

Carbon Leakage Review

Submission to the Department of Climate Change, Energy, the Environment and Water

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Summary of recommendations

Recommendation 1: The Australian Government should take a proactive approach to addressing carbon leakage risk.

Recommendation 2: Australia should promptly develop and implement a CBAM to address carbon leakage.

Recommendation 3: The Australian CBAM should cover steel, cement and aluminium in its first iteration.

Recommendation 4: The Australian Government should proactively explore expansion of the CBAM to other emissions-intensive, trade-exposed products after implementation.

Recommendation 5: The Australian CBAM should apply to scope 1 emissions embedded in products covered by the mechanism.

Recommendation 6: In calculating liability on an imported product, the Australian CBAM should:

- Account for shifting liabilities under domestic and international emissions pricing schemes,
- Measure embodied emissions and the emissions price payable per unit of production, irrespective of other features of applicable emissions pricing mechanisms, and
- Measure each international facility's emissions price liability against the average price paid on the same product by Australian facilities.

Recommendation 7: The Australian CBAM should require importers to provide credible data regarding a product's embodied emissions and the emissions price paid, equivalent to that provided by Safeguard Mechanism facilities. Where such data is unavailable, it should prescribe an adverse but not unreasonable default liability.

Recommendation 8: The Australian Government should assess the provision of international development resources to support trade partners' carbon accounting capabilities.

Recommendation 9: Compatibility with World Trade Organisation rules should inform but not impede development of the Australian CBAM.

Summary of findings

Finding 1: Australian climate policy must balance long-term emissions abatement, economic and strategic considerations.

Finding 2: Facilities covered by the Safeguard Mechanism will be exposed to increasing carbon leakage risk as emissions reduction requirements under the instrument increase.

Finding 3: The CBAM is strongly supported by experts as both an effective intervention to address carbon leakage, and as a climate leadership measure.

Finding 4: Unlike other potential policy responses, an Australian CBAM would address carbon leakage risk directly and proportionately.

Finding 5: The Australian CBAM would complement other public investment programs and/or product standards intended to address embodied emissions.

Finding 6: The Australian CBAM would meet its climate, economic, strategic and foreign policy objectives irrespective of the risk of shuffling.

Finding 7: The Australian CBAM would not adversely impact Australia's vulnerable trade partners. Most affected countries would be high and upper-middle income countries with ambitious emissions abatement policy.

Finding 8: The Australian CBAM would incentivise production and trade in low emissions goods in accordance with Australian trade policy.

Finding 9: Expert opinion strongly supports the view that the Australian CBAM can be designed for consistency with World Trade Organisation rules.

Finding 10: Dissenting views regarding a CBAM's World Trade Organisation compatibility are untestable and likely to remain so for the foreseeable future.

Finding 11: Given plurilateral and multilateral responses to carbon leakage remain nascent, Australia must act unilaterally.

Finding 12: The Australian CBAM would confer Australia an advantage in development of plurilateral and multilateral responses to carbon leakage.

1. Introduction

The Australian Workers' Union (AWU) is one of Australia's largest and most diverse unions. We represent around 72,000 workers across the length of the country and breadth of the economy.

Our membership includes strong representation in the manufacturing, metalliferous mining and oil and gas sectors. This affords the AWU a particular interest in and exposure to the Safeguard Mechanism. We have members at 160 of the 215 facilities covered by the instrument, including a large number of sites producing emissions-intensive, trade-exposed (EITE) goods. For example, the AWU counts around 6,000 members from Australia's steel industry, together with over 5,000 in aluminium smelting and alumina processing, and more than 1,000 in cement and concrete production.

Safeguard facilities must be supported to steadily reduce their emissions, remain competitive amidst fundamental change and eventually thrive as Australia emerges as a green energy and manufacturing superpower. Achieving such a transition requires carefully calibrated public policy balancing climate, economic and other considerations.

To this end, the AWU engaged closely with the Australian Government and other stakeholders throughout the landmark Safeguard Mechanism reform processed finalised earlier this year. But while the safeguard overhaul is an important achievement, by no means should it be considered an endpoint. In particular, the AWU believes a Carbon Border Adjustment Mechanism (CBAM) represents an important and necessary complement to this work to ensure an effective transition for Australian industry and its workforce. A CBAM would also confer further benefits - in particular, aiding Australia in its efforts to claim a leadership role in international climate policy.

