



The Australian Industry Group
Level 2, 441 St Kilda Road
Melbourne VIC 3004
PO Box 7622
Melbourne VIC 3004
Australia
ABN 76 369 958 788

12 December 2023

Carbon Leakage Review
Department of Climate Change, Energy, Environment and Water

AI GROUP RESPONSE TO THE CARBON LEAKAGE REVIEW CONSULTATION PAPER

The Australian Industry Group (Ai Group) welcomes the chance to make a submission on the Carbon Leakage Review 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.

Carbon leakage and tools to address it may affect our members in several ways. Some of our members are what has previously been defined as Emissions Intensive Trade Exposed; some are in the supply chains of major EITEs and have a stake in their fate; some use EITE products as key inputs to their own businesses. All have an interest in a successful and economically efficient transition to net zero that limits climate change and maximises Australian opportunity.

The potential for carbon leakage, and the rational fear of it, are serious risks to that transition:

- There has been a welcome broadening and deepening of climate action through the Paris Agreement and the evolving policies of major economies. But global climate policies remain messy, multi-speed, and generally structured to minimise out-of-pocket costs to vulnerable industries.
- Dramatic improvements in the cost and performance of renewable electricity generation and some other key technologies have greatly reduced the expected costs of transition. But for many key industrial processes, in the absence of policy there is still expected to be a significant cost premium for clean pathways over high-emissions pathways.
- In advanced economies like Australia, emissions reduction ambition is rapidly reaching the point where incremental efficiencies will not suffice and transformational investments in new production processes are needed.

It thus remains perfectly possible – perhaps more likely than ever – that in the absence of corrective measures, a combination of uneven international policies, clean production cost premiums, and tightening Australian climate policies could cause serious disadvantage to Australian producers who ought to have a strong future in a net zero global economy, and lead them to pursue that future elsewhere.

This would be a terrible outcome for Australia. If businesses do not think they can recover the costs of those investments they will not make them here. If we lose otherwise-viable economic activity we would undermine our prosperity. We would also undermine the political conditions for a sustained, ambitious and efficient climate response.

That nightmare scenario is avoidable. Carbon leakage needs durable solutions, and Ai Group believes they can

be found.

The Carbon Leakage Review is a crucial opportunity for Australians to converge around an effective long term approach. That approach will likely require several components:

1. Existing anti-leakage measures, including the Trade Exposed (TE) elements of the Powering the Regions Fund, the Trade Exposed Baseline Adjusted (TEBA) element of the reformed Safeguard Mechanism, and the Safeguard baselines themselves. These play an important role today but will have to evolve over time. The advent of other measures will need to be carefully choreographed to avoid both gaps and duplication.
2. Enhanced transition investment by both the private and public sectors, including through announced and potentially emerging policies to underpin low- and zero-emissions industrial investments. Measures like clean industry Contracts for Difference could speed decarbonisation and reduce exposure to carbon constraints, but they may have significant budgetary costs and a necessarily time-limited role.
3. A non-discriminatory and pragmatic Carbon Border Adjustment Mechanism (CBAM) on vulnerable imports and exports. A CBAM would be a significant reform and require careful design, international collaboration and domestic policy evolution. Its application would need to be limited to addressing carbon leakage, and so it could not resolve all problems connected with climate transition or with trade. But it could be a major and increasingly important element of an effective Australian climate policy suite.
4. International cooperation, including through close consultations with our trade partners to ensure any CBAM is well understood and navigable; and through plurilateral coordination with other economies pursuing CBAMs and related measures, in order to share methodologies, data and best practices.

With these measures there is every prospect that Australia can combine high and rising ambition on climate mitigation with a strong and growing industrial economy.

We address key issues raised by the Review in the **Annexure**, and we look forward to engaging with the Review through the remainder of its essential work.

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,



Louise McGrath
Head of Industry Development & Policy

Annexure

Overarching issues

Carbon leakage – is the description of carbon leakage appropriate for the purposes of this Review?

