Position statement

Factors to consider in the setting of the terms of reference for the 2017 review of Australian domestic climate change policy

Carbon Market Institute

October 2016

Executive summary

The Carbon Market Institute (CMI) is an independent membership-based not-for-profit business organisation. We aim to work constructively with government and to assist Australian businesses in meeting the challenges and opportunities associated with market-based approaches to emissions reduction in the transition to a low carbon economy.

The Australian Government has scheduled a review of domestic climate policy in 2017. The outcomes of the review will be vital to how Australia's existing climate policies can evolve to meet current and future emissions reduction commitments made under the Paris Agreement.

It is critical that in establishing the terms of reference for the review, factors are considered that will enable the review to examine how policies can ensure the effectiveness, stability and predictability of the domestic policy framework over the long term, and outline the pathway for the economic transition to a low (or zero) carbon economy.

The international targets, set by Australia in our commitment under the Paris Agreement, of a 26-28 per cent reduction on 2005 levels by 2030 is a floor. The targets will be reviewed and strengthened in line with the stocktake and review process. Australia will need to scale up our UNFCCC target over time and report on how we will strengthen policy implementation efforts in the years ahead.

It is not clear at present how the policies implemented or proposed in Australia's Nationally Determined contribution submission to the UNFCCC will specifically contribute to achieving our 2030 target. There is widespread recognition in the business community that policy settings will have to tighten in the near future. With this in mind, emphasis should be placed on providing clarity on the terms of reference for the policy review as soon as possible. The review process should examine how the existing policy suite will evolve to achieve our current and future targets, providing clarity for business and predictability essential to stimulate investment in clean energy and technology, emissions avoidance and carbon abatement.

The CMI has undertaken extensive research and consultation to provide input into the process to establish the terms of reference for the review. This position statement summarises CMI's position. The factors to consider that we recommend have been developed with input from CMI's annual Australian Climate Policy Survey 2016, CMI's corporate member policy and land sector working groups, and extensive consultations with CMI members and international carbon market experts and international agencies.

In developing this position statement, CMI has been guided by a series of central principles. These are:

- The national emissions reduction target should be in line with the global response to the threat of climate change to keep temperature rise this century well **below 2 degrees Celsius** above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5 degrees Celsius.

- The Carbon Market Institute views a **market-based approach** to emissions reduction as providing an effective, efficient framework to meet emissions reduction goals and challenges at lowest cost.

- Australia's policy suite should be **comprehensive and enduring** to create a stable and predictable policy landscape for business.

- The policy suite should be **aligned with the trajectory** required to meet current and future emissions reduction targets.

- To meet emissions reduction targets at lowest cost to the economy, the design of Australia's policy suite should keep open opportunities to **link and trade with other international markets**.

- **Bipartisan agreement** on climate policy is central to alleviate uncertainty for business and develop an effective, stable and enduring suite of instruments.

This position statement focusses on providing recommended factors to consider under three broad themes:

- The Emissions Reduction Fund (ERF);
- The safeguard mechanism and
- International carbon market developments and linkages.

In determining these recommended key factors to consider we have not discussed alternative policy options and the frame of reference is on how the existing policy suite will evolve. We have not proposed a position outlined in this position statement on the Renewable Energy Target and have kept our focus on electricity sector transition to the emissions reduction pathway that can be achieved through the safeguard mechanism. We do acknowledge that the effective incorporation of climate policy considerations into existing electricity market governance frameworks and processes also needs to be addressed in the policy review.

This position statement is an evolving document that we will seek to enhance and on which we will consult further consult on as the policy review process becomes clearer.

It is under the above paradigms that CMI has formulated the following factors to consider in developing the terms of reference for the 2017 review of Australia's domestic climate change policy suite.

**The following executive summary represents a synthesis of views and is not representative of any individual or CMI member company position.*

Summary of Factors to Consider - Australian Climate Policy Review

Emissions Reduction Fund

1. The review should consider the appropriate **quantum of future funding allocations to the ERF** required to ensure the continuity of the domestic carbon offset industry until the time it transitions to a market driven by demand under the safeguard mechanism.
2. The review should consider **modifying the ERF method development and governance processes** so that new methods are participant-led and there is transparency and stakeholder engagement ahead of any method changes.
3. It is important the review considers how additional **sources of private sector demand for carbon units** credited under the ERF can be created.
4. The review should consider how methods developed under **the ERF can be aligned with international standards,** and how developments under the implementation of the Paris Agreement can enhance integration of markets and possible export market opportunities for Australian Carbon Credit Units and Australian expertise.

Safeguard Mechanism

5. The review should determine **the specific contribution the safeguard mechanism will make to meeting Australia's emissions reduction targets** under both current and future UNFCCC commitments.
6. The review should consider how **the trajectory of baselines set under the safeguard mechanism can be set to align with the trajectory of emissions reduction** required under Australia's current and future international emissions reduction commitments.
7. The review should provide clarity on the conditions, criteria and process for **how emissions baselines under the safeguard mechanism will be adjusted** in the pre and post-2020 period.
8. The review should consider how coverage of the electricity sector can most effectively be treated under the current policy suite, in order to **send a price signal to transition to lower emissions sources of electricity generation**.
9. The review should consider the options and implications for **expanding the threshold of coverage** for entities under the safeguard mechanism.
10. The review should examine options for how the safeguard mechanism can evolve and **transition to a baseline and credit trading system** to drive lowest-cost emissions reductions across the economy.
11. The review should consider **the appropriate enforcement options and penalties for non-compliance** under the safeguard mechanism, sufficient to provide a strong signal for covered entities to invest in emissions reduction and clean technology projects.

International carbon markets

12. The review should consider the **use and eligibility of international units and the ratio with domestic units** for use to meet safeguard mechanism compliance obligations.

13. The review should consider the **factors affecting availability and future supply and demand for domestic and international units** as countries implement their commitments made under the Paris Agreement.

14. The review should examine how Australia could **be part of internationally linked carbon markets** as they evolve under the Paris Agreement and examine the pathway to open up opportunities for the **export of Australian Carbon Credit Units** into other markets.

15. The review should examine the potential need and the options for Australia to set up **a strategic reserve of international units** to meet our 2020 and 2030 targets.

Targets

16. The review should consider and define the **long term emissions reduction trajectory** for the Australian economy beyond 2030 leading to net zero emissions.

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Position statement: Factors to consider in the setting of the terms of reference for the 2017 review of Australian domestic climate change policy.

Introduction

The Australian Government has scheduled a review of domestic climate policy in 2017. The outcomes of the review will be crucial to how Australia's existing climate policies can evolve to meet current and future emissions reduction commitments made under the Paris Agreement.

