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Department of Energy, Environment, Climate Change and Water

AI GROUP RESPONSE TO SAFEGUARD MECHANISM REFORMS CONSULTATION PAPER

The Australian Industry Group (Ai Group) welcomes the chance to make a submission on the Securing Safeguard Mechanism Reforms Consultation Paper (the Paper).

Ai Group is a peak national employer organisation representing traditional, innovative and emerging industry sectors. We have been acting on behalf of businesses across Australia for nearly 150 years. Ai Group is genuinely representative of Australian industry. Together with partner organisations we represent the interests of more than 60,000 businesses employing more than 1 million staff. Our members are small and large businesses in sectors including manufacturing, construction, engineering, transport & logistics, labour hire, mining services, waste services, the defence industry, retail, aged care, civil airlines and ICT.

Our members include many businesses covered by the current Safeguard Mechanism; those who would be covered if thresholds dropped in future; and many who would never be covered, but have an interest in environmentally effective and economically responsible transition to net zero emissions in the industry supply chains in which they participate.

Our attached submission addresses many critical issues raised by the Paper. A satisfactory approach to trade competitiveness risks is central to the success of an evolved Safeguard Mechanism. Ai Group considers that while the approaches to Emissions Intensive Trade Exposed industries considered in the Paper may suffice in the early years, a better solution will be needed before long. An Australian Carbon Border Adjustment Mechanism could be that answer, and our submission describes how such a reform could be considered and implemented, practically and in full compliance with Australia's trade commitments.

For any questions in relation to this submission, please contact Ai Group Director of Climate Change and Energy Tennant Reed (tennant.reed@aigroup.com.au, 0418 337 930).

Sincerely yours,

Innes Willox
Chief Executive

Ai GROUP SUBMISSION ON THE SAFEGUARD REFORM PAPER

1.	<i>Overarching comments</i>	2
2.	<i>Consolidated recommendations</i>	4
3.	<i>Key Issues</i>	6
3.1.	Safeguard share of the national abatement task	6
3.2.	Setting baselines	7
3.3.	Crediting and trading, domestic offset and international units	8
3.4.	Trade exposure	12
3.4.1.	Continuing relevance of the issue.....	12
3.4.2.	Defining trade exposed industries, facilities or products of concern	12
3.4.3.	Trade exposure treatment options in the Paper	15
3.4.4.	A better alternative: an Australian CBAM	16
3.5.	Multi Year Monitoring Periods (MYMPs).....	19
3.6.	Baseline decline rates	19
3.7.	Enforcement	19
3.8.	Other issues	20
	<i>Appendix A – Design issues and indicative settings for an Australian CBAM</i>	22

1. Overarching comments

The nation and industry are committed to deep medium term emissions reductions and to achievement of net zero emissions by 2050. Ai Group supports the [principles](#) of the Australian Climate Roundtable, including this description of ideal policy:¹

Policy instruments should: be capable of achieving deep reductions in Australia’s net emissions in line with our overall goal; provide confidence that targeted emissions reductions actually occur; be based on an assessment of the full range of climate risks; be well designed, stable and internationally linked;² operate at least cost to the domestic economy while maximising benefits; and remain efficient as circumstances change and Australia’s emissions reduction goals evolve. The interests of trade exposed industries, low income households and potentially displaced workers are not in conflict and good policy will ensure each group is not negatively impacted by the transition.

This ideal is challenging but important to approach. The reformed Safeguard Mechanism has the potential to be an important component of an effective climate policy suite. We must recognise that it will involve trade-offs between different facilities and sectors, however. Australia has absolute net emissions reduction goals and the Government has indicated it intends to achieve an absolute contribution towards that outcome through the Safeguard.

Costs imposed in complying with the SGM (“Safeguard compliance costs”) can be reduced and wider climate action advanced by allowing access to abatement from elsewhere in the Australian and global economies. But it would be neither efficient, fair nor feasible for the Safeguard facilities bear a hugely disproportionate share of the burden of economy-wide net emissions reduction. The more one sector is entitled to emit, the less the entitlement of others must be. Complementary policies will be needed across the Australian economy.

Similar trade-offs apply inside the Safeguard between different sorts of facility. Given all this there are several things we should aim for in an evolution of the Safeguard:

- **Durable solutions.** Policies that don’t last – at least in their broad structure, allowing for evolving settings – will be little use for underpinning investment decisions. And policies that don’t work won’t last. If policy is not reducing emissions, and being seen to do so, then it will be replaced before long. At every stage we must consider whether individual design choices collectively amount to an overall policy that works.
- **Efficient design.** Efficiency and simplicity will ultimately reduce costs for industry and for Australia as a whole, making reductions easier to achieve and enabling greater ambition. A particularly important element is to credit overperformance against baselines and allow the trading of those Safeguard Mechanism Credits (SMCs) between entities. This greatly improves the scheme by smoothing out abatement costs across covered facilities, producing one carbon price at the marginal cost of the entire Safeguard sector rather than the more than 200 wildly varying facility-specific carbon prices that would exist without crediting and trading. Together with some access to domestic offsets and, in future, international units, SMCs mean that the physical limitations on internal abatement opportunities for any one facility at a point in time become vastly less relevant than their ability to bear a share of the efficient costs of sectoral, national or global abatement.
- **Secure the path for industries with a net zero future.** The competitiveness context to climate is evolving, but the issue remains as relevant as ever. We need effective, sustainable solutions for industries that are emissions intensive and trade exposed today but have a clear future in a net zero emissions world, such as steelmaking, chemicals, cement, paper and many others. Their products will remain essential but their production processes will have to evolve significantly. It is vital that

¹ Australian Climate Roundtable, *Joint Principles for Climate Policy* (November 2020)
https://www.australianclimateroundtable.org.au/wp-content/uploads/2020/11/Climate_roundtable_joint_principles-Updated_November_2020.pdf

² International linkage of climate policies can take many forms depending on policy type, from trade in emissions offsets or entitlements, to shared regulatory standards or project methodologies, to coordinated tax settings.

policy help them get there, both by driving transformative investment as it becomes viable, and by ensuring that internationally uneven climate policies don't cause Australia to lose these industries.

Addressing trade competitiveness is central to a sustainable Safeguard. Concerns about the distribution of emissions entitlements across sectors and facilities are compelling to the facilities concerned but of little wider significance unless there is a serious risk of the loss of Australian facilities to international competition.

Ai Group appreciates the Government's intention to address trade competitiveness through tailored treatment for Emissions Intensive Trade Exposed (EITE) industries within the Safeguard. Baselines in the evolved Safeguard likely mean little risk to competitiveness in the early years of the new scheme. However, as baselines decline the risk to competitiveness will increase and the solutions offered are all inadequate in different ways.

We therefore propose the Government develop options for a more durable, efficient and trade-neutral approach to EITE for decision and implementation as soon as practical: a Carbon Border Adjustment Mechanism, comparable to that which is expected to be approved in the European Union by the end of this year, but adapted to Australia's own policy, governance and economic circumstances. A well-designed and well-governed CBAM would be a complex and significant reform and cannot be in place for the commencement of the reformed Safeguard in July 2023. But it can realistically be implemented within the next three to five years, by which time the urgency of competitiveness solutions will have greatly increased and the limitations of other approaches will be clearer. Any Australian CBAM should only make adjustments to the extent of the Australian carbon constraint; should be fully respectful of our commitments under trade law; and should be practical to implement and minimise transaction costs.

