CLIMATE ANALYTICS

Briefing

Submission to the 2026-27 Safeguard Mechanism Review

Climate Analytics

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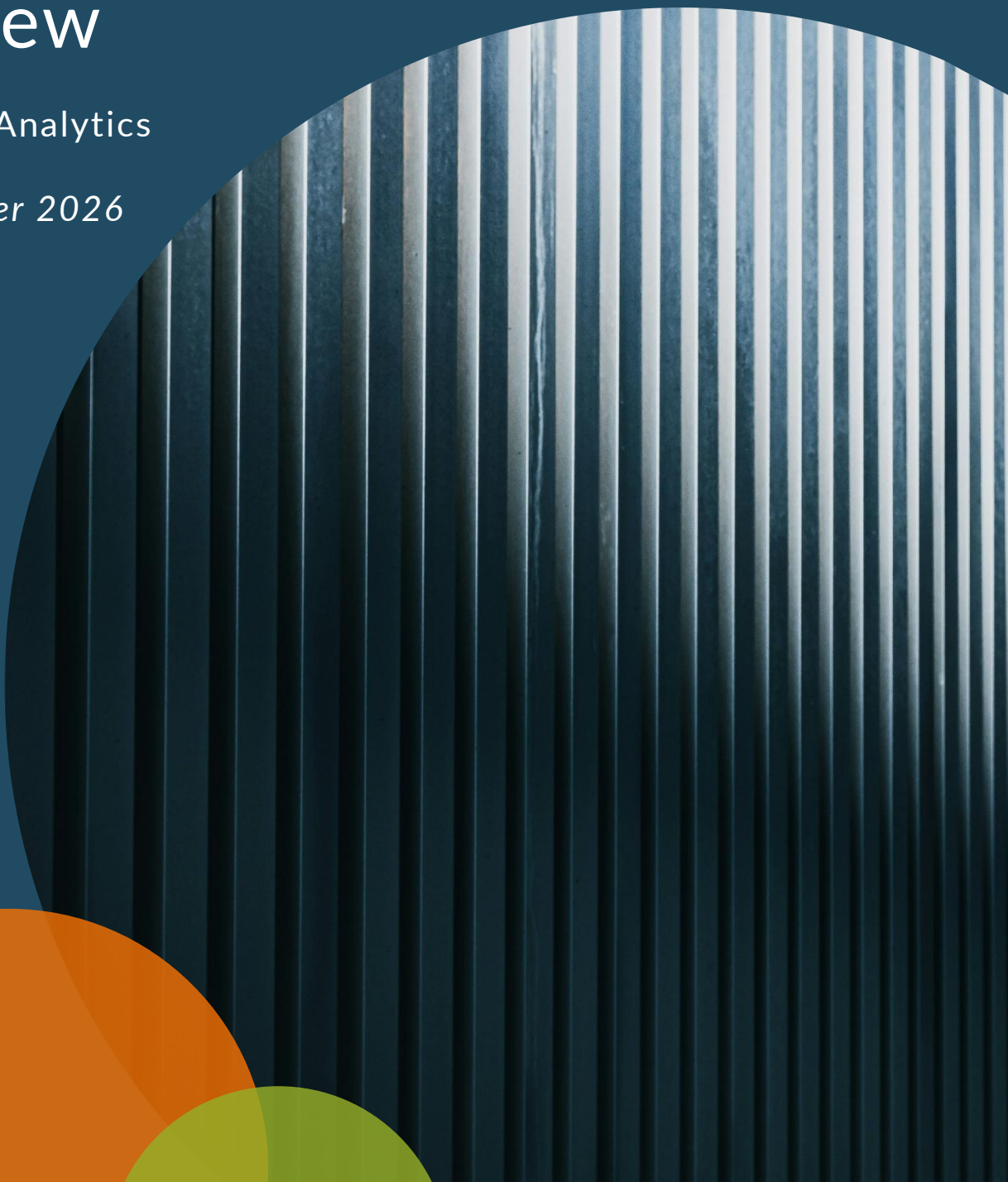


