AIGN Feedback on the *Safeguard Mechanism Reforms* Position Paper

February 2023

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1 SUMMARY

The Australian Industry Greenhouse Network Limited (AIGN) welcomes the opportunity to engage with the Department of Climate Change, Energy, the Environment and Water (the Department) on the *Safeguard Mechanism Reforms* position paper (2023).

AIGN is a network of industry associations and corporations. AIGN provides a forum for discussion on key climate change issues, providing information and analysis in the consideration of national and international climate change policy and the role industry can play in the transition to net zero emissions by 2050.

In considering this submission, the Department should note AIGN's broad range of members, and give regard to specific sector and corporate matters raised in member submissions. Several AIGN members have prepared input to the consultation paper directly, covering a range of issues and perspectives from different industry sectors and individual liable entities. AIGN members will direct their industry-specific responses through industry association submissions, while corporate members may make individual submissions highlighting their specific situations. Please consider the AIGN submission alongside input from our members.

The design for the Safeguard Mechanism reforms should be forward-looking, considering the long-term outcome within the framework of rising ambition.

- **Timeframe for reforms**
  AIGN supports a phased approach to ease into the transition and is eager to discuss with the Department how this approach could be developed to support long-term transformational change, including phasing in of key elements to balance attention to detailed design with timely implementation.

- **Proportional share of emissions reduction task**
  AIGN acknowledges the Government's position to apply a proportional share approach to the abatement required from Safeguard liable entities. In some sectors, the technology needed to drive significant abatement is still some way off, limiting options for these sectors to meet their scheme obligations. Therefore, the available compliance options are vital for some entities to support transformational change. AIGN also notes that an equitable proportional share approach demands every sector is subject to a mandatory obligation to ensure their contributions to Australia's abatement task.

- **Baselines**
  AIGN understands the Government's desire to balance flexibility and support during the phasing in of reforms with a uniform approach to setting baselines. The proposals outlined in the paper demonstrate the volume of work to be completed to fully implement Safeguard Mechanism reforms.

- **Baseline decline**
  The baseline decline rate will represent a significant incentive to liable entities to undertake abatement activity wherever possible (noting the difficulty for some sectors to engage in significant direct abatement action in the short to medium term). Despite the steady decline rate, which supports institutional stability, some variability at the facility level will remain. This includes the provision to enable adjustment to the decline rates to 2030.
  Aligning the setting of post-2030 decline rates with Paris Agreement obligations is supported for consistency.
  Consultation on the detailed settings for the reserve will be welcome.

- **Crediting and trading**

  AIGN supports the provision of flexible compliance options, noting their increased importance with the cumulative ambition and abatement required within the Safeguard Mechanism. Access to high-integrity units to support ambition and smooth the transition to net-zero at the facility level will be vital to facilitate genuine abatement and support ambition.

  AIGN notes that the use of Australian Carbon Credit Units (ACCUs) is a vital option for compliance, particularly in the current decade (and beyond) while direct abatement options will be very limited for many Safeguard facilities. This is particularly true while Safeguard liable entities have no access to credible international abatement, and because the availability of Safeguard Mechanism Credits (SMCs) is expected to be limited.

  Providing greater compliance flexibility in the early years of the scheme, while uncertainty for liable entities is high, should be seriously considered.

- **Managing trade exposure and competitiveness impacts**

  AIGN supports the basic principle of comparative impact to target assistance to ensure businesses are not competitively disadvantaged and avoid carbon leakage as a result of the operation of the Safeguard Mechanism.

  The Safeguard Transformation Stream is capable of significantly incentivising abatement to be brought forward if the scale of the fund is revisited over time.

  In principle, AIGN supports assistance measures to recognise trade competitiveness cost impacts. We look forward to detailed discussions on the proposed treatment of Trade-Exposed, Baseline-Adjusted facilities and note that further information sharing between the Government and liable entities is needed to fully explore whether the proposed treatment genuinely addresses trade exposure and competitiveness impacts across Safeguard facilities.

