

Carbon Leakage in the Export Market

A report by the Commission for Carbon Competitiveness

July 2025

Executive Summary

The Commission for Carbon Competitiveness was founded in 2023, as a cross-party and cross-industry effort to explore how the UK can reach net zero without undermining the competitiveness of British industry.

The Commission's first report, *Fixing the Carbon Leak*, successfully advocated for the introduction of a Carbon Border Adjustment Mechanism (CBAM) in the UK. But with a CBAM only applying to imports, the job is unfinished, so the Commission has now turned its attention to carbon leakage in the export market.

Through a targeted consultation aimed at industry, academics, and legal experts specialising in trade, the Commission heard that successive Government's plans to mitigate carbon leakage do not go far enough, do not apply to enough sectors, and do not do enough to put the UK on a strong footing to tackle the underlying competitiveness challenges faced by industry.

1

Maintain long-term free allowances under the UK ETS for products destined for the export market

Deliver quick and effective carbon leakage mitigation measures through the existing UK Emissions Trading Scheme, by keeping free allowances in place for the long-term on exported products.

2

Make the case for export support with conviction regardless of WTO challenges brought by other nations – and be willing to see it through

In line with the new Trade Strategy, acknowledge the challenges the WTO faces in this new geopolitical era, and do not allow outdated deference to act as a straitjacket when a wealth of industry and legal opinion and international precedent supports action.

3

Show leadership to support UK manufacturing

Demonstrate global leadership by developing measures to support manufacturing industries now, rather than waiting for the outcome of talks on potential linkage of the UK and EU ETS schemes.

4

Adopt a comprehensive approach to tackling carbon leakage

Build on the CBAM's coverage of imports by taking action on exports, rather than leaving the job of carbon leakage mitigation unfinished.

5

Apply carbon leakage mitigations to all manufacturing sectors

Move on from the current piecemeal approach to ensure all sectors that are exposed to carbon leakage are covered by mitigation measures.

Summary of Evidence

The UK's Current Approach to Carbon Leakage

Almost all respondents identified the threat that carbon leakage posed to the UK's manufacturing industries, and the damage that it could inflict on the UK's ability to both decarbonise and protect the competitiveness of its industry.

There was broad support in principle of proposals designed to tackle carbon leakage, particularly the development of a CBAM, and a variety of other suggestions on how to mitigate carbon leakage as a whole, grouped around the following themes:

UK ETS

Many respondents raised concerns about the efficacy of successive Government's approach to decarbonising industry through the UK ETS.

For example, respondents understood the principle of free allowances and how the free allowances system could be adapted for certain sectors as a means of tackling carbon leakage. But some organisations, including the **Mineral Products Association and Essar Energy Transition (EET)** noted the number of free allowances available under UK ETS is decreasing faster than the ability of hard-to-abate sectors to decarbonise. **EET** called for a coherent package of policies to facilitate industrial decarbonisation, including investment support for electrification, fuel switching, and Carbon Capture and Storage.

