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smarter climate policy

CBAM call for evidence part 2/3 (Art 31)

Response to the call for evidence on adjustment to take account of free ETS allowances - September 2025

This is Sandbag's response to the call for evidence on adjustment to take account of free ETS allowances under Article 31 of the CBAM regulation.

In 2024, the European Commission ran a targeted stakeholder survey on CBAM discounts (adjustment) to take account of free allocation. In Sandbag's response, we used the DRI loophole to illustrate why the CBAM will require a reform of EU ETS benchmarks. Our response assumed that free allocation discounts had to be attributed to CBAM goods **in the same way as free allocation is attributed to EU ETS factories**.

However, on 18 December 2024 (five days after closing the consultation), the Commission posted a list of Q&A explaining that, instead, free allocation discounts will be calculated using **CBAM benchmarks**, and that a list of these benchmarks (hundreds of them) will be published.

Mirroring the EU ETS: the straightforward way

The proposed approach is surprisingly complex. A different approach (which we had assumed as the obvious solution) would consist of simply mirroring the EU ETS. In the ETS, there is no such thing as a steel benchmark, so the allowances given for the production of steel are dispatched between individual process.

So for example, if 100,000 tonnes of crude steel are produced using 90,000 tonnes of hot metal, which itself used 95,000 tonnes of sintered ore, the unit producing hot metal receives a number of EUAs equal to 90,000 times the hot metal benchmark, and the one producing the sintered ore 95,000 times the sintered ore benchmark.

Table 1. Free allowances allocated in the EU ETS for 100,000 crude steel

	Benchmark 2026-30[1]	Free allocation
Process 1: 95,000 t sintered ore	0.153 EUA / t sintered ore	14,915 EUA
Process 2: 90,000 t hot metal	1.248 EUA / t hot metal	112,320 EUA
Producing: 100,000 t crude steel	?	126,855 EUA

Table 2. Free allowances allocated in the EU ETS for 100,000 crude steel

	Agglom. ore	Hot metal / DRI	Scrap	Steel	Free allocation
Factory A	95,000 t	90,000 t	20,000 t	100,000 t	**126,855 EUA**
Factory B	55,000 t	50,000 t	60,000 t	100,000 t	**70,815 EUA**

Altogether, as illustrated by Table 1, it's easy to find out that the 100,000 t of steel produced caused the allocation of 126,855 EUAs, so the total number allocated for each tonne of steel will be 1.269 EUAs. Since there is no steel benchmark in the EU ETS, the production of that same amount of steel using different proportions of inputs could lead to different amounts of free allocation, as shown by Table 2.

To calculate the CBAM discount applied to a tonne of steel imported from a particular plant, a very logical approach would be to make it match the EU ETS process-based method. In contrast, creating product-based CBAM benchmarks would amount to **treating imports and domestic production differently**, which is questionable from a trade perspective.

The DRI loophole

The problem with mirroring the ETS process-based free allocation is that it would create **loopholes, for example for long steel products**.

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[1] Sandbag estimates

Many third countries make long steel products from DRI using natural gas, which could emit as little as 0.5 tonne of CO_2 per tonne of DRI produced. The CBAM is calculated by the equation in Figure 1, which would give a negative value for the DRI portion of imported steel products.

