Carbon Market Institute

Submission - Setting Australia's post-2020 target for greenhouse gas emissions

April 2015

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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 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, secondary market participants, 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

As part of efforts to develop a new global climate agreement under the United Nations Framework Convention on Climate Change (UNFCCC) Conference of the Parties (COP) 21 in Paris in late 2015, countries who are parties to the convention have agreed to outline their post-2020 emissions reduction targets. Known as Intended Nationally Determined Contributions (INDCs), it is agreed these targets will be fair and ambitious and contribute to achieving the UNFCCC's ultimate objective to limit the global average temperature increase to below 2 °C[1]. The Australian Government has agreed to announce Australia's INDC in mid-2015, in the lead up to the Paris meeting.

The decision on Australia's post-2020 emissions reduction target will directly influence the nature of our domestic policy response to meet the target. The linkage between the post-2020 target and the policy instruments required to achieve it will heavily influence current and future national climate change policy debate. It will be critical to have bipartisan support for Australia's target which will, in turn, help to provide stability of the policy landscape, critical for businesses to invest in emissions reductions.

CMI's submission

CMI's submission on Australia's post-2020 emissions reduction target was developed from consultation with CMI members through dedicated Policy Working Groups and one-on-one meetings with members, and builds on earlier consultations with CMI members and meetings with the Foreign Minister, Minister for the Environment, Department of Foreign Affairs and Trade, Department of the Environment, the UNFCCC Taskforce and participation at the 20th Conference of Parties in Lima.

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.

CMI's submission on the setting of Australia's post-2020 target for greenhouse gas emissions is set out in three parts. The first section refers to the core principles that should underpin the setting of the target. The second section reflects business views on the target drawn largely from the most comprehensive national survey on emissions reduction carried by CMI late last year. The third section looks at the domestic policy response required to meet international obligations.

1. **The core principles which should underpin the setting of the target include:**

    a) Australia's post-2020 target needs to be set within the framework of the UNFCCC and its objective to limit the global average temperature increase to below 2 °C.
    b) Australia's target should be a fair and equitable contribution to the global effort needed to address to climate change.
    c) Australia's post-2020 target should set as the overarching policy objective against which an effective domestic policy response should be implemented.
    d) Australia's post-2020 target should be reflective of the common direction many leaders in the international and domestic business community are taking to transition to a low carbon economy.

[1] United Nations Framework Convention on Climate Change.

e) Setting an ambitious post-2020 emissions reduction target will help frame the economic transition required for Australia to harness economic growth opportunities in a low carbon world.
f) A market-based mechanism is the most cost-effective means to meet Australia's increasing emissions reduction task.
g) The setting of Australia's post-2020 emissions reduction target and design of the Australian Government's national policy approach should be considered in context with the policy measures and market developments that are taking place internationally.
h) Australia's post-2020 target and actions to address climate change should be aligned with the international community, particularly key trading partners, so to not risk negative economic implications.
i) Bipartisan agreement on climate policy is essential to alleviate uncertainty for business.

2. Business Views on international targets

The following points are key findings from CMI national survey of 245 businesses on emissions reductions.

a. The vast majority of survey respondents supported stronger 2020 emissions reduction targets, particularly if they align with our key trading partners.
b. It is important that input on setting the target to be provided by an independent body, such as the Climate Change Authority, and the business and research communities.
c. Australia's future economic costs and underlying emissions growth, along with economic costs are key factors which should be considered in setting the target.
d. Setting Australia's target in line with China, the Unites States and the European Union was supported by 80 per cent of respondents.
e. The overwhelming majority of survey respondents consider Australian business trade, investment and export markets to be impacted economically by climate policy developments in other countries.
f. The majority of respondents agree Australia's target needs to be set in line with our key trading partners to avoid adverse implications for trade and investment for Australian companies.
g. Seventy five per cent of respondents believe Australia should price carbon effectively, in line with our key trading partners, to avoid economic disadvantage.

3. Domestic policy response

a. CMI believes a market-based approach is the most cost effective means to reduce emissions and meet current and future emissions targets.
b. The business community has voiced strong support for market-based mechanisms to effectively and efficiently reduce emissions.
c. According to CMI's recent survey, 63 per cent of 111 companies who conduct greenhouse gas producing activities are factoring a carbon price in decisions about major investments.
d. If designed effectively, the Government's safeguard mechanism offers an opportunity to set long term enduring policy to effectively limit Australia's emissions and meet obligations under international agreements.

e. Introducing a range of additional complementary emissions reduction policies should be considered to support emissions reduction efforts.

1. CORE PRINCIPLES THAT SHOULD BE CONSIDERED IN SETTING AUSTRALIA'S EMISSIONS REDUCTION TARGET

a) Australia's post-2020 target needs to be set within the framework of the UNFCCC and its objective to limit the global average temperature increase to below 2 °C.

An outcome of the COP20 in Lima in 2014 was an agreement by all parties, including Australia, that countries' post-2020 targets will represent a progression beyond current undertakings, be fair and ambitious and maintain consistency with the ultimate objective of the UNFCCC to limit the global average temperature increase to below 2 °C[2]. The Australian Government has reinforced this objective, most recently with a commitment by Minister Hunt on 14 April 2015[3].

Further to the ultimate objective of the UNFCCC, Australia's target should be aligned with the framework of the UNFCCC and its objectives. This is particularly important to allow comparison of targets, promote transparency, and improve the quality of discussion within international climate change negotiations and help countries develop and understand their own and others' targets[4]. Expressing targets according to the framework of the UNFCCC enables assessment that countries' targets are beyond current undertakings and fair and ambitious and strengthen global emissions reduction efforts over time[5].

b) Australia's target should be a fair and equitable contribution to the global effort needed to address to climate change.

Given the global scale of climate change and the need for all countries to reduce emissions, Australia must contribute a fair and reasonable emissions reduction target, reflective of its national circumstances. The global effort required, as agreed to under the ultimate objective of the UNFCCC, should limit the global average temperature increase to below 2 °C[6].

A global emissions budget can be used to define the limit on emissions that is consistent with this objective. CMI supports considering emissions reduction goals in the context of a global budget which would enable Australia's fair share of the global effort to be determined[7].

Emissions reduction targets, such as many of those announced to date, typically state an intended level of emissions (or emissions intensity) in a certain year. Emissions budgets specify a total limit on emissions over a period of time. Budgets can ensure greater consistency between actions taken and

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[2] Report of the Conference of the Parties on its twentieth session, held in Lima from 1 to 14 December 2014 Addendum Part two: Action taken by the Conference of the Parties at its twentieth session, Feb 2015.
[3] Hunt confirms commitment to 2-degree goal. Business Spectator, 15 April 2015.
[4] Comparing countries' emissions targets: A practical guide. Climate Change Authority, Australian Government, March 2015.
[5] Comparing countries' emissions targets: A practical guide. Climate Change Authority, Australian Government, March 2015.
[6] Report of the Conference of the Parties on its twentieth session, held in Lima from 1 to 14 December 2014 Addendum Part two: Action taken by the Conference of the Parties at its twentieth session, Feb 2015.
[7] Reducing Australia's Greenhouse Gas Emissions - Targets and Progress Review. Climate Change Authority, Australian Government. February 2014.

action required and clarify the trade-offs between early and later action[8]. Delaying emissions reduction efforts consumes more of the emissions budget now, meaning greater efforts are required in the future. Conversely, early action can reduce the impact and cost of future efforts[9].

