs would be unaffected.

6. In a global trading system in which no differentiation is made between steel that has paid those externalities and those that have not, the result of a high UK carbon price would be UK producers outcompeted in domestic and export markets and very quickly ceasing to produce. UK domestic emissions would decrease due to reduced industrial activity, but global emissions would remain the same or increase as UK production is substituted by more carbon-intensive steel production elsewhere which must also be shipped here. The UK would also need to export all of its scrap steel, creating further emissions, as it no longer had the ability to recycling it into new steel products domestically.
7. The steel sector is particularly at risk from carbon leakage:
 - a. Steel is one of the most intensively traded products in the world with 25% of all steel produced globally being exported, and 39%³ international traded outside of China
 - b. The UK has an even more trade intensive steel market with an import penetration of around 60%⁴, exports accounting for 45% of production and a corresponding 'trade openness'⁵ of 102%⁶.
 - c. This point is well demonstrated by HMT's recent Net Zero Review which shows that the basic metals sector (dominated in tonnage and value by steel products) has a trade openness (value of imports + exports / value of UK market) of 72%, combined with the highest carbon intensity (cost of carbon / gross output), and the third-highest proportion of CO₂ from domestic sources.
 - d. The HMT review showed that the gross output of the steel/basic metals sector was the most reactive to high carbon pricing amongst all industries. The UK basic metals sector also has significantly lower CO₂ intensity embodied in export than non-OECD countries and somewhat lower than OECD countries.
 - e. In the UK, EU, US and most other developed nations there are no MFN tariffs on steel products.
 - f. The vast majority (73%) of the world's steel is produced by blast/basic oxygen furnaces. On average this leads to the emission of 2.3 tonnes of CO₂ (tCO₂) per tonne of steel. (In the UK this figure is 1.95 tonnes)
 - g. 26% of the world's steel is produced through recycling scrap steel in electric arc furnaces (EAF) which is significantly less carbon intensive particularly in countries, such as the UK, with low-carbon power generation. The average CO₂ emissions from EAF production is 0.69tCO₂/tonne steel compared to UK average of 0.35tCO₂. Virtually all steel is recovered and recycled meaning were are already at the current limits of how much steel can be made via this route.
8. As such, when it comes to trade and carbon intensive products like steel until there is a common approach to climate change policy and carbon pricing across the globe there is a need for national governments to intervene and place certain limits on free trade. Such intervention is already made in the UK for example on food standards, and now an analogous approach is required on industrial products to guard against carbon leakage, differentiate between carbon-intensive and low-carbon production routes, and critically create markets for low-carbon industrial products. This last element is key if we are to attract the levels of inward investment required to decarbonise steel production in the UK. No company, whether UK based or multi-national, can be expected to invest in processes that will radically increase their production costs (CCUS - estimated 16-26% increase in costs, Hydrogen based production - estimated 30% increase) if there is no market that differentiates between low-carbon and carbon-intensive steel, providing a price premium for the former to allow on a return on investment.
9. In these circumstances maintaining a highly conservative position on free trade, in which any barrier to the free movement of goods is to be avoided, is increasingly no longer tenable. The principles of ever fewer barriers to free trade and reaching net-zero by 2050 are will increasingly

³ World Steel Association (2021) World Steel in Figures

⁴ 2019 figures as 2020 not a typical year and full 2021 data not yet available. UK Steel consumption of 10.2 million tonnes and imports of 6.4 MT.

⁵ Trade Openness = (value of imports + exports / value of UK market)

⁶ 2019 HMRC data for tariff codes 7206 through to 7306. Exports 4.0MT + Imports 6.4MT / UK Supply/Market Size 10.2 MT = Trade Openness of 102%

tug in different directions until such time that all major economies have adopted similarly rigorous levels of climate production. The two principal policy mechanisms proposed to develop this market for low-carbon products, and guard against carbon leakage are carbon border adjustment mechanisms (CBAM) and low-carbon product standards (LCPS) – both policies which UK Steel has encouraged the Government to examine with some urgency as part of its industrial decarbonisation strategy.

