**MULTI-PARTY CLIMATE CHANGE COMMITTEE**

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# CARBON PRICE MECHANISM

This document contains a proposed carbon price mechanism that has been discussed by members of the Multi-Party Climate Change Committee (MPCCC). The proposal has been agreed by the Government and Greens members of the Committee. Mr Windsor and Mr Oakeshott have agreed that the proposal be released to enable consideration by the community and to demonstrate the progress that has been made.

The MPCCC has discussed a number of different ways in which a carbon price could be introduced into the economy and the advantages and disadvantages of each. This paper outlines the result of that discussion.

The proposal focuses on the high level architecture, start date, potential mechanisms to allow flexibility to move to emissions trading, sectoral coverage and international linking arrangements.

Further detailed discussions will be required in relation a starting price for the carbon price mechanism, and in relation to the associated assistance arrangements for households, communities and industry, and support for low emissions technology and innovation.

The outlined architecture also allows for consideration of other design options such as phased coverage of sectors over time and coverage of the electricity sector via an intensity-based allocation scheme.

## Broad architecture of the carbon price mechanism

A carbon price mechanism could commence with a fixed price (through the issuance of fixed price units within an emissions trading scheme) before converting to a cap-and-trade emissions trading scheme, with the following broad architecture.

*Start date*

The mechanism could commence as early as 1 July 2012, subject to the ability to negotiate agreement with a majority in both houses of Parliament and pass legislation this year.

*Length of fixed price period*

The fixed price phase could be of between three and five years, with the price increasing annually at a pre-determined rate. The initial fixed price could begin to drive economic transformation and investment in low emission technologies, and ensure greenhouse gas emission reductions.

*Transition arrangements*

At the end of the fixed price period, the clear intent would be that the scheme convert to a flexible price cap-and-trade emissions trading scheme. In relation to the transition to a flexible price, it would be important to design the arrangements so as to promote business certainty and a smooth transition from the fixed to flexible price.

An option could exist to defer the commencement of the flexible price arrangements. A decision on whether to exercise the option to continue with a fixed price could be taken at least 12 months before the end of the fixed price phase. Unless there is a deferral, a particular 2020 target could be set no later than this date.

If the flexible price arrangements were to be deferred, a decision could also be required on whether any changes to the level of the fixed price and/or the escalation rate were to be made. Any such changes could take into account the level of international carbon prices (including whether international prices were lower than the fixed price) and the impact of the price on the economy and reductions of carbon pollution.

In making a decision about whether to exercise the option to defer the transition to a cap-and-trade emissions trading scheme, the following issues could be considered:

- the state of the international carbon market including the availability, integrity and price of international units;
- developments in carbon pricing in key competitor economies, including carbon price forms and levels;
- Australia's internationally agreed targets and progress towards meeting them, including whether they have been incorporated into a binding legal agreement;
- the fiscal implications of any on-budget purchases of internationally accepted emissions units that may be required for Australia to comply with any internationally agreed emissions target;
- potential impacts on the Australian economy including impacts on households, workers, regions and communities, and the competitiveness of Australian industry; and
- the implications for investment certainty in clean technologies, energy efficiency and carbon markets.

*Coverage*

A carbon price mechanism could cover all six greenhouse gases counted under the Kyoto Protocol and have broad coverage of other emissions sources encompassing:

- the stationary energy sector
- transport sector
- industrial processes sector
- fugitive emissions (other than from decommissioned coal mines)
- emissions from non-legacy waste.

Emissions from sources covered under the proposed Carbon Farming Initiative, such as agricultural emissions sources, would be excluded from coverage under the carbon pricing mechanism.

Another important matter to be determined is how to maintain and enhance the carbon carrying capacity of the landscape, which would have important sustainability and biodiversity conservation co-benefits. Land use and water issues are also important. Options

to provide economic value to activities which store or reduce carbon in the land sector could potentially include the use of Kyoto-compliant credits in the carbon price mechanism or alternative funding arrangements for the land sector.

*International linking*

During the fixed price phase, liable parties may not be entitled to use international emissions units for compliance.

In the flexible price phase, international emissions units (offsets) meeting appropriate criteria concerning their quality could be able to be used for compliance. In advance of a move to emissions trading, a decision could be made on any restrictions on the quantity and any other criteria for the use of international emission units.

