EMISSIONS TRADING SCHEME DISCUSSION PAPER

NFF SUBMISSION

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Introduction

The NFF welcomes the opportunity to provide comments on the Garnaut Climate Change Review’s Emissions Trading Scheme Discussion Paper.

The NFF agrees that climate change is a global issue requiring global solutions and hopes that the domestic policy response to mitigating emissions will be designed in this context. While it is crucial to get the policy settings right at home, we agree that ultimately, it is what happens globally that will make all the difference. This is especially true for Australian agriculture which is intrinsically exposed to the global marketplace.

To this end we would reinforce the Professor Garnaut’s previous statement that Australian agriculture emits less than other developed countries. Therefore it is in the best interests of the global community to see more of the world’s agricultural production needs met from countries like Australia, where modern farmers are implementing cutting edge technologies and greenhouse efficient farm systems. The introduction of poor or ill-informed domestic policies on ETS design that result in production moving off-shore in sectors where Australia is both energy and economically efficient, like agriculture, would be disastrous and would only add to the overall global carbon footprint.

Likewise, the NFF must reinforce that the costs of an ETS and other domestic policy responses to mitigate greenhouse gases must be distributed fairly across the Australian community. This principle must apply to sectors and communities regardless of whether they are covered under the ETS. This is crucial for agriculture which currently faces practical limitations for coverage in an ETS in areas such as measurability and transaction costs. Farmers, as price takers in the marketplace, are extremely vulnerable to increasing costs that may result from the implementation of an ETS – even as an uncovered sector.

Using Australian Bureau of Agriculture and Resource Economics data, approximately a third of total broad acre farming input costs are energy dependant. This includes direct costs such as fuel and electricity, as well as other energy dependent farm costs such as freight, fertilizers and crop contracting. This figure increases to a substantial 45% of input costs for cropping operations.

In the context of the current global shortage of food stocks, Australian farmers must not be forced into a position whereby the only way that they can meet their liabilities under an ETS is by reducing production. Government must ensure that the design of the ETS and transitional policies that incentivise Australian farmers to continue to make an equitable contribution to reducing greenhouse gas emissions do not inhibit the future expansion of agricultural production. It will be equally important that strong market signals are given to producers to invest in technologies and adopt practices that enable both the increase of production capacity while delivering a lower intensity of emissions per unit of agricultural output. Increased R&D
capacity, delivered in a partnership arrangement between Government and industry, will play a key role in achieving this outcome. Australian farmers are willing and able to play their part, however we need strong and sensible policies that will enable us to do so. Meanwhile we will continue to provide competitively priced, high quality and environmentally sustainable food and fibre – not only for Australian consumers but for millions of people across the globe.

The NFF looks to the Final Garnaut Report to offer appropriate ETS design solutions and additional transitory policy mechanisms which recognize the net carbon footprint of various farming systems rather than emissions alone. This will treat Australian agriculture on an equitable basis in the climate change challenge.

**ETS design recommendations**

Appropriate ETS design is vital to ensure that the ETS will not have a perverse impact on Australian agricultural productivity, broader environmental issues and regional communities. The potential for ‘leakage’ to the detriment of the global environment is significant, particularly taking into account the fact that Australian agriculture is a low intensity emitter of greenhouse gases.

**Agriculture coverage within the ETS**

The NFF notes that the Garnaut ETS Discussion Paper has called for agriculture to be included as a covered sector within the ETS “as soon as practicable”. This acknowledges that there are a number of impracticalities that currently prevent agriculture from equitably and fairly being covered by the ETS. In addition, agriculture has concerns that must be addressed within the context of its ETS coverage, to ensure that perverse outcomes do not emerge post implementation. Impracticalities and concerns include:

- **A lack of demonstrable commercially viable abatement and sequestration options for all agricultural sectors**

- **A lack of accurate, verifiable and cost effective emissions measurement and reporting mechanisms for agriculture** - Reportable emissions for agriculture must be a true reflection of actual emissions. Furthermore, measurement and reporting of emissions must not involve excessive transaction costs. The NFF also notes that the National Carbon Accounting System (NCAS), in its current form, has not been demonstrated to be an appropriate carbon measurement mechanism for agriculture. Industry has concerns that it does not effectively account for the complexities of agricultural land use. Indeed, we must be careful in contemplating any type of ‘rule of thumb’ measure for estimating agricultural emissions that may not take the complexities of the sector’s emissions into account.
- **International greenhouse gas accounting rules do not appropriately reflect the net emissions contribution of agriculture** – International agricultural ETS accounting rules do not appropriately acknowledge the full sequestration function of agricultural production systems. These accounting rules are not appropriate for Australia’s ETS and are adding to misleading interpretations on agriculture’s contribution to global warming. Significant Life Cycle Assessment (LCA) is required to demonstrate agriculture’s real greenhouse gas contribution while acknowledging the wide variation of Australian agricultural systems. Review is also needed of the appropriateness of additionality and permanence rules as they apply to agriculture.

