



Carbon Leakage Review

KPMG submission

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Executive summary

As a leading professional services firm, KPMG Australia (KPMG) is committed to meeting the requirements of all our stakeholders – not only the organisations we audit and advise, but also employees, governments, regulators and the wider community. KPMG is pleased to provide a response to the Carbon Leakage Review’s (the Review) Consultation Paper on the proposed approach to assess and address carbon leakage risk.

KPMG brings both an Australian and a global perspective to this Review. Through our Global Decarbonisation Hub and broader expert network, we bring together a global climate policy advisory capability. Assisting clients to respond to the European Union’s (EU’s) Carbon Border Adjustment Mechanism (CBAM), both within the EU and trading into that market, has been a particular focus of this work.¹

In Australia, we have extensive involvement with the existing range of policies to address leakage. Our response focuses on some of the issues we have encountered from a client perspective, as they address the practical challenges of potential carbon leakage and policies designed to address this.

KPMG broadly supports the approach to carbon leakage outlined in the Review. In summary, we consider a multifaceted policy response is warranted, including consideration of a carefully implemented CBAM for impacted import-competing industries, and a combination of other policy measures for industries that face carbon leakage risks.

KPMG welcomes the Review and the open approach taken in the Consultation Paper. We consider the issue of carbon leakage to be critical for achieving a sustained net-zero transformation. We look forward to continuing to engage with the Review, and assisting our clients in understanding and responding to the issues it raises for them.

Our comments below follow the structure of the Consultation Paper (the Paper), and specific answers to the questions are outlined in an Appendix.

KPMG’s principal recommendations are:

RECOMMENDATION 1:

KPMG considers that a CBAM should be developed to address carbon leakage in the Australian context, but that this should be part of a multi-faceted approach including other measures, tailored for industry needs.

RECOMMENDATION 2:

Any introduction of a CBAM needs to be carefully coordinated with other measures aimed at addressing carbon leakage, to achieve efficient emissions reduction and to remain consistent with WTO requirements.

RECOMMENDATION 3:

A CBAM should be initially focussed on a narrow range of products, starting with the most emissions-intensive trade-exposed industries.

¹ See the KPMG Global pages on the [EU Carbon Border Adjustment Mechanism \(CBAM\)](#) and [Decarbonization, Climate and Nature](#) for more information. KPMG’s comments on the European Commission’s Public Consultation on the Carbon Border Adjustment can also be viewed [here](#).

RECOMMENDATION 4:

Efforts should be made to streamline compliance with a CBAM, including looking for opportunities to collaborate globally around accepted measurement and verification of embedded emissions, and the use of digital platforms with traceability functionality to track these emissions across the supply chain.

RECOMMENDATION 5:

Any CBAM should be introduced in a phased way, commencing with measurement of more simply transformed products, ahead of financial compliance.

RECOMMENDATION 6:

Wide industry engagement around a CBAM is needed at all points, including the range of stakeholders involved in the movement of goods across borders.

RECOMMENDATION 7:

In addition to ensuring compliance with WTO obligations in substance, it is critical that any introduction of a CBAM (or other new policy to address carbon leakage) does not give rise to any perception that it is aimed at introducing trade-distorting, protectionist measures.

RECOMMENDATION 8:

While adaptation of any CBAM design to Australian circumstances is necessary, our own trade context suggests Australia should be careful in pursuing novel approaches to CBAM design such as application to exports.

KPMG welcomes the Review and the open approach taken in the Paper. We consider that addressing the issue of carbon leakage is critical for achieving a sustained net-zero transformation. We look forward to ongoing engagement with the Review.

Should you wish to discuss this response further, please do not hesitate to reach out.

Yours sincerely,

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KPMG Australia

Background

About KPMG

KPMG is a global organisation of independent professional firms, providing a full range of services to organisations across a wide range of industries, governments and not-for-profit sectors. We operate in 146 countries and territories and have more than 227,000 people working in member firms around the world. In Australia, KPMG has a long tradition of professionalism and integrity combined with our dynamic approach to advising clients in a digital-driven world.

KPMG insights

KPMG insights

1. Context for the Review

KPMG considers the risk of carbon leakage is real, and if not addressed it could hinder Australia's efforts to decarbonise the economy and take advantage of clean energy opportunities.

Australia's trading partners face a highly dynamic trade landscape with a range of different climate and energy policy imperatives. Energy security remains a key priority in the Indo-Pacific region, though investors, consumers and the policies of major global economies are drawing increasing focus on decarbonisation. In this environment, uneven climate policy responses can be expected. Table 1 below illustrates the variety of carbon pricing policies across the region.