The nature of carbon leakage is well described in the paper. However Ai Group wishes to emphasise two further points:

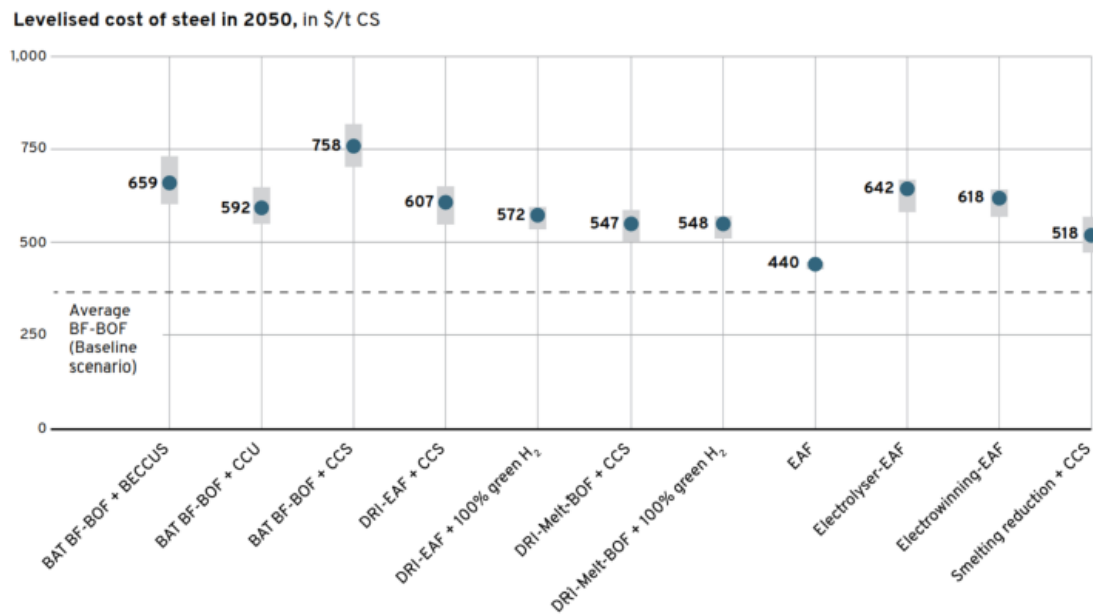
- Firstly that carbon leakage due to uneven international climate policies is a real and serious risk. While we acknowledge that it is hard to see evidence of any policy-driven leakage taking place around the world so far, that is very easily explicable. Few economies have had explicit carbon prices; all of those economies have had substantial anti-leakage measures built into their pricing systems; and their ambition has generally not yet been such as to require transformational investments rather than incremental improvements by covered emitters. But pricing is spreading, ambition is rising, and anti-leakage measures are evolving. We are firmly convinced that there remains a serious leakage risk that requires responsible and effective solutions.
- Secondly, we must all recognize that Australia has multiple policy objectives beyond the avoidance of policy-induced carbon leakage. Those include limiting global warming to less than 1.5C; building our national prosperity; increasing the competitiveness of our trade-exposed industries; maintaining sovereign capability in sectors of significance to our national security, broadly conceived; and more. The scope of the Review is properly focused on leakage and its terms of reference. However national policy making as a whole must consider and address the overall interests of the nation. A solution to leakage will not necessarily solve or address other concerns, so wider economic, industrial and climate policies will remain vital.

The Safeguard Mechanism – What is your view on how your business or industry could be affected by carbon leakage?

Ai Group represents a very broad range of industries who may be affected in different specific ways. Sector-specific discussions and deep consultation are essential. For instance, our members in steel and cement have voiced concerns about the accuracy of the sectoral emissions intensity data presented in the Paper, particularly where national averages may represent wide dispersions of performance.

The steel sector provides a strong illustration of the challenges of maintaining competitiveness while decarbonising. Nearly all current steel is made either through blast furnaces using metallurgical coal to reduce iron ore; or electric arc furnaces that recycle scrap steel. Recycling is vital, can be as clean as its power source, and has potential to grow locally and globally; but it cannot fully displace the need for primary steel, particularly as we go through a period of vast global and local infrastructure deployment to achieve decarbonisation. Clean primary steel production is essential.

However the best available evidence, for instance from the Energy Transitions Commission's Mission Possible work, is that clean steel will have a significant pre-policy production cost premium over high emissions steel for at least the next several decades. In the absence either of a green premium paid by customers, or a substantial capital and/or operating subsidy paid by governments, a clean steelmaker would expect to lose substantial amounts of money. The cost premium is absolutely bridgeable by policy, and will reduce with global deployment, learning and innovation. But if it is not addressed there will not be a viable pathway for new or continuing steel production under tight carbon constraints in Australia.



