

SUBMISSION TO THE  
SENATE STANDING COMMITTEE ON ECONOMICS  
INQUIRY INTO THE EXPOSURE DRAFTS OF  
LEGISLATION TO IMPLEMENT THE  
CARBON POLLUTION REDUCTION SCHEME

MARCH 2009

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**VOLUNTARY CARBON MARKETS ASSOCIATION  
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THE CARBON POLLUTION REDUCTION SCHEME**

## **1. INTRODUCTION**

The Voluntary Carbon Markets Association (VCMA) welcomes the opportunity to provide comments to the Senate Standing Committee on Economics Inquiry into the Exposure Drafts of Legislation to Implement the Carbon Pollution Reduction Scheme (CPRS).

We note that this Senate Standing Committee on Economics Inquiry has invited submissions in relation to the Exposure Draft Legislation and the CPRS.

The VCMA believes that greenhouse gas emissions must be reduced significantly to limit the impacts of dangerous climate change. We support the overarching objectives of the CPRS in reducing Australia's greenhouse gas emissions and the proposed timing for introduction of a carbon price. However, we believe that the current design of the CPRS is flawed in a number of areas and requires modification in order to achieve effective outcomes that involve all sectors of the community and the economy. The necessary changes are relatively minor and easy to implement, as outlined in this submission.

It is imperative to recognise and promote voluntary action by individuals and businesses that want to make a difference to global emission reductions. The current design of the CPRS will:

- drive voluntary emissions abatement offshore, through the purchase of international permits – slamming the brakes on the growth of Australia's clean and green businesses:
- stall the growth of a low carbon economy by killing 'green-collar' jobs, innovation, skills and knowledge in Australia's renewable energy and carbon abatement industry:
- push investment in Australian low-emission technology offshore – making Australia a clean-industry follower, instead of a leader: and
- kill the incentive for Australian businesses, households and individuals to voluntarily make a difference to greenhouse emissions.

Voluntary abatement is good for the environment, the economy and the community and should be encouraged – in fact there is no logical reason to discourage it. The problem is with the structure of the proposed CPRS, as contained in the Exposure Draft. This structure effectively discourages voluntary activity since there is no obligation to recognise voluntary abatement in the Exposure draft legislation. In addition, according to the Exposure Draft legislation, the Scheme cap is set five years in advance, so any adjustment of the Scheme cap to account for voluntary action cannot take place within this period. The adjustment would be relative to a projected emission trend rather than today's actual emissions and Scheme cap. Further, ongoing adjustments would be subject to the discretion of future Ministers and governments, whose policies and attitudes may change, as there is no obligation to recognise voluntary abatement in the Exposure draft legislation.

This model is top-down and paternalistic in its assertion that only Government can determine appropriate aggregate levels of abatement and that businesses and households cannot choose their preferred abatement methods.

Voluntary action is critically important as a means of galvanising community and business support for Australian abatement activity, to reduce global greenhouse gas emissions. Voluntary action does not run counter to the objectives of the CPRS: rather it complements and enhances them.

This submission outlines how the Australian Government can overcome the perverse outcome of disempowering individuals and organisations by adjusting Australia's emission reduction targets to recognise independently verified voluntary action.

The VCMA's key recommendation in relation to the design of the CPRS is to empower voluntary domestic action and make it count as additional abatement at the time it occurs, and where this can be justified, by establishing a framework that quarantines voluntary abatement activity from CPRS and Kyoto compliance requirements, by:

- (a) establishing a register to record the creation of and transactions in Australian voluntary abatement;
- (b) facilitating monitoring, management and accounting for voluntary abatement which can be certified and cancelled from CPRS and Kyoto caps;
- (c) stipulating that, in exchange for each unit of certified voluntary domestic abatement the Government will adjust the CPRS and Kyoto caps at the next permit auction after the actual abatement is certified; and
- (d) establishing institutional arrangements for oversight of the above voluntary abatement framework be established.

This can be achieved by the insertion of a small number of clauses into the legislation implementing the CPRS, giving effect to items (a) to (d) above, in addition to conferring power to make regulations where necessary in relation to consequential details

## **1.1 About the VCMA**

The VCMA aims to restore the link between voluntary abatement action by Australians and real reduction in Australia's (and global) greenhouse gas emissions. This link is now threatened by the mechanisms of the proposed CPRS.

The VCMA was established in November 2008 as an independent not-for-profit association. It represents a broad range of organisations and individuals, including (for example):

- **Providers of offsets** from both within and outside sectors covered by the CPRS;
- **Organisations** (such as businesses, local governments, etc) that wish to be seen as '**carbon neutral**', or wish to reduce their greenhouse gas emissions and contribute to Australia's reduction in emissions by purchase of Greenpower or offsets;
- **Businesses** that provide **goods and services** that may contribute to voluntary abatement; and
- **Community organisations**, households and/individuals wishing seeking recognition for their voluntary abatement action.

One of the immediate focus areas of the VCMA is to advocate simple changes to the design of the proposed CPRS so that voluntary abatement action by households and businesses contributes to additional reduction of Australia's greenhouse gas emissions beyond those delivered under the CPRS. VCMA's view is that failure to give appropriate credit to voluntary abatement will disenfranchise Australian households and businesses, and drive investment in low carbon businesses and infrastructure offshore.

Another key focus area of the VCMA is advocacy in relation to the proposed National Carbon Offset Standard (NCOS). The voluntary abatement market is absolutely dependent on public acceptance of its credibility. As such we must ensure the integrity of all claims made by both those organisations that seek to undertake abatement activities and those that seek to provide products and services to facilitate abatement and offsetting. For detailed views on assuring the integrity of abatement providers and establishing minimum criteria for marketing and branding of environmental claims (including "carbon neutrality"), please refer to VCMA's submission in response to the Government's National Carbon Offset Standard Discussion Paper, dated December 2008<sup>1</sup>.

