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Safeguard Mechanism Reforms Submission

September 2022

Australian
Chamber of Commerce
and Industry

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Executive Summary

Share of the National Abatement Task

- The facilities covered under the safeguard mechanism should undertake their share of the emissions reduction task. A 28% emissions reduction from covered facilities between 2023 and 2030, represent a fair share of the emission reduction effort.
- The cumulative (multi-year emissions budget) approach provides greater flexibility for covered facilities and is the most efficient means of achieving their emissions reduction commitment.

Baseline Setting

- Baselines should be set using a production-adjusted baselines, encouraging covered facilities to reduce emissions by lowering emissions-intensity, rather than just decreasing output, this will drive facilities to invest in new emissions reduction technology that will also reduce production costs and lead to lower consumer prices.
- Production-adjusted baselines should be set using site-specific calculation.
- Headroom should be removed so that facilities don’t face artificially high baseline decline rates and crediting and trading can commence as soon as possible.

Crediting and Trading

- The timing of investment in emissions reduction technology by individual facilities will be uneven. Crediting and trading, and multi-year monitoring periods should be available to provide flexibility and enable covered facilities to optimise their investment in low emissions technology.

Domestic and International Offsets

- Allowing covered facilities to purchase ACCUs should be accepted where they are proven to provide emissions reduction above the national targets for industry sectors from which they are sourced (i.e. there is no double-counting).
- While covered facilities should continue to be able to register new projects under the Emissions Reduction Fund, where it can be verified there is no double-counting.
- Transparency would be enhanced by the Climate Change Authority monitoring and requiring covered facilities to publish their holding of ACCUs.

- Until a credible international standard for verification has been developed, international credits should not be accepted in the Safeguard Mechanism.

Tailored Treatment for EITEs Businesses

- Some support should be given to EITEs, but they should still be required to contribute their share of emissions reduction through the Safeguard Mechanism.
- Support is best provided by grants through the Reconstruction Fund and low interest loans through CEFC and ARENA.

Indicative Baseline Decline Rates

- Facilities covered under the Safeguard Mechanism should undertake their share of the emissions reduction task. ACCI consider the proposed 29% emission reduction (4.1% per year) representing a fair share for a sector contributing 28% of total emissions.

Australian Chamber of Commerce and Industry

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1 Introduction

ACCI welcomes the opportunity to contribute to the review of Australia's Safeguard Mechanism. With the new climate change legislation committing Australia to reduce national emissions by 43% below 2005 levels by 2030 and achieve net zero by 2050, changes to the design of the Safeguard Mechanism are essential.

To date the Safeguard Mechanism, covering the 215 largest emitting incorporated facilities releasing at least 100,000 tonnes of greenhouse gases per year, has played a very limited role in contributing to Australia's emissions reduction efforts. While contributing 28% of total emissions in 2020-21, facilities covered by the Safeguard Mechanism increased emissions by 4%. This was largely due to an increase in the number of covered facilities under the mechanisms, but there have been minimal emissions reductions per facility since the Safeguard Mechanism was introduced in 2016. This is holding back progress to reduce Australia's emissions and move towards a sustainable decarbonised economy.

We accept that the facilities covered under the Safeguard Mechanism must play a central role in reducing emissions to meet the ambitious targets set by the Government. Yet it is important that in the transition to a decarbonised economy, the Safeguard Mechanism provide certainty for investment in low emissions technology and a level of flexibility so facilities can optimise their investment and achieve the most effective outcomes.

The following responds to the key issues raised in the Consultation Paper.

2 Share of the National Abatement Task

ACCI agree covered facilities should contribute their proportional share of the emissions reduction effort.

The proposed rate of emissions reduction, with facilities covered under the Safeguard Mechanism required to reduce emissions from 137 Mt to 99 Mt CO_2-e between 2023 and 2030, is achievable, but will require substantial effort and investment.

This 28% reduction over 7 years for facilities covered under the Safeguard Mechanism, represents a fair share of the overall emissions reduction commitment to the climate targets.

