



AUSTRALIA

Emissions Trading and the Project-based Mechanisms

Submission to the AWG-KP and the AWG-LCA

Australia welcomes the opportunity to submit further views to the AWG-KP and AWG-LCA on possible improvements to the flexibility mechanisms.

Carbon markets are an important means of achieving large-scale emissions abatement in a cost-effective and flexible way. A comprehensive and well-functioning carbon market will assist countries to commit to, and achieve, ambitious mitigation objectives. The expansion and improvement of the flexibility mechanisms are therefore a critical component of an effective post-2012 framework.

Australia submits that the flexibility mechanisms should be developed in line with the following core principles to ensure that they operate as effectively as possible. Specific comments on the proposals contained in annexes I and II of FCCC/KP/AWG/2008/5 are included in the attached paper.

Supportive of ambitious, differentiated mitigation actions

The flexibility mechanisms should be developed to accord with the more ambitious mitigation objectives of the post-2012 framework. To be effective, the post-2012 framework will need to reflect a range of differentiated responses from Parties according to their national circumstances and respective capabilities. The mechanisms will need to support these new commitment structures and provide incentives for enhanced mitigation action by all major economies. Approaches which facilitate national contributions to mitigation projects by host Parties may be one way of progressing such an outcome.

Comprehensive coverage

An effective response to climate change will require all countries and all sectors to be engaged in the task of emissions reduction. It is therefore

important that the full range of abatement opportunities are available to the market through the flexibility mechanisms. Technological and methodological improvements since the adoption of the Kyoto Protocol mean there is now much greater scope for measurable, reportable and verifiable abatement through carbon capture and storage and reduced emissions from deforestation and forest degradation (REDD). There is also an opportunity to promote the uptake of land use, land-use change and forestry (LULUCF) activities through improving the rules and procedures associated with them.

Environmental effectiveness

If the flexibility mechanisms are to effectively support mitigation efforts, they must be environmentally effective. It will therefore be important to ensure the emissions reductions associated with them are genuine. This suggests avoiding multiplication factors on Kyoto units. Not only could multiplication factors distort the market, they could jeopardise the ultimate objective of the Convention.

Care must be taken to avoid perverse outcomes. In this regard, the merit of HFC-23 incineration projects under the CDM is a particular issue. If implemented properly, HFC-23 incineration projects deliver emissions abatement. However, there is some evidence that these projects have resulted in adverse climate and ozone impacts. The AWGs should remain conscious of the potential interaction of these projects with the Montreal Protocol.

Sound governance

Sound governance and institutional arrangements are critical to ensuring that the objectives of the flexibility mechanisms are delivered in an efficient, transparent and accountable way. In the interests of economic efficiency, the governance arrangements should provide as much certainty and predictability for the market as practicable, balanced with the flexibility to respond to changing circumstances and new technologies. In addition, every effort should be made to minimise administrative costs.

Market integrity

In considering improvements to the flexibility mechanisms, the AWGs should be mindful of preserving market integrity. A properly functioning market will facilitate abatement at a lower cost to the global economy because abatement will occur where and when it is most cost-effective. The broader the scope of the market, the more opportunities for emissions reduction will be available. This means that limitations

regarding abatement sources and location should be avoided. In addition, increasing banking by eliminating carry-over restrictions on Kyoto units will increase the intertemporal flexibility of the carbon market, which is likely to improve its efficiency.

The flexibility mechanisms are a means of achieving our climate change mitigation objectives. It is essential that they are developed in a way that supports and promotes the broader post-2012 framework. Consideration of improvements to the post-2012 operation of the flexibility mechanisms should therefore not be carried out in isolation from the work being done in other work-streams and, in particular, the AWG-LCA.

To promote consistency and effectiveness, the post-2012 flexibility mechanisms should be available to the widest range of Parties, including those which are Parties to the Convention but not the Kyoto Protocol. Consideration of flexibility mechanisms by the AWG-LCA will facilitate contribution by any such Parties.

The attached paper sets out initial Australian views regarding the policy merit of specific proposals. It does not purport to discuss any potential legal implications of any of the proposals. Discussion of any such implications should be addressed in 2009, in accordance with the AWG-KP work program. In the meantime, it is important that the AWGs consider the policy merits of all proposals for improving the flexibility mechanisms, regardless of their eventual legal form. Prematurely limiting options will impact adversely on the effectiveness of the final post-2012 framework.