The AWU acknowledges that design and implementation of a CBAM poses a complex and in many respects novel challenge. We therefore welcome the Commonwealth's commitment to thorough analysis and engagement through the Carbon Leakage Review. We are pleased to provide the following submission exploring the case for a CBAM, key design considerations and other issues raised in the Carbon Leakage Review consultation paper (the consultation paper). We look forward to further engagement as the review progresses.

2. Policy landscape

A policy agenda befitting Australia's climate policy ambition poses unique challenges to the industry sector. Any pathway towards meeting Australia's 2030 emissions reduction commitment under the Paris Agreement will require a meaningful contribution from industry - the source of about 28% of national emissions. In the longer-term, the sector will also be required to shift more comprehensively to low emissions and carbon neutral technologies as Australia approaches net zero emissions.

Yet much of the industry sector is notably difficult to decarbonise. Particularly in manufacturing, low emissions alternatives to many incumbent processes and baseload power arrangements remain under development - straining short and medium-term emissions reduction.

A poorly calibrated transition would not just place Australia's climate goals in peril. Absent a clear and managed pathway to transition, many facilities risk

closure or relocation offshore. The stakes for workers in ensuring Australia avoids such deindustrialisation could scarcely be higher. The sector remains a very large employer; nearly one million Australians work in manufacturing.¹ The sector often provides good pay and conditions, and many large industrial facilities serve as their communities' largest employer.

Moreover, the capacity to produce goods such as steel and cement are important sovereign capabilities. Continuity for the industrial base will also be necessary to allow Australia to achieve any shift to a clean manufacturing superpower in the coming decades.

The Safeguard Mechanism is notable for its success in reconciling these disparate, often conflicting considerations in the short-term. The mechanism prescribes a framework for steady, manageable energy transition in line with Australia's emissions reduction goals. It allows for a predictable rate of emissions decline, with facilities' emissions baselines adjusted for production volume and especially EITE status.

However, this certainty and security is largely predicated on liberal provision of 'free' emissions allowances in the short-term. That is, as safeguard facilities are required to reduce emissions by 1% to 4.9% per year, they will mostly be permitted to emit on an as-usual basis in coming years. But the cumulative impact of persistent, year-on-year decline to baselines will soon take effect. Facilities' emissions will be increasingly exposed to the price of \$75 per tonne of CO₂-equivalent emissions prescribed by the mechanism.

The increasing price payable on safeguard facilities' emissions will fuel growing concerns around 'carbon leakage'. The AWU defines carbon leakage in the same manner as that laid out in the consultation paper: A shift of production of EITE goods from countries with stronger emissions reduction policies to those with weaker policies, through altered trade or investment attributable to that policy disparity. Such outcomes, we suggest, constitute manifestly unfair exposure for Australian industry to competitors with lesser or no commitment to emissions abatement. The seriousness of such risk is consistently borne out in the literature,² and the AWU welcomes the Carbon Leakage Review's recognition of the reality of the threat.

Further action is required to address the growing risk of carbon leakage and ensure a level playing field for Australian industry affected by the Safeguard Mechanism. This will be crucial to ensuring Australian climate policy continues to balance emissions abatement, economic and strategic considerations in the medium and long-term.

Finding 1: Australian climate policy must balance long-term emissions abatement, economic and strategic considerations.

Finding 2: Facilities covered by the Safeguard Mechanism will be exposed to increasing carbon leakage risk as emissions reduction requirements under the instrument increase.

3. Addressing carbon leakage

Balancing multiple and conflicting policy considerations in an era of emissions pricing calls for new solutions. In this light, the AWU considers the European Union's development of a CBAM a significant economic policy achievement, as well as "*one of the most important global climate policy developments since the signing of the Paris Agreement*".³

Any CBAM will be complex with a range of idiosyncrasies. Nonetheless, this submission takes the term to refer to a charge on EITE imports' embodied emissions, paid by an importer, and adjusted such that the price per unit of embodied emissions is not less than that paid on equivalent products made in the importing jurisdiction. A CBAM functions as a complement to emissions pricing, applied in a manner proportionate to the emissions pricing scheme to ensure abatement does not come at the expense of a jurisdiction's economic and strategic interests.