With the objective to reduce overall emissions, the cumulative (multi-year emissions budget) approach is the most effective means of achieving the commitment. This provides greater flexibility to facilities on the timing of investment necessary to meet their emissions reduction baselines, while ensuring the total volume of emissions over the decade is achieved.

Recommendation:

- The facilities covered under the safeguard mechanism should undertake their share of the emissions reduction task. A 28% emissions reduction from covered facilities between 2023 and 2030, represent a fair share of the emission reduction effort.

- The cumulative (multi-year emissions budget) approach provides greater flexibility for covered facilities and is the most efficient means of achieving their emissions reduction commitment.

3 Baseline Setting

Redesigning the baseline settings for facilities covered by the Safeguard Mechanism is required to support business and economic growth and maintain competition whilst also ensuring their share of the 2030 and 2050 targets are met. Under the current structure, some facilities have baselines above their current emissions level, lessening the incentive to lower their emissions intensity.

3.1 Fixed vs Production-Adjusted Framework

ACCI supports a transition from fixed (absolute) baselines to production-adjusted (intensity) baselines.

Fixed baselines set an absolute limit on emissions from covered facilities, allowing covered facilities to meet their emissions baseline by simply reducing their output. Covered facilities should not be pushed to reduce output to meet emission reductions as this is not conducive to economic growth.

Intensity baselines require covered facilities to reduce the emissions-intensity of their production, incentivising investment in competitive upgrades and low emissions technologies. This decouples emissions from production, supporting economic growth through investments and jobs.

Additionally, once a facility invests in low emissions technology that reduces the emissions intensity of production, each new unit of production will come with lower associated emissions. Therefore, effort focused on reducing emissions from the facilities entire operations is partially covered by reduced emissions from each unit of production. Comparatively, the fixed baseline is independent of production, creating a full cost scheme that is filtered more heavily onto pricing decisions.

The importance of cost reduction can't be overstated considering the current economic environment and the forecasted slowing of productivity growth. Inflation is a dominant concern with consumer prices (CPI) increasing to 6.1% and producer prices (PPI) increasing 5.6% in the year to June 2022. This heavily contributes to the RBA's recent decision to increase the cash rate to 2.35% and downgrade its economic growth forecast, with GDP projected to slow from 3½% in 2021-22 to 2¼% in 2022-23, then 1¾% in 2023-24.

Production-adjusted baselines should be set facility-by-facility, ensuring the emissions reduction baselines are specific to the covered facility. For some industries, there is less scope for facilities to reduce the emissions-intensity of their productions. Either the technology is yet to be developed or the nature of their operations (eg. using gas as a feedstock in production), limit opportunities to reduce the emissions-intensity of their operations. Under site-specific baselines, discrepancies within the industry are accounted for including location, the nature of productions and the current technologies installed at each site. This still holds facilities accountable to their proportional share of the emissions reduction targets in 2030.

Recommendation:

- Baselines should be set using a production-adjusted baselines, encouraging covered facilities to reduce emissions by lowering emissions-intensity, rather than just decreasing output, this will drive facilities to invest in new emissions reduction technology that will also reduce production costs and lead to lower consumer prices.
- Production-adjusted baselines should be set facility-by-facility, using site-specific calculations.

3.2 Headroom

Due to the previous design of the Safeguard Mechanism, current baselines, in aggregate, are above actual emissions produced. With aggregate baselines in 2020-21, set at 180 Mt CO_2-e and only 137 Mt CO_2-e released, there is 43 Mt CO_2-e of 'headroom'. Removing this headroom will improve the integrity of the Safeguard Mechanism, ensuring all covered facilities continue to lower their emissions-intensity and contribute their share of the national abatement task.

Under the higher baseline of 180 MT CO_2-e, the rate of decline to meet 2030 emissions targets will be much steeper, as it is calculated from a higher starting point. All facilities would be impacted by these steeper decline rates, but it disproportionately benefits the facilities without headroom, relative to facilities below their baseline. The removal of headroom, whilst resulting in sharper emissions reduction rates in the first few years for facilities with emissions at, or above, their current baselines, will provide a smoother and easier decline rate overall.

