Submission to the *Carbon Leakage Review - Consultation paper No 2*

Australian Steel Institute

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Submission to the Carbon Leakage Review Consultation paper

The Australian Steel Institute (**ASI)** is pleased to make a submission to the *Carbon Leakage Review Consultation paper number 2.*

About ASI

The ASI is the nations peak body representing the entire steel supply chain, from the primary producers through to end users in building and construction, resources, heavy engineering and manufacturing.

Its membership base includes approximately 6,000 individuals that are associated with more than 500 corporate memberships and over 350 individual memberships.

A not-for-profit member based organisation, the ASI's activities extend to, and promote, advocacy and support, steel excellence, standards and compliance, training, events and publications. The ASI provides marketing and technical leadership to promote Australian-made steel as the preferred material to the resources, construction, and manufacturing industries, as well as policy advocacy to government.

The Australian steel industry

The Australian steel industry consists of three primary steel producers, supported by over 300 steel distribution and processing sites throughout the country and hundreds of manufacturing, fabrication and engineering companies.

Australia's primary steel producers and steel product manufacturers together form a strategically important value chain that has the capability to supply in excess of 90 per cent of the steel grades and qualities required in this country.

Australia produces around 6 million tonnes of steel per annum across five major manufacturing locations. It is important to note the economic and social contribution of the Australian steel industry. It employs over 100,000 people and generates $29 billion in annual revenue, and importantly provides a large share of skilled jobs in regional and rural areas.

The economic contribution of the Australian steel industry is very significant. Based on recently completed analysis conducted by BIS Oxford Economics, it is estimated that for every $1 million invested,

- 5 workers are employed in the steel and closely related industries,
- $2.8 million output is contributed to the economy, and
- $1.1 million of value is added to Australian GDP.

Within the downstream value chain, steel fabrication is essential for manufacturing of value-add construction products such as foundations, piling, columns, beams, girders, gantries, platforms, and towers. Areas of specialisation include wind towers,

transmission towers, storage tanks, chemical processing plant, boilers and pressure vessels, mining infrastructure refurbishment, mobile equipment for underground and surface mining, mobile cranes, bridges, armoured vehicles for Defence, naval and domestic ship building, rolling stock, truck bodies and trailer chassis.

The steel industry is a key enabler for the nation's renewable energy transition and associated legislated climate targets. Between now and 2030 it is estimated that at least 400,000 tonnes of extra fabricated steelwork will be required per annum to service over 23 GW of existing renewable energy generation projects across wind, solar, water and transmission infrastructure.

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Carbon Leakage Review Consultation

The following responses are based on consultation with ASI steel producer and steel product manufacturer member businesses.

1. Introduction

The ASI fully concurs with the need for a well designed Carbon Border Adjustment Mechanism (CBAM) to prevent carbon leakage for steel, to support the maintenance of Australia's sovereign capability in steel production and downstream value add processes, to help protect 100,000 steel jobs and our capability and capacity in this critical sector for our economy.

Australia's economy potentially sits on the verge of benefitting highly from the next generation green iron production, followed by low carbon steel manufacturing in time, if a number of key enablers allow it to do so. A strong and effective CBAM policy will be one such important enabler.

Its vital that Border Carbon Adjustments (BCA) provide a fair and level playing field for Australian steel makers as significant investment and work continues in their decarbonisation endeavours, to not only prevent carbon leakage but also help protect heavy investments, local jobs and the economy.

Much needed growth in manufacturing output from a *Future Made in Australia* will not be possible without a carefully designed CBAM, and ASI and its members urge this review to ensure all other government policies which interconnect with this policy, such as the Safeguard Mechanism, must be carefully weighed together as to potential reactions, risk management and the nullification of unintended consequences.

ASI highly recommends to this review that the Australian steel industry requires a steel specific CBAM policy, tailored to our industry specific needs, to prevent significant carbon leakage and enable the development of our industries very high potential and important role socio-economically and sustainably for our nation.

ASI has been working closely with our steel producing members to develop consensus for a united approach on how a Steel-CBAM would most effectively and efficiently work for our industry.