## **1.2 Why is voluntary action important?**

- There are many organisations, individuals, households and community groups who want to actively make a difference in reducing global emissions. The practical effect of the CPRS is an almost complete failure to recognise the voluntary market in Australia, which is currently dynamic and growing, and which plays a number of important but often unacknowledged roles.
- As a matter of principle, failure to recognise voluntary abatement properly (that is, by ensuring its impact on net emissions is additional) – disenfranchises and disempowers these individuals, households, non-liable parties under the CPRS, community groups and the community generally. It relegates the role of individuals, organisations and community groups to nothing more than passive respondents to price signals that are anticipated to flow through from the operation of the compliance market under the CPRS. The VCMA strongly believes that this will result in community alienation, division and inaction on an issue of urgent national and international significance, where community support and collaboration should be prioritised as critical.
- Without proper recognition of voluntary abatement, community adoption of other government programs and measures is likely to be lower, as people will say "it's the government's problem, they can fix it". On the other hand, positive encouragement of voluntary action empowers and motivates people while building a sense of collective responsibility.
- Voluntary abatement action encourages creative solutions and captures (unpaid) volunteer labour. Advertising and promotional activity by voluntary

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<sup>1</sup> <http://www.vcma.org.au/wp-content/uploads/2009/02/090227-vcma-submission-to-ncos.pdf>

abatement providers as they compete for market share increases the profile of abatement in the community and stimulates positive attitudes.

- Voluntary abatement investment will be driven offshore through purchase of international permits. The government has shown great concern about possible loss of investment in energy intensive industries to other countries, yet it shows no concern about losing investment in the industries that will form a basis of our future economy.
- Voluntary abatement creates more demand for zero and low carbon technologies, goods and services, so it helps to build the industries of the future, and supports competition and markets over compliance and regulation.
- The innovation and economies of scale of voluntary action drive cost reduction and risk reduction regarding climate change. Voluntary abaters are often prepared to pay a premium as part of their commitment, and this plays an important role in underpinning the early stages of development and commercialisation of emerging innovations. For example, Green Power has provided a useful complementary market to the Mandatory Renewable Energy Target (MRET), so that the industry has been less volatile. Also, designers and builders of high performance, low emission buildings have driven innovation in the building sector.
- Many individuals, businesses and even government agencies and local government wish to demonstrate to stakeholders or friends and family that they are playing a responsible role with regard to climate change. This can also be a way for organisations to differentiate themselves from competitors.
- Businesses may value the multiple benefits a focus on abatement delivers within their organisations, as staff develop new positive attitudes and explore ways of improving business productivity that reduce other business costs, create new product or service opportunities and streamline activities.
- Consumers may wish to reward responsible business behaviour and make things tougher for businesses that are high emitters or who work against effective climate change response.
- The Voluntary market may not be as significant as the proposed mandatory market under the CPRS in terms of size, but its existence is critical in terms of shaping public support, maximising abatement and minimising costs.

## **2. IMPLICATIONS OF THE CURRENT CPRS DESIGN FOR THE VOLUNTARY MARKET**

### **2.1 Voluntary action under the Exposure Draft legislation to implement the CPRS**

As acknowledged by the Government<sup>2</sup>, the present design of the CPRS creates a disconnection between an *entity's* activities and *aggregate* emissions, through the introduction of the scheme cap. This undermines the environmental credibility of

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<sup>2</sup> Australian Department of Climate Change, National Carbon Offset Standard Discussion Paper, pg 5

offsetting as part of a household's or organisation's carbon management strategy. To remain credible, offsetting must be underpinned by genuine additional abatement, over and above what will occur through the operation of compliance measures under the CPRS and Australia's Kyoto obligations.

According to the Exposure Draft of the CPRS legislation, options for voluntary abatement or offsets that will reduce Australia's overall level of greenhouse gas emissions are limited to:

- Voluntary purchase and surrender of Australian Emissions Units (AEUs);
- Voluntary purchase and surrender of internationally traded permits eligible under the CPRS – which does not include privately certified offsets such as Gold Standard and Voluntary Carbon Standard, as they are not recognised under the Kyoto Protocol; and
- Under some circumstances, domestic offsets from uncovered sectors.

The VCMA is particularly concerned about the implications of the CPRS on the voluntary market in Australia. Australian families, local governments and businesses concerned with climate change will continue to want their voluntary actions to make a difference over and above the limited reductions in emissions that can be delivered through the CPRS alone.

In the absence of meaningful provision for voluntary action under the CPRS these people will have no other option than to purchase and surrender offsets and other credits created overseas. This will disenfranchise more than 850,000 Australian families (and many leading businesses) that are currently active in the voluntary market and will lead to a loss of local investment to emission reduction technology and projects overseas. It will compromise the development of the clean energy and carbon abatement industry in Australia, causing loss of innovation, skills, jobs and investment.

The proposed design of the CPRS discriminates against some forms of abatement in favour of others. For example, purchase of offsets from independent providers relative to purchase of Green Power (in relation to cost) and abatement in covered sectors within Australia relative to purchase of permits (in relation to national or global abatement outcomes).

The VCMA does not challenge the overarching CPRS principles; nor do we wish to subvert the operation of the mandatory market – rather we are suggesting a mechanism to facilitate appropriate certification of voluntary abatement and adjustment of scheme caps to recognise the significance of such voluntary abatement. In other words, to correct a distortion that is created by the CPRS.

The Exposure Draft confirms VCMA's fear that voluntary abatement action within covered sectors will not reduce Australia's level of greenhouse gas emissions beyond the level set by the CPRS, because any reduction by one agent will simply free up more permits within the CPRS cap for other emitters to purchase and surrender. The only reference to voluntary abatement in the Exposure Draft is in Section 14(5)(c)(iv), which states that "the Minister may have regard to voluntary action which is expected to be taken to reduce Australia's greenhouse gas emissions".

There is no provision in the Exposure Draft legislation for the establishment of mechanisms or allocation of resources to support registration, certification and recognition of voluntary abatement, nor any commitment to development of a methodology to do this. There is no obligation on the Minister to act to adjust the cap in response to voluntary abatement. Thus, recent suggestions by the Minister for Climate Change that adjustments to the cap in the future could recognise voluntary abatement<sup>3</sup> ring hollow.