2 BACKGROUND

AIGN members represent a substantial portion of the Safeguard Mechanism liable entities and have a strong record of compliance and voluntary reporting. As such, they are well placed to provide feedback on the impact of the proposed design to transition the Safeguard Mechanism into a key tool for safeguard-liable entities to contribute to Australia's emissions reduction task.

Since the enactment of the Safeguard Mechanism Rule in 2015, AIGN members have invested considerable resources in building expertise to manage the implementation of compliance requirements (e.g., establishing emissions databases, annual reporting, purchasing and surrender of carbon units, external auditing, and the appointment and training of personnel).

AIGN has welcomed the opportunities to engage with the Department and share expertise on key issues as the Government works to redesign the Safeguard Mechanism to be fit-for-purpose on the path to net-zero.

2.1 International context

AIGN supports the Government's commitment to the Paris Agreement and to meeting its goals, recognising the need for increasing ambition to keep the 1.5°C warming goal within reach and to achieve carbon neutrality by 2050 or sooner.

AIGN members are committed to playing their part in this transition, as attested by the climate statements and goals of our association and corporate members.

Meeting Paris goals requires a whole-of-economy transition to lower emissions processes and products (which may also require significant reshaping of these processes); maintaining quality of life and economic prosperity compels us to favour a smooth and orderly transition.

The establishment of a suitable and adequate policy architecture to support all sectors to transition at the least cost, in line with Paris goals, will be paramount.

2.2 Long-term policy stability

The implementation of effective, efficient, and enduring policy is a prerequisite to encourage further investment in Australia as we transition to a low-carbon economy and, eventually, to a net-zero world.

A stable policy environment is a critical factor in ensuring Australia's industrial sector can continue to grow and prosper sustainably.

As a signatory of the Paris Agreement, the Australian Government is expected to offer increasing levels of ambition in Australia's emissions reductions – and AIGN members expect this to be reflected in evolving domestic policy settings. The required ambition can be achieved whilst maintaining the viability of key industry sectors.

We appreciate the Government's intent to support policy stability by extending existing mechanisms rather than repealing and replacing large parts of the policy suite.

2.3 Supporting ambition

AIGN members have shown their support of the Paris Agreement through their various climate policy principles, emissions reduction targets, and climate ambitions along with many net-zero commitments.

These send a clear signal that Australia's private sector is already supporting the implementation of the Paris Agreement.

AIGN encourages the Government to remain mindful of the need to support ambition as it seeks to update the climate policy suite, including the Safeguard Mechanism. Incentives to take action can bring forward abatement in some instances, noting that this can be a complex matter, especially for certain industrial emissions sources.

Both the principles and the administrative framework should be designed for this purpose.

2.4 Timeframe for reforms

The consultation paper acknowledges the timeframe for consulting on, designing, and implementing these reforms is exceptionally tight. AIGN encourages the Government to favour good policy design despite the clear need to begin driving down emissions in line with our 2030 and 2050 targets.

AIGN continues to support a phased approach to implementation given the significant amount of work remaining to operationalise Safeguard Mechanism reforms. There are several approaches the Government could take to support orderly implementation and work with liable entities to ensure they have sufficient time to adjust to the new obligations.

AIGN supports an orderly, phased approach to facilitate the transition, and is eager to discuss with the Department how a phased approach could be developed to support the long-term transformational change required by both domestic and international climate policy goals. The scale of transformation needed will require extensive work well into the next decade.

Some industries will have limited abatement opportunities in the early years of the reformed scheme (due to both investment and planning timeframes and technological availability) and are expecting step changes beyond 2030 to enable them to achieve deeper abatement.

3 PROPORTIONAL SHARE OF EMISSIONS REDUCTION TASK

To meet Australia's emissions reduction goals, all sectors should be enabled to reduce emissions within a framework that recognises intrinsic limitations and marginal abatement incentives, ultimately aimed at prioritising lowest cost abatement.

With the Government's decision that Safeguard facilities will deliver a proportional share of the national 2030 target, AIGN acknowledges the intention of inherent impartiality – at its core, it is a commitment that all sectors of the economy must contribute equally to the transition effort.

