

15 September 2022

Safeguard Mechanism Taskforce  
Department of Industry, Science and Resources

Uploaded to:

<https://consult.industry.gov.au/safeguard-mechanism-reform-consultation-paper/submission>

Dear Sir/Madam,

### **Safeguard Mechanism reform: consultation paper**

Thank you for the opportunity to comment on the Safeguard Mechanism reform.

The IPA supports the intent and objectives of this reform, recognising it as a responsible, long-term policy that aims to address the maintenance of Australia's competitiveness in global markets. The need for industries to adapt to decarbonisation in the medium-term and net zero by 2050 is non-negotiable in the international arena, and now enshrined into Australian law with the passing of the *Climate Change Bill 2022* in August 2022.

The current Safeguard Mechanism, a legacy of the Abbott Government, has been unsuccessful in reducing the emissions of Australia's largest polluters. Responsible for over one-quarter of Australia's national emissions in 2021, tightening the Safeguard Mechanism holds the key to reaching the 43% emissions reduction target by 2030.

Subject to the final views of Safeguard Mechanism participants, the IPA welcomes the introduction of crediting and trading. As an economic concept, this extension of the mechanism should enable emissions reductions at the least cost, as trading creates an incentive for entities that are able to outperform their emissions baseline. Headroom should be removed as soon as possible to facilitate signals for crediting and trading to commence earlier than it otherwise would have.

However, we raise some points for consideration to ensure an effective and efficient Safeguard Mechanism can be realised.

1. **The Emissions Reduction Fund (ERF):** The ERF is long-known as a low-integrity and ineffective system for emissions reductions. Findings from the Australia Institute suggest that more than 80% of ACCUs are judged "low integrity"<sup>1</sup>. The recommendations from the Chubb

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<sup>1</sup> Australia Institute (2022). *Renewed Call for Review of \$4.5 Billion Carbon Credit Scheme*.  
<https://australiainstitute.org.au/post/renewed-call-for-review-of-4-5-billion-carbon-credit-scheme/>

Review of ACCUs, expected on 31 December 2022, should strongly influence the reformed Safeguard Mechanism.

2. **International recognition and compatibility:** Aligning the Safeguard Mechanism with overseas developments, such as the EU's plans for the Carbon Border Adjustment Mechanism (CBAM), is essential to maintain the global competitiveness of Australian exports.
3. **Technology & innovation:** Both the previous and current government has emphasised the role of technology in the transition to net zero. The Long-Term Emissions Reduction plan alludes to Carbon Capture, Utilisation and Storage (CCUS) and low emissions transport to improve the ERF. The reformed Safeguard Mechanism needs to incentivise innovation to reduce the proportion of emissions reductions categorised as human-induced regeneration, avoided deforestation, and landfill gas (~75% of the ERF)<sup>2</sup>.
4. **Fuel efficiency standards:** In a submission to the Senate Standing Committees on Economics on the Treasury Laws Amendment (Electric Car Discount) Bill 2022<sup>3</sup>, the IPA emphasises Australia's reputation for having the dirtiest fuel in the world. Aligning fuel efficiency standards to the equivalent of Euro 6 should be a low hanging fruit that drives emissions reductions at the source.

Our response to selected questions in the consultation paper are in Attachment 1.

If you have any queries with respect to our comments or require further information, please contact me at [vicki.stylianou@publicaccountants.org.au](mailto:vicki.stylianou@publicaccountants.org.au) or on mobile 0419 942 733.

Yours faithfully



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### **About the IPA**

The IPA is one of the professional accounting bodies in Australia with over 47,000 members and students across 80 countries. Approximately three-quarters of our members either work in or are advisers to the small business and SME sectors. Since merging with the Institute of Financial Accountants UK, the IPA Group has become the largest SME and SMP focused accounting body in the world.