Inquiry Questions:

The answers provided below are the views of UK Steel and related specifically to the issues of trade and environment priorities of the steel sector.

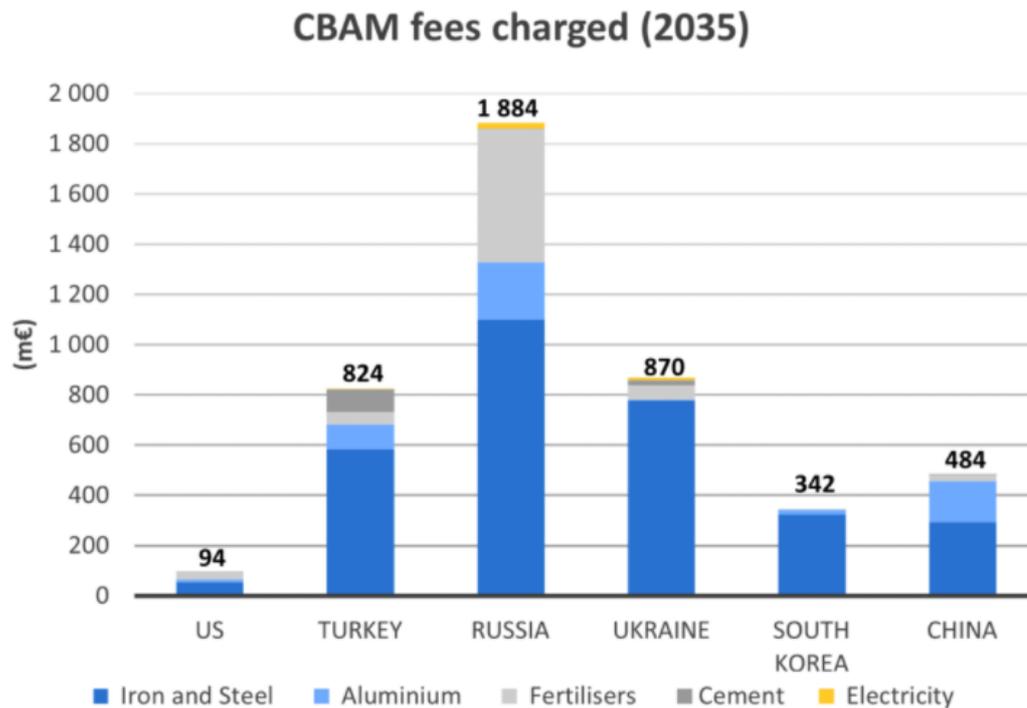
How well are the Government's free trade agenda and its environmental policies aligned? And is the Government ambitious enough in its approach?

10. Despite having taken the decision to leave the EU, its Customs Union and the Common Market over five years ago it still isn't entirely clear what the Government's 'free trade agenda' entails at least not in strategic terms. It would be strongly advisable if DIT were to publish a trade strategy setting out its objectives and ensuring that trade agreements and decisions are taken with the aims of that strategy in mind. Without such a strategy the UK is at significant risk of pursuing trade deals for their own sake and approaching them with a 'quantity over quality' mindset. The UK's approach to date appears to fit this model with a need to prove the success of 'global Britain' by agreeing as many deals as quickly as possible.
11. Whilst the UK has clearly made attempts to advance its environmental objectives in trade negotiations to date, the outcomes have not always been hugely successful. The recent UK/Australia FTA provides a good example here, where it was commonly reported that the UK had to give way on its desire to have specific net-zero commitments and Paris Goals of keep global heating below 1.5C.
12. With increasing thought being given by policy thinkers to climate measures that would traditionally be considered 'trade distortive practices' the UK should have far clearer environment objectives in its FTA negotiations and should increasingly be seeking 'climate waiver' clauses to ensure that any domestic policy it introduces to tackle climate change cannot be challenged in investor-state dispute settlement systems or similar mechanisms. Measures like LCPS and CBAMs will ultimately be necessary to help UK industry decarbonise, and the UK should be safeguarding these policies in trade agreements where it can.