Climate Analytics welcomes the opportunity to respond to the consultation on the 2026-27 Review of the Safeguard Mechanism. We have contributed to the Safeguard Mechanism process for years. In 2022, we submitted to the reform review. In 2023, we analysed the risks that new fossil fuel projects pose to the scheme. In 2025, we discussed the Mechanism in our submission to the Climate Change Authority's Annual Progress Report. Climate Analytics recommends that the 2026-27 Review re-anchor the Safeguard Mechanism on direct emissions rather than net emissions, informed by the Fossil Fuel Phase-Out (FFPO) scenario in the report A fossil free Australia:

1. Set binding baselines on direct emissions within a Paris-aligned envelope: facility baselines should be defined against actual on-site (gross) emissions, and their sum should sit within an aggregate emissions envelope for covered sectors that declines in line with the FFPO pathway. In that scenario, gross Safeguard emissions fall by around 7% per year to 2030 and 12% per year from 2030 to 2035, reaching near zero by 2045.
2. Cap offset use at 10% of the declining baseline: ACCU surrender should be limited to no more than 10% of aggregate baselines. Because the baseline declines, the absolute volume of ACCUs that can be used falls every year, delivering an effective phase-out of offsets by 2040. The limit must create no new headroom, follow a fixed, published trajectory and start as soon as possible, as most Safeguard facilities face only one or two major investment cycles before 2050.
3. Transition to an emissions trading system: putting Safeguard Credits at the centre of the policy instead of ACCUs would reward overachievement and create an incentive for further investment in abatement across covered sectors. Over time, free baseline allocation should give way to auctioning, aligning the price signal with actual abatement costs and generating revenue for industrial decarbonisation and for conservation funded directly rather than through offset demand.

As supporting, complementary measures:

4. Differentiate fossil fuel production: coal mining and oil and gas extraction should face steeper baseline decline rates, tighter offset limits or discount rates than other sectors. As a climate policy, the Safeguard Mechanism must address the cause of climate change by both limiting fossil fuel expansion and driving down emissions from existing operations.
5. Fix permanence discounting: the current discount on 25-year ACCU projects is inadequate for offsetting CO_2 given the gap between land-based sequestration and CO_2's atmospheric lifetime, and should be revised, distinguishing methane, for which shorter-term offsets are more defensible.
6. Rule out international units: they would expand cheap credit supply while importing unresolved integrity and accounting complications.
7. Lower the coverage threshold to 25,000 tCO_2e: this aligns the Safeguard with the existing NGERS facility reporting threshold and removes the incentive to stay below the current threshold.

8. Complement the Safeguard with a comprehensive industrial decarbonisation package: end counterproductive subsidies, broaden capital support for electrification and fuel switching, promote and implement demand-side measures (such as a border carbon adjustment) and the buildout of common-user infrastructure.

Are Safeguard policy settings and Government support mechanisms suitable for developing and deploying emissions reduction technologies for the industrial sectors?

The central issue with the Safeguard Mechanism, and with Australia's national goal-setting more broadly, is its emphasis on net rather than gross, or direct, emissions reductions. This is both an architectural and a practical problem.

As set out in our previous publications, the Safeguard Mechanism is not designed to drive the scale and pace of direct industrial emissions reductions required for a 1.5°C aligned transition, because of the role ACCUs play within it. This review is the opportunity to correct that.

