AiGROUP

Ai Group statement

Inquiry into the Safeguard Mechanism (Crediting) Amendment Bill 2022

Statement by Tennant Reed, Principal Advisor National Public Policy, Australian Industry Group to the Senate inquiry by the Environment and Communications Legislation Committee into the Safeguard Mechanisms (Crediting) Amendment Bill 2022

Ai Group represents businesses of all sizes across Australia in sectors including many critical to our economy's path to net zero emissions, including manufacturing, construction, transport and logistics, energy and more. These opening remarks briefly address the context for the Safeguard Mechanism, the Government's proposed reforms generally, and the specifics of the Bill that is the subject of this Inquiry. An annexure contains a more extended statement.

Australia's future prosperity depends on the world's success in limiting climate change, and our own national success in transitioning our economy to pursue advantage in a net zero emissions world. Industry is at the heart of both elements.

Durable and efficient public policy is needed. The Safeguard Mechanism has always had the potential to become an efficient market mechanism to underpin industry investment in decarbonisation. Declining baselines would provide impetus, while flexibility through offsets and tradable credits for outperformance would unlock broader abatement and moderating overall costs. Ai Group supports this reform direction.

The specific design now proposed for a reformed Safeguard is broadly consistent with this vision. There appear to be three outstanding issues to resolve: competitiveness and carbon leakage; the treatment of new facilities, particularly coal and gas facilities; and the role of domestic offsets.

Carbon leakage concerns remain relevant despite broader and deeper global climate action. In the short term the baselines, Trade Exposed fund and Trade Exposed Baseline Adjusted system help considerably. Further nuances of these elements are being debated. However before long we will need more sustainable long-term measures. An Australian Carbon Border Adjustment Mechanism could efficiently fill that role while fully upholding our trade commitments. The Government's 2023 review. The sooner we deliver a clear long-term framework for avoiding carbon leakage, the greater will be industry's confidence in its ability to invest in deep decarbonisation.

Global demand for coal and gas will shrink dramatically in the long term, while these commodities play important roles here and overseas in the medium term. Absence of supply while demand remains would be painful and unwelcome. Thus Ai Group does not support flat bans on new facilities. Australia should advance our own energy transition and prepare to deal with the consequences of others'.

Offsets must have high integrity and will not be sufficiently available or cheap to simply obviate deep internal emissions reductions by industry over time. However they play critical roles both in moderating abatement costs in the near term and addressing residual emissions in the long term. While there is room for nuance and creativity in the rules around use of offsets and transparency, we would not support any proposals to simply deny access to ACCUs to covered facilities.

Ai Group strongly supports passage of the Bill itself, which contains only provisions essential to underpin an evolved Safeguard Mechanism. The most important of these establish a basis for the issuance, tracking, ownership and use of Safeguard Mechanism Credits. This is essential legislative infrastructure for the climate policy goals of this and future Australian Governments.

Annexure

The Australian Industry Group (Ai Group®) is a peak national employer organisation representing traditional, innovative and emerging industry sectors. We have been acting on behalf of businesses across Australia for 150 years.

Ai Group and partner organisations represent the interests of more than 60,000 businesses employing more than 1 million staff. Our membership includes businesses of all sizes, from large international companies operating in Australia and iconic Australian brands to family-run SMEs. Our members operate across a wide cross-section of the Australian economy and are linked to the broader economy through national and international supply chains.

Our purpose is to create a better Australia by empowering industry success. We offer our membership strong advocacy and an effective voice at all levels of government underpinned by our respected position of policy leadership and political non-partisanship.

The context for the Safeguard reforms

Australia's future prosperity will be heavily shaped both by the world's success in limiting climate change to the Paris temperature goals, and our own national success in transitioning our economy to pursue advantage in a net zero emissions world. Industry is at the heart of both elements. Ai Group's members will make the bulk of the investments that will get us to net zero. These businesses are charting their course, including through the recently released "Pathways to industrial decarbonisation" report of the Australian Industry Energy Transitions Initiative.

Public policy has an important role to play too, both through public investments where appropriate and through policy frameworks that provide the confidence and signals for private investment. Ai Group and many others have long recognised the potential of the Safeguard Mechanism to be an important and efficient driver of industrial decarbonisation by progressively lowering emissions baselines while crediting overperformance against baselines and enabling trading of those credits between covered facilities.

