SUBMISSION TO THE HOUSE STANDING COMMITTEE ON CLIMATE CHANGE, ENVIRONMENT AND THE ARTS

INQUIRY INTO THE CARBON CREDITS (CARBON FARMING INITIATIVE) BILL 2011, THE CARBON CREDITS (CONSEQUENTIAL AMENDMENTS) BILL 2011, AND THE AUSTRALIAN NATIONAL REGISTRY OF EMISSIONS UNITS BILL 2011

APRIL 2011

The Climate Institute

SUBMISSION TO THE HOUSE STANDING COMMITTEE ON CLIMATE CHANGE, ENVIRONMENT AND THE ARTS

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SUBMITTED VIA EMAIL TO:

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TCI KEY POINTS ON CARBON FARMING INITIATIVE BILLS

Item		TCI comments
Driving abatement in the land sector—the importance of a price on pollution.		• Support linking Carbon Farming Initiative and carbon pricing mechanism and a 25 per cent reduction in emissions by 2020. • Permit the export of carbon credits from the CFI pending the introduction of a domestic carbon price. • Use direct funding—from price revenue—to top-up market drivers of abatement in the land sector.
Permanence		• Ensure the flexibility in the CFI's permanence provisions are properly communicated to landholders. • Following the proposed 2014 review of the scheme, replace the universal 5 per cent buffer with a 'sliding scale' of discount rates according to project risk. • Review the 5 per cent figure no less than every three years and, for future projects, adjust accordingly.
Leakage		• Do not support removing requirement to account for leakage from project approvals. • Apply a reasonable discount rate to account for the risk of leakage as appropriate. • Properly monitor different kinds of leakage.
Additionality		• Support removal of strict financial additionality requirement from consultation draft of Bill. • Some flexibility is warranted but, as a rule, only projects unlikely to have occurred without the scheme should be approved. This should be reflected in legislation. • Additionality should be monitored.
Maximizing participation		• Lack of an obvious and well-funded research, development, extension and commercialization programme a major problem. • The Australian Government should commit at least an additional $200 million—drawn from carbon price revenue if necessary—over four years to ensure the broad sectoral uptake of credible abatement activities.
Indigenous participation		• Support recognition of exclusive possession of native title in the Bill and the opening up of opportunities for Indigenous participation. • Support efforts to recognize nonexclusive native titleholders' carbon rights. • Call for tailor-made extension designed and delivered in partnership with Indigenous communities.
Managing the risks to the carbon price		• Support the introduction of a reasonable limit on offsets in a future carbon pricing scheme if and when there is evidence of a significant risk.

signal and revenue		
Environmental co-benefits and minimizing perverse outcomes.		• Support integration of CFI with other, complementary schemes intended to deliver conservation and other co-benefits. • Note that the Bills provide for the public to scrutinize the CFI at various points and levels—the Australian Government should ensure these are well advertised to maximize public participation in the scheme's development and minimize perverse outcomes. • Proper, independent monitoring of the scheme's performance is needed. • Regional natural resource management organizations need active support to enable them to fulfil the role envisaged for them by the Government—including additional funding to prepare plans and guides for proponents, and the development of a code of best practice for biosequestration projects.

INTRODUCTION

The Climate Institute welcomes this opportunity to present the Committees with our views on the Bills currently before the Parliament, and, consequently, the proposed Carbon Farming Initiative (CFI or 'the scheme').

Established in late 2005, The Climate Institute is an Australian-based non-partisan, independent research organisation focused wholly on finding solutions to climate change. Our vision is for a resilient Australia prospering in a low carbon global economy, and participating fully and fairly in international climate change solutions. We seek to achieve this vision by catalysing and driving the change and innovation needed for a low-pollution economy and culture in Australia.

On the whole, The Climate Institute is reasonably confident that the Bills strike a balance between the scheme's twin principles of environmental integrity and broad participation. The Institute is therefore broadly supportive of the proposed scheme, although we submit that a better balance is still possible, and that other policy measures are prerequisites to the scheme's success. In essence, these are:

- A price on industrial carbon pollution—linked to the CFI—without which demand for abatement in the land sector will remain low; and
- Additional funding, of at least $200 million over four years—drawn from carbon price revenue if necessary—to establish a strong mitigation research, development, extension and commercialization programme for the land sector.

