



Terms of Reference - Carbon Leakage Review

Preamble

The Australian Government has increased Australia's emission reduction ambitions, legislated targets of 43 per cent below 2005 levels by 2030 and net zero by 2050, and has recently reformed the Safeguard Mechanism in line with these targets.

Many other countries are also stepping up efforts to tackle climate change. But the level of ambition differs between jurisdictions. This creates the potential for production to shift from countries with more ambitious emissions reduction policies to those with lower (or no) emission reduction policies, and potentially resulting in increased global emissions. Where such shifts in production occur solely because of different policy settings, they are termed 'carbon leakage'. Carbon leakage undermines national and international climate action and may require a policy response where carbon leakage risk is significant.

In May 2023, the Australian Government completed landmark reforms to significantly strengthen the Safeguard Mechanism. Under the reforms, legislated limits on emissions for Safeguard facilities —known as baselines—decline from 1 July 2023, on a trajectory consistent with Australia's emissions reduction targets. The reforms will reduce over 200 million tonnes of greenhouse gas emissions by 2030, while improving incentives and confidence for facilities to invest in decarbonising their operations.

The reform package included elements to support industry competitiveness in a decarbonising global economy and to mitigate the risk of carbon leakage. This includes access to reduced annual baseline decline rates for trade-exposed facilities that experience particular scheme impacts and \$1 billion in funding for trade-exposed Safeguard facilities through the Powering the Regions Fund.

The Government has agreed to a Review of additional policy options to address carbon leakage, including considering the feasibility of an Australian Carbon Border Adjustment Mechanism (CBAM), particularly in relation to steel and cement (including clinker and lime).

The Review will be led by an eminent Australian expert who will be responsible for the strategic direction of the Review, and its key deliverables, including a final Review report outlining findings, conclusions and recommendations. The Lead Reviewer will be supported by a team within the Department of Climate Change, Energy, the Environment and Water, with representation from other Australian Government agencies.

The Review will consult extensively with two rounds of public consultation, including calls for written submissions. Key stakeholders include industry, peak business groups, experts and researchers, Commonwealth and State and Territory government agencies, international trading partners, relevant international bodies and the broader community.

The final Review report will be provided to the Government by 30 September 2024. Detailed design of any agreed policy options would take place after the Review and could be taken into account in the Government's Net Zero 2050 plan.

Terms of Reference

1. Assessment of carbon leakage risks

- a. Assessment of the extent of carbon leakage risks due to differences in emissions reduction policies between Australia and key trading partners, currently and into the future.
- b. Identification of key products and sectors affected by carbon leakage risk, the likelihood and consequence of any significant risks, with particular focus on, but not limited to, steel and cement.

2. Policy options to address carbon leakage

- a. Review of current and potential measures to address carbon leakage, in partnership with business, including:
 - i. existing measures under the Safeguard Mechanism;
 - ii. an Australian CBAM;
 - iii. emissions product standards;
 - iv. targeted public investment in firms' decarbonisation;
 - v. multilateral or plurilateral initiatives.
- c. Analysis of potential measures, should they be found necessary, with regard to: implications for industry competitiveness, emission reductions, adaptability for changes in other domestic policy settings, broader economic productivity and resilience, administration costs, legal requirements and Australia's international trade commitments, including World Trade Organization (WTO) rules.
- b. Draw on the lessons from other countries' approaches to assessing and addressing carbon leakage risk, such as the EU's CBAM and the UK's Review of carbon leakage risks, including their assessment of product standards.

3. Feasibility of policy options to address carbon leakage, including an Australian CBAM

Assessment of the feasibility of policy options to address carbon leakage, with consideration of:

- a. Principles underpinning policy options to address carbon leakage and implications for policy design, including for an Australian border carbon adjustment.
- b. Potential scope of policy options to address carbon leakage, including for an Australian border carbon adjustment: the coverage of products and sectors, the emissions scope, and the direction of trade (i.e. whether and how the adjustment falls on imports and/or exports).
- c. Impacts of policy options to address carbon leakage, including an Australian border carbon adjustment, on firms' (decarbonisation) investment decisions, emission reductions, and other economic impacts, such as on Australia's relative attractiveness for foreign direct investment for net zero aligned projects.
- d. How border carbon adjustments under an Australian CBAM could work, including issues relating to measurement of emissions embedded in traded goods, carbon costs incurred in origin countries, setting of the adjustment, obligations on importers/exporters, adaptability to changes in policy context over time, as well as the legislative and administrative requirements for establishment and operationalisation.
- e. The implications of policies to address carbon leakage, including an Australian CBAM, for wider trade strategy and priorities, including legal consistency with and implications for international trade obligations, including the WTO, and inter-operability with carbon leakage measures taken by others, such as the EU CBAM.
- f. Interests of Australia's trading partners, including those of developing countries in our region, and how an Australian CBAM or other policy measures could best support reductions in global and regional emissions intensities.