Section 14 (2) states that the Minister must take all reasonable steps to ensure that:

- (a) regulations declaring the national scheme cap number for the eligible financial year beginning on 1 July 2010; and
- (b) regulations declaring the national scheme cap number for each of the next 4 eligible financial years;

are made before 1 July 2010.

This structure effectively discourages voluntary activity since it clearly shows that any consideration of voluntary action will not take place for at least five years. Further, adjustments beyond 2015 will be at the discretion of the particular Minister in the particular Government at a particular time in the future.

This certainty that voluntary abatement will not be considered for at least five years – and may not in fact be considered at all - destroys any impetus for the survival and growth of an innovative and dynamic market which currently drives job growth and multiple benefits for the community. This also disempowers the actions of many community members, local governments and companies wishing to make a difference to global emissions and undermines the community's support for abatement broadly.

## **2.2 Why isn't the option of buying CPRS permits and voluntarily surrendering them good enough?**

Buying a permit under the CPRS has no direct link to the kind of abatement that will be implemented as a response. It might be:

- closure of a factory, with loss of jobs;
- purchase of an additional international permit with no local benefit, or
- an improvement in the energy efficiency of a uranium mine or coal-fired power station that the person believes should not exist.

Hence there is no guarantee that the abatement will take a form that is satisfying or acceptable to the person who voluntarily buys and retires a permit. For increasing numbers of people and businesses pursuing an ethical approach or trying to meet corporate sustainability objectives, this is a serious problem.

In the experience of members of the VCMA, people prefer to support measures that achieve multiple benefits – for them, their community and/or the environment. As noted above, local voluntary abatement does this. Retiring a permit is not a public statement of commitment to reducing emissions like a solar PV system on the roof or hybrid car parked in the driveway; nor does it offer the personal satisfaction of

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<sup>3</sup> <http://www.abc.net.au/iview/#/view/342635>

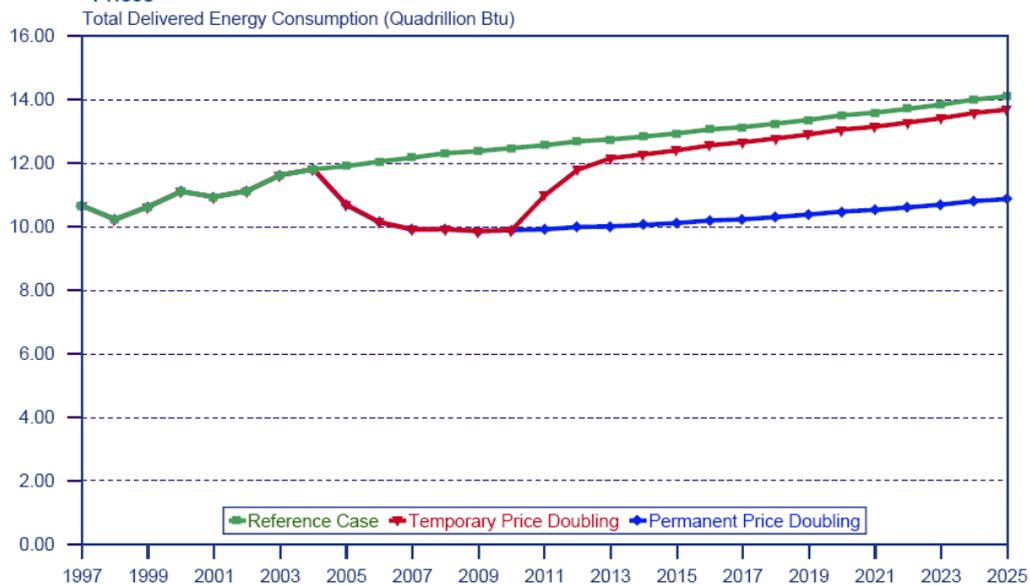
helping to increase habitat for threatened species or improve the wellbeing of communities in developing nations.

### 2.3 What is wrong with the Government’s approach to voluntary action?

As noted above, the CPRS design, as currently proposed, places a cap on aggregate emissions from covered emissions sources: it breaks the link between individual action and aggregate emissions. There are a number of flaws in the Government’s approach to voluntary action, as outlined below:

1. The Government’s approach to the CPRS design is based on the assumption that the price signal flowing through the economy will provide an incentive for voluntary abatement activity. The VCMA rejects this logic: in the VCMA’s view, the financial signal of the carbon price will be weak motivator for voluntary emission reductions. For example, the average impact of a carbon price on goods and services is estimated by Treasury at less than 1% - not noticeable to the average consumer. Even electricity, which is expected by Treasury to increase in price by around 17%, is fairly unresponsive to price signals: in recent years, annual price increases of 8% or more have not reduced growth, while a US Energy Information Administration study (see Figure 1) suggests that even a doubling of the energy price (a carbon price of around \$150/tonne) would reduce demand by only 15-20% below a Business As Usual trend. Australian economic modellers typically use low price elasticities for energy and indeed, one of the reasons why high carbon prices are required in modelling to shift behaviour is that the elasticities (that is, relationships between energy price and behaviour) are so poor.

**Figure 1. Response of Residential Delivered Energy Demand to a Doubling of Residential Sector Energy Prices**



Source: Energy Information Administration, calculated from the following price path scenarios using NEMS AEO2003: regeneration of the reference case price path, ELAST03.D121203B; permanent price doubling case, ELAST03.D121202J; temporary price doubling case, ELAST03.D121203K.

From Wade (2005) *Price responsiveness in the AEO2003 NEMS residential and commercial buildings sector models* US Energy Information Administration  
[www.eia.doe.gov/oiaf/analysispaper/elasticity/index.html](http://www.eia.doe.gov/oiaf/analysispaper/elasticity/index.html)

Those who want to take voluntary abatement action are self-evidently prepared to pay a premium to make a difference to reducing aggregate emissions. In the VCMA's view, to argue that such people and organisations will be satisfied that payment of slightly higher energy prices will make an effective difference to overall emissions, highlights the Government's dismissive attitude to a shared responsibility and whole-of-community efforts to address climate change.

2. The Government attempts to provide reassurance that voluntary action will make a difference by reducing competition for the limited number of permits, thereby reducing the price of permits and reducing the overall cost of achieving a given abatement target under the CPRS. It also argues that this will increase the potential to set tougher future CPRS targets. However, the Exposure Draft legislation allows 100% purchase of international permits while (at least in the short term) banning export of Australian permits. This effectively means Australian Liable Parties will have access to the large international CDM market, which is considered by many to be capable of providing large numbers of low cost permits, while inability to export permits will hold Australian permit prices down. Hence, there is likely to be no shortage of low cost permits, and the impact of voluntary abatement on permit price is actually likely to be small, contrary to the Government's assertions. Accordingly, VCMA refutes the Government's assertions that voluntary action will support the tightening of future caps.
3. As outlined in section 2.1 above, adjustment of future abatement trajectories will be made by future governments, based on political compromise, not the criteria that voluntary abaters value. Many Australians are sceptical about the likelihood that future governments will maintain policies agreed today on environmental issues. Further, they see the enormous lobbying power of vested interest groups, and the impacts of this power on government policy. The Government faces a significant lack of trust when it attempts to promise future action on climate change without strong mechanisms for accountability, evidence of resource commitment, and very strong legislation.
4. The CPRS is based on a disconnect between voluntary abatement of an individual's or business' emissions and net abatement at a national level, even though the Government has previously acknowledged that a primary expectation of voluntary abaters is that they will 'make a difference' at a national level<sup>4</sup>.

The VCMA argues that, to be credible, and to justify community and business investment, individual abatement must necessarily also deliver overall net abatement. This is not a fallacy: it is a basic criterion that must be met if Australians are to be motivated to voluntarily abate. Indeed, the DCC Discussion Paper on the National Carbon Offset Standard<sup>5</sup> acknowledges that this link is a critical driver of voluntary action.

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<sup>4</sup> Australian Department of Climate Change, National Carbon Offset Standard Discussion Paper, pg 5

<sup>5</sup> Australian Department of Climate Change, National Carbon Offset Standard Discussion Paper, pg 5

5. According to the CPRS White Paper released in December 2008<sup>6</sup>, for the first five years of CPRS operation, there will be a price cap, which means that the Government can theoretically issue an infinite number of permits for the first five years of the Scheme. This feature renders the Scheme cap practically ineffective since it will override the cap if prices increase, so that there is no longer a limit on the level of emissions.

The price cap is a potential barrier to effective voluntary abatement under the Scheme. Retirement of AEU's on a voluntary basis can only work when there is a confirmed and tight scheme cap, not a price cap. The EU ETS has a scheme limit (emissions cap) with some banking and borrowing from future issuances. However, this comes with a reduced future allocation and a heavy future borrowing price (1 future EUA = E100, with cancellation of free allocation from future allocations). Unlimited banking and borrowing from future allocations means slow emission years for industry will mean it is easier to meet targets in the future. A price cap also risks diluting the price signal intended to drive abatement action.

Given the provision for unlimited purchase of international Kyoto units and ban on export of Australian units, it seems unlikely that a well-chosen price cap would come into play, but this is, nevertheless, a potential spoiler of the credibility and quality of the CPRS.

### **3. VCMA'S RECOMMENDATIONS TO ADDRESS ADVERSE IMPLICATIONS OF THE CPRS FOR THE AUSTRALIAN VOLUNTARY MARKET**

Of critical concern to the VCMA is Australia's ability to quantify the effect of local actions which can be shown to be additional to abatement which would have occurred as a result of CPRS price signals. It is the VCMA's contention that without timely recognition of this abatement through adjustments to the CPRS and Kyoto caps, individuals, organisations and communities will feel disempowered and eventually disengage from any effort to make a difference. The VCMA contemplates a process whereby verifiable additional action above business as usual will result in cancellation of AEU's and AAU's in order to compensate for distortions in the caps caused by the design of the proposed CPRS.

In light of the above, in the VCMA's view, mechanisms are required to establish a framework that:

- (a) empowers voluntary domestic action and make it count as additional abatement where this can be justified;
- (b) quarantines voluntary abatement activity from CPRS and Kyoto compliance requirements; and
- (c) facilitates monitoring, management and accounting for voluntary abatement which can be certified and cancelled from CPRS and Kyoto caps.

Accordingly:

1. The VCMA urges the Government to explicitly stipulate in the legislation implementing the CPRS that, in exchange for each unit of agreed or certified

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<sup>6</sup> "Carbon Pollution Reduction Scheme: Australia's Low Pollution Future", White Paper, Australian Department of Climate Change, December 2008, Policy Positions 8.9 (page 8-34) and Policy Position 8.10 (page 8-35)

voluntary domestic abatement the Government will adjust the CPRS and Kyoto caps. This is explained in greater detail in Section 3.1 below.

2. The VCMA also recommends that a framework for registration and certification of voluntary abatement is established, with appropriate oversight. This is also explained in greater detail in Section 3.1 below.

The enabling legislation must include a commitment to establishing the above framework, and outline the principles underpinning it, in addition to conferring authority to make regulations to prescribe relevant details.

The VCMA proposes that voluntary abatement prior to the introduction of the CPRS and within the 2008-2012 Kyoto period should also be recognised as additional. If the Government proposes to apply the Kyoto cap of 108% of 1990 emissions for this period, and/or to set a starting point for future emissions caps (under the CPRS and/or an international agreement), it should do this by adjusting the caps. Thus, for the post 2012 period, the 108% starting point would be tightened by the amount of certified abatement that occurs in the 2008-2012 period.

The abovementioned framework proposed by the VCMA and the methodologies developed by the Expert Panel that we suggest in section 3.1 below, could be utilised in this regard.