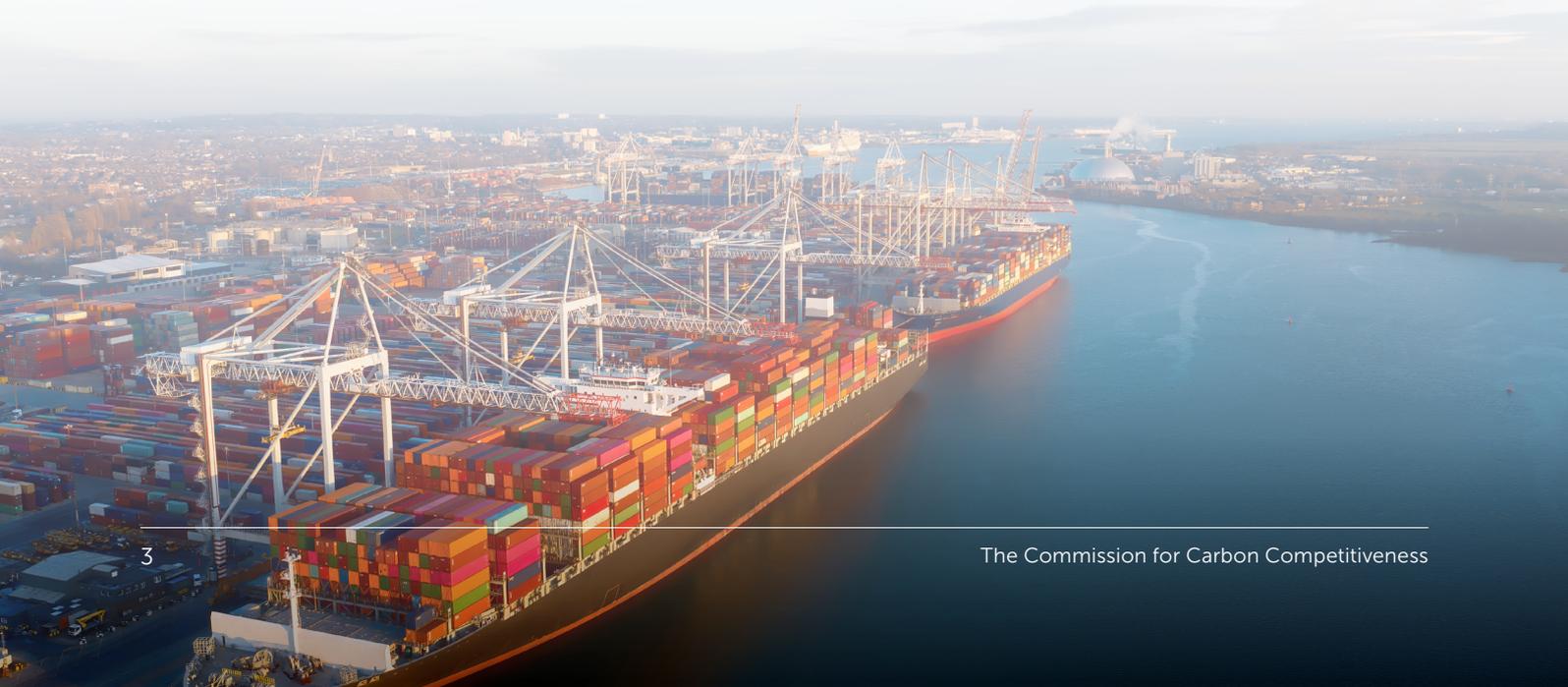
It was widely noted the existing approach to carbon leakage and industrial decarbonisation had failed to reduce emissions without harming UK industry. **Fuels**

Industry UK cited a Committee on Climate Change Report from 2024, which said that "consumption emissions are 24% lower than they were in 1990. However, this is mostly driven by reductions in territorial emissions." **Fuels Industry UK** concluded that although territorial emissions fell 47% between 1990-2021, this was significantly offset by a 21% increase in imported emissions during that time, implying a significant offshoring of emissions. **ExxonMobil** noted carbon leakage meant substituting UK-based, lower carbon intensity production with higher emitting manufacturing elsewhere, which ultimately doesn't reduce global emissions.

The role of a CBAM in the wider policy landscape

Several respondents raised concerns with the existing proposals for a CBAM. The most frequently cited concern was that the UK CBAM would not address carbon leakage in the export market. The majority of respondents who noted issues with the existing proposals highlighted this.

Chemical Industries Association noted that the UK CBAM scheme is being developed in isolation from other climate-related policies, particularly the ETS and free allowance policy, and highlighted that there is as of yet no transparency on the criteria, process or timeline for the expansion of the CBAM's sectoral scope. **Cast Metals Federation** stated that although they were supportive of the concept of a CBAM, carbon leakage remained a risk because of the UK's high electricity costs, and argued that the UK should be looking to grow its industry, not just taking defensive action to hold on to what we already have. While **CEMEX** welcomed plans for a CBAM and the inclusion of cement within its scope, they called for it to be designed to reflect the specific manufacturing make-up of the UK, an increase in the implementation



pace so that the UK CBAM was implemented in 2026, and alignment with the EU's CBAM to eliminate the resource burden on companies.

CBAM sectoral scope

Fuels Industry UK noted that the existing approach to carbon leakage was undermined by the fact that it varies across sectors, with refining not included within the scope of the proposed CBAM, and **Valero** noted their deep disappointment that refining and refined petroleum products were not included in the scope of the UK's CBAM, given the refining sector is heavily exposed to carbon leakage. **EET** also highlighted the decision not to include refining within the scope of a CBAM as a matter of concern.

Venator Materials criticised the uncertainty around scope, saying that if free allowances were removed without an alternative mechanism in place to minimise carbon leakage, there would be a direct threat to the UK's manufacturing viability. They also called for CBAM revenues to be used directly for the decarbonisation of industry, as high energy costs were already acting as an incentive for industry to reduce their carbon emissions.

