Decarbonisation and the Australia–China Economic Relationship

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On 1 December 2023, EABER hosted a track two expert Dialogue with the China Center for International Economic Exchanges in Beijing. The Dialogue, building on the statement of joint outcomes agreed by Prime Minister Albanese and President Xi on the Prime Minister's visit to China in November, discussed the implications of decarbonisation and the energy transition for the Australia–China economic relationship.

Decarbonisation will bring far-reaching changes to both countries, especially their trade and investment relationship. It will have a profound impact on bilateral relations for decades to come, given the primary role that Australia and China will each need to play in the other's successful energy transformation. As long as differences are handled appropriately, there is significant scope for Australia and China to cooperate while safeguarding their national interests.

The Dialogue identified the following potential for cooperation on decarbonisation and transformation of the trade and economic relationship:

1. Financial authorities from Australia and China can share ideas and experience in developing national, regional and global frameworks for sustainable investment.
2. Intensified think tank and industry dialogues with the iron and steel industries can support their energy transition efforts.
3. Focus on decarbonisation as an agenda item in the resumption of bilateral policy dialogues can help manage the transformation of the relationship.

Decarbonisation and financial cooperation

The energy transition will require improved access to climate finance, ensuring both that existing funds are properly allocated and that they are utilised in a way that does not undermine climate goals.

The global climate finance landscape is growing rapidly, with large amounts of financing now coming from China, but funding amounts are still insufficient to fulfil the Paris Agreement objectives. There will be an estimated annual US$5 trillion gap in sustainable financing over the next 10 years, which is primarily a consequence of a misallocation of funding.

It is essential to ensure that investment incentives align with climate goals. The efficacy of financial markets can be strengthened by harmonising sustainable finance taxonomies across jurisdictions and improving corporate disclosures and data sharing. China and the European Union have worked together on green finance definitions, publishing the Common Ground Taxonomy Table, but Australia is still in the early stages of its efforts to establish a long-term sustainable finance strategy. China has also worked extensively on developing its domestic green financial system by accelerating the construction of its carbon trading market and promoting green credit, bonds, insurance and funds. Australia and China could work together with other countries in the region to develop a strategy that accounts for green credentials in investment.

Participating in regional and multilateral frameworks, on top of bilateral engagement, is an essential element of Australia's and China's joint roles in facilitating global decarbonisation. Creating international frameworks will enable experience sharing and inclusive cooperation, reducing costs and helping to diffuse the benefits of technological developments. It will

also help manage the growing uncertainties posed by the destabilising effects of geopolitical developments, such as those in Ukraine and Israel, on energy prices and supply.

Iron ore and steel industry transition

China has adopted the '3060' goal of peaking carbon emissions by 2030 and achieving carbon neutrality by 2060. Central to this objective is the greening of the Chinese iron and steel industries, which will have significant implications for the Australia–China bilateral relationship given the deep economic linkages between Chinese steel and Australian iron ore. Though there are many pathways towards emission reductions, all of them have three principles in common: a need for radical economic transformation, a need for massive investment and a need for essential minerals.

The trajectory of decarbonisation will be defined by five key factors: the age of capital stock, existing endowments, policy settings, requirements for affordable steel and exposure to international competition. There are three distinct stages in the transition: optimisation of existing facilities (which is associated with a 20 per cent improvement in emissions), technological transformation (approximately 30–60 per cent improvement) and the green end-state (80 per cent improvement). China is rapidly progressing from the optimisation to the transformation phase. By 2050 it will almost be ready for completely green production.

Several developed countries in the Asia-Pacific, including Japan, South Korea and Australia, are at a similar stage to China. But emerging economies are yet to experience their full demand for steel and are some way off this decarbonisation path. It will be essential for this steel to be produced with the lowest possible emissions at an affordable cost.

Increasing the use of electric smelting furnaces is an important step towards achieving this objective and could be the focus of a partnership between Australia's iron ore industry and China's steel industry. A valuable future exercise will be tracing paths for cooperation in the steel and iron ore mining industries in China and Australia using this five-factor decarbonisation framework and considering the demography of China's steel capacity.

Decarbonisation also has implications for the nature of the resources trade. It is currently cheaper for Australia to mine domestically and have minerals processed in other countries, but this will not always be the case. Hydrogen is extremely costly and difficult to transport, for example, and it may become more efficient for Australia to develop some domestic processing capability. It will be critical to study the shifting economic and technical advantages in resources trade as the energy transition continues.

Dialogues and transformation of the relationship

The energy and resources trade has played a critical role in the economic development of Australia and China, and it will be important to both countries economic security that they continue to do so. But the global response to climate change must influence the future direction of this cooperation.

Achieving net zero carbon emissions will be costly, with low carbon emissions necessary not only in consumption (for example, via increased use of electric vehicles) but also in inputs to production (via the sourcing of electricity, the processing of metals and materials manufacture). Improving energy efficiency is a high priority in reducing the costs of

decarbonisation and will be best achieved through international trade in the whole range of consumer and producer goods and inputs (such as electric vehicles, solar panels, wind turbines, processed lithium, iron and other minerals) that are necessary to achieve it. Using the strong complementarity in the new energy production and supply chains between Australia and China is important to reducing those costs.

The track two dialogues between Australian and Chinese think tanks have identified the potential for cooperation on decarbonisation between Australia and China, including through the promotion of bilateral investment.

While there is no way to get rid of the politics from international economic relations, both countries have a strategic interest in reaffirming global and sustainable development as a common goal that will improve economic relations and facilitate bilateral and international cooperation on decarbonisation.

Beyond track two dialogues, deepening official dialogues in the three areas of high potential for cooperation can include:

1. Sharing ideas and experience in the development of national, regional and global frameworks for sustainable investment through the cooperation of financial authorities in both countries.
2. Complementing think tank and industry dialogue on energy transition in the iron and steel industries through one and a half track dialogue, and the resumption of official bilateral policy dialogues (the Strategic Economic Dialogue and the Comprehensive Strategic Partnership) with new focus on decarbonisation.

3. Renewed dialogue between ministers responsible for climate change. These official dialogues are a crucial mechanism to signal political commitment to finding an efficient and low-cost pathway in the transformation of the trade and economic relationship required over the coming decades.

This agenda for dialogue on economic cooperation will need to build on the many complementarities in the fossil fuels-based economic relationship that are linked to complementarities in the new renewable energy-based economic cooperation agenda. Engagement with regional and multilateral, as well as bilateral, frameworks for global trade and investment will be essential to facilitate decarbonisation and manage the risks and costs.

But it cannot be confined narrowly to cooperation in climate change, energy and resources trade.

It will also require addressing political difficulties and undertaking renewed commitment to the framework and principles needed to underpin confidence in international and bilateral economic cooperation. This commitment includes cooperation within multilateral agreements, cooperation within existing regional agreements (such as RCEP) and negotiating new regional arrangements, revisiting established bilateral agreements such as ChAFTA and developing new arrangements. The Strategic Economic Dialogue, the Australia–China Comprehensive Strategic Partnership and the China–Australia Free Trade Agreement are all instruments that can be deployed to pursue these priorities for cooperation.