



Safeguard Mechanism review

Productivity Commission submission

Key points

- ✳ **The Safeguard Mechanism is an important part of Australia's climate policy framework.**
 - Its broad, market-based incentives are important for achieving emissions reductions at least cost.
 - As Australia's emissions reduction task becomes more demanding, the scheme should build on these foundations and provide credible, predictable signals for long-term investment.
- ✳ **The Safeguard Mechanism should preserve flexibility over how facilities comply.**
 - Departures from flexible compliance should address a clearly identified problem and deliver benefits that justify the additional costs. Any concerns around ACCU methodologies or credits should generally be addressed directly rather than through Safeguard Mechanism settings.
- ✳ **The Safeguard Mechanism should cover more industrial facilities.**
 - Lowering the coverage threshold would unlock additional lower-cost abatement opportunities.
 - The review should favour broadening coverage over time, while taking into account additional administrative costs this would create.
- ✳ **The border carbon adjustment recommended by the Carbon Leakage Review should be introduced, initially for cement and clinker. Trade-exposed baseline-adjusted treatment should be removed in tandem with the introduction of a border carbon adjustment.**

Introduction

The Productivity Commission welcomes the opportunity to make this submission to the statutory review of the Safeguard Mechanism. The settings adopted following this review will affect the contribution the Safeguard Mechanism makes to Australia's emissions targets and the cost of achieving those targets. As Australia's emissions reduction task becomes more demanding, the Safeguard Mechanism should remain a central part of the policy framework, with future changes building on its market-based incentives to achieve emissions reductions at least cost.

This submission considers how flexible compliance, scheme coverage and carbon leakage arrangements can evolve in a manner consistent with the scheme's market-based foundations.

The PC supports the scope of this review. The PC previously recommended introducing a policy to drive electricity sector decarbonisation, and suggested an appropriate approach could use a baseline-and-credit system similar to the Safeguard Mechanism (PC 2025a, p. 16). The design of an electricity sector

decarbonisation policy should take into account reforms that also address reliability and other energy system objectives. Future integration with the existing Safeguard Mechanism scheme may be desirable but would require sufficient lead times to underpin certainty and investment incentives in the scheme and associated carbon credit markets. This would also apply to other sectoral policies like any low carbon liquid fuel demand mechanism (DCCEEW and DITRDCSA 2026, pp. 49–51).

Build on the Safeguard Mechanism's market-based foundations

The Safeguard Mechanism is an important part of Australia's emissions reduction policy framework. It covers around 80% of heavy industry emissions and combines declining emissions limits with flexibility over how facilities comply (PC 2025a, p. 9). To meet their obligations, facilities can reduce their own emissions, purchase Safeguard Mechanism Credits (SMCs) from other facilities or surrender eligible ACCUs. By allowing emissions reductions to occur where they are cheapest, the scheme helps reduce the cost of achieving Australia's emissions targets.

The Safeguard Mechanism's market-based incentives will be most effective if businesses have credible and predictable information about future policy settings. This is particularly important for emissions reductions that require large, long-lived investments. Expectations about future credit prices can significantly affect investment decisions (EY-Parthenon Strategy 2026, p. 12). Setting a clear and credible trajectory for the Safeguard Mechanism beyond 2030 would help businesses make efficient long-term abatement investments.

Preserve flexibility over how facilities comply

The PC supports preserving flexibility over how facilities meet their Safeguard Mechanism obligations, including no general restrictions on the use of ACCUs.

The review will consider whether the Safeguard Mechanism is 'appropriately incentivising onsite abatement' (DCCEEW 2026a). The least-cost mix of onsite and offsite abatement will change over time, and the use of credits at a particular point in time is not itself evidence that onsite abatement is too low. As the Climate Change Authority has noted, the mix of onsite abatement and ACCU use responds to their relative costs and availability over time (CCA 2026, p. 25). Onsite decarbonisation investments can take several years to implement, meaning that facilities may initially rely more heavily on credits. Modelling commissioned by the PC illustrates this dynamic: newly covered facilities initially relied on external abatement while onsite actions were implemented, before increasing onsite abatement and reducing their reliance on credits (RepuTex Energy 2025, pp. 20–22). The review should focus on whether the Safeguard Mechanism allows the mix of onsite and offsite abatement to adjust efficiently over time, rather than targeting a particular level or share of onsite abatement.

The consultation paper canvasses quantitative limits, discounting and qualitative restrictions on ACCU use to increase onsite abatement (DCCEEW 2026b, p. 14). These approaches would operate differently, but each would constrain or reduce the value of ACCUs for Safeguard compliance. To the extent they shift abatement onsite that would otherwise have occurred at lower cost through the ACCU Scheme, they would increase the cost of achieving Australia's emissions targets.