The Intergovernmental Panel on Climate Change (IPCC) has highlighted the scale of global emissions reductions required. This has and continues to influence the ambition of targets set by other countries, such as the 2050 targets set by the European Union, Norway and Japan[10]. Consistent with the Climate Change Authority's Targets and Progress Review 2014, considering Australia's post-2020 emissions reduction targets in the context of a global emissions budget will ensure the target adopted represents an appropriate contribution to tackling climate change and Australia's fair share of the global effort required.

Australia's domestic policy response will be examined by the international community alongside the post-2020 target in determining its viability[11]. This questioning is by the international community as part of the UNFCCC process, is already occurring[12]. There is a focus on Australia's position from the international community and a real risk that an inadequate target will cause concern and pressure on Australia to increase ambition.

c) Australia's post-2020 target should set as the overarching policy objective against which an effective domestic policy response should be implemented.

The long term domestic policy response to climate change will be shaped according to Australia's post-2020 emissions reduction goals. International targets have a major bearing on the development of domestic policy.

The nature of Australia's climate policy history has been quite tumultuous. Inherent in the setting of a fair and ambitious post-2020 emissions reduction target is the opportunity to set in motion the process for shaping enduring domestic policy to effectively limit emissions growth across the Australian economy. Developing enduring policy mechanisms is not only consistent with achieving the post-2020 target, but it is also conducive to achieving the Government's goal of providing a stable and predictable policy landscape to facilitate decision making and investment by business. The policy measures adopted also have a major influence on the costs and benefits associated with reducing emissions[13].

[8] Comparing countries' emissions targets: A practical guide. Climate Change Authority, Australian Government, March 2015.
[9] Australia's future emissions reduction targets, Special Review. Draft Report, April 2015. Climate Change Authority, Australian Government.
[10] Reducing Australia's Greenhouse Gas Emissions - Targets and Progress Review. Climate Change Authority, Australian Government. February 2014.
[11] A compilation of questions to Australia from Session SB142, Bonn, Germany (2015), United Nations Framework Convention on Climate Change.
[12] A compilation of questions to Australia from Session SB142, Bonn, Germany (2015), United Nations Framework Convention on Climate Change.
[13] Australia's future emissions reduction targets, Special Review. Draft Report, April 2015. Climate Change Authority, Australian Government.

d) Australia's post-2020 target should recognise the common direction many leaders in the international and domestic business community are taking to transition to a low carbon economy.

The international business community recognises the need for a strong and effective global agreement to address climate change. At a recent meeting of the International Monetary Fund (IMF), CEOs from 43 of the World's largest companies representing operations in over 150 countries signed a letter calling for governments to set ambitious and effective post-2020 emissions reduction targets and for an ambitious climate deal to be reached at[14]. This builds on the existing momentum of the international business community supporting the setting of ambitious targets and policies to reduce emissions and transition the global economy to a new low carbon path through programs such as Prince of Wales's Corporate Leaders Group, the 2014 Global Investor Statement on Climate Change, the Caring for Climate Initiative and subsequent Carbon Pricing Leadership Coalition[15].

e) Setting an ambitious post-2020 emissions reduction target will help frame the economic transition required for Australia to pursue economic growth opportunities in a low carbon world.

Many of the world's most renowned companies are now coming out in support the setting of ambitious emissions reduction targets and robust policy mechanisms which reconcile the twin goals of emissions reduction and economic growth[16,17,18].

Ambitious emissions reduction targets and robust, enduring policies provide the framework for investment in new industries and opportunities for competitive advantage[19]. This has been the case in many regions including Asia, Europe and the United States[20,21,22,23,24].

Emissions reduction policies have a major bearing on new industries by incentivising investment in low-carbon technology and provide positive pressure to reduce emissions[25].

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[14] Open Letter from Global CEOs to World Leaders Urging Concrete Climate Action, www.medium.com.
[15] World Bank, Projects and Operations, Pricing Carbon, http://www.worldbank.org/en/programs/pricing-carbon
[16] Open Letter from Global CEOs to World Leaders Urging Concrete Climate Action, www.medium.com.
[17] www.worldbank.org.
[18] Global corporate use of carbon pricing. Disclosure to investors. CDP, March 2014.
[19] Australia's future emissions reduction targets, Special Review. Draft Report, April 2015. Climate Change Authority, Australian Government.
[20] Bloomberg New Energy Finance, Global Trends in Renewable Energy Investment 2014 (http://www.unep.org/pdf/Green_energy_2013-Key_findings.pdf)
[21] International Renewable Energy Agency, Renewable Energy and Jobs 2014 (http://www.irena.org/publications/rejobs-annual-review-2014.pdf)
[22] The Solar Foundation, National Solar Jobs Census 2014 (http://www.thesolarfoundation.org/national-solar-jobs-census-2014/)
[23] Environmental Defence Fund, Seven Growth Sectors Driving California's Clean and Efficient Economy 2012 (http://www.edf.org/sites/default/files/EDFSevenSectors-5.24.2012pdf.pdf)
[24] Renewable Energy Policy Network, 10 Years of Renewable Energy Progress 2014 (http://www.ren21.net/Portals/0/documents/activities/Topical%20Reports/REN21_10yr.pdf)
[25] CEO: Carbon trading will help airlines innovate to meet ambitious climate goals, World Bank (http://blogs.worldbank.org/climatechange/ceo-willie-walsh-carbon-trading-will-help-airlines-innovate-meet-ambitious-climate-goals).

The opportunities to attract investment and create jobs enjoyed by Australia's key trading partners will be impacted if the current long term policy uncertainty is maintained. It is crucial that emissions reduction policies support the growth of new industries and allows Australia to capitalise on the opportunities in the global shift to a low carbon economy.

f) A market-based mechanism is the most cost-effective means to meet Australia's increasing emissions reduction task.

A market-based mechanism represents the most cost-effective means to meet Australia's ongoing emissions reduction task, including the post-2020 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[26], 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 the Emissions Trading Scheme in conjunction with the Emissions Reduction Fund and other supporting policies will enable Australian businesses to meet their own emissions reduction goals and compliance costs more efficiently, harmonise with key trading partners, stimulate domestic investment and capitalise on opportunities in the inevitable transition to a low carbon economy.

g) The setting of Australia's post-2020 emissions reduction target and design of the Australian Government's national policy approach should be considered in context with the policy measures and market developments that are taking place internationally.

In setting Australia's post-2020 emissions reduction target, the policy developments in international markets and mechanisms favoured by the business community should be taken into consideration. It is particularly important to consider the emissions reduction policy measures taken in Australia's key trading partners.