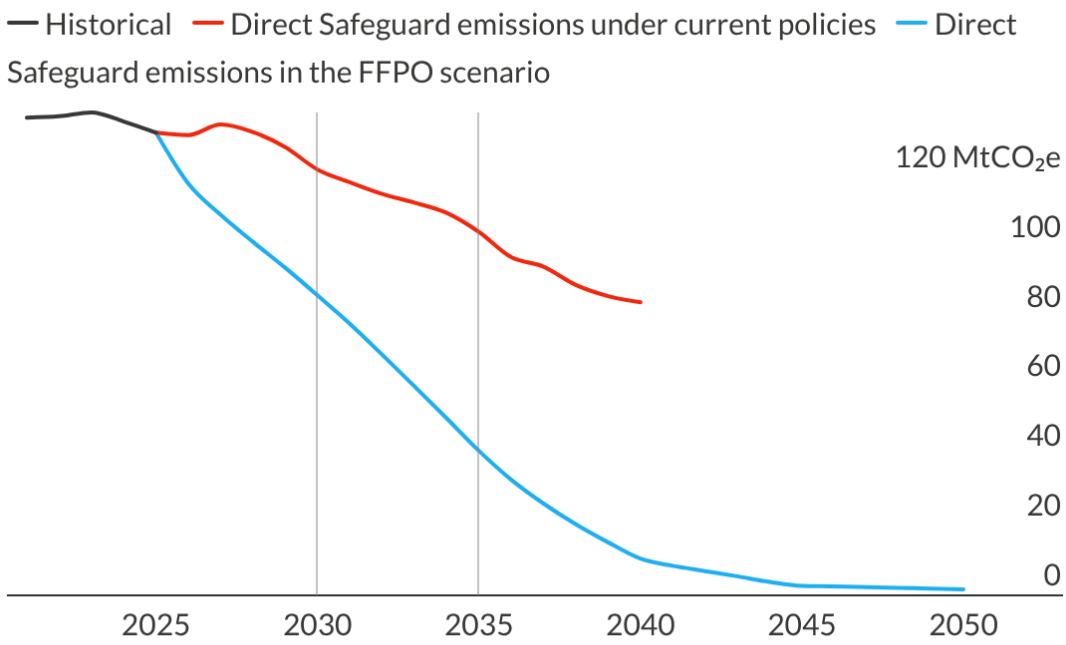
Architecturally, allowing facilities to meet their obligations with ACCUs rather than actual, on-site abatement weakens the investment signal for electrification, fuel switching, process change and the other technologies needed to decarbonise Australian industry. In practice, comparatively cheap ACCUs deter investments in new technologies. Surrender data from the scheme's first years of operation, the fact that the fall in headline emissions has been driven by interruptions at a few facilities – and can be, in the future, influenced by production because of the nature of the baselines – and that the cost containment cap was never hit illustrate these dynamics.

Ultimately, the effectiveness of the Safeguard Mechanism depends on whether facilities make real on-site reductions in a predictable manner rather than buying offsets.

Our report A fossil free Australia identifies substantial opportunities for industrial decarbonisation using technologies that are available today or can be commercialised with appropriate backing. These include renewable-powered mine electrification and electric haulage; electric arc furnaces, recycling and green hydrogen in iron and steel; electrification and green hydrogen in alumina; alternative fuels and lower-clinker products in cement; and renewable hydrogen replacing fossil gas in ammonia production.

In the Fossil Fuel Phase-Out (FFPO) scenario, where Australia aligns with the Paris Agreement's goal, direct (gross) emissions from Safeguard facilities decline immediately and at a steeper pace than under Current Policy Projections (CPP), to 35% below 2025 levels by 2030 and 69% by 2035, compared to 8% and 21% as anticipated by the government, reaching near zero by 2045. That corresponds to a decline in gross emissions of 7% per year to 2030, and 12% between 2030 and 2035.

Direct Safeguard facilities emissions in the FFPO scenarios compared to the government's 2025 projections



Source: 2024 - 2025 Safeguard Mechanism data insights, Australia's emissions projections 2025
Figure 14

If policy measures are needed, what would be the best way to reduce reliance on ACCU use without unduly disrupting the carbon market and when should any such measures start?

Given these shortcomings, new policy measures are needed to constrain the use of ACCUs so that the scheme delivers the on-site abatement required on a Paris-aligned pathway. Australia is one of the few countries that allow unlimited offset use. In 2025, the OECD found that "almost all Emissions Trading Schemes that allow for the use of carbon credits for compliance place a limit on the quantity which can be used". We welcome the inclusion of quantitative limits, discounting and qualitative restrictions in the consultation paper.

A quantitative limit must bind in practice, create no new headroom, and have a fixed published trajectory to provide stakeholders with clarity. Having the limit as a fixed proportion of the baseline, where that baseline declines in line with the FFPO scenario shown above, would naturally achieve the goal of phasing offsets out with added simplicity (see figure above).