- **The international competitiveness of Australian agricultural production cannot be jeopardized** - Agriculture must have assurances that our export competitiveness will not be placed at risk as a result of the implementation of the ETS. Similarly, import exposed sectors should not be placed at a disadvantage on the domestic market. Compensatory provisions may be necessary to ensure that agriculture does not face such outcomes that lead to disproportionate loss being incurred by the sector. It also must be remembered that even as an uncovered sector, agriculture is significantly exposed to higher energy costs that will emerge following the ETS. The ETS design and supporting policies must also take into account international competitiveness trade exposed, emissions intensive (TEEI) sectors that are uncovered by the ETS. Table 1 below demonstrates the extent of agriculture’s exposure across a range of broad acre sectors.

### Table 1: Energy and energy dependent farm input costs as a proportion of total farm input costs. Averages for 3 years ending 2006 (Source: ABARE 2007)

<table>
<thead>
<tr>
<th>Industry</th>
<th>Energy</th>
<th>Energy-dependent</th>
<th>Crop contracts</th>
<th>Chemicals</th>
<th>Fertilisers</th>
<th>Freight</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Electricity</td>
<td>Fuel and oil</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wheat and cropping</td>
<td>$2.819</td>
<td>$35.942</td>
<td>$12.037</td>
<td>$12.73</td>
<td>$14.50</td>
<td>$5.05</td>
</tr>
<tr>
<td>Subtotal</td>
<td>0.75%</td>
<td>9.51%</td>
<td>3.32%</td>
<td>12.73%</td>
<td>14.50%</td>
<td>5.05%</td>
</tr>
<tr>
<td>Subtotal</td>
<td>0.31%</td>
<td>8.41%</td>
<td>4.64%</td>
<td>7.54%</td>
<td>11.91%</td>
<td>3.70%</td>
</tr>
<tr>
<td>Sheep</td>
<td>$1.818</td>
<td>$10.416</td>
<td>$3.046</td>
<td>$3.682</td>
<td>$12.486</td>
<td>$4.663</td>
</tr>
<tr>
<td>Subtotal</td>
<td>1.17%</td>
<td>8.69%</td>
<td>1.06%</td>
<td>2.40%</td>
<td>8.61%</td>
<td>2.03%</td>
</tr>
<tr>
<td>Beef</td>
<td>$1.318</td>
<td>$13.165</td>
<td>$2.637</td>
<td>$1.501</td>
<td>$7.654</td>
<td>$7.624</td>
</tr>
<tr>
<td>Subtotal</td>
<td>9.79%</td>
<td>5.72%</td>
<td>11.5%</td>
<td>0.78%</td>
<td>3.34%</td>
<td>3.32%</td>
</tr>
<tr>
<td>Sheep beef</td>
<td>$2.082</td>
<td>$12.219</td>
<td>$4.086</td>
<td>$4.442</td>
<td>$16.435</td>
<td>$7.146</td>
</tr>
<tr>
<td>Subtotal</td>
<td>0.94%</td>
<td>5.67%</td>
<td>1.87%</td>
<td>2.03%</td>
<td>7.61%</td>
<td>3.27%</td>
</tr>
<tr>
<td>All broadacre industries</td>
<td>$2.099</td>
<td>$18.951</td>
<td>$9.052</td>
<td>$15.22</td>
<td>$23.753</td>
<td>$9.627</td>
</tr>
<tr>
<td>Subtotal</td>
<td>0.94%</td>
<td>7.54%</td>
<td>2.62%</td>
<td>8.13%</td>
<td>9.81%</td>
<td>3.85%</td>
</tr>
</tbody>
</table>

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• **Proposed ETS emissions caps must reflect a business as usual operating environment while acknowledging agriculture’s previous contribution** – Proposed emissions caps for agriculture must reflect emissions under “normal” seasonal conditions. Furthermore, caps should take into account the significant costs incurred by the farm sector in reducing Australia’s carbon profile through land use change on behalf of the entire community since the 1990’s.