It is critical that in establishing the terms of reference of the review, factors are considered that will enable the review to ensure the effectiveness, stability and predictability of the domestic policy framework over the long term, and outline the pathway for the transition to a low (or zero) carbon economy.

The international targets set by Australia in our commitment under the Paris Agreement will be reviewed and strengthened in line with the stocktake and review process. Australia will need to scale up our UNFCCC target over time with due consideration of Australia's carbon budget and we will need to report on how policy implementation efforts will strengthen in the years ahead.

At present, the alignment of the emissions reduction achieved through the policy suite with Australia's 2030 target remains unclear and there is widespread recognition that policy settings will have to tighten in the near future. With this in mind, emphasis should be placed on providing clarity on the terms of reference of the policy review as soon as possible.

The review process should examine how the existing policy suite will evolve to achieve our current and future targets, providing clarity for business and predictability essential to stimulate investment in clean energy and technology, emissions avoidance and carbon abatement.

The CMI has undertaken extensive research and consultation to provide input into the process to establish the terms of reference for the review. This position statement summarises CMI's position. The factors to consider that we recommend have been developed with input from CMI's annual Australian Climate Policy Survey 2016, CMI's corporate member policy and land sector working groups, and extensive consultations with CMI members and international carbon market experts and international agencies.

This statement focuses on providing recommended factors to consider under the three broad themes:

- The Emissions Reduction Fund (ERF);
- The safeguard mechanism and
- International carbon market developments and linkages.

In determining these recommended key factors to consider we have not discussed alternative policy options and the frame of reference is on how the existing policy suite will evolve. We have not proposed a position outlined in this position statement on the Renewable Energy Target and have kept our focus on electricity sector transition to the emissions reduction pathway that can be achieved through the safeguard mechanism. We do acknowledge that the effective incorporation of climate policy considerations into existing electricity market governance frameworks and processes also needs to be addressed in the Review.

This position statement is an evolving document that we will seek to enhance and further consult on as the policy review process becomes clearer.

It is under the above paradigms that CMI has formulated the following factors to consider in developing the terms of reference for the 2017 review of Australia's domestic climate change policy suite.

**The following position statement represents a synthesis of views and is not representative of any individual or CMI member company position.*

Australia's emissions reduction commitments

As part of its Intended Nationally Determined Contribution (INDC) submitted under the Paris Agreement, the Australian Government committed to an emissions reduction target of 26 to 28 per cent below 2005 levels by 2030[1]. As outlined in the INDC, Australia plans to meet this target through a combination of policies including:

- The Emissions Reduction Fund;
- The safeguard mechanism;
- Renewable Energy Target (23 per cent of Australia's electricity by 2020);
- National Climate Resilience and Adaptation Strategy;
- National Energy Productivity Plan (40 per cent improvement between 2015 and 2030);
- Improvements in the efficiency of light and heavy vehicles and
- Enhanced management of synthetic greenhouse gas emissions under ozone protection laws and the Montreal Protocol.

The contribution of each of the above policies to reducing Australia's emissions is illustrated in Figure 1 below.

[1] Commonwealth of Australia, Department of the Prime Minister and Cabinet, *Setting Australia's post-2020 target for reducing greenhouse gas emissions. Final report of the UNFCCC Taskforce.*

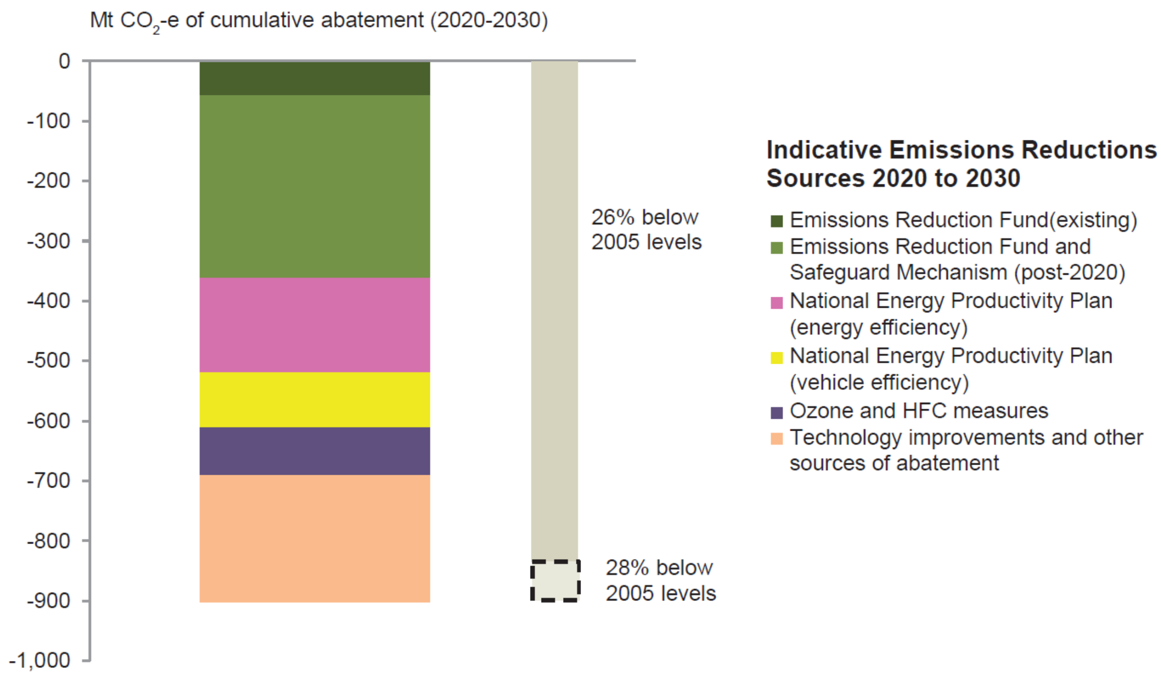


Figure 1: Emissions reduction contributions that the Australian Government's Direct Action policies could make towards the 2030 target. Source: Commonwealth of Australia, Department of the Prime Minister and Cabinet, Setting Australia's post-2020 target for reducing greenhouse gas emissions. Final report of the UNFCCC Taskforce.

In line with Paris Agreement's pledge and review mechanism, targets will be reviewed every five years (commencing in 2023). With each revision, countries (Parties) will have the option to maintain their existing target or increase the level of ambition. The pledge and review mechanism will mean Australia's emission reduction targets are examined by the international community which may lead to pressure to commit to greater emissions reductions.

