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Department of Industry, Science, Energy and Resources

Industry House

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Canberra ACT 2601

Submitted via email to: [safeguard.mechanism@industry.gov.au](mailto:safeguard.mechanism@industry.gov.au)

To whom it may concern,

### **ClimateWorks submission on the Safeguard Crediting Mechanism Discussion Paper**

ClimateWorks Australia welcomes the opportunity to respond to the *Discussion Paper: King Review Safeguard Crediting Mechanism* (the Discussion Paper) of the Department of Industry, Science, Energy and Resources (the Department). ClimateWorks develops expert, independent solutions to assist the transition to net zero emissions for Australia, South-east Asia and the Pacific. A non-profit organisation, it was co-founded in 2009 by the Myer Foundation and Monash University and works within Monash Sustainable Development Institute.

### **Submission summary**

- ClimateWorks is concerned that the proposed changes to the safeguard mechanism, on its own, will not provide the signal or impetus for the necessary transformative changes needed in Australia's most emissions intensive facilities, at the scale and pace required to align with 1.5 or 2 degree scenarios.
- ClimateWorks can see potential issues in putting in place a safeguard crediting mechanism without broader changes to the safeguard mechanism, and recommends that the Department and/or the Climate Change Authority do further work to explore the impact that a new SMC market may have on the existing voluntary ACCU market.
- Additional changes to the safeguard mechanism could accelerate emissions reductions in the largest emitting industrial facilities in Australia, helping facilities to take advantage of the economic opportunities offered in the shift to net zero.
- A strong safeguard mechanism could be a key tool to support government ambitions to reach net zero emissions.

### **Context - scale of emissions reductions needed and how to get there**

The government has indicated a desire to get to net zero emissions as soon as possible, and preferably by 2050. The Government is also committed to the Paris climate goals.

ClimateWorks' *Decarbonisation Futures*<sup>1</sup> analysis shows, by sector, how the gap between the

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<sup>1</sup> ClimateWorks Australia, *Decarbonisation Futures* (2020). Available here:

<https://www.climateworksaustralia.org/resource/decarbonisation-futures-solutions-actions-and-bench>

Paris climate goals and implementation can be bridged. The report:

- Reviews technologies available to reduce emissions, their progress and maturity
- Identifies actions that government, businesses and individuals can take to support them
- Provides benchmarks for emissions reductions achievable in different sectors and the scale of uptake of the technologies to align with the Paris goals
- Models three scenarios to illustrate possible pathways to net zero by 2050, with transitions compatible with the global goals of 2 and 1.5 degrees of warming.

ClimateWorks' scenario analysis shows that Australia can still achieve trajectories compatible with the Paris climate goals, however those trajectories involve very strong emissions reductions this decade:

- about 75% reduction below 2005 levels for the 1.5 degree scenario; and
- about 50% reduction below 2005 levels by 2030 for the 2 degree scenarios.

The industry sector, the key sector for the safeguard mechanism, produces nearly half of Australia's emissions, with a significant proportion from non-energy sources (eg, process emissions). In the past decade, emissions from industry have fluctuated but increased overall, because the growth in industrial activity (especially production and export of LNG) has outpaced reductions in emissions intensity of industrial processes.

ClimateWorks' analysis finds that in the industrial sector, emissions need to reduce by 87% by 2050 to align with the 1.5 degree scenario, and by at least 79% by 2050 for the 2 degree scenario. In the shorter term, ClimateWorks' scenario of a least-cost pathway aligned to limiting warming to 1.5 degrees sees industry emissions reduced by 49 per cent in Australia by 2030. This includes reductions of 79 per cent in cement production, 70 per cent in aluminium and alumina production, and 82 per cent in coal mining.

Because of the diverse emissions sources in this sector (energy use, direct fuels, process emissions etc.) and the diverse range of activities undertaken by different industries, a wide range of abatement solutions is required. A number of technologies are ready to be deployed at scale to reduce energy emissions, in particular increased energy efficiency and recycling. Deployment of a number of these solutions is 'no regrets' as they are cost-effective over the life of the asset. Technologies to deeply decarbonise other sources of industrial emissions are emerging or being demonstrated.

