

Position Paper on Emissions Trading



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INTRODUCTION

All countries that have ratified the United Nations Framework Convention on Climate Change (UNFCCC), including Australia, have an obligation to take action to prevent dangerous climate change. To do so, global average warming needs to be limited to a peak of less than 2 degrees Celsius above pre-industrial times, and then reduced as fast as possible from this peak. To achieve the limit of 2 degrees Celsius, industrialised countries need to reduce greenhouse gas (GHG) emissions by at least 60% below 1990 levels by 2050, with further reductions in global emissions by 2100.

CANA considers that these cuts are achievable through a reduction in the use of fossil fuels combined with a much greater utilisation of renewable energy, energy efficiency technologies and demand management. They are necessary if we are going to prevent dangerous climate change and avoid its significant economic, social and environmental costs. CANA has developed a comprehensive greenhouse strategy for Australia in its document *The Real Way Forward*, which emphasises that sustainable transport planning is also vital in achieving significant reductions in greenhouse gas emissions.

Currently, the market does not recognise the environmental, social and economic costs of GHG emissions through energy and other prices. Creating a market in emissions trading is one way of ensuring that some of these costs are included in the economy.

In establishing a price signal for GHG emissions, CANA's preference is for a carbon tax, in conjunction with or instead of emissions trading. A carbon tax could be implemented more quickly with minimum transaction costs and therefore would deliver earlier GHG reductions and minimise opportunities for manipulation of the market and deferral of real reductions. This position paper, however, addresses the key design issues for an emissions trading scheme (ETS) if that option is chosen.

The primary objective of any ETS must be to deliver substantial, real and timely reductions in GHG emissions. If designed correctly, an emissions trading scheme could help Australia meet its international obligations and help reduce the cost of achieving emissions reductions.

The success or failure of emissions trading as a tool to reduce GHG emissions is highly dependent on the design and parameters of the scheme. A badly designed scheme could impose a cost on consumers for little or no environmental benefit, and could hinder future efforts to reduce GHG emissions by creating an erroneous impression that action is being taken. For this reason, if the principles outlined in this position paper are not met, CANA will be strongly arguing for a carbon tax instead of an emissions trading scheme.

KEY ISSUES AND PRINCIPLES

1. Emissions Trading Must be Part of a Broad Policy Response

While an emissions trading scheme has benefits, such a scheme, or a carbon tax alone, will be insufficient to meet Australia's international obligations under the Kyoto Protocol or to prevent dangerous climate change. An ETS, therefore, needs to be part of an overall policy response to reduce GHG emissions and fundamentally restructure Australia's energy and transportation sectors. This response should include a range of measures and cover all sectors. Other programs that are essential include:

- Reform of the National Electricity Market and electricity network regulation away from its current bias towards energy supply and towards the provision of energy services, including energy efficiency and demand management;
- Halting of land clearing along with the adoption of other sustainable land management and agriculture mechanisms and responses;
- Increasing market incentives for renewable energy through, for example, increasing the Mandatory Renewable Energy Target to 10% by 2010 and 20% by 2020, and other market development schemes;
- Implementation of robust residential, commercial and industrial energy efficiency programmes;
- Implementation of low-emission transport funding mechanisms, removal of perverse tax incentives favouring GHG unfriendly transport choices and the development of an appropriate transport related emissions reductions scheme or instruments; and
- Supporting new business opportunities for renewable and demand management technologies, including for export .

2. Emissions Reduction Target – the Cap

An ETS must be consistent with achieving at least a 20% overall emissions cut relative to 1990 levels by 2020 and at least a 60% cut by 2050 using a progressively lowering cap. This would mean that fewer permits would be auctioned in each period.

3. Type of Scheme - Cap and Trade

A cap and trade scheme is the only scheme design that will ensure environmental outcomes. Caps should be on actual emissions, not on a per capita basis. Under a cap and trade system, a total cap is set on the absolute quantity of emissions over a defined period of time and the total is subsequently divided into allowances and auctioned to individual sources.