To-date, there has been precious little public support—from any quarter—to price agricultural emissions, except perhaps for affixing a carbon price to the clearing of native vegetation. There have been expert suggestions of the theoretical efficiency of such an approach, to be sure, but nothing approaching a community consensus. In the absence of broad support for coverage of the land sector under a carbon price or equivalent regulation, and given the technical and economic barriers, establishing a domestic market for land sector offsets would seem to be the logical way to:

- Begin to catalyse investment and innovation in diverse abatement practices and technologies in Australian agriculture and land management;
- Reduce the total emissions of the land sector, and hence begin to make a substantial contribution to Australia's overall pollution reduction effort;
- Substantially raise the level of carbon literacy in rural communities and industries;
- Start to build a mandate in rural and regional Australia for stronger action on climate change;
- Develop practices, systems and technologies transferable to other parts of the world, and hence assist in the global effort to avoid dangerous climate change whilst maintaining or improving food security.

Designed well, the CFI also has the potential to drive the delivery of important biodiversity, employment, cultural and economic co-benefits.

The CFI, this does not preclude the introduction of other, complementary measures—both state and federal—to secure additional abatement with important environmental, social, cultural and economic benefits.

The Institute believes that the scheme does not pose a significant risk to Australia's food security or to native biodiversity overall, and indeed offers the potential to enhance both.

DRIVING ABATEMENT IN THE LAND SECTOR—THE IMPORTANCE OF A PRICE ON POLLUTION

Speculation aside, it is very difficult to predict the likely demand for carbon credits under the CFI. Without a compulsory carbon market, demand for Australian land sector offsets is likely to remain low, and the success of the CFI is put at risk by lingering uncertainly, low returns, low participation rates, and meagre investment in innovative abatement projects. Were the CFI to falter, this could have the effect of entrenching opposition to any future such scheme, no matter the distance between perception and reality.

The Climate Institute notes that the Chicago Climate Exchange—perhaps the world's most famous voluntary offsets company—has recently ceased trading for lack of policy certainty.[1]

In the absence of a compliance market, it seems reasonable to attempt to test international demand by allowing the export of 'Kyoto' CFI credits. It should be noted, however, that such abatement could not then be counted towards Australia's target.

- To ensure the scheme lives up to its design principles, Australia needs a pollution price that will ensure emissions peak in the short-term to achieve at least 25 per cent reduction in emissions by 2020. Analysis indicates the price must rise to approximately $60 by 2020. Households and industries will need to be supported under a price on pollution to ensure that the transition is just and fair.

- Pending legislation on a domestic carbon price, the Government should permit the export of CFI credits but look to restrict this with the advent of a domestic price on pollution; and

- The Carbon Farming Initiative should be linked to any future pricing mechanism to generate demand for abatement projects in the land sector.

In the meantime, the Government should:

- Use direct funding to stimulate abatement activities as appropriate, including funding or co-funding (with industry) trials of costly abatement systems and practices to accelerate their commerciality. Credits from trial projects might later be sold to recoup costs.

PERMANENCE

The 100-year 'permanence' standard is likely to be perceived by many landholders as a substantial, even insurmountable barrier to participation in the scheme. The Bill, however, make it clear that there is actually considerable flexibility to switch from a carbon-credited land-use and/or management practice should the landholder wish to do so, as long as they are prepared to pay for the credits. This flexibility needs to be communicated effectively to landholders; underscoring the need for a well-funded extension programme.

The Climate Institute fully supports the use of buffers or reserve carbon pools or similar discounting as a measure of insurance against reversal of abatement. The five per cent risk-of-reversal buffer for biosequestration projects would appear to be a reasonable starting point, especially given how little is known about the risk of reversal associated with different project types under Australian conditions.

A reasonable discount rate is appropriate not only for the permanence of biosequestration projects, however, but to account for the risks of leakage and mismeasurement associated with a wide range of potential projects (e.g. savannah fire management, livestock emissions abatement, etc.).