Table 1: Carbon Pricing of Australia's Regional Trading Partners

COUNTRY	RELEVANT CARBON PRICING POLICIES
China	Has a carbon price as part of its emissions trading scheme covering the electricity sector. There are discussions about expansions to cover other sectors, though there is no firm commitment on this or the associated timing.
India	Does not have any explicit carbon pricing but does have a carbon levy on coal and a series of policies to promote renewable generation. Working with emissions-intensive export industries to prepare for EU CBAM requirements.
Indonesia	Does not have any explicit carbon pricing policies but has some targeted support for renewables.
Korea	Has a carbon price as part of its emissions trading scheme; however, there are significant free

allocations, including less than 90% free allocation provided to subsectors subject to auctioning and 100% free allocation for EITE sectors.

Singapore	Has a carbon tax applying to all sectors with emissions above 25,000 tCO ₂ e fixed at US\$3.7/tCO ₂ e until 2024 and reaching US\$36-58/tCO ₂ e by 2030. There is no exemption framework; however, there will be a transition framework for trade exposed, emissions intensive sectors.
Japan	Voluntary national carbon price introduced this year, with auctions for emissions allowances commencing for power producers in 2033/34.
Thailand	Does not have any explicit carbon pricing policies.
Vietnam	Roadmap for implementation of an ETS developed with a National Crediting Program and pilot ETS expected to start in 2024 and 2026 respectively, becoming fully operational by 2026 and 2028. ²

For Australia's emissions-intensive industries, the environment outlined above raises uncertainties as to the competitive environment for new investments in decarbonised production. Although investor and customer pressures are driving interest in strong decarbonisation strategies like never before, transformative investments can still fail financial hurdles based on the range of technology and commercial factors. Risk of competition from goods produced in jurisdictions with lower carbon ambition can add to these concerns.

This context suggests that the investment leakage channel raised in the Paper should be a particular focus. Robust and scalable policy instruments that provide some certainty over the

² [Carbon Pricing Dashboard | Up-to-date overview of carbon pricing initiatives \(worldbank.org\)](https://www.worldbank.org/en/indicators/SH.UO.EC.CO2V)

investment horizon can assist in unlocking opportunities for decarbonisation investment and take advantage of Australia's competitiveness in low-carbon production.

2. Assessment methods

KPMG welcomes the Review's analytic approach to assessing carbon leakage and responses.

The Review is right to cast the net widely in terms of trade-exposed industries potentially affected by leakage. However, there needs to be a particular focus on industries at greater risk of leakage within the group that are trade exposed, and particularly those with high emissions intensity of production relative to industry value added.

In our view, the analytic approach should include appropriate consideration of the dynamic decarbonisation and energy context. Rapidly rising investor and consumer attention on the net-zero emissions transition is affecting supply chains independently of the impact of policy. Technological options for lower-cost decarbonisation are also changing rapidly. This may suggest that industry responses to carbon policy signals, including differential ambition in different jurisdictions, might be stronger now than in the past. Equally, the costs and risks in terms of lost opportunities from incomplete policy frameworks may be greater. The Review's engagement with industry and investors on current opportunities and market dynamics will be valuable in this context.

3. Policy options to address carbon leakage risks

Australia's efforts to address leakage are likely to require a mixture of all the policy options identified in the Paper. Different industries may require a different mix of policies given policy and implementation challenges in the Australian context.

The EU has introduced a CBAM as part of a wide range of policies to address leakage, encompassing all the potential responses listed in the Paper, and integrating these in a single package. The EU package combines a legislated phase-in of its CBAM with an extensive range of decarbonisation grant funding of relatively long duration, reflecting the significance and depth of the net-zero transition. This is consistent with

investment certainty being a key aspect of avoiding carbon leakage.

KPMG considers that a CBAM should be part of the policy response to carbon leakage in the Australian context. This is particularly important for the industries facing the strongest impacts from differential carbon policy. Our view is based on the following considerations:

- A CBAM, by design, adapts with the most flexibility to changing carbon policy conditions in our trading partners. It does this by adjusting automatically to carbon policies in our trading partners, and to varying carbon intensities of production in our competitors. This has advantages given the dynamic international and regional policy environment outlined above.
- As a structural mechanism built into the market, a CBAM provides strong longer-term signals for domestic producers that carbon policy will be evenly applied to competing foreign facilities. This will aid planning for decarbonisation investments and help ensure that the private and public benefits from improvements in carbon competitiveness can be secured.
- As such, a CBAM can facilitate more ambitious carbon policy settings by directly addressing carbon leakage, which is often a key barrier to support for climate action, including the risks to affected regions and workforce. A CBAM can provide a basis for the ongoing carbon competitiveness of key industries and regions.