Aligning with other emissions trading schemes around the world would significantly reduce the room for offset use: as per the OECD, for the use of carbon credits, "most limits are below 10% of compliance obligations." Applying a 10% upper bound to the Paris-aligned baseline shown above leads to their effective phase-out as early as 2040.

A quantitative limit is the first step towards the Safeguard operating as an emissions trading system. Once offsets can no longer close the gap between a facility's emissions and its baseline because of that new cap, facilities must either abate on site or acquire units from facilities that have overachieved on theirs. Safeguard Mechanism Credits, introduced by the 2023 reforms, provide the unit traded in this system. Over time, the government needs to move allocation progressively from free baselines to auctioning, which would strengthen the price signal and generate revenue that can fund conservation directly rather than through demand for offsets.

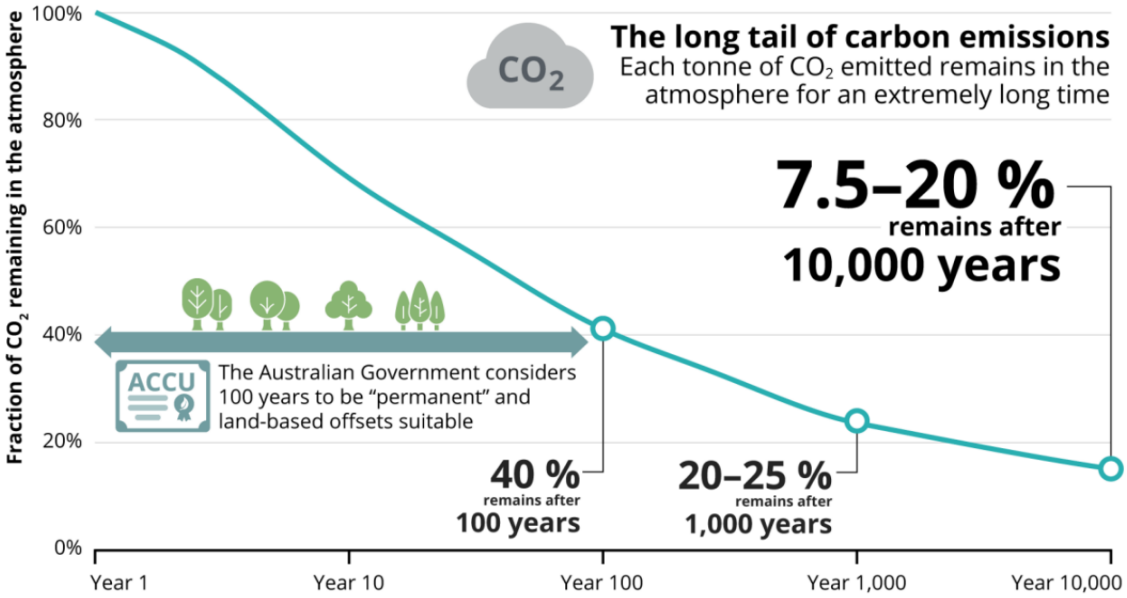
The consultation discusses quantitative limits at the facility level, either as a share of emissions or of baselines. Applying the limit at the scheme level instead, as a scheme-wide cap on ACCUs, would direct offsets towards the facilities willing to pay the highest prices for them. It would also make offset use decline predictably, rather than change with individual circumstances such as changes in production levels because of the way baselines are set.

The quantitative limit on offset use needs to apply as soon as possible, since industrial investment decisions will lock in technological choices for decades. The consultation paper itself recognises that many Safeguard facilities may have only one or two major investment cycles between now and 2050, and that abundant low-cost ACCUs can defer the investments required for long-term industrial decarbonisation. Delaying the constraint until well into the 2030s would incentivise the very investment decisions the policy is intended to change.

Discounting, by contrast, may alter the relative price of ACCUs while leaving the underlying problem in place, and should only be used as a complement to the quantitative limits.