The preferred model for an ETS does not include offsets, which merely divert investment and resources. An ETS should therefore exclude a baseline and credit approach. Baseline and credit schemes are extremely vulnerable to gaming and fraud. The setting of baselines, against which abatement is measured, is difficult and contentious, and the additionality of the reductions achieved is uncertain. The experience of both the NSW Greenhouse Gas Abatement Scheme (NGAS) and the Kyoto Protocol's Clean Development Mechanism (CDM) bears this out. Cap and trade regimes provide greater certainty for determining the environmental outcomes of the trading system and are more equitable and efficient. The exclusion of off-sets from a cap and trade scheme also precludes the use of sinks.

4. Coverage of Scheme – Stationary Energy Sector

The coverage of an ETS should focus initially only on the stationary energy sector. After a period of time the scheme should be reviewed to assess whether emissions trading is appropriate for other sectors. However, action is needed immediately in all sectors, and measures other than ETS will be required to meet overall emissions targets irrespective of whether the scheme is extended.

5. Cap Set to Achieve at least 60% Emissions Reduction

The cap should be set at a level consistent with achieving an overall emissions reduction of at least 20% below 1990 levels by 2020 and a long term target of at least 60% below 1990 levels by 2050. Annual targets should be set by back-casting from 2050. To achieve long-term, deep cuts, the cap should be progressively lowered in each period by reducing the amount of permits auctioned. Intermediate caps should be set to ensure a smooth transition and avoid unnecessary shocks to the economy.

6. Auctioning of Permits

It is essential that permits are auctioned rather than administrative allocation.¹

So called “grandfathering”, or allocation according to historic emissions is the worst form of administrative allocation as it discourages early action and rewards polluters. “Grandfathering” is also the most expensive form of allocation as it has high transaction costs, is open to manipulation and rorting, and does not provide a transparent cost of carbon. “Grandfathering” is equivalent to a property right being given away and represents a transfer of wealth from the community to polluters. “Grandfathering” would make it much harder to guarantee emission reductions.

The major bonus of auctioning is that revenue raised can be recycled through energy R&D spending or structural adjustment schemes.² Consumers will face cost increases whether permits are auctioned or administratively allocated, but only auctioning provides revenue for governments to use to compensate and assist dislocated workers and the community, and to assist industrial transition.

¹ The issuing of permits to emitters and firms in a domestic emission trading scheme according to their historical emissions.

² For example, structural adjustment packages from revenue raised by auctions could be used for transitioning coal communities, compensating low-income consumers, funding energy efficiency programmes or reducing payroll taxation.

7. Overseas Permits

As Australia is a signatory of the Kyoto Protocol, but has not yet ratified it, it is not currently allowed to trade with overseas schemes.

If Australia ratified the Protocol, selling permits from Australia to other trading countries would be allowed, and would increase the attractiveness of the scheme to the business community. However, the use of overseas-sourced permits should only be supplemental to domestic action and restricted to Kyoto-compliant trading schemes.

8. Accommodating Different State Liabilities

Different states and territories have different emission intensities that to a large extent reflect the type of fossil fuel mix available to them. This means that under a common ETS, some states may end up with a heavier financial burden than others, depending on the scheme design.

To avoid comparative economic disadvantage, revenue from the auctioning of permits could be allocated to States to assist with structural adjustment in the same way that GST revenues are distributed. However, the ETS should have one total cap and one auction scheme across states to prevent companies and states from gaming the system.

9. Regulatory framework

The regulating body established to oversee the functioning of the ETS must be independent and accountable to the public. The Board or Committee overseeing the regulating body must include representatives from the environmental and social NGO sectors.

Fines for non-compliance must be in addition to the requirement to purchase permits and must be set at a level that ensures compliance. Reporting must be on an annual basis, must be included in formal Annual Reports and must be publicly accessible on the internet. Late reporting must be subject to penalties.

10. Public Participation and Transparency

Full community participation is essential for the development of market rules for an ETS. The operation of the scheme must be transparent and open to public view.