Impacts of inaction

Respondents were unequivocal on the potential impacts. **Valero** warned that high costs under UK ETS and no mitigation through a CBAM for refining risks the wholesale deindustrialisation of the UK's manufacturing regions with limited impact on global emissions. **Fuels Industry UK** cited Grangemouth's transformation from a refinery into a terminal as a real-world demonstration of this.

Carbon Leakage in the Export Market

As was expected, export-dependent industries who responded to our consultation were the most concerned about carbon leakage in the export market. The Commission received multiple responses on this topic from representatives of the chemicals, refining and metals industries.

Respondents from the refining and chemicals industry were particularly concerned about the potential impacts of carbon leakage in the export market, given those two industries are not covered by the scope of the UK's CBAM.

Chemicals

The **Chemical Industries Association** cited a report by Frontier Economics which showed that in the absence of a CBAM export solution, the effects of emissions pricing in the UK would be to reduce sales of UK ETS-covered exports on global markets.

Venator Materials highlighted that once lost, market share in the international marketplace is very difficult to regain, given the relationships between supply chains. They concluded reduced market share over the medium-to-long term would result in the loss of large numbers of highly skilled jobs. They also noted the bulk of their exports went to the EU, so any disparity on timelines between the UK and the EU CBAM may risk to dumping of high carbon intensity products.

Refining

All responses from the refining industry noted their industry was both highly exposed to carbon leakage and extremely export intensive. **Valero** said this was in part due to the co-production process of refining, where meeting demand for certain refined products in the UK necessitates the creation of others, which are then exported. Carbon leakage in the import and export markets are intrinsically linked.

Fuels Industry UK identified a "policy gap" on carbon leakage mitigation, costing the then six refineries (Grangemouth has closed since the research was undertaken) in the UK a combined £149m. **EET** said ultimately the impact of carbon leakage in the export market could have a significant impact on their investment plans for the UK moving forward.



Metals

UK Steel noted that their industry was highly export-intensive and heavily based on volume, saying it was vital to take actions on exports on that basis. They also highlighted that three quarters of the industry's exports went to the EU, so called for alignment on approach with the bloc. **Cast Metals Federation** noted that although it was difficult to forecast the precise impact, not addressing carbon leakage in the export market would inevitably lead to their members losing out to competitors abroad.

Mechanisms to Address Carbon Leakage in the Export Market

Respondents shared a variety of potential mechanisms for addressing carbon leakage in the export market, the most frequently raised of which was proposals to reform the free allowances regime under UK ETS to maintain free allowances for products destined for export.

The **Chemical Industries Association** highlighted that the regime is broadly understood in international markets and the UK would therefore be able to be more confident in its arguments around the WTO. The organisation also recommended that export products were exempted from carbon pricing altogether.

Mineral Products Association noted that adjusting free allowances to consider products destined for exports was the clearest option.

UK Steel called for exempting goods destined for export from UK ETS, a process they argued would be simple and keep in place the incentive to decarbonise. They claimed that, in keeping the status quo, the government's de facto policy position was that the steel industry shouldn't export.

Reforming free allowances – compliance with international trading obligations

Venator Materials argued that there would be no conflict with international trade rules from this approach, as long as products sold in the UK are treated equally regarding carbon costs as imports into the UK. They called for 100% free allowances for products for export.

Valero called for free allowances under UK ETS to be maintained for the refining sector for exported goods. They highlighted the international precedent for trade-exposed nations to provide relief to their industry from domestic carbon pricing, citing the example of South Korea – where free allowances cover most carbon costs, and the remaining allowances are sold at relatively low prices. The efficacy of this scheme shows that there is international precedent for implementing measures to tackle carbon leakage while remaining compliant with WTO obligations. More broadly, Valero argued that a maintenance of free allowances cannot be categorised as a subsidy as it simply the removal of a unilaterally imposed cost (UK ETS).

UK Steel and **Cast Metals Federation** both noted that there has been significant development in the arguments around compliance with WTO obligations in recent months. Both noted that the EU, having previously identified export support as a "red line", was being creative in seeking mitigation measures that would be compliant with international trade obligations. They noted that if the UK stuck to the strictest possible interpretation of WTO rules, the UK would be the only ones doing so while our competitors move forward without us.