1 Data source: *Mission Possible: Making Net Zero Steel Possible (2023)*

Similar concerns exist for other products. Obviously the cement manufacturing sector faces significant costs to capture, store and utilise process emissions. But while other options exist to moderate emissions, such as the use of alternative feedstocks like slag, these are subject to costs and constraints of their own. These constraints can differ greatly from one market to another, and a deep Australian abatement requirement may thus create a significant disadvantage and leakage risk in the absence of anti-leakage measures.

Another important point is that under the status quo following the 2023 Safeguard Mechanism reforms there are two channels for impacts on potentially vulnerable industries:

1. Direct impacts on covered facilities, which are reduced to the extent of the baselines as modified by the Trade Exposed Baseline Adjusted program; and
2. Indirect impacts on facilities, whether covered or nor, through passthrough of costs by covered facilities. Ai Group members who are large industrial gas users report that they have already been required by gas suppliers to agree to price uplifts to cover those suppliers' expected costs under the Safeguard Mechanism. Upstream Scope 3 cost exposure could be expected to become a more relevant issue for a wider range of inputs under a potential CBAM. To the extent that upstream suppliers are able to pass through their costs, their leakage risks are addressed and further measures for them are unnecessary (and existing measures could be scrutinized). By the same token, downstream impacts will need to be considered.

Relevant goods and commodities – are there other goods or commodities beyond those identified as trade exposed under the Safeguard Mechanism that should be included in the assessment?

Steel and cement are high priorities to address because of their combination of significant current carbon intensity and substantial cost premia for low-carbon production pathways; high trade exposure; clear continuing need for their output in a net zero emissions world; and their expressed concern about leakage and desire to be covered by effective solutions. However there may be many sectors and products that are in

a similar position, whether now or over time as the Safeguard and leakage measures evolve. Ai Group therefore recommends consideration of objective and generalisable criteria for the application of carbon leakage measures.

There are existing approaches to this definition, including most prominently the Emissions Intensive Trade Exposed activity definition criteria originally developed for the Carbon Pollution Reduction Scheme in 2008-09. However these are not necessarily sufficient for the current context. The data sets involved are now old; and the scope of relevant carbon emissions and associated costs will be wider if a tool like CBAM is adopted and enables greater pass-through of upstream carbon costs.

Our initial suggestions for the product eligibility criteria for additional carbon leakage measures, all of which would need to be satisfied to be eligible, are:

- Competitively significant carbon intensity, assessed on the basis of Safeguard-covered emissions (including upstream Scope 3 where passthrough is expected), multiplied by a plausible price range for Australian carbon units, and compared to an appropriate metric for typical product price, profit or value added. The underlying issues is that at some point potential carbon policy unevenness-induced production cost differentials become large enough to make existing production or new investment uncompetitive and/or unattractive to investors. A threshold cutoff value will be needed, beneath which potential competitive impacts will be considered insufficiently significant. Such a value is inherently arbitrary, but necessary.
- High trade exposure, assessed against both the exported share of domestic production and the imported share of domestic consumption.
- A clear and credible pathway for the product and its global sector to thrive in a net zero emissions world. That need not mean that the product is itself ultimately zero emissions, but that it will continue to be needed in and compatible with a world that succeeds in meeting the Paris temperature goals.
- Expressed desire by Australian producers of the product for an additional leakage measure. A threshold will be needed, potentially of businesses accounting for at least half of domestic production. An additional leakage measure, such as CBAM, should not be applied where the affected Australian sector is not confident that it can meet their circumstances.

These eligibility criteria could be applied not just to the traditional products and sectors that have been the focus of past and present leakage policies, but potentially to complex goods, for instance those incorporating material inputs that are covered by a CBAM. The multiple inputs and value added of complex goods would tend to dilute potential competitive impacts and make them less likely to pass the tests sketched above. However it is very plausible that some complex goods would pass such as assessment. For instance, should steel and cement be covered by a CBAM, wind towers and offshore platforms – in which these materials are a high share of total input costs – could be subject to leakage risk and would be worth assessing.

Assessing impacts of carbon leakage and policy instruments - Is this characterisation of the potential impacts of carbon leakage and instruments to address it appropriate for the purpose? Are there other aspects that should be considered?

The paper is very satisfactory in this respect.

Analytical approach – What domestic economic effects from carbon leakage and policy approaches to address it are of particular importance for analysis and modelling? Would the analysis benefit from an assessment of impacts on bilateral trading partners and net global emissions?

The paper covers the issues well in general.