In a recent survey of 245 major Australian companies conducted by CMI, the importance of China, the United States and the European Union in setting Australia's target was highlighted, with 80 per cent of respondents saying that Australia should look to the targets and actions of each of these nations or blocs[27].

To date, 34 countries have announced their INDCs, including Australia's largest trading partners[28,29]. A range of market-based policy instruments (among others) are being utilised by many countries to meet their national emissions reduction targets for both the 2020 and post-2020 periods[30] (Box 1).

It will be important to understand the dynamics of these markets and post-2020 targets and monitor their influence on global climate change negotiations. Given the scale of the Chinese, US and

[26] World Bank, Projects and Operations, Pricing Carbon, http://www.worldbank.org/en/programs/pricing-carbon.
[27] 2014 Australian Emissions Reduction Survey, Carbon Market Institute.
[28] United Nations Framework Convention on Climate Change.
[29] Composition of Australian Trade 2012-13, Department of Foreign Affairs and Trade, Australian Government, December 2013.
[30] States and Trends of Carbon Pricing. World Bank Group. May 2014, Washington DC, USA.

European economies and their contribution to global emissions, the post-2020 targets announced by these economies will have strong bearing on Australia's position in international efforts to mitigate climate change.

Box 1: The emissions reduction targets and policy measures employed in Australia's key trading partners.

- **China -** Australia's largest trading partner has committed to peak CO_2 emissions around 2030, with the intention to try to peak early, and to increase the non-fossil fuel share of all energy to around 20 percent by 2030. China has established seven regional pilot emissions trading schemes comprising 25% of total GDP with the aim of introducing a national emissions trading scheme in 2016.
- **European Union -** Australia's second largest trading partner has committed to 40% domestic greenhouse gas emissions reductions below 1990 levels by 2030. Within the EU, several member states have announced further 2030 targets, such as the UK - 50 per cent below 1990 levels, Germany - 55 per cent below 1990 levels and Norway - 40 per cent below 1990 levels[31]. The central pillar of EU climate policy is their emissions trading scheme, the EU Emissions Trading System, the world's largest carbon market which covers 31 countries which account for 20% of global GDP and 17% of global energy-related CO2 emissions.
- **Japan -** Australia's third-largest trading partner has an unofficial target to reduce emissions by 20 per cent relative to 2013 levels by 2030. Japan is aiming to meet its emissions reduction targets through a combination of sub-national emissions trading schemes Tokyo, Saitama and Kyoto covering 8% of total emissions and feed-in tariffs for renewable energy[32].
- **USA -** Australia's fourth largest trading partner has committed to reduce net GHG emissions by 26–28% below 2005 in 2025 and the Clean Power Plan to reduce power plant emissions by 30% by 2030. This is being driven by a combination of emissions trading programs in 10 states including California and the Regional Greenhouse Gas Initiative (RGGI) covering nine north eastern states.
- **Republic of Korea -** Australia's fifth largest trading introduced a national ETS on 1 January 2015 which covers companies emitting over 125,000 tCO2e and workplaces emitting over 25,000 tCO2e.
- **New Zealand -** Australia's eighth largest trading partner introduced an emissions intensity-based uncapped ETS in 2008 which covers 100 per cent of national emissions.
- **India -** Australia's eleventh largest trading partner employs two market-based mechanisms to meet its emissions reduction targets along with several pilot emissions trading schemes focused on particulate matter.

Sources: Market-based Approached to Emissions Reduction - Australia's Key Trading Partners. Carbon Market Institute briefing note, July 2014.
www.climateactiontracker.org

[31] Australia's future emissions reduction targets, Special Review. Draft Report, April 2015. Climate Change Authority, Australian Government.
[32] Market-based Approached to Emissions Reduction - Australia's Key Trading Partners. Carbon Market Institute briefing note, July 2014.

h) Australia's post-2020 target and actions to address climate change should be aligned with the international community, particularly key trading partners, so to not risk negative economic implications.

The position Australia takes in the international effort to mitigate climate change through our post-2020 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. Failing to align our targets and policy settings with international trends risks negative consequences for the Australian economy[33].

In a recent survey of 245 major Australian companies undertaken by CMI, 83 per cent of respondents agreed that Australia's economic growth will increasingly depend on how well we adapt to a lower carbon world. Of particular importance is the need to involve the private sector in developing Australia's emissions reduction targets and funding emissions abatement. The policy suite should consider a market-based mechanism to reduce emissions, in line with much in of the international community[34]. Seventy-four per cent of businesses surveyed by CMI agreed that Australia will be economically disadvantaged if we do not price carbon in line with our key trading partners[35].

The global transition to a low carbon economy will have increasingly significant consequences for the Australia's economy. It is crucial that as a nation we set appropriate targets and policies to align with the international community. Our competitiveness will continue to be affected throughout this transition and Australia must create the platform for innovation and structural reform if business is to capitalise on the opportunities and avoid the major economic risks of failing to act.

i) Bipartisan agreement on climate policy is essential to alleviate uncertainty for business.

There have been very significant developments among Australia's key international trading partners and the broader international community in their approaches to carbon pricing and positioning their economies for a low carbon future. Every major economy is adopting a suite of policies to limit emissions growth. This momentum will continue to increase as countries unveil their post-2020 national emissions reduction targets and the discussion intensifies in the lead up to COP21 in Paris later this year.

It is critical that the design of Australia's emissions reduction policy suite has bipartisan support so that industry, the market and investors can invest in emissions reductions with an increased level of certainty. This elevates the need for Australia to undertake a mature bipartisan debate about what our post-2020 emissions reduction target should be and frame and implement our policy response accordingly.

[33] 2014 Australian Emissions Reduction Survey, Carbon Market Institute.
[34] Market-based Approached to Emissions Reduction - Australia's Key Trading Partners. Carbon Market Institute briefing note, July 2014.
[35] 2014 Australian Emissions Reduction Survey, Carbon Market Institute.

