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Dear Professor Jotzo,

Carbon Leakage Review: Consultation Paper

BHP welcomes the opportunity to provide feedback on the Consultation Paper released in November 2023 to inform the Carbon Leakage Review (the Review).

About BHP

BHP is a global resources company. We have an extensive presence in Australia, comprising iron ore and nickel assets in Western Australia, copper assets in South Australia and metallurgical coal assets in Queensland. Our total economic contribution in Australia was A\$60 billion in FY2023, which included the payment of wages and benefits to around 50,000 employees and contractors.

BHP supports the aims of the Paris Agreement to limit the increase in the global average temperature to well below 2°C above pre-industrial levels and pursue efforts to limit the increase to 1.5°C, and the 2030 and 2050 emissions reduction targets of the Australian Government. We also supported the recent decision of the Australian Government to transform the Safeguard Mechanism into an emissions trading scheme.

Assessing and addressing carbon leakage

The Review will explore two key questions: (1) what is the nature and magnitude of the carbon leakage risk facing Australia? and (2) what is the best way for Australian governments to address this risk?

The first of these questions will be challenging to answer, given that:

- Trade and investment decisions are inherently multifaceted which can make it difficult to isolate the effects
 of cross-border differentials in climate policy;
- Global climate policy continues to evolve as countries seek to increase their ambition, take advantage of clean technology opportunities, and address cost of living concerns; and
- The existing literature on carbon leakage is limited and 'provides at best little guidance for policy'1.

In order to maintain stakeholder confidence in Australia's overarching climate policy approach, it is crucial that the Review assesses carbon leakage risks as robustly and transparently as possible, and communicates outcomes within a range of potential impact. We have provided more detailed thoughts on the proposed analytical approach of the Review in Appendix A.

¹ Florian Misch and Philippe Wingender (2021), 'Revisiting carbon leakage', IMF Working Paper, August.

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On the question of how Australian governments can best address carbon leakage risks, we offer the following points to assist the Review in its deliberations:

- The most significant and straightforward way Australian governments can mitigate carbon leakage risks is to enhance Australia's competitiveness relative to other regions. This will help ensure that climate legislation does not become a 'tipping point' for industry to move to jurisdictions with less stringent climate legislation. In relation to mining, we believe governments can enhance Australia's competitiveness by providing stable and globally competitive fiscal settings, robust, transparent and streamlined permitting processes, best-in-class enabling infrastructure and a world-class Mining Equipment, Technology and Services (METS) sector and workforce of the future. For more information on BHP's views on Australia's competitiveness in mining, please visit our recently published report, <u>Recapturing Australia's Competitiveness</u>.
- We continue to encourage the Australian Government to cover a greater proportion of the economy in the Safeguard Mechanism, and furthermore, seek ways to foster a unified carbon market across different sectors of the economy, as recently recommended by the Productivity Commission². Doing so, if designed well, could allow Safeguard facilities to access a greater pool of lower cost abatement options, such as from the electricity sector. Establishing a framework that allows emitters to optimise the sequence of abatement across Scope 1 and Scope 2 would be preferable for preventing carbon leakage.
- The Safeguard Mechanism currently manages carbon leakage risks by providing facilities that satisfy the Trade Exposed Baseline Adjusted (TEBA) criteria with slower baseline decline rates. This approach is inequitable as it requires non-TEBA facilities to deliver a higher share of the abatement task so that TEBA facilities can benefit, and is unlikely to be sustainable in the medium to long term in the case that trade exposure persists.
- The Australian Government should ensure that any mechanism to address carbon leakage does not undermine the country's domestic emissions reduction undertakings. Measures that in effect further narrow the companies and sectors on which the burden of emissions reduction falls will have implications for Australia's ability to maintain economic competitiveness, protect consumers and meet its decarbonisation targets.
- Any carbon leakage policy approach adopted by the Australian Government must be grounded in the reality of Australia's relatively small and trade-dependent economy, noting that, compared to other major economies like the European Union and the United States, Australia may:
 - have more to lose in terms of pursuing carbon leakage policies that undermine the rules-based trading system, increase trade friction and/or antagonise trading partners; and
 - need to give greater regard to the issue of export competitiveness.

Considering these factors, it is questionable whether an import-oriented measure like the European Union's Carbon Border Adjustment Mechanism will be appropriate in the Australian context, particularly given the large administrative burden that such a policy could entail.

- As the Consultation Paper notes, measures to address carbon leakage risks can come with their own risks in the form of higher consumer costs, dulled incentives for decarbonisation and general market distortions. It is therefore vital that any future carbon leakage policy approach is:
 - based on robust and transparent evidence;
 - as narrowly targeted as possible and aims to minimise potential new sources of regulatory burden;
 - sufficiently dynamic so it can account for changes in the international policy environment that may affect the level of carbon leakage risk; and
 - designed to be consistent with Australia's World Trade Organization and free trade agreement commitments.

² Productivity Commission (2023), 5-year Productivity Inquiry: Managing the climate transition, Vol. 6, Inquiry Report no. 100.

- Regarding the potential role that emissions product standards could play in mitigating carbon leakage, we would note based on our broader experience that:
 - performance standards are typically only effective in practice when they are leveraging a common set of credible and harmonised international standards; and
 - the proliferation of standards can generate significant complexity for organisations to navigate and can risk distracting organisations from focussing on the most material risks.

Thank you again for the opportunity to contribute to the Carbon Leakage Review. We would be happy to answer any questions or provide further information on any of the points raised above, if required.

Appendix A: Responses to specific questions posed in the Consultation Paper

1.1 Is the description of carbon leakage appropriate for the purpose of this Review?

1.2 What is your view on how your business or industry could be affected by carbon leakage?1.3 Are there other goods or commodities beyond those identified as trade exposed under the Safeguard Mechanism that should be included in the assessment?

The proposed analytical approach to determine sectors that will be affected by carbon leakage is relatively narrow. We recommend that consideration also be given to a wider range of competitiveness factors to assess carbon leakage risks, including:

- Recognising the importance of certain commodities, such as copper, nickel and uranium, to global decarbonisation supply chains, and the potential for Australia to expand its presence in clean energy value chains.
- Reviewing the market structure for specific industries to understand relative competitiveness along the
 global supply cost curve. In the event that a) Australian producers sit in the highest cost tier for global
 goods, b) the global cost curve for a commodity is relatively flat, and/or c) there is excess supply capacity
 in the market, then even a small shift in costs could lead to an inability to pass costs to consumers without
 trade and investment flows re-directing to more competitive regions (many of which will be higher
 emissions intensity jurisdictions). While carbon policy in and of itself may reflect a small cost relative to
 overall earnings, the nature of the cost curve could lead to outsized impacts on domestic industry and
 future investment.
- Analysing not only the direct cost impact of carbon policies on trade-exposed industries, but also
 secondary cost impacts because of the policy. For example, the Review's analysis should include the
 impact of carbon policy on electricity and labour costs, noting that in some instances overall costs could be
 lower as policy induces decarbonisation (e.g. due to investments in efficiency or the reduced purchases of
 diesel due to electrification).
- In assessing secondary impacts, giving due consideration to reduced price volatility that may occur as a result of coordinated and enduring economy-wide carbon policies. Policy that is fragmented, uncoordinated across states, and that increases overall transaction costs are much more likely to lead to carbon leakage than policies that are predictable and enduring.