Further, if headroom is retained then the commencement of crediting and trading will be delayed, until aggregate baselines are below aggregate emissions. Crediting and trading is important in helping businesses manage their compliance costs. Estimates provided in the *Safeguard Mechanism Reform Consultation Paper* show that crediting and trading would not commence until 2026-27 if current baselines are retained and headroom is not removed. This delays an essential process that provides flexibility to facilities in meeting their incentivises facilities to reduce emissions below their baseline.

Recommendation:

- Headroom should be removed so that facilities don't face artificially high baseline decline rates and crediting and trading can commence as soon as possible.

4 Crediting and Trading

Adding features to the Safeguard Mechanism that grants facilities flexibility throughout a transition that is not linear is highly recommended. ACCI is in support of crediting and trading, and multi-year monitoring periods, which afford more flexibility to covered facilities in achieving their emissions reduction baselines.

Allowing facilities to generate tradable credits when their emissions fall below their baseline provides an incentive to businesses to overachieve in their emissions-reduction efforts. It also assists facilities whose abatement tasks has proven more costly or have more limited options in adopting lower emissions technology to purchase Safeguard Mechanism Credits (SMCs) from other covered facilities to meet their baselines. Using the Clean Energy Regulator to issue and monitor the trading of SMCs that can be surrendered to meet compliance, helps streamline the process and ensure efficient regulation.

For similar reasons, ACCI supports the ongoing use of multi-year monitoring periods (MYMPs) to provide inter-temporal flexibility to facilities. This measure allows covered facilities to exceed their baseline in one year as long as average emissions over the following 2 to 3 years are at or below the facility's average baseline for the period. Technology advancements can be uneven, therefore facilities shouldn't be expected to meet their baselines in a rigid way. MYMPs supports business growth and profitability by allowing them to invest in low emissions technology when they become accessible and affordable. It doesn't alter the climate change targets, rather simply enables them to optimise their investment to achieve the lowest cost emissions abatement pathway.

Recommendation:

- The timing of investment in emissions reduction technology by individual facilities will be uneven. Crediting and trading, and multi-year monitoring periods should be available to provide flexibility and enable covered facilities to optimise their investment in low emissions technology.

5 Domestic and International Offsets

Currently, the Government is the primary purchaser of Australian Carbon Credit Units (ACCUs), however, demand for ACCUs from the private sector is increasing.

Under the current Safeguard Mechanisms framework, covered facilities can purchase ACCUs to offset up to 10% of their emissions from productions. Accepting ACCUs in the Safeguard Mechanism provides facilities further flexibility in the timing of their investments. A facility can purchase ACCUs until it becomes economically viable to purchase the technology required to reduce on-site emissions.

Covered facilities can also participate in the Emission Reduction Fund, gaining ACCUs from projects that lower emissions below their baselines.

As baselines are ratcheted down under the Safeguard Mechanism reforms, and increase in demand for ACCUs is expected, which will likely increase their price. By letting the market for ACCUs act freely, there will be ongoing cost trade-offs between purchasing ACCUs or investing in low emissions technology. This will enable covered facilities to achieve their declining emissions reduction baselines at lowest cost.

Treating the Safeguard Mechanism framework as a closed system, with trading of credits only allowed between covered facilities (i.e. only allowing covered facilities to trade SMCs) will result in different pricing of SMCs and ACCUs. It will limit the options and reduce the flexibility in where covered facilities can source credits.

ACCI accept that ACCUs generated outside the Safeguard Mechanism should only be allowed to be purchased by covered facilities where they are proven to provide emissions reduction above the national targets for industry sectors from which they are sourced. That is, they are additional to the reduction in emissions that would have occurred anyway.

Further, covered facilities should also have the opportunity to generate ACCU's to be sold in the national market, where they are proven to provide emissions reduction above the covered facility's baseline and it can be verified there is no double-counting.

