



**CARBON MARKET**  
INSTITUTE

**Submission to the Climate Change Authority's Special Review Second Draft  
Report on Australia's Climate Policy Options**

**Carbon Market Institute**

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## **ABOUT THE CARBON MARKET INSTITUTE**

The Carbon Market Institute (CMI) is an independent membership-based not-for-profit organisation. Our aim is to assist Australian businesses in meeting the challenges and opportunities associated with market-based approaches to emissions reduction and the transition to a low carbon economy.

As the peak body for carbon market participants, CMI has established an important role in the evolution of climate policy and the carbon market in Australia. The Institute facilitates the networks, knowledge exchange and commercial interaction amongst key government policy makers and regulators, industry, financiers and investors, professional services companies and technology solution providers.

CMI membership represents a broad range of professionals, organisations and industry. Our members include leading professional service providers, large energy users, carbon offset providers, academia and international organisations. Individuals within the CMI membership base are some of Australia's most respected carbon market innovators and leaders.

## EXECUTIVE SUMMARY

### Introduction

The signing of the Paris Agreement in December 2015 has set the framework for the downward trajectory of global emissions. All 196 countries who are parties to the United Nations Framework Convention on Climate Change and signatories to the Agreement will need to implement policy options to reduce their emissions in line with their targets and transition their economies to the low carbon future toward which the world is heading. Over 180 countries through their Intended Nationally Determined Contributions outlined their emissions reduction plans and the policy levers and complementary measures to achieve their targets.

Australia's INDC submitted ahead of the Paris COP was a target to reduce emissions by 26-28 per cent on 2005 levels by 2030. With the Paris Agreement committing Parties to review and ratchet up ambition, the emission reduction target is likely to get greater over the next decade. The Australian Government has implemented a number of core policy options, such as Emissions Reduction Fund and safeguard mechanism, as well as indicating that it plans to introduce a range of additional measures to meet the cuts to emissions required in the post-2020 period.

The challenge now is for the Australia Government to consider how our economy will continue to grow in a two-degree world to be founded on the Paris Agreement and look to implement a suite of policies, including market-based mechanisms, to reduce emissions, facilitate economic growth and set a stable and predictable landscape for business into the future.

### CMI's submission

CMI's submission on the policy options to meet Australia's 2030 emissions reduction target of 26-28 per cent below 2005 levels builds on earlier consultations with CMI members and submissions on the setting of Australia's post-2020 emissions reduction target and the design of policy options such as the Emissions Reduction Fund and safeguard mechanism.

CMI recognises it has a diverse membership base and while the submission reflects the broad view of members, no comments or viewpoints are attributed to any individual or organisation.

### Overarching principles which should underpin the setting of Australia's climate policy options:

- **Australia's short and long term domestic climate policy settings should be designed and implemented with the overarching goal of meeting obligations committed to in the Paris Agreement and setting Australia on the pathway to a zero net emissions economy.**
- **A suite of complementary emissions reductions policies are required to meet Australia's 2030 emissions reduction target outlined in its INDC.**
- **The Paris Agreement highlights the role of carbon markets and a new sustainable development market mechanism will be established to help in international efforts to meet emissions reduction targets.**
- **A market based mechanism is the most cost effective means to meeting Australia's increasing emissions reduction task.**
- **The international and domestic business communities have voiced strong support for a carbon price and market-based mechanisms to meet emissions reductions targets at least cost.**
- **It is important to maintain a well-designed, well governed domestic offsets industry.**

- **Australia’s climate policies should be aligned with key international trading partners in order to enhance and capitalise on emerging economic opportunities as well as avoid any negative economic implications.**
- **To cost effectively meet current and future targets, the safeguard mechanism should evolve into the primary means of limiting emissions growth across the economy.**
- **Bipartisan agreement on climate policy is essential so that industry, the market and providers of capital can invest in emissions reductions with an increased level of certainty.**