It is well understood that much of the abatement task for entities captured within the Safeguard Mechanism depends on technologies that require further technical and commercial development, and which often involve increased availability of zero-emissions energy. Indeed, in some sectors, the technology needed to drive significant abatement is expected closer to 2040 than 2030. This severely limits options for these sectors to meet their Safeguard Mechanism obligations.

3.1 Compliance requirements

A proportional share will see Safeguard-liable entities required to deliver around 45 million tonnes of abatement, with a target of about 100 million tonnes by 2030.

A considerable measure of this abatement to 2030 will need to be achieved through compliance mechanisms. The Safeguard Mechanism therefore needs to be complemented by a deep, liquid, and high integrity carbon market, which is best achieved with both domestic and offshore options.

It is worth noting that in the short to medium term, Safeguard-liable entities will need to balance any investments in emissions reduction activity with their compliance obligations.

3.2 Sectoral considerations

Declining entitlements to create emissions do not necessarily correspond with declining emissions – particularly in the context of a sectoral policy suite where the logical sequence to facilitate least-cost abatement economy-wide cannot be encouraged by a carbon cost.

Because the climate framework is not conducive to setting a single, economy-wide emissions reduction target, AIGN recommends further consultation on how to best meet Australia's emissions reduction targets efficiently. The sectoral approach that is being taken requires careful consideration to ensure our emissions reduction efforts are not coming at an excessive economic cost.

The sectoral approach will be truly proportional only when every sector is also subject to a compliance mechanism to ensure their contributions -including energy, waste, transport and agriculture, among others. At this time, the Government's policy approach to all sectors other than those covered by the Safeguard Mechanism is unclear.

4 BASELINES

AIGN appreciates the Department's intent to provide a practicable approach to baseline-setting. This is a crucial element of the new design and has significant flow-on implications on other design issues. The proposals outlined in the paper demonstrate the volume of work to be completed as baselines are adjusted, including work on outstanding and existing production variables and finalising emissions intensity values.

4.1 Production-adjusted baselines

AIGN supports retention of the current production-adjusted framework using emissions intensity, which allows baselines to grow and fall with production, supports facilities to maintain competitiveness through incremental growth, and can account for the natural variability of industrial processes (including year-on-year production variability).

Conversely, production-adjusted baselines can only provide limited certainty for the facility and across the mechanism, as growth (and new facilities) will inherently be required to be equalised across the mechanism's liable facilities.

AIGN notes that consultation around implementing production-adjusted declining baselines will need to be extensive. This could include consideration of how previously collected data from Safeguard facilities might be utilised in this process. If data supplied by individual facilities for determining industry averages could be reused, it could significantly reduce the amount of work required to establish new baselines.

There will be additional complexity in integrating facility-level gross production reporting, and several factors outside the scope of NGER and Safeguard compliance will need to be addressed (e.g. potential differences from corporate financial reporting disclosures).

Some AIGN members have observed that there may be infrequent events that impact a facility's emissions and, consequently, the liability faced in that year.

Normal variation within a facility would not typically impact the relationship between production and intensity at a substantial scale. However, there may be isolated events that do substantially impact this relationship.

To address such cases, the Regulator could be given the authority to equitably deal with this situation. This would allow the facility to avoid facing a significant liability due to the loss of the relationship between production and intensity when there is a drop in absolute emissions and output.

4.2 Existing facilities

Given the diversity of views the Department received in the previous submission process on how baselines should be set for existing facilities, it would be difficult to provide enough flexibility to suit all preferences.

AIGN encourages the Department to continue consulting with liable entities on the particulars of their needs and challenges in the baseline design. It will be crucial, for example, to ensure facilities' marginal abatement incentive is maintained and an openness on the Government's part to consider factors impacting individual facilities would be very welcome.

4.2.1 Phased implementation

In its previous submission on the Safeguard Mechanism reforms, AIGN appealed to the Government to consider how important the timeframe is for developing and implementing these reforms. The Department's collaborative approach in this process is appreciated, and AIGN recognises the complexity of some of these design elements.