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<sup>2</sup> Macintosh, A., Butler, D., & Evans, M.C. (2022). *We blew the whistle on Australia's central climate policy. Here's what a new federal government probe must fix.* <https://theconversation.com/we-blew-the-whistle-on-australias-central-climate-policy-heres-what-a-new-federal-government-probe-must-fix-185894>

<sup>3</sup> [https://www.publicaccountants.org.au/news-advocacy/submissions/treasury-laws-amendment-\(electric-car-discount\)-bill-2022](https://www.publicaccountants.org.au/news-advocacy/submissions/treasury-laws-amendment-(electric-car-discount)-bill-2022)

## **ATTACHMENT 1: IPA's response to selected matters where feedback is sought**

*The Safeguard Mechanism's share of the national abatement task*

### **What should the Safeguard Mechanism's share of Australia's climate targets be?**

As stated in the consultation paper, the ~215 entities captured under the Safeguard Mechanism accounted for 28% of Australia's national emissions in 2020-21.

Therefore, we expect that, at minimum, the reformed Safeguard Mechanism should be the vehicle for 28% of Australia's climate targets. However, the reformed Safeguard Mechanism paired with the climate ambition of Australia's largest polluters creates an opportunity for this share to be greater than 28%, particularly as SMEs will generally not have comparable scale of resources to decarbonise at the same pace.

*Fixed (absolute) versus production-adjusted (intensity) Framework*

### **Should we retain, and build on, the existing production-adjusted (intensity) baseline setting framework or return to a fixed (absolute) approach?**

Continuing to build on the production-adjusted (intensity) pathway is recommended to foster a reliable pathway to net zero, irrespective of peaks and troughs in production.

A sustainable economy should decouple economic growth from environmental degradation (SDG 8.4<sup>4</sup>). As noted in the consultation paper, the fixed (absolute) approach potentially incentivises the downscaling of production, as opposed to the design and uptake of innovative emissions reduction solutions. The IPA agrees that the fixed (absolute) approach increases the risk of carbon leakage, negating the objective of the safeguard mechanism, while also negatively impacting Australia's productivity.

*Setting baselines for existing and new facilities*

### **Views are sought on the proposal to reset baselines in a way that removes aggregate headroom so crediting and trading can commence when baselines start to decline.**

