

Friday, 18 April 2008

Garnaut Climate Change Review Secretariat
Level 2, 1 Treasury Place
East Melbourne, Victoria 3002

Submission to ETS Paper

Some limited comments relating to the Garnaut Climate Change Review Emissions Trading Scheme Discussion Paper follow. These comments are provided in a personal capacity.

Benefits of broad coverage of an emissions trading scheme are clear, providing depth and liquidity in the market, and access to low-cost abatement across the economy.

Support for the concept of auctioning of permits across all covered sectors should be provided, with the associated revenue clearly demarcated, over each compliance period, for compensation for social welfare purposes for those adversely affected by inflationary pass-through effects of carbon pricing, and investment in low-emissions measures and technology development.

Carbon credits deriving from project-based abatement from sectors outside the coverage of an emissions trading scheme should be considered for eligibility. Careful note should be made of existing methodologies for those projects, including those developed under the auspices of the Clean Development Mechanism of the Kyoto Protocol. Such methodologies are considered best practice: they are carefully developed, are subject to extensive review by both public and specialists and, ultimately, deemed appropriate by the political governance structures under the United Nations Framework Convention on Climate Change. Should certain methodologies be considered poorly-construed, then appropriate mechanisms exist within the governance framework to amend any deficiencies.

While considering the inclusion of domestic project offset categories, careful note must also be made of the implications of allowing eligibility of project categories that are not universally recognised. Such permissiveness may, as noted in the Discussion Paper, jeopardise the ability to link to other emissions markets. The detrimental effects of this should be seriously considered. This applies, *inter alia*, to Land Use, Land Use Change, and Forestry project categories. However, the importance of LULUCF options of abatement strategies specifically should be heeded, given the potential contribution.

Furthermore, as discussed in the paper, interoperability with white certificate schemes based on energy efficiency abatement downstream should be an active consideration of emissions trading scheme design. One pertinent program currently functions in NSW, while the VEET proposed program in Victoria also focuses on providing incentives for downstream abatement through allocation of permits to energy efficiency measures. Such programs may or may not be tradeable, but consideration of adjusting aggregate 'targets' is important to reflect influence on upstream emissions and, (particularly where any grandfathering of permits might occur) so as to avoid double-counting of abatement.

White certificate trading schemes are typically counter-inflationary through reducing electricity costs to end-users, and may assist in unlocking significant abatement potential through more direct attribution of carbon value to asset owners.

In relation to the international policy context as it pertains to emissions commitments and limitations for the post-2012 period, permissiveness in domestic emissions limits subject to the degree of engagement by other Parties to the Convention is appropriate. However, it is important to balance an appreciation of the seriousness of effort that may be required, with realistic expectations of the extent of engagement that many Parties may eventually actually assume. Such engagement will be contingent upon many factors including, as pointed out by the Discussion Paper, human, technical, and financial capacity issues, and considerations relating to morality and equity.

Therefore, limiting connectivity on the basis of uniquely Australian perceptions of required mutual action may be ungrounded and unrealistic. Australian unilateral determinations of appropriateness of geographical market source of carbon credits are at best unhelpful and, at worst, significantly detrimental to the political process that has sought to generate consensus around market mechanisms for over a decade, with ramifications for future cooperation and the likelihood of driving greater market fragmentation and undermining market liquidity benefits.

Emerging markets account for over three quarters of the increase in global CO₂ emissions in the 2006 IEA reference scenario in 2030. This finding is echoed in the report of Working Group III of the Intergovernmental Panel on Climate Change. Much existing and future low-cost abatement will also be derived from those economies, which will be an important factor in the ability of the Parties to meet the objectives of the Convention. It is important that these emissions can be captured within a market framework, whether or not binding emissions limitations are involved in those markets.

As noted within the Discussion Paper, Certified Emissions Reductions (CER) and the methodologies underpinning them have emerged as the clear common currency between the different markets, linking both Annex 1 and Non-Annex 1 Parties.

This was implicit in the agreement at COP 7 to the Marrakech accords, but has only become evident with the recent increase in market liquidity, and growing familiarity and experience in the trade of carbon credits.

The world's leading investment banks have implicitly recognised that role through their delineation of the ECIS voluntary carbon protocol, for which the Clean Development Mechanism project construct acts as a basis. The basis of the development of the ECIS protocol was concern as to the integrity of the 'currency' in question.

In any event, linking to a compliance market that in turn recognises CERs from sources not recognised by Australia would in any case nullify an approach as carbon credits could be swapped in those markets for permits that are permissible under an Australian scheme.

Furthermore, arbitrary unilateral decisions that fragment the carbon market according to geography has interesting possible ramifications not under international trade rules. Discrimination on the basis of product or service on the basis of the argument provided is questionable under the GATT and WTO, and clauses permitting exception for environmental protection are unlikely to stand up to challenge. It is suggested that those implications be the subject of a full discovery exercise should consideration of such a strategy be pursued. In addition, the foreign policy dividend through market linking of this nature may well be overshadowed by decisions that discriminate against some Parties. The seriousness with which both the trade and policy aspects of such an approach are

considered by our international partners are only likely to increase with the continued growth of the carbon market, and associated investment flows.

The principle of the proposed treatment of TEEIs is a valid one. However, the methodology proposed for the assessment of the extent of trade exposure and loss is somewhat difficult, and perhaps merits further investigation. It is suggested that this work be considered in light of the existing international sectoral work on greenhouse gas emissions – in terms of the knowledge that this has generated, but also in view of the potential international market constructs that have been raised under the auspices of the post-2012 framework and appear somewhat palatable to the emerging market neighbours with which Australia should partner on these issues. It is important that Australia's treatment of TEEIs does not compromise that work, and is fungible into such approaches should they emerge.

Thank you for the opportunity to comment.

Yours sincerely

Andrew Jones