Australia's emissions reduction policy suite must therefore not only achieve the 2030 target, but be sufficient to achieve deeper emissions reductions likely to result over time through the pledge and review process. With a well-designed, effective and long term policy suite, Australia can provide a stable landscape for business decision making and navigate the low emissions transition in line with our international commitments. The 2017 review is a key starting point for this goal.

This position statement focuses on the Emissions Reduction Fund, safeguard mechanism and international market developments. While not explicitly covered in this document, the importance of other complementary policies is recognised.

Position statement development process

This position statement was developed by the Carbon Market Institute through a national survey of business, an extensive series of one-on-one consultations with both members and broader industry, working groups, meetings with government departments and policy makers and international collaborative research. Detail on each component of the development of this position statement is provided below:

- **National business survey - *Australian Climate Policy Survey 2016* –** CMI's annual Australian Climate Policy Survey was conducted from 15 July to 5 august 2016. A total of 208 senior-level individuals completed the 2016 Survey. Respondents represent a broad cross-section of energy intensive industry, primary industries, local government, carbon offset project developers, and financial and professional services. Thirty-five percent of respondents represented NGER reporting companies while 18 per cent were liable under the ERF safeguard mechanism.

- **One-on-one consultations with CMI members and industry –** CMI has undertaken a broad consultation with industry (particularly those impacted under the safeguard mechanism, including emissions intensive trade exposed industries), both within and outside the companies comprising the membership. Consultations have included discussion across the factors to consider listed in this paper.

- **CMI member Working Groups –** CMI convened both our Land Sector Working Group and Policy Working Group, attended by 22 and 60 companies respectively. The working groups to discuss this position statement and the factors to consider in detail.

- **Meetings with government and policy makers –** CMI has met with a broad range of policy makers, both departmental staff (Department of Environment and Energy and Department of Foreign Affairs and Trade) and members of Parliament from major and minor parties. Discussion with policy makers assisted in shaping the factors outlined in this document.

- **Consultations with international carbon market experts and international agencies –** In collaboration with the International Emissions Trading Association, CMI is preparing a report highlighting the opportunities for Australia in international carbon markets. This report has aided in providing background information for this position statement.

NOTE – all figures in the following section are derived from the Carbon Market Institute's Australian Climate Policy Survey 2016. Please visit carbonmarketinstitute.org to obtain a copy.

Australian Climate Policy Review – Factors to Consider.

Emissions Reduction Fund

1. **The review should consider the appropriate quantum of future funding allocations to the ERF required to ensure the continuity of the domestic carbon offset industry until the time it transitions to a market driven by demand under the safeguard mechanism.**

The ERF has played a valuable role in supporting continuity of demand for domestic abatement, catalysing the development of a suite of emissions reduction projects and preserving the highly developed expertise in the Australian market. Of the initial $2.55 billion ERF, $1.733 billion has been contracted in the first three auctions. $816 million remains in the Fund, with a fourth auction scheduled for November 2016. With no further allocations of funding signalled, there remains uncertainty over the future of role of the purchasing and crediting mechanisms under the ERF and government purchasing of domestic abatement.

The review should consider the appropriate quantum of future funding allocations to be made to the ERF and, importantly, provide clarity on the timeframe for these allocations. This is especially important for investment certainty in domestic abatement projects and ensuring adequate future supply of Australian Carbon Credit Units (ACCUs).

In addition, under the safeguard mechanism, there will need to be the availability of offsets that can be purchased by facilities emitting above their baseline. If, as expected, safeguard mechanism baselines tighten over time, there will be an increased requirement for a viable supply of domestic offsets. It is important that the policy review examines the quantum of funds required once the existing funds are expended in the next few auctions.

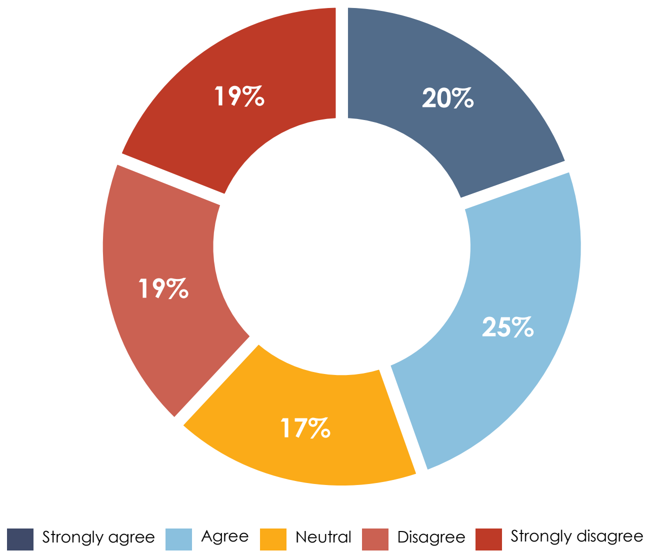


Figure 2: The ERF should be maintained as an ongoing component of Australia's policy suite and progressively topped up with more Government funding to add to the $2.55 billion.

2. The review should consider modifying the ERF method development and governance processes so that new methods are participant-led and there is transparency and stakeholder engagement ahead of any method changes.

Under the Carbon Farming Initiative, the development of abatement methods occurred with strong input from the private sector. This ground-up approach leveraged the expertise within the abatement industry to identify opportunities for emissions reduction and prioritisation method development in an efficient and effective manner. Under the ERF, method development and prioritisation is led principally by the Department of Environment and Energy.

Leveraging the private sector expertise in the development of methods is important for identifying the most efficient and effective means to generate abatement. Furthermore, industry-led method development will assist in prioritising methods most useful to industry and therefore most widely adopted.

In addition, it is essential that the method development and method review process is transparent. Any changes to current methods should be undertaken through appropriate stakeholder engagement to ensure industry views are incorporated and timeframes are appropriate.

3. It is important the review considers how additional sources of private sector demand for carbon units credited under the ERF can be created.

In addition to an evolving safeguard mechanism that increases demand for credits created under the ERF, others sources of demand can be investigated in the policy review. A key sector which represents a potential source of significant demand is electricity generation. Should some form of market-based mechanism, such as an emissions intensity trading scheme, be introduced, significant demand could be created for domestic - and in particular land sector - abatement (in the form of ACCUs) if they are fungible into this scheme. Allowing domestic abatement from a diversity of ERF registered projects would also ensure lowest cost abatement for electricity generators, limiting any increases in power prices.

A further option for stimulating private sector demand for ACCUs is through the incorporation of offsetting requirements in environmental and planning approval legislation. Requirements for emissions from major infrastructure projects have previously been explored at the state level[2]. By introducing requirements for emissions from major projects to be offset by domestic abatement, investment in local projects could be catalysed. Projects could deliver a range of additional social, economic and environmental benefits to the region in which the project is located.