A New Approach for the UK – Herbert Smith Freehills

Herbert Smith Freehills put forward a proposal for changes to the UK free allowance regime which was summarised thus:

- *“If the carbon price in the country of destination is lower than that represented by the number of allowances that the UK producer is required to surrender in the UK to account for its GHG emissions, there would be an allocation of free allowances corresponding to the difference.*
- *If the carbon price in the country of destination corresponds to that represented by the number of allowances that the UK producer is required to surrender in the UK to account for its GHG emissions, there would be no allocation of free allowances.*
- *If the carbon price in the country of destination is higher than that represented by the number of allowances that the UK producer is required to surrender in the UK to account for its GHG emissions (for example, on the basis of current price levels, in the EU), there would be a reduction in the allocation of free allowances (in effect, a requirement to surrender allowances corresponding to the difference).”*

Herbert Smith Freehills also addressed how this policy would work in practice under our international trading obligations, saying that although in the strictest interpretation of WTO definitions a free allocation could be considered a subsidy, “it would only be “actionable” for the purposes of the WTO Subsidies Agreement if it is shown to be injurious to the country of export. This is a danger faced by all government financial interventions (and indeed the existing free allocation regime) and only rarely justifies remedial action by the country of destination.”

Direct mechanism within the UK CBAM

The Chemical Industries Association suggested a direct mechanism to tackle export carbon leakage should form part of the UK’s CBAM. **Fuels Industry UK** noted such an approach would be compliant under WTO as a CBAM is an environmental measure not a subsidy. They also noted the reversal or mitigation of a unilateral policy measure (UK ETS) cannot be considered a subsidy.

CEMEX said a strict definition of carbon price must be considered when developing a policy that is consistent with WTO rules and alleviates carbon leakage in the export market.

Lessons from the EU

The European Roundtable on Climate Change and Sustainable Transition (ERCST) has recently published a set of solutions for exports of EU CBAM-covered goods. These could be broadly defined in two ways: policies that reduce the risk of carbon leakage, and designing a suitable mechanism to address export-related leakage under the CBAM.

The first set of policies looks to reduce the risk of carbon leakage. This could be done by reducing the costs of low-carbon transition via grants, loans or tax incentives, or supporting low-carbon pilot projects via direct investment support. These would reduce the cost advantage enjoyed by foreign firms that have not made such investments by enabling firms to reduce their emissions intensity, ensuring their liability under ETS is lowered.

The second set of policies would seek to design a suitable mechanism to address export-related carbon leakage under the EU’s CBAM, with the objective being a mechanism that mitigates risk, preserves incentives to decarbonise, is compliant with WTO obligations and avoids administrative complexity. **ERCST** suggests a carefully designed partial rebate system, creating a system of incentive-aligned export adjustment certificates, calculated on the basis of existing EU ETS product benchmarks, that would be exchangeable for EU ETS allowances. This would offer robust leakage protection while maintaining a decarbonisation incentive and minimising the risk that it is considered a financial contributing benefiting exporters, and thus open to WTO challenge.

Recommendations

The Commission for Carbon Competitiveness 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 following are detailed recommendations for how the UK government should approach this policy:

1

Maintain long-term free allowances under the UK ETS for products destined for the export market

The existing regime of providing free allowances under the UK Emissions Trading Scheme offers the most straightforward and effective means of mitigating carbon leakage in the export market. The Commission recommends that free allowances are maintained in the long-term for products destined for the export market – a move that would have broad industry support and international precedent. The alternative is increasing the exposure of UK manufacturing to carbon leakage, with significant knock-on effects for investment, growth and industrial communities.

Although the management of the UK's ETS and CBAM schemes are up in the air after the intention to link with the EU was announced, our industrial communities do not have the luxury of delay. They need quick and effective carbon leakage mitigation measures to be put in place.

2

Make the case for export support with confidence regardless of WTO challenges brought by other nations – and be willing to see it through

The UK's approach to its interaction with the WTO is overly risk averse. Too often we seek to avoid any complaints from other members, rather than being willing to fight our corner and justify our chosen course of action.

This attitude places too much emphasis on the idea that any complainants would be doing so in good faith. It also ignores the operational issues the WTO faces.

The recently published Trade Strategy acknowledged that “The WTO is facing new challenges in this new geopolitical era and needs to change in response. As the membership of the WTO has expanded, it has, sadly, become increasingly difficult to secure consensus among its membership to forge new rules”

In this new era, the UK needs the organisation to change if it is to continue to serve our interests.

In addition, industry and legal opinion and international precedent support the idea that applying mechanisms to mitigate the threat of carbon leakage in the export market is consistent with the UK's international trade obligations under the WTO. This is especially true if those mechanisms are simply the removal of unilateral ETS costs, rather than direct financial support.

To level the playing field our manufacturing sectors face internationally, the UK must be willing to set a course assertively and see it through.

3

Show leadership to support UK manufacturing

Having previously treated mitigation measures for carbon leakage in the export market as a “red line” it would not take action on, the position of the EU has developed in recent months. The EU Commission is now actively considering proposals to do just that.