Australian Industry Energy Transitions Initiative<sup>2</sup>, which ClimateWorks co-convenes with Climate KIC, is continuing to explore solutions to industrial decarbonisation with a focus on hard to abate supply chains. The Australian Industry Energy Transitions Initiative is supporting industry to accelerate action towards net zero emissions in five supply chains – steel,

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[marks-for-a-net-zero-emissions-australia/](https://energytransitionsinitiative.org/)

<sup>2</sup> Further information available at <https://energytransitionsinitiative.org/>.

aluminium, liquified natural gas, other metals and chemicals. This pioneering initiative convenes Australian industry and business leaders to collectively explore challenges and identify the opportunities associated with emissions reductions in hard-to-abate sectors. The first phase of work wrapped up in June 2021<sup>3</sup>, with a key finding that in the five focus supply chains, deployment of existing and emerging technologies can achieve more than 85% emissions reductions.

### **The safeguard mechanism could achieve far more than it currently does**

ClimateWorks welcomes the Department's review of the safeguard mechanism. There are changes that could be made to aspects of the safeguard mechanism that would make it effective in accelerating emissions reductions in safeguard mechanism facilities, and help those facilities to take advantage of the economic opportunities offered in the shift to net zero. Given that these facilities represent the largest industrial emitters in Australia, a strong safeguard mechanism could be a key tool to support government ambitions to reach net zero emissions. Depending on design, a strong safeguard mechanism could also be recognised internationally as an adequate compliance framework aligned to net zero emissions by 2050, thereby meaning that Australian exports would not be subject to planned carbon border adjustments.

The safeguard mechanism as it currently operates is not incentivising the type of emissions reductions necessary in Australia's heaviest emitting facilities to set them up for the emerging global economy, nor to support government ambitions to reach net zero emissions. The safeguard mechanism includes a regulatory regime with a number of criteria for increasing and adjusting baselines, and practically speaking, baselines for safeguard mechanism facilities are in most cases higher than their actual emissions. Jotzo and McKibbin, in their recent analysis of Australian climate policy note that 'During the 2019-20 reporting year, just 0.25 MtCO<sub>2</sub>-eq of excess emissions were covered through surrendered credits, compared to total emissions covered of 143 MtCO<sub>2</sub>-eq<sup>4</sup>.

Changes to the safeguard mechanism over time have provided additional flexibilities for increased baselines for facilities. The recent Grattan Report on industrial decarbonisation policy notes that 'Of the 184 facilities whose 2020 baselines are known, 140 have room to increase emissions by 10 per cent or more before breaching their baseline.'<sup>5</sup>

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<sup>3</sup> Key findings from the first phase are contained in the Australian Industry Energy Transition Initiative's report *Setting up industry for net zero* (2021). Available here: <https://energytransitionsinitiative.org/wp-content/uploads/2021/06/Phase-1-Highlights-Report-June-2021.pdf>.

<sup>4</sup> Jotzo, Frank and McKibbin, Warwick J. *Low Hanging Fruit in Australia's climate policy*. 9 September 2021. CAMA Working Paper No. 78/2021, Available at SSRN: <https://ssrn.com/abstract=3920173> or <http://dx.doi.org/10.2139/ssrn.3920173>.

<sup>5</sup> Wood, T., Reeve, A., and Ha, J. (2021). *Towards net zero: Practical policies to reduce industrial emissions*. Grattan Institute at 24. Available here:

For grid connected electricity generator facilities, the safeguard mechanism is not incentivising emissions reductions, and is unlikely to in the future. These facilities are grouped together under one sectoral baseline and an individual facility baseline only applies if the sectoral baseline is exceeded. Sectoral emissions are about 20 per cent below the sector cap and trending downward<sup>6</sup>.

### *Proposed changes*

The Discussion Paper proposes to establish a ‘below-baseline crediting arrangement’ for safeguard mechanism facilities, initially as a pilot trial. The arrangement would provide Safeguard Mechanism Credits (SMC) to facilities who reduce their emissions below their Safeguard baselines by undertaking ‘transformative’ abatement projects. (It is worth noting that grid-connected electricity generators, subject to a sectoral baseline, would not be eligible to participate in the Safeguard Crediting Mechanism.)

This scheme is intended to operate alongside the Emissions Reduction Fund (ERF), as the King Review found there has been limited take-up of this fund in safeguard facilities. The Discussion Paper notes that often the most cost-effective abatement opportunities involve early replacement or upgrades of equipment - which can be difficult to credit under the ERF<sup>7</sup>. Further, the cheapest abatement has tended to be land based measures, with agriculture, vegetation, landfill and waste, agriculture and savanna burning representing the bulk of successful projects bidding into the ERF<sup>8</sup>. The proposed safeguard crediting mechanism is intended to provide a low-emissions technology deployment incentive.