2. Consolidated recommendations

Issue	Recommendation
Safeguard share of national abatement task	<ul style="list-style-type: none"> ● Accept an absolute goal for net emissions from covered Safeguard facilities for 2030. ● Tentatively accept the preservation of Safeguard facilities' share of national net emissions from 2020 to 2030. ● Encourage linkages to and effective complementary policies in other sectors to ensure efficient and equitable effort.
Setting baselines	<ul style="list-style-type: none"> ● Adopt intensity baselines, with ongoing five-year-lagged adjustment of scheme settings to ensure overall absolute goals are achieved ● Remove aggregate headroom through the adoption of industry average emissions intensity baselines ● Apply technology-neutral global best practice benchmarks to new facilities and significant expansions
Crediting, trading and use of offsets and international units	<ul style="list-style-type: none"> ● Automatic issuance of SMCs and full tradability, subject to a rolling vintage window for compliance usage, suggested to be set at five years from issuance ● Access to ACCUs, subject to the same vintage window as SMCs, with consideration of a facility-level quantitative limit on reliance in any one year ● Preserve and update the legislative basis for future acceptance of Paris-compliant international units, excepting CERs carried forward from the CDM. Subject international units to the same vintage window as SMCs and any quantitative limits applicable to ACCUs ● Work with international partners to accelerate the development of liquid markets for credible international units ● Consider options for the inclusion of additional credible domestic units, subject to the same vintage window as SMCs and any quantitative limits applicable to ACCUs
Trade exposure	<ul style="list-style-type: none"> ● Safeguard design needs to address both the risk of lost competitiveness from internationally uneven policies, and the risk of lost competitiveness from insufficient action ● Consider ways to improve the Paper's proposed new facility-based EITE definition by addressing the adoption of a suitable threshold for cost intensity, ensuring internalised abatement costs remain visible, and avoiding excessive status volatility ● Consider a simpler alternative definition approach that updates the existing EITE approach with new data, removal of Scope 2 and discounting emissions intensity by the intensity baseline ● In the near term address EITE through access to decarbonisation funding and finance, and through slower baseline decline rates for EITEs matched by faster declines for non-EITEs ● Establish a work program to explore design options for an Australian Carbon Border Adjustment Mechanism as a long term solution to EITE issues, in full consultation with industry, importers, the wider Australian community and our trade partners. ● Clarify that any resulting CBAM would not be implemented before 2025 at the earliest, and commit to providing adequate notice and transition arrangements for importers and EITEs if and when a decision to adopt a CBAM were to be taken. ● Adopt the BizMEF CBAM principles, in particular reassuring our trading

Issue	Recommendation
	<p>partners that any CBAM adopted would be fully consistent with our WTO, plurilateral and bilateral trade commitments, and practice strong transparency during the design and potential implementation of a CBAM.</p> <ul style="list-style-type: none"> • Work with other jurisdictions including the EU on procedures for the validation and assurance of emissions data declared at the border, on the accreditation and mutual recognition of national systems of facility-level emissions data reporting, and on the range of other options for collaboration on CBAM data, law and policy suggested by BizMEF
Multi year monitoring periods	<ul style="list-style-type: none"> • Ensure that the cumulative impact of access to tradable units, banking and borrowing, and MYMPs is adequate to ensure facilities' marginal abatement costs converge • Review MYMP settings if a CBAM is adopted
Baseline decline rates	<ul style="list-style-type: none"> • Acknowledge that baseline decline rates will have to evolve with national ambition and performance • Ensure that decline rates are as firm as possible within a rolling time horizon of five years, with amendments or adjustments taking effect beyond this window, other than any needed to reflect EITE treatment
Enforcement	<ul style="list-style-type: none"> • Raise penalties for noncompliance to levels high enough to motivate compliance • Consider a volumetric penalty for net emissions above baseline set at a rate high enough that it is expected to be a backstop for compliance rather than an escape valve • Consider, rather than remitting any penalties to consolidated revenue, whether they should be: <ul style="list-style-type: none"> ○ added to the Powering the Regions Fund to purchase abatement and support industry decarbonisation; or ○ added to Australia's international climate finance and climate aid efforts; or ○ divided among all Safeguard facilities that were compliant in the year of the penalty
Other issues	<ul style="list-style-type: none"> • Consider the evolution of the electricity component of the Safeguard into a binding sectoral cap, pegged to expected power system emissions reductions and divided up among individual facilities, to address fears of potential perverse consequences from industry electrification and capacity mechanisms

3. Key Issues

3.1. Safeguard share of the national abatement task

The Australian Climate Roundtable's [principles](#) include that "[t]he costs of climate policy should be spread fairly within the Australian community".

The Consultation Paper raises the question of how to set the appropriate share for the Safeguard Mechanism of effort towards the 2030 and subsequent climate goals. There could be many ways to define this, but the paper only canvasses one: preserving the Safeguard facilities' share of national net emissions from 2020 to 2030, even as national emissions fall.

Whatever the method of defining the share, the underlying Government position is that the Safeguard must contribute a defined share towards the absolute national net emissions goals (at least 43% below 2005 levels by 2030 and net zero by 2050). Given our commitment to the national emissions goals and the Safeguard facilities' significant share in national net emissions, Ai Group accepts the need for an absolute Safeguard goal. However we recognise that this serves as a discipline on every other design decision, necessitating trade-offs and limiting the overall flexibility that design elements can provide.

The specific share-of-effort option presented by the Paper is a variation on pro-rata: national emissions must fall 43% by 2030, so to preserve the Safeguard share of national emissions (28% in 2020-21), Safeguard emissions must also fall to 99mt. In practice this is somewhat more generous to Safeguard facilities than a simple pro-rate, since the economy-wide 2030 commitment is in relation to reductions from a 2005 base. Total emissions from facilities now covered by the Safeguard are substantially higher today than in 2005. This is largely because many Safeguard facilities were built after 2005, rather than from increases at pre-2005 facilities.

Whether we consider effort in terms of the reduction of an entitlement of the right to emit, or of the carrying out of abatement activities, there is no particular reason to think that pro-rata reductions allocated by share of existing net emissions are optimal. However, the credible and available alternatives are limited:

- Economic modelling exercises can attempt to divine where emissions reductions can most efficiently be made across the Australian and global economies. Such models are highly imperfect, and their results are likely to be heavily contested.
- Economy-wide, or at least broadly interlinked, carbon pricing systems can enable abatement effort to be made wherever it is most efficient, subject to other regulatory barriers and market failures not addressed by carbon pricing. While the existing Safeguard amounts to a form of carbon pricing, and an evolved version will operate more efficiently and connect more economic sectors via domestic offsets and eventually international units, it will be some time if ever before this approaches an economy-wide set of market mechanisms. Important effort allocation judgments need to be made at the outset.

Both these approaches also have much more relevance to the question of where abatement should take place than to who should bear the cost.