- The Institute expects that, following the 2014 review a blanket five per cent buffer will no longer be appropriate. We submit that this should be replaced with a simplified scale of discount rates to account for different risks associated with different projects or, more simply, types of projects.

This would better reflect reality and also serve to encourage a high standard of risk management from project inception.

- Moreover, the five per cent figure should be reviewed periodically (but no less than every three years), in the light of monitoring data, leaving open the option to vary it (up or down, or a mix) for future projects.

LEAKAGE

The Climate Institute regards carbon leakage as a significant ongoing problem, and one that is still poorly understood and demands constant vigilance. At the same time, the Institute believes that it is crucial to spur on the uptake of new and genuine abatement practices in the rural sector.

The Institute is concerned that the Bill does not now require proponents to account for leakage—a prerequisite for a credible scheme of this sort.

We submit that the risks of internal (within-project) and within-sector leakage should be dealt with in the following ways:

- Ensure that accounting for the risk of leakage is integral to approval *in practice* as well as on paper;
- Establish a clear protocol for fairly and cost-effectively assessing the risk of leakage associated with a project, and ensure require proponents to identify any potential leakage within the project and within their company;
- Where there is a significant risk of internal and/or within-sector leakage, then apply a reasonable additional discount factor to account for this and/or require proponents to clearly show how they will ameliorate the risk to the extent possible; and
- Establish a permanent, ongoing fund for monitoring and reporting on leakage associated with the CFI, including via routine auditing (or spot-checks for projects below a particular threshold).

Similarly, cross-sectoral and international (or cross-border) leakage are serious risks. Lawmakers need to take them into account when deliberating on Australia's national pollution reduction target; the higher the target, the lower the leakage risk.

Of course, extending the cap to cover agriculture and forestry emissions would serve to remedy much of cross-sectoral leakage problem. The transaction costs association with monitoring compliance, however, together with the lack of ready abatement practices, and sheer political opposition make this approach highly unlikely in the short-term. There are, however, a wide range of alternative policy strategies and mixes potentially available to progressively reduce land sector emissions without undermining rural economies.[2]

To attend to the risk of leakage generally, the Australian Government will need to:

- Appoint a suitable body to document and report publicly on leakage on an ongoing basis; and
- Encourage the public to note leakage and make appropriate submissions to this body.

ADDITIONALITY

The Institute is pleased to see that the Government has removed the overly strict financial additionality clause from the consultation draft of the Bill. This should improve scheme participation;

farmer participation in particular. It should also serve to encourage permanence by allowing projects that deliver multiple business benefits.

The Government now proposes to develop a 'positive list' of project types deemed to be additional by virtue of Ministerial consultation with the DOIC and experts; to ascertain whether a project type is beyond 'common practice'.

We appreciate that this is intended to streamline the approvals process and that there is a need for flexibility, but it does raise the risk of non-additional projects being approved. Clear guidelines for establishing additionality are needed. A failure to properly gauge and monitor additionality jeopardizes the environmental integrity, public acceptance and international credibility of the scheme.

- The Institute submits that only projects unlikely to have occurred without the scheme should be regarded as additional. The legislation should reflect this principle. T
- The process of determining 'common practice', and of consulting experts, should be open to civil society, including local community stakeholders.
- Additionality should be monitored and the 'positive list' should be a key topic in the 2014 review of the scheme.

MAXIMIZING PARTICIPATION

The CFI's implementation is arguably as important as the legislation. Unfortunately, there is still precious little detail on an implementation strategy.

In the Institute's view, the scheme's biggest deficiency is the lack of an implementation plan. The Government has allocated $4 million (of the total $46 million committed to the CFI) to Landcare facilitators to provide landholders with advice and information. This is a worthwhile start, but TCI is concerned that it is insufficient. Instead, a larger package of funds and a strategy for roll-out are needed to ensure landholders a properly empowered to make the best of the scheme and hence secure the highest possible abatement with co-benefits.

The vast majority of potential CFI participants are wholly or mostly unfamiliar with the carbon market. The Institute acknowledges the Commonwealth's already substantial investment in assistance to the livestock industries, in particular, to develop abatement knowledge and practices. It appears, however, that the majority investment to-date has been for agricultural adaptation to climate change. Comparatively little weight has been given to helping landholders (including, but not only farmers) to come to grips with the nascent low-carbon economy, and the factors that will define their success or failure in a low-carbon world.

It is crucial that adequate resources are set aside for extension and information support to raise carbon literacy amongst rural and regional communities. Without this, rorting, poor trade-offs, confusion, scepticism, and waste become much more likely, undermining the scheme's design principles.

A substantial commitment of dollars, time and expertise is needed to build the carbon literacy or carbon market capacity of Australia's regional catchment or natural resource management groups ('regional NRM groups'), landcare networks, Indigenous organizations, and industry associations. The private sector will invest in developing those abatement practices that hold promise, but public investment is also warranted, especially given the uncertainties.

As part of the programme, a national steering group should be established forthwith to oversee and inform the roll-out of the CFI. The group should comprise farming, forestry, carbon market, knowledge brokerage, and natural resource management expertise, together with the National Landcare Facilitator, and representatives from the relevant government department(s).

The steering group should:

- Provide oversight and high-level strategic coordination of the rollout of the CFI to rural and regional communities;
- Coordinate and oversee the design and development of appropriate communications, extension and training materials, tools, strategies and programmes; and
- Become a source of high-level advice, consistent information, and practical knowledge to regional NRM groups, nongovernmental organizations (NGOs), proponents, and managers of projects.

TCI suggests that many regional NRM groups, landcare networks and some conservation NGOs are well suited to coordinate communications, extension and training at the subnational level. Many regional groups in particular now have more than ten years' experience in planning and delivery of public environmental programmes, and some are experienced in the use of market- based instruments; they should be encouraged to become aggregators. Whilst regional NRM groups are best placed to coordinate and aggregate biosequestration projects with ecosystem management goals, however, they are unlikely to be immediately qualified to deliver information in other areas; livestock emissions reduction, for instance. We would encourage the development of cross-sectoral partnerships to bring together relevant expertise and networks, and to minimize overlap, waste and mixed messaging. Regional groups can still play a key coordinating role and house locally relevant information in 'one-stop-shops'.

The Institute suggests the following as priorities for the Australian Government and the steering group in 2011:

- Develop a preliminary CFI information package—to be delivered via existing regional NRM, landcare, Indigenous and industry organizations;
- A series of regional and sector workshops to set the context and enable regional, industry, Indigenous, and conservation to determine their role (e.g. aggregators) in the CFI and start to provide feedback;
- A series of 'train the trainer' workshops for industry, conservation and NRM extension professionals;
- A series of case studies and hypothetical scenarios of the development of carbon offset products—from their inception, through methodological development, to market; and
- Three academic scholarships to study the development of the CFI, from different perspectives, from its inception and for a minimum of three years. These would serve to inform the ongoing development of, not just the CFI itself, but also future and associated public policy in the field of land sector climate change mitigation.

We further recommend that:

- The Commonwealth augments and extends the *Australia's Farming Future* programme, including *FarmReady*, to provide financial assistance to individual landholders, NGOs, and industry groups for training and industry development. These should aim to ease the rural sector's entry into the low-carbon economy without hampering the market in the long-term; and
- In addition to funding methodology development, the Australian Government should dedicate an *additional* $200 million—using carbon price revenue if necessary—over four years for research, development, extension and commercialization of abatement practices and technologies.
- This should be accompanied by a clear strategy to assist farmers, indigenous communities and regional NRM groups to enter the new market with confidence, deliver co-benefits if possible, and manage any trade-offs.

INDIGENOUS PARTICIPATION

The Climate Institute is eager to see the broadest possible participation—including Indigenous participation—in the scheme consistent with the maintenance of environmental integrity. Indigenous Australians manage around twenty per cent of the continent and, potentially, can make a substantial contribution to mitigation efforts through the management of fire, vegetation, ruminant animals and more. To that end, we are pleased to note that the Bill recognizes exclusive possession of native title and opens up avenues for Indigenous participation that did not exist in the consultation draft.

The Institute does not pretend to be an authority on native title. We note, however, the National Native Title Council's concerns and submissions regarding the Bill's treatment of nonexclusive native titleholders.[3] We urge the Parliament to make such amendments as necessary and practicable to enable nonexclusive native titleholders to be recognized for their co-ownership of carbon rights.

