The Climate Institute

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factsheet USING INTERNATIONAL POLLUTION PERMITS

A number of myths and misunderstandings have emerged in the climate change debate around the role of financing clean energy in developing countries to meet Australia's pollution targets. This fact sheet deals directly with these misunderstandings. Three myths are explained here:

MYTH 1 *Using international reductions to meet a target means action does not happen in Australia.*

FACT A pollution price in Australia will start to unlock billions of dollars of new investment in low pollution technology. Together, the combined effect of the pollution price and indicative estimates of the impact of additional policies (not modelled by Treasury) indicates that Australian pollution levels should begin to decline over the coming decade. Modelling by Treasury shows that only 15 per cent of Australia's total pollution in 2020 will be off-set through the purchase of international permits. (Figure 1)

MYTH 2 *Using international reductions means the Government can't fund revenue commitments such as compensation to households, industry assistance and clean energy projects.*

FACT Every single Australian pollution permit will be sold to companies that are covered by the Clean Energy Future package, generating revenue to support households, jobs and businesses and investment in important areas such as energy efficiency and clean energy.

MYTH 3 *International pollution reductions are not real and credible.*

FACT Audit processes of international permits have become increasingly stringent through time. International pollution credits are created by investing in projects that reduce pollution in developing countries under agreed international rules. To date over 3,000 projects have been approved globally, with over 80 per cent of these aimed at expanding renewable energy, reducing dependence on fossil fuels and improving waste management. These projects are monitored and verified by independent processes. Australia's overseas permit scheme would only accept legitimate permits and is subject to domestic independent review.

FACT The value of low pollution permits from developing countries in 2007/8 was US$4.5-8.5 billion a year. This is estimated to have leveraged 10 times as much overall investment in low pollution development in those countries. Perhaps a quarter to a half of the total pollution reduction technology investment in developing countries has been driven by international trading.

BACKGROUND

Climate change is a global problem that requires a global response. Pollution does not stop at the Australian border. The Government's proposed Clean Energy Future Package is intended to be a starting point in Australia's contribution to global efforts to reduce carbon pollution and keeps open the possibility of meeting the full range of Australia's agreed targets.

Allowing companies to meet a proportion of their liabilities through international trading makes economic sense and supports clean energy financing at a global level. Under the Clean Energy Future Package, from 2015 the 500 largest polluters will be able to buy credible international pollution permits up to 50 per cent of their overall liability. This is designed to give companies some flexibility in how they take responsibility for the pollution they cause.

Removing this flexibility would likely rule out meeting the full range of agreed pollution targets and make it more difficult and more costly for Australian industry to adjust to a low pollution economy. Ultimately this would increase costs to households.

Under the Government's proposed plan, Australia's emitters will have a financial incentive to take steps to reduce their pollution in order to avoid paying the carbon pollution price. For any pollution that cannot easily or cost effectively be reduced, businesses will still need to pay the pollution price. While at least 50 per cent of their liability must be paid for with Australian issued permits, the remainder can be purchased by investing in pollution reduction projects in other countries.

FACT For many years Pacific Hydro, one of Australia's leading renewable energy companies, has invested more than $2 billion in new clean energy in Chile and Brazil. These investments have been largely underpinned by revenue from international trading through the Kyoto Protocol's Clean Development Mechanism. The combined effect of just two of these projects, would contribute to avoiding up to 900,000 tonnes of carbon pollution every year.

Key issues:

- The use of international investments to meet targets means the Australian pollution price is tied to action in other countries. If stronger action occurs internationally, the pollution price will increase resulting in even greater domestic reductions. If action is weaker the price will be lower. The proposed pollution price floor in the scheme and domestic measures such as the Renewable Energy Target and the proposed National Energy Savings Initiative will provide a vital buffer that can help ensure domestic transformation.

- Allowing companies to invest in pollution reduction projects overseas helps promote global action in clean energy, and enables Australia to make a much larger contribution to global pollution reduction efforts than if we had acted in isolation. In the absence of international trading countries commit to weaker targets.

It is important to note that under the Clean Energy Future pollution pricing scheme, Australia's 500 heaviest polluting businesses will pay the pollution price and the revenue will be used in part to fund clean energy and other developments here and overseas. Under the Coalition's plan, clean energy developments in other nations will need to be funded by taxpayers if Australia targets are to be achieved.

MYTH 1 *Using international reductions to meet a target will mean action does not happen in Australia.*