• **On-farm energy reductions and abatement measures must be credited to agriculture** – In order to send effective signals to the farm sector to reduce their on-farm emissions, there must be transparent incentives to encourage farmers and other regional industries to adopt local-scale renewable technologies.

• **The point of obligation for agriculture must have minimal transaction costs while not obscuring market signals**

**Permit allocations**

Australian Agriculture is a trade-exposed sector that is set to incur additional costs from an ETS, even while classified as an uncovered sector. It must be recognised that any additional costs incurred by Australian agriculture from an ETS will not be faced by its major international competitors and the Australian sector is not in a position to pass on the additional costs to global customers due to the highly elastic nature of these markets. Agricultural firms will therefore suffer disproportionate loss as a result of the introduction of an aggregate constraint on Australia’s emissions.

Transitional compensatory provisions for industries such as agriculture may be provided in the form of an up-front, free allocation of permits in recognition of the disproportionate (that is, significantly larger than average) loss of asset value as a result of the introduction of an aggregate constraint on Australia’s emissions. Trade exposed, emissions intensive (TEEI) firms should also receive free permits while their international competitors do not face a comparable carbon constraint.

Failure to ensure that agriculture is provided with transitional compensation on commencement of an ETS will damage the competitiveness of Australian agriculture in its major international markets, result in a disproportionate burden of the ETS being incurred by the agriculture sector and will have a negative impact on the broader Australian economy.

Regarding permit allocations under an ETS, the NFF also reiterates the need to acknowledge prior efforts undertaken by farmers, both voluntarily and due to regulation, that have seen emissions from agriculture, forestry and fishing reduce by 41.7% between 1990 and 2005.

**Offsets**
Without a clear understanding of agriculture’s possible transition to becoming a covered sector, agriculture should be cautious about delivering offsets into the market or carrying out early abatement activities. Farmers face uncertainty on a timeframe of when they will make the transition to becoming a covered sector within the ETS and in doing so require access to their own offset credits. Farm business wanting to account for these credits within their own carbon profile will not be able to do so if these credits have already been sold.

Furthermore, the NFF recognises that, assuming demand for credits remains constant and depending on the target trajectory adopted, the price of carbon may gradually increase should free permit allocations under an ETS be reduced over time. In doing so, this will mean that farmers who sell offset credits into the market while agriculture is an uncovered sector, may later be required to re-purchase those same credits at a higher price at a later time when agriculture becomes a covered sector.

Such complexities regarding agriculture’s transition from being an un-covered to a covered sector are extremely concerning. As a result, the NFF believes that it is prudent for farmers to wait for more clarity about the design and transitional timeframes of the ETS before any direct participation within the offset market can be contemplated.

The NFF also believes that clarity is needed on the life of offset credits delivered to Australia’s ETS, and believes that a defined time period is required covering the validity of the offsets sold into the market. Without certainty on this issue, we believe that farmers may lack incentive to abate prior to commencement of the ETS as they are unsure about the period under which the credits generated will continue to be valid. Furthermore, the capacity to enter and leave the market in response to market signals is vital to ensure food and carbon farming are driven by the market. It will also allow farmers to participate in a secondary market rather than simply providing long term sinks at a price that may bear no relationship with the current market price.

In addition, with the Government indicating its intention for a smooth transition for the economy in terms of initial emission caps, it may be more beneficial for farmers to wait for the carbon price to appreciate before offering their offset credits to the marketplace. Certainty over the legal life of offset credits will therefore help farmers in making their abatement decisions.

**Point of obligation**

The NFF recognises that the point of obligation is a complex issue for agriculture due to the large number of farming enterprises, and the transaction costs involved in monitoring and measuring their emissions.
New Zealand has proposed that their ETS will initially have the processing sector as the point of obligation for agriculture in order to overcome some of these transaction cost issues. However, this assumes that agricultural emissions are a function of output only, without recognising the differences between various farm systems. Having the processing sector as the point of obligation may therefore not encourage farm enterprises to utilise the full range of options to reduce emissions per unit of output. Farmers require this market signal in order to make appropriate adjustments to their farm systems and absence of this signal may exacerbate problems with leakage.¹

Clearly, this generates a dilemma for incorporating the agriculture sector into an ETS for which no clear solution currently exists. However implementation of voluntary, accredited BMP programs for individual agricultural commodity sectors, developed with farmer input, may provide a future mechanism by which such an issue can be managed. Third party audited, environmental quality assurance certification for producers who adopt farming practices that decrease emissions, implemented by downstream supply chain members, could also be a viable mechanism.