AIGN continues to support a more graduated phasing in of reforms to allow sufficient time to explore and develop some of these complexities.

This would assist in getting the design right. Options could include a longer first phase or adding further phases to the implementation timetable.

4.3 New facilities and significant expansions

AIGN acknowledges the Government's preference for using the principle of international best practice to set baselines for new facilities.

In the context of Australia's Paris Agreement commitments, emissions from new investments must be assessed within the overall targets and sectoral policy framework. The policy design should ensure that the treatment of new entrants and significant expansions is consistent with Australia's national target objectives.

The major consideration for new facilities (and significant expansions) has to do with the overall emissions budget for all sectors covered under the Safeguard Mechanism.

If the overall budget remains the same with a new entrant, this may mean existing facilities would need to reduce their emissions faster than expected, regardless of other considerations. There are many variables that will ultimately decide whether this would occur and is an area of considerable uncertainty for AIGN members.

The Department has spent considerable time exploring the concept of best practice for setting baselines for new entrants. AIGN members have appreciated the open and extensive dialogue on this issue, and we look forward to continuing this conversation.

Operationalising the best practice principle will need careful consideration. Sectors with a very small number of facilities, for example, may require further thought than taking a simple averaging approach. New facilities performing at approximately the same level as existing facilities should be treated equally for crediting.

AIGN looks forward to continued discussion as the treatment of new facilities is cemented.

5 BASELINE DECLINE

Declining baselines are an important component of meeting Australia's emissions reduction targets within the context of the chosen climate policy framework.

A steady decline rate supports institutional stability, allowing liable entities to assess the costs and impacts of the reformed Safeguard Mechanism. Conversely, several factors will mean that facilities cannot follow a steady, year-on-year path to reducing emissions.

AIGN notes that the annual decline rate of 4.9% per year, along with other policy settings, will result in some variability in the facility-level impact of liable entities. The provision to enable an adjustment to the decline rates in 2028-29 and 2029-30 adds to this potential variability.

Aligning the setting of post-2030 decline rates with updates to Australia's Nationally Determined Contribution under the Paris Agreement is supported for consistency, and to provide institutional stability.

AIGN looks forward to consultation as the details of the 'manageable portion of the Safeguard Mechanism emissions budget' to be kept in reserve to accommodate higher-than-expected production growth are settled. The reserve has merit, though will come at a cost to all Safeguard facilities and must therefore be judiciously constructed.

Ultimately the long-run marginal cost of abatement will set the unit price and influence preferred sources of abatement, in the absence of other incentives. That is why the Powering the Regions Fund and technology incentives are key elements of the Powering Australia policy suite. Without significant public and private investment in technology, supply chains, infrastructure, capacity, and skills the transition will be delayed.

6 CREDITING AND TRADING

AIGN's policy principles support the equitable treatment of abatement (the principle of a tonne is a tonne) and a technology-neutral approach to reducing emissions.

AIGN supports the provision of flexible compliance options within the Safeguard Mechanism. Removing 'headroom' and declining baselines will change the incentives for liable entities and encourage marginal abatement.

6.1 Compliance flexibility

AIGN members have good reason to believe that the reformed Safeguard Mechanism will significantly change the compliance landscape very soon after implementation.

There seems to be an expectation that the early years of the scheme will not have a considerable impact on liable entities, or that they will continue to have 'headroom' so compliance obligations will not be immediately felt. AIGN members do not share this expectation.

Rather, AIGN members anticipate compliance obligations to be comparatively significant from quite early after implementation of the reforms, reflecting the ambition in the legislated emissions reduction targets in the Climate Change Act 2022.

Because technological barriers in hard-to-abate sectors will prevent early deep abatement at many Safeguard facilities, having access to credible units is a legitimate and important smoothing tool for managing compliance obligations.

Particularly in the early years of the reformed Safeguard Mechanism, flexibility mechanisms will assist the operations of the scheme.