[2] Environmental Assessment Guidelines. Preparation of Management Plans Under Part IV of the Environmental Protection Act 1986. Environmental Protection Authority, Government of Western Australia. August 2015.

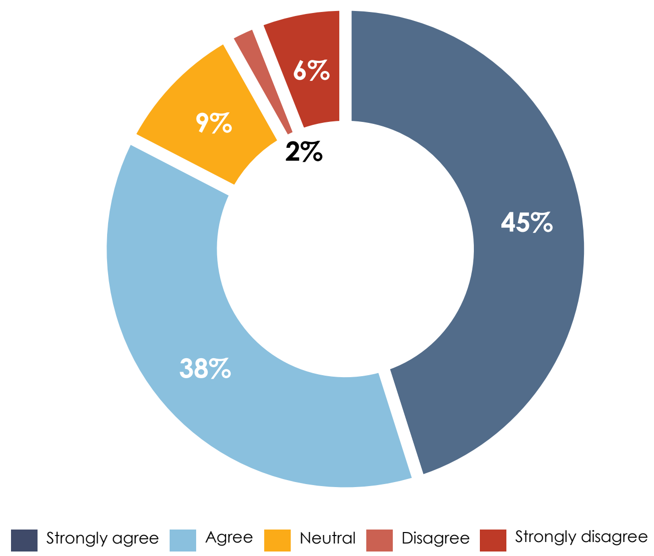


Figure 3: In addition to Government purchasing, it is important there are other sources of private sector demand for carbon units credited under the ERF.

4. The review should consider how methods developed under the ERF can be aligned with international standards, and how developments under the implementation of the Paris Agreement can enhance integration of markets and possible export market opportunities for Australian Carbon Credit Units and Australian expertise.

International carbon markets are going to evolve under the framework of the Paris Agreement. The suite of emissions reduction project methods developed under the Carbon Farming Initiative and ERF represent carbon abatement and emissions avoidance projects that could be aligned with international standards and form part of suite of project types that have applicability in other jurisdictions.

It is likely that a significant portion of the ACCUs generated from ERF projects in the future will be needed to meet Australia's domestic emissions reduction targets. However, the potential exists to invest in and implement largely land-based emissions reduction projects at a scale that represents an opportunity to generate surplus abatement. This surplus abatement could potentially be exported (in the form of ACCUs) into foreign compliance markets, creating additional demand for Australian abatement.

Australia also has extensive expertise and capacity in project development and across the broader emissions reduction project and services spectrum. Many of the countries in our region are lacking such expertise as they develop their emissions reduction institutions and frameworks to meet their obligations under the Paris Agreement. This represents a potential opportunity to export Australian expertise to assist with these processes, creating economic opportunities for Australian business.

The review should consider how Australia's combination of advanced methods and world-leading expertise could be leveraged to create opportunities for Australian businesses in markets in our region. The majority of Australian businesses in CMI's recent survey supported the exploration of export markets for ACCUs (Figure 4) and the review should consider opportunities for Australia as markets evolve under the Paris Agreement.

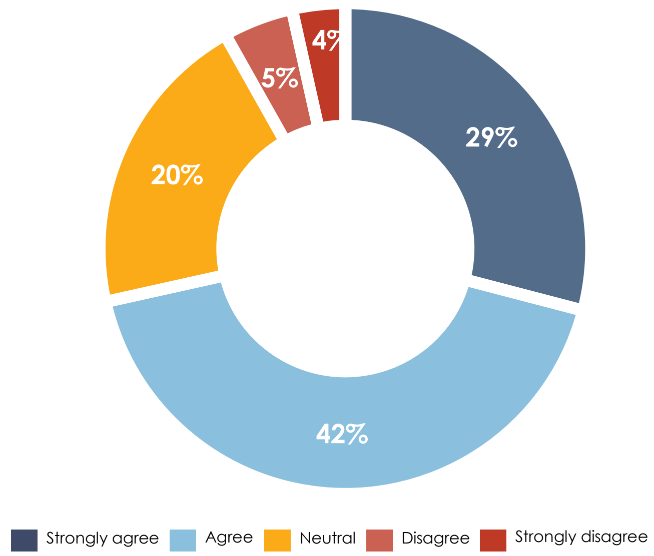


Figure 4: The Australian Government should work to open up market opportunities for the transfer/export of credits created under the ERF into other markets.

The safeguard mechanism

5. The review should determine the specific contribution the safeguard mechanism will make to meeting Australia's emissions reduction targets under both current and future UNFCCC commitments.

The safeguard mechanism is estimated to be required to contribute approximately 300MtCO2-e of emissions reductions to 2030 to achieve Australia's target of 26-28 percent below 2005 levels submitted as part of our NDC under the Paris Agreement[3]. This is the largest of all emissions reductions sources outlined by the Government, implying the safeguard mechanism will play a significant role in reducing Australia's emissions, especially in the post-2020 period.

In its current form, the safeguard mechanism is unlikely to make a significant contribution to reducing emissions below business as usual levels, as the baselines are not set to drive the significant emissions reductions required to meet our 2030 target. The review should therefore determine the contribution in terms of the quantum or percentage of emissions reductions the safeguard is to make to Australia's targets. It is particularly important that the contribution of the safeguard mechanism, relative to other policy mechanisms, is made clear by the review process.

An outcome of the review should be to determine how the safeguard could evolve into a robust and enduring mechanism and become the primary means to limit emissions growth across the Australian economy in line with emissions reduction targets set under the UNFCCC.

[3] Setting Australia's Post-2020 Target for Reducing Greenhouse Gas Emissions. Final Report of the UNFCCC Taskforce, Australian Government, August 2015

6. The review should consider how the trajectory of baselines set under the safeguard mechanism can be set to align with the trajectory of emissions reduction required under Australia's current and future international emissions reduction commitments.

Aligning baselines allocated under the safeguard mechanism with Australia's internationally committed emissions reduction targets will provide the basis for both an effective policy lever and a stable and predictable landscape for business.

Australia's target under the Paris Agreement is a starting point. Our international obligations are likely to become more stringent over time with the five yearly pledge-and-review system of the Paris Agreement. Any mechanism that is introduced today needs to be flexible to accommodate changing emissions reduction circumstances and increased international obligations. Aligning the trajectory of safeguard mechanism baselines with international targets is central to allowing our current and future commitments to be met. Clearly aligned baselines will also allow the safeguard mechanism to effectively meet its objectives over the long term.