Figure 1: CBAM charge per tonne of DRI contained in imported steel

$$0.5^* - 1.248 = -0.748$$
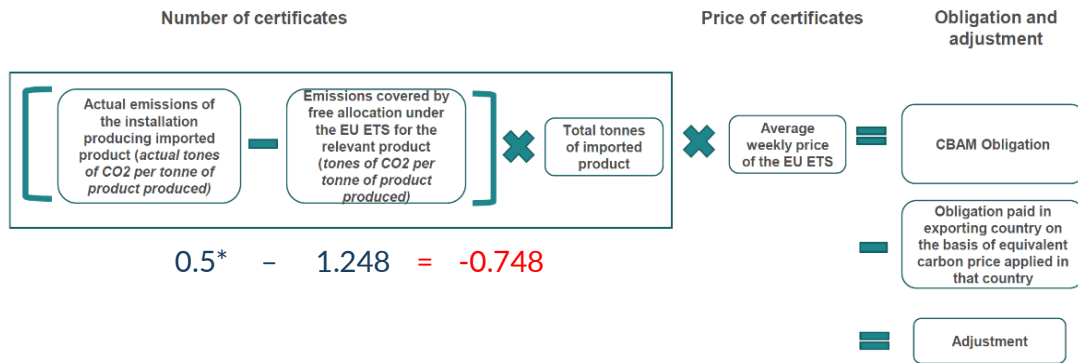
In contrast, European manufacturers of long steel products tend to use electric arc furnaces with up to 100% scrap, paying for their emissions but only receiving 0.145 free allowance per tonne produced.

Solution: make free allocation product-based

The hot metal benchmark awards free allowances based on an intermediary material (DRI or hot metal) rather than steel output. This creates perverse incentives within the EU ETS, by discouraging the recycling of steel scrap to the benefit of more polluting inputs based on the transformation of iron ore with coal and gas.

Instead, process-based free allocation benchmarks should be replaced with product-based ones, so that **free allocation for a flat steel product would be independent of the process used**. We explained in an April 2023 paper how a product-based free allocation system could work. It would have high environmental benefits, making scrap recycling more attractive to flat steel manufacturers, allowing their transition from blast furnaces to (less polluting) electric furnaces, which can use more scrap, without losing out on free allocation.

Product-based free allocation benchmarks should then be used to calculate CBAM discount. It would ensure equal treatment between domestic and imported goods and avoid loopholes such as described above. In our example of imported long steel product, CBAM fees would no longer be negative but positive.

Figure 2: CBAM charge per tonne of imported long steel made from 100% DRI (proposed)

$$0.5^* \quad - \quad 0.145 \quad = \quad 0.355$$
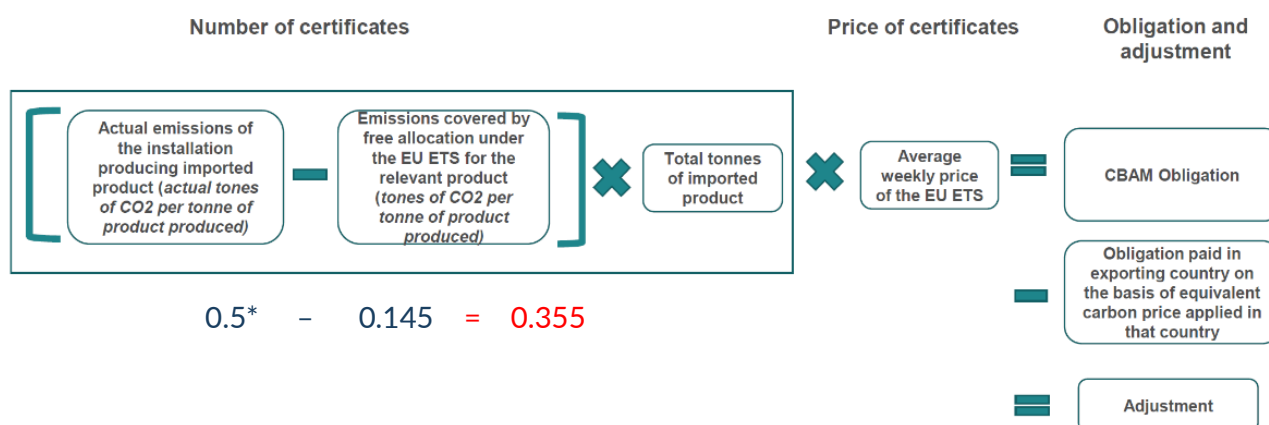
*Assumed emission intensity of natural gas-based DRI; assuming 1t DRI per tonne of steel