If a compliance obligation is not met, the operator of that facility will face a compliance penalty (referenced to the number of units and days the facility is in deficit), along with a make-good provision to maintain scheme integrity. Access to ACCUs, particularly in the early years before significant direct abatement is possible, will be key to the success of the scheme, particularly if other flexibility mechanisms remain limited as proposed.

Currently, aside from access to ACCUs, the only other options for meeting compliance obligations include limited borrowing with interest, and the creation of SMCs (which are not expected to be abundant). It is therefore worth investigating precedents set by various environmental trading schemes in other jurisdictions, including within Australia.

The Renewable Energy Target Scheme, for example, allows three years to make good on the exceedance of the 10% borrowing cap. In New South Wales, comparable schemes have allowed up to 20% borrowing in the initial years of operation in recognition of the greater uncertainty for participants in the first year or two. AIGN has proposed a stay of interest on borrowing in the first two years in this submission (see section 6.4.1) in recognition of uncertainty in the initial implementation of the scheme.

6.2 Access to units

For many Safeguard-liable facilities, it will not be possible to reduce emissions in a linear fashion – the decline in baselines is unlikely to be matched by equilateral year-on-year emissions reductions at each facility.

The projects required to complete periodic, technology-driven step changes typically need substantive capital investment, engineering approvals, and perhaps a temporary shutdown to facilitate the building and integration of new equipment, restart, and calibration, to achieve emissions reductions.

In other words, industrial abatement projects take time, planning, and access to capital to be realised. Even in a year where emissions have not reduced significantly, resources have likely been committed to achieving corporate targets which contribute to Australia's collective ambition.

Access to units like ACCUs and SMCs (and, in time, high-integrity international units) will in fact support ambition and smooth the transition to net-zero at a facility level. Robust governance arrangements to underpin the credibility and governance of these units will be crucial.

The intent is to facilitate the achievement of Australia's emissions reduction targets by encouraging entities to bring forward their action and drive genuine abatement. AIGN supports measures that will enable industry to do this work. Access to

credible units is not a prop to avoid action, but a tool to support ambition.

Consistent with the goal of encouraging entities to bring forward their action and invest early in genuine abatement we are aware that some entities relied on the incentive afforded by the deemed surrender provision to realise that very ambition. As such, AIGN supports the grandfathering of deemed surrender for the duration of existing contracts.

Access to units requires availability of units at the time they are required to meet compliance obligations. In this context, the depth and liquidity of the ACCU market in the short to medium term is crucial, particularly with limited, and expensive, borrowing as the only other flexibility option.

6.3 Cost containment measure

AIGN supports the provision of stability regarding price risks posed by compliance costs and obligations.

The cost containment measure relies on the availability of ACCUs, for both this and for compliance. Any limiting of ACCUs for the Safeguard Mechanism could effectively negate the cost containment measure.

It should also be noted that demand for ACCUs will be increasing steadily as Australia's deeper emissions reduction targets are implemented. More sectors will be looking to use ACCUs to meet both mandatory and voluntary goals.

In this scenario, with natural scarcity driving up ACCU prices and determining ACCU distribution between sectors, artificial scarcity measures (e.g. limits to ACCU availability in the Safeguard Mechanism) would risk the effectiveness of the cost containment measures. AIGN therefore supports the Government's position to allow the market to drive the use of ACCUs within the Safeguard Mechanism.

AIGN looks forward to discussing the detailed proposal for the cost containment measure further with the Department. For example, AIGN members are interested in the Department's view of what impact the cost containment measure may have on the price of ACCUs, and its capacity, or expectation, to function as a cap on ACCU (and compliance) costs.

In general, buttressing a new scheme in the early years to smooth its operation is a sensible idea. The cost containment measure may assist in this regard, however, more detail on its design is needed before a definitive view can be offered.

6.4 Safeguard crediting and trading

Crediting and trading of Safeguard Mechanism Credits (SMCs) are supported as a sensible addition to the range of flexible compliance options; available to Safeguard facilities SMC trading will be helpful in managing interannual variability, as well as for longer periods to manage emissions before transformative technology can be implemented.

AIGN supports the banking of SMCs to provide a useful tool for incentivising the decarbonisation of facilities.