2. AUSTRALIAN BUSINESS VIEWS ON THE TARGET

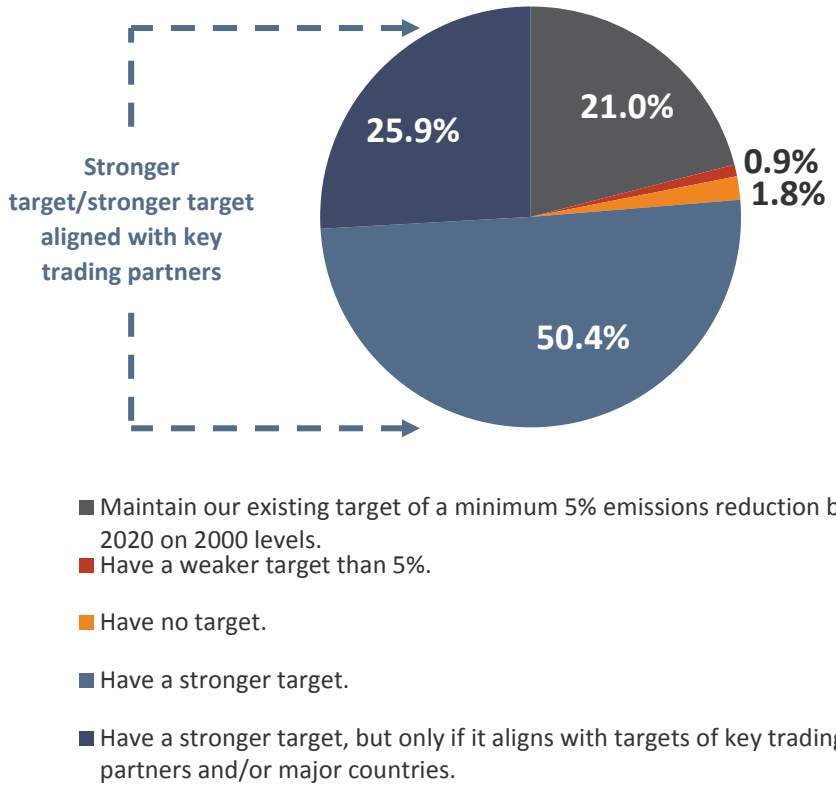
In September 2014, CMI undertook the Australian Emissions Reduction Survey which examined the actions and attitudes toward emissions reduction and policy of 245 experts and senior executives from major greenhouse gas emitting industries, investors and professional service providers. The survey was the most comprehensive Australian business survey on emissions reduction taken in 2014. The survey results have provided a unique and timely insight in to the business views on emissions reduction policies and targets.

The key findings of the Australian Emissions Reduction Survey are outlined in the following section.

a) The vast majority of survey respondents supported stronger 2020 emissions reduction targets, particularly if they align with our key trading partners.

2020 target: Seventy-six per cent of survey respondents supported a stronger 2020 emissions reduction target than the existing five per cent target (*Fig 1*). Of these, 50 per cent said unequivocally that the target should be stronger, while 26 per cent said it should be stronger if it aligns with targets by major countries and trading partners. Only three per cent supported a weaker target or no target at all for 2020.

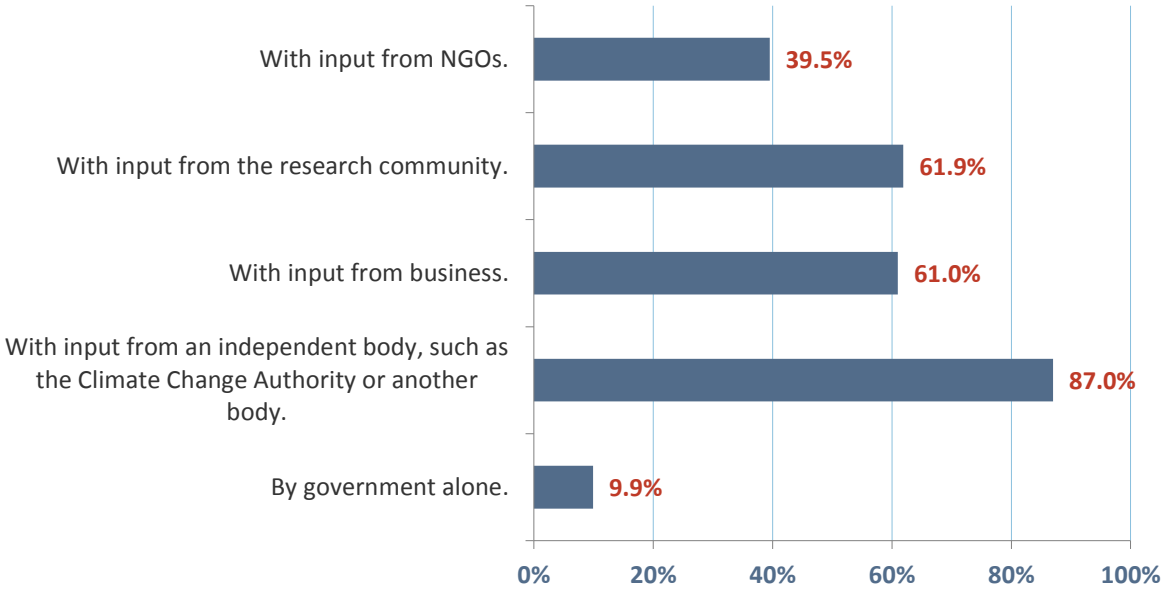
Fig 1 - Regarding Australia's 2020 emissions reduction target, in your view, given international developments, Australia should:



b) It is important for input on setting the target to be provided by an independent body, such as the Climate Change Authority, and the business and research communities.

Input in setting INDC: The survey results indicated overwhelming support to involve an independent body such as the Climate Change Authority in setting Australia's target, and strong support for input from the business and the research community in setting Australia's post-2020 emissions reduction targets was strongly supported. Eighty-seven per cent of respondents said that input from an independent body should be sought, and over 60 per cent said input from the research and business community respectively is needed (*Fig 2*).

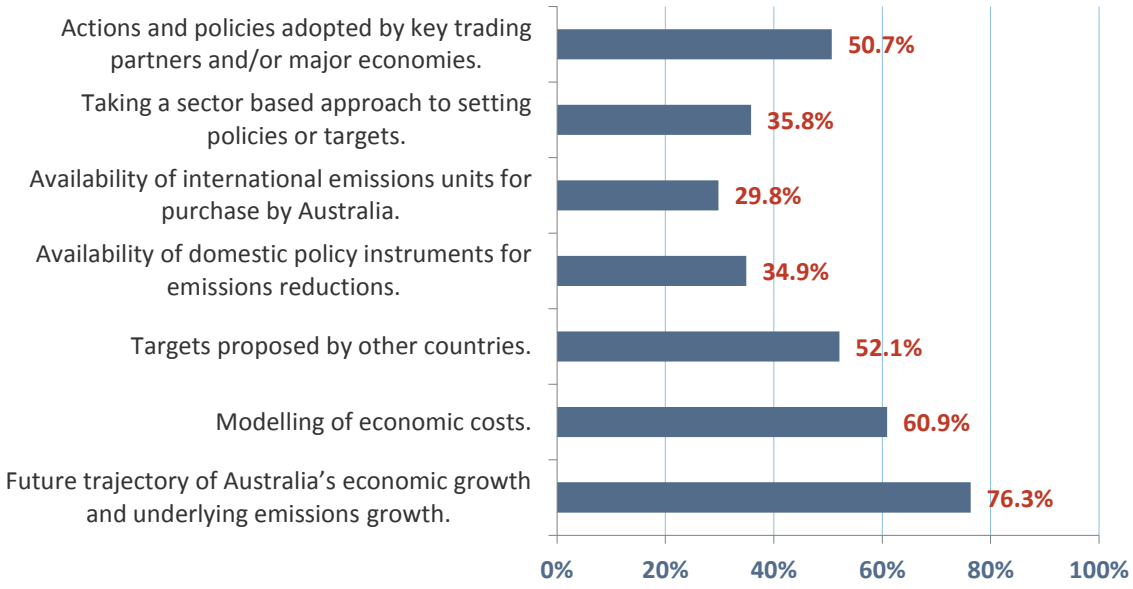
Fig 2 - How should Australia's emissions target (or "intended nationally determined contribution") for the post-2020 period be decided?



c) Australia's future economic costs and underlying emissions growth, along with economic costs are key factors which should be considered in setting the target.