We note that nine of the ten users of ACCUs in 2024-25 were fossil fuel facilities, and five of them were coal mines. As discussed below, climate policy should differentiate fossil fuel emissions from other activities, and the Safeguard Mechanism could do so by applying different quantitative limits or discount rates to ACCUs depending on facility type.

The introduction of additional discounting within the Safeguard Mechanism should also address permanence. ACCUs are issued for either a 25-year or a 100-year period, with up to a 25% permanence discount rate applied to 25-year projects. Given the transient nature of land-based sequestration compared to the long tail of CO_2's presence in the atmosphere (see figure below), the lack of guarantees that sequestration will extend beyond a project's end date, and the fact highlighted by the Climate Change Authority that these ACCUs are now bought for Safeguard compliance, that discount rate is fundamentally inadequate.



In parallel, as we get closer to 2050, Australia will also need to invest in a framework for technological carbon dioxide removals, work begun by CSIRO. Many CDR technologies rely on geological storage, which needs to occur in a safe manner over thousands of years. This represents, in theory, truly permanent storage in contrast to land-based ACCU issuing methods because of the lifetime of carbon dioxide in the atmosphere.

While current offsetting projects should not be assumed adequate for sequestering CO_2, recent evidence shows that short-term climate forcers like methane can adequately be compensated by 25-year or 100-year offsetting projects in the way that carbon dioxide cannot. These discussions are relevant for fossil fuel operations under the Safeguard: Ember found that "over 58% of the ACCUs used for compliance [by coal mines] originate from projects like avoided deforestation, which primarily address carbon dioxide", while methane accounted for 61% of the sector's emissions, with RepuTex adding that coal mine CH_4 emissions could be 64-113% higher than current inventories.

The introduction of discounting for ACCUs within the Safeguard Mechanism, and revisions to the current discounting in place for short-term ACCU projects, are therefore opportunities to take permanence concerns into account, in line with the Climate Change Authority's recommendation to examine the appropriateness of short-term ACCU projects under the SGM.

Both a declining limit on offset use defined in this manner and the introduction of discounting would give the government clarity on the scheme's effectiveness and its ability to deliver emissions reductions, and give industry and carbon-market participants certainty about its direction of travel.

Are there any important areas that are not covered by government policy or programs?

The most significant gap is the absence of an integrated industrial decarbonisation framework capable of moving technologies from demonstration to widespread deployment while creating strong demand for low- and zero-emissions production.

Despite welcome initiatives such as the Future Made in Australia, support for facilities undertaking capital-intensive electrification and switching to cleaner technologies remains too narrow. In some sectors, subsidies for fossil fuel consumption pull in the opposite direction and should be eliminated.

Demand-side measures are needed to complement leadership and support for transitioning facilities. These include measures such as a border carbon adjustment mechanism, to level the playing field against carbon-heavy commodities while supporting Australian industry, and measures to scale up technologies that can then decarbonise industry, such as sustainable aviation fuel. Many sectors have linkages: buildings and transport, which are for the most part not covered under the scheme, are tied to outputs from cement and steel.

In these two sectors, we find in the FFPO scenario that final energy consumption in the cement sector can be decarbonised by 2035, and that Australia's aviation sector can transition fully to sustainable aviation fuel by 2050. Green public procurement, embodied-carbon limits, clean-product certification and international market-development arrangements can create the revenue certainty needed to make new facilities bankable, and are all policy options that can contribute towards this goal.

Foundational upstream work for decarbonisation can also enable it by resolving what the Climate Change Authority refers to as the "chicken-and-egg" problem between common user infrastructure and customer industrial demand. This recommendation is echoed in the Industry Decarbonisation Plan, which states that "Proactive grid planning from grid bodies such as AEMO, state and federal governments, and network providers to consider industry specific needs will help to reduce the chance of costly delays". The Pilbara is one example. Developing shared grid infrastructure would enable the decarbonisation of facilities there by shifting on-site generation to the grid. This would not only contribute to facilities' decarbonisation, but also make the region more competitive in attracting clean investment in future, with a massive supply of clean electricity from a renewable-rich region. The CEFC has found that it could save AUD 30bn over 25 years.