6.4.1 Safeguard borrowing

AIGN notes the Government's proposal to allow limited borrowing with interest.

As previously addressed, the implementation timeframe for reforms is extremely ambitious (and new in this regulatory context). Many detailed elements of the scheme will not be finalised by the time it is implemented on 1 July 2023.

This creates a potentially problematic compliance condition for liable entities. Many significant parts of the current scheme will change and some detailed elements will not yet be finalised. As a result, entities will begin the scheme without fully understanding their compliance obligations as baselines will not be fully finalised.

As a transitional measure in recognition of this difficult compliance environment, AIGN suggests the Government consider removing the interest rate on borrowing for the first two years of the scheme. This would give some time for entities to fully understand their positions and for the operation of the ACCU market to smooth out as it adjusts to the reforms.

6.5 Australian Carbon Credit Units (ACCUs)

AIGN supports continued access to domestic offsets, especially in light of the challenges some Safeguard-liable entities will face in the medium term as baselines begin to decline significantly and before options for step-change direct abatement are available.

As noted above, demand for ACCUs will be increasing steadily as Australia's deeper emissions reduction targets are implemented. More sectors will be looking to use ACCUs to meet both mandatory and voluntary goals. AIGN therefore supports the Government's position to allow the market to drive the use of ACCUs within the Safeguard Mechanism.

It should be emphasised that acquiring units to offset emissions is an important smoothing mechanism to help reconcile the linear nature of increasing Safeguard obligations with what will happen 'in the real world' where abatement at Safeguard facilities will occur in stages that will see sharp drops in emissions before stabilisation at a new level. Incremental abatement rarely occurs in practice.

The acquisition of ACCUs (as well as SMCs and, in time, international units) represents a genuine cost with interest for liable entities. This will be balanced against the availability and cost of direct abatement options. Access to ACCUs is not expected to prevent the implementation of direct abatement projects, but simply to assist in meeting compliance obligations until such projects can be implemented.

It is acknowledged that ERF projects creating ACCUs will no longer be able to be registered at Safeguard facilities.

6.6 Integrity and market liquidity

With the Clean Energy Regulator overseeing the market for crediting and trading, AIGN is confident that the transparency arrangements will ensure market integrity.

Notwithstanding the recent release of ACCUs from Carbon Abatement Contracts, there is room to improve liquidity in the ACCU market, particularly for the forward compliance market.

Surrenders of ACCUs for compliance with the Safeguard Mechanism have historically been between 750,000 and 500,000. This is well short of the millions per year that may be required once the Safeguard Mechanism reforms are implemented.

The Paris Agreement includes a collective goal of reaching net-zero by mid-century. Australia is among the large group of nations that have adopted a net-zero by 2050 target in support of this goal, which implies that the use of offsets is a legitimate pathway to reducing emissions.

As cited in this submission, the use of offsets is not a solution to avoid direct abatement, but a strategy to enable emissions to reduce at least-cost and to smooth the abatement pathway for sectors still waiting for the capacity to deeply cut their direct emissions. In the absence of an economy-wide price on carbon which enables the most cost-effective abatement options to be implemented, with sectoral instruments and a proportional share approach, offsets are an essential tool to achieve emissions reductions efficiently,

Consistent with Australia's commitment to the Paris Agreement as a whole, AIGN expects Australia to be connected to the international carbon market through the developing Article 6 market mechanism, which will facilitate distribution of effort through market efficiencies at the global level.

6.7 International units

AIGN supports the use of verifiable, credible international units for domestic compliance and other purposes.

International carbon offset markets will play an important role in accelerating the transition to a net zero global economy. Importantly, with the development of Article 6 mechanisms, these markets will be required to also contribute to mitigation, adaptation, indigenous and other social and environmental objectives, unlocking private capital and accelerating the transition to a net zero economy.

It is of utmost importance that the measurement, reporting, and verification of these units is beyond reproach and that a transparent accounting and

disclosure framework is adopted to confirm abatement integrity.