2.1 Safeguard Mechanism settings

Preliminary findings for consultation

Current Safeguard Mechanism settings are effective at mitigating carbon leakage risk in the short- to medium-term. But settings for some sectors may need to be augmented with additional measures over time. Reduced baseline decline rates for Trade Exposed Baseline Adjusted (TEBA) facilities constrain the contribution of Safeguard Mechanism sectors to Australia's overall emissions reduction efforts.

Our industry members agree with the consultations findings that current Safeguard Mechanism (SGM) settings, Trade Exposed Baseline Adjusted (TEBA), mitigate carbon leakage for steel in the short term – however this will need to be monitored closely in the future for the need for additional measures. Our members are concerned leakage risks are expected top rise in the future and combined with specific TEBA baselines decline and a rise in business compliance costs, longer term support measures will be required.

Future policy certainty is most important for significant business decisions around carbon leakage risks. Currently there is some uncertainty around potential changes in 2026-27 to the SGM regarding rules for the short to medium term use of SGM Credits. Such pending decisions along with anticipated future SGM baseline decline rates post 2030 bring together heightened risks for steel producers. We agree with the consulting paper recommendations that longer term policy measures will be required to support important local manufacturers decision making processes. We acknowledge post 2030 TEBA decline rates will be set in five year blocks in line with Australia's commitment to the Paris Agreement.

TEBA is a most important component of SGM to assist our hard to abate trade exposed steel manufacturers as our members transition to extremely high capital intensive low carbon facilities. Whilst TEBA continues to be in place, a number of critical policy enablers will be required to bring about the steel making decarbonisation transition, especially for our Primary Blast Furnace producers in Port Kembla and Whyalla:

- Policy to dramatically increase the supply of Natural Gas, for Direct Reduced Iron (DRI) technology;
- Firmed cost competitive Renewable Energy, for both our Secondary EAF and Primary BF steel makers;
- Commercialisation of the Hydrogen industry;
- Access to appropriate high grade iron ore for DRI technology.

2.2 Public investment

Preliminary findings for consultation

Public investment to help reduce emissions intensity can help address the risk of carbon leakage in specific cases and is particularly relevant for export-oriented industries. A range of such programs exist in Australia.

While fulfilling a range of functions, public investment would not be sufficient as a systematic and fiscally sustainable standalone solution for commodities with high carbon leakage risk.

Very significant capital investment is required for the commercial transition of our industry to low carbon steel making. This is especially so for our BlueScope and Liberty GFG Primary BF-BOF steel producers. Direct Reduced Iron (DRI), from pilot stage to large scale production with commercialised technology and energy sources, phased from Natural Gas-DRI to Hydrogen-DRI, is expected to require in the vicinity of $2.5 to $5Bn in capital costs.[1] Current EU project developments show that public investment in overseas jurisdictions is providing up to approximately 50 percent of such projects capital funding. Furthermore, significant capital investment will be required for both steel and iron ore industry enablers to decarbonisation, such as the development of appropriate iron ore grades for DRI in relation to both green iron and steel making.

Whilst such investments from both public and private sources of green finance schemes are extremely large, the high potential outcome for our economy and jobs in the green iron industry for both domestic and especially export markets is enormous.

2.6 Findings of leakage by commodity

Preliminary findings for consultation

The following commodities are found to be subject to potentially material carbon leakage risk over time: cement, clinker and lime; ammonia and derivatives; **steel**; and glass.

Our members agree with the consultation papers finding there are material carbon leakage risks for steel, and at a later stage additional policies will be needed.

[1] Based on current EU operations

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Border Carbon Adjustment

Preliminary findings for consultation

A border carbon adjustment applied to imports could be an appropriate policy measure for selected Safeguard-covered commodities with high carbon leakage risk from imports. It could provide a robust underpinning of the Safeguard Mechanism for commodities where carbon leakage risk is material, and efficiently support industrial decarbonisation.

Implementation could be phased and could involve the removal or phase out of TEBA provisions for facilities producing commodities where a border carbon adjustment is introduced.