Indigenous participation would be further enhanced with proper funding of tailor-made extension programmes and services, designed in partnership with Indigenous communities.

MANAGING THE RISKS TO THE CARBON PRICE SIGNAL AND REVENUE

The Institute believes that impact of offsets on the price signal and/or revenue is likely to be minimal. Firstly, during the fixed price period, offset credits will have no effect on the incentive to reduce industrial pollution at its source. Secondly, the transaction and opportunity costs associated with offsets—particularly with biosequestration projects—will limit uptake. The difference between the *technical* level of abatement possible in the land sector and the *actual* level is high likely to be orders of magnitude less.

- If, following the fixed price period, the number of offset credits appears to present a genuinely significant risk to the either the price signal and/or the revenue so generated, then the Government should introduce a cap on allowable offset credits, as suggested by Professor Ross Garnaut.[4] That is, a limit on liable entities' purchase of credits from Kyoto offsets to the tune of four per cent in 2012, rising by 0.75 per cent per annum to ten per cent in 2020. To do so arbitrarily, however, risks undermining the incentive for landholders to undertake abatement action.

ENVIRONMENTAL CO-BENEFITS AND MINIMIZING PERVERSE OUTCOMES

The CFI has raised considerable interests, particularly amongst groups and landholders interested in promoting conservation. Whilst the primary raison d'être for the CFI is not biodiversity conservation, the Institute is pleased to see that the Government proposes to enable participants to test the market for biodiverse carbon. This should, in turn, help to secure broad support for the scheme.

Where conservation and carbon goals meet, and where the CFI is unlikely to deliver these, then there is a case for additional, direct funding of biodiverse carbon (i.e., conservation and restoration projects) using a portion of revenue raised by a carbon price; to top-up market drivers. There is also a case for funding projects aimed at restoring or shoring up ecosystem services in the as part of a broader climate change adaptation effort. The CFI is not incompatible with calls for raised resourcing of conservation, but conservation is not its main aim.

It should be borne in mind, moreover, that grants-based funding programmes have a poor track record of delivering abatement; tending to be more costly to the taxpayer.[5]

- TCI submits that the CFI should be so designed as to enable the relatively straightforward integration of carbon offset projects with other environmental programmes and incentives. An offset provider should be able to 'stack' other financial incentives for environmental action on top of the carbon credits received from the scheme. This will help to maximize participation and deliver the broader benefits desired by the community.

The Bills would seem to open up multiple opportunities for public scrutiny and debate, at various levels: it empowers the Commonwealth to steer change in publicly acceptable directions, and to influence local and state planning; it opens up the potential for regional and catchment management organizations to align carbon projects with broader landscape goals; and it establishes an online registry of projects. Moreover, the scheme is due to be reviewed in 2014.

- In the interests of openness and strong social support, the Australian Government should make sure that these opportunities for scrutiny are well-advertised and that the community is facilitated to take part in the scheme's ongoing development.

Until and unless a domestic carbon price is introduced, the scale of abatement generated via the CFI is likely to remain very small given the paucity of voluntary demand, nationally and internationally. Even with price on pollution, however, and while the *technical* potential for abatement in the land sector at low cost appears enormous, for a range of economic, social, regulatory, administrative reasons, the *actual* level of abatement is likely to be much smaller.

This means that, to begin with, carbon forestry and other land-use projects are highly unlikely to undermine Australia's capacity to feed itself or supply our export markets. Moreover, the price of food is going up and carbon forestry is unlikely to prove competitive in most instances.

While the Bill doesn't stipulate that every biosequestration project should deliver biodiversity benefits, it does go a long way to minimising the risk of further damage to the landscape, and provides for projects with environmental and other co-benefits.

In an effort to allay fears about perverse impacts, the Bill allows for a 'negative list' of projects that will be excluded a priori. Specifically, the Bill gives the Federal Minister for Climate Change and Energy Efficiency discretion to exclude projects that pose a significant risk to water resources, biodiversity, employment and/or local communities in and *in the vicinity* of the project. The list will be established by regulations that will first need to be tabled in Parliament—opening them up to public scrutiny and discussion. The Government has signalled its intention to exclude projects that involve a conversion of timber plantations (including managed investment schemes) into carbon sinks and types of projects likely to pose a risk to the availability of ground and surface water.