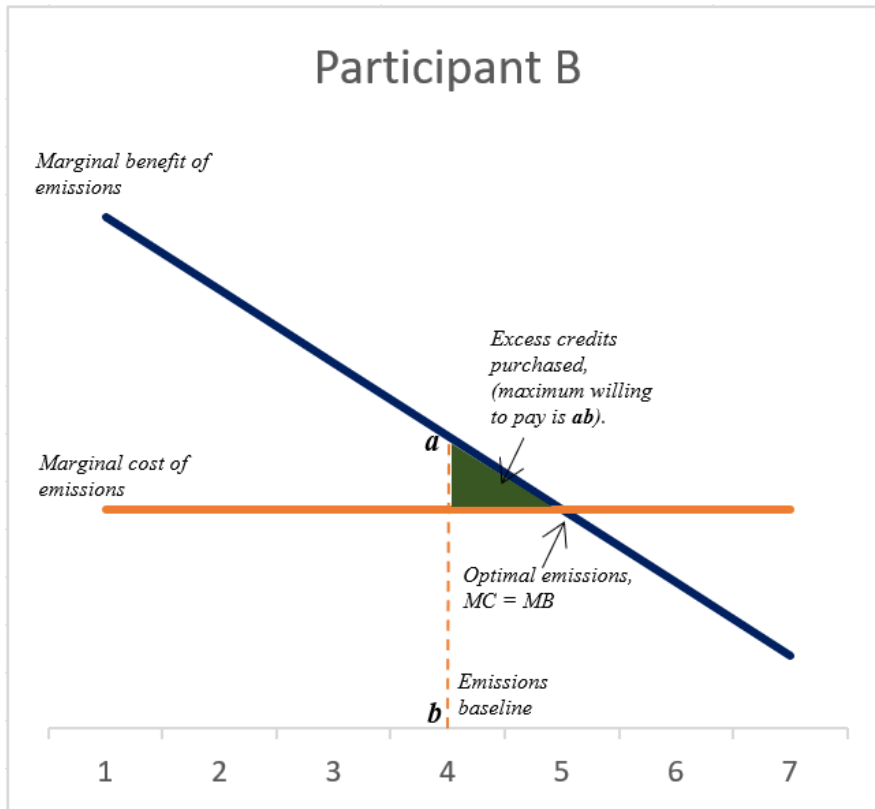
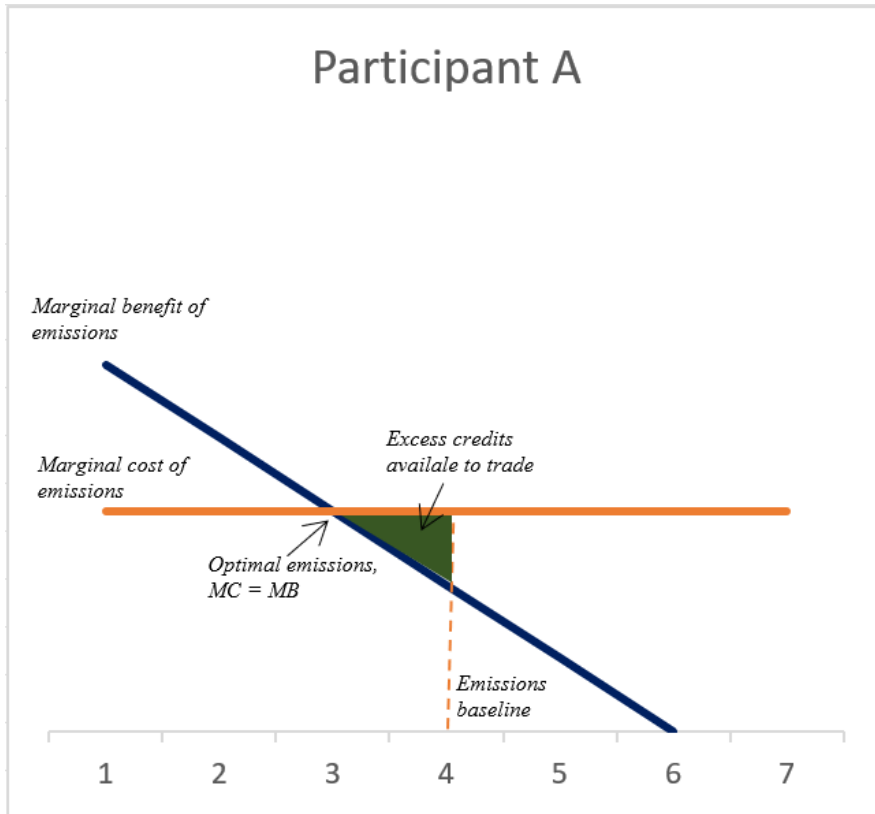
The removal of headroom will create the necessary signals to incentivise crediting and trading immediately, maximising the efficiency of emissions reductions (least cost).

Keeping headroom is simply delaying emissions reductions and the commencement of trading. If it is not abolished straight away, a plan to remove it within a year of the reform is recommended.

Using environmental economics, a firm's optimal emissions quantity is where the marginal benefit (\$) is equal to the marginal cost (\$). In the simplified example below, participant A is signalled to emit less (3) than the emissions baseline (4). Therefore, crediting and trading enables participant A to trade their excess credits to participant B, whose optimal emissions (5) overshoot the baseline. This allows for more efficient emissions reductions, as it acknowledges the differing readiness of participants to decarbonise.

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<sup>4</sup> Target 8.4: Improve progressively, through 2030, global resource efficiency in consumption and production and endeavour to decouple economic growth from environmental degradation, in accordance with the 10-Year Framework of Programmes on Sustainable Consumption and Production, with developed countries taking the lead.