As has been obvious since the Safeguard was first legislated in 2014, this would produce a form of emissions trading scheme, albeit one quite different in many respects from those previously considered or implemented in Australia. Key differences include that under an evolved Safeguard facilities would be directly liable only for the fraction of their emissions above their baseline; and that emissions credits would not be auctioned by government, but generated and traded by liable facilities based on their performance and by offset activities under the Carbon Farming framework.

The benefits of an evolved Safeguard would include a clear long-term signal for decarbonisation, with the potential for costs to be avoided and financial benefits achieved through efficient investment in industrial transformation; and the flexibility, thanks to trading of credits and offsets, to even out marginal abatement costs across all Safeguard facilities. Facilities differ widely in the nature, timing and cost of their abatement options, and market mechanisms can handle these differences without requiring government regulators to understand those options better than businesses themselves do.

Australia's journey to net zero is achievable, but it will be much more challenging if we do not pursue it with a clear eye to economic efficiency.

The Safeguard reforms

The Safeguard reforms now proposed by the Government are consistent with this broad vision. They necessarily include many specific design decisions, often bridging different views from within industry and other stakeholders. For instance, the choice of a hybrid baseline that shifts from largely facility-specific to entirely industry-average over several years is an important and necessary compromise. It is necessary because of the strong views from some parts of industry that an immediate industry-average baseline would have a very sharp impact on above-average emissions intensity facilities, and from other parts of industry that an ongoing facility-specific baseline would disadvantage facilities that have already invested in emissions reduction. This compromise is also important because, together with the multi-year implementation timeframes for most businesses to trigger and complete transformational investments, it means there will be few available Safeguard Mechanism Credits in the early years of the reformed Safeguard. That underlines the importance of other forms of flexibility for efficient cost control, particularly access to domestic offsets.

Overall the proposed Safeguard reforms constitute a solid design in the face of complex conditions. There appear to be three major outstanding issues raised by stakeholders: competitiveness; the treatment of new facilities, particularly coal and gas facilities; and the role of domestic offsets.

Competitiveness

Competitiveness is the central issue for Ai Group's affected members and has long been our focus in climate policy design. Our concern is to avoid carbon leakage – the exit of industry and emissions from Australia to elsewhere, driven not by underlying economics but by the uneven international application of climate policies. The global context has developed dramatically over the past fifteen years, with climate action wider and deeper than ever before. However this action remains messy and multi-speed, with those nations acting most ambitiously also ensuring that in the process they do not lose competitiveness in trade exposed industries. Our challenge is to ensure that industries with a bright future in a net zero emissions world are able to pursue that future in Australia. There are risks both in a lack of policy and in a policy that ignores competitiveness.

In the short term the Safeguard baselines, supplemented by the $600 million fund for Trade Exposed (TE) facilities and the Trade Exposed Baseline Adjusted (TEBA) system, should be effective in addressing these risks. There are important nuances now being debated by different facilities and sectors and the Government over the precise settings for TE and TEBA. However these nuances are resolved, these measures will eventually need to give way to more sustainable long term measures to avert the risk of carbon leakage. Based on our own research, Ai Group believes that an Australian Carbon Border Adjustment Mechanism could meet that need, though we do not underestimate the complexity of this reform and the need for deep consultation with domestic and international stakeholders. We welcome the Government's commitment to review options for longer term carbon leakage measures, including CBAMs, starting later this year. The sooner that process is able to deliver a clear long-term framework for avoiding carbon leakage, the greater will be industry's confidence in its ability to invest in deep decarbonisation.