Aligning baselines with emissions reduction targets provides additional clarity on potential future obligations for Australian business. The majority of Australian businesses foresee more stringent limits on emissions coming into force in the near future and require a clear understanding of their future baselines to inform operational and investment decision making. In CMI's recent survey of major Australian businesses, 83 per cent of the 208 respondents were of the view baselines under the safeguard mechanism should decline over time in line with Australia's emissions reduction target (Figure 5).

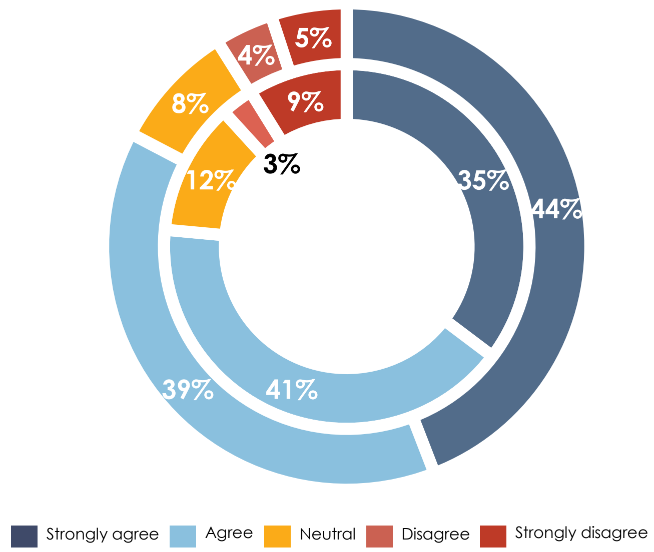


Figure 5: Baselines allocated under the Safeguard mechanism should be set to tighten over time in line with the trajectory of Australia's 2030 emissions reduction target. Inner series represents entities covered by the safeguard mechanism, outer series represents all respondents.

7. The review should provide clarity on the conditions, criteria and process for how emissions baselines under the safeguard mechanism will be adjusted in the pre and post-2020 period.

The Explanatory Statement for the safeguard mechanism states that the review will cover a range of elements including any conditions and criteria for existing facilities to adjust baselines[4].

According to CMI's Australian Climate Policy Survey 2016, 92 per cent of 208 respondents were of the view that the conditions and criteria for how emissions baselines under the safeguard mechanism will be adjusted in the post-2020 period should be an essential component of the review (Figure 6). This position is further supported by consultations CMI has undertaken with industry.

It is critical that the review consider the conditions and criteria for future baseline adjustment to provide clarity for business to undertake their own modelling and assessments of their potential liability and future emissions reduction task. Clear conditions and criteria are also important for informing investment decisions on abatement projects and, in a broader context, participation in the ERF. These conditions and criteria could include:

- The contribution of the volume of abatement purchased at ERF auctions;
- The quantum of abatement required to 2030 under agreed international; obligations
- The results of national inventory of emissions;
- The prospect of sector specific baselines declining at different rates;
- The contributions to the abatement task from other policies and
- Business as usual emission trajectories of entities covered under mechanism.

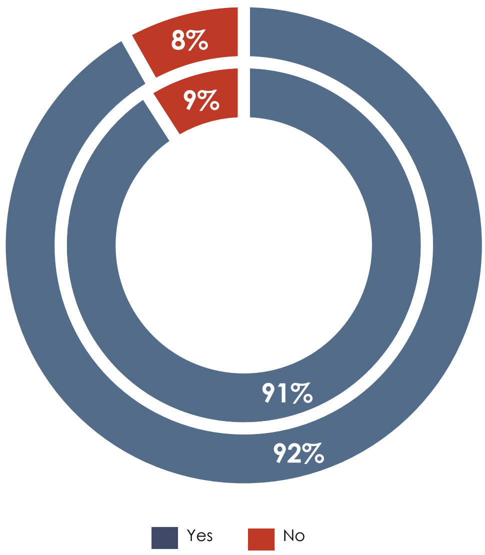


Figure 6: The conditions and criteria for how emissions baselines under the safeguard mechanism will be adjusted in the post 2020 period should be an essential component of the review. Inner series represents entities covered by the safeguard mechanism, outer series represents all respondents.

[4] National Greenhouse and Energy Reporting (Safeguard Mechanism) Rule 2015 Explanatory Statement. Issued by the authority of the Minister of the Environment.

8. The review should consider how coverage of the electricity sector can most effectively be treated under the current policy suite, in order to send a price signal to transition to lower emissions sources of electricity generation.

Emissions reduction policy and the low-carbon transition of the Australian economy will impact different sectors and industries in different ways. It is important the review consider options for the treatment of some sectors that are likely to be more substantially impacted as the policy suite evolves. This is particularly the case for the electricity generation sector and emissions intensive trade-exposed (EITE) industries (Figure 7).

A clear price signal is required to decarbonise the electricity generation sector while providing a clear signal to investors and removing potential volatility in the transition. The review should consider the most appropriate market-based-mechanism, linked to the overall national emissions cap and facilitating trade in carbon or a version of an intensity-based trading scheme, to determine the most cost-effective and simple means to provide the required price signal. Any approach needs to cover the National Electricity Market (NEM) and be at the national scale.

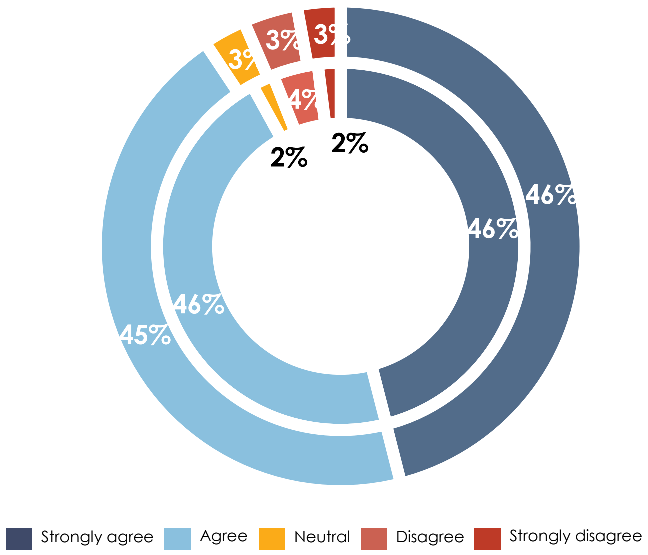


Figure 7: The successful decarbonisation of the Australian economy will involve taking into account the specific sectoral needs of transforming the electricity system. Inner series represents NGER reporting entities, outer series represents all respondents.

At the same time, as the electricity generation sector may require particular treatment under the domestic policy suite (Figure 8), the review should consider competitiveness impacts for EITEs. The policy approach needs to avoid penalising EITEs relative to our international competitors. This could be in the form of enhanced access to international units, together with a combination of reduced emissions reduction obligations and targeted exceptions.