The CBAM enjoys consistent expert support as an effective intervention to directly address carbon leakage and safeguard the competitiveness of domestic industry in jurisdictions where emissions are priced.⁴ The measure is also endorsed as a climate leadership measure – assisting its adopters to attain leadership status in international climate policy and drive stronger emissions abatement abroad.⁵ Indeed, The World Bank reports that China, Taiwan and Ukraine have cited the EU CBAM as a factor in their development of an emissions pricing scheme.⁶

The AWU notes questions in some quarters as to whether the Safeguard Mechanism is sufficiently onerous to warrant a CBAM in the near-term.⁷ Such an outlook does not serve Australia's interests. The Australian Government must provide certainty and confidence as industry and its workers navigate the energy transition. This can be achieved through policy that addresses issues with foresight, rather than deferral or a 'wait and see' approach. The effects of the previous government's highly reactive approach are clear: Australia has required a series of major reforms and public investments in the past 18 months to align policy with its vision for climate and industry.

A proactive approach to concerns around carbon leakage is also the preferred approach of key economies and Australian partners. While the EU CBAM marks Europe out as the most notable early mover, the United Kingdom, US, Canada and Japan are all exploring pricing embodied emissions for imported EITE goods.⁸ California has also operated a limited CBAM on interstate electricity for some time.⁹

Recommendation 1: The Australian Government should take a proactive approach to addressing carbon leakage risk.

Finding 3: The CBAM is strongly supported by experts as both an effective intervention to address carbon leakage, and as a climate leadership measure.

3.1 CBAM and alternative measures

In the AWU's firm submission, the CBAM stands alone in its capacity to address carbon leakage in a direct manner proportionate to emissions pricing imposed by the Safeguard Mechanism.

The consultation paper raises the prospect that public investment in industry sector decarbonisation, and/or standards prescribing a limit on embodied emissions in select products, could serve as alternatives to a CBAM. Such interventions may be warranted or even essential. In particular, the AWU strongly supports investment initiatives such as the National Reconstruction Fund as essential to facilitating the capital allocation necessary for the energy transition. Product standards, too, are not necessarily inconsistent with or duplicative of a CBAM (though they may represent an additional compliance step if applied to the same products). However, we suggest these measures should be regarded as complements rather than alternatives to the CBAM. Despite their utility as part of a broad suite of industry and climate policy measures, they lack the CBAM's capacity to address carbon leakage in a direct and proportionate manner.

The prompt development and implementation of an Australian CBAM is therefore essential, irrespective of public investment and/or product standards deployed concurrently.

In addition, concerns about operability between a CBAM and non-emissions pricing measures to reduce embodied emissions are a red herring. Such programs are not intended as substitutes for pricing and are not treated as such by governments. Indeed, Australia should expect most of its trade partners to provide some level of public investment in low emissions industry, irrespective of any emissions price supported in those jurisdictions.

Recommendation 2: Australia should promptly develop and implement a CBAM to address carbon leakage.

Finding 4: Unlike other potential policy responses, the Australian CBAM would address carbon leakage risk directly and proportionately.

Finding 5: The Australian CBAM would complement other public investment programs and/or product standards intended to address embodied emissions.

4. CBAM design principles

No CBAM offers a transferrable, 'one size fits all' solution. While the instrument developed by the European Union may offer design cues to Australia in some instances, and Australian CBAM would need to be formulated for compatibility with our nation's own unique system of emissions pricing and our particular carbon leakage risks. In the AWU's submission, the following principles should be foremost among the Carbon Leakage Review's deliberations to this end.

4.1 Products covered

The terms of reference for the Carbon Leakage Review make clear the Commonwealth's focus on steel and cement as subjects of a potential Australian CBAM.

Coverage for steel and cement is appropriate on both an economic and a scientific basis. Steel and cement production are sizeable local industries, and patently vulnerable to carbon leakage. Most Australian-made steel and cement is also supplied to other domestic industries;¹⁰ In particular, they are fundamental to local construction and difficult to substitute with other materials. Steel is also an important input for many manufacturers. In total, locally made steel and cement support many tens of thousands of upstream and downstream jobs across the country.¹¹

Furthermore, manufacturing of both products is highly emissions-intensive and difficult to abate. The International Energy Agency stresses the need to develop a range of innovative technologies and other solutions to support large-scale decarbonisation of steel and cement production. It also highlights carbon leakage risk in relation to both products.¹²