In the absence of a clearly better proposal we do not oppose the Government's indicative burden-sharing approach. It is important that abatement opportunities be unlocked across the economy. Linkage outside the Safeguard facilities helps with this. Strong complementary policies will also be needed to avoid inefficiency and inequity with those covered by the Safeguard.

3.2. Setting baselines

The paper raises several elements of baseline-setting:

- intensity versus absolute;
- facility-specific versus industry average;
- approach to eliminating aggregate headroom
- approach to new facilities

All of these need to be considered in relation to each other and consistency with the overall absolute emissions objective. Trade-offs are very important.

Intensity baselines offer greater flexibility and less potential for distortions in light of swings in production, and do not provide an incentive to reduce emissions by curtailing production or closing. On the other hand absolute baselines offer greater certainty about the emissions outcome, and in some circumstances it may be efficient for a facility to close and sell off or cede its emissions baseline.

On balance Ai Group supports intensity baselines. However a necessary corollary of this, given absolute overall emissions objectives, is some allowance for the potential that production varies from expectations and puts overall absolute scheme goals at risk. The Government has suggested the establishment of a reserve within the overall emissions budget to account for this. However a reserve entails tighter initial baselines, or faster decline rates, than would otherwise be required. And a reserve could be exhausted by sufficient departures from initial expectations.

The Government could instead consider a regular but lagged process to review scheme performance and adjust settings as appropriate to maintain achievement of the overall outcomes targeted. For instance, the planned annual Climate Change Authority (CCA) reviews of policy performance could consider this issue and recommend adjustments to baselines or decline rates, with any decision to take effect after a notice period of five years. This would give a rolling window of certainty about policy settings while preserving flexibility to adapt. This is likely to be better either than a commitment to total setting certainty that proves unsustainable, or an unbounded scope for setting adjustments. Flexibility comes at the cost of some certainty, but a good balance is for the review process to be regular and for changes to take effect with a decent lead time. The recently passed Climate Change Act provides for consultative reviews of progress and future targets by the CCA and transparent reporting of progress by the Minister. It is important to maintain this consultation and transparency when it comes to reviews of, and any future decisions to amend, the Safeguard.

Aggregate headroom – the extent to which the sum of all baselines currently exceeds actual emissions – is incompatible with the overall climate objective and with the critical design element of crediting below baseline: in a system that is over-baselined in total, issued credits would be seen as having no integrity or meaning. It is appropriate to remove aggregate headroom. The choice of means by which to do so is largely a distributional question among Safeguard facilities, but there are some efficiency implications.

Industry average baselines would create initial winners and losers. This would tend to reward those who have already taken steps to reduce emissions, but often also those facilities that are simply younger, or (in the resources sector) those with a favourable geology. The outcome of arguments about whether these rewards are fair or efficient is important for confidence in the SMC market, since below-average-emissions facilities might be credited from day one.

In many sectors Australia has only a small number of facilities, making industry averages very lumpy. Individual facility baselines simply rebased to a recent actual level would punish more carbon-efficient facilities; efforts to sculpt each baseline to reflect judgments about merit would be complex and contested. On the other hand, all of these differences will become less relevant over time as all baselines decline.

On balance Ai Group narrowly prefers industry average baselines, as they provide better-targeted incentives

for carbon-efficient investment and operational decisions.

The treatment of new facilities and significant expansions is absolutely crucial. The Government is considering the idea of a 'new entrant reserve' within the overall Safeguard carbon budget to allow for new facilities. Given the number of new coal mines and gas fields that are proposed, generous treatment of new facilities means substantially harsher baselines and decline rates for existing facilities.

The Paper considers two options for new facilities: emissions benchmarks set at Australian best practice (the existing emissions intensity of the best 10% of current facilities); or benchmarks set at the current industry average. Once set for a facility, the benchmarks would decline like baselines in either case.

These options are inadequate, especially the industry average, and would significantly increase pressure on existing facilities while discouraging new investment from net-zero-readiness. We propose that new facilities be subject to global best practice benchmarks for new facilities. This should be significantly tighter in most cases than a purely Australian focus. Any new facility benchmark should be technology-neutral, applying to any process on the basis of its ultimate product. It should also avoid distinctions on the basis of location or geology.

3.3. Crediting and trading, domestic offset and international units

Crediting, trading and the use of offsets play an extremely important role in controlling the overall cost of a scheme and evening out compliance costs between individual participants. The Australian Climate Roundtable's [principles](#) state in part that:

Policy should allow Australia to meet its short and long term emissions reduction goals at least cost.

To achieve this policy should:

- *drive domestic abatement wherever it is efficient and internationally recognised across all sectors of the Australian economy;*
- *make use of internationally recognised abatement from overseas to ease the transition towards net zero emissions;*

That inclusiveness is critical across Australian policy as a whole. The situation within a single policy instrument like the Safeguard is a little more complex.

The more fungible carbon is across time (through banking and borrowing) and sectors of the local and global economies (through the equivalence of different kinds of carbon unit), the more theoretically efficient a design can be. There are many sectors outside the Safeguard Mechanism, particularly land and agriculture, that appear to have significant though finite volumes of abatement potential at moderate cost.

However, there are also risks from complete fungibility:

- There are many examples of offsetting and cap-and-trade systems going awry. Sometimes this represents technological surprise, sometimes forecast error, sometimes bad design, sometimes fraud. The result can be a flood of units that have low credibility and which reduce the effectiveness of the overall scheme. For example, Europe greatly overestimated future business-as-usual emissions when setting caps under the initial phases of its ETS – economic growth was lower than expected, the energy intensity of growth was lower, and the carbon intensity of new energy was lower. The result was a large overhang of emissions units and low prices providing weak signals.
- Fungibility across time can greatly limit the ability of a scheme to update its ambition, or to respond when a stock of excess or questionable units mounts up. For instance the longevity of EU ETS allowances meant that it took many years, and major adjustments to the previously stated scheme rules, to reduce the allowance surplus created by bad initial scheme settings.

The value of crediting, trading and offsets is too high to ignore. However there is a strong case for 'bulkheads' – limitations on full fungibility that help to prevent an error or integrity breach in one connected element from flooding the entire policy.

Any such bulkheads should satisfy at least three principles:

- They should be as simple as possible. Quantitative limits or time limits on the use of units would be vastly preferable to case-by-case audits.
- They should avoid increases to the cost of doing abatement. Discounting units beyond their actual uncertainty level, garnishing issued units for public policy reasons, or holding units back to address a risk of reversal from unrelated units would all make it less attractive to do abatement.
- They should be considered in light of their cumulative effect. Individually reasonable limits or guardrails can become unreasonable if multiple limits apply to a single credit type or the sum of restrictions on a facility's options leads to substantial increases in the marginal cost of abatement.

There are three broad classes of unit of current interest: SMCs, ACCUs (and potentially other domestic units) and international units.

The Paper indicates that SMCs will be considered compliance units, not offsets, since they will originate within a mechanism that has a hard overall limit on net emissions. There will be automatic issuance of SMCs without case-by-case inquiry, and no limit on their use except, potentially, a limit on carryover of 'Phase 1' SMCs (2023-24 to 2024-25) to 'Phase 2' (2025-26 to 2030-31). The Government envisages no use of SMCs outside the Safeguard itself, though there may be scope for parties other than Safeguard facilities to buy, hold and trade SMCs – for instance as intermediaries.

