

14 November 2012



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Dear Mr Fraser

**RE: *RENEWABLE ENERGY TARGET REVIEW DISCUSSION PAPER: APPEA COMMENTS***

Please find following comments from the Australian Petroleum Production & Exploration Association (APPEA) on the Renewable Energy Target (RET) Review *Discussion Paper*, issued by the Climate Change Authority (CCA) on 26 October 2012.

APPEA is the peak national body representing the Australian upstream oil and gas industry. APPEA member companies collectively produce around 98 per cent of Australia's oil and gas. Further details about APPEA can be found at our website, at [www.appea.com.au](http://www.appea.com.au).

APPEA's comments address specific sections and recommendations contained in the *Discussion Paper*, focussing on those areas that are particularly important for the upstream oil and gas industry.

**General Comments**

APPEA reiterates the concerns expressed in its September 2012 submission to the Review's *Issues Paper* that with a carbon price mechanism now in place through the *Clean Energy Act 2012*, the continued purpose of the RET, which forces a fixed quantum of renewable energy into the supply mix, displacing lower cost non-renewable but relatively low-emission alternatives (most notably natural gas) should be the subject of rigorous assessment.

As reviews by the Productivity Commission, Garnaut Climate Change Review, the Strategic Review of Australian Government Climate Change Programs (the Wilkins Review) and BAEconomics analysis<sup>1</sup> commissioned by APPEA as part of its response to the *Issues Paper* (and available at [Attachment 1](#)) have found, the

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<sup>1</sup> See [www.appea.com.au/images/stories/Reports/baeconomics%20appea%20ret%20report%208sep12.pdf](http://www.appea.com.au/images/stories/Reports/baeconomics%20appea%20ret%20report%208sep12.pdf) for a copy of the BAEconomics report, *Implications of the RET for the Australian economy*.

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continuation of the RET with the carbon price mechanism mean that the RET will not result in extra greenhouse gas emissions abatement, but will result in extra cost.

The *Discussion Paper* itself acknowledges that the RET is a costly policy option but the Review has been unable to recommended whether or not the RET should be retained, but rather what “improvements” can be made to it. This limited terms of reference has prevented the Review from carrying out a rigorous assessment of the RET to consider whether it does indeed have a legitimate place in a post-carbon pricing policy environment.

**The RET is an economically inefficient policy and APPEA continues to recommend that it should be discontinued.**

### Comments on specific *Discussion Paper* recommendations

APPEA offers the following comments on specific recommendations in the *Discussion Paper*.

Recommendation 1: The preliminary view of the Authority is that the frequency of scheduled scheme reviews be amended from every two years to every four years, so that the next review would be in 2016

APPEA acknowledges there are arguments both for and against changing the frequency of Reviews. APPEA’s concern, however, is that the next Review, whenever it is held, must have broader terms of reference (as set out above) that would allow it to consider whether or not the RET should continue to exist in the presence of a carbon pricing mechanism.

APPEA recommends the terms of reference for the next Review, whenever it is held, be expanded to include a threshold consideration of whether or not the RET should continue to exist in light of the policy and economic conditions prevailing at that time.

Recommendation 2: The preliminary view of the Authority is that the form of the target should continue to be expressed in legislation in terms of a fixed gigawatt hour level

APPEA continues to recommend the fixed gigawatt hour (GWh) target should be revised down to reflect the level required to achieve the 20 per cent by 2020 commitment.

Recommendation 3: The preliminary view of the Authority is that the existing large-scale renewable target of 41,000 GWh and interim targets should be maintained in their current form

As with Recommendation 2, APPEA continues to recommend the fixed gigawatt hour target should be revised down to reflect the level required to achieve the 20 per cent by 2020 commitment.

The *Discussion Paper* places a strong emphasis, in this recommendation at least, on the need for policy stability and investment certainty. APPEA notes this rationale does not appear to apply equally to all recommendations (Recommendation 20, considered below, for example). In addition, this rationale means the Review has failed to appropriately consider all of the issues (particularly those for the broader economy and not just the direct recipients of the subsidy provided by the RET) associated with maintaining a fixed GWh target at a level significantly above a 20 per cent target level.

APPEA recommends the CCA reconsider this recommendation.

Recommendation 9: The preliminary view of the Authority is that discounting (multipliers of less than one) of the number of certificates to be created in respect of each megawatt hour be provided to allow the Minister to control the cost of the SRES and ensure the subsidy level is appropriate

As noted above, APPEA does not support the RET (including the SRES component) and views it as an expensive, inefficient and inequitable policy. Within that context, this Recommendation, however, is a practical way to control the costs of a poorly designed scheme and is supported.