Any international units allowed within the Safeguard Mechanism should be of high integrity and able to be formally counted towards Australia's Paris Agreement commitments.

The Climate Change Act 2022 explicitly links Australia's emissions reduction with the Paris Agreement in legislation. Given that the Paris Agreement Article 6 measures that will enable international linking are still being developed, international units will not be available within the Safeguard Mechanism until several years hence. At this time, it is expected that the cumulative impact of declining baselines will mean liable entities would benefit from the full level of compliance flexibility available, consistent with the integrity of the scheme.

Provided international offsets are credible and their surrender can be accounted towards Australia's emissions reduction efforts, there should be no arbitrary constraints placed on the use of international offsets.

Given the historically variable liquidity in the ACCU market, and the unknown cost of abatement across facilities, the use of credible international offsets will smooth the transition as facilities manage their increasing compliance obligations under declining baselines.

7 MANAGING TRADE EXPOSURE

Trade-exposed facilities will face additional costs on the proportion of emissions above their baselines. There will be many relevant variables that impact this fraction, including availability of transformational technologies enabling emissions reductions.

7.1 Tailored treatment

AIGN would like to revisit the Government's policy intent on the treatment of trade exposed facilities facing competitiveness impacts under the reformed Safeguard Mechanism. The basic job of the mechanism to address trade exposed facilities is to ensure the impacts of the reformed Safeguard Mechanism on competitiveness are mitigated so that carbon leakage does not occur.

An important element in understanding trade competitiveness impacts is understanding the relative carbon cost impost on competitors. This is among the issues explored in a study completed by the CIE for AIGN in May 2018. While the policy landscape has moved on since this time, the essential observations in the study continue to hold true.

Prior to the release of the position paper, the Department announced the policy approach to addressing trade competitiveness impacts would be to offer tailored treatment on a facility basis, to those facilities feeling a cost impost from trade exposure. AIGN suggests that the current proposal requires further refinement to fully meet this intent.

7.2 Comparative impact principle

The Government had already informed stakeholders that the principle of comparative impact would guide the design of measures to tailor treatment for emissions-intensive, trade-exposed facilities. While AIGN supports the basic principle of helping ensure businesses are not competitively disadvantaged, it is worth repeating that the issue to be managed for is trade exposure. Emissions intensity influences the degree, but is not the cause, of the cost impost and risk of leakage.

Another factor in the costs faced by trade-exposed facilities over time relates to the availability of abatement options. For a significant number of facilities, transformative abatement options are tied up in the availability of technology that may not be impacted in the short term by the increasing incentive to abate provided by declining baselines (whether at the full, or a differentiated, decline rate).

The proposed two-category approach does not adequately address the expected impact on trade-exposed facilities. For example, the revenue measure for underpinning eligibility criteria for TEBA will exclude many highly trade-exposed businesses that produce high-value, low-margin products. Previous government policy has recognised these shortcomings with a value-add measure, which could

be reconsidered for inclusion as part of the intended reforms. Conversely, the assistance associated with each category is unlikely to address the competitiveness issues over time imposed by the Safeguard Mechanism in a meaningful, tailored, and targeted way.

7.3 Facility-level impacts

In the position paper, as well as in prior papers and discussions, the Department has concluded that only a small number of facilities are likely to experience significant impacts in the early years of the reformed Safeguard Mechanism. AIGN encourages the Department to seek input from AIGN members on this matter. Internal discussions indicate that with the 4.9% baseline decline rate and without assistance, there is perhaps a greater than expected possibility that facilities may struggle to remain viable to 2030 and beyond, when abatement options are expected to be more widely available in hard-to-abate sectors.

7.4 Safeguard Transformation Stream (trade-exposed assistance)

The concept of the Safeguard Transformation Stream (dedicated funding within the Powering the Regions Fund) is generally supported; however, $600 million should be considered as a preliminary amount if transformation of Safeguard facilities is indeed the goal. The intended scale of transformation must be the principal determinant in allocating the level of support for trade-exposed (TE) facilities.