## CONSIDERATIONS IN THE DEVELOPMENT OF POLICY OPTIONS TO MEET AUSTRALIA'S POST-2020 EMISSIONS REDUCTION TARGET

- **Australia's short and long term domestic climate policy settings should be designed and implemented with the overarching goal of meeting obligations committed to in the Paris Agreement and setting Australia on the pathway to a zero net emissions economy.**

Inherent in Australia setting a 2030 emissions reduction target through its Intended Nationally Determined Contribution (INDC) in the lead up to the United Nations Framework Convention on Climate Change (UNFCCC) 21st Conference of the Parties (COP21) in Paris in December 2015, is the opportunity to set in motion the process for shaping enduring domestic policy to effectively limit emissions growth across the Australian economy. This opportunity and the need for an effective and enduring policy suite is even more apparent as Australia delivers on its commitments under the Paris Agreement. Developing enduring policy mechanisms is not only consistent with achieving the 2030 target, but it is also conducive to achieving a stable and predictable policy landscape to provide long term clarity and certainty to allow decision making and investment by business. The policy measures adopted also have a major influence on the costs and benefits associated with reducing emissions<sup>1</sup>.

The agreement signed in Paris has set the framework for the downward global emissions trajectory. Currently, Australia's INDC stipulates that the Emissions Reduction Fund (ERF) is the primary mechanism to achieve 2030 emissions reduction targets. In order for Australia to meet these targets in the most cost effective way, the focus must shift quickly from the ERF auctions to the safeguard mechanism. The thresholds for coverage and safeguard mechanism baselines have been set at generous levels to start with in July 2016. However, for the safeguard mechanism to make a meaningful contribution to emissions reduction, baselines will need to decline.<sup>2</sup> The 2017 review of Australian climate policy needs to identify the conditions and criteria as to how baselines will be adjusted and at what point they will pivot to start to give covered entities a material liability. Under the right settings, with effective baselines that drive ever increasing emissions reductions, the safeguard mechanism can evolve to become the primary means of limiting emissions growth across the economy and, combined with complementary policies, create an effective policy suite to aim for zero net emissions over the long term.

- **A suite of complementary emissions reductions policies are required to meet Australia's 2030 emissions reduction target outlined in its INDC.**

In the lead up to COP21 in December 2015, 196 countries submitted INDCs outlining their commitments to reduce emissions in the post-2020 period. In their INDCs, countries also outlined their broader suite of emissions reduction policies, both those already implemented and those under development. What is most apparent is that all countries are looking to implement a combination of policies in order to reach their targets.

Every major economy is adopting a suite of policies to limit emissions growth. While market-based mechanisms to price carbon are the primary instrument in many of Australian key trading partners,

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<sup>1</sup> Australia's future emissions reduction targets, Special Review. Draft Report, April 2015. Climate Change Authority, Australian Government.

<sup>2</sup> Castellás, P (2016) A New Era for the Global Economy, Ecogeneration, pp 16

such as China (from 2017), the European Union, Republic of Korea, and New Zealand, a comprehensive suite of complementary policies, both market and non-market-based, are necessary to deliver emissions reductions at lowest cost. Complementary policies include renewable energy targets, tax incentives for improved energy efficiency and fuel economy and electricity generation emissions standards<sup>3</sup>. For example, in addition to the EU Emissions Trading Scheme (ETS), in 2014 EU member states created a 'Framework for 2030', including at least 40 per cent domestic greenhouse gas emissions reductions below 1990 levels by 2030, a renewable energy target of 27 per cent and an energy savings target of 27 per cent<sup>4</sup>. Japan has ambitious feed-in tariffs with rates of between 19 and 46 c/kWh, with differentiated tariffs for solar, wind, hydro, geothermal and biomass. Japan's Basic Energy Plan indicates a goal of 20 per cent renewable by 2030<sup>5</sup>. India has included targets to lower their emissions intensity of GDP by 33 to 35 per cent below 2005 levels by 2030 as well as increasing the share renewable based power generation capacity to 40 per cent of installed electric power capacity over the same period<sup>6</sup>. China has implemented significant policies to address climate change, including recently aiming to restrict coal consumption by 160 million tonnes in the next five years.<sup>7</sup>