Key factors in setting targets: In setting Australia's post-2020 emissions reduction targets, survey respondents indicated that Australia's future economic growth and underlying emissions and the modelling of economic costs were seen as the most important factors in setting these targets, with 76 per cent and 61 per cent respectively naming these factors (*Fig 3*). Several respondents raised the need to consider the economic costs of climate change in the modelling of economic costs. Over half of the respondents also named targets and actions by other countries as important factors. Fewer respondents saw the availability of domestic policy instruments, international units or sector-based policies or targets as important factors.

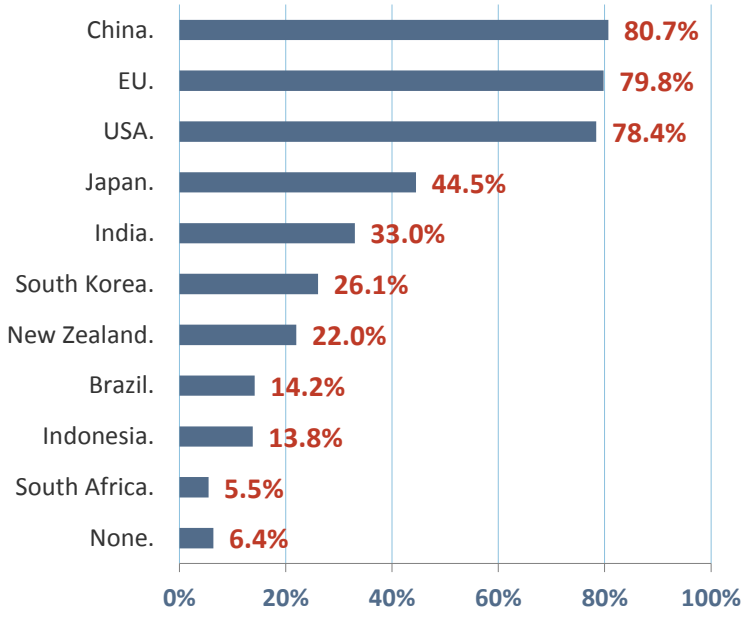
Fig 3 - What factors should determine Australia's emissions reduction target for the post-2020 period?



d) Setting Australia's target in line with China, the Unites States and the European Union was supported by 80 per cent of respondents.

Actions by other countries: Considering Australia's emissions reduction target in line with other countries, particularly China, the United States and the European Union, is strongly supported by the business community. Around 80 per cent of survey respondents were of the view Australia should look to the targets and actions of each of these nations or blocs in setting our post-2020 target (*Fig 4*).

Fig 4 - If Australia's post-2020 target is calibrated with reference to targets and actions by other countries, which countries should Australia look to as a priority?



e) **The overwhelming majority of survey respondents consider Australian business trade, investment and export markets to be impacted economically by climate policy developments in other countries.**

Economic impacts of Australia's target: The overwhelming majority (80 per cent) of survey respondents consider climate policy developments in other countries to have an economic impact on Australian business trade, investment and export markets. Just six per cent said there is no impact (*Fig 5*). A similar share of respondents (73 per cent) said that if Australia does not harmonise its emissions reduction targets with key trading partners, there will be risks of adverse implications for trade and investment (*Fig 6*). The majority (78 per cent) of respondents also agreed a range of business sectors will be disadvantaged without harmonisation with key trading partners (*Fig 7*). According to 74 per cent of respondents, Australia will be economically disadvantaged if we do not price carbon in line with our key trading partners (*Fig 8*).

f) **The majority of respondents agree Australia's target needs to be set in line with our key trading partners to avoid adverse implications for trade and investment for Australian companies.**

g) **Seventy five per cent of respondents believe Australia should price carbon effectively, in line with our key trading partners, to avoid economic disadvantage.**

Fig 5 - Climate policy developments in other countries have an economic impact on Australian business trade, investment and export markets.

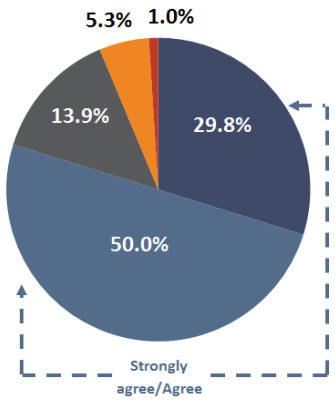


Fig 6 - There are risks of adverse implications for trade and investment for Australian companies if our emissions reduction targets are not harmonised with key trading partners.

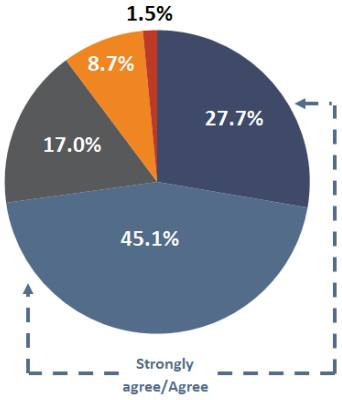


Fig 7 - Some Australian business sectors will be disadvantaged if Australia's emissions reduction targets are not in line with key trading partners.

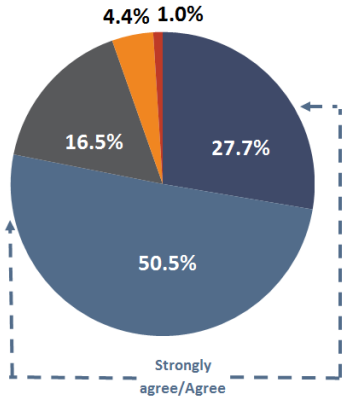
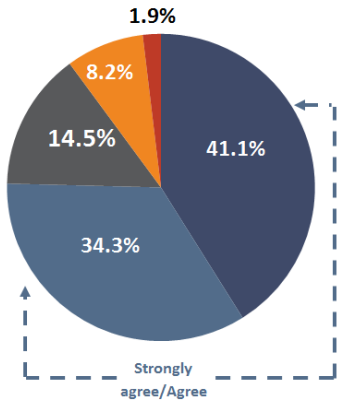
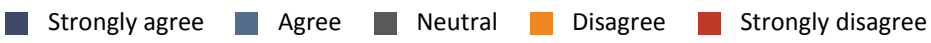


Fig 8 - Australia will be economically disadvantaged if we do not effectively price carbon in line with key trading partners.





3. DOMESTIC POLICY RESPONSE

Australian Government Climate Policy

Following the repeal of the Carbon Pricing Mechanism, the Australian Senate passed legislation in November 2014 to establish an Emissions Reduction Fund (ERF) as the principal policy instrument that the Federal Government is relying on to meet the current target of reducing Australia's greenhouse gas emissions to five % below 2000 levels by 2020.

The key elements of the ERF are a A$2.55bn fund to credit and purchase carbon abatement through a reverse auction and a safeguard mechanism under which large emitting facilities will be required to stay below an emissions baseline. Given the ERF creates a buyer for domestic abatement and the safeguard mechanism will allow for use of domestic (and potentially international) units for companies that exceed their baseline, a key question in implementation is whether these policy mechanisms translate to a stable and enduring framework that delivers a market-based approach to emissions reductions that can meet obligations under the UNFCCC.