A CBAM can be consistent with Australia's strong support for a rules-based global trading order based around the WTO (see Section 6 for further discussion). To achieve this, it needs to be strictly neutrally applied between domestic and traded production and be based on the actual embedded carbon of specific trade flows (rather than broad country parameters).³

A CBAM cannot contain hidden protection if it is to be WTO compliant. That is, the level of a CBAM needs to be calibrated to achieve emissions-reduction goals neutrally between the domestically produced good and the imported alternative. To illustrate, if the production of a good domestically attracts a carbon price of \$35 per tonne, the CBAM must be no greater than \$35 per tonne. Exclusions of domestic coverage from carbon price coverage, and other design

³ See [Emerson and Moritsch \(2021\) Making Carbon Border Adjustment proposals WTO-compliant](#) for further discussion on this point.

outcomes, must similarly be mirrored in the CBAM.

Further, the importer must have the right to perform its own calculations of the carbon embedded in its product. This is to prevent the authorities applying a CBAM from exaggerating the carbon content of the imported product.

Any introduction of a CBAM therefore needs to be carefully coordinated with other measures aimed at addressing carbon leakage, to achieve efficient emissions reduction and to remain consistent with WTO requirements. For example, the EU has mirrored the introduction of its CBAM with the withdrawal of free permit allocations for domestic industry (they are mathematically linked). Free permits under the EU ETS are analogous to the provision of emissions baselines in Australia under the Safeguard Mechanism, suggesting any CBAM here will need to be closely calibrated to these baselines.

The broad EU approach has also been informed by limits to the practical feasibility of applying a CBAM widely. It is focused on a relatively narrow range of more simply transformed goods, at least initially. Even with the proposed coverage in the EU, there are significant practical issues to address, which we turn to in the next section.

4. Feasibility and Implementation Considerations for a CBAM

With respect to the feasibility of implementation, the EU CBAM raises some practical lessons for Australia. It is very early days in the implementation of the EU CBAM following many years of high-level discussion, two years of detailed design work, and with full implementation of financial arrangements phased in from 2026 to 2034. This lead-time suggests early attention to practical issues associated with an Australian CBAM is warranted.

Our experience from working with clients responding to the EU CBAM suggests the following design approaches would assist successful implementation:

- **A CBAM should be initially focussed on a very narrow range of products.** Products subject to the CBAM need to be precisely defined by customs tariff code to enable

shipment-by-shipment application of a charge. And the measurement of embedded carbon in the relevant foreign market needs to be traceable and capable of verification.⁴ Australian market structures are considerably simpler than those in the EU. However, the degree of implementation complexity can expand rapidly with the addition of new industries and product lines, particularly those involving more complex manufacturing processes. KPMG also considers an initial narrow scope of application will reduce any risks around regional trade relationships, as it allows for more focused communication (see below).

- Flowing from this, **efforts should be made to streamline compliance, particularly around measurement and verification.** Opportunities should be explored for mutual recognition of emissions measurement regimes, including of EU standards to which many regional exporters will already be adhering to export to that market. Implementation should also explore the use of digital platforms with traceability functionality to track these emissions across the supply chain⁵.
- **Any CBAM should be introduced in a phased way.** The EU has introduced a phased approach to measurement, reporting and verification requirements, ahead of the imposition of financial liabilities. This eases the implementation load and develops a better data picture of embedded trade emissions ahead of full implementation. Australia has a simpler supply chain and opportunities for simpler CBAM coverage (due to Scope 2 emissions not being covered by domestic carbon pricing here). Nevertheless, full consideration should be given to ways of reducing implementation load, including phasing in of industries.
- **Wide industry engagement around a CBAM is needed at all points.** A CBAM necessarily involves more parties in the supply chain than other measures aimed at leakage (e.g. grants, safeguard measures). It also brings in a wide range of stakeholders beyond 'climate focused' industry participants – those involved in trade and logistics, for example. The CBAM also has wide implications for corporates – spanning compliance, strategy, government

⁴ [CBAM: Transitional period rules adopted – KPMG Global](#)

⁵ For an example of existing analogous approaches, in this case for recording supply chain emissions in building construction, see the case study drawing on

KPMG Origins capability on p34 in [Tackling embodied carbon within Australia's construction and infrastructure sector \(kpmg.com\)](#)

engagement and tax functions – and our experience with EU clients suggests that it can take time to develop integrated responses. Hence industry engagement needs to capture relevant groups beyond those generally involved in climate policy engagement.

We support the focus of the Paper in examining the implications of carbon leakage policy for Australia's wider trade strategy and priorities. This is a critical element of assessing the feasibility of implementing a CBAM.

In addition to ensuring compliance with WTO obligations in substance, it is critical that any introduction of a CBAM (or other new policy to address carbon leakage) does not give rise to any perception that it is aimed at introducing trade-distorting, protectionist measures. Facilitating this will be a design that ensures neutral trade impact, a streamlined approach to measuring and verifying embedded carbon, and focused implementation.

