CLIMATE ENERGY FINANCE

The safeguard mechanism is imperfect, but a huge win after a lost decade of climate policy failure

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The federal government's plan to pass its safeguard mechanism overhaul – a centrepiece of its climate policy – through parliament in the next three weeks has hit some major roadblocks. The political landscape around the reform has prompted commentators to recall 2009, when the Rudd government's Carbon Pollution Reduction Scheme was delivered DOA.

The mechanism is designed to drive down "Scope 1" carbon emissions from Australia's 215 biggest carbon polluting facilities – those that emit more than 100,000 tonnes of CO_2 equivalent a year (Scope 1 emissions are greenhouse gases released as a direct result of an activity undertaken at an industrial facility). Major fossil fuel multinationals such as Rio Tinto, Chevron, Woodside, Santos and BHP are captured under its remit. The sites covered by the mechanism account for 28% of Australia's emissions.

Essentially, the policy requires these facilities to ratchet down their carbon emissions by 5-6% per year. It also puts a firm, high and rising price on emissions, currently capped at $75/tonne, but increasing by CPI plus 2 percent every year. This incentivises companies to reduce their carbon footprint and invest instead in clean technology. The government estimates that the mechanism will save 205 million tonnes of emissions over this decade, equivalent to taking two thirds of Australia's cars off the road.

While the business community and unions are supportive, the Coalition has shown it has learnt precisely nothing from its electoral drubbing, reigniting the climate wars by opposing the safeguard reform and calling it "one of the world's biggest carbon taxes" (the Albanese government inherited a version of the mechanism from the Coalition, which failed to enforce it). Energy Minister Chris Bowen responded succinctly: "hypocrites."

The Greens have threatened to withdraw support unless the government rules out new coal and gas developments. This stance is aligned with the climate science and the International Energy Agency's position, which said in 2021 that there can be no new fossil fuels if we are to limit global warming to safe levels and achieve net zero by 2050.

The safeguard proposal is imperfect. It permits unlimited use of offsets, allowing polluters to buy carbon credits as an alternative to directly reducing their emissions. One carbon credit represents one tonne of emissions reduction elsewhere. By purchasing a credit, a company can offset, or write off, a tonne of its carbon emissions, reducing its emissions on paper but doing nothing to directly cut its carbon footprint.

This lets high-emitting facilities buy their way out of directly curbing emissions and continue polluting. For these reasons offsets should be a last resort. Further, credits issued under the previous government were flawed and lacked credibility. The recent Chubb Review's integrity reforms should dramatically restrict the future creation of junk credits.

Notwithstanding our reservations, our founding premise is that financial markets are phenomenally powerful, but they need an explicit, high and permanent price on carbon to mobilise investment away from carbon based activities to clean alternatives. In our view, the safeguard reforms create a foundational framework to re-establish that high, credible price on carbon emissions. This is essential to drive decarbonisation and ultimately avert catastrophic climate change.

The mechanism should not be considered in isolation. In its nine months in office, the federal government has also made very significant headway on climate and energy policy across multiple fronts after a devastating decade of failure under the LNP.

Its major initiatives include the Climate Act legislating a 43% emissions reduction by 2030, the commitment to 82% renewable energy by 2030, the $15 billion National Reconstruction Fund, the $20 billion Rewiring the Nation program, designed to catalyse the build out of transmission infrastructure we need to deliver low cost, zero emissions renewable energy to homes and business, the new Capacity Mechanism, which will turbocharge renewables investment, and its commitment to the global pledge to cut methane.

Importantly, the federal government is also making critical minerals central to its agenda. Australia has some of the largest geostrategic reserves of energy transition materials such as lithium, copper, nickel, rare earths and cobalt in the world – resources essential for the batteries, wind turbines and other tech that underpin global decarbonisation. This gives us a once in a century, multi-hundred-billion-dollar opportunity to pivot away from our dependence on fossil fuel exports to mining, refining and adding value to these resources pre-export using our abundant renewable energy.

The government must now set a clear timeline for banning all new fossil fuel projects, and for phasing out government fossil fuel subsidies. It should also ensure fossil fuel multinationals pay their fair share of corporate tax in Australia – currently most pay next to nothing – and use this revenue to help fund and attract private investment to clean energy and critical minerals refining.

The proposed safeguard mechanism should be considered in the above context, as part of an ecosystem of reforms. While the proposal has flaws, and needs to be modified to strictly limit the use of offsets so as to prioritise direct emissions reduction, it does provide the carbon-pricing architecture to accelerate progress on the energy transition.

After nearly 10 years of going backwards under the ineptitude of the previous government, we need this massive win. The opportunities are too huge to squander.