A border carbon adjustment that provides rebates for exports would be inconsistent with Australia's emissions reduction targets and could raise considerable international trade law concerns. For these reasons a border carbon adjustment for exports is unlikely to be appropriate for Australia or achieve the relevant policy objectives. Well-designed border carbon adjustments in other countries would provide market premiums to Australian low emissions export commodities.

Any border carbon adjustment would need to mirror domestic emissions policy settings for imports to provide a level playing field and be designed to minimise administrative burdens. It would need to be consistent with Australia's longstanding support of an open, rules-based trading system and its international trade law obligations. Australia could advance relevant work with plurilateral initiatives and support trade partner countries with implementation.

Contingent upon the need for associated pre-requisites and firmly controlled measures, our members agree TEBA provisions could be phased out in time with the rollout out of a well-designed, effectively synchronised BCA. These pre-requisites or low carbon steel enablers include detailed planning timeframes for changes, longer term fixed policy and other key enablers as discussed:

- Policy to dramatically increase the supply of Natural Gas, for Direct Reduced Iron (DRI) technology;
- Firmed cost competitive Renewable Energy, for both our Secondary EAF and Primary BF steel makers;
- Commercialisation of the Hydrogen industry;
- Access to appropriate high grade iron ore for DRI technology.

To be clear, the TEBA baseline decline rates must provide adequate time allowances for Primary steel productions difficult to abate transition. Further existing TEBA must stay in place as the CBAM policy and related BCAs are phased in, to assure risks of carbon leakage are well addressed.

Australian steel exports continue to be an important market and revenue provider, especially when local markets present 'patchy' demand. The Australian steel export country of destination regularly do not have carbon costs for their local industry, and therefore export rebates will be critical for our steel exports to remain competitive.

We support the consultation papers claim of further investigation on international trade law issues regarding export rebates is warranted.

3.4 Sectoral application

Preliminary findings for consultation

Cement and clinker would be suitable for initial consideration for a border carbon adjustment. Lime would also be suitable for early consideration, however production coverage under the Safeguard Mechanism is only partial and would need to be carefully considered to align with the international trade law principle of non-discrimination between domestic products and imports.

Based on current analysis, ammonia and derivatives, and steel, as well as glass would be worth further policy consideration and could be candidates for a border carbon adjustment later.

A border carbon adjustment would most suitably be implemented in a phased approach, starting with commodities at relatively high risk of carbon leakage and for which implementation is likely to be simplest.

Should a border carbon adjustment be pursued, coverage of commodities could be expanded over time where the suitability criteria are met, as experiences accrue and reliable emissions monitoring is expanded. Further stakeholder consultation would need to be undertaken before the addition of other commodities.

Application of CBAM and Border Carbon Adjustments to downstream value-add steel products

The ASI and our members disagree with the draft papers findings that carbon leakage risk is limited to materiality[2], and firmly maintain that a well-designed CBAM will need to apply to the steel industry's downstream value add products, such as: light gauge rain water goods, sheds, steel house frames, utility scale wind towers and solar frames, and, most critically imported fabricated structural steel – which ASI estimates currently accounts for up to 50 percent of the fabricated steel market. The

[2] Carbon Leakage Review, Consultation Paper 2, page 30

ASI has clearly articulated in recent government submissions and forms that during 2024 our local market has received a massive spike in imported fabricated steel volumes, which is having an enormous impact on our downstream fabrication sector in relation to revenue earnings, job losses and business closures.[3]

Whilst the paper asserts 'value added to downstream goods is small as compared to the value of the products embodied carbon, and therefore carbon costs in steel production will be material relative to the downstream production price', excluding downstream products in a CBAM for steel will place a very high risk of carbon leakage for a large section of the steel value chain – which in turn will lead to very high leakage risks for Australian steel producers supplying the extremely high number of downstream value add companies.

In our commoditised industry, there is no current evidence of a price premium for lower carbon products, and purchase decisions between imports and domestic value add products are largely price driven.

3.5 Design considerations

Preliminary findings for consultation

A border carbon adjustment would need to mirror key provisions of the Safeguard Mechanism. Should a border carbon adjustment be pursued, a border carbon liability could be applied to emissions in exceedance of the Safeguard Mechanism baselines and to the extent that the assessed effective carbon price paid in the originating country is lower than in Australia. This assessment would be based on explicit emissions prices only.