It is helpful that Australia is fast-following EU design and implementation experience. This allows us to observe the EU's experience, including in socialising this with their trading partners, many of whom are shared with Australia.

While adaptation of any CBAM design to Australian circumstances is necessary, our own trade context suggests Australia should be careful in pursuing novel approaches to CBAM design such as application to exports. This has additional implications for trade relationships and design complexities and is not being pursued at this stage by the EU. Australia's very different trade profile to the EU may argue in favour of considering such an approach; however, this needs to be balanced against ease of communication and broader risks to trade arrangements. This, in KPMG's view, adds to the argument for a multi-faceted policy approach, that keeps all policy options on the table to provide a range of options to address carbon leakage risks.

Appendix

CONSULT FEEDBACK QUESTIONS	KPMG RESPONSE
1.1 Carbon leakage	
Is the description of carbon leakage appropriate for the purpose of this Review?	The description set out in the Paper is appropriate, with a strong focus in the Review on investment leakage as discussed in Section 1 above.
1.2 The Safeguard Mechanism	
What is your view on how your business or industry could be affected by carbon leakage?	Current arrangements within the Safeguard Mechanism to address carbon leakage are appropriate. We consider more targeted and robust measures will be needed over the longer run to address the complex and evolving carbon emissions policy environment in our region and provide a more certain policy environment for decarbonisation investments.
2.1 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?	While we agree with the proposed approach to cast a wide net in terms of potentially affected industries, we also note that some trade-exposed industries are much more acutely impacted than others. We suggest that the assessment should consider tailored approaches for the most affected industries and products. See Section 2 for further discussion.
2.2 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?	Agreed, the assessment approach outlined is appropriately comprehensive.
2.4 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 analytic approach looks comprehensive. The analysis should take into account the fast-changing environment including sustainable investment trends, consumer preferences and policy reactions in other countries. Within this approach there should be a focus on potential regional economic and employment impacts of carbon leakage.
3 Policy options to address carbon leakage risks	
Are there additional policy options that should be considered alone or as part of a portfolio of approaches to address carbon leakage?	We agree with the menu of policies considered. Examination of grants to facilitate public investment should include consideration of the range of policy objectives associated with such grants, including low-emissions technology development, and facilitating regional and workforce support.
3.1 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?	The current Safeguard Mechanism arrangements should form part of a portfolio of policy responses to address leakage risks. For the most strongly affected industries we consider these will need to be supplemented with a more nuanced and enduring measure such as the CBAM. As noted in Section 3,

different industries may require a different mix of policies given policy and implementation challenges in the Australian context. Any CBAM will need to be closely coordinated with existing Safeguard policy aspects to maintain neutrality with respect to traded goods.

3.2 Australian carbon border adjustment mechanism

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

An Australian CBAM should be considered for industries facing the strongest impacts from differential carbon policy. See Section 3 for discussion on this point. WTO consistency should be a key principle and design feature of any proposed package of measures including a CBAM.

3.3 Emissions product standards

What is the appropriate role for emissions product standards to mitigate carbon leakage?

Emissions product standards are unlikely to be the first-best policy for the most emissions-intensive products, as they are relatively blunt instruments and do not easily reward innovation in decarbonisation technology. These may have a role in more complex products where leakage risks remain, but where CBAM implementation may be infeasible.

3.4 Targeted public investment in firms' decarbonization

What is the appropriate role for public investment measures to mitigate carbon leakage?

Measures such as direct grant support for emissions-intensive trade-exposed industries will have an ongoing role as part of a multifaceted policy response. As discussed in Section 3, this has also been the experience of the EU, with long-term grant support playing an important role alongside the CBAM to provide investment certainty in the face of a dynamic context for international carbon pricing. Decarbonisation grants generally achieve a range of policy objectives besides mitigating carbon leakage and these wider purposes should be given due weight (e.g. regional adjustment, technology development and deployment).

3.5 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?

Australia should continue to seek to align carbon policies to the extent possible in our trading partners via global and regional agreements. Unilateral measures will likely be needed for some time given the variable implementation of climate policies in the region, but opportunities to collaborate should be fully explored (e.g. on emissions measurement). Unilateral measures should be carefully implemented and communicated to regional stakeholders to ensure the policy intent is understood.

4 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?

In Section 4 we outline some key design features, including based on our experience with the EU CBAM. These include: starting with a narrow range of products; a phased implementation approach; a focus on streamlining measurement, reporting and

verification; and undertaking wide industry engagement. Australia should adapt current EU approaches to our circumstances. Pioneering new or novel CBAM designs should be approached cautiously given our trade context.



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