SMCs play a critical role in underpinning decarbonisation investments within an evolved Safeguard and there should be no quantitative limits on their use for compliance, particularly if new facility benchmarks are extremely strict as proposed above.

However there may be a case for time limits on the life and use of SMCs. This would limit the long term significance of any early mistakes in baseline-setting. It would also encourage trading and market liquidity by limiting the potential benefits of hoarding. This should not undermine the benefits a Safeguard facility can expect from investing in their own decarbonisation, since the investment will produce a stream of SMC issuance for as long as actual emissions remain below the declining baseline, and each issued SMC can be monetised through trade within the vintage window.

A rolling time limit on the compliance use of SMC vintages would be better than a system of phases; the latter would provide sharp reductions in the value of abatement activity as the end-of-phase approaches, and no guardrail at all once an indefinite phase is reached. The time limit on use of vintages should be aligned with the rolling five year time window suggested above for other tweaks to scheme settings to take effect.

ACCUs are an important means to access abatement potential across the wider Australian economy and avoid concerns that the Safeguard facilities might be exposed to a much higher marginal cost of abatement than other sectors and sizes of business. ACCUs are currently being considered by the Chubb Review in response to concerns about the integrity of some existing units and methodologies. It is unclear what this independent review will find, and it is possible that ACCU prices and available volumes will be significantly different afterward. In the long term offsets are unlikely to be cheap and their efficient role will be to supplement deep direct emissions reductions, not substitute for them. We have also observed some resistance from the agricultural sector to the idea that their abatement potential will be purchased by Safeguard facilities. On the other hand, in the absence of any proposed regulatory obligations on landholders that are comparable to the Safeguard, future private demand from Safeguard entities is currently the largest plausible driver of emissions reduction and carbon removal on the land, including from emerging options like methane-reducing livestock feed supplements.

Use of ACCUs by Safeguard entities should be subject to the same five-year vintage limit suggested above for SMC use. Any other limits should be considered in light of the cumulative impact of any reforms flowing from the Chubb Review, but there may be a case for an additional quantitative limit on usage, to satisfy agricultural concerns about overreliance on their sector and to keep the SMC market central. A limit applied to individual facilities would provide greater clarity and access than a market-wide cumulative limit. A limit is probably best expressed in terms of a share of the initial value of the facility baseline, rather than a share of current year emissions, so as not to become excessively onerous as facility emissions decline. The appropriate level of any limit would need careful consideration and adjustment over time.

International offsets are not proposed to be initially accepted, but would be reconsidered down the track. Ai Group has long emphasised the importance of access to international units for moderating Australian abatement costs and we advocated for the successful conclusion of workable global rules for this under Article 6 of the Paris Agreement. However since these rules were only agreed at Glasgow in 2021, we are likely several years away from the emergence of new Paris-compliant units and markets.³ It is not clear what prices and volumes might be available through bilateral cooperation under Article 6.2 or the new global mechanism under Article 6.4.

It is therefore reasonable to defer decisions on the inclusion of specific international units. In the meantime the Government should:

- Commit to the principle that Safeguard entities should have access to credible Paris-compliant international units as they emerge;
- Ensure that the legal infrastructure is in place for the future recognition of such units. Section 22XM of the *National Greenhouse and Energy Reporting Act 2007* (NGER Act), which underpins the current Safeguard, provides legal scope for the issuance of rules that allow use of units recognised under a successor to the Kyoto Protocol. This scope should be preserved while updating the text to reflect the Paris Agreement and making related amendments to the *Australian National Registry of Emissions Units Act 2011*;
- Contribute to the multilateral work to rapidly operationalise the Article 6.4 global market mechanism and ensure it has high integrity and low transaction costs; and
- Explore bilateral arrangements under Article 6.2, including the Indo-Pacific Carbon Offset Scheme and potential linkages to compliance mechanisms in Canada, Europe, South Korea and elsewhere.

Future use of international units should be subject to whatever reasonable limitations apply to the use of ACCUs.

The Paper does not raise the idea of recognising other domestic units as well as ACCUs, but this could be considered. Victoria's Victorian Energy Upgrades scheme, the NSW Energy Security Safeguard and the Large-scale Renewable Energy Target could all be considered as offset schemes. Their inclusion would require careful rules to avoid double-counting and the development and maintenance of 'exchange rates' for carbon emissions avoided (since only VEU units are currently expressed in tonnes of CO₂ equivalent). Inclusion might inspire some concern from existing liable parties under those schemes, who might expect extra demand to increase their compliance costs. However it could be a useful way of increasing offset liquidity and equalising marginal abatement costs across the industrial and electricity sectors and between large and small energy users. To maintain overall scheme stability and the centrality of the SMC market, any use of alternate domestic offsets should be subject to the same vintage (and potentially quantitative) limitations as the use of ACCUs.

³ The Glasgow outcome did allow for the transfer of a limited number of Certified Emission Reduction units from the old Clean Development Mechanism to the registry of the new Article 6.4 global market mechanism. However these specific units are widely seen as having no integrity, their transfer being a diplomatic price of agreement by large developing and emerging economies to the Article 6 rules. They should not be accepted into the Safeguard.

3.4. Trade exposure

The risk of a climate policy-related loss of trade competitiveness, and options for how best to manage it, are at the heart of climate policy and have been central to Ai Group's thinking over many years.

3.4.1. Continuing relevance of the issue

There have been many differing formulations of the trade competitiveness problem and it is important to be explicit about this. The Australian Climate Roundtable's [principles](#) state:

Policy should prevent the unnecessary loss of competitiveness by Australia's trade exposed industries and net increases in global emissions that might otherwise occur due to the uneven international application of climate policies.

On this view it is not any and all loss of competitiveness or production that is of concern, but a loss that is due to climate policies that are unevenly applied across economies; and which results in an increase in global emissions. In a net zero emissions world Australia's economy will be different to today's, not least through the fate of coal and gas production. But it would be highly undesirable for industries with a strong net zero future to be lost before they get there because they bear a higher direct carbon cost than their competitors. Most economic activities are not so emissions intensive that a carbon cost would be competitively relevant. But some clearly are: for instance, conventional approaches to steelmaking, cement production and aluminium smelting involve large emissions compared to their revenue or value added, and emerging low emissions approaches look to have cost increments that are competitively significant in the absence of policy signals.

The context for these concerns has evolved significantly. Under the Paris Agreement all nations must commit to emissions limitation or reduction. The major economies all have net zero emissions commitments and meaningful action towards medium and long term goals is widespread. There is also an increasing converse risk that in a world where investors and customers expect decarbonisation, and trade measures are emerging that embody climate objectives, industry could lose competitiveness by failing to move fast enough.

However the original competitiveness issue remains extremely relevant. Global action is uneven and diverse. There is no imminent prospect of a single global carbon pricing system, though bottom-up cooperation between clubs of like-minded nations may be emerging. Those economies that are acting most aggressively to reduce emissions through carbon pricing are all doing so in ways that seek to preserve trade competitiveness, including through free allocation of emissions rights or tax deductions comparable to Australia's past treatment of Emissions Intensive Trade Exposed (EITE) industries.