The basis for emissions assessment should be the same as the Safeguard Mechanism, covering only scope 1 emissions and all relevant greenhouse gases.

Further consideration would be needed before a border carbon adjustment is applied to a commodity with less than 100% Safeguard Mechanism coverage of domestic production.

A border carbon adjustment for a particular sector would remove the policy basis for TEBA provisions for that sector.

A border carbon adjustment may generate revenue. Stakeholders have suggested that in addition to offsetting the costs of implementation of the policy, funds could also be provided to programs to support implementation and industrial decarbonisation objectives in trade partner developing countries.

[3] <https://www.steel.org.au/what-we-do/impact-of-imported-fabricated-steelwork>

Should the government decide to pursue a border carbon adjustment, detailed design and implementation would need to be considered and consulted on. Consultation would need to encompass both domestic stakeholders and trading partner countries.

CBAM Design

The ASI and its members maintain the design of an effective CBAM policy and Border Carbon Adjustments will completely close all advantage gaps an importing country of origin has, so that:

- The policy applies to all steel imports when the carbon price paid in the originating country is lower than in Australia, applying to all emissions greater than SGM baselines;
- The assessment of the total carbon price paid in the country of origin must also include all indirect carbon support adjustments received by the exporter;
- Australian steel producers will be left with no economic disadvantage on carbon assessments based on Scopes 1 and 2 GHG emissions;
- The policy ensures all State based emissions reduction policies are incorporated into assessment modelling so that our steel producing members are at no carbon price disadvantage such as business costs arising from all emissions reduction policies to ensure a level playing field;
- The BCA in its assessment needs to ensure all foreign government subsidies and indirect carbon support for steel being imported into Australia, including energy subsidies, is included into the foreign net carbon liability;

The ASI agrees with the consultation paper that the methodology for calculating BCAs should only apply to all emissions above the baseline threshold, deducting all carbon costs at the country of production. Maintaining TEBA alongside BCA for an agreed period in the detailed plan is required for success of this policy due to what's at stake for the Australian steel industry.

We agree there must be a detailed consultation plan and implementation program with our steel producers which minimises administration of our industry members and government; and, that there needs to be a detailed review of all lessons learned in overseas jurisdictions which have or are in the process of implementing similar CBAM policy arrangements.

Importantly, a most accurate and validated BCA assessment method will encourage greater investment in new high tech, low carbon Australian steel manufacturing facilities, and will decrease the overall risk of carbon leakage. Without such occurring, the knock-on effect of increased industry assistance will be required.

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Australian Steel Producers Agreed Position Statement on the Introduction of a CBAM Policy

The ASI and our steel producing members, BlueScope and Liberty-Infrabuild Group have been working together to develop an industry agreed position statement, outlined below, on the key important elements for the introduction of a Steel CBAM, and wish to work closely with the Climate Change Authority on the detailed requirements for an Australian Steel CBAM rollout plan.

"*The Australian steel industry supports the Federal Government's investigation of policy to prevent carbon leakage, which could include a well-designed Carbon Border Adjustment Mechanism (CBAM).*

The steel industry welcomes the preliminary finding of the Carbon Leakage Review that steel is a product subject to a potentially material risk of carbon leakage in Australia and worthy of additional policies to address such leakage.

To ensure the achievement of agreed goals and the optimisation of a tailored CBAM for the steel industry, and prevent carbon leakage without triggering potential unintended consequences for the domestic steel value chain, our industry members recommend the following:

- *The careful planning, joint modelling, and design of a CBAM for major steel product groups, which includes learnings from implementation of CBAMs in international jurisdictions;*
- *That key design parameters be addressed by government, including:*
  - *Ensuring broad steel product coverage;*
  - *Not disadvantaging steel exports;*
  - *Ensuring that Safeguard Mechanism arrangements for trade exposed industries (TEBA) remain in place until all the enablers of steel industry decarbonisation are available;*
  - *Taking into account the effect of both state and federal climate change policies;*
  - *Accounting for the impact of climate change policies on electricity prices; and*
  - *Taking into account subsidies to foreign steelmakers.*

Further to this careful planning and design, Infrabuild recommends that a steel CBAM be piloted for its reinforcing bar products, with the pilot closely monitored and reviewed by government and the industry for its effectiveness.