In the AWU's submission, an Australia CBAM should also cover aluminium. Locally produced aluminium has a distinct import-export profile to that of steel or cement. Nonetheless, the product is highly vulnerable to carbon leakage.¹³ Over 19,000 workers are directly employed in Australia's aluminium supply chain.¹⁴ The strategic value of domestic production of the commodity is also beyond question, as its inclusion in the Commonwealth's new Strategic Materials List reflects.¹⁵ Indeed, aluminium is crucial to the production low emissions technologies including wind turbines, batteries, hydrogen electrolyzers and solar panels.¹⁶

Guarding against carbon leakage will not just support continuity for domestic producers of these goods. The upside, potentially, is much larger. Australian-made, low emissions 'green steel' is an especially promising future export. Our nation enjoys significant comparative advantages in this space – notably, a highly capable industrial workforce and abundant iron ore and renewable energy resources.¹⁷ On every front – a large and capable workforce, world-leading bauxite reserves and renewable resources – the same is true of potential green aluminium production.¹⁸

But green steel and aluminium industries will not emerge from a vacuum. Realising this potential will require (among other supports) efforts to ensure domestic capability and infrastructure remains in place for the transition from conventional production.

The AWU accepts that an Australian CBAM would evolve over time, including in relation to the breadth of EITE products covered. Steel, cement and aluminium are appropriate as a first tranche of CBAM products. But we note the Safeguard Mechanism lists 54 other EITE products.¹⁹ Many of these goods, such as glass, also represent key sovereign capabilities and are significant employers. The Commonwealth should thus take a proactive approach to exploring options to expand the Australian CBAM following implementation.

Recommendation 3: The Australian CBAM should cover steel, cement and aluminium in its first iteration.

Recommendation 4: The Australian Government should proactively explore expansion of the CBAM to other emissions-intensive, trade-exposed products after implementation.

4.2 Type of emissions covered

An Australian CBAM must function as a genuine equalisation measure. It should ensure the price paid on imports' embodied emissions is not lower than that paid by local producers, rather than unduly shield industry from competition. Accordingly, as the Safeguard Mechanism regulates and prices facilities' scope 1 emissions, the Australian CBAM should apply to scope 1 emissions embedded in covered products only.

Recommendation 5: The Australian CBAM should apply to scope 1 emissions embedded in products covered by the mechanism.

4.3 Calculating liability

Determining the price payable by an importer under a CBAM poses a design challenge in several respects. However, none of these obstacles is insurmountable; We suggest a CBAM consistent with the objective of balancing abatement, economic and strategic objectives could navigate these challenges as follows.

First, it is important that the mechanism support price flexibility. The CBAM must have the capacity to reflect changes in the emissions price per unit of production paid by safeguard facilities in line with declining baselines, as well as that paid by importers under foreign pricing schemes.

Another consideration is that the Safeguard Mechanism calculates baselines on a production-adjusted basis – that is, with reference to both a facility's emissions intensity and its varying output. This method is distinct from other emissions pricing schemes – most obviously, emissions trading schemes (ETS) that set baselines with reference to absolute emissions reductions and carbon taxes applied to emissions uniformly. These design choices will lead to distinct decarbonisation pathways for facilities in different jurisdictions producing the same product. However, they do not preclude like-for-like assessment for the purpose of a CBAM – that is, measuring a product's embodied emissions and the emissions price payable per unit of production. That price is the discrepancy which a CBAM should seek to address. The mechanism can and should be agnostic as to trade partners' design preferences for any emissions pricing scheme they choose to implement.

A further complication is that the emissions intensity of production for EITE products often varies substantially between facilities, both within Australia and internationally. In the AWU's contention, an importer's CBAM liability should be

calculated against the average price per unit paid on EITE products produced in relevant safeguard facilities. That is, the scheme should compare each international facility's emissions price liability per unit of output with the average price paid by Australian facilities. Measuring against the national average is consistent with the notion of a level playing field for domestic industry as a whole which the CBAM seeks to enshrine.

Recommendation 6: In calculating liability on an imported product, the Australian CBAM should:

- Account for shifting liabilities under domestic and international emissions pricing schemes,
- Measure embodied emissions and the emissions price payable per unit of production, irrespective of other features of applicable emissions pricing mechanisms, and
- Measure each international facility's emissions price liability against the average price paid on the same product by Australian facilities.