What might be the impacts of measures introduced by the UK's trading partners designed to reduce reliance on carbon-intensive fossil fuels – for example carbon border adjustment mechanisms – on UK trade?

13. The EU will be the first country/bloc to introduce a CBAM between 2023 and 2026 applying to iron and steel, cement, fertiliser, aluminium, and electricity generation. There are three core impacts from a UK steel sector perspective that could materialise in the absence of any reactive policy from the UK Government:
14. **UK exports to EU:** UK steel exports to the EU could be faced with a new CBAM charge. Whilst the precise details are not entirely clear yet, the principle is clear that EU imports must face an equivalent carbon charge to those of EU producers. At present UK steel producers face a higher carbon price than their EU counterparts but with the introduction of the CBAM EU industry's 'free allocation' of allowances will gradually be reduced meaning it will become exposed to the full costs of carbon for the first time.
15. Assuming UK steel producers continue to receive a certain level of free allocation, they will likely be facing a lower carbon price than EU producers and therefore will face an additional CBAM cost when exporting to the EU. This cost will not necessarily reduce UK exports to the EU provided producers on both sides of the channel face ultimately the same costs. However, if the EU's CBAM policy is accompanied with increasing state support for decarbonisation investment as is already happening in many EU countries⁷ and the UK fails to follow suit, then UK steel producers could find themselves priced out of the EU market in the future.

16. **UK Imports of Steel:** The EU CBAM could lead to trade diversion of steel exports away from the EU to other open and nearby markets – namely the UK. Whilst the CBAM is not expected to have a major impact on EU trade overall, for the products it covers it likely to have a profound impact and will make the EU a much more challenging market for carbon-intensive steel producers to export to. As the chart below shows, Russia, Turkey and Ukraine are particularly exposed in relation to their steel exports. If they UK were not to take some form of reactive policy action it could expose the UK steel market to significant volumes of trade diversion away from the EU. This could seriously injure to UK producers and could undermine the case for investment in UK steel production.



Source: E3G and Sandbag Analysis⁸

17. **UK Consumers of steel:** In the absence of any new policy from the UK Government in reaction to an EU CBAM, UK consumers of steel may experience a benefit in depressed steel prices (due to trade diversion from the EU) as well as a competitive advantage against EU manufacturers where steel prices will rise significantly as consumers are exposed to the full costs of carbon embedded in the steel products they consume. This however must be considered in the context of the injury it could cause to UK steel producers and naturally the consideration that an influx of cheap carbon-intensive steel is hardly in keeping with the UK's stated climate change objectives.

And what could a UK carbon border adjustment mechanism mean for its imports and exports?

18. UK Steel believes the UK Government must start putting serious consideration into the introduction of a UK CBAM to avoid the negative impacts noted above. There are naturally draw backs and complications with doing so, but the UK may have little choice now that our biggest export market, the EU, will be introducing this policy next year. The UK sends 70% of exports to the EU and similar proportion of our steel imports currently come from the EU. Despite now having independence of trade policy we will still be hugely impacted by decisions made by the EU and will be steered to a significant degree by EU trade and climate policy.

⁷ [German Government commits to £48 million investment in ArcelorMittal Hydrogen based steel production](#)
[German Government puts forward 'industrial CfD' plans](#)
[Spanish Government signs MOUS with ArcelorMittal for Hydrogen based steel plant](#)
[Swedish SSAB \(Steel producer\) joint venture in Hydrogen based steel making with Swedish State owned Vattenfall and LKAB](#)
[Belgian and Flemish Governments investment in ArcelorMittal DRI Plant](#)
[French Government support for ArcelorMittal investment in EAF and DRI](#)
⁸ <https://www.e3g.org/publications/a-storm-in-a-teacup/>