ATTACHMENT

Comments on the proposals in annexes I and II of FCCC/KP/AWG/2008/5

ANNEX I

I. A. Include other land use, land-use change and forestry activities

Australia draws attention to its submission to the AWGs on LULUCF. There is an opportunity to promote the uptake of LULUCF activities in the flexibility mechanisms by improving the rules and procedures associated with them. The use of robust, spatially-explicit estimation methodologies would deliver greater confidence in the measurability and verifiability of reductions from the LULUCF sector and, in turn, allow for greater equivalence of units generated from LULUCF activities. Australia recognises that transitioning to such robust methodologies will represent a significant challenge and is ready to assist countries with capacity building and technology transfer to reach this standard of estimation.

Reducing emissions from deforestation and forest degradation in developing countries (REDD) is included under proposal I.A (include land use, land-use change and forestry activities). Australia submits that REDD should be a separate item on the CDM list under Annex I. While related to LULUCF, REDD is a separate issue and is at a different stage of development. A market-based approach to REDD would award credits for avoided deforestation and forest degradation in non-Annex I Party countries, whereas LULUCF rules assign debits for emissions from deforestation in Annex I Parties. Conflating REDD and LULUCF may obfuscate the issues pertinent to each. Australia therefore proposes removing the - “reducing emissions from deforestation and degradation” dot point from the LULUCF note and replacing it with:

“A1. Include reducing emissions from deforestation and forest degradation in developing countries

Note: The following issues, inter alia, may be relevant to consideration of this element:

- *resolution of methodological issues;*
- *resolution of policy issues;*
- *modalities for the inclusion of REDD;*
- *environmental integrity.*

The AWG-KP should also take account of work being done in other processes on this issue, including the AWG-LCA.”

I.B. Introduce a cap for newly eligible land use, land-use change and forestry activities

Australia does not support a cap on eligible LULUCF activities under the CDM. All genuine abatement activities should be included in the flexibility mechanisms without restriction. Placing undue limitations on particular activities will increase the cost of abatement to the global economy.

I.C. Include carbon dioxide capture and storage

Carbon dioxide capture and storage (CCS) is a key technology for reducing greenhouse gas emissions and should not be excluded from the flexibility mechanisms. Fossil fuels, especially coal, will remain major sources of the world's energy in the coming decades. All major models of how the world can achieve lower greenhouse gas emissions expect a significant part of the reduction to be achieved through the use of CCS. Australia supports discussing this item under both the SBSTA and the AWG-KP.

Australia has recently announced a proposal to establish a Global Carbon Capture and Storage Initiative which includes a Global Carbon Capture and Storage Institute. The Institute will aim to accelerate the development and commercialisation of CCS technology by facilitating demonstration projects, leveraging and sharing experiences, and supporting necessary research. This Initiative will accelerate collective learning on CCS and help in the effort to realise commercial scale CCS plants as soon as possible.

Australia draws attention to its submission to the SBSTA (FCCC/KP/2006/MISC.2) regarding approaches to including CCS in the flexibility mechanisms.

I.E, I.F & I.G Sectoral and NAMAs: proposals

Moving beyond the project-based approach and considering approaches that enable sectoral activities to benefit from private sector investment may be a way of delivering broader technology benefits, as well as larger cuts in emissions. Sectoral approaches may also open up abatement opportunities in sectors which have not been readily accessible using a project-based approach.

Sectoral approaches have the potential to build capacity around national and sectoral inventory capabilities within host countries.

I.H & I.I Environmental integrity and additionality proposals

The requirement to demonstrate additionality has been identified as one of the most resource-intensive steps in the CDM process. Methods to assess additionality through the development of standardised, multi-project baselines and positive lists which grant automatic in-principle approval for technical aspects of well-recognised technologies may assist in improving the efficiency of the approvals process.

Assessment of additionality through negative lists of project activity types should be approached with caution. As noted above, in order to best achieve large-scale emissions reduction at least cost, the flexibility mechanisms should cover as many abatement sources as possible. In cases where the operation of the flexibility mechanisms give rise to perverse incentives, for example where HFC-23 incineration projects prolong the operation of existing HCFC-22 plants or lead to the construction of new HCFC-22 plants, which may affect other international environmental activities, it may be preferable to address these issues directly.

I.J Differentiate the eligibility of Parties through the use of indicators

The mechanisms will need to support new and differentiated commitment structures and provide incentives for enhanced mitigation action by all major economies. Consequently, it may be that purely offsetting approaches will remain most appropriate for certain developing countries and consideration should be given to approaches which facilitate national contributions by more advanced developing economies.

I.K Improve access to clean development mechanism project activities by specified host Parties

It is to be expected that CDM and JI projects will be concentrated in those countries where there is high potential for cost-effective mitigation. However, creating the right enabling environments (legal, social and economic policy frameworks) to promote private investment is of critical importance. It would be valuable for the AWGs to consider lessons learnt from successful host Parties, that could be adopted in other Parties. In addition, Parties may also wish to consider ways to reduce market barriers to the uptake of project-based activities in certain locations.