The need for a suite of policies was supported in the final report of the UNFCCC Taskforce: *Setting Australia's Post-2020 Target for Reducing Greenhouse Gas Emissions*, and will be required to meet Australia's increasing emissions reduction challenge. While a market-based mechanism is the most cost-effective primary instrument to reduce Australia's emissions, a combination of policy instruments supporting this primary mechanism will enable us to meet our emissions reduction targets. Australian business has indicated strong support for a cap-and-trade ETS according to CMI's Australian Emissions Reduction Survey 2015 (74 per cent of respondents). Other policies viewed as important by Australian business include a renewable energy target (RET), standards for energy efficiency and industrial processes, vehicle emissions standards and emissions limits on power stations (Fig. 1).

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<sup>3</sup> Reducing Australia's Greenhouse Gas Emissions - Targets and Progress Review. Climate Change Authority, Australian Government. February 2014.

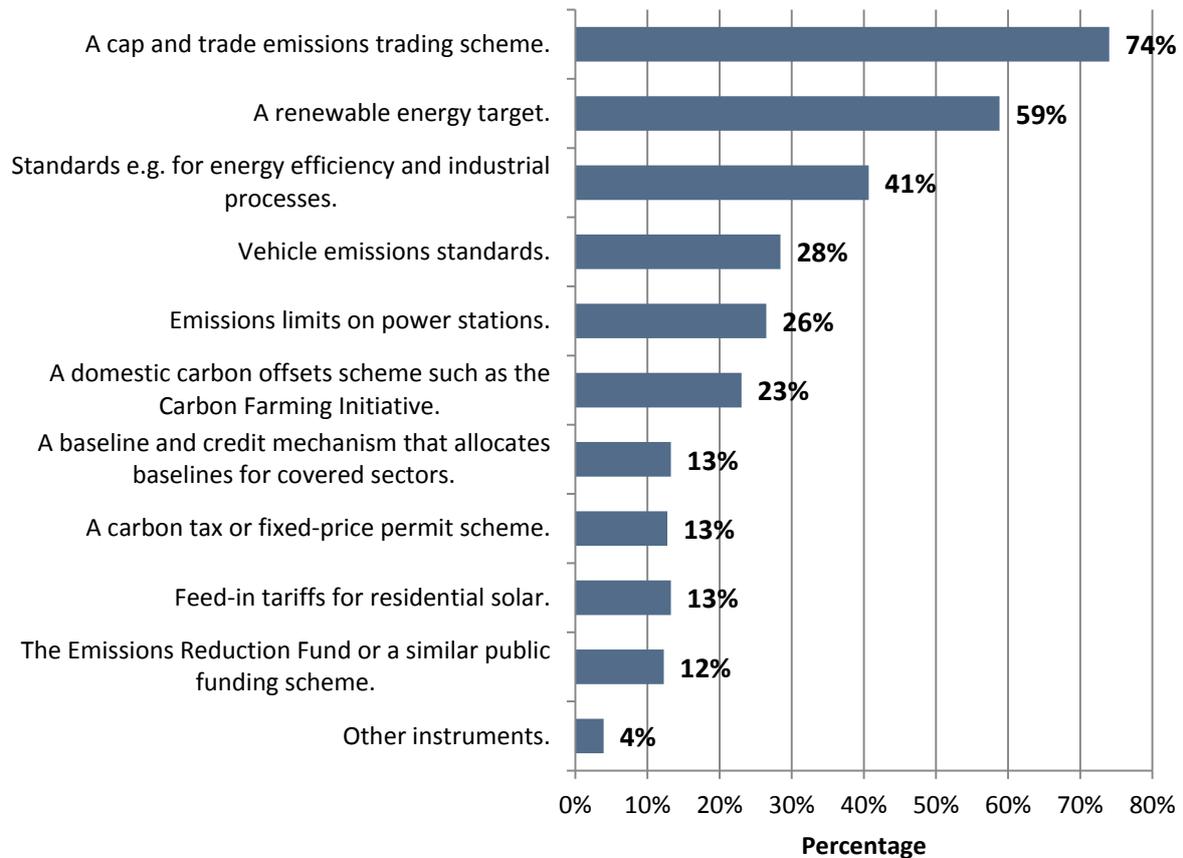
<sup>4</sup> Climate Action Tracker (2016) European Union, Tracking INDCs, <http://climateactiontracker.org/countries/eu.html>