We acknowledge the proposed changes to the Safeguard Mechanism framework raise concerns around double counting of credits generated covered facilities, as the declining baselines mean that credits generated by covered facilities may no longer be additional. Yet measures can be introduced to limit the risk of double counting of credits generated by projects registered under the Emissions Reduction Fund by covered facilities.

ACCI agree that transparency surrounding the ACCU market would be enhanced if facilities are required to publish their holdings of ACCU contributing to their emissions reduction. This could be amended on the Australian National Registry of Emissions Units Act and monitored by the Climate Change Authority.

International offsets are not allowed within the current design of the mechanism and should continue to be left out. Currently, there is no credible international standard for the verification of international offsets, and this limits the ability of Australian regulators to place any confidence and integrity on the offset. Until an international standard is commissioned, covered facilities should not be allowed to use international offsets to meet their emissions baselines.

Recommendation:

- Allowing covered facilities to purchase ACCUs should be accepted where they are proven to provide emissions reduction above the national targets for industry sectors from which they are sourced (i.e. there is no double-counting).
- While covered facilities should continue to be able to register new projects under the Emissions Reduction Fund, where it can be verified there is no double-counting.
- Transparency would be enhanced by the Climate Change Authority monitoring and requiring covered facilities to publish their holding of ACCUs.
- Until a credible international standard for verification has been developed, international credits should not be accepted in the Safeguard Mechanism.

6 Tailored Treatment for EITE Businesses

Emissions-intensive, trade exposed (EITE) businesses are defined by its two components. To be emissions-intensive the business is assessed at the industry level and the relative impact of costs on a facility's operation is determined. A trade exposed business must have a trade share (ratio of value of imports and export to value of domestic production) greater than 10% or a demonstrated lack of capacity to pass through costs due to the potential for international competition.

ACCI is in support of granting tailored treatment to EITEs businesses such that they remain competitive relative to international competitors. This support is best provided by grants through the Reconstruction Fund, providing financial assistance for the facilities to invest in low emissions technology. This aids the transition to improved emissions intensive production and is preferred over leniency in the baseline decline rates as this would disincentivise investment in low emissions technology and make the national emissions targets harder to reach.

Similarly, low interest loans from the Clean Energy Finance Corporation (CEFC) or the Australian Renewable Energy Agency (ARENA) could also be used to support EITE facilities. With their exposure to international competition this provides adequate support to these Australian facilities and reduces the risk of emissions leaking overseas.

It is necessary to balance the pressure of the European Union to reduce emissions in exported goods and also to ensure that any support provided to business does not run foul of WTO rules on anti-dumping.

Support granted to EITE should not be all encompassing. These facilities should still be required to contribute their share of national abatement task through the Safeguard Mechanism. The current mechanism has been unsuccessful in decreasing emissions produced by the 215 covered facilities due to its leniency. Whilst some flexibility granted towards EITE facilities, they still need to be put under pressure to make the transition to net zero emissions.

Recommendation:

- Some support should be given to EITEs, but they should still be required to contribute their share of emissions reduction through the Safeguard Mechanism.
- Support is best provided by grants through the Reconstruction Fund and low interest loans through CEFC and ARENA.

7 Indicative Baseline Decline Rates

A range of 3.5% and 6% range for the baseline decline rates was suggested in the Consultation Paper. However, the actual decline rates cannot be ascertained until other policy settings have been finalised (in terms of the choice between absolute vs intensity framework, presence of a reserve, the starting point, linear decline or soft start, and treatment of EITEs).

In general, a 29% emissions reduction for a sector representing 28% of total national emissions appear to represent a fair share of the emissions reduction effort to achieve the 43% below 2005 emission reduction by 2030.

Recommendation:

- ACCI consider facilities covered under the Safeguard Mechanism should undertake their share of the emissions reduction task. The proposed 29% emission reduction (4.1% per year) represents a fair share for a sector contributing 28% of total emissions.

8 About the Australian Chamber

The Australian Chamber represents hundreds of thousands of businesses in every state and territory and across all industries. Ranging from small and medium enterprises to the largest companies, our network employs millions of people.

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