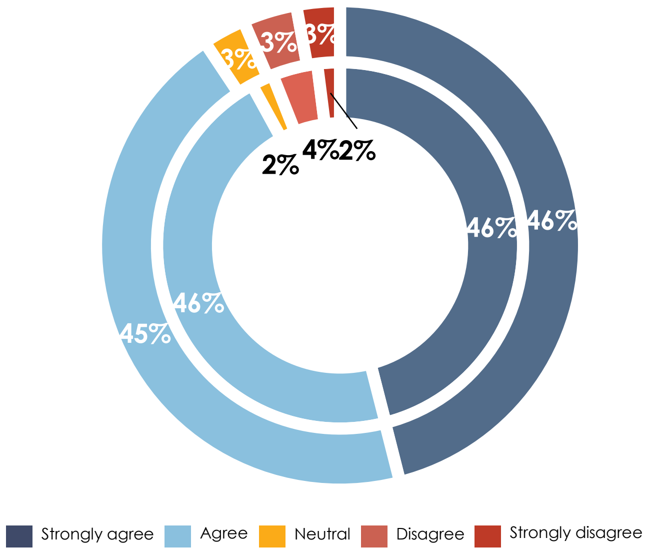


Figure 8: The successful decarbonisation of the Australian economy will involve taking into account the specific sectoral needs of transforming the electricity system. Inner series represents NGER reporting companies, outer series represents all respondents.

9. The review should consider the options and implications for expanding the threshold of coverage for entities under the safeguard mechanism.

The Clean Energy Regulator has allocated baselines under the safeguard mechanism to approximately 250 high-emitting facilities[5] representing around 50 per cent of Australia's national emissions (CY15[6]). There is still a significant portion, approximately half, of Australia's emissions that are not covered. Without a greater portion of entities covered under the safeguard mechanism, the emissions reduction task will rely more heavily on a relatively small number of companies.

The review should consider the options and implications for expanding the threshold of coverage under the safeguard mechanism (Figure 9). Coverage should be based on modelling of the emissions abatement profile and trajectory of emissions reductions required to meet our Paris Agreement commitments. Calibrating the coverage of the safeguard mechanism against the abatement task is crucial for ensuring the threshold is set correctly.

[5] Safeguard baselines table. Clean Energy Regulator, available at http://www.cleanenergyregulator.gov.au/NGER/National%20greenhouse%20and%20energy%20reporting%20data/Safeguard-baselines-table#Safeguard-baselines-table. Last updated 29/9/2016.
[6] Quarterly Update of Australia's National Greenhouse Gas Inventory: December 2015. Australia's National Greenhouse Accounts. Australian Government Department of the Environment.

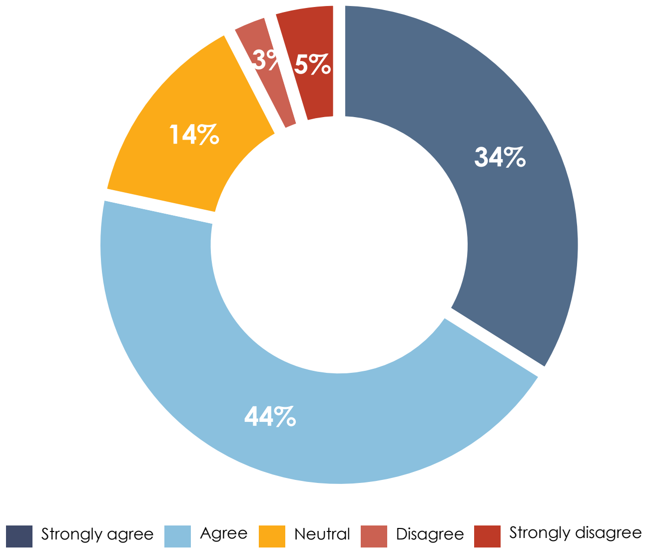


Figure 9: The Government should consider expanding the threshold of coverage for entities under the safeguard mechanism (i.e. to include lower emitting companies or facilities).

10. The review should examine options for how the safeguard mechanism can evolve and transition to a baseline and credit trading system to drive lowest-cost emissions reductions across the economy.

Transitioning the safeguard mechanism to a baseline and credit trading scheme will enable the mechanism to become an effective, long term and stable instrument which underpins lowest cost emissions reduction across the economy. In CMI's recent Australian Climate Policy Survey, 79 per cent of respondents agreed or strongly agreed that the safeguard mechanism should transition to a baseline and credit trading scheme (Figure 10). In addition, Carbon pricing is well understood and utilised across Australian business, particularly among larger emitting entities covered under the safeguard mechanism. Seventy-three per cent of Australian companies surveyed by CMI are factoring a carbon price in investment decisions, including 70 per cent of NGER reporting companies (Figure 11).

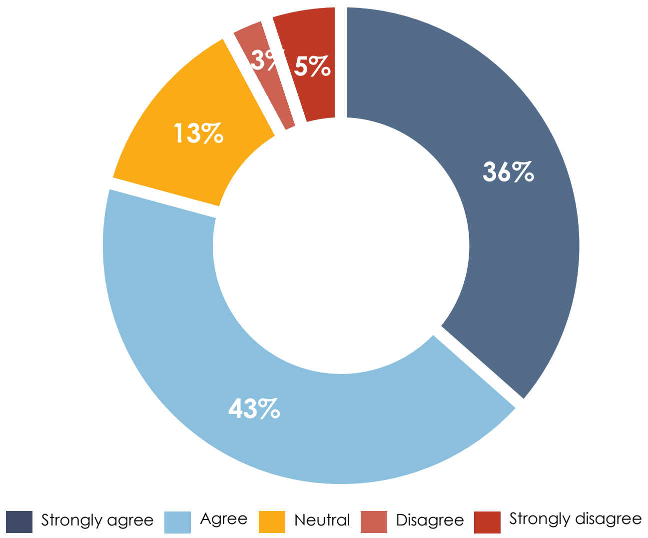


Figure 10: The Safeguard mechanism should transition into a baseline and credit trading scheme.

The full transition of the safeguard mechanism into a market-based mechanism such as a baseline-and-credit trading scheme would assist in stimulating early innovative action to meet emissions reduction targets, 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.

In a baseline and credit scheme, covered entities can offset their liability by reducing emissions below the baseline, creating credits through emissions reductions 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.

