

CBAM DRI loophole requires new free allocation reform

Feedback to Targeted Stakeholder Survey on CBAM methodologies for calculating embedded emissions

The CBAM's DRI loophole

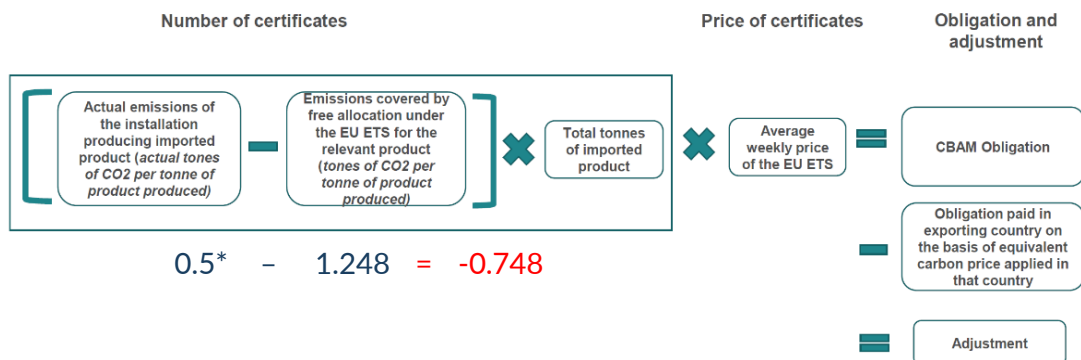
The current system of free allocation under the EU Emissions Trading System (ETS) is creating a **loophole for long steel products under the Carbon Border Adjustment Mechanism (CBAM)**, charging negative CBAM to importers.

The number of free emission allowances (EUA) received by steel plants under the EU ETS **depends on the process** they use as defined by 'product benchmarks':

- As per the 'hot metal' benchmark, a plant producing ore-based metallics (OBM) such as hot metal or direct reduced iron (DRI) will receive **1,248 emission allowance (EUA) per tonne of hot metal / DRI produced¹**.
- As per the 'EAF carbon steel' and the 'EAF high alloy steel' benchmarks, an electric arc furnace will receive only **0.145 or 0.176 EUA per tonne of steel produced²**, depending on the alloying content.

Many third countries make long steel products from DRI using natural gas, which typically emits about 0.5 tonne of CO₂ per tonne of DRI produced. The CBAM is calculated by the below equation, which will therefore give a negative value for the DRI portion of imported steel product.

Figure 1: CBAM charge per tonne of long steel made from 100% DRI (current)



*Assumed emission intensity of natural gas-based DRI; assuming 1t DRI per tonne of steel

¹ Sandbag estimate for 2026-30

² Sandbag estimate for 2026-30

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 (or 0.176) free allowance per tonne of steel produced.

Solution: calculate free allocation based on steel output

Unlike the EAF benchmarks, 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.

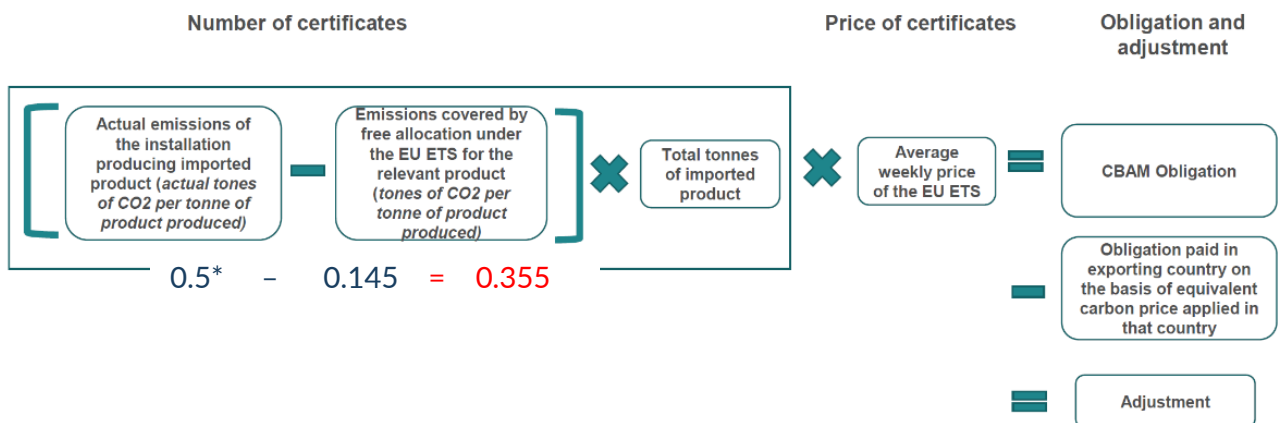
Instead, the hot metal benchmark should award free allowances based on **either flat or long steel output**, just like the EAF benchmarks do. The benchmarks should be independent of the manufacturing process, and instead award:

- **1,123 European allowances (EUA)³** per tonne of **flat steel** produced (regardless of the process used).
- **0.145 or 0.176 EUA** per tonne of **long steel** produced (regardless of the process used), depending on the alloying content.

This would make scrap recycling more attractive to flat steel manufacturers. It would allow their transition from blast furnaces to (less polluting) electric furnaces, which can use more scrap, without losing out on free allocation.

But it would also ensure that the CBAM does not give an unfair competitive advantage to imports of long products made from DRI made from fossil fuel, as illustrated by the below figure.

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



*Assumed emission intensity of natural gas-based DRI; assuming 1t DRI per tonne of steel

³ The exact amount should correspond to the current hot metal benchmark x average content of hot metal per ton of flat steel.

The Free Allocation Regulation (FAR) was reformed in 2024. During consultations preceding that reform, [Sandbag had made a proposal](#) addressing the perverse incentives created by the amended regulation. The DRI loophole is another negative consequence of the bad choice made in that regulation.

By amending the hot metal benchmark again, the EU has a chance to “kill two birds with one stone” and correct incentives for both imports (under the CBAM) and EU-made steel products (under the EU ETS).