Some of the domestic economic factors to address may be hard to illuminate with CGE models. Partial equilibrium sector models can help, but firm-level scenario analysis may be useful too. For example, if a steelmaker decides in 2030 to start making H2 DRI green steel, what would we expect to happen:

- a) with no carbon policy
- b) with a strong Safeguard but no further leakage measures
- c) with Safeguard plus CBAM
- d) with Safeguard plus each of the other measures under consideration?

Regional impact analysis will be of interest, given the concentration of activity, investment and jobs in leakage risk sectors in Australia's regions. However, there are also limitations to these analytical approaches, which can risk a spurious appearance of accuracy. Broad indications of regional impact would be useful.

International economic effects are well worth considering. Discussions at COP28 have underlined that there is a widespread and inaccurate perception that CBAMs would impose serious costs on developing country trade partners. A full and reasonable analysis is likely to find that trade partners are not necessarily disadvantaged at all, relative to realistic scenarios for Australian policy. Such analysis will be a useful step, along with deep international consultations and engagement, in allaying international concerns.

Three further points of importance are:

- the Review should be cautious about drawing simple conclusions based on economic modelling that continued manufacture of particular products needed by a net zero world will not be viable in Australia even with effective anti-leakage measures. Such findings may be extremely sensitive to input assumptions and fail to account for the full range of public policy objectives and instruments. Modelling is better suited to coherently illustrating the consequences of our assumptions and illuminating relevant dynamics to guide policy design, rather than predicting the future.
- Members anticipate that modelling global emissions impacts will be complex, given the importance of detailed product market dynamics and second-round effects as a range of suppliers adapt to changed market and policy conditions. The effort is worth attempting, but the results will need caveats.
- Clear definitions and clear thinking will be needed, particularly with respect to the potential issue of resource shuffling, where existing high- and low-emissions product outputs may be redirected as a result of limited-extent price signals without greatly affecting global emissions.

Policy options to address carbon leakage risks – are there additional policy options that should be considered as part of a portfolio of approaches to carbon leakage?

The list is good but the international agreement element is even broader than canvassed. It also includes sectoral agreements such as those for aviation and shipping developed or being developed by ICAO and IMO; and, more controversially, the Global Arrangement on Sustainable Steel and Aluminum being negotiated by the United States and the European Union for potential accession by other parties if agreed.

It is also important to note that concerns about carbon leakage are related to but distinct from broader trade-related concerns, such as general competitiveness or the response to industry subsidies (including new green subsidies) in other economies. These issues are very important even if they do not fall within the Review's scope or cannot be dealt with directly by the tools under consideration. Broader government policies in relation to traditional trade remedies and potentially to clean industry development support through financial incentives, public procurement or otherwise, will be vital for the Australian Government as a whole to consider and pursue where warranted.

Existing measures under the Safeguard Mechanism – what is the capacity of current policy settings of the Safeguard Mechanism to mitigate carbon leakage risk into the future?

Existing Safeguard measures are helpful in the near term but their utility is limited by the available fiscal budget and by the decline rates dictated by the current and plausible future carbon budgets.

The funding committed to Trade Exposed facilities is welcome and will be helpful, but it is unlikely to make a large dent in the investments required for these facilities to decarbonise in line with the baselines. There is scope for further financial incentives, which could play a very useful role, as addressed below.

The baselines themselves constitute a very important feature for limiting carbon leakage risk, but they necessarily decline rapidly and it is anticipated that rapid sustained declines will be needed beyond the period of current firmly committed decline rates in order to contribute to Australia's forthcoming emissions targets for 2035. Meanwhile, the Trade Exposed Baseline Adjusted (TEBA) system of slower decline rates is very helpful in the near term for significantly affected facilities. However it appears that in the absence of market and/or policy changes it will be increasingly difficult beyond 2030 to reconcile these slower decline rates with the broader carbon budget for the Safeguard.

Even with these measures, covered members are concerned that they will be exposed to competitively significant out-of-pocket costs within a few years as their baselines decline faster than they can reduce their own emissions and as available carbon unit prices rise with stronger demand. Members are also very aware that the future of TEBA will be reviewed, along with many other important features of the Safeguard, in 2026-27. Future solutions are needed that are more environmentally and economically effective, sustainable and predictable as soon as possible, noting the complexity of potential policy options and the need for careful design and consultation.