EY modelling suggests that constraining ACCU use to increase onsite abatement could impose substantial costs. EY estimated that offsite ACCUs account for around two-thirds of available cost-effective abatement at relevant prices (EY-Parthenon Strategy 2026, p. 28). Capping facility-level ACCU use at 50% increased onsite abatement but approximately tripled compliance costs and resulted

in material non-compliance as some facilities exhausted cost-effective onsite options (EY-Parthenon Strategy 2026, pp. 36–38). The modelling found that a system-wide restriction would provide more flexibility than the facility-level cap but would still constrain access to offsite abatement.

The review should directly target barriers to efficient long-term abatement, for example uncertainties that weaken incentives to invest. A range of global and domestic uncertainties can affect expectations about future carbon prices and reduce the bankability of abatement investments, which can have payback periods of 5–20 years (EY Net Zero Centre 2026, p. 27). The consultation paper notes that the timing of major investment decisions matters because some facilities may have only one or 2 major investment cycles remaining before 2050 (DCCEEW 2026b, p. 13). If the review finds evidence that uncertainty is discouraging otherwise cost-effective investment, it should target the identified investment barrier while preserving, as far as possible, businesses' flexibility to choose lower-cost sources of abatement. Any adjustments should be assessed against a target-consistent carbon value as a benchmark for cost-effectiveness, and complexity and compliance burden should also be taken into account (PC 2025a, pp. 30–35; PC 2025b, 33–55).

Issues around ACCU methodologies and crediting, for example around 25-year crediting periods (CCA 2026, pp. 14, 34–35), should ideally be addressed directly through the ACCU framework, for example, by addressing risk of reversal buffer, as has been recommended by the CCA (2023, p. 42).

Broaden coverage to unlock lower-cost abatement

Broadening the Safeguard Mechanism would extend emissions reduction incentives to more facilities and bring additional low-cost abatement into the scheme. The PC has previously recommended that the Australian Government lower the current 100,000 tonne coverage threshold (2025a, p. 21). Modelling commissioned for that inquiry found that lowering the threshold to 25,000 tonnes, while holding the aggregate abatement task constant, could reduce average annual abatement costs by about 10% over 2031–35, with estimated gross benefits of about \$914 million (PC 2025a, pp. 18–20). By 2035, the average cost of achieving the same abatement volume would be 27% lower than under the reference case (RepuTex Energy 2025, p. 22).

Lowering the threshold and bringing more facilities into the scheme would create additional administrative and compliance costs. The PC's earlier estimate of \$914 million in benefits from lowering the threshold to 25,000 tonnes was a gross estimate and did not deduct these costs. Facilities emitting over 25,000 tonnes are already generally subject to NGER reporting requirements, which may limit some of the incremental costs of lowering the threshold to that level (PC 2025a, pp. 19–20). We welcome the review's focus on additional administrative and compliance costs and note consultation with industry can refine these assessments so they can be weighed against the benefits of bringing more low-cost abatement opportunities into the scheme.

The PC's previous modelling supports lowering the Safeguard Mechanism threshold, although it does not establish that 25,000 tonnes is necessarily the optimal threshold. A staged reduction would allow experience at progressively lower thresholds to inform subsequent changes. Any future threshold trajectory should be announced sufficiently in advance for affected businesses to incorporate it into their investment decisions.

Broadening coverage can reduce the cost of meeting a given Safeguard emissions reduction task by bringing additional lower-cost abatement opportunities into the scheme. A separate question is how much of the national emissions reduction task should be allocated to the Safeguard Mechanism. In

setting the post-2030 trajectory, the Government should have regard to evidence about the cost of emissions reductions available across the economy.

The consultation paper proposes continuing to base the Safeguard Mechanism's contribution to the national emissions reduction task on the share of national emissions accounted for by Safeguard facilities (DCCEEW 2026b, p. 40). This provides a transparent basis for allocating the task. However, the efficiency of this approach depends on the relative cost of emissions reductions available across the economy. Target-consistent carbon values could provide a benchmark for calibrating the Safeguard Mechanism's post-2030 settings against the marginal cost of emissions reductions needed to meet Australia's targets (PC 2025a, pp. 30–32).

Progressively introduce a border carbon adjustment and remove overlapping assistance

The PC supports introducing the border carbon adjustment recommended by the Carbon Leakage Review. The proposal aligns with the PC's approach to addressing carbon leakage: an adjustment should mirror the effective carbon liability faced by equivalent domestic production, account for explicit carbon prices paid overseas and avoid becoming a form of industry protection (PC 2024, pp. 3–4). Consistent with the PC's emphasis on evidence-based assessment of carbon leakage risks, the adjustment should initially be limited to cement and clinker, which the Carbon Leakage Review identified as most suitable for initial coverage following its assessment of leakage risks and implementation feasibility (DCCEEW 2025, pp. 19, 71–78).

Trade-exposed baseline-adjusted treatment should be removed in tandem with the introduction of a border carbon adjustment to maintain trade neutrality, consistent with the PC's previous recommendation and the Carbon Leakage Review (PC 2024, p. 4; DCCEEW 2025, p. 19). A border carbon adjustment would address carbon leakage risk more directly by applying to imports a carbon liability equivalent to that faced by domestic producers, removing the rationale for reducing the Safeguard obligations faced by domestic producers.

References

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