Further, APPEA notes that the 2013 estimation of SRES liability has recently been revised upwards significantly, to around 35 million certificates (or a \$1.4 billion subsidy in 2013). This is a part of a continued trend in the SRES where costs have been grossly underestimated. Noting that the CCA Recommendations will require time to implement, APPEA recommends that the Minister use his existing powers to immediately reduce the solar multiplier to 1. This is the most direct way, in the short-term, for the “*Minister to control the cost of the SES*”.

Recommendation 12: The preliminary view of the Authority is that large electricity consumers should be able to opt-in to assume direct liability for Renewable Energy Target obligations. The Authority will consult further with participants and the Clean Energy Regulator on a workable model for opt-in arrangements

APPEA supports this recommendation. Arrangements that improve flexibility and potentially lower costs for liable entities represent improvements to what is a costly scheme. APPEA looks forward to consultation on the specific arrangements for an opt-in scheme.

Recommendation 17: The preliminary view of the Authority is that the level of the emissions-intensive, trade-exposed exemption under the Renewable Energy Target should be considered by the Productivity Commission as part of its broader review of the carbon pricing mechanism Jobs and Competitiveness Program in 2014-15

The Productivity Commission’s review in 2014-15, as the Recommendation notes, is of the arrangements for trade-exposed industries set out in the *Clean Energy Act 2012*

and not the arrangements set out in the *Renewable Energy (Electricity) Act 2000*. On this basis, it is unclear as to why the CCA has not included a review of the level of treatment under the *Renewable Energy (Electricity) Act 2000* as part of this Review.

APPEA recommended in its submission to the *Issues Paper*, and continues to recommend, that the Partial Exemption Certificate (PEC) level for trade-exposed industries, including LNG, be increased to 100 per cent.

In addition, the definition of LNG production used to determine the PEC under the *Renewable Energy (Electricity) Regulations 2001* should be amended to ensure consistency with the definition included in the *Clean Energy Amendment Regulation 2012 (No. 6)*<sup>2</sup>, made on 28 September 2012. This will ensure consistency between the definition of LNG production used under both the *Clean Energy Act 2012* and the *Renewable Energy (Electricity) Act 2000*.

Australia's LNG exporters are amongst the most trade-exposed of all Australian exporters. They cannot pass increased costs on to consumers and any loss of international competitiveness would benefit Australia's international LNG competitors or suppliers of alternative, higher greenhouse gas emitting, energy sources.

This means that while APPEA supports the policy intent of the PEC approach, a partial exemption means that trade-exposed industries continue to face cost increases that inefficiently and unnecessarily reduce their international competitiveness. Indeed, the PEC is in effect, a "partial, partial" exemption, as the PEC only applies to the portion of the RET above the former Mandatory Renewable Energy Target (MRET) target of 9,500 GWh.

As noted above, in the case of LNG, a PEC set at 60 per cent was included in Part 38 of the *Renewable Energy (Electricity) Amendment Regulation 2012 (No. 1)*<sup>3</sup>, which amended the *Renewable Energy (Electricity) Regulations 2001* and was made on 22 February 2012. This means that the industry remains exposed to significant additional costs associated with the RET. This reduces Australia's international competitiveness for LNG production and does not reduce greenhouse gas emissions in Australia.

Recommendation 18: The preliminary view of the Authority is that Partial Exemption Certificates should be tradeable and made usable by any liable entity to reduce liable electricity acquisitions

APPEA supports this recommendation. Arrangements that improve flexibility and potentially lower costs for liable entities represent improvements to what is a costly scheme. APPEA looks forward to consultation on the specific arrangements for a PEC trading scheme.

<sup>2</sup> See [www.comlaw.gov.au/Details/F2012L01957](http://www.comlaw.gov.au/Details/F2012L01957) for further information.

<sup>3</sup> Available at [www.comlaw.gov.au/Details/F2012L00399](http://www.comlaw.gov.au/Details/F2012L00399).

Recommendation 19: The preliminary view of the Authority is that the Commonwealth Government should consider opportunities to align application processes and data requirements for the Jobs and Competitiveness Program and Renewable Energy Target as closely as possible

APPEA supports this recommendation. Arrangements that improve flexibility and potential lower costs for liable entities represent improvements to a costly scheme. APPEA looks forward to consultation on the specific arrangements to implement this recommendation.