4.4 Data and data availability

A CBAM consistent with the principles outlined above would require importers to provide the Australian government with credible data covering an EITE product's embodied emissions and the price paid on those emissions. To support like-for-like comparison, this data should be directly equivalent to that provided by safeguard facilities. For accuracy, it should also be verified by a qualified third party.

However, any CBAM will require a level of tradeoff between accurate, site-specific data and practicality. While Australia possesses advanced carbon accounting capabilities, facilities in some partner jurisdictions may face administrative and financial challenges delivering equivalent data.²⁰

Where international facilities are unable to verify actual emissions, the CBAM should set a default figure. The European Union precedent is instructive here. The EU CBAM prescribes a default price based on the 10 per cent of least efficient producers within the EU.²¹ This relatively (though not unreasonably) adverse default appears to represent a fair assumption in the absence of reliable data. It may also incentivise the advancement of carbon accounting practices in jurisdictions trading with the European Union.

Recommendation 7: The Australian CBAM should require importers to provide credible data regarding a product's embodied emissions and the emissions price paid, equivalent to that provided by Safeguard Mechanism facilities. Where such data is unavailable, it should prescribe an adverse but not unreasonable default liability.

We note also that climate change is an increasing focus of Australia's international development program. The Commonwealth's recently refreshed development policy commits to enhance climate investments and better address climate risks

in the Indo-Pacific.²² The Commonwealth has also committed to significantly increase its overall development budget year-on-year for the next decade.²³

There is a clear confluence between these commitments, an Australian CBAM and the carbon accounting constraints faced by some trade partners. The Australian Government should therefore assess the provision of development resources to improve partners' carbon accounting capabilities following implementation of the CBAM.

Recommendation 8: The Australian Government should assess the provision of international development resources to support trade partners' carbon accounting capabilities.

4.5 Shuffling

The AWU acknowledges that a CBAM would give rise to a risk of 'shuffling'. Shuffling would occur where international producers prioritised export of EITE products with lower embodied emissions to Australia while higher emission equivalents were exported to jurisdictions without a CBAM.

However, a CBAM that incentivised shuffling would still meet its primary objective – to balance climate, economic and strategic goals by affording industry a level playing field as it decarbonises. Potential shuffling by foreign exporters does not touch on those considerations. A CBAM would also advance Australia's international climate goals. The fact that some producers may avoid abatement through shuffling would not negate the overall efficacy of the instrument as an incentive for international facilities to reduce emissions, nor the leadership status it would afford Australia as the operator of one of the world's first CBAMs.

Finding 6: The Australian CBAM would meet its climate, economic, strategic and foreign policy objectives irrespective of the risk of shuffling.

5 Trade and foreign policy significance

The CBAM concept has generated considerable discussion around adverse impacts on trade. It has also been suggested that a CBAM may impede efforts to address carbon leakage at the plurilateral or multilateral level.

As an open, outward-facing society, these concerns warrant serious consideration by Australia. That said, they appear heavily overstated and should thus not impede development of a CBAM.

5.1 Bilateral trade

The European Union CBAM has given rise to concern that the 'global south' will be unable to adapt to its requirements with the pace and efficiency required to remain competitive.²⁴

However, a CBAM appears aligned to both the economic status and climate outlook of Australia's major trading partners. The overwhelming majority of Australian steel and cement imports are from high and upper middle-income countries, rather than the 'global south'. These nations have largely adopted an emissions abatement outlook similar to that of Australia. Most also operate an

emissions pricing scheme. The same is largely true of aluminium imports (see Figures 1-3,²⁵ page over).

More generally, a CBAM would foster greater production and trade in low emissions goods. This is an important objective of Australian trade policy: It has driven development of the pioneering Australia-Singapore Green Economy Agreement,²⁶ and strongly informed engagement with the innovative Indo-Pacific Economic Framework.²⁷ It follows that, to the extent that the CBAM did alter Australia's trade relationships, it would do so in a manner consistent with Australian interests. A CBAM's trade impacts should therefore be considered an opportunity rather than a risk.

Finding 7: The Australian CBAM would not adversely impact Australia's vulnerable trade partners. Most affected countries would be high and upper-middle income countries with ambitious emissions abatement policy.

Finding 8: The Australian CBAM would incentivise production and trade in low emissions goods in accordance with Australian trade policy.