**Transitional measures for agriculture**

The NFF recognises that in markets without impediment, an ETS is the most economic way to reduce national greenhouse gas emissions, however this should be viewed as one part of a broad suite of measures. An ETS is not the only instrument available to bring changes to farming systems through establishing positive incentives for reductions in on-farm greenhouse gas emissions. Indeed, due to the issues raised earlier in this submission facing agriculture, it may be significantly more cost effective in the short-to-medium term to implement alternative schemes in partnership with the farm sector that assist in reducing carbon levels in the atmosphere.

Alternative mechanisms that may work effectively in conjunction with the ETS, while helping with transitional issues faced by agriculture, include voluntary Greenhouse Best Management Practice (BMP) adoption programs, environmental quality assurance programs, stewardship programs and grant schemes. Such programs should be industry owned and developed, and may help to ensure maximum uptake of emissions abatement activities by the farm sector as well as assist in the potential transition of agriculture to become a covered sector. Government must consider adoption of not just one, but a range of complementary mechanisms that may help to ensure that the farm sector is not disproportionately affected by the introduction of the ETS.

BMP programs are just one of a number of measures that could be an effective transitional measure to encourage farm business managers to take early action to mitigate emissions during the period when it is deemed impractical to cover agriculture within an ETS. Under such a mechanism, Governments and industry must partner in the development of voluntary greenhouse BMP standards for specific agricultural production systems. Farmer involvement is the development and design of BMP standards is vital in ensuring that proposals are realistic and achievable by all sectors of agriculture and in all regions. The adoption of these BMP standards by farmers would be encouraged by industry organisations, and should be supported by annual payments based on greenhouse and other services delivered as a consequence of BMP adoption. This will also assist in limiting leakage issues within Australian agriculture post ETS implementation. Accredited BMP standards should be progressively refined on a no-regrets basis as new information becomes available. Agricultural greenhouse BMP standards should incorporate recognition of the widest possible range of actions available to farmers to mitigate greenhouse emissions, including management of pastures, soils, farm inputs, livestock, and plant and animal wastes.

The net emission advantages derived from the adoption of greenhouse BMPs will reduce Australia’s annual greenhouse emissions inventory, and reduce the costs associated with the nation meeting its emission target under the Kyoto Protocol. In doing so, the BMP will act as a complementary tool while agriculture is deemed unsuitable for inclusion under a national emissions trading scheme.

To limit international leakage and retain Australian agricultural competitiveness, the NFF recommends that the Greenhouse BMP incorporate an annual payment system that may incorporate the following components;

- A payment for ‘early action’ greenhouse gas sequestration or mitigation based on the volume of emission reduction achieved and the prevailing ‘carbon’ price,
- An emission leakage adjustment payment calculated on the basis of the additional cost impact that Australian greenhouse policies impose on Australian farm input costs, relative to those of major competitors, and

Policy settings that redirect resources away from agricultural production will not be consistent with the world’s ever increasing food demands and the role that Australian agriculture must play in meeting this challenge. Agricultural production delivered under a BMP framework will not only help with the mitigation of global emissions but could also help to improve farmer productivity that will be essential in meeting the world population’s food and fibre needs. With the correct policy parameters, both these critical aims of Government can be achieved.

The NFF does not support a regulatory approach to dealing with climate change. Such practices have been utilised by Australian Governments in the past, through the restrictive regulation of land clearing in order for Australia to meet its Kyoto targets. This regulatory practice has come at significant cost to Australian farmers,
led to numerous perverse outcomes and has created significant limitations to future farm productivity.²

**Conclusion**

The design of the ETS is paramount to ensuring that sectors, such as agriculture, do not incur disproportionate loss and that economic, social and broader environmental issues are taken into account. Providing clear emissions abatement incentives to all sectors in the lead-up to, and following commencement of the ETS is of vital importance and will set precedents for the scheme and how it will operate.

In this regard, we must be careful to not only look at the specific design of the ETS but also look at complementary mechanisms such as Greenhouse BMP’s. Such transitional mechanisms can help industries such as agriculture to make a contribution to mitigating greenhouse gas emissions while it is impracticable for that sector to be covered by the ETS.

The NFF looks forward to engaging in further discussions with the Garnaut Climate Change Review on ETS design.

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