<sup>5</sup> Climate Action Tracker (2016) Japan, Tracking INDCs, <http://climateactiontracker.org/countries/japan.html>

<sup>6</sup> Climate Action Tracker (2016) India, Tracking INDCs, <http://climateactiontracker.org/indcs.html>

<sup>7</sup> Climate Action Tracker (2016) China, Tracking INDCs, <http://climateactiontracker.org/countries/China.html>

**What are the most effective policy instruments or mix of instruments that Australia should have for reducing GHG emissions?**



**Figure 1 - Australian business views on the mix of emissions reduction policy instruments. Source: Australian Emissions Reduction Survey 2015.**

- **The Paris Agreement highlights the role of carbon markets and a new sustainable development market mechanism will be established to help in international efforts to meet emissions reduction targets<sup>8</sup>.**

The Paris Agreement highlights the role of carbon markets in international efforts to meet emissions reduction goals through a new mechanism to support sustainable development. As the Australian Government has now signalled strongly that we will likely have international units as part of our mix to meet UNFCCC obligations, harmonisation of market mechanisms will be critical. The new rules of the post 2020 global carbon market will be set over the next few years. How the rules are set and the framework adopted will be directly relevant to all Australian companies that will have a liability under a compliance market (the safeguard mechanism or an another form of an ETS) and want to participate in an international carbon market. If the Australian government is proactive, the way the rules are designed could also potentially open the door for the export of domestically generated credits into other emission trading schemes. The design features should maintain a line of sight to our 2030 targets and the international fungibility of Australian Carbon Credit Units (ACCUs) so as to

<sup>8</sup> UNFCCC Paris Agreement, 12 December 2015, adopted at the 21<sup>st</sup> Conference of the Parties. Paris, France, 30 November to 11 December 2015.

enable linkages with other markets to be developed over time. It is important that as this new market is designed, the private sector has a seat at the table and is on the front foot.

- **A market based mechanism is the most cost effective means to meeting Australia’s increasing emissions reduction task**

A market-based mechanism represents the most cost-effective policy option to meet Australia’s ongoing emissions reduction task, including the 2030 target and any future goals. Market-based mechanisms allow the greatest reduction in emissions at the least cost and are crucial to efficient carbon price discovery. A market-based approach can stimulate early innovative action to meet emissions reduction targets<sup>9</sup>, allowing them to be achieved at least cost to the economy. Crucially, caps or limits on emissions under a market-based mechanism can be adjusted to meet current and future abatement targets.

Moving sooner to a market-based system, an effective safeguard mechanism or a revised form of cap-and-trade in conjunction with the ERF and other supporting policies will enable Australian businesses to meet their own emissions reduction goals and support the transition from predominantly public to private sector funding of abatement. A well designed market mechanism can help liable entities captures under the scheme meet compliance costs more efficiently, harmonise with key trading partners, stimulate domestic investment and position Australia competitively in the transition to a low carbon economy which is underway.

Market-based mechanisms to price carbon are the primary instrument in many of Australia’s key trading partners such as the EU, the Republic of Korea , China (from 2017), New Zealand and in parts of the US and Canada (e.g. California and Quebec).