Adapted from Wills, I. (2006). *Economics and the Environment: A signalling and incentives approach* (2nd ed.). Crows Nest, NSW: Allen & Unwin.

## What is the preferred approach for setting baselines for existing facilities?

**Option 1. Which would see all baselines set using industry-average benchmark values.**

**Option 2: Which would see all baselines set using facility-specific emissions-intensity values.**

**Option 3. Other proposals, noting there are many possible approaches.**

Option 1 – We should be incentivising innovative solutions that significantly cut emissions. The industry average baseline approach will ensure that these entities are rewarded for outperforming their industry, through the ability to trade their excess credits.

Option 2 – A grandfathering approach would mean high emissions firms (relative to their industry peers), are equally as likely to outperform their baseline as low emissions firms. The rationale for a grandfathering approach would be that an entity has contributed its fair share by outperforming its baseline, irrespective of its total emissions.

Recommendation – Free allocation in the EU Emissions Trading Scheme (ETS) has used a system in which the benchmark value is set as “the average performance of the 10% most efficient installations” using “data delivered by industry associations”. While this is more aspirational than a whole-of-industry average, it indicates that best practice is to reward the firms who reduce emissions most effectively. The industry-average approach should also avoid the administrative burden necessary to devise facility-specific values through grandfathering.

### *Crediting and trading, domestic offsets and international units*

**Are there any other issues to consider with the proposal to allow the Clean Energy Regulator to automatically issue tradable credits to Safeguard facilities whose emissions are below their baseline, with crediting and trading commencing on 1 July 2023 subject to baseline setting arrangements that remove aggregate headroom?**

We acknowledge that the Safeguard Mechanism is distinct from a cap and trade scheme (such as the EU ETS), although it provides some potential learnings for the long-term planning of the mechanism as a vehicle to drive Australia to its medium-term target (43% reduction from 2005 levels by 2030) and net-zero by 2050.

It is worth considering whether the Safeguard Mechanism is always going to remain in the proposed form (SMCs awarded for emitting less than baseline), or if there is a future in which only a percentage of the baseline is allocated for free. Clarity and certainty on the future of the Safeguard Mechanism will incentivise action and long-term planning by participants.

EU ETS<sup>5</sup>:

- Phased approach to remove the free allocation of credits, ensuring those captured within the scheme incur the full cost of carbon.
- The electricity sector has received no free allocation since 2013, therefore incurring the full cost of carbon (aside from some exceptions and allowances).
- Manufacturing participants – 80% free allocation up to 2020, which has since reduced to 30%. This is then planned to be removed by the completion of Phase 4 (2030).
- Sectors most at risk of ‘carbon leakage’ (what the CBAM aims to address) receive 100% of their allocation for free.

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<sup>5</sup> European Commission. (2021). *Allocation to industrial installations*. [https://ec.europa.eu/clima/eu-action/eu-emissions-trading-system-eu-ets/free-allocation/allocation-industrial-installations\\_en#free-allocation-in-phase-4-2021-2030](https://ec.europa.eu/clima/eu-action/eu-emissions-trading-system-eu-ets/free-allocation/allocation-industrial-installations_en#free-allocation-in-phase-4-2021-2030)

*Indicative baseline decline rates*

**What are the appropriate characteristics for the decline trajectory to 2030 that can deliver the Safeguard Mechanism's share of Australia's climate targets, and the process for setting baselines post-2030?**

The decline trajectory should be Paris-aligned with a 1.5° C pathway under rigorous climate modelling. The reformed Safeguard Mechanism presents an opportunity for Australia to become more aspirational leaders on the global stage.

Looking specifically at beyond 2030, a similar approach to the phases/blocks of the EU ETS provides a clear roadmap for the setting of future baselines, with sufficient time for participants of the Safeguard Mechanism to prepare for future conditions.