We also note that the future of baselines and TEBA would need to be carefully considered if other leakage measures are adopted. Several courses of action may be possible but would need to be assessed against multiple objectives including upholding our WTO obligations. TEBA might remain relevant even under an Australian CBAM, but it would require careful choreography to ensure neither gaps nor doubleups ensue:

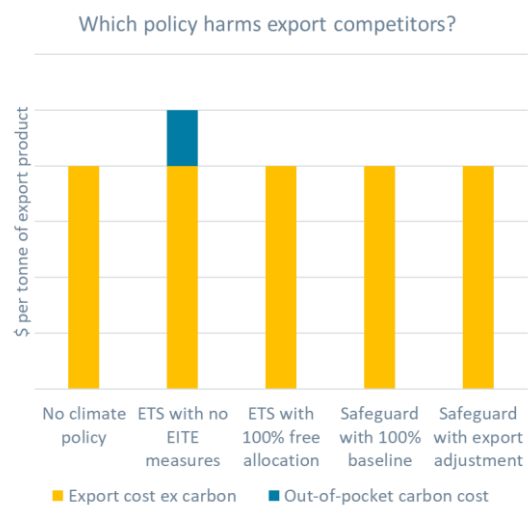
- Under a combination of CBAM and TEBA it may be that most facilities notionally covered by both no longer qualify for TEBA, because the application of CBAM would lead to product prices rising broadly in line with post-policy production costs, erasing the revenue share or EBIT impacts on which TEBA is based. This would leave TEBA in the role of an emergency backstop for CBAM-covered facilities. However note that since TEBA eligibility is assessed prospectively against expected impacts based on an estimated carbon cost, this would also require post-policy product prices to be assessed prospectively.
- To the extent that any facilities covered by both CBAM and TEBA were both so relatively emissions intensive that their production costs increased faster than their selling prices, and were unable to invest in cost-effective decarbonization, they might still qualify for TEBA. This would raise difficult questions about the purpose of TEBA and the scope for other policies, including financial support, to enable decarbonization investments. However to the extent that TEBA continued and moderated the baseline decline rates of any facilities relevant to a CBAM, the applicable import adjustment would need to reflect the extent of any TEBA activity in order to maintain WTO nondiscrimination.

Australian carbon border adjustment mechanism -is an Australian carbon border adjustment mechanism desirable? If so, which design features should be considered?

Yes, a CBAM could be an efficient, effective and sustainable tool to avert carbon leakage and facilitate greater investment and trade in low- and zero-carbon goods that Australia and the world will continue to require as we achieve net zero emissions. A CBAM would be a significant reform and require careful design, international collaboration and domestic policy evolution. It could not resolve all problems connected with climate transition or with trade. But it could be a major and increasingly important element of an effective Australian climate policy suite.

There are many critical design features to be settled. Ai Group suggests the following; some elements we merely note as important to determine, while for others we have initial proposals.

- **Generalisable rules for product coverage** (as discussed above), including treatment of complex goods with inputs subject to an upstream adjustment. Design thought will also be needed on when complex goods are best covered by simple extension of upstream product adjustments (ie assuming a wind tower is simply the equivalent tonnage of steel) or via a dedicated adjustment and product benchmark.
- **Scope of emissions adjusted.**
 - Scope 1 emissions are the starting point.
 - Scope 2 emissions cannot be considered or adjusted for as long as Australia does not meaningfully apply the Safeguard or equivalent mechanisms to the electricity sector. There are potential distortions that come with limited scope coverage, and a CBAM that does not cover Scope 2 will be of limited relevance to aluminium (a major export and vulnerable product type). Ai Group has previously advocated the meaningful coverage of electricity in the Safeguard via a distinct stream without access to ACCUs or non-electricity SMCs. However we recognize that this issue is out of scope for the present Review and better addressed through future consideration of the evolution of the Safeguard. Whatever that evolution, any CBAM would need to evolve in line.
 - Upstream Scope 3 emissions should be covered where they are covered by the Safeguard Mechanism, subject to practicality. For instance, covered upstream emissions by gas producers are relevant to the emissions footprint and competitive situation of downstream gas-intensive manufacturers.
- Whether to **adjust for exports** as well as imports. An export adjustment would be essential for a CBAM to meaningfully address many vulnerable Australian products, such as aluminium. However an export adjustment raises important design issues.
 - Legality. Ai Group’s analysis of the legal and substantive trade context is that an export adjustment need not in any way prejudice the interests of the businesses with whom Australian producers compete in export markets. The conceptual chart at Figure 2 illustrates the point: for a given level of effective leakage shielding, there is no competitor-relevant difference in outcomes between free allocation, baselines, export adjustment, and no climate policy. However it appears essential, in order to comply with the letter and spirit of the Agreement on Subsidies and Countervailing