- **The international and domestic business communities have voiced strong support for a carbon price and market-based mechanisms to meet emissions reductions targets at least cost.**

In the lead up to COP21, in May 2015 at the Business & Climate Summit, 25 global business networks representing more than 6.5 million companies called for “robust and effective carbon pricing mechanisms as a key component to gear investment and orient consumer behaviour towards low carbon solutions and achieve global net emissions reduction at least economic costs”<sup>10</sup>. During the Paris talks, global business support for market-based mechanisms was clear with the CEO’s of 78 major global companies calling on world leaders to include carbon pricing in a global climate deal.<sup>11</sup>

Globally, approximately 450 companies were reported to be using an internal shadow carbon price in assessing their investments in 2015, an increase from 150 companies in 2014.<sup>12</sup> Many are also

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<sup>9</sup> World Bank, Projects and Operations, Pricing Carbon, <http://www.worldbank.org/en/programs/pricing-carbon>.

<sup>10</sup> Rydge, J., 2015. Implementing Effective Carbon Pricing. Contributing paper for Seizing the Global Opportunity: Partnerships for Better Growth and a Better Climate. New Climate Economy, London and Washington, DC. Available at: <http://newclimateeconomy.report/misc/working-papers/>.

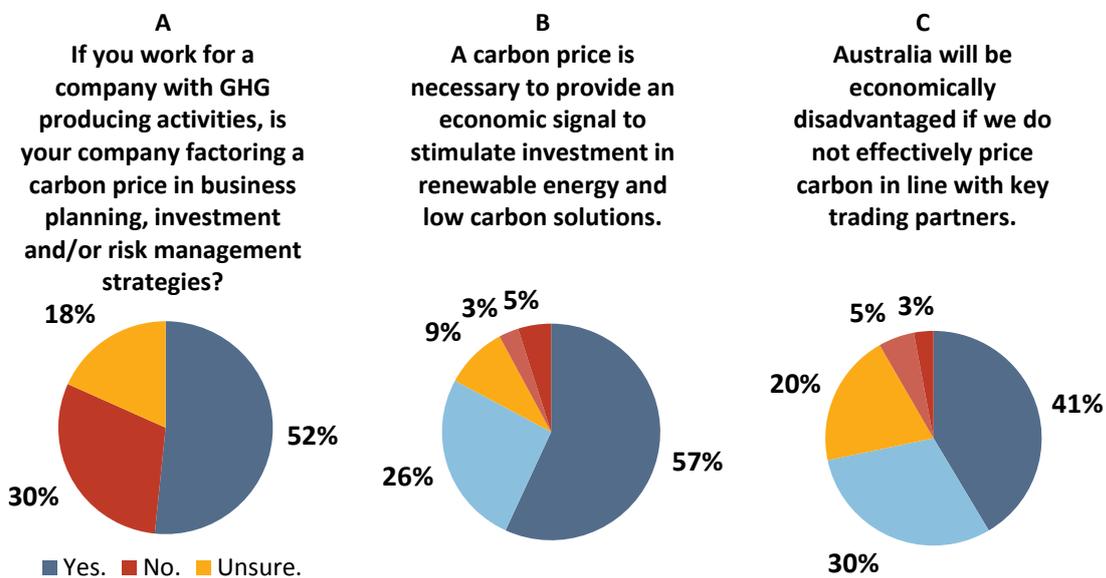
<sup>11</sup> 2015, CEOs of 78 major firms call for carbon pricing COP21 deal, Climate Action, UNEP, November 2015

<sup>12</sup> Rydge, J., 2015. Implementing Effective Carbon Pricing. Contributing paper for Seizing the Global Opportunity: Partnerships for Better Growth and a Better Climate. New Climate Economy, London and Washington, DC. Available at: <http://newclimateeconomy.report/misc/working-papers/>.

using a carbon price to prepare for regulation, which is in place or considered to be imminent in many jurisdictions<sup>13</sup>.