Recommendation 20: The preliminary view of the Authority is that there is no strong case for the exemption from liability under the Renewable Energy Target for self-generation, and that the exemption should be removed for new self-generation (but retained for existing self-generators)

**APPEA rejects this poorly considered recommendation.**

The policy rationale for the treatment of self-generators, which has been a feature of the RET since its inception and which has been reviewed and endorsed on three separate occasions (when the RET was established, during the Tambling Review in 2003 and during the COAG review process in 2010), was set out in APPEA's submission to the *Issues Paper* and is set out on page 115 of the *Discussion Paper* itself, namely

*... exclusion of self-generators could be considered as supporting the development of self-generation, of which a substantial proportion used more efficient cogeneration technologies and less greenhouse intense fuels.*

As noted in its submission to the *Issues Paper*, APPEA supports the clearly defined policy intent of the existing provisions. The natural gas industry, including the LNG industry, uses natural gas for self-generation purposes (or proposes to) at many facilities around Australia.

Natural gas produces significantly fewer greenhouse gas emissions than coal when used in power generation and is generally significantly lower than the average emissions intensity of grid-based power supply. The self-generation provisions, as they apply to the natural gas industry, are important in supporting lower emissions power generation options. Furthermore, in many cases, self-generation negates or defers the investment in costly transmission infrastructure thus reducing the cost to electricity consumers and associated transmission losses.

The provisions also support efficient commercial decision-making, by allowing projects, particularly those operating in rural and remote areas distant from the grid, to access the most cost effective form of power supply available to them.

Any move to further limit the application of the self-generation provisions would run counter to this policy intent.

**APPEA reiterates its recommendation that the provisions contained in subsection 31(2) of the *Renewable Energy (Electricity) Act 2000* should be retained.**

The maintenance of the provisions, for existing and new LNG developments (which together represent nearly \$300 billion dollars worth of investment, either committed (around \$180 billion) or under consideration, in the Australian economy in coming years) is vital to maintaining investment confidence and policy stability. These issues appear to loom large for the Review in many of its recommendations. They are even more important here, given the size of investment under consideration, and it is disappointing that they appear to have been downplayed by the CCA in its consideration of this issue.

The *Discussion Paper* also appears to confuse the policy rationale for the self-generator provisions which, as noted above, have been a feature of the RET since its inception, and the separate inclusion of the PEC arrangements in 2009. The validity of the self-generator provisions is not changed by the inclusion of PEC arrangements, which serve a different purpose. Each measure should be assessed on its own merits.

In addition, APPEA continues to recommend amendments to the current self-generator provisions. The self-generation provisions contained in subsection 31(2) (specifically, subsections 31(2)(a) and 31(2)(b)) of the *Renewable Energy (Electricity) Act 2000* should be amended to allow for contemporary resource development projects, such as those currently planned in the upstream oil and gas industry, to also be eligible under the provisions.

The self-generation provisions contain strict eligibility criteria through restrictions on ownership (the end-user of the electricity must have generated the electricity), distance (the electricity is to be used less than one kilometre away from the point of generation) or line-use (there is a dedicated line between the point of generation and the point of use). These criteria limit the ability of self-generators to avail themselves of the provisions.

By limiting access to the self-generation provisions, these criteria can impact adversely on optimal project design for a range of upstream oil and gas projects. This is particularly so in the case of a number of LNG projects currently in the planning and/or construction stages around Australia.

As noted in APPEA's submission to the *Issues Paper*, a number of contemporary or planned projects may not meet the strict eligibility criteria outlined above. Project proponents may then be forced to make development decisions that are non-economic, purely to meet the requirements of the Act. Some examples illustrate relevant circumstances facing project proponents in the upstream oil and gas industry and highlight the adverse impacts of the current strict eligibility criteria:

- Four large scale coal seam gas (CSG) developments are being planned or developed in eastern Australia. These developments essentially represent single resource projects, but in many cases production infrastructure and electricity

demand is dispersed over a large area. In many cases, combined demand will be over 100 megawatts but not necessarily in any single location;

- In areas that are relatively distant from existing generation sources, some project proponents may consider sharing a transmission line with the proponent of another resources development. In this case, the most efficient model may be for the proponents of the two projects to jointly construct a power station and invest in a transmission line they would then share. The self-generation provisions currently provide an incentive for each project to invest in its own separate generation, leading to duplicate infrastructure; and
- All else being equal, if a project proponent invests in self-generation there may also be economic merit in investing in a grid connection to provide power in the event of an outage at their own plant. The self-generation provisions provide a disincentive for the project proponent to do this.

Whilst these examples are not exhaustive, