

A beginner's guide to the Carbon Farming Initiative and Emissions Reduction Fund

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Paper:

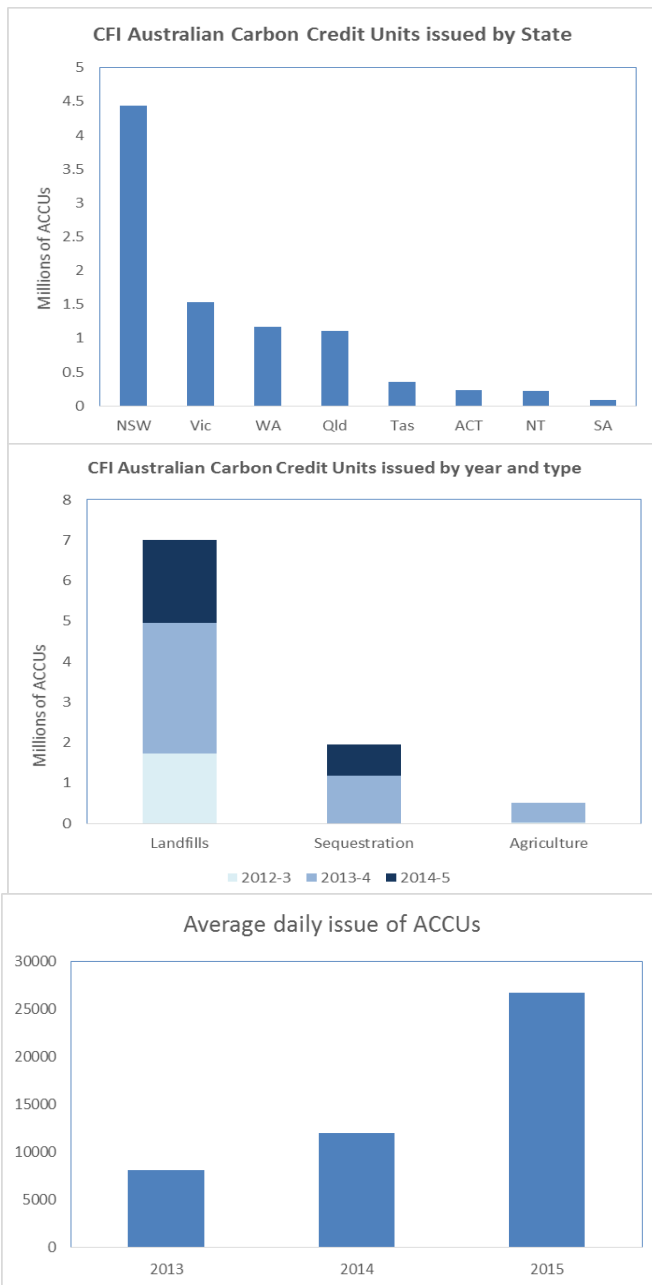
- Is it cheating to off-set carbon, instead of eliminating emissions?
- What does carbon dioxide equivalence really mean?
- What is an Australian Carbon Credit Unit?
- Who can buy them and where is the marketplace?
- How do Australia's carbon emission reduction (CFI/ERF) and reporting (NGER) systems connect?
- How does Australia's carbon market relate to international markets?
- What would entice you or your organisation to buy carbon credits on a voluntary market?
- What will the benchmark price for carbon be under the Direct Action scheme?
- And most importantly, is this framework helping to mitigate global warming, or just creating a whole lot of bureaucratise?

This paper will demystify carbon markets by answering these questions in clear and accessible terms presented with real-life examples. It will also explore the outlook for Australia's carbon markets and propose options for maximising the capacity of carbon markets to deliver genuine and significant emission reductions over time.

Carbon trading is a market-based approach for reducing greenhouse gas emissions. Carbon accounts measure emissions. Legislation and drivers such as corporate social responsibility, push operators to reduce their emissions. In most cases, the first priority is to reduce emissions internally, by saving energy and improving processes, but if significant emissions remain then carbon trading is an option for reducing a carbon footprint.

Australia established the Carbon Farming Initiative (CFI) in 2011 to allow farmers and land managers to generate carbon credits through activities such as sequestration and improved farming and landfill management practices. The changes are generally not cost effective in the absence of carbon markets, and so the emission avoidance is genuinely additional to business as usual. To participate in carbon markets, projects must prove this additionality among other tests.

The Emissions Reduction Fund (ERF) is being established through an amendment to the *Carbon Credits (CRI) Act 2011* is currently before the Senate and aims to broaden the range of activities that are eligible to earn carbon credits. The ERF also aims to establish a reverse auction system for government purchase of credit units. Both systems are establishing methodologies consistent with international standards that allow landholders to put projects forward for approval to generate carbon credits. CFI and ERF emission reductions are measured in Australian Carbon Credit Units (ACCUs), each of which represents one tonne of carbon dioxide equivalent (tCO_{2e}) of greenhouse gas emission reductions.



The CFI has been highly effective in generating ACCUs. By mid-October 2014 there were 165 approved projects and over 8 million ACCUs issued. Graphs 1 and 2 below show that these were distributed very unevenly between jurisdictions and sectors. Over 48 per cent of ACCUs were issued in NSW and less than 1 per cent in SA. Over 74 per cent were issued for landfill projects and only 5 per cent in agriculture. The average daily issue of ACCUs has been increasing more-than-linearly since the first was issued in November 2012 with the 2014-15 daily average issue now standing at

nearly 27,000 compared with just over 8,000 in 2012-3.

In 2012-3 ACCUs carried a statutory price of \$23 and had a total value over \$40m. In 2013-4 the unit price was \$24.15 and the total value nearly \$106m. Fixed prices for ACCUs were removed for 2014-5 with the repeal of the *Clean Energy Act 2011*.

The reverse auction system within the ERF legislation aims to support a target of five percent emission reductions below 2000 levels by 2020 by purchasing ACCUs at the lowest cost. The proposal is for auctions to be run by the Clean Energy Regulator. Project operators will submit an estimate of the number of ACCUs expected to be generated over five years together with a bid price for the auction. The government will use price only to select lowest-cost projects and enter contracts with proponents to buy the ACCUs at that price.

The government has promised \$300m in 2014-5, \$500m in 2015-6 and \$750m in 2016-17 to purchase ACCUs at auction.

Assuming the legislation gets through the senate, one big question is what benchmark price for carbon will be established at auction. We can get a rough idea by estimating the number of ACCUs that would be generated in 2014-15 if today's average rate of issue was constant over the year, and then dividing five-years of that quantity into the \$300m available. This gives a possible benchmark of \$6 per ACCU – much lower than the previous price. But since the number of projects may be increasing exponentially, and operators suggest that many CFI projects can deliver ACCUs below the current price, the benchmark may be much less.

With this ballpark as a starting point, it seems unlikely that the Australian carbon price will collapse any time soon to the extent of the Kyoto Protocol Certified Emission Reduction Units (CERs). Over 1 billion CERs were issued by 2012 and by December that year the price had dropped to a record low of 31 cents per tCO₂e.

One certainty is that innovative and edgy Australian carbon farming projects would not be viable with such a low price. But if the price is pushed so low that some good quality projects, with multiple co-benefits are not viable, what are the options for voluntary markets where householders and business purchase ACCUs? Examples and options will be explored.