2 Costs of Australian supply to export markets under assorted leakage approaches

Measures, for any export adjustment not to exceed the original value of exporter's liabilities – no net subsidy should be provided through an export adjustment. This could be achieved in several ways, including implementing an adjustment by means of a reduction in exporting facilities' liable emissions (bounded at zero); or the use of a tighter benchmark for export adjustment than the relevant facility's applicable intensity baseline. For example, a best Australian practice baseline could apply, or a global average, or global best practice.

- Fiscal and carbon budgets. Just like free allocation or emissions baselines, export adjustment comes at a cost – whether that cost is explicitly recognized and accounted for or not. Emissions rights have a financial value and represent a portion of the limited national carbon budget. To the extent that rights are not limited in one area of the economy, overall targets require more action in other areas or limit total action. However, a Safeguard with symmetrical import and export adjustments is considerably more fiscally and carbon-budget sustainable than one entirely dependent on free allocation via the baselines. Import adjustments offset the fiscal costs of export adjustments and furnish resources that can be applied to procuring or funding additional abatement.
- Interaction with other nations' policy regimes. The proper purpose of an export adjustment, like that of an import adjustment, would be to level the playing field on applicable carbon pricing in the relevant market. To the extent that export markets themselves apply a carbon price, export adjustments to that market are not required for competitive neutrality reasons. Whether Australia applies the Safeguard in full to these exports, and the costs paid are appropriately recognized at the destination; or Australia makes the export adjustment and costs are imposed via import adjustment at the destination; is largely of concern only to the governments concerned and for fiscal reasons. However clear rules, transparency and coordination with other jurisdictions will be required for an export adjustment to be credible and maximally practical. Australia would need to provide information about the extent and basis of export adjustment to trade partners, in addition to any domestic disclosure.
- The approach to **importer data declaration and assurance**. The emerging procedures of the European Union CBAM will merit close examination and potentially convergence, as will approaches to measurement reporting and verification from other exercises dealing with similar problems such as Australia's Guarantee of Origin schemes, other hydrogen and clean energy certification efforts worldwide, emerging embodied carbon measurement methodologies, and environmental product declarations. While addressing any unique Australian circumstances is important, ideally Australia will apply common international approaches in order to minimise compliance costs and ease trade.
- A basis for **default emissions values** to be used if data is not declared. These values should both respect non-discrimination and incentivize accurate declaration. The EU approach is to have two defaults (in the first instance, the national average emissions for the like good in the country of origin; if this is not known or not trusted, a benchmark for the least carbon-efficient production of the like good in the country applying the CBAM). Further refinements may be possible:
 - Refining national average defaults in light of the actual emissions data declared by other suppliers from the same nation; on the expectation that suppliers would only declare their data if it was better than the national average, this refinement would increase the assumed emissions intensity of undeclared supply and make productive use of adverse selection to sharpen incentives for accurate data declaration.
 - Addressing the expected decline in emissions intensity within Australian industries covered by the Safeguard Mechanism. A default that declined with local emissions, but not necessarily international emissions, would no longer be a functional incentive to declare validated data. Options could include fixing the default at initial values; or shifting to internationally-based data sets as and when trustworthy data becomes available.

Any approach needs to be practical, equitable and provide effective incentives.

- The **relationship between CBAM and TEBA** would need to be defined, as discussed above.
- The **basis for giving imports the benefit of domestic baselines** would need to be decided. Given that there will be some variation in baselines between facilities until 2030, and perhaps beyond depending on the status of TEBA, what baseline should apply to imports? An industry average makes

sense, but note this would be distinct from the industry averages currently used in the reformed Safeguard, as it would be reflective of all effective baselines for covered facilities producing relevant products. An alternative would be to give imports the benefit of the highest baseline applicable to any Australian covered facility producing relevant products. In any event, import adjustments cannot be imposed for costs not faced by domestic producers. We note that the EU are phasing in their CBAM in line with a gradual phaseout of free allocation to covered leakage risk sectors, in a process running from 2026-27 to 2034.