The design of a more aggressive Safeguard Mechanism needs to address both the risk of lost competitiveness from uneven policies, and the risk of lost competitiveness from insufficient action.

3.4.2. Defining trade exposed industries, facilities or products of concern

The starting point for considering trade competitiveness in the Safeguard is that while this policy context is quite different to that in the former Carbon Pricing Mechanism (CPM), it is illuminating to analyse them on the same basis.

- In the former CPM all liable parties had to purchase all of their emissions rights from the Clean Energy Regulator, except for those parties defined as EITE. Through the Jobs and Competitiveness Program (JCP) EITEs received a free allocation of emissions rights equal to their production times a historic industry average emissions intensity times an allocation factor, starting at 94.5% for High EITEs and 66% for Moderate EITEs. These allocation factors declined by 1.3 percentage points per annum. There was provision for future review by the Productivity Commission to advise whether, given local and global circumstances, the allocation decline should speed up, slow down, halt or reverse.
- In a reformed Safeguard all covered facilities receive baselines or benchmarks that start at or close

to their actual emissions and decline over time. This is equivalent to the JCP free allocation arrangements, except it applies to all facilities; the starting allocation rate is higher for all; and the decline rate will be faster given the deeper overall targets and later start point.

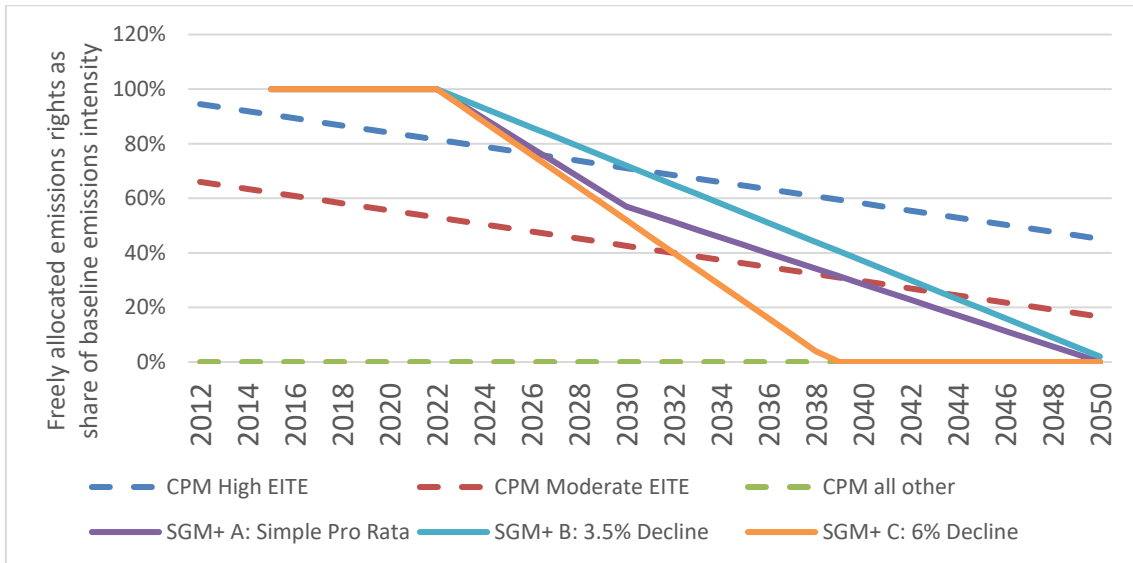


Figure 1 - comparison of JCP allocation rates and indicative SGM baseline decline rates

Figure 1 above compares the High, Moderate and Non-EITE free allocation rates under the old CPM to three illustrative baseline decline trajectories under a reformed Safeguard Mechanism. The latter trajectories are above prior allocation rates until at least 2026 (for former High EITEs), 2033 (for former Moderate EITEs), or ever (for former non-EITEs).

The Safeguard design itself thus initially addresses EITE issues at least as thoroughly as previous approaches. However, continued baseline decline will eventually see the re-emergence of tensions between emissions goals and competitiveness – just as would have happened under a continued CPM. As allocation rates or baselines fall, eventually out-of-pocket carbon costs become large enough to be competitively relevant. Some further solution to competitiveness issues will be needed.

We interpret the Government’s proposed new approach to defining EITE as a response to the circumstances outlined above.

The existing EITE definitions originate with the CPRS and CPM and survive through the RET exemption arrangements. They define EITEs as activities with a trade share (value of imports and exports divided by value of domestic production) above 10% and an industry average emissions intensity above 1000t per \$m revenue or 3000t per \$m value added (for Moderate EITEs) and above 2000t per \$m revenue or 6000t per \$m valued added (for High EITEs). These definitions are well understood and involved substantial work to develop, so they should not lightly be set aside. However the old EITE definitions have some weaknesses:

- they are based on industry data that is now very old: emissions from 2006-07 and 2007-08, revenue or value add data from 2004-05 to 2008-09 and trade share data from 2004-05 to 2007-08. Some industries have significantly altered their emissions intensity since then, and trade patterns have shifted in several ways;
- they are based on carbon emissions from both Scope 1 (direct) and Scope 2 (embodied in offsite electricity consumed onsite). However as proposed the Safeguard reforms only apply to Scope 1, making electricity consumption irrelevant to potential exposure (particularly given the complete exemption of existing EITE activities from gross costs of the RET). The former EITE definition also applied an assumption that every megawatt-hour of electricity consumed was associated with the production of 1 tonne of CO2 equivalent. But over the past 15 years electricity sector emissions have

declined substantially and are set to fall much further; and

- they reflect a policy context where emitters were by default responsible for the whole of their emissions, rather than only those above a declining baseline.

As we understand it the Government's suggested new EITE definition approach would involve a test of trade share and carbon cost intensity, applied at a facility level not an activity/industry level. We interpret the key change to be the cost intensity focus, with the switch to a facility focus a consequence.

A carbon cost intensity calculation tries to take account of the fact that with a baseline in place a Safeguard facility faces potential out-of-pocket costs only on the fraction of its emissions above that baseline. It is therefore very likely that under this approach, many fewer facilities would be defined as EITE – perhaps none at the outset when baselines were high. Over time, more facilities would qualify as baselines fell. If marginal abatement costs increased with higher demand for abatement this would also expand EITE, though falls in clean technology costs will also be relevant.

The proposed new approach to defining EITE has some merit. But there are at least three challenges:

- The Government must set a threshold for carbon cost intensity above which there is a concern about potential carbon leakage. It is not clear what an appropriate number would be and we expect this will be the subject of plenty of argument. A significance threshold is necessary, but also necessarily somewhat arbitrary.
- Carbon costs will become less visible, and potentially go uncounted, once they are internalised in facility equipment and processes. The traded price of SMCs or ACCUs can be workable proxy for marginal abatement price but the volume of costs may become more complex to assess over time.
- Recalculating EITE status annually would be a lot of work and, given volatility in markets, facilities could flip back and forth under a simple approach. This would be bad for predictability and certainty. Trailing averages for calculation inputs such as trade share or value added would likely be better than single-year calculations.