5.2 Multilateral trade

Australia supports the World Trade Organisation as fundamental to both its prosperity and strategic outlook.²⁸ The alignment of carbon border adjustments with WTO rules has attracted extensive scrutiny. Of particular concern is that a CBAM should not discriminate between domestic and foreign suppliers, nor between different foreign suppliers, as per key WTO edicts.²⁹

While no uniform view has emerged, the weight of expert opinion strongly supports the notion that the WTO does support members to implement a CBAM broadly of the type explored in this submission.³⁰ Indeed, the basic rationale for a CBAM – equity between domestic and foreign producers – appears synonymous with WTO doctrine. Even if a CBAM were initially shown to be incompatible with WTO non-discrimination rules, it may also be affirmed on the basis of exceptions provisions.³¹ Notable exceptions include those protecting policy measures 'necessary to protect human, animal or plant life or health', and 'relating to the conservation of exhaustible natural resources'.³²

Skepticism as to WTO compatibility does persist in some quarters. However, the legitimacy of these doubts remains theoretical. Because no CBAM that could attract WTO scrutiny has yet commenced operation, any finding of WTO incompatibility is not currently possible; "*The general conclusion is that CBAMs are uncharted territory*".³³ While the same is true to some extent of any regulation yet to take effect, it is particularly so in relation to WTO jurisprudence, which leans strongly towards discrete case-by-case reasoning.³⁴

The impracticality of showing inconsistency with WTO rules is heightened by ongoing dysfunction in the institution's dispute settlement system. Since 2019, the US has refused to agree to the appointment of an appellate body for WTO disputes. This has allowed states to 'appeal into the void' – sending unfavourable decisions to the vacant appellate body as a means of blocking them.

Figure 1: Australian steel imports - overview

Country	Percentage of total imports	GDP per capita global rank	Income classification*	Net zero target	Emissions pricing
China	28.5%	75	Upper-middle income	2060	ETS
USA	11.5%	7	High income	2050	Partial: Several state based ETS
S. Korea	6.8%	35	High income	2050	ETS
Japan	6.3%	34	High income	2050	Carbon tax
Thailand	6.1%	95	Upper-middle income	2065	No
Malaysia	4.7%	71	Upper-middle income	2050	No
Germany	4.1%	20	High income	2045	ETS
Singapore	3%	5	High income	2050	Carbon tax

Figure 2: Australian cement imports - overview

Country	Percentage of total imports	GDP per capita global rank	Income classification	Net zero target	Emissions pricing
China	30.9%	75	Upper-middle income	2060	ETS
Canada	11.3%	18	High income	2050	Output-based system
S. Korea	11.3%	35	High income	2050	ETS
Indonesia	9%	116	Upper-middle income	2050	Carbon tax
USA	7.9%	7	High income	2050	Partial: Several state based ETS
Malaysia	6.7%	71	Upper-middle income	2050	No
Japan	3.6%	34	High income	2050	Carbon tax
Germany	3.4%	20	High income	2045	ETS

Figure 3: Australian aluminium imports - overview

Country	Percentage of total imports	GDP per capita global rank	Income classification	Net zero target	Emissions pricing
Qatar	39.5%	6	High income	No	No
Bahrain	29.1%	38	High income	2060	No
India	20.2%	139	Lower-middle income	2070	No
China	4.4%	75	Upper-middle income	2060	ETS
Japan	1.7%	34	High income	2050	Carbon tax
Malaysia	1.5%	71	Upper-middle income	2050	No
S. Korea	0.9%	35	High income	2050	ETS
Netherlands	0.7%	12	High income	2050**	ETS

* Per The World Bank

** Officially a 'climate neutral target exceeding net zero requirements'

This tactic is now employed frequently by the world's largest economies,³⁵ reducing the system to paralysis. With the US refusing to offer concrete proposals to end the impasse, no end to the crisis around the appellate body is in sight.³⁶

In light of the prima facie compatibility of a CBAM with WTO rules, and the unknowable substance of any objection, we suggest WTO compliance should inform but not impede development of an Australian CBAM. This approach would be consistent with that adopted by the European Union, for which WTO compatibility was a conscious goal in formulating the EU CBAM.

Recommendation 9: Compatibility with World Trade Organisation rules should inform but not impede development of the Australian CBAM.

Finding 9: Expert opinion strongly supports the view that the Australian CBAM can be designed for consistency with World Trade Organisation rules.

Finding 10: Dissenting views regarding a CBAM's World Trade Organisation compatibility are untestable and likely to remain so for the foreseeable future.

