Key Tests for an Australian Emissions Trading Scheme

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The Climate Challenge

Australia's greenhouse gas emissions are rising. Government, business and the public have committed to take action to stop this. The task now before us is turn down Australia's emissions trajectory as quickly as possible - and then to become global leaders in tackling climate change.

Australia's reduction targets must be based on the best available science and aim to avoid the worst impacts of climate change. This means that the (now inevitable) global warming must be kept as far below 2ºC as possible. To give us the best chance of achieving this, greenhouse gas concentrations in the atmosphere must be stabilised at or below 400 parts per million of CO_2 equivalence.

Australia must do its fair share to achieve global stabilisation of the climate. The IPCC has identified that to keep warming between 2ºC and 2.4ºC developed countries emissions must peak by 2010 and then fall 25 to 40% below 1990 levels by 2020. This was recognised by the Australian Government at the United Nations' Climate Change Conference in Bali in December 2007. If we are to keep warming at a safe level, as far below 2ºC as possible, then Australia must aim for at least the top end of this range, and we need the IPCC to identify new below 2ºC pathways.

Robust Scheme Design is Essential

A robust carbon price signal will place a cost on emissions and assist Australia's economy to move to a low emissions future. Australian business has signalled its preference for a carbon price signal to be provided through a cap and trade emissions trading scheme, rather than a carbon tax. The Australian Government has committed to introducing an emissions trading scheme by 2010, with the design to be finalised by the end of this year.

We will support the introduction of an Australian emissions trading scheme, but only if it is designed to effectively, efficiently and equitably achieve significant reductions in greenhouse gas emissions.

A number of key tests must be met to do this.

Additional Measures will be Required

After over more than a decade of delay and rising emissions, Australia needs to show that it is serious about making significant near term emission reductions. An emissions trading scheme will not, in the short term, achieve the necessary emissions reductions on its own. It is a medium to long term measure because the price signal will not be high enough to drive large-scale, short term reductions.

To achieve deep cuts rapidly, a suite of complementary measures are necessary including a strong renewable energy target, energy efficiency measures, deployment at commercial scale of low emission technologies, and direct regulation (e.g. to stop land clearing and improve appliance, equipment and building efficiencies). Every sector must assume responsibility for its fair share of reductions. If one sector is exempted, then other sectors will have to bear the costs of meeting the exempted sectors' shortfall.

1 Emissions Trading Scheme Target

> The caps under the emissions trading scheme must be consistent with reducing national emissions by at least 25 to 40% cuts by 2020 (compared to 1990 levels) taking into account any exemptions for non-covered sectors.

> There must be a long-term, science-based emissions reduction target with which short-term targets are consistent.

> The legislation needs to ensure there are periodic reviews of the effectiveness of the scheme and that targets can be tightened in response to new evidence in climate science dictates. Periodic reviews should not allow targets to be weakened for financial or political reasons.

> The implementing legislation must include the emissions trading scheme reduction targets.

2 Timing

> The emissions trading scheme must start no later than 1 July 2010.

> The emissions trading scheme legislation must be passed in the first parliamentary session of 2009.

3 Permit Allocation

> The fairest, most economically efficient and transparent approach is for 100% of permits to be auctioned from the outset of the emissions trading scheme.

> No permits should be given away for free.

> Revenue from permit auctions should be used to support the deployment of climate change solutions and minimise the impact of climate change on those most affected. This should include:

< Renewable energy research, commercialisation and deployment.

- < Assistance for low-income households to improve energy efficiency and minimise the impact of any increase in energy costs.
- < Contributing to international adaptation financing for least developed countries.
- < Land stewardship payments to reduce land-based emissions.
- < Addressing other market failures in areas such as energy efficiency.
- < Providing adjustment measures to assist the most adversely affected communities and workers.

4 Adjustment Measures for Trade-Exposed Energy-Intensive Industries and Their Workers

- > The need for any adjustment assistance should be subject to a rigorous, transparent assessment process and take into account any existing subsidies or favourable tax treatment.
- > To avoid market distortions and "windfall gains", free permits should not be given away or "grandfathered" to trade-exposed energy-intensive industries. Any adjustment assistance should be separated from the emissions trading scheme system.
- > Border tax adjustments are a more equitable, effective and transparent method of avoiding leakage of emissions internationally than free allocation of permits.
- > Any adjustment assistance should be conditional on the industry funding and participating in a long term, low carbon transition plan. Industries such as aluminium smelting must plan to move away from their reliance on coal-fired power in the near future.
- > Any adjustment assistance should only be available until international competitors face similar carbon constraints.
- > Non-trade-exposed industries should not receive any compensation for reduced profits or asset value due to carbon pricing, but we do believe that adjustment assistance for affected communities and workers is necessary.

5 Coverage

- > The emissions trading scheme should cover all major emissions sources for which it is practical to measure emissions with the accuracy needed to support a robust emissions trading scheme. At least 70% of Australia's emissions should be covered.
- > Currently only agriculture, land use and forestry should be excluded due to a lack of robust measurement. These sectors may be covered in the future, however complementary measures will be required urgently to begin reducing emissions from these sectors. Every sector must do its fair share to reach the national reduction target.
- > Complementary measures will be needed in both covered and non-covered sectors to maximise emission reduction efficiencies and the speed at which reductions are initiated.

6 Penalties and safety valves

- > The penalty rate must be set to encourage compliance, be well above the anticipated market price of permits and increase over time. The EU emissions trading scheme rate of ¤100 per tonne CO_2-e, with make good provisions, provides a benchmark.
- > The penalty rate should not be used as a safety valve. Inclusion of a safety valve would automatically exclude trade with the European ETS, the world's biggest ETS. To preserve the environmental integrity of the emissions trading scheme, a make-good provision is required in addition to a penalty for any emissions incurred without surrender of sufficient permits.
- > Banking of permits for future use should be allowed, but to prevent erosion of environmental effectiveness, borrowing must not be allowed (and to ensure we do our fair share of work now, and don't postpone action for future generations to deal with).

7 International Links and Offsets

- > The large majority of effort should be directed at reducing Australia's domestic emissions by at least the top end of the 25 to 40% target. There should be limits to the amount and type of credits allowed, or if more credits are to be allowed the targets should be increased commensurately.
- > The Australian scheme should allow linkage to Kyoto Protocol compliant carbon markets and the Protocol's flexibility mechanisms. Limits on the amount and type of these credits allowed into Australia's emissions trading market will need to be considered.
- > Rules are needed to ensure any credits accepted into the Australian emissions trading scheme from the Kyoto Protocol flexibility mechanisms are from high quality sources that achieve permanent and additional abatement. As a minimum Clean Development Mechanism credits must be required to meet the CDM Gold Standard, and the Australian emissions trading scheme must disallow "hot air".
- > "Credits" should be limited to those generated by Kyoto Protocol flexibility mechanisms. Incentives for tree-planting and other forms of land-use based sequestration can be increased with alternative policies such as land stewardship payments outside of the emissions trading scheme.

8 Governance

- > There must be a separation of powers and governance arrangements between those who set the direction of the emissions trading scheme, make the rules, enforce the rules and assess whether they are working.
- > An independent regulator should be established with sufficient powers to ensure the emissions trading scheme rules are enforced, audits are conducted and penalties paid.
- > Greenhouse gas emissions data, permits surrendered and any shortfall should be made available to the public through a central registry. This provides transparency and will assist in engendering the market and public confidence fundamental for the effective operation of the emissions trading scheme. It will ensure that important information about facilities and emissions are available to potential purchasers and financiers.