Ai Group is open in principle to the cost intensity approach to defining EITE, subject to further discussions of these challenges. There may be simpler alternatives. For instance, the old EITE calculation could be remade with updated data for trade share and Scope 1 emissions intensity, then discounted by the expected decline of the baseline below its initial value. This would produce a more predictable forward schedule of EITE status.

3.4.3. Trade exposure treatment options in the Paper

However EITE is defined, what treatment flows? The Paper raises three options which are all unsatisfactory in different ways.

- Access to finance and funding outside the Safeguard to accelerate decarbonisation. Substantial concessional finance and some grant funding are expected to be available collectively from ARENA, CEFC, NAIF, NRF and PRF. This could help some facilities to make investments that reduce or eliminate their exposure to costs above the baseline. However, there is no direct and necessary correlation between the assistance that may be available and the competitiveness risks that facilities face at a point in time. Some facilities may be many years away from commercially available technologies that can be made investable through concessional finance. In short this option is potentially helpful, but insufficient.
- Garnishing a share of SMC issuance to allocate freely to EITEs. This is a terrible option that pays for EITE assistance by increasing the effective cost of doing abatement. For instance a facility that cuts emissions below baseline by one tonne at a cost of \$50 per tonne might be issued with 0.9 SMCs, with 0.1 SMCs transferred to EITEs. That would raise the effective cost to \$55.56, discouraging tradable abatement within the Safeguard in favour of increased reliance on purely internal cuts and out-of-Safeguard offsets. Marginal abatement costs and overall abatement costs would be higher than necessary and industrial decarbonisation would be delayed.
- Slower baseline decline rates for EITEs. This is potentially a more effective protection than access to finance and does not increase marginal abatement costs. However it has two problems:
 - with a fixed overall emissions goal, slower decline for EITEs requires faster decline for others. This may be manageable if few facilities qualify as EITE, but would become more challenging if EITE is expansive (noting nearly half of current Safeguard facilities were formerly defined as EITE);
 - eventually tensions will re-emerge between the overall emissions ambition and the cost-competitiveness of industry. At the latest this comes when non-EITEs are at net zero baselines (unless they are to become liable for more than their own emissions) and either EITEs have to assume competitively significant costs or the emissions budget has to give.

The combination of baselines, access to finance and potentially slower baseline declines for a narrowed definition of EITE may well be sufficiently functional to avoid a loss of competitiveness during the early years of a reformed Safeguard.

For some activities technological and market change may eventually mean that low- or zero emissions production is cost competitive even without a policy signal. This has happened for electricity generation, much to the surprise of many. It may happen to others, and already-proposed public funding for innovation and finance for commercialisation will help.

However for other activities it currently appears that there will always be a cost premium for low- or zero-carbon production in the absence of a firm carbon constraint. Ultimately a different solution to trade competitiveness will be required for these activities. That solution will need to be durable, economically efficient, fair and environmentally effective. Ai Group thinks that an option not considered in the Paper could fit this requirement: an Australian Carbon Border Adjustment Mechanism (CBAM).

3.4.4. A potentially better alternative: an Australian CBAM

A CBAM would level the international playing field for Australian producers of products with a risk of carbon leakage. It would do so by imposing an equivalent to their carbon cost on relevant imports, and rebating an efficient metric of carbon costs to relevant exports.

The European Union is currently in the final stages of agreeing the design and implementation of a CBAM, which is likely to commence as a reporting obligation in 2023-25 and as a financial obligation from 2026. The EU CBAM will initially apply to aluminium, cement, chemicals, iron and steel and potentially hydrogen, and will likely expand over time to the full range of products for which there is a serious risk of carbon leakage. Other jurisdictions are also considering CBAMs, and the United States and Europe are developing an agreement to encourage trade in cleanly produced aluminium and steel and to discourage trade in high emitting metals. Trade-related climate measures are becoming tangible internationally and relevant to Australia.

The Major Economies Business Forum on Energy Security and Climate Change (BizMEF), including peak business bodies from Europe (BusinessEurope), Japan (Keidanren) and the United States (US Chamber of Commerce and US Council for International Business) has considered the issues around CBAMs and endorsed [three key principles](#) for their potential use:⁴

1. **Purpose:** *Border Adjustments should only be considered as a complement to domestic emissions reduction policies that create meaningful burdens on domestic emitters. If pursued, their primary purposes should be to:*
 - a) *Support mitigation that is environmentally effective while being economically, politically and socially sustainable; and*
 - b) *Enhance the credibility of markets for low, zero and negative emissions goods.*
2. **Trade commitment compatibility:** *Border Adjustments should reflect and respect the commitments that nations have made to each other through bilateral, plurilateral and multilateral trade agreements. Border Adjustments should first and foremost be compatible with the World Trade Organization (WTO) rules. Key implications are that Border Adjustments should be:*
 - a) *Non-discriminatory, offering formal and procedural fairness to all trade partners;*
 - b) *Open and transparent in development, design and administration;*
 - c) *Designed to equalise carbon constraints for trade-exposed industries, not penalise particular nations, sectors or businesses; and*
 - d) *Designed to facilitate trade, not to discourage it.*
3. **Practicality:** *Border Adjustment designs must be practical to implement and minimise transaction costs. They should limit coverage to those products where there is a serious potential for carbon leakage, but this consideration should take account of Border Adjustment flow-on impacts across supply chains that may extend leakage risks to additional products.*

[Ai Group research](#)⁵ has considered the economic, legal and practical aspects of CBAMs and concluded that they are a potentially viable option for Australia once we have a meaningful domestic carbon constraint to adjust for.

With respect to economics, under a CBAM domestic production for domestic consumption will be able to recover its carbon costs from customers to the extent that it is keeping up with the pace of decarbonisation by alternate suppliers of substitutable products. This production therefore does not require any shielding from carbon costs. Consumers face an incentive to switch consumption to more carbon-efficient products, since these will be able to offer a lower selling price. Meanwhile relevant exports can be shielded from

⁴ Major Economies Business Forum on Energy Security and Climate Change, *Border adjustments for carbon: perspectives from global business* (2021) <https://www.globalenergyinstitute.org/sites/default/files/2021-11/COP26%20bizmef%20paper%20carbon%20border%20adjustment%20-%20Final%2011042021.pdf>

⁵ Ai Group, *Swings and Roundabouts: the unexpected effects of Carbon Border Adjustments on Australia* (2021) https://cdn.aigroup.com.au/Reports/2021/Carbon_Border_Adjustments_Policy_Paper.pdf

domestic carbon costs at a much lower net call on the carbon budget than under previous free allocation approaches. Export markets may plausibly apply a CBAM of their own to these imports. Trade distortions can be fully avoided.

With respect to trade law, a CBAM can be implemented while fully respecting the letter and spirit of trade commitments under the General Agreement on Tariffs and Trade and Australia's other plurilateral and bilateral Free Trade Agreements. The keys to trade compatibility are for a CBAM to avoid discrimination against imports as compared to domestic production or against one nation as compared to another; and to avoid provision of an unlawful subsidy to exports. It would be vital to discount import imposts to reflect the baselines provided to relevant Australian producers and any out-of-pocket carbon cost paid in the country of origin. Any rebates to Australian exports should not be greater than their actual carbon cost.