While this is a welcome development, the UK can go further and develop its own programme of recommendations, demonstrating global leadership on how to support its manufacturing industries while talks on potential linkage of the UK and EU ETS schemes are ongoing.

4

Adopt a comprehensive approach to tackling carbon leakage

Although the principles behind implementing a CBAM are sound, doing so in isolation will not solve the problem of carbon leakage. A CBAM by its very nature only applies to imports, so inaction when it comes to exports leaves the job of mitigating carbon leakage unfinished.

More broadly, the UK Government must ensure that all policies aimed at promoting decarbonisation in a competitive way are designed in lockstep. This means viewing UK ETS (pricing and free allowances), UK CBAM and direct incentives for decarbonisation technologies, such as CCUS, hydrogen and electrification, as different mechanisms to achieve a common goal. The disparity between the removal of free allowances and pathway for new decarbonisation technologies coming online shows this is not the case.

5

Apply carbon leakage mitigations to all manufacturing sectors

The CBAM and other mitigation measures should apply to all manufacturing sectors without exception, even if the timeline for inclusion will differ sector by sector and need to take into account the nature of each product.

At present, industries such as chemicals and refining that are export-intensive and heavily exposed to carbon leakage are being left out of effective mitigation measures. The recent trend in chemical and refining sites across the UK reducing or reviewing their production exposes the risk of the UK’s decarbonisation efforts being achieved through large-scale deindustrialisation, with major impacts on economic growth and industrial communities.

Appendix A: The Commissioners



Henry Tufnell MP (Chair)

Labour MP for Mid and South Pembrokeshire

Henry was elected MP for Mid and South Pembrokeshire in July 2024. Henry is a member of the Environment and Rural Affairs Select Committee and the Co-Chair of the All-Party Parliamentary Group on Carbon Capture, Utilisation and Storage. Prior to his election, Henry was a barrister and an organiser for the Cleaners and Allied Independent Workers' Union (CAIWU).



Melanie Onn MP (Commissioner)

Labour MP for Great Grimsby and Cleethorpes

Melanie was elected MP for Great Grimsby and Cleethorpes in July 2024, and was previously MP for Great Grimsby from 2015-2019. Melanie was Shadow Deputy Leader of the House of Commons from 2015-2016 and Shadow Minister for Housing from 2017-2019. From 2020-2023, Melanie was Deputy Chief Executive of RenewableUK.



Baroness Evans of Bowes Park (Commissioner)

Conservative member of the House of Lords

Baroness Evans has been a Conservative Member of the House of Lords since 2014. Having served as a Minister in David Cameron's government, between 2016 and 2022 she was in the Cabinet under Theresa May and Boris Johnson, as the longest serving Leader of the House of Lords for 70 years.



John Penrose (Commissioner)

Chairman of the Conservative Policy Forum

John was Conservative MP for Weston-super-Mare from 2005-2024, and chairs the Conservative Policy Forum. John served as a Minister in the Cameron and May's governments in the Department for Culture, Media and Sport (DCMS), Northern Ireland Office and Cabinet Office, as well as a Lords Commissioner to the Treasury, as well as being the UK's Anti-Corruption Champion from 2017-2022. John is the founder of the Commission for Carbon Competitiveness and was Chair from 2023-2024.



Arjan Geveke (Commissioner)

Director of the Energy Intensive Users Group

Arjan Geveke has been Director of the Energy Intensive Users Group (EIUG) since 2022. The EIUG represents the interests of energy-intensive industrial consumers, including manufacturers of steel, chemicals, fertilisers, paper, glass, cement, lime, ceramics, and industrial gases. Prior to joining the EIUG, Arjan was Assistant Director of Energy Policy at the Department for Business, Energy and Industrial Strategy (BEIS) and Senior Policy Analyst at the Department for Business, Innovation and Skills (BIS).

Appendix B: List Of Evidence Received

Written evidence was provided to the Commission for Carbon Competitiveness by the following organisations (in alphabetical order):

1. Cast Metals Federation
2. CEMEX
3. Chemical Industries Association
4. Essar Energy Transition
5. ExxonMobil
6. Fuels Industry UK
7. Herbert Smith Freehills
8. Mineral Products Association
9. Valero Energy Ltd
10. Venator Materials

Oral evidence was provided to the Commission by the following:

- Simon Forrester MICME, CEO, Cast Metals Federation
- Matthew Rhodes, Cast Metals Federation
- Frank Aaskov, Director, Energy and Climate Change Policy, UK Steel