- **Treatment of recycled materials.** As the Review has canvassed in its paper and discussions, there is a potential complication around recycled materials, given that they are generally very low emissions compared to primary production but that there is also a large existing supply of recycled metals in the world (albeit with different prevalence in different markets). If there were resource shuffling, with existing recycled product redirected to CBAM markets without an increase in global recycling rates, a CBAM might not achieve a product price uplift consistent with clean primary production. However it is unclear whether this risk is real, and if so how it might be dealt with. The Review should include a specific piece of work to explore whether resource shuffling of recycled metals is a genuine prospect for Australia given our location and specific trading context, and proceed with careful consideration and close consultation. We note that some Ai Group members in metal recycling consider that the practical risks are more limited given challenges to redirection and the scope to increase local recycling.
- **Basis to calculate the domestic price for adjustment.** The price estimation processes used for TEBA will not be suitable as it is prospective and is likely to be incorrect; the carbon price imposed on imports needs to be closely tied to that faced by domestic production in order to achieve WTO nondiscrimination. The choices would be a frequently updated peg to ACCU or SMC prices, comparable to the EU approach; or an obligation meetable through direct use of those units. Early Ai Group member feedback would strongly prefer that importer obligations be in the form of a new class of unit, issued by the Australian Government in unlimited quantity at a price pegged to the price of ACCUs or SMCs. These new units would not be tradeable or transferrable, or bankable for long periods, but could be resold to the Australian Government for their purchase price if not needed for compliance. This would avoid any unintended consequences for the price or liquidity of the Australian carbon units markets.
- **Treatment of overseas carbon costs,** including explicit prices and potentially regulatory costs. Recognition of explicit prices paid overseas is essential for nondiscrimination, though it needs to be cognizant of any direct or indirect rebate of carbon costs overseas. For instance European exporters of leakage risk products currently face a carbon price but also receive very high levels of free allocation. There may be some request for recognition of regulatory costs borne as a result of policies overseas. This deserves consideration but we anticipate that such costs should not be counted. Regulated emissions standards that result in lower product emissions will be recognized through lower liabilities for those emissions when verified data is declared. Furthermore there should be no attempt to recognize or adjust for the overall level of national emissions ambition of a country of origin. CBAM is not about equalizing national ambition, but levelling the playing field for trade products. National ambition is a distinct issue with no necessary direct bearing on product competitiveness.

We anticipate that the deep work and consultation required fully to address these complex issues will extend well beyond the timeframe for in-principle decisions on this Review. Nonetheless the Review can recommend key directions, principles and architectural features and make substantial progress on detail.

Timing issues are a substantial challenge. Ai Group's members have expressed two concerns to balance while pursuing a potential Australian CBAM. There is a need to move fast enough to help with the emergence of competitively relevant burdens as Safeguard baselines decline, even as modified by TEBA. But there is also recognition of the considerable policy and implementation work required to develop and stand up a CBAM and the need to take the time to get it right. Different industries, and even companies within industries, will have different preferences for the appropriate balance of these concerns. Some members have suggested the time needed to implement a CBAM suggests the need for additional transitional measures beyond those accompanying the existing Safeguard. Some such measures might themselves require substantial development and implementation time, however. Targeted public investment may be the most appropriate candidate for transitional or complementary support.

Emissions product standards – what is the appropriate role for emissions product standards to mitigate carbon leakage?

We are open to further information and idea, but Ai Group is very cautious about the potential role of product emissions standards in addressing carbon leakage, though product standards may be very useful in other contexts (for instance, Australia's system of Greenhouse and Energy Minimum Standards for various complex appliances, which focus on usage emissions rather than production emissions).

Our key concerns with this approach are:

- To be WTO-compatible, standards must apply to domestic production too. Banning domestic production above a certain emissions intensity would be a very substantial step and require a considerable notice period. Bans may not of themselves substantially ease investment decisions for new clean local production capacity.
- Standards appear to be a much more rigid and inflexible approach than pricing, which does not ban products or restrict choice but lets covered entities (and, under a CBAM, their customers) make their own decisions in light of the price signal.
- Australian product standards cannot address export competitiveness concerns.

Targeted public investment in firms' decarbonisation – what is the appropriate role for public investment measures to mitigate carbon leakage?

Targeted investment has a strong role in the short and medium terms and is being widely pursued in order both to push currently-expensive technologies down their cost curves faster through more rapid deployment than short-term cost-optimising policies such as carbon prices are likely to support. The US Inflation Reduction Act is the most obvious example, but the European Union Green Deal Industrial Plan, the Made In Canada Plan, the Korean Green New Deal and others all represent variations on the application of public financial supports and incentives to support the transition of key sectors.