Market Based approaches

a) CMI believes a market-based approach is the most cost effective means to reduce emissions and meet current and future emissions targets.

Globally, 39 national and 23 sub-national jurisdictions representing 52 per cent of global GDP have implemented or are scheduled to implement market-based policy instruments to meet their emissions reduction targets[36]. This is supported by over 1,000 businesses and investors who have signalled their support for carbon pricing[37].

Consistent with the Coalition's position before and after the September 2013 Federal election, the ERF and safeguard mechanism will involve a market-based approach. Market mechanisms allow the greatest reduction in emissions at the least cost and are crucial to efficient carbon price discovery.

A market based approach, such as a bassline and credit scheme, involves pricing carbon. Designed effectively, a baseline and credit mechanism puts a price on carbon which provides a signal for business to make investment decisions and most efficiently reduce emissions[38]. Globally, many companies consider carbon pricing to be the most effective and efficient means to reduce emissions[39]. Many Australian businesses factor an internal carbon price in investment decisions to assess their exposure under future policy scenarios. In a national business survey CMI found that the majority of respondents believe Australia will be economically disadvantaged if we do not price carbon in line with our international partners[40].

[36] States and Trends of Carbon Pricing. World Bank Group. May 2014, Washington DC, USA.
[37] 73 Countries and Over 1,000 Businesses Speak Out in support of a Price on Carbon. World Bank, 22 September 2014 (http://www.worldbank.org/en/news/feature/2014/09/22/governments-businesses-support-carbon-pricing)
[38] Market-based Approaches to Emissions Reductions: Australia's Key Trading Partners. CMI Briefing Note - July 2014, Carbon Market Institute
[39] Pricing Carbon, The World Bank (http://www.worldbank.org/en/programs/pricing-carbon)
[40] 2014 Australian Emissions Reduction Survey, Carbon Market Institute

The economic implications of Australia's post-2020 target will have different impacts across different sectors of the economy[41]. This is also true of the policy mechanisms introduced to limit emissions growth and meet the target. Policy mechanisms which make more concerted efforts to reduce emissions earlier will make achieving both 2020 and post-2020 emissions reductions targets both easier and less costly. Delayed action will increases both the challenge and cost of reducing emissions[42].

Within the policy suite is also the opportunity to reduce the costs of the transition to a low carbon economy for industry, particularly Emissions Intensive Trade Exposed (EITE) industries. The efficient design of the domestic policy suite is essential to reducing costs for business and is highly conducive to achieving ambitious targets at least cost[43].

Business views on market-based mechanisms

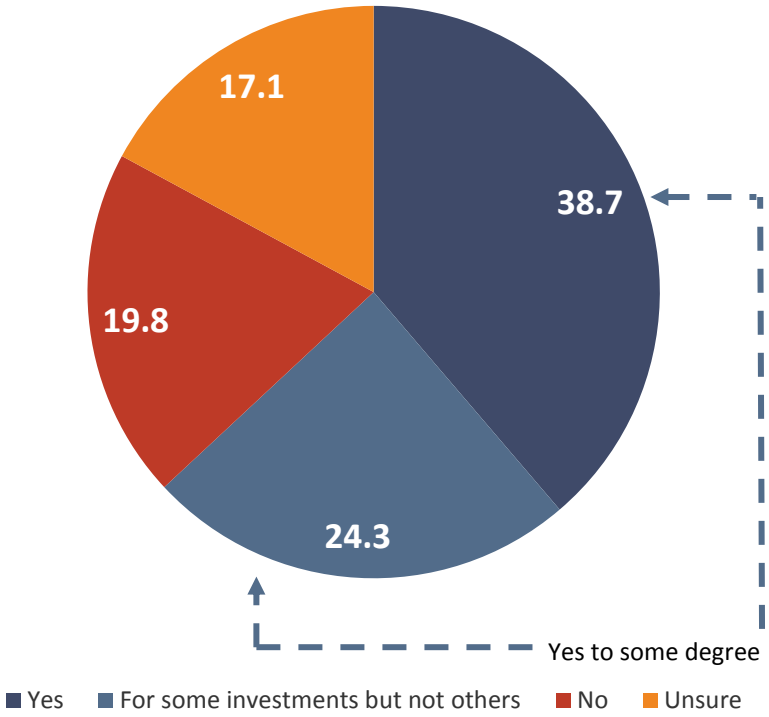
b) The business community has voiced strong support for market-based mechanisms to effectively and efficiently reduce emissions.

In 2014 over 1,000 companies and investors globally gave their support for carbon pricing, with over 150 factoring in a shadow carbon price[44]. A shadow carbon price provides business with a tool to drive investments and decision making. Many are also using a carbon price to prepare for regulation, which is in place or considered to be imminent in many jurisdictions[45]. A recent letter supporting market-based mechanisms signed by the CEOs of some of the World's largest companies stated "effective climate policies have to include explicit or implicit prices on carbon achieved via market mechanisms or coherent legislative measures according to national preferences, which will trigger low-carbon investment and transform current emission patterns at a significant scale."

c) According to CMI's recent survey, 63 per cent of 111 companies who conduct greenhouse gas producing activities are factoring a carbon price in decisions about major investments (Fig 9).

[41] Australia's future emissions reduction targets, Special Review. Draft Report, April 2015. Climate Change Authority, Australian Government.
[42] Australia's future emissions reduction targets, Special Review. Draft Report, April 2015. Climate Change Authority, Australian Government.
[43] Australia's future emissions reduction targets, Special Review. Draft Report, April 2015. Climate Change Authority, Australian Government.
[44] World Bank, Projects and Operations, Pricing Carbon, http://www.worldbank.org/en/programs/pricing-carbon
[45] Global corporate use of carbon pricing. Disclosure to investors. CDP, March 2014.

Fig 9 - If you work for a company with greenhouse gas producing activities, is your company factoring in a carbon price in decisions about major investments?



The ERF Safeguard mechanism design and rules

d) If designed effectively, the Government's safeguard mechanism offers an opportunity to set long term enduring policy to effectively limit Australia's emissions and meet obligations under international agreements.

The safeguard mechanism rules, which need to be set by 1st October 2105, will determine if it is going to be an effective market-based policy to achieve our emissions reduction targets to 2020 and beyond. The amendments made to the Carbon Farming Initiative Act in 2014 empower the government to set the rules to develop the safeguard mechanism as an effective policy to limit emission growth in the economy, in conjunction with the $2.55 billion ERF funding. Through the consultation and rule setting period, there is an opportunity to ensure the initial scheme is designed so it is an enduring mechanism that provides long-term policy certainty.

The Government's explanatory memorandum to the *Carbon Credits (Carbon Farming Initiative) Amendment Bill 2014* which established the ERF, states that the primary objective of the ERF is to help Australia meet its international obligations under the UNFCCC. The A$2.55 billion allocated to the ERF can, in the short term, make a contribution to helping to meet Australia's current five per cent reduction target. However, as Australia's post-2020 target becomes clear, the final design rules will assume great importance.