Treatment of new facilities

There has been extensive discussion of the new coal and gas facilities that are proposed, or expected to be proposed, for development in Australia in coming years; and whether the Safeguard Mechanism, or some other intervention, can or should prevent this. The distribution of emissions entitlements between new and existing facilities is a complex question with difficult trade-offs. However we make two observations:

- In the long term the fate of Australia's coal and gas exports rests with our customers overseas. Commitments by all our major trading partners to achieve net zero emissions from 2050 to 2070 strongly imply that their demand for exports of these commodities will sharply reduce in coming decades. Australia cannot force those decisions, nor can we reverse them. We will have to prepare for the results, diversify our economy, and promote a fair and successful transition for workers, communities and supply chains impacted by decisions overseas.
- In the medium term coal and gas will continue to play important, but shrinking, roles in Australia and overseas. This includes metallurgical coal for conventional primary steelmaking and natural gas as a fuel for flexible electricity generation, a source of high-grade industrial heat, and feedstock for essential chemical products. The absence of supply of these resources while they are still in demand would be painful and unwelcome anywhere, as we have seen with the disruption of global gas markets caused by Russia's invasion of Ukraine.

Thus while individual developments should be judged on their merits, and the overall coal and gas sector can be expected to contract sharply in coming years, we would consider any flat ban on new coal and gas developments to be unwise for Australia.

The role of offsets

Access to offsets generated by crediting emissions reductions and carbon dioxide removals outside the Safeguard facilities are an essential source of flexibility for any scheme as ambitious as the reformed Safeguard. Two questions have been raised about offsets in relation to the Safeguard: whether offsets have integrity; and whether offsets will be over-used to endlessly defer internal decarbonisation by industry.

The overall integrity of offsets is essential, particularly where they are used for compliance with a scheme such as the Safeguard Mechanism. The recent Chubb Review has confirmed both that Australia's offsetting system needs reform to remain strong and relevant, and that its fundamentals are sound. The full implementation of the Chubb recommendations should further bolster confidence that Australian Carbon Credit Units represent real reductions in emissions and real removals of carbon from the atmosphere.

The Safeguard reforms propose no legal limits on the use of domestic offsets for compliance. This is important because individual facilities' circumstances and internal abatement options might necessitate strong reliance on offsets at particular times. However there are very strong practical reasons why facilities will not, and indeed cannot, rely solely on offsets for their long term strategies. While significant volumes of offsets have so far been able to be generated at relatively low cost through land management, afforestation and methane capture, these activities can only expand so far. With falling Safeguard baselines, demand for offsets will see their price rise over time. This will make more abatement and removal options competitive, including both options within Safeguard facilities and new forms of offset activity.

We recognise that industry cannot simply offset its way to net zero without transforming our production processes and energy sources over time. Price signals will provide a strong incentive for internal abatement. In the long term offsets will address residual emissions that are impractical to reduce. Thus while there is room for nuance and creativity in the rules around use of offsets and transparency, we would not support any proposals to simply deny access to ACCUs to covered facilities.

The Bill

Ai Group strongly supports the passage of the Bill itself.

The Bill contains the bare minimum of provisions essential to underpin an evolved Safeguard Mechanism. The principal elements include:

- Adding emissions reductions to the purpose of the Safeguard;
- Establishing a basis for the issuance of Safeguard Mechanism Credits (SMCs), their inclusion in the Australian National Registry of Emissions Units, property rights in those units, and the use of those units to comply with Safeguard baselines; and
- Amend existing penalty provisions to be based on the volume of any uncorrected exceedance of baselines.

Overall the amendments take an approach consistent with the existing Safeguard provisions of the *National Greenhouse and Energy Reporting Act 2007*: broad enabling legislative provisions, with the bulk of scheme design to reside in regulations. This approach is broadly appropriate.

The specific changes proposed are necessary and sensible. While it will likely be several years before significant volumes of SMCs are issued, the establishment of clear and firm property rights in SMCs now is essential to underpin transformative investment decisions by industry. The Bill provides essential legislative infrastructure for the Safeguard Mechanism to contribute to the climate policy goals of this and future Australian Governments.

The legislation will likely need further amendment in future as the policy and context evolve. For instance, the amendments to the Australian National Registry of Emissions Units do not make provision for the use of Paris-compliant international carbon units. Ai Group has long supported the principle of access to valid and high-quality international units. However we accept that Australia is not yet party to any cooperative arrangements under Article 6.2 of the Paris Agreement, and that the new global market mechanism under Article 6.4 has not yet been operationalised. These matters should be considered further in a review foreshadowed by the Government, and in due course appropriate amendments should be made. Should Australia decide to implement a Carbon Border Adjustment Mechanism, we expect that this too will require a range of legislative amendments.