Expanding the scope of the flexibility mechanisms to include additional sectors, in particular those relating to LULUCF and REDD, may facilitate a wider geographical distribution of projects.

Mandating where project activities should occur would impede the efficiency of the market and raise the cost of abatement to the global economy.

I.L Include co-benefits as criteria for the registration of project activities

In line with the objective of the Convention, the flexibility mechanisms should remain tightly focused on emissions reduction. While projects should be allowed scope to contribute towards sustainable development and other co-benefits, the introduction of additional mandatory criteria may inadvertently detract from the emissions reduction objective. Host Parties are best placed to determine what constitutes sustainable development and which co-benefits are most appropriate to their circumstances.

I.M Introduce multiplication factors to increase or decrease the certified emission reductions issued for specific project activity types

Market-based approaches deliver least-cost abatement by providing incentives to reduce emissions where this is most cost-effective. It is therefore preferable to allow the market to determine which types of project activity to pursue.

The introduction of multiplication factors also risks undermining the environmental integrity of the mechanisms. It is important that each Kyoto unit accurately represent one tonne of CO₂-e reduced or, given the offset nature of the CDM, emissions will rise.

IV.A Relax or eliminate carry-over (banking) restrictions on Kyoto units

Facilitating increased banking by relaxing carry-over restrictions on Kyoto units will improve intertemporal flexibility and therefore improve the economic efficiency of the market.

IV.B Change the limit on the retirement of temporary certified emission reductions and long-term certified emission reductions

It is important that the post-2012 agreement maximises the LULUCF sector's capacity to reduce emissions and increase removals. The rules regarding credits generated from LULUCF activities has discouraged projects in this sector. The use of robust, spatially-explicit estimation methodologies would deliver greater confidence in the measuring, verifying and monitoring of emissions reductions and potentially allow for greater equivalence among Kyoto unit types.

IV.C Introduce borrowing of assigned amount from future commitment periods

Like banking, borrowing would also improve intertemporal flexibility and therefore improve the economic efficiency of the market. However, long-term borrowing could lead to significant and potentially detrimental delays in the global abatement effort. Australia assesses that this risk outweighs the potential flexibility benefits of any form of long-term or unlimited borrowing. Depending on the eventual form of the post-2012 framework, there may be scope to consider some form of short-term, limited borrowing between commitment periods.

IV.D. Share of proceeds

The flexibility mechanisms are a key mitigation tool. Applying a share of proceeds to the flexibility mechanisms may distort international market price signals and reduce incentives to invest in mitigation projects, negatively affecting the role of the mechanisms in reducing greenhouse gas emissions.

It is important that the international community identify additional means to finance adaptation that are efficient, effective and equitable. However, a discussion on share of proceeds as a means of assisting developing countries to meet the costs of adaptation should not be considered in isolation from the broader discussion on financing adaptation which is to be taken up in the AWG-LCA.

ANNEX II

I.A Introduce a different supervisory structure and institutional arrangement in case of modification to the clean development mechanism

Significant amendments to the clean development mechanism or the introduction of additional mechanisms will require appropriate, and

potentially different, supervisory structures and institutional arrangements. These structures and arrangements should be designed in light of the new mechanisms and detailed consideration should be deferred until the precise structure of the reformed flexibility mechanisms is settled.

The new structures should be designed to facilitate the core principles of market integrity, environmental integrity and economic effectiveness. There should be appropriate lines of accountability and processes should be as transparent as possible.

Given the ongoing and increasing importance of the flexibility mechanisms, there may be value in considering revising the governance and institutional arrangements to provide for full-time, professional appointments to the relevant supervisory bodies. Consideration should also be given to strengthening the eligibility criteria for members.

Australia also draws attention to its submission to the Article 9 review on how the current institutional arrangements, governance and rules of procedures of the CDM and joint implementation may be improved in the first commitment period.

I.I Introduce alternative accounting rules for afforestation and deforestation project activities in order to increase demand

Australia suggests this should read “Introduce alternative accounting rules for afforestation and reforestation project activities in order to increase demand”. This was the wording from the proposal in the annex II list attached to the Report of the Ad Hoc Working Group on Further Commitments for Annex I Parties under the Kyoto Protocol on its resumed fifth session, held in Bonn from 2 to 12 June 2008.

III.B Enhance equivalence among Kyoto unit types

Australia notes its comments under I.A and IV.A and IV.B of the proposals in Annex II. Reducing unnecessary differences between the rules for carry-over and longevity of different types of Kyoto units would simplify accounting and improve market efficiency.