If designed effectively, the safeguard mechanism could translate to being a baseline and credit mechanism that meets emissions reduction goals and become the primary long term approach to manage emissions growth.

The full transition of the safeguard mechanism into a market-based scheme such as a baseline-and-credit mechanism will be necessary to defray the future public cost of funding emissions reduction.

In a baseline and credit scheme, a forward emissions baseline against which performance is measured is established. If actual emissions for covered entities are below this baseline, the difference between the two represents a reduction in emissions, and would be eligible for credits. Conversely, emissions above the baseline represent excess emissions and can be penalised[46]. Covered entities can offset their liability by reducing emissions below the baseline or purchasing offset units from others who have been issued credits, or a combination. Consistent with the baseline and credit model, the safeguard mechanism should ultimately operate to both credit emissions reductions and penalise excess emissions for emitting below or above allocated baselines respectively.

The final design of the safeguard mechanism should allow for a secondary market to evolve, facilitating trading between entities participating in the ERF auctions and/or covered under the safeguard mechanism and enabling those companies to meet any make-good provisions or meet compliance at least cost. In enabling business to meet compliance at least cost, a combination of domestic and eligible international units should be considered.

The policy approach adopted in Australia should evolve in parallel with developments in other international markets. The design features should maintain a line of sight to our 2020 and post-2020 targets and the international fungibility of ACCUs so as to enable linkages with other markets to be developed over time. This would benefit, for example, companies that have compliance obligations under any compliance mechanism that could potentially manage exposure in a cost effective manner using a range of trading and hedging strategies such as the use of international units to meet compliance obligations, particularly so for large multi-national companies with operations in Australia. Allowing the use of international units also assists Australia to continue to exploit its comparative advantage in emissions intensive industries while contributing to international emissions reduction efforts[47]. The development and expansion of domestic abatement projects through the ERF could enable the potential export of ACCUs to international markets.

The Government has not indicated that it will contribute any more funds in excess of the A$2.55 billion committed to the ERF. As the public funding of the ERF reduces over time and the allocated safeguard mechanism baselines become more stringent, the policy framework could transfer to a more efficient market-based scheme where the cost to the economy to meet international targets will progressively move from the public to the private sector.

e) Introducing a range of additional complementary emissions reduction policies should be considered to support emissions reduction efforts.

There have been very significant developments among Australia's key international trading partners and the broader international community in their approaches to reducing emissions and positioning their economies for a low carbon future. While market-based mechanisms to price carbon are the primary instrument in many of Australian key trading partners such as the EU and the Republic of Korea, every major economy is adopting a suite of policies to limit emissions growth. A

[46] Coverage, Additionality and Baselines - Lessons from the Carbon Farming Initiative and other schemes, April 2014. Climate Change Authority, Australian Government.
[47] Australia's future emissions reduction targets, Special Review. Draft Report, April 2015. Climate Change Authority, Australian Government.

comprehensive suite of policies, both market and non-market-based, are necessary to deliver emissions reductions at lowest cost[48].

Complementary policies such as renewable energy targets, tax incentives for improved energy efficiency and fuel economy and electricity generation emissions standards[49]. For example, in addition to the EU Emissions Trading System, EU member states have implemented a range of complementary domestic climate polices including 20% renewable energy and 20% energy efficiency targets by 2020[50]. Japan has feed-in tariffs for all renewable energy sources with the goal of generating 10% of primary energy supply from renewables by 2020 while India also supports investment in renewables through setting targets for power companies to purchase a certain percentage of total power from renewable sources[51]. China is planning to install between 800 and 1,000 GW of zero emissions power by 2030[52].

According to CMI's Australian Emissions Reduction Survey, the policies most strongly supported by Australian business include a renewable energy target (RET), domestic offsets program, energy efficiency and vehicle emissions standards and feed-in tariffs for residential solar (*Fig 10*). The business community believes these policies are likely to be in place by 2020, in addition to an internationally linked emissions trading scheme (*Fig 11*)[53]. While a market-based mechanism should be the primary instrument to reduce Australia's emissions, a combination of policy instruments will support the primary mechanism and spur investment in low emission technologies, enabling us to meet our emissions reduction targets.

[48] Australia's future emissions reduction targets, Special Review. Draft Report, April 2015. Climate Change Authority, Australian Government.
[49] Reducing Australia's Greenhouse Gas Emissions - Targets and Progress Review. Climate Change Authority, Australian Government. February 2014.
[50] Market-based Approached to Emissions Reduction - Australia's Key Trading Partners. Carbon Market Institute briefing note, July 2014.
[51] Market-based Approached to Emissions Reduction - Australia's Key Trading Partners. Carbon Market Institute briefing note, July 2014.
[52] Australia's future emissions reduction targets, Special Review. Draft Report, April 2015. Climate Change Authority, Australian Government.
[53] 2014 Australian Emissions Reduction Survey, Carbon Market Institute.

Fig 10 - What policy instruments or mix of instruments should Australia have for reducing greenhouse gas emissions?