In practical terms, a CBAM can be made highly implementable by focussing only on products for which carbon costs can make a material competitive difference; by maximising the use of existing Customs and Clean Energy Regulator systems for data reporting; by converging with international approaches for the declaration and validation of embodied emissions data; and by using simple default emissions intensities derived from well-understood domestic data as a backstop where credible data is not declared at the border. Emissions directly associated with the production of basic materials and the simple products that incorporate them are the focus. There is unlikely to be any need to grapple with more complex products or reach further up supply chains, because the potential emissions costs involved will be too dilute to be competitively relevant.

CBAMs are not currently widely understood in Australia and have been discussed, if at all, entirely in the context of the impact of other economies' potential adjustments on Australian exports. An Australian CBAM could usefully borrow some design elements and methods from the EU, but our own distinct policy, governance and economic circumstances would require a CBAM tailored to our needs, not a copy. For instance:

- EU approaches to assessing and validating emissions data at the border, and applying defaults in the absence of data, could be very useful to mirror or adapt – the issues are complex and benefit from harmonisation;
- The EU may or may not apply an export adjustment, but Australia's more export-oriented EITE industries make an export adjustment essential whether or not the EU follows suit.

It would take considerable work within government and with domestic stakeholders to put a CBAM into the realm of the potentially decidable.

Even more work would be needed to implement a CBAM, which would involve many design options. The issues include defining the scope of products of concern; establishing a basis for an import adjustment; establishing a basis for an export adjustment; and establishing necessary supporting systems for the operation of the CBAM, drawing on existing data and mechanisms wherever possible. There may be many viable answers, but one plausible model is sketched at **Appendix A** below.

It is not plausible for an Australian CBAM to be agreed and implemented for the targeted commencement of the evolved Safeguard in July 2023.

That said, with hard work a CBAM could realistically be implemented within five years, in which time the decline of Safeguard baselines will make such an effective and durable system necessary and experience with the EU CBAM will provide useful systems, data sets and knowledge.

We therefore recommend that the Government establish a work program to explore design options for an Australian CBAM, in full consultation with industry, importers, the wider Australian community and our trade partners. The Government should clarify that any resulting CBAM would not be implemented before 2025 at the earliest, and commit to providing adequate notice and transition arrangements for importers and EITEs if and when a decision to adopt a CBAM is taken. The Government should adopt the BizMEF CBAM principles, in particular reassuring our trading partners that any CBAM adopted would be fully consistent with our WTO,

plurilateral and bilateral trade commitments, and practice strong transparency during the design and potential implementation of a CBAM. The Government should work with other jurisdictions including the EU on procedures for the validation and assurance of emissions data declared at the border, on the accreditation and mutual recognition of national systems of facility-level emissions data reporting, and on the range of other options for collaboration on CBAM data, law and policy suggested by [BizMEF](#).

An agreed design emerging from such a process, if consistent with the principles we have laid out, could be a more effective, efficient and sustainable solution to trade competitiveness concerns. Ai Group is ready to participate in such a process and work for a successful outcome.

3.5. Multi Year Monitoring Periods (MYMPs)

The Paper raises the prospect of allowing longer-term MYMPs than today, but to a more limited set of facilities on a case by case basis to smooth out compliance future abatement prospects are delayed and lumpy.

The necessity of this setting depends heavily on the resolution of other elements. Full access to tradable SMCs and some level of access to domestic and international offsets greatly reduce the impact of individual facility characteristics on their marginal cost of abatement, though not the volume of abatement from whatever source that they may require above their baseline. To the extent that there is banking and especially borrowing of future SMCs, this substitutes for MYMPs; conversely, limiting banking and borrowing increases the case for MYMPs. The treatment of trade exposure risks is probably the most important setting. If trade exposure risks are fully addressed, such as through a CBAM, the consequences of baseline decline are vastly reduced. Thus whatever the initial MYMP settings, these should be reviewed if a CBAM is introduced after the commencement of an evolved Safeguard.

3.6. Baseline decline rates

Ai Group understands that baseline decline rates for any facility depend heavily on the overall emissions goal and the cumulative effect of the treatment of all facilities through other design elements. Decline rates must be higher for some facilities if they are lower for other facilities. They must be higher for all facilities if baselines start higher. They must accelerate later if they are slower at the outset.

Baseline decline rates will need to be adjusted over time, particularly as national emissions goals evolve and new Nationally Determined Contributions are developed for 2035, 2040 and 2045. Decline rates could also be amended if a CBAM were to be introduced. However, some confidence is needed in the security of settings. In line with other recommendations in this submission, decline rates should be as firm as possible within a rolling time horizon of five years, with amendments or adjustments taking effect beyond this window, other than any needed to reflect EITE treatment.

3.7. Enforcement

The evolved Safeguard will need to be enforceable to ensure a level playing field between compliant and noncompliant facilities. Section 22XF of the *NGER Act* provides for civil penalties, to be set in the Safeguard Rules, to ensure that emissions do not exceed baselines. However the Rules are currently set such that penalties are per breach, rather than reflecting the volume of excess emissions, and are capped at 10,000 penalty units (currently \$2.2m).

The maximum penalty will need to be larger to be a credible sanction for an evolved Safeguard, or potentially be uncapped. The Government could consider an uncapped volumetric penalty for noncompliant net emissions. This would provide a credible and scalable guarantee of compliance.

The noncompliance penalty per unit could potentially serve as a cap on compliance costs, since a facility might judge that their compliance costs were higher than the penalty (allowing for the impact of the nondeductibility of penalties from company tax). This would help contain potential marginal abatement costs, particularly if the SMC market is immature and illiquid at the outset. On the other hand, a cap set low enough to bind regularly could prevent the Safeguard from achieving its overall emissions objective.

On balance a volumetric penalty should be set high enough that it is expected to be a backstop for compliance rather than an escape valve. Given the Government's position that the Safeguard is not a revenue-raising mechanism, to the Government should consider whether rather than remitting any penalties to consolidated revenue, they could be:

- added to the Powering the Regions Fund to purchase abatement and support industry decarbonisation; or
- added to Australia's international climate finance and climate aid efforts; or
- divided among all Safeguard facilities that were compliant in the year of the penalty.

3.8. Other issues

The Paper's position is to propose no change to the current treatment of electricity generation facilities under the Safeguard. These are presently included on a sectoral basis; if the historic high point of electricity sector emissions were ever breached, which it is now clear will never happen given ongoing decarbonisation, absolute baselines for individual facilities would be triggered. These would be perversely dysfunctional in many cases.

Electricity sector emissions have fallen deeply, reflecting the growth of wind and solar and the combination of retirement by some coal and gas generators and the declining output of others. Stakeholders and governments now expect relatively rapid coal retirement and renewables deployment to continue, as reflected for instance in the central scenario of the 2022 Integrated System Plan for the National Electricity Market.