5.3 Transnational carbon leakage initiatives

The EU CBAM has generated debate around the efficacy of unilateral solutions to carbon leakage, relative to alternative responses at the plurilateral or multilateral level. As the consultation paper notes, there are several potential advantages to international coordination in this space, including greater aggregate impact on emissions abatement, streamlined regulation and compliance, and decreased shuffling.³⁷

However, the reformed Safeguard Mechanism, Australia's emissions abatement targets and its clean manufacturing superpower goal necessitate prompt action to address carbon leakage while supporting reduced emissions. Plurilateral and multilateral responses to climate leakage, by contrast, remain nascent. The G7-led Climate Club has pledged a focus on industrial decarbonisation but has not determined how it will do so.³⁸ In 2021, the US and EU committed to lead multilateral agreements to 'restrict market access for dirty steel and reduce trade in high-carbon steel and aluminum'.³⁹ However, neither a mechanism nor clear principles for how this will be achieved has materialised.

Near-uniform adoption of the *Carbon Offsetting and Reduction Scheme for International Aviation*⁴⁰ indicates that multilateral, sector-based climate solutions are possible. But no such agreement for EITE goods is at all likely in the near future. Australia must therefore address the pressing issues at hand unilaterally.

Even in the event of later progress towards a plurilateral or multilateral carbon leakage regime, a CBAM would not impede Australia. Rather, Australia's experience with designing, implementing and operating one of the world's first carbon border adjustments would support it to shape such agreements and/or institutions to its advantage. Some analysts suggest that, by removing trade barriers for jurisdictions with a similar emissions price, a CBAM may even incentivise international emissions pricing arrangements.⁴¹

Finding 11: Given plurilateral and multilateral responses to carbon leakage remain nascent, Australia must act unilaterally.

Finding 12: The Australian CBAM would confer Australia an advantage in development of plurilateral and multilateral responses to carbon leakage.

6. Outlook

With a well-managed energy transition, Australian industry's capacity to stay open, reduce emissions and ultimately transition to 'superpower' status is clear. But this outlook is increasingly threatened by carbon leakage. Absent further intervention following the safeguard reforms, facilities supplying EITE goods will face rising and manifestly unfair exposure to competitors with fewer or no commitment to reduced emissions.

Against this rising tide of uncertainty, an Australian CBAM is the best response. Only a carbon border adjustment can deliver the level playing field required by exposed safeguard facilities in a direct and calibrated manner. The scheme will also advance Australia's international climate policy interests.

While design of such an instrument presents complexities, these are by no means insurmountable. Particularly given the magnitude of both the risks and opportunities in play, the Commonwealth should not be dissuaded from design and implementation as soon as practicable.

The AWU looks forward to further participation in the Carbon Leakage Review.

¹ Australian Bureau of Statistics (2023), '*Labour force - employed persons by industry division of main job*', <https://www.abs.gov.au/statistics/labour/employment-and-unemployment/labour-force-australia-detailed/oct-2023/6291004.xlsx>

² See, for example, Overland, I & Huda, M.S. (2022), '*Climate clubs and carbon border adjustments - a review*', Environmental Research, <https://iopscience.iop.org/article/10.1088/1748-9326/ac8da8/pdf>, p. 8; Ambec, S. (2022), '*The European Carbon Border Adjustment Mechanism: Challenges and perspectives*', Toulouse School of Economics, https://www.tse-fr.eu/sites/default/files/TSE/documents/doc/wp/2022/wp_tse_1365.pdf, p. 4; Davies, A. (2022), '*The EU's proposed Carbon Border Adjustment Mechanism and compatibility with WTO law*', Trade Law and Development, vol 14 no 2, https://cronfa.swan.ac.uk/Record/cronfa62086/Download/62086__26934__b21658f8e6174a7e94e2aa4bb047e2dc.pdf, p. 95

³ Overland, I & Huda, M.S. (2022), '*Climate clubs and carbon border adjustments - a review*', Environmental Research, <https://iopscience.iop.org/article/10.1088/1748-9326/ac8da8/pdf>, p. 12

⁴ Zhong, J. & Pei, J. (2022), '*Border carbon adjustment: Systemic literature review of latest developments*', Renmin University of China, https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID4128234_code2982151.pdf?abstractid=4128234&mirid=1, p. 10

⁵ Ibid., p. 11

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