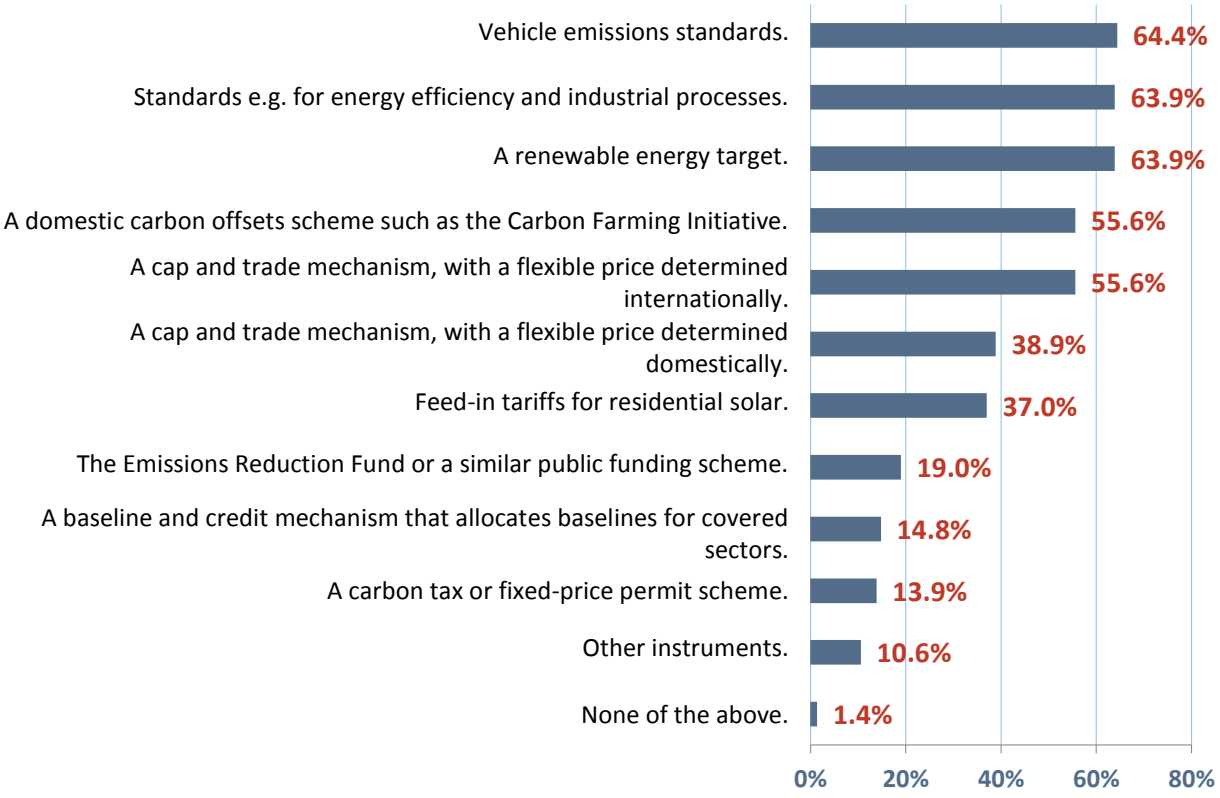
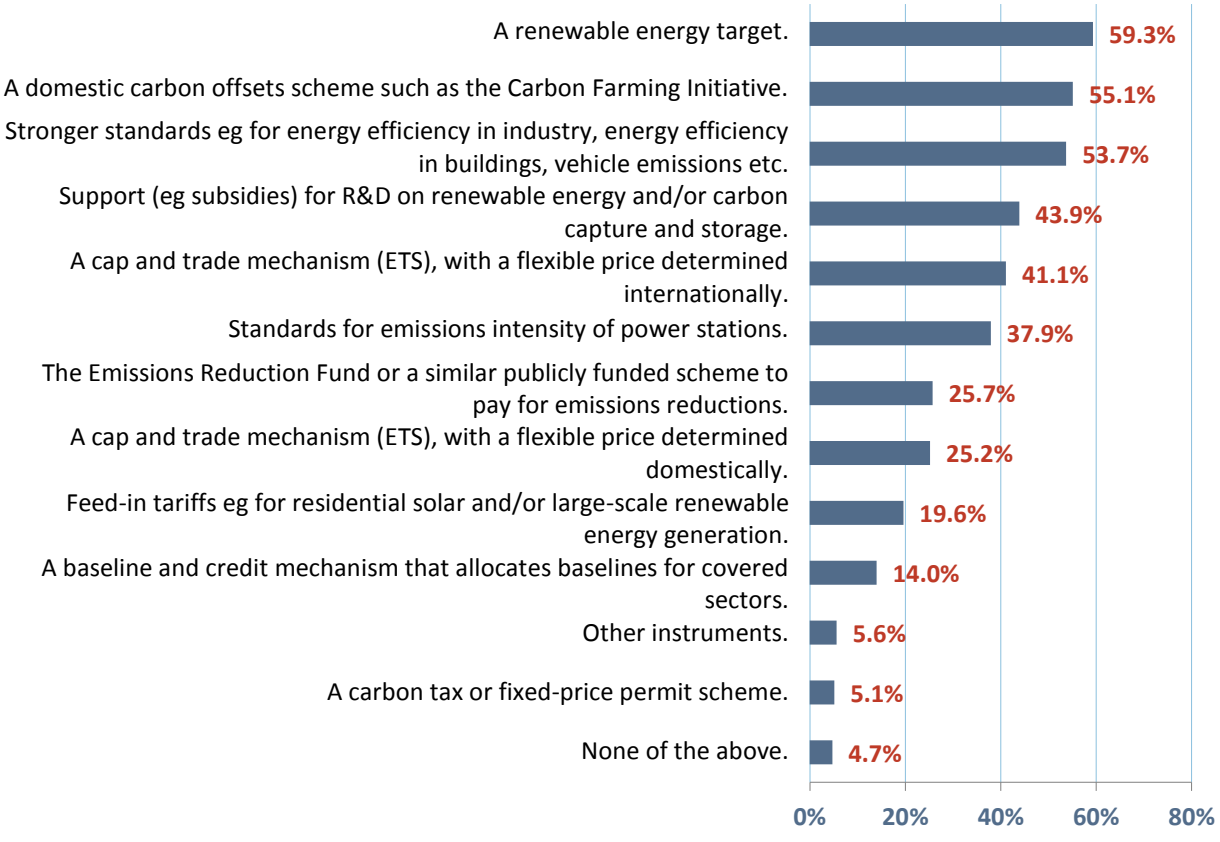


Fig 11 - Looking ahead to 2020, which of the following policy instruments do you expect will be in place in Australia nationally by 2020?

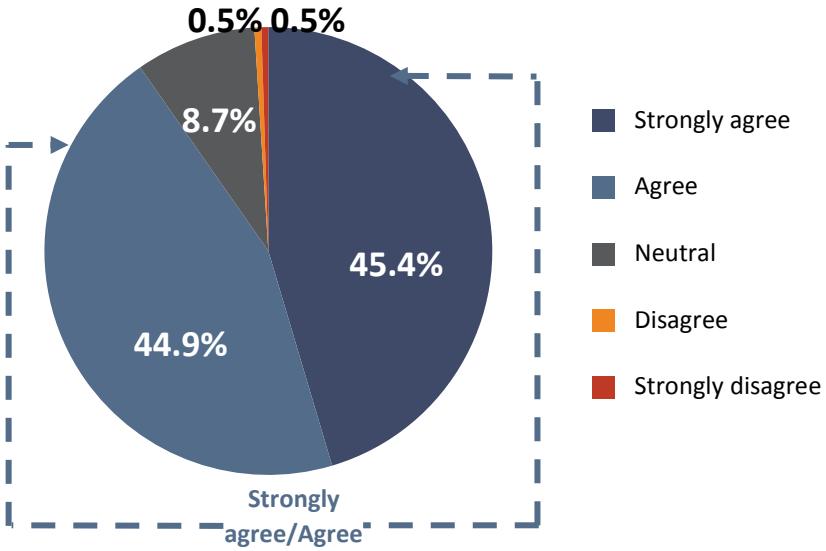


The role of the private sector

Although government policies to support the 2020 are critical to drive emissions reductions, the private sector has a key role to play. *CMI's recent survey reflected this, with the overwhelming majority (90 per cent) of survey respondents agreed the private sector has a key role to play in funding emissions reduction initiatives (*

Fig 12).

Fig 12 - The private sector has a key role to play in funding emissions reduction initiatives.



Many major countries and global companies support the setting of ambitious emissions reduction targets and robust policy mechanisms which reconcile the twin goals of emissions reduction and economic growth. This is the clear view of the Australian business community with 83 per cent of 245 businesses surveyed by CMI agreeing that Australia's economic growth will increasingly depend on how well we adapt to a lower carbon world (*Fig 13*).

Fig 13 - Economic growth for Australia will increasingly depend on how well we adapt to a lower-carbon world