Reflecting international support for carbon pricing, Australian business continues to recognise the role of carbon pricing and an increasing number of companies are factoring in a carbon price in investment decisions. In CMI’s recent Australian Emissions Reduction Survey 2015, the majority (52 per cent) of companies who conduct greenhouse gas producing activities indicated they factor in a carbon price in business planning, investment and risk management strategies (Fig. 2, A). This was a noticeable increase from 39 per cent in 2014. A carbon price was viewed by 83 per cent of survey respondents as necessary to stimulate investment in renewable energy and low carbon solutions (Fig.2, B).

Corporate awareness of the importance of carbon pricing was also reflected strongly in terms of the implications for Australia internationally, with 71 per cent of businesses strongly agreeing or agreeing that Australia will be economically disadvantaged if we do not price carbon in line with key trading partners (Fig. 2, C).



**Figure 2 - Australian business views on the mix of emissions reduction policy instruments. Source: Australian Emissions Reduction Survey 2015.**

- **It is important to maintain a well-designed, well governed domestic offsets industry.**

The 92 million tonnes of abatement contracted under the ERF will make an important contribution to Australia’s emissions reduction task, with additional abatement purchased through further auctions adding to this contribution. The ERF has provided an important source of funding to support the domestic offsets industry, with \$1.2 billion allocated through the first and second auctions in the transition from the Carbon Farming Initiative. However, for the domestic offset industry to survive the ERF will need additional funds to continue to fund abatement and new demand drivers from the compliance obligations under the safeguard mechanism will need to be sufficient to warrant investment in carbon abatement projects.

<sup>13</sup> Global corporate use of carbon pricing. Disclosure to investors. CDP, March 2014.

The investment in domestic abatement through the ERF should continue to provide an opportunity for domestic offsets to be generated and traded in the primary and secondary markets established under the scheme and potentially traded internationally.

While the ERF has made an important contribution to the emissions reduction task to date, limiting emissions growth in the period 2020 to 2030 also needs to be considered as a central part of Australia's policy framework. If the crediting and purchasing elements of the ERF continue as the primary basis for reducing emissions beyond 2020, the call on the Government budget may increase to unsustainable levels. Therefore the transition to a market-based mechanism, using the safeguard mechanism or other market-based approaches, will be necessary to defray the ongoing, indefinite public cost of funding emission reductions.

- **Australia's climate policies should be aligned with key international trading partners in order to enhance and capitalise on emerging economic opportunities as well as avoid any negative economic implications.**

International agreements and targets have a major bearing on the development of domestic policy. The position Australia takes in the international effort to mitigate climate change through our 2030 target and domestic policy suite will have major economic implications. These implications will be further compounded by the effects of climate policy developments in other countries on Australian business trade, investment and export markets. Aligning our policy settings with international trends will enable Australia to capitalise on emerging economic opportunities and avoid risking negative consequences economic consequences<sup>14</sup>.

The global transition to a low carbon economy will have increasingly significant consequences for Australia's economy. It is crucial that as a nation we set appropriate policies which align with the international community. Internationally, competition for low carbon development has gained significant momentum in the lead up to, and post Paris. It has injected the US and China relationship with a new vitality, and the EU, India, Japan and Korea have all signalled their intentions to actively participate in scaling up the global deployment of low carbon solutions.<sup>15</sup> The evolution of domestic policy and business in the face of global climate change is critical in ensuring Australia's economy capitalises on a series of new economic opportunities. The competitiveness of certain industries will continue to be affected throughout this transition, however it is clear that Australia must create the platform for innovation and structural reform if business is to capitalise on the many opportunities and avoid the potential economic risks of failing to act in concert with other key trading partners.

In a recent survey of 219 major Australian companies undertaken by CMI, 79 per cent of respondents were of the view that Australia risks adverse implications for trade and investment if emissions reduction targets are not aligned with our key trading partners<sup>16</sup>. In addition, Australian business indicated the key trading partners to which Australia should look when calibrating emissions reduction targets are the United States, the EU and China (Fig 3).