It is pleasing to see that projects—presumably only biosequestration projects?—will need to take account of regional natural resource/catchment management and water allocation plans. Precisely how this will be achieved is yet to be determined, but it should allow regional and catchment communities to scrutinize the sustainability credentials of carbon forestry and other new land-uses, and help to ensure they do not exacerbate stress on land and water ecosystems. This raises the question of what additional resources will be available to enable regional NRM organizations to deal with abatement project applications—a separate but linked issue to the Bill. TCI understands that the Government is aware of the need for additional funds but has yet to make a decision.

The Bill also includes provision for landholders to add value to their project by generating co-benefits that will accompany the project on an online public registry. This should mean that biodiversity restoration, Indigenous employment and other benefits will be encouraged and communicated in a way that clearly, consistently and reliably informs the marketplace. To this end, the Government intends to develop a 'co-benefits index' as a standard way of differentiating projects in the new marketplace.

Native forest ecosystems are an important store of carbon and crucial to the maintenance of ecosystem services in a changing climate. TCI is pleased to see that the clearing of native forest or the use of material obtained from the destruction or degradation of native forests will be added to the 'negative list'. Additionally, all projects must meet with local, state and federal environmental regulations and planning provisions; the Government has said that it will use the negative list to deal with inadequacies in local and state laws and provisions. We expect more detail on this to be forthcoming.

The Government has also said that it will monitor the (both negative and positive presumably) implications of the scheme for regional communities, and that it will introduce further restrictions on abatement projects as necessary.

- The Government should clearly spell out how the scheme's development and its impacts (positive and negative) are to be monitored, by whom and according to what indicators.

In most instances, afforestation and reforestation projects are likely to present few environmental or social downsides. It is crucial, however, that all projects are properly planned and executed such that they do not exacerbate stress on land, water and biodiversity, and meet with community expectations. At the same time, it would be counter-productive to unnecessarily hamper investment. We welcome the Government's recognition of these challenges and attempts to address them. This is an area where State and Territory Governments should assume greater responsibility, but where the Commonwealth can show better leadership.

The stipulation that approval be conditional on a project having met with regulatory processes is important, as is a demonstration of compliance with regional NRM/catchment plans. The Institute is concerned, however, that the draft legislation may rely too heavily on deferral to existing regional NRM or catchment plans. It assumes that such plans are prepared for an expansion in carbon forestry, when this may not be the case. Likewise, unduly cumbersome arrangements—including the task of negotiating different levels of government— may curb investment unnecessarily. In view of these concerns, we suggest the following:

- The preparation of a guide for proponents to relevant planning provisions nationwide;
- Ensure relevant NRM plans are easily accessible by proponents;
- The development (with public input) of a code of best practices for offsets to guide approvals;
- A commitment of additional funds to regional NRM organizations to, if necessary, enable them to prepare addenda to their plans, and communications materials for proponents; and
- More broadly, the Commonwealth should lead an intergovernmental review of NRM and planning arrangements in each State and Territory with respect to the emerging carbon market.

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[1] *Environmental Leader* 2011, 'Carbon Cap-and-Trade wraps up on CCX', viewed 15 April 2011, <http://www.environmentalleader.com/2011/01/04/carbon-cap-and-trade-wraps-up-on-ccx/>.

[2] The Climate Institute, discussion paper, *Towards Climate-Friendly Farming*, viewed 17 April 2011, <http://www.climateinstitute.org.au/our-publications/reports/532-agricultural-discussion-paper>.

[3] National Native Title Council (2011), *Submission of the National Native Title Council, Senate Standing Committee on Environment and Communications.*

[4] Ross Garnaut 2011, *Carbon pricing and reducing Australia's emissions*, Garnaut Climate Change Review Update 2011, Update Paper 6, viewed 15 April 2011, <www.garnaut.org.au>.

[5] John Daley and Tristan Edis 2011, *Learning the hard way: Australia's policies reduce emissions*, Grattan Institute Report No. 2011–12.