19. The main impacts of a UK CBAM for imports and exports, in relation to steel, can be summarised as:
- a. **Increase in steel import prices:** The price of imports would increase. If imports of steel faced a CBAM charge equivalent to today's UK ETS price of £90/tonne, steel imports (which account for 60% of the UK steel market) would increase by around £160/tonne, or around 30% compared to current market prices.
 - b. **Less competitive exports of steel:** As noted above, the EU introduction of a CBAM will be accompanied with a reduction in free allocation of EU ETS allowances, meaning EU steel producers will ultimately be exposed to the full costs of carbon. Assuming a UK CBAM would follow a similar approach (to ensure WTO compliance), UK steel would be considerably more expensive to produce. It would remain competitive in UK and EU markets as all producers would be facing the same costs, however UK steel exporters could struggle in other markets without equivalent carbon prices that account for some 30% of exports today. For this reason, some industry voices in the EU are calling for 'export rebates' for the costs of carbon levied on those volumes of steel destined for extra-EU markets.
 - c. **Less competitive exports of steel containing products:** A CBAM and full exposure of UK steel producers to carbon pricing will increase the costs of steel in the UK for consumers in the manufacturing and construction sectors. This will naturally increase the costs of the good they produce (everything from cars, to barbed wire, to tools). Depending on the product in question, this could reduce their competitiveness. At £100/tCO₂ the average car could cost an extra £150-200 to produce. Sourcing steel from a low-carbon steel producer will mitigate some of these additional costs. Moreover, because UK imports of steel containing goods will not be levied with a CBAM and may be made from cheaper carbon-intensive steel, UK manufacturers may also find themselves at a competitive disadvantage to imported products in the UK and EU. For some products this cost differential may not be material, but for others the Government may have to consider ameliorative measures.

What are the benefits and costs of the UK's approach to environmental and climate change commitments in free trade negotiations to date? And to what extent might the inclusion of Investor-State Dispute Settlement clauses in free trade agreements affect the UK's climate change policies?

20. As noted above, the UK has had a mixed success rate to date in ensuring its climate objectives have been reflected in its FTAs to date and this, understandably, has largely been determined by the negotiating partner. For example, the EU/UK TCA had extremely ambitious environmental and climate change commitments, whilst Australian negotiators pushed hard to ensure binding commitments on climate action were not included. Similarly, the US has a Congress mandated policy of not including any reference to climate change in its FTAs, which is unlikely to change any time soon.
21. As noted above, the UK should aim to guard against challenges in future ISDS by securing a climate waiver in future agreements to ensure it retains the freedom to introduce the climate policy it deems necessary and not risk this being struck down as 'trade distortive behaviour'.

What opportunities are there for the Government to innovate to create more opportunities for "green" goods and services to export, to decarbonise and green supply chains?

22. UK Steel has been clear in discussions with the Government that any industrial decarbonisation strategy must come equipped with policies to create a market for low-carbon industrial products (including steel) here in the UK. Steel producers must be sure that they can secure a market return on the £billions of capital investment required to decarbonise steel production if such expenditure is to be made. As noted above, this can be done through a CBAM and/or LCPS. Both should be given serious consideration and it was promising to see the Government launch a call for evidence for Low-Carbon Industrial Products last year. Accompanying these policies, the Government will also need to provide investment support to steel companies with decarbonisation strategies and investment plans, as is already happening in multiple countries from Sweden, to Spain, to Canada.
23. In developing the right conditions for investment and decarbonisation the UK can be one of the first to achieve a net-zero steel sector producing green steel products for the UK and export markets. One of the cheapest routes for decarbonisation will come from the increased use of electric arc

furnaces in the UK and the greater utilisation of the 10 million tonnes of steel scrap produced in the UK each year.

24. As the globe ultimately moves towards net-zero the demand and price for both net-zero steel and the scrap steel required to produce it most cost effectively, will increase. The UK is well placed to take advantage of this development if the right policies are put in place and the UK takes a long-term strategic view of this issue, and the importance of securing its future supply of materials.

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