Providing supporting finance for genuine abatement activity is an intelligent incentive to encourage investments to be brought forward. It will be important to pitch this at a level that will genuinely incentives abatement. The scale of transformation required to reach Australia's targets suggests tes initial amount will need to be augmented, particularly as technology starts to become available for deployment.

AIGN sees potential in the ability of the Safeguard Transformation scheme to support significant abatement at Safeguard facilities. Currently, key details of this funding are undecided, and it is not possible to assess its impact at present. Depending on the Department's development timelines, this may still be the case at the commencement of the reformed scheme on 1 July 2023. AIGN looks forward to further consultation on the design of the Safeguard Transformation Scheme to ensure it can support all trade-exposed Safeguard facilities to transform in line with Australia's emissions reduction commitments.

AIGN is also interested to learn how other funding incentives (e.g., additional PRF funding, National Reconstruction Fund, etc.) will come together to form the tapestry of support for significant transformation at the facility level. Perhaps the work recently released by the Australian Industry Energy Transitions Initiative will prove useful in assessing the requirements needed for a successful transition in some Safeguard sectors.

7.5 Differentiated baseline decline rates (trade-exposed baseline-adjusted assistance)

AIGN members have expressed some concern over the effectiveness of the proposed approach to offer differentiated baselines for trade-exposed, baseline-adjusted (TEBA) facilities.

In view of other design decisions, the TEBA category in particular will be difficult to sustain as it would embed a cross-subsidy within the scheme. This could create significant tension and distortions towards the end of the decade.

Some AIGN members have Safeguard-liable facilities that will be exposed to competitiveness issues within the first two years of the scheme and may not qualify for TEBA baselines, and where the cost to abate is very high.

Specifically, the use of the revenue metric to determine qualification for differentiated baselines is not a good fit for businesses with high revenue and low margins. The combination of the latter with very limited abatement options at this time creates a risk that they cannot operate competitively.

For these facilities, access to limited funding from the Safeguard Transformation Stream is unlikely to assist decarbonisation (if available options exist) sufficiently to maintain their competitiveness.

AIGN looks forward to further discussion as measures to sustainably address trade exposure at Safeguard facilities are refined.

AIGN appreciates the Department's considered approach to this complex issue. In principle, we support the intent to recognise trade competitiveness cost impacts and preserve the marginal incentive to abate.

AIGN supports the provision of appropriate support to all facilities that will struggle to compete against imported (possibly carbon cost-free) commodities and products.

7.6 Carbon border adjustment mechanism (CBAM)

AIGN acknowledges the Government's intent to explore the concept of a CBAM to complement abatement activity within Australia. We note that the possible future availability of an Australian CBAM cannot, at this time, be considered as a viable measure to address trade competitiveness impacts. Indeed, in the event a CBAM is developed, trade competitiveness impacts in the years before its implementation will still need to be addressed.

There is general support among AIGN members for undertaking a considered analysis of how such an approach may be designed and how it can help to ameliorate trade competitiveness impacts. We note the development of the EU CBAM, and consideration of a carbon border adjustment in other jurisdictions (e.g., the USA).

AIGN notes there continues to be some debate about the ability of a CBAM to provide both import and export adjustments while maintaining compliance with WTO rules. Depending on how this is resolved at the international level, and the potential existence of an Australian CBAM in future, further consideration addressing carbon leakage for predominately export-competing industries may be needed.

The Government's proposed review of the reforms to the Safeguard Mechanism will be an important step in finding sustainable, long-term solutions to carbon leakage.

AIGN looks forward to engaging with the Government as the potential of carbon border adjustments is explored.

8 CONCLUSION

Thank you for the opportunity to provide input to the Department on the Safeguard Mechanism reforms position paper.

AIGN has long upheld the need to work within an international setting to achieve meaningful economic transition and emissions reductions at the global level.

AIGN's position on climate change and energy policy is underpinned by our principles, which have been the basis of AIGN's contributions to the climate change policy discussion for many years (available on our website: www.aign.net.au).

AIGN welcomes future opportunities to engage with the Department. Please direct any queries on this submission to Susie Smith (CEO).