There are certainly opportunities currently existing within facilities to reduce emissions through measures such as energy efficiency, equipment upgrades and so on, and ClimateWorks is supportive of policy measures that will spur on emissions reducing projects that would not otherwise have occurred.

### *Potential issues*

There are no details on how much a SMC might be worth in the proposed system. The Grattan Institute works through an example price of \$10 per SMC, and finds that the below-baseline credit would reduce emissions by only 3 million tonnes each year<sup>9</sup>, quite modest compared with overall annual emissions from the sector which are projected to average 160 million

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<https://grattan.edu.au/wp-content/uploads/2021/08/Towards-net-zero-Practical-policies-to-reduce-industrial-emissions-Grattan-report.pdf>.

<sup>6</sup> As above, at p29.

<sup>7</sup> Discussion Paper: King Review Safeguard Crediting Mechanism, p2.

<sup>8</sup> Clean Energy Regulator, Emissions Reduction Fund projects. Available at:

<http://www.cleanenergyregulator.gov.au/maps/Pages/erf-projects/index.html>. Accessed 28 September 2021.

<sup>9</sup> Grattan Institute, *Towards net zero: Practical policies to reduce industrial emissions* (2021) at 25.

tonnes across the next decade<sup>10</sup>.

The expected relatively modest SMC price seems unlikely to be enough to spur on ‘transformative’ emissions reducing projects, particularly given that the ERF has for the most part been ineffective at facilitating emissions reductions in sectors outside land based measures. There is also the risk that SMCs are utilised for projects that would have been undertaken anyway (“hot air” emissions reductions).

Another potential risk that ClimateWorks flags in the proposed Safeguard Crediting Mechanism is that the suggested changes continue to add to the complexity of the scheme, which introduces increased risk of unforeseen outcomes. For example, how will SCMs interact with ACCUs? Is there a risk that SCMs will undermine the ACCU market?

ClimateWorks therefore recommends that the Department and/or the Climate Change Authority do further work to explore the impact that a new SMC market might have on the existing voluntary ACCU market.

### ***Broader changes to the safeguard mechanism***

ClimateWorks is concerned that the proposed safeguard crediting mechanism, on its own, will not provide the signal or impetus for the necessary transformative changes needed in Australia’s most emissions intensive facilities, at the scale and pace required to align with 1.5 or 2 degree scenarios.

However, if included as part of a broader suite of changes, the safeguard mechanism could shift towards a type of baseline and credit scheme that supports facility operators by bringing forward the economic opportunities of the low carbon transition, and at the same time becomes a valuable tool for the government’s ambitions to reach net zero emissions. Changes might include baselines that reduce over time along a trajectory consistent with Paris goals, emissions intensity benchmarks for new safeguard facilities that are substantially lower than industry average and removal of administrative provisions that allow facilities to avoid consequences for breaching baselines<sup>11</sup>.

ClimateWorks’ work to date in the Australian Industry Energy Transitions Initiative has observed growing momentum and urgency for action towards net zero emissions, with industry companies starting to act and seeking out the opportunities offered in the transition. The Carbon Market Institute’s recent survey to industry as a whole found that around 80% back reform to the Safeguard Mechanism for mandatory declining baselines<sup>12</sup>.

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<sup>10</sup> Grattan Institute, as above at 24.

<sup>11</sup> Further examples of changes provided in the Grattan Institute report at p2.

<sup>12</sup> Carbon Market Institute, Australian Climate Policy Survey 2021. Available here: [https://carbonmarketinstitute.org/app/uploads/2021/10/CMI-Survey-Report-2021\\_final.pdf](https://carbonmarketinstitute.org/app/uploads/2021/10/CMI-Survey-Report-2021_final.pdf).



ClimateWorks supports a broader suite of changes to the safeguard mechanism to set it up as a tool for bringing forward opportunities for emissions reductions across the heaviest emitting facilities, and more broadly as a tool to support government action to get to net zero.

Thank you for taking the time to consider our submission. We would welcome an opportunity to brief your team if you would like to explore our responses in further detail.

Yours sincerely,

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