*Assistance and other matters still to be determined*

Ways to promote the environmental effectiveness of the scheme, to support technological innovation, and ways to manage the impacts of the scheme on households, communities and business are to be developed consistent with the MPCCC principles (attached). The principle of fairness, in particular, acknowledged that the introduction of a carbon price will affect Australian households and communities, but that assistance should be provided to those households and communities most needing help to adjust to a carbon price. The principle of competitiveness recognised that the overall package should take appropriate account of impacts on the competitiveness of all Australian industries, and the principle of energy security recognised that the introduction of the carbon price should be accompanied by measures that are necessary for maintaining energy security.

Further consideration could also be given to reviewing existing Commonwealth, State and Territory policies so that they are complementary to the mechanism. Such complementary measures may support research, development and commercialisation of clean technologies.

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**ATTACHMENT:**

**MPCCC AGREED PRINCIPLES TO GUIDE DEVELOPMENT OF A CARBON PRICE MECHANISM**

The Committee acknowledges that Australia needs to reduce its carbon pollution, as part of global efforts to combat climate change. Cuts in global pollution are necessary to reduce the risks posed by unmitigated climate change. For Australia, these risks are large, threatening our economy, our natural heritage (including icons such as the World Heritage listed Great Barrier Reef), and our way of life.

The Committee considers that a carbon pricing mechanism is the most cost-effective and economically responsible way of reducing Australia's carbon pollution, and that its introduction would enable Australia to play its part in global efforts to reduce the risks posed by climate change. A carbon price will also provide opportunities for innovation and investment in lower carbon technologies, and opportunities and rewards for improved land use management.

The Committee has agreed that the following principles should guide the development of any carbon price mechanism. The principles are not stated in any order of priority.

The Committee acknowledges that some principles will be more relevant than others when examining each of the specific design issues and that design decisions may require a trade off.

The Committee notes that each of these principles builds on the fundamental need to develop and foster lasting community consensus and understanding of the need for a carbon price.

The principles are:

1. **Environmental effectiveness:** The mechanism should be capable of delivering reductions in carbon pollution that are informed by the climate science, to ensure that Australia contributes to the global mitigation task and to help transform our economy by driving investment and innovation in clean energy and low emissions technologies and processes.
2. **Economic efficiency:** A mechanism to price carbon should harness the most cost-effective pollution reduction options and facilitate informed and efficient investment decisions. It should also minimise costs of our pollution reduction to the economy as a whole and be consistent with Australia's broader economic reform agenda.
3. **Budget neutrality:** The overall package of a carbon price mechanism and associated assistance measures should be budget-neutral. This does not preclude other measures to address climate change being funded from the Budget, consistent with the Government's fiscal strategy.
4. **Competitiveness of Australian industries:** The overall package of carbon price design and associated assistance measures should take appropriate account of impacts on the competitiveness of all Australian industries, having regard to carbon prices in other countries, while maintaining incentives to reduce pollution.

5. **Energy security:** Introduction of the carbon price should be accompanied by measures that are necessary for maintaining energy security.
6. **Investment certainty:** A mechanism to price carbon should provide businesses with the confidence needed to undertake long-term investments in low emissions technology and infrastructure, which will reduce costs for households and businesses in the long-term. It should keep our industries at the forefront of the research, development and deployment of new clean technologies, attracting global investment flows and creating new jobs.
7. **Fairness:** The introduction of a carbon price will affect Australian households and communities. Assistance should be provided to those households and communities most needing help to adjust to a carbon price, while striving to maintain incentives to change behaviour and reduce pollution.
8. **Flexibility:** Internationally, climate change policy is continuing to evolve. A mechanism to price carbon should be sufficiently flexible to respond to changing international circumstances, including improvements in international accounting rules, developments in climate change science, and tangible international action to deliver an effective global solution.
9. **Administrative simplicity:** A mechanism to price carbon should be designed with a view to minimising both compliance costs and implementation risks.
10. **Clear accountabilities:** A mechanism with transparent scheme rules and clear accountabilities will help promote business and community confidence in carbon pricing.
11. **Supports Australia's international objectives and obligations:** An effective global solution requires action from all major emitters to limit the global temperature rise to less than 2 degrees. A carbon price mechanism should support the goal of promoting international action to deliver an effective global solution, and be consistent with Australia's foreign policy and trade objectives.

21 December 2010