Ai Group has [urged](#) the Australian Government to consider a range of supportive policies and facilitative reforms, including tens of billions of dollars of incentive equivalent, to promote opportunities in clean energy intensive products including green metals and ammonia for industrial use, along with transition minerals and – where necessary or competitive – various components for the clean economy. We recently joined with a broader coalition of diverse organisations to [similarly urge](#) pursuit of these opportunities and more, while underlining the scale of the efficient construction and social license that will be needed to achieve successful transition and even moreso energy superpower status.

Despite this, we recognise that it is implausible that public spending will be available in sufficiently unlimited quantities and permanent duration to fully resolve industry transition. This is particularly the case where the best evidence indicates that there will be an enduring pre-policy cost gap between high- and low-emissions products, such as in steel. Public financial supports will have to phase down and out over time and give way to other policy mechanisms.

There can be a very productive synergy between public investment and a CBAM. The extent of public subsidy for initial and future green products can be reduced to levels that are more manageable for the public Budget to the extent that carbon prices flow through to product prices. Similarly, initial public subsidy can increase the amount of early decarbonised production that is viable in the context of a CBAM, without recourse to effective carbon price levels that are impracticably high.

Multilateral and plurilateral initiatives – what is the appropriate role for multilateral and plurilateral initiatives to help to mitigate carbon leakage, and the impact of unilateral measures taken to address carbon leakage?

As noted above, international initiatives are a broad category. Different kinds of initiative may contribute to leakage prevention in different ways but also suffer from diverse limitations and complexities. Several kinds of initiative that may be worth considering include:

- Pursuit of a global minimum carbon price to be applied by all relevant economies. We welcome the efforts of the OECD and its Secretary-General Mathias Cormann towards this. However it does not appear imminently likely to achieve its full aims, and given the prevalence of anti-leakage measures in existing carbon pricing schemes, especially via free allocation, harmonization would be needed for other features in addition to price levels before a substantially level playing field could be achieved in this way.
- Plurilateral initiatives like the Global Arrangement on Sustainable Steel and Aluminium currently being negotiated by the United States and the EU. If successfully agreed, this would be open to accession by other parties that can meet its conditions. However it is not yet clear that it can be agreed, with the EU preferring a CBAM-like approach that prioritises equalizing carbon prices and WTO compatibility, and the US proposing a tariff-based model that ignores carbon prices and excludes parties with substantial state involvement in their metals sectors. Australia should maintain a watching brief.
- There is potential for deep dialogue and coordination with the EU and other economies that may implement CBAMs in order to share best practices, common methodologies, data sets or even platforms for administering adjustments. Arrangements for coordinating outbound and inbound adjustments between CBAM jurisdictions would be essential. Mutual recognition of emissions data reporting systems would be important. Full linkage of emissions limitation schemes would be more complex. Australia could not simply copy and paste Europe's arrangements in all respects, but substantial benefits may be obtained from commonality where possible.
- Extensive international engagement will be needed as Australia investigates a CBAM and potentially designs and implements it.
- International trade agreements to ease trade in environmental goods are positive, but complex and unlikely to directly assist with leakage related concerns.

All these options are worth some level of investigation and support. None is imminently likely to solve the full range of concerns around carbon leakage on their own, and we should be very careful not to mistake them for such solutions.

Feasibility of policy options – what principles should guide Australian policies to prevent carbon leakage? Should other factors be considered to assess the feasibility of potential policies?

Ai Group proposes that the Review and eventual anti leakage policies should have regard to the following broad principles:

- Clear aims. Leakage measures should solve uneven-policy leakage risk, boost investability of low/zero carbon, and otherwise aim to do no harm.
- Non-discrimination. Measures should adhere to the letter and spirit of the GATT, WTO and our bilateral trade deals.
- Sustainability. Measures should aim for a policy combination that can remain relevant and effective over the long term transition to net zero.
- Materiality. Measures should focus leakage policy where it matters, without trying to cover everything.

- **Extendability.** Measures should constitute an approach that can be applied to more sectors and scopes of emissions as and when needed.
- **Procedural efficiency.** Measures should limit administrative burdens on all parties to the minimum necessary.
- **Substantive efficiency.** Measures should ensure the system encourages investment that maximises global welfare.