### **3.1 Proposed Voluntary Domestic Abatement Scheme**

The VCMA's proposed framework for recognition of and accounting for additional voluntary domestic abatement is set out below. This proposed framework will have the effect of adjusting Australia's CPRS and international (Kyoto) caps to reflect the additional voluntary domestic abatement.

The VCMA proposes that a "Voluntary Domestic Abatement Scheme" is established for both covered and uncovered sectors. This Scheme will be operated as a separate but complementary, parallel process to CPRS. The Scheme will incorporate a mechanism for adjustment of the proportion of abatement that is certified, based on assessment of the certainty and additionality of the domestic voluntary abatement.

This approach protects the integrity of the CPRS by quarantining it from domestic voluntary abatement. VCMA recognises that it is important for the CPRS to achieve and maintain international credibility, so that international trade in permits is facilitated. This means any permit certified under CPRS must meet Kyoto standards. This can be difficult for some types of voluntary abatement, such as energy efficiency, where proving additionality or verifying actual abatement can be difficult. Further, the cost and resources required to meet stringent Kyoto compliance standards can undermine the viability of some forms of voluntary domestic abatement.

The framework comprises 4 major elements and one possible further extension:

- (a) Establishment of a registry to record the creation of and transactions in Australian voluntary abatement We note that the Department of Climate Change, in its Discussion paper on the Proposed National Carbon Offset

Standard<sup>7</sup>, it is stated that the Government is considering establishment of a separate registry for permitted domestic offsets. The VCMA endorses this approach – however, such a parallel registry must include all forms of certified voluntary abatement, including Green Power and energy efficiency measures. The models of ORER or the NSW GGAS scheme could be adapted for this purpose.

Whatever model is adopted for such a registry, it is critical that it tracks the chain of transactions of voluntary action – for example, in relation to voluntary offsets, all transactions from issuing of certificates to final retirement.

(b) Certification of voluntary domestic abatement (application of adjustment factors)

There are many possible reasons why a tonne of voluntary abatement may not have the same level of credibility as a tonne of Kyoto standard abatement. But the need for adjustment does not justify ignoring voluntary abatement that cannot meet a stringent Kyoto standard. Many existing schemes (e.g. the NSW GGAS and VEET) make estimates of abatement from a range of activities, taking into account uncertainties, or requiring appropriate monitoring and ongoing adjustment. The key is to determine credible levels of abatement.

The VCMA also acknowledges that there will be some degree of abatement driven by the flow-on price effect of the CPRS, and the voluntary abatement could be discounted by an appropriate factor for this purpose during the certification process.

In practice, the degree of difficulty of setting adjustment factors will vary from activity to activity. For example, energy savings at a large industrial plant can be accurately measured whereas savings from some household energy efficiency programs may be difficult to estimate accurately. GGAS has developed a number of methodologies for estimation of abatement from energy efficiency improvement and other abatement activities. Its experience provides a valuable basis to develop factors for many activities. For example, for forestry activities, factors such as the quality of the risk management strategy, or an insurance scheme, or diversity of locations of tree projects may contribute to the selection of an appropriate adjustment factor.

To address the variability in adjustment factors, the VCMA strongly recommends that an **independent Expert Panel** be established, comprising specialists in verification and carbon accounting. The Expert Panel will conduct relevant analysis of specific abatement activities. It will recommend appropriate adjustment factors and publish the rationales for its proposals. The Expert Panel must be supported by appropriate staff and financial resources.

(c) Adjustment of CPRS and Kyoto targets to recognise voluntary domestic abatement

Following the adjustment process outlined above, the VCMA urges the Government to reduce the number of CPRS permits (AEUs) available by the

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<sup>7</sup> Australian Department of Climate Change, Draft National Carbon Offset Standard, pg 20

amount of certified voluntary abatement in covered sectors and to reduce Australia's Kyoto target by the amount of certified voluntary abatement in all sectors. In relation to voluntary abatement in covered sectors both AAUs and AEU's would be cancelled and in respect of uncovered sectors only AAUs would be cancelled.

Please note that the proposed framework above does not cover voluntary abatement generated from outside Australia. We are not seeking to have the Government retire CPRS permits or Kyoto units based on offsets purchased internationally.

(d) Enabling Legislation

The VCMA submits that the approach outlined in (a), (b) and (c) above, which would establish the platform for the Voluntary Domestic Abatement Scheme, should be incorporated into the final legislation establishing the CPRS.

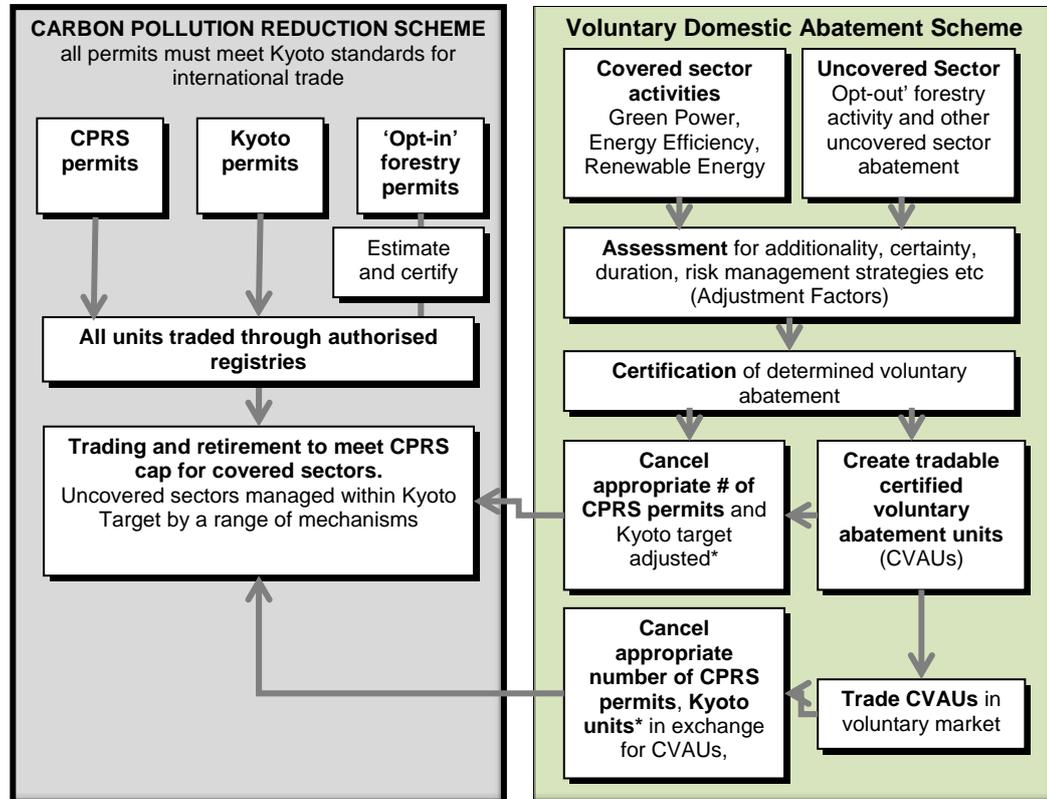
(e) A possible further extension of the Voluntary Domestic Abatement Scheme

A possible addition to the above framework exists, which would provide incentive for further abatement, in particular in the area of high technology. This would involve the creation of a recognised voluntary credit at the point of cancellation of AEU's / AAUs, which is tradable in the voluntary market for the purpose of making environmental claims under the proposed National Carbon Offset Standard. For the purposes of our proposed model, the VCMA refers to such a credit as a "Certified Voluntary Abatement Unit".

This process would have the effect of transferring the credit from the abatement from one party's declared inventory to another's – only after the abatement has been certified in accordance with the abovementioned process of adjustment.

The VCMA notes that one of the major implications of the design of the CPRS is that the supply of voluntary offset credits into the voluntary market will be severely limited (since the government has indicated that no offsets can be created from covered sectors). The proposed VCMA framework addresses this market failure by creating an opportunity for abating organisations to create a tradable commodity that could supply the voluntary market and therefore provide incentive for innovation and stimulus for new abatement projects. In this sense, it may operate as an incentive scheme similar to Renewable Energy Certificates.

The proposed framework for the Voluntary Domestic Abatement Scheme is summarised in the following diagram:



\* Note that voluntary abatement in a covered sector would require cancellation of both CPRS permits and Kyoto units. For voluntary abatement in an uncovered sector, only Kyoto units would be cancelled.

### 3.2 Institutional Arrangements for the proposed Voluntary Domestic Abatement Scheme

In order to give effect to the proposed framework outlined above, institutional arrangements will need to be established. Such institutional arrangements will involve the following areas:

- Establishment of a formal registry to record transactions in voluntary offsets and retirement thereof, as outlined in section 3.1 (a) above;
- Convening of the independent Expert Panel, as outlined in section 3.1 (b) above
- Administration of verification processes; and
- Creation and administration of other relevant mechanisms and protocols.

The VCMA considers that a number of existing proven models can be drawn upon to establish an appropriate institutional structure – for example, the unit within IPART that administers the NSW GGAS, the Australian Government's Office of Renewable Energy Regulator (ORER) and the Greenhouse Friendly™ Scheme.

This means that, whilst arrangements to establish the framework for the Voluntary Domestic Abatement Scheme are aligned with the design of the CPRS, they remain

separate and avoid administrative complexity. For example, in the case of ORER, the legislation creates the framework and the Regulations map out the administrative procedures and interpret the requirements in the legislation.

### **3.3 Financial impacts of timely recognition of certified voluntary abatement**

VCMA recognises that withdrawal of permits from auctions and retirement by the Government in response to certified voluntary abatement (according to the VCMA's framework described in section 3.1 above) will lead to a reduction in Government revenue from sales of permits. However, it also means that the Australian community is effectively gaining a number of benefits. Some ways of looking at this issue include:

- Additional abatement is being captured at the marginal permit price – when much of that abatement is more expensive, with the additional cost being borne by the voluntary abater.
- Voluntary action is supporting innovation and market development – factors which are often subsidised by Government due to market failures.
- The perceived cost can be offset against the added community support for all forms of abatement due to the sense of community empowerment created, and higher public awareness of abatement due to the activities of the voluntary market.
- The perceived cost could be treated by government as a legitimate form of incentive for people to take voluntary action in the broader community interest – using the same rationale for the Government providing tax deductions for charitable donations.
- The perceived cost to the Scheme is offset by retaining abatement activity and industry in Australia, instead of driving it offshore. This not only creates more employment and economic activity, but it also increases tax revenue to Government.
- Underlying this issue is a fundamental principle of fairness. Removal of CPRS permits in recognition of certified voluntary action restores the effective cap to the level it would have been set at if the voluntary abatement had not taken place. In this sense, the foregone revenue can be seen as a basic cost of running a CPRS, in the same way that if the Government set an less stringent cap, it could have generated more revenue by auctioning more permits.

Accordingly, while removal of permits from the CPRS cap may be seen as a cost, this is not the case. It is paying for valid and important benefits for Australia, while correcting a distortion introduced by the CPRS.

## **4. GOVERNANCE OF THE VOLUNTARY MARKET**

A number of issues must be addressed in order to ensure the integrity and credibility of the Voluntary Market, which the VCMA believes should be dealt with in Regulations. Such issues include:

1. Registers of verified abatement and other institutional arrangements as described in section 3.1 above;
2. Integrity of abatement providers; and
3. Credibility of marketing environmental claims (including “carbon neutrality”).

In relation to item 2, the VCMA endorses all actions by government and other organisations designed to ensure that claims made by providers of products and services are credible and reliable, so that consumers have confidence in the market, can make informed decisions and will ultimately take voluntary abatement action that they are assured is meaningful.

It is also critical to assure the integrity of abatement providers, for example through a Code of Conduct. The VCMA is well placed and willing to work with Government on development of such an initiative.

To that end, and in relation to item 3, it is critical that Government provide minimum, rigorous and credible criteria for claims of organisational abatement or “carbon neutrality” and that a government-certified standard for accreditation and branding of environmental claims underpinning products and services be maintained.

In this area, the VCMA urges the Government to engage in detailed dialogue with all relevant stakeholders to determine agreed understandings and definitions of terms that presently create confusion amongst consumers, to review current programs against international practice and to develop credible approaches that ultimately achieve genuine abatement at entity and global level.

For detailed views on assuring the integrity of abatement providers and establishing minimum criteria for marketing and branding of environmental claims (including “carbon neutrality”), please refer to VCMA’s submission in response to the Government’s National Carbon Offset Standard Discussion Paper, dated December 2008<sup>8</sup>.

## **5. STARTING DATE FOR A CARBON PRICE**

Certainty with regard to timing of the introduction of a carbon price is critical for investors across the economy. This includes investors in energy infrastructure, renewable energy and the voluntary market. While there is uncertainty about the starting date, much investment throughout the Australian economy will be on hold, at a critical time of global financial crisis. Certainty is critical to growing jobs that support the Government’s stated vision of a low-carbon economy.

In the VCMA’s view, if a consensus cannot be reached on the CPRS in time for a mid 2010 implementation, an interim Carbon Tax should be introduced at that time. This will free up investment in the transition to a low carbon, sustainable future.

Failure to achieve this certainty could undermine the reliability of energy supply and other essential infrastructure investments. Groups as diverse as the Energy Supply Association and the Clean Energy Council recognize the enormous economic damage that could result from delay and uncertainty the commencement of a carbon price signal.

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<sup>8</sup> <http://www.vcma.org.au/wp-content/uploads/2009/02/090227-vcma-submission-to-ncos.pdf>

## 6. TREATMENT OF REFORESTATION AND DEFORESTATION PROJECTS

### 6.1 Reforestation

Reforestation is a critically important form of abatement. It is currently difficult to comment on the adequacy of the CPRS legislation's treatment of forestry since we understand that many issues in this regard will be addressed by regulations, which will not be promulgated until after the legislation is enacted.

VCMA proposes that the following principles should be incorporated into the final legislation for the CPRS, or regulations pursuant thereto, as the case may be.

The CPRS design allows providers of abatement within forestry sectors to 'opt in' to create additional emission permits, or they can 'opt out'. The overall abatement outcome will vary, depending on the choices made by the forestry operation and how the government treats the action for Kyoto accounting purposes.

However, we note that the CPRS suggested mechanisms for certifying forests provide no test for additionality, or leakage and in its base form. It appears that CPRS will not require independent verification of abatement from registered forest entities for approved projects where 'the computer program', presumably the National Carbon Accounting Toolbox (NCAT) defaults are used.<sup>9</sup>

This means that in addition to new plantings, existing forests which were established for harvesting can also be a source of permits under the Scheme (and thus a source of offsets to the voluntary as well as the mandatory markets). Furthermore, using an average longer term carbon estimate, rather than a minimum long term estimate, has been proposed in generation of CPRS emission units and is of a lower standard than that applied in the NSW Greenhouse Gas Abatement Scheme and Greenhouse Friendly™. This lower standard will likely increase the supply of units from commercial forests to the market but will diminish the reputation and credibility of the Australian Emissions Trading Scheme in generating permanent greenhouse reductions.

The Greenhouse Friendly™ standard for forest abatement encompasses these tests. We note the Government's recent announcement to abandon Greenhouse Friendly™ from commencement of the CPRS. No transitional arrangements for those organisations that have invested in Greenhouse Friendly™ abatement provider approval have been provided.

Given that the previously mentioned proposed National Carbon Offset Standard is likely to impose additional requirements on the abatement provider, it seems unreasonable that this voluntary abatement is not fungible with the CPRS, particularly when forest emission units generated under the CPRS can be used for the voluntary market.

The VCMA proposes that the enabling legislation for the CPRS includes the following mechanisms to overcome the abovementioned dilemmas for forestry as a source of additional abatement:

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<sup>9</sup> **Guidance and Regulations** - We note that to date no draft regulations or guidance have been formally released by the Department of Climate Change, dealing with the detail on how reforestation projects will be administered. The statements made rely on informal discussions with Department of Climate Change staff.

## **1. Cancel Emission Removal Units (RMUs) and AAUs for Verified Voluntary Market Reforestation and Avoided Deforestation (ie non-opted in)**

Cancellation of RMUs generated through voluntary reforestation and subsequent cancellation of AAUs, is neutral to Australia's Kyoto target, is price neutral to the CPRS and will create a net reduction in aggregate greenhouse emissions in the atmosphere (on a global basis).

We note that this approach can be undertaken by Registered Forest Entities that wish to voluntarily retire permits generated under the CPRS but is not an option currently available to the forests that are not opted into the CPRS.

## **2. Cancel RMUs, AAUs and AEU for voluntary action**

Cancelling RMUs, AAUs and AEU has a positive impact on the CPRS and Kyoto as it places greater pressure on large emitters to do more and does not subsidise their actions - in fact, it will send a clear signal that they have to do more.

This approach provides the community, and thus the Government, an opportunity to determine how far and deep reductions in emissions can go beyond the minimum mandated by Government.

## **6.2 Avoided Deforestation**

The VCMA also notes that avoided deforestation is not permitted as a source of abatement under the CPRS, It is possible that entities holding existing rights to clear forests may forfeit these rights in exchange for recognition of voluntary abatement. There has been precedent set in recognising avoided deforestation in Australia under Greenhouse Friendly™ and with REDD projects overseas. It is appropriate that the Government recognises the contribution of local avoided deforestation, particularly given the terrible contribution that deforestation makes to global emissions and the lack of liability under the CPRS for non-opted in forests. In short, the CPRS provides no incentive for maintaining old growth forests that were established prior to 1990 and if fails to send a signal to neighbouring countries that there is a credible market for avoided deforestation projects.