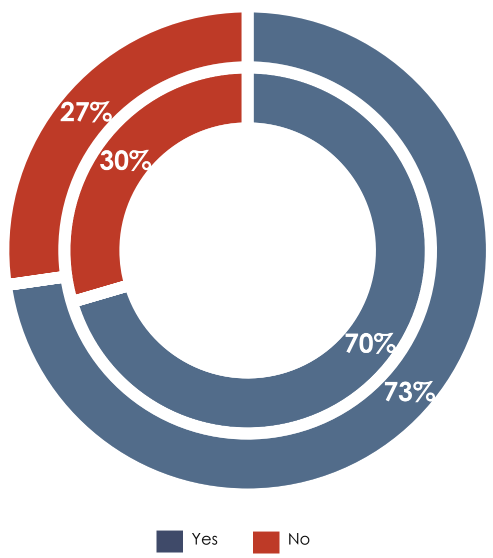


Figure 11: If you work for a company with greenhouse gas producing activities: Is your company factoring in a carbon price in investment and/or operational decisions? Inner series represents NGER reporting companies, outer series represents all respondents.

In addition, a market-based safeguard mechanism will enable the transitioning of future cost of funding emissions reduction from the public to the private sector. As public funding of the ERF reduces, the safeguard mechanism baselines can be made more stringent, transferring the policy framework 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.

11. The review should consider the appropriate enforcement options and penalties for non-compliance under the safeguard mechanism, sufficient to provide a strong signal for covered entities to invest in emissions reduction and clean technology projects.

The maximum final sanction under the safeguard mechanism is currently $1.8 million (the maximum amount set at the lesser of 100 penalty points per day (currently $18,000 per day), to a maximum of 10,000 penalty points in total)[7]. At this level, the sanction may not be of sufficient scale to incentivise entities covered by the safeguard mechanism to invest in emissions reduction projects under the ERF to hedge against potential baseline exceedance. A more substantial final sanction would increase the consequence of exceeding baselines, potentially leading to a reduced risk appetite from covered entities and a hedging strategy through investment in ERF projects or purchasing of credits.

At the same time, the allocation of funds received through the final sanction could be directed toward funding emissions reduction projects. Funding screens could be applied to ensure these funds are directed toward projects that deliver substantial social, economic and/or environmental co-benefits but are marginal in terms of their viability. Directing funds received through the safeguard mechanism final sanction could enable such projects to proceed, delivering additional benefits to the emissions reduction required to bring net emissions back under baseline levels for the covered facility subject to the final sanction.

International carbon markets

12. The review should consider the use and eligibility of international units and the ratio with domestic units for use to meet safeguard mechanism compliance obligations.

In order for covered entities to meet compliance at lowest cost, a balance of international and domestic offset units should be considered. It is important to achieve this balance to ensure continuity of demand and protection of the domestic abatement sector, while ensuring compliance costs can be managed most effectively for safeguard mechanism covered entities.

The review should consider how the balance of international and domestic units can be determined and the associated timeframes. This process needs to consider which international units are most appropriate, eligibility requirements and their forward price curves, particularly in the post-2020 period. By mapping the forward price curves of selected international units together with the ACCU price, the review can determine the weighted average cost of compliance for covered entities, assisting with identifying the optimal unit balance.

[7] National Greenhouse and Energy Reporting (Safeguard Mechanism) Rule 2015 Explanatory Statement. Issued by the authority of the Minister of the Environment.

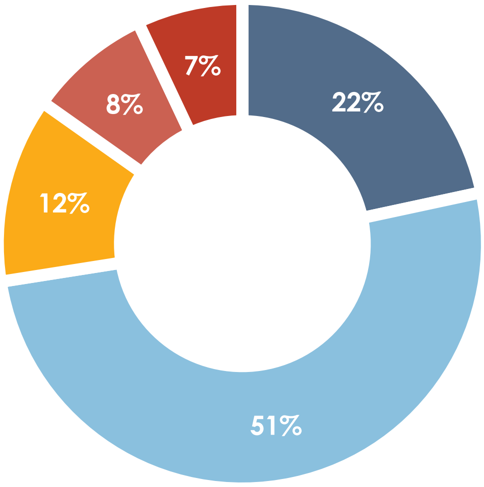


Figure 12: The range of emissions offset units that could be used by businesses that exceed their safeguard mechanism baselines should include both domestic and eligible international units.

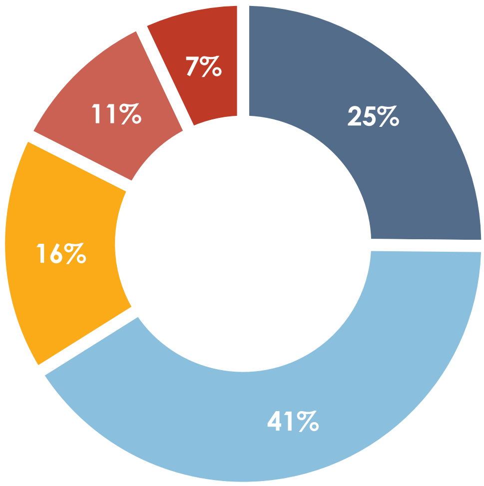


Figure 13: There should be strict limits on the use of international units in Australian schemes in order to protect the domestic abatement market.

Strongly agree | Agree | Neutral | Disagree | Strongly disagree

13. The review should consider the factors affecting availability and future supply and demand for domestic and international units as countries implement their commitments made under the Paris Agreement.

The Kyoto Protocol is due to draw to a close in 2020, and consequentially the future of the underlying Clean Development Mechanism (CDM) and associated offset credits (CERs) remains unclear. The Paris Agreement's Article 6 provides a framework for 'Internationally Transferred Mitigation Outcomes – ITMOs' which may develop into a new form of credit issuance protocol in the post-2020 period. Taken together, these factors will have strong bearing on the future price of international units issued under the UNFCCC, traditionally the most abundant and cheapest robust units available. The supply of units will be further impacted by the Chinese ETS - the world's largest market - coming online in 2017.

It is important for the review to consider how the future supply and demand of international units and the subsequent price impacts as the CDM transitions in the post-2020 period. This is an important consideration for ensuring the appropriate balance of international and domestic units for compliance under Australia's domestic emissions reduction policy.