Lastly, and most importantly, nothing in government planning, either as part of the SGM or in other policy frameworks, is set to deliver a roadmap for the transition away from fossil fuels that the government has signed up to. The Safeguard Mechanism, as the government's flagship policy for industry and one that covers much of coal mining and oil and gas extraction, needs to contribute towards that goal. As it stands, the Safeguard Mechanism is not able to, first, stop or limit the expansion of fossil fuel activities and, second, address emissions from existing ones. In the FFPO scenario, we find that coal mining emissions need to approach zero by 2040 as Australia phases out production and undertakes on-site abatement, and LNG emissions a few years later. More stringent rules for fossil fuel extraction would also leave more breathing room for other industries that

have a role to play in the transition, as well as new entrants from a lowering of the inclusion threshold.

Multiple options have been discussed to differentiate fossil fuels in the SGM and drive their phase-out. One is a stronger baseline decline rate for LNG and fossil fuel extraction as investigated by RepuTex, which found that a 6.8% decline rate for fossil fuel extraction and LNG processing delivers only a 68% reduction in net emissions by 2035, short of the upper bound of a target that is already assessed as insufficient. This proposal would address the headroom that lets coal mines and LNG plants generate large amounts of Safeguard Mechanism Credits because of intensities set as per older data. Other than differentiated baselines, both the design of the quantitative limits and specific discounting mechanisms can introduce asymmetry in the treatment of fossil fuels under the scheme.

3.1.2 Domestic offsets

Are new policy measures for ACCU use needed to accelerate industrial decarbonisation?

As discussed above, the government needs to constrain offset use by implementing binding, declining quantitative limits, and to apply asymmetric treatment to the fossil fuel sector through differentiated baselines and/or ACCU discounting.

If policy measures are needed, what would be the best way to reduce reliance on ACCU use without unduly disrupting the carbon market and when should any such measures start?

These measures should start as early as possible, to give investors in industrial decarbonisation and in ACCU projects long-term visibility on their outlook, and to allow for the direct emissions reductions needed to align with the Paris Agreement.

3.1.3 International units

Is there any ongoing interest in using international offsets for Safeguard Mechanism compliance in the future and what is the rationale for this?

Allowing international offsets would reproduce, and potentially amplify, the central weakness of unrestricted ACCU use. It would increase the supply of credits that regulated facilities could buy instead of investing in domestic emissions reductions, and it would do so through a channel the Australian framework makes no provision for. This runs against the principle that the Safeguard Mechanism should be tightened to constrain offsets and deliver ambitious reductions in direct rather than net emissions.

The rationale sometimes advanced for international units is access to lower-cost abatement and greater market liquidity. That rationale does not hold where the objective is the structural decarbonisation of long-lived Australian industrial assets. International

units also carry unresolved questions of integrity and accounting. Resolving these would take years, when the abatement is needed now.

3.5.1 Coverage threshold

Should the Safeguard Mechanism threshold be lowered and, if so, when?

The Safeguard Mechanism threshold needs to be lowered as much as possible to increase the scope of the economic sectors covered by climate policies under the current framework. This would also avoid the adverse effects of the Safeguard on the basis of small differences in emissions, and the ability of facilities to drop in and out of the scheme.

Lowering the threshold to 25,000 tCO_2e widens the scheme's scope as far as the NGERS allows. As the Productivity Commission notes, the additional costs for smaller businesses would be limited as they already report their emissions under the NGERS. It also removes by design the perverse incentive that inflates SMC supply under the way the scheme works now, where facilities that fall below the threshold can keep creating SMCs without having to surrender any.

The financial burden argument for these new entrants depends on how baselines are set, and on the longer-term architecture of the Mechanism. Where baselines begin to decline from the time coverage begins, and fossil fuel facilities face a steeper decline rate as we propose, the baselines generate demand for credits that smaller entrants are well placed to sell and therefore generate revenues from. Under the transition to an auction-based system that needs to be the end goal of the Safeguard Mechanism, the additional proceeds generated can be directed towards supporting smaller businesses to abate emissions, and support conservation with a more efficient allocation of resources as ACCUs are phased out from the Safeguard.