## **7. OTHER ISSUES**

The VCMA has identified the following issues as warranting consideration by the Senate Standing Committee on Economics in relation to the Exposure Draft Legislations for the CPRS.

### **7.1 The need for a stronger CPRS target**

The Australian Government has failed to commit to emission reductions that adequately address the need for decisive action on climate change mitigation. The 2020 target outlined in the CPRS White Paper fails to heed the authoritative advice of the landmark Garnaut Review and globally accepted climate change science. Similarly, it is completely at odds with the consensus of developed nations at the Bali Conference of the Parties in December 2007, that the appropriate range of emissions reductions by 2020 is between 25% and 40%. VCMA supports a

commitment to stronger targets that respond to recent developments in climate science and position Australia early on its trajectory to cut 2050 emissions to 2 tonnes of CO<sub>2</sub> equivalent per capita or other level consistent with globally equitable emissions at a sustainable rate.

The CPRS legislation should also make provision for the Government to tighten the cap with less than five years notice where credible research indicates that the cap fails to adequately address changes in accepted climate science.

## **7.2 Impacts on Australian economy**

The impact of the CPRS on the economy depends to a great extent on how it is managed. Treasury modelling, and many other studies, show small net impacts that are really 'in the noise' of the range of uncertainty of the models.

That said, VCMA believes that some fundamental points can be made about the likely impacts of the CPRS on the Australian economy.

Revenue from a carbon price flows through the economy as the government assists with adjustment, encourages low emission development and creates more demand for products and services that help to abate. The carbon price is not an indicator of the cost of emissions trading to the economy, but it is an indicator of the scale of price signal required to shift behaviour. This may have impacts on individual entities, but their loss is another entity's gain.

A shift from high carbon to low carbon economic activity typically shifts activity from high capital intensity, low employment intensity industry to higher employment intensity activity, particularly services and light manufacturing. For example, extra labour in building more complex solar-efficient buildings replaces investment in power stations and transmission lines. Effective policy can enhance this shift and capture additional benefits. For example, driving demand for double glazed windows reduces their price through economies of scale, thus improving the net economic outcome. So overall, the employment impact of CPRS should be positive, particularly if effective policy measures are applied to support retraining and expansion of new businesses in affected regions.

Economic studies tend to overstate the net costs of transition to a low carbon economy for several reasons:

- economic models typically focus on the costs of economic impacts, and ignore the economic costs of failure to abate.
- as described by Professor Garnaut in his Final Report<sup>10</sup>, economic analysis considers only some of the costs of failure to abate, even where they are considered at all. Garnaut's Final Report (at page 10) identifies currently measurable market impacts, market impacts not readily measurable, insurance value against high damages, and non-market impacts. Of these, only the first has typically been considered in economic analysis.
- economic analysis typically discounts future costs. Further, as Professor Garnaut points out, the costs of delay are high, yet these kinds of costs are difficult to estimate.

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<sup>10</sup> <http://www.garnautreview.org.au/index.htm>

- economic models are based on the assumption that the economy is quite efficient at allocating economic resources, so that a shift to other activities may be modelled as more costly than it actually is in practice, particularly where there is innovation, ‘learning by doing’ or a shift in community values. For example, a person who buys a locally made Camry hybrid and invests \$30,000 in making her/his home carbon neutral may spend the same amount of money as (s)he would have spent to buy an imported luxury car. So the cost of this abatement example is actually infinitely negative. Such options are extremely difficult to model. Similarly, some studies (such as McKinsey & Co<sup>11</sup> and the CIE for the Australian Sustainable Built Environment Council<sup>12</sup>) have identified significant abatement at negative cost, yet modelling has generally failed to incorporate such profitable abatement.

It is essential that claims by individual businesses implying that any impact on their business success will damage the economy are critically analysed. Garnaut’s reports challenge such claims by the LNG and coal-fired electricity industry, and have not been refuted by public evidence. All government policies have winners and losers: the challenge is to maximise the benefit while minimising the pain to society.

Claims that the present financial crisis is justification for delay simply do not stand up: now is the time when old, inefficient and polluting plant may be shut down and replaced by modern efficient plant and infrastructure that will underpin the transition to a low carbon future. The certainty that will come from a timely start to emission pricing will underpin investment that would otherwise be delayed or diverted to other countries.

## **8. CONCLUSION**

In the VCMA’s view, the current design of the CPRS disempowers voluntary action by those organisations and households that want to make a difference to global emission reductions.

In the absence of mandated action over the last decade, the voluntary carbon market in Australia has made an important contribution to emission reductions, through the purchase of voluntary offsets, Green Power and other abatement activities by households, communities and businesses wanting to reduce or eliminate their impact on climate change.

It is therefore imperative to encourage voluntary action by individuals and business to achieve emissions reductions beyond the relatively minor levels that will result from the CPRS.

The VCMA believes that a number of relatively simple modifications can be made to the design of the CPRS to overcome the perverse outcome of disempowering individuals and organisations by adjusting Australia’s emission reduction targets to recognise independently verified voluntary action. These modifications can be made in an administratively efficacious and relatively cost effective manner, by

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<sup>11</sup> “An Australian Cost Curve for Greenhouse Gas Reduction”, McKinsey and Company, February 2008.

<sup>12</sup> “Capitalising on the Building Sector’s Potential to Lessen the Costs of a Broad- Based GHG emissions cut”, prepared for Australian Sustainable Built Environment Council by the Centre for International Economics, September 2007.

implementing the framework for the proposed Voluntary Domestic Abatement Scheme, as outlined in this submission.

Such modifications will empower businesses, households, and individuals and ensure that their voluntary action can:

- make a difference in contributing to greater global greenhouse emission reductions; and
- spread responsibility for abatement action beyond government, to include all spheres of the community and the economy.

This in turn will inspire greater public confidence in the Government's commitment to reducing Australia's carbon footprint and buy-in to a suite of programs and initiatives designed for businesses, communities and households in this regard.