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SUBMISSION ON SAFEGUARD CREDITING BELOW BASELINE

The Australian Industry Group (Ai Group) welcomes the chance to make a submission on the Crediting Below Baseline (CBB) initiative.

Ai Group is a peak national employer organisation representing traditional, innovative and emerging industry sectors. We have been acting on behalf of businesses across Australia for nearly 150 years. Ai Group is genuinely representative of Australian industry. Together with partner organisations we represent the interests of more than 60,000 businesses employing more than 1 million staff. Our members are small and large businesses in sectors including manufacturing, construction, engineering, transport & logistics, labour hire, mining services, the defence industry, civil airlines and ICT.

CBB has several potentially contradictory objectives. It could be:

1. A way to deliver near-term industrial abatement with value-for-money. This pushes towards use of reverse auctions but fears about genuine additionality of the cheapest abatement offered will inspire tight scrutiny. Government is the only real source of demand.
2. A way to deliver transformational abatement in industry. More expensive abatement is easier to deem additional, but it would be hard to do much of it within the $280m funding committed so far. Again, government is the only clear buyer.
3. A piece of infrastructure for future Safeguard evolution. If and when Safeguard baselines are ratcheted down, CBB would help converge marginal abatement costs across businesses and over time, improving efficiency. But to be useful for this purpose CBB needs:
    a. to be as simple and automatic as possible, without complex additionality requirements; and
    b. to allow and actually involve some business-to-business transactions in the pilot phase so there is some learning.

Trying to meet all these goals in one program will be very difficult.

If the Government does try, they could consider segmenting CBB. One approach would be to commit one chunk of funding to purchase the lowest cost abatement offered through reverse auctions; and to commit another chunk to purchase from among bids that achieve a large minimum reduction in the total emissions of the underlying facility (perhaps 50%+).

Integrity concerns with CBB are understandable and need to be solved. Nobody ultimately benefits if public or private funds are wasted on purported emissions reductions that turn out to be illusory or fraudulent. However, the solutions need to be as simple and predictable as possible or there will be no take up and no learning, as we have seen with the Facilities Methodology for industry in the Emissions Reduction Fund.

The underlying reason for concern about additionality in relation to CBB is that Safeguard baselines

are not very tight, so crediting overperformance could easily be money for nothing. Solutions could include:

- Ratcheting baselines down. A significant across-the board cut followed by ongoing reductions could be simple; would give great confidence that performance below baseline is real; and would drive demand for abatement and valid offsets. Any such move would need to be coupled with solutions to preserve competitiveness for trade exposed industry. This option does not seem to be under current consideration. But this is the eventual direction widely expected; Ai Group would support it in principle, with appropriate consideration of trade competitiveness; and it is worth keeping in mind as CBB is designed.
- Establish distinct crediting baselines. A simple approach that does not require reductions in current Safeguard compliance baselines would be to establish CBB-specific crediting baselines. These should be set by reference to existing production-adjusted compliance baselines but be significantly lower. To ensure simplicity and avoid protracted wrangling the degree to which crediting baselines are lower than compliance baselines should be the consistent across entities and activities. A crediting baseline set 10% below the relevant compliance baseline, for example, would provide considerable confidence that further reductions that seek crediting are genuine, without the need for complex assessment and validation processes.
- Set thresholds for crediting. Qualification for crediting could depend on exceeding a minimum threshold for emissions reductions against the compliance baseline, while the quantity of crediting could depend on total performance against that baseline. For example, with a threshold set at 10% below baseline, an emitter falling 5% below baseline in a year would be ineligible for CBB issuance, while an emitter falling 15% below baseline in that year would be eligible for CBB issuance equal to 15% of their baseline. Setting a minimum threshold for creditable reductions would be more generous than a separate baseline, but also likely more effective in encouraging participation in a pilot. With a sufficient threshold it is likely that only facilities that have made genuine abatement efforts will be credited, even if a few percentage points of the improvement credited may be business-as-usual fluctuations.

Contamination of other current and future markets is a real fear given experience with many other schemes (EU ETS, RGGI, CDM) that have become flooded with excess units (often due to errors in forecasting), requiring years of effort to work through. Designing policy 'bulkheads' to prevent flooding is important, even beyond the additionality solutions above. But care is needed to avoid making participation unattractive. Options include:

- Limiting life of credits. This is a tried and tested approach in other schemes. But note that shorter-lived credits will need a higher unit price to motivate investment, if and when private credit demand becomes significant. It makes sense to set a relatively short credit life for a pilot phase and to consider longer (but probably not unlimited) lives for subsequent phases.
- Limiting issuance of credits. Discounting issuance to allow for non-additionality or other concerns is equivalent to reducing the issuance baseline. It can be reasonable, but it gets complex if you try to vary the discount based on the nature of the sector or abatement activity. The point of a discount is to be a simple approach to uncertainty. Also, if pushed too far a discount will discourage participation. Again, a threshold may be better than a discount in eliciting significant new activity – it may over-reward genuine improvements but not non-genuine ones.
- Limiting use of credits. The Government could put limits on several potential uses of CBB credits. One example is the Government's commitment that its own CBB purchases in a pilot phase will be via a dedicated new funding stream and not the previous Climate Solutions Fund allocation. Compliance-related demand from Safeguard entities could be constrained, for example by a limit on the number of CBB units that can be retired towards Safeguard compliance, set as a percentage of the relevant baseline. Voluntary demand for CBB units is simple to block completely – regulations could provide that these units are only transferrable to government and to Safeguard entities. However more nuanced limits on voluntary action

could be difficult to enact. Voluntary systems could come up with their own approaches. Government could also reflect limits in the Corporate Emissions Reporting Transparency initiative currently under development.

It is important to consider all proposed CBB limits, individually and as a whole, for their:

- Simplicity
- Predictability
- Net effect on the attractiveness of abatement investment.

The single most important variable for easing concerns about CBB is **demand for abatement**.

Currently government demand for abatement purchases is modest and limited. Private compliance demand for abatement is very low and will not rise much on current policy. Private voluntary demand has increased, but from a very low base. Sustained strong demand growth is unlikely in the absence of policy.

In this environment existing suppliers in the Climate Solutions Fund crediting market are very nervous about CBB. There is zero-sum competition for shares of a small market. This magnifies concerns about additionality and contamination.

Steps to increase demand would greatly ease these concerns:

- Higher, more long-term public demand, particularly if it were segmented between ERF/CSF and CBB demand, would give greater confidence to all; and/or
- Driving higher private demand through Safeguard ratcheting would reduce both additionality fears and market share fears. But it will require trade competitiveness solutions.

Our recommendations are that the Government should ensure CBB provides useful infrastructure for future Safeguard evolution by:

- Allowing CBB unit transfer and compliance usage, within percentage limits, among Safeguard entities;
- Using crediting baselines or thresholds that are significantly lower than compliance baselines as the primary tool for ensuring additionality;
- Ensuring any other limits on CBB issuance and usage are simple, predictable and not so onerous as to excessively dissuade participation; and
- Reviewing all CBB pilot settings before committing to future phases.

For any questions in relation to this submission, please contact Ai Group adviser Tennant Reed (tennant.reed@aigroup.com.au, 0418 337 930).

Sincerely yours,

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