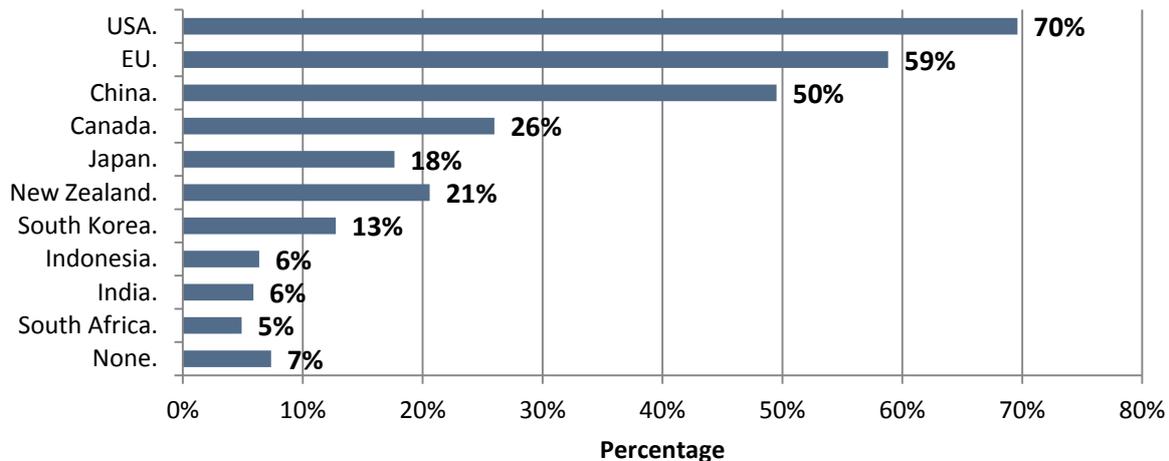
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<sup>14</sup> 2015 Australian Emissions Reduction Survey, Carbon Market Institute

<sup>15</sup> Castellas, P (2016) A New Era for the Global Economy, Ecogeneration, pp 18

<sup>16</sup> 2015 Australian Emissions Reduction Survey, Carbon Market Institute

**To which countries or regions should Australia look to in calibrating emissions reduction targets and actions?**



**Figure 3 - Australian business views on which countries or regions Australia should look toward in calibrating emissions reduction targets and actions. Source: Australian Emissions Reduction Survey 2015.**

- **To cost effectively meet current and future targets, the safeguard mechanism should evolve into the primary means of limiting emissions growth across the economy.**

The safeguard mechanism will assume an increasingly important role in enabling Australia to meet its emissions reduction targets in the most cost effective way. Cost effective emissions reduction will become increasingly important as the target pledge and review system within the Paris Agreement may mean Australia’s targets become more onerous over time.

For the safeguard mechanism to be an effective means of limiting emissions growth across the economy, focus must shift to how baselines will decline.<sup>17</sup> The 2017 review of the safeguard mechanism and broader current Australian climate policy needs to identify the conditions and criteria as to how and when baselines will be adjusted to give covered entities a material liability. Proving detail on the criteria or factors which may be considered in adjusting baselines in the post-2020 period will provide business with greater certainty on possible future compliance obligations. By providing a clearer picture of factors that will influence the future trajectory of baseline adjustments, business may be more incentivised now to make investments in emissions reduction and carbon abatement activities ahead of any potential liability.

- **Bipartisan agreement on climate policy is essential so that industry, the market and providers of capital can invest in emissions reductions with an increased level of certainty.**

It is critical that the design of Australia’s emissions reduction policy suite has bipartisan support so that industry, the market and investors can implement emissions reductions with an increased level of certainty. This elevates the need for Australia to undertake a mature bipartisan debate about the policy suite required to meet our 2030 emissions reduction target. Bipartisanship on the

<sup>17</sup> Castellás, P (2016) A New Era for the Global Economy, Ecogeneration, pp 16

fundamental principles of climate change policy is required to frame and implement our policy response most effectively and efficiently.



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