Tim Kelly
South Australia

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Consultation Support Team
GPO Box 854
Canberra ACT 2601
Australia
CarbonPriceSubmissions@climatechange.gov.au

This submission is not confidential

Thank you for the Opportunity to comment on the *Architecture and Implementation Arrangements for a Carbon Pricing Mechanism.*

The architecture of the pricing mechanism is most important particularly as the mechanism is to evolve from a greenhouse gas emissions levy, to a cap and trade scheme based on permits within a short time. Both of these approaches are very different in how they influence change by emitters, their consumer markets and community behaviour.

Of critical importance is the need to provide clarity on what the two different mechanisms would deliver, and the inherent constraints of the each mechanism.

This submission focuses on the way that the price mechanisms work and in particular the ineffectiveness of complementary measures under a cap and trade scheme.

1. ARCHITECTURE OF A FIXED PRICE GREENHOUSE GAS EMISSIONS LEVY (usually referred to as a carbon tax)

The fixed price levy required of large polluters should be high enough to provide a significant disincentive for pollution and an incentive for low emissions technology, not only by polluters, but for the entire market and communities that will feel the pass through costs of the fixed price levy.

Under a levy:

- All actions are voluntary from householders communities and business alike
- All are able to take technology, purchasing or efficiency choices to reduce emissions
- Everyone participates and contributes to the overall outcome.

Complementary measures work under a fixed price levy! Actions such as regulating out the worst emitting processes and supporting low emissions technologies can add to the effectiveness of the fixed price levy for a more rapid transition to a low carbon economy.

A large part of the revenue should be used to reduce our biggest sources of pollution such as replacing our fossil fuel power stations with many sources of renewable energy including baseload renewable technologies.

If the fixed price levy is characterised by large exemptions and compensation it cannot work effectively as a market mechanism.

Fairness of fixed price pass through costs

The architecture of the fixed price scheme should ensure fair pass through costs. Under current accounting rules and proposals, GreenPower customers that voluntarily pay for renewable energy are not protected against the carbon costs associated with emissions they have paid to avoid. Such situations if allowed to eventuate would be most unfair, particularly when big electricity users who do not voluntarily contribute to any GreenPower may also be largely exempted from both pass through carbon costs and costs associated with the Mandatory Renewable Energy Target.

The methodologies to determine pass through costs are likely to be complex and largely removed from public disclosure. For this reason, an independent authority such as the ACCC or committee should be tasked with overseeing the fairness of pass through cost methodologies.

2. ARCHITECTURE OF A CAP AND TRADE SCHEME.

Cap and trade schemes work completely differently to a levy. It is critical for the Federal Government to acknowledge that conceptually it is the Government determines the emissions that can be released and no matter what individuals do in a voluntary sense the outcome is not changed once the cap is set.

The basic problem is that where one party in a covered sector makes a change to cause less emissions, another party can access the freed up permits so overall emissions are not changed. **Complementary measures don't really work under a cap and trade scheme, they mostly pick winners within the scheme!**

During the Federal Government's previous consultation on the Carbon Pollution Reduction Scheme, this impact on voluntary was only partially addressed with policy fixes largely made on the run resulting in a voluntary policy mess.

The Government must address known problems:

- 'Voluntary actions have already been taken into account' – This logic was conveyed during the CPRS consultation and creates a feeling of futility and distrust. Under the current market and with a levy scheme, all actions are voluntary. As the scheme evolves to a cap and trade scheme it will be important to not repeat the mistake of telling consumers that their voluntary efforts are already exploited in the National commitments.
- Additionality – Different kinds of additionality:
    - National additionality (whether an action reduces Australia's total emissions) is largely determined by the way that the Government makes adjustments to Australia's greenhouse policies given the progress of reducing emissions.
    - Tangible additionality relates more to real things that people and businesses can do such as using less and choosing better technologies or alternatives. Even turning off lights and turning down air conditioners or heaters are additional tangible actions that everyone can take.
    - Hypothetical additionality is often the construct of paper or electronic trading of permits, emission units and derivatives for voluntary surrender. Such mechanisms

may or may not make any real difference depending on how these mechanisms interact with other schemes.

The Government has applied additionality tests inconsistently, particularly when stopping support for some initiatives under the former Greenhouse Friendly scheme, by ruling these as ineligible for the NCOS Carbon Neutral Program. Tangible additionality should be supported by the architecture of the scheme and not ruled as **non-additional** just because the action may occur within a sector covered by the scheme.

- Traditional tangible actions under a Cap and Trade Scheme – Many people and businesses will continue to take real tangible action to reduce emissions under a cap and trade scheme, and should be encouraged to do so. The actions to use less or switch to low emission alternatives does free up permits directly or indirectly which could cause emissions elsewhere but it does make the situation more feasible for the Government to tighten caps. Unfortunately these efforts become futile if the following voluntary mechanism is allowed at the same time.
- Voluntary surrender of permits – The CPRS proposal included the voluntary surrender of permits. The concept is that by throwing permits in a bin, others cannot access these and under a fixed cap this forces lower emissions elsewhere in the economy. The consequence is however that no actual emissions are reduced and by creating scarcity of permits and higher prices for permits the situation becomes less feasible for the government to tighten caps. The hypothetical additionality of this approach fails if the Government hopes for tangible greenhouse reduction actions to have meaning.
- Coverage of Sectors – There has been a move toward approving voluntary actions in sectors not covered by the scheme and dismissing voluntary activities where it is arguable that they fall within a covered sector. Such an approach is potentially dangerous. Progressively, emissions reductions will be required in all sectors in all countries. By relying on non covered sectors for voluntary offsets (or from countries without emission caps) the architecture could build in a dependency on uncovered areas and may deter coverage.
- The Carbon Pollution Reduction Scheme did not have a cap! Under the CPRS, there was a safety valve for an unlimited number of permits at a fixed price that always had the potential to be used if the cap was breached. Under these circumstances the term “cap and trade scheme” becomes a misnomer. The architecture of the scheme should not allow the implementation of a cap and trade scheme without a true and agreed cap.
- Reducing Australia’s emissions? – The architecture of the carbon price mechanism as it moves to cap and trade must be transparent about the extent to which it will be designed to reduce Australia’s greenhouse gas emissions, or emissions in other countries. By allowing the import of emissions allowances or offsets from other countries, Australia does not reduce its emissions.

Fairness of cap and trade pass through costs

As with a fixed price levy, there needs to be a process to ensure fairness in pass through costs.