A broad-based CBAM for steel should only be implemented with the agreement of all Australian steelmakers, with its design informed by international experience and the pilot steel CBAM, and tailored to ensure it prevents carbon leakage across the range of different steel value chains."

Mandatory emissions product standards

Preliminary findings for consultation

While mandatory emissions product standards can be suitable for other policy objectives, they are not likely to be an effective policy intervention to address carbon leakage risk.

Our members agree with the consultation papers findings that mandatory emissions product standards will not be an effective policy to address carbon leakage risk.

Emissions Default Values

A complicating factor in relation to the development of emissions default values is that our industry has two major production streams, Primary BF-BOF and Secondary EAF manufacturing routes, the latter Electric Arc Furnace technology relying on 95-100 percent recycled ferrous scrap steel inputs. Therefore, each would need to have their own specific emissions default values. Also there exist numerous international methodologies for calculating GHGe for steel making, with some jurisdictions using a mass balance approach to attributing carbon both across various facilities and Secondary and Primary steel making routes. Therefore, by establishing set default values our industry would be exposed to overseas producers finding loop holes to avoid carbon imposts using their own measurement interpretations.

BCA Liability Mechanism and Modelling of BCA Impacts

Our industry members highly recommend BCA liabilities should be met by paying a fee, not by acquiring and surrendering ACCUs. Regulating payment through ACCU surrender would have the negative consequence of increasing demand for ACCUs and thus driving up such carbon credit prices. This would also have the knock-on effect to steel producers needing to pay inflated prices for ACCUs when required.

With regards to modelling requirements for BCAs, ASI recommends close direct consultation between our members and government.

Multilateral and plurilateral initiatives

Preliminary findings for consultation

Given Australia's strong stake in the international rules-based system, policy responses to address carbon leakage risks should advance and support the international system.

Enhanced global climate action would reduce carbon leakage, but divergences in ambition and policy approaches will persist in the medium-term.

An internationally agreed solution to address carbon leakage risk developed through multilateral and plurilateral initiatives would be ideal, but is uncertain and would take time to develop. Possible long-term international solutions will not replace the near- and medium-term need for domestic policy action. Multilateral and plurilateral initiatives could support the implementation of border carbon adjustments through the development of interoperable standards and approaches, for example, the development of agreed default emissions intensities or standards to measure embedded emissions.

Australia's active engagement in these initiatives would support the development of best practice policy to address carbon leakage. Enhanced engagement is an opportunity for Australia to contribute positively to international policy development.

The ASI and its members are in full agreement with the reviews findings that both multilateral and plurilateral government initiatives are needed to reduce carbon leakage risk and promote GHG emissions reductions in steel manufacturing. It is anticipated such policy developments will be needed due to anticipated wide discrepancies with other jurisdictions regarding climate change and carbon policy and regulations.

In summary

The market for steel in Australia is such that there are essentially very low or no barriers to international trade, and pricing is set by import parity benchmarks. Since many steel products are pure commodities in the sense that the market treats them as generic provided basic mandated property requirements (e.g., mechanical strength) are satisfied, the domestic steel producers are obliged to compete directly with pricing determined by steel importers.

Understanding the importance and very high risk of carbon leakage for Australian steel manufacturing, the critical nature of our sovereign capability for domestic steel making and steels very deep value chain, whilst also taking account of the socio-economic contributions our industry provides, we very much welcome the process which has been undertaken through the Carbon Leakage Review, and we look forward to ongoing close dialogue with government on this initiative.

This policy will be critical in developing steel industry stakeholder confidence as we head quickly towards very major investments in green iron and low carbon steel making technologies. It is critical that a new CBAM for Australian steel manufacturers enables our industry to maintain domestic and international competitiveness, and the capacity to invest significant resources towards our steel making future.

Yours sincerely

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