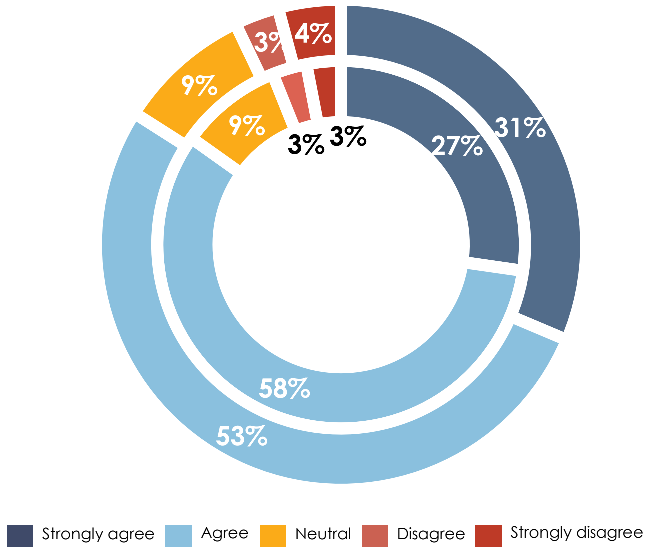


Figure 14: The review should encompass issues related to international trade in carbon including: the use and eligibility of international units, the factors affecting future supply and demand for domestic and international units, the potential export of Australian Carbon Credit Units, and options to link carbon markets under the Paris Agreement. Inner series represents entities covered by the safeguard mechanism, outer series represents all respondents.

14. The review should examine how Australia could be part of internationally linked carbon markets as they evolve under the Paris Agreement and examine the pathway to open up opportunities for the export of Australian Carbon Credit Units into other markets.

The policy approach adopted in Australia should evolve in parallel with developments in other international markets. Over 90 countries identified the possible use of carbon markets in achieving their NDCs submitted under the Paris Agreement. The design features of Australia's domestic policy suite should maintain a line of sight to our post-2020 targets and the potential for international fungibility of ACCUs so as to enable the development of linkages with other markets over time. Engaging with international markets can provide an opportunity to both allow entities covered under the safeguard mechanism to meet compliance at lowest cost and support the development of export markets for ACCUs.

Companies that have compliance obligations under the safeguard mechanism, particularly if baselines are to decline, could potentially manage their exposure cost effectively by using a range of trading and hedging strategies that involve international units.

The review should examine the pathway to open up market opportunities for the transfer and export of Australian Carbon Credit Units into other markets. Engaging with the many countries that outlined the use of international markets in their NDCs is an effective way to create an export market for ACCUs credited under the ERF. Export markets represent a potential additional demand for ACCUs beyond a domestic compliance policy such as the safeguard mechanism or Government funding of abatement.

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.

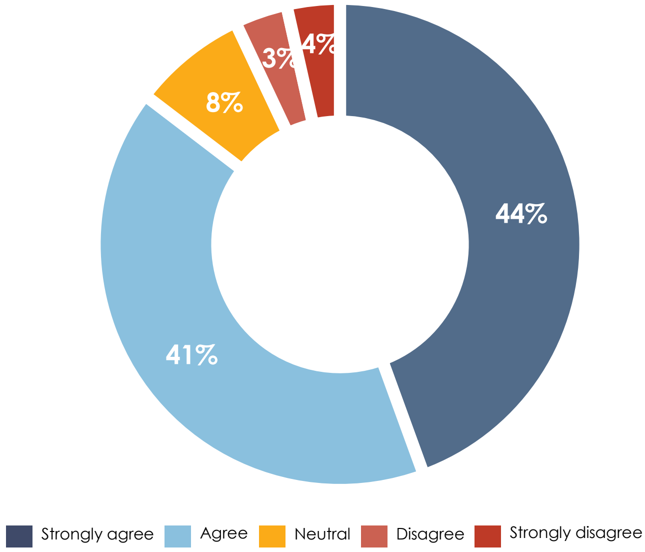


Figure 15: Australia should be part of internationally linked markets as they evolve under the Paris Agreement.

15. The review should examine the potential need and the options for Australia to set up a strategic reserve of international units to meet our 2020 and 2030 targets.

Australia's emissions reduction target of 26-28 per cent below 2005 levels by 2030 submitted as our NDC under the Paris Agreement will require a significant downward change in the trajectory of our national emissions. Under the current policy suite, the safeguard mechanism is estimated to be required to contribute approximately 300MtCO2-e of emissions reductions to 2030, the largest contribution of any current policy instrument[8]. As currently designed, safeguard mechanism baselines reflect business as usual emissions levels and are unlikely to result in the reductions required to meet our target. Considering the potential for establishing a strategic reserve of international units may enable Australia to ensure we achieve our international commitments.

A strategic reserve is a fund created to procure a sufficient quantity of eligible international units to meet an emissions reduction target and to provide a reserve of credits for use by domestic entities, should they be required. Should it be established, a strategic reserve could serve as a mean to ensure that Australia meets its 2030 emissions reduction target. Australia can draw on models used by other countries and private sector institutions when designing its strategic reserve and develop a mandate that suits our specific policy requirements and emissions reduction goals.

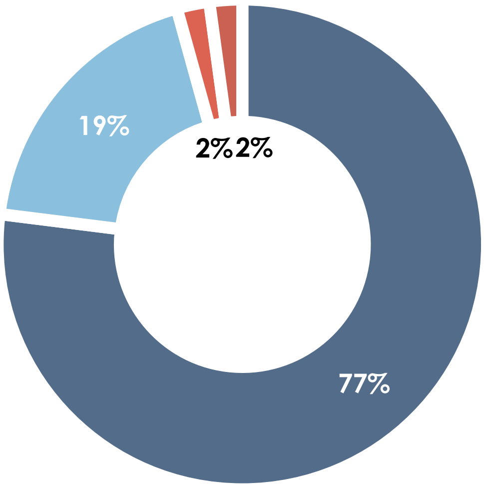
The establishment of a strategic reserve would complement the current policy suite and, as part of a suite of well-designed climate policies, would ensure that Australia can meet its current and future emissions reduction targets.

[8] Setting Australia's Post-2020 Target for Reducing Greenhouse Gas Emissions. Final Report of the UNFCCC Taskforce, Australian Government, August 2015

Targets

16. The review should consider and define the long term emissions reduction trajectory for the Australian economy beyond 2030 leading to net zero emissions.

As highlighted in Australia's INDC, it is important the review and policy suite provide a long term signal on how the Australian economy will transition to net zero emissions beyond the 2030 target. Providing long term indications, beyond the 2030 period, of how Australia will reach net zero emissions is central to allowing business to make long term decisions and optimise their position in the transition to a low carbon economy (Figure 16).



- Have a stronger target, in line with the Climate Change Authority's recommended post-2020 target of 40-60 per cent below 2000 levels by 2030.
- Maintain our existing target of a minimum 26-28 per cent emissions reduction by 2030 on 2005 levels.
- Have a weaker target than 26-28 per cent.
- Have no target.

Figure 16: In your view, given the need to continually ratchet up ambition over time, Australia should:

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