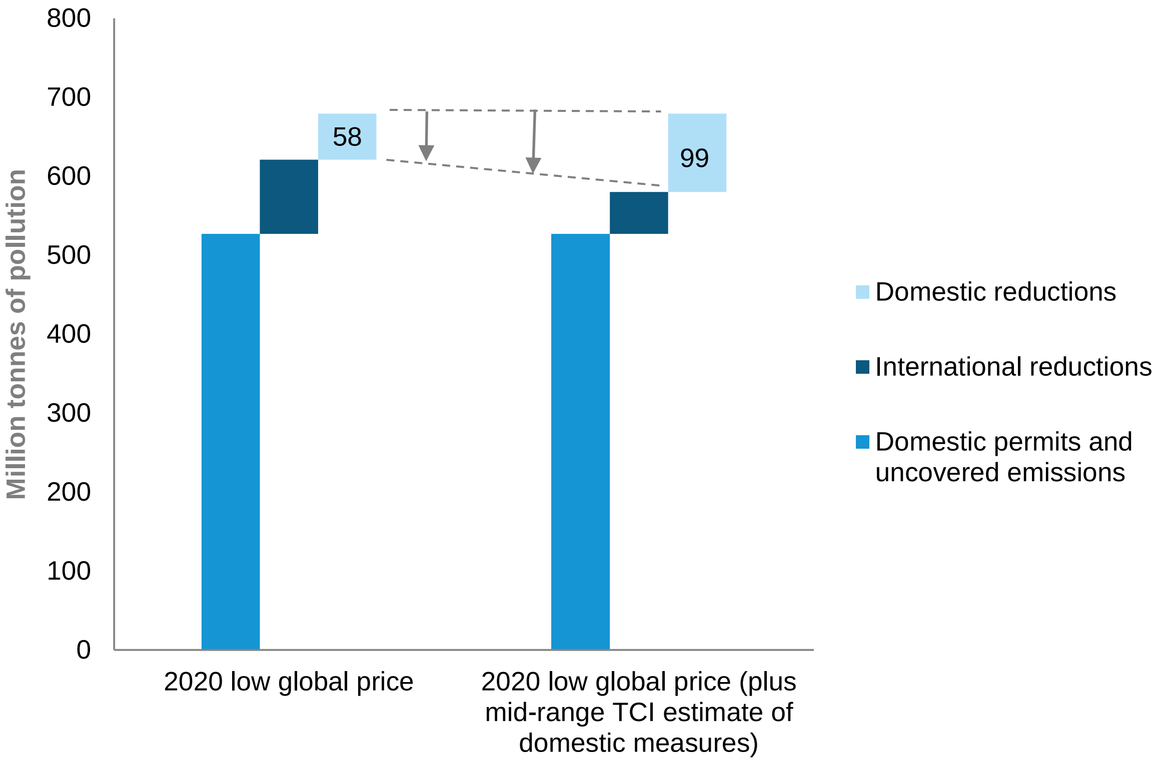
FACT A pollution price in Australia will start to unlock billions of dollars of new investment in low pollution technology. Modelling by Treasury shows that only 15 per cent of Australia's total pollution in 2020 will be off-set through the purchase of international permits. This means that at least 85 per cent of the money spent by Australian companies occurs in Australia, either through the purchase of Australian permits, or through investment in pollution reduction projects, such as energy efficiency and renewable energy.

Treasury's estimate of the share of pollution reductions that will occur in Australia is likely to be too conservative, because the modelling does not account for the full range of policies proposed under the Clean Energy Future plan. (A broad feature of economic modeling is that it generally underestimates what can be achieved at low cost because businesses are generally smarter than economic models.)

The Climate Institute's preliminary assessment of the plan suggests that between 28 and 53 million tonnes of additional pollution reductions could occur within Australia, on top of the 58 million tonnes predicted in the Treasury modelling. This means that most of the pollution reductions, as well as most of the permits, will likely be sourced within Australia.

Experience in the EU ETS has been that companies have used international investments to meet about 4 per cent of their emission reduction liabilities. New Zealand also allows such investment in its scheme and has seen similarly modest take up.

Figure 1: Source of pollution permits and pollution reductions in the Treasury modelling, compared to The Climate Institute's estimate of the full suite of policies proposed in the Clean Energy Future package.



MYTH 2 *Using international reductions means the Government can't fund revenue commitments such as compensation to households, industry assistance and clean energy projects.*

FACT Every single Australian pollution permit will be sold to companies that are covered by the Clean Energy Future package, generating revenue to support households and businesses and to invest in energy efficiency and renewable energy. Any use of international permits by companies to meet their obligations under the plan will be additional to the use of domestic permits. This means there is no reduction in revenue to the Government due to the use of international permits.

Businesses will have no greater incentive to favour international permits over Australian permits, because the cost of domestic and international permits will be closely tied together. Just like other commodities, such as iron ore, oil and coal, the price of Australian permits will be linked to the international price. Australian permits will sell at auction and the prices bid by companies will reflect the international alternative. As the international price goes up, so too will the Australian permit price, and vice-versa. If demand for Australian permits is weak the price of these permits at auction would fall below the international price. No sensible business is going to buy an international permit at higher cost than a cheaper domestic one.

MYTH 3 *International pollution reductions are not real and credible.*

FACT International pollution credits are created by investing in projects that reduce pollution in developing countries. To date over 3,000 projects have been approved globally, with over 80 per cent of these aimed at expanding renewable energy, reducing dependence on fossil fuels and improving waste management.

The use of international trading has been controversial but the current international debate focuses on improving the mechanisms not dismantling them. For example, under agreed international rules companies have to jump though a number of hoops before they can create a pollution credit. This has become more difficult through time as a result of increased experience and scrutiny. For example, rejection rates of projects have increased from less than 2 per cent for projects in 2004/2005 to over 10 per cent for projects submitted in 2007.

While the use of international offsets has been and remains controversial in some quarters, assessments to date suggest that 70-80 per cent of clean energy projects financed by international trading would not have occurred without this incentive.

The Clean Energy Future plan includes some important safeguards to ensure international permits imported to Australia are linked to real and verifiable international abatement. As well as limiting the type of permits that can be imported, the independent Climate Change Authority will also be empowered to advise on the integrity of international permits.