Electricity decarbonisation will likely continue without changes to the Safeguard treatment of the sector. However, there are two reasons to consider amending the electricity component of the Safeguard:

- There is some potential for the evolved industry safeguard to drive perverse consequences, at least in the medium term, without corrective action. Industrial, resources and transport facilities covered by an evolved Safeguard would be liable only for their Scope 1 (direct) emissions. A facility can reduce its liable emissions by electrification, for instance by the use of high temperature heat pumps, electrolysis or electric vehicles. This would be counted as full emissions reduction whatever the offsite generation mix involved. While in the long term the ongoing decarbonisation of the electricity sector reduces the risk of perverse outcomes, it would be possible for real overall facility emissions outcomes to fall short, or even worsen, in the medium term. Compromising the automatic nature of facility accounting and SMC crediting to address this through audits or life cycle analyses would significantly impede the efficient functioning of the evolved Safeguard.
- Energy Ministers and energy stakeholders have been debating the introduction of a Capacity Mechanism to the National Electricity Market as a key tool for ensuring a successful transition to very high expected levels of renewable energy and the exit of coal generation. This debate has been marked by intense fears from some stakeholders that a capacity mechanism may inadvertently increase emissions or slow the exit of expensive and unreliable generators; and by fears from other stakeholders that the mechanism may result in excessive costs for energy users through mandating an excess of new capacity, on the assumption that existing assets serve out their currently announced operating lives. These fears have resulted both in widespread opposition to specific capacity mechanism proposals, and in proposals for jurisdictional opt-outs, technological exclusions or other complicating amendments to a mechanism.

Converting the electricity element of the Safeguard into a binding cap on sectoral emissions could resolve all these problems, ensuring that electrification by industrial Safeguard facilities and the operations of any resources participating in a capacity mechanism fall within the cap. At the same time, given that rapid coal retirement and emissions reduction is now the business-as-usual expectation for the electricity system, such a cap would be unlikely to impose additional costs on energy users.

Ai Group outlined a possible model for an evolution of the electricity element of the Safeguard in our submission to the Energy Security Board's High Level Design for a Capacity Mechanism:

- The electricity sector-wide cap could be lowered annually in line with collective emissions goals – perhaps pegged to the central scenario of the ISP, with some allowance for the emissions paths of Australia's non-NEM electricity systems.
- That sector cap could be divided up annually amongst generators. There would be many options for that division – amongst all generators, or only those currently captured by the Safeguard Mechanism; evenly according to share of sector output, or according to different technological starting points; or with individual facility pathways.

- It would be important to allow crediting of performance below baseline by relevant generators, and the voluntary transfer of those credits to other generators, to provide flexibility for the most efficient mix of assets to operate at any point in time.
- However there would be no need to connect the electricity component of the Safeguard to the wider Safeguard or other domestic and international crediting systems through the export or import of credits. The purpose of the evolved electricity Safeguard would be in part to provide additional certainty about outcomes within the electricity sector, easing concerns by stakeholders and investors, and this would not be served by wider linkage.

A reform along these lines would not force asset retirement – economics, age, investor appetite and consumer preference will do that. But it would provide a backstop for the outcome that stakeholders expect anyway, and an extra layer of confidence about the overall emissions outcome and pace of retirement. We expect that would exorcise the bulk of concerns about gold plating and emissions with respect to a Capacity Mechanism.

Appendix A – Design issues and indicative settings for an Australian CBAM

Issue	Plausible option
Scope of products of concern	<p>Products proposed for inclusion in a CBAM would be assessed against trade share and emissions intensity or carbon cost intensity metrics with a significance threshold, similar to the old EITE definition or the Paper’s proposed model. The assessment would focus most directly on products, not facilities or activities, and the averages associated with their production in Australia.</p> <p>While the existing range of EITE activities would be the obvious starting point (for instance aluminium, ammonia and ammonium nitrate, cement, and iron and steel), there would be scope to consider inclusion of a wider range of more elaborate goods incorporating EITE products and associated emissions or carbon costs. However their higher value added would tend to make it unlikely for complex goods to pass the significance threshold.</p>
Basis for inward adjustment	<p>Imports of EITE products would be liable to acquire and retire carbon units equal to their liability. The carbon units could be SMCs or other units accepted for Safeguard compliance, or potentially a new non-tradable class of unit issued by the Clean Energy Regulator and pegged to the SMC price (equivalent to the EU approach).</p> <p>The level of importer liability (L_i) would be the difference between the product of the volume imported (V_i) multiplied by the difference between the import Scope 1 emissions intensity (EI_i) and the average current domestic baseline for the relevant product in the import year (B_x), minus the quotient of the total carbon cost paid in the country of origin (T) divided by the current unit price of SMCs (S).</p> $L_i = (V_i \times (EI_i - B_x)) - \left(\frac{T}{S}\right)$ <p>Initially L_i should be limited to values of zero or greater for the sake of simplicity. In future it could be considered whether negative values could be permitted, for instance to recognise negative-emissions production processes, and whether to reflect this through issuance of SMCs or some new class of unit tradable among liable importers.</p> <p>The import emissions intensity would be determined in the first instance by declaration at the border. If a credible declaration was not made, the first default would be the average emissions intensity of like products in the country of origin. If credible data for the first default were not available, the second default would be the average emissions intensity of the <i>least efficient</i> 10% of Australian production in the most recent year for which final data is available.</p> <p>Procedures for the acceptance of credible data and the accreditation of auditors will be needed but could be adapted from those adopted in Europe.</p>

Issue	Plausible option
Basis for outward adjustment	<p>Exports of EITE products would be eligible for a reduction in the emissions counted for compliance purposes at their domestic facility of origin, in addition to whatever baseline applies to their production for domestic consumption.</p> <p>Assuming that Safeguard baselines are production-adjusted, exporter liable emissions L_e would be the difference between the difference between total emissions E_t and the product of the volume of exported product V_e multiplied by the Scope 1 emissions intensity of the most efficient 10% of Australian production EI_a, minus the product of the difference between the total volume of production V_t minus the volume of exports multiplied by the relevant facility baseline B_f.</p> $L_e = (E_t - (V_e \times EI_a)) - ((V_t - V_e) \times B_f)$ <p>To avoid penalising potential future exporters of products with a net negative emissions intensity, the export adjustment ($V_e \times EI_a$) should be limited to values of zero or greater.</p> <p>Initially L_e should be limited to values of zero or greater to avoid net transfers to exporters which might attract WTO concern. In future there would need to be consideration of the treatment of net negative emissions production and how to recognise this while clearly not subsidising exports <i>qua</i> exports.</p> <p>Information about this adjustment would be made available to other jurisdictions on request by the jurisdiction or by the exporter, to enable the adjustment to be taken into account in other economies' CBAMs where applicable.</p>
Implications for other Safeguard design elements	<p>Domestic baselines that are production-adjusted and developed from industry averages will make the development of product emissions intensities easier and more defensible, but such intensities can be constructed even if compliance baselines are absolute and facility-specific.</p> <p>With a CBAM in place baseline declines would not necessarily burden industry and could accelerate in line with national ambitions.</p>
Supporting systems	<p>The CBAM would require the integration of existing data from the Customs systems operated by the Department of Home Affairs, including weights and tariff codes for imports and exports; and from the Clean Energy Regulator, including Scope 1 emissions (production data would also be needed, whether required for regular Safeguard compliance or not).</p> <p>These systems would need to be connected so that relevant tariff codes could be associated with EITE product categories and the relevant default emissions intensities.</p> <p>Importers of relevant products would also need access to the existing Australian National Register of Emissions Units for the acquisition and retirement of relevant units to acquit liabilities.</p>