CLIMATE ENERGY FINANCE

The Safeguard Mechanism

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Energy Minister Chris Bowen this month reported on the Federal Government's review of the Safeguard Mechanism (SGM), the central policy driver of scope 1 industrial emissions reductions by Australia's 215 biggest emitting facilities.

Firstly, it is important we acknowledge energy and climate momentum established over the last 8 months in Australia. Federally we have come a long way, and in co-operation with the States, we are really encouraged about the shifting narrative and action in Australia. And it is not in isolation; the US IRA, the REPowerEU and EU Net-Zero Industry Act, China's 14th FYP, India's PLI and most recently, the Japanese GX Roadmap. Australia can leverage domestic voter support in middle Australia by showing climate action is good for our economy, regional jobs and exports, and this narrative shift is well underway.

The safeguard mechanism (SGM) and Chubb review of Australian Carbon Credit Units (ACCU) review sit alongside the Climate Act, the 82% RE by 2030, the $15bn Reindustrialising Australia Fund, the progress in critical minerals and EVs. SGM is scope 1, 82% RE by 2030 is scope 2, and this is separate to dealing with our still expanding fossil fuel export industry (scope 3).

But today, let's fight the fight in front of us, using the SGM to put industrial emissions (scope 1) on a rapid declining path. Scope 3 exported emissions is the huge elephant in the room, but a clearer voter mandate is needed to deal effectively with that, no matter what the climate science says. And I'd rather fight to appropriately tax fossil fuel export war-profits than try to prevent them in the middle of Putin's war against Ukraine.

And we should also acknowledge the momentum at the state level is also building the national narrative. The Victorian re-election of the Andrews Government brings huge momentum on electrifying everything, a Gas Substitution Roadmap and 95% RE by 2035, and just today the NSW EPA is talking about regulating carbon emissions across all businesses to align with the 70% emissions reduction by 2035 target Minister Kean announced pre-Xmas.

Our key point about the SGM is that it is creating a credible framework to re-establish a price on carbon emissions in Australia. Finance needs a high price on carbon. That was made politically toxic by the previous government. The foundation of Climate Energy Finance is that financial markets are phenomenally powerful, but they need an explicit, high, permanent price on carbon. For finance, the direction of policy is key, we don't have to get there on day 1. We are excited to see Chris Bowen change the landscape last week to cap carbon pricing at *just* A$75/t. That is double where we are today. And it is subject to aggressive indexation (CPI +2% annually). The $75/t cap becomes ~$110/t by 2035. International linkage to emissions trading schemes (ETS) of integrity would see it go to the EU ETS price today of €88/t (A$138/t). International linkage will give our price another huge boost, again creating the confidence for finance and corporates in Australia that the $75/t price cap is an interim promise, the long term will likely be double that.

David Leitch published an excellent framing table in Renew Economy. I've expanded it here:

Table 1: The Safeguard Mechanism - A Path to Formal, High Emissions Pricing

	Baseline Mt CO2	Reduction Factor	Annual Reduction %	Reduction Mt CO2 pa	Cummulative Reduction Mt CO2 pa	$m cost Accumulated pa	Annual Increase in total carbon costs	CO2 Price A$/t	Inflation pa	Inflation +2% pa
FY2023	143	100.0%		Nil						
FY2024	136	95.1%	-4.9%	7.0	7	525		75.00		
FY2025	129	90.2%	-5.2%	7.0	14	1,050	100%	75.00		
FY2026	122	85.3%	-5.4%	7.0	21	1,575	50%	75.00		
FY2027	115	80.4%	-5.7%	7.0	28	2,100	33%	75.00		
FY2028	108	75.5%	-6.1%	7.0	35	2,756	31%	78.75	3.0%	5.0%
FY2029	101	70.6%	-6.5%	7.0	42	3,473	26%	82.69	3.0%	5.0%
FY2030	94	65.7%	-6.9%	7.0	49	4,254	23%	86.82	3.0%	5.0%
FY2031	87	62.4%	-5.0%	4.4	53	4,864	14%	91.16	3.0%	5.0%
FY2032	80	59.1%	-5.3%	4.2	58	5,510	13%	95.72	3.0%	5.0%
FY2033	73	55.8%	-5.6%	4.1	62	6,193	12%	100.51	3.0%	5.0%
FY2034	66	52.6%	-5.9%	3.9	65	6,912	12%	105.53	3.0%	5.0%
FY2035	59	49.3%	-6.3%	3.7	69	7,666	11%	110.81	3.0%	5.0%
FY2036	52	46.0%	-6.7%	3.5	73	8,453	10%	116.35	3.0%	5.0%

** CEF assumes long term inflation is 3.0% pa.*

Firstly, the -4.9% pa is something of a slight of hand. The SGM proposes a 7Mtpa reduction which is -4.9% in FY2024, but this is not a fixed % off a reducing base. We estimate the real **CAGR is -5.8%** from FY2024 to FY2030.

Secondly, the power of compounding means **$75/t becomes $87/t by 2030 and $110 by 2035**. That is a seriously positive trajectory that finance can now bank on, particularly relative to the uncertain ~$30-35/t we had just a month ago. Finance will extrapolate this rate of change, and won't wait a decade to act. This will get built into decisions immediately, with growing confidence as the legislation and regulations solidify.

Thirdly, we acknowledge the 215 facilities will use offsets initially; from a standing start, they can't move collectively that quickly after a decade of going backwards. But if they all use offsets and do nothing, by 2030 the annual cost of collectively doing so will be **$4.3bn**. Annually, because the emission reduction of 7Mtpa is cumulative, and the price goes up each year.

Fourth, getting an **Australian CBAM** proposal into discussion is a really important new step forward to encourage global action and for Australia to play a constructive leadership role. It is also in the context of the accelerating climate and energy decarbonisation trends globally.

Fifth, we are encouraged by the cumulative budget for total emissions of no more than 1,233Mt of CO2-e in total between 2021 and 2030, and the 100Mtpa target for FY2030. It is important this be clearly mandated and enforced, and ideally legislated.

Finally, I'd rather a review in 2026 with implementation effective 1 July 2027, so the SGM isn't a political football going into the next election, and hopefully our next government is elected with a much greater climate mandate, consistent with climate science and underpinned by the progress by our trade partners.

The SGM could be a lot stronger, but it does deliver a number of positive steps Australia needs. CEF acknowledges we should have a retrospective review of phantom ACCUs issued without substance and more public disclosure and transparency of the issues raised by Professor Andrew Macintosh. Trust and credibility need to be earned.

The proof will be in the delivery and integrity, as with the implementation of the **outcomes of the (ACCU) review**, also out this month. While the review might understate the distrust and abuses of ACCUs enabled by the Coalition, it does recommend strong improvements in transparency and integrity, e.g. an independent integrity review committee, and the abolition of new credits for "avoided deforestation", where bogus credits were applied to land which would not have been cleared.

We need to move forward. We see the complementary SGM and ACCU reforms as a very important step, one of many the Federal government is doing in concert with the states of real actions to build a stronger community consensus. After a decade of going backwards, strong corporate momentum needs to be built, and this won't happen overnight. Climate Energy Finance views the SGM as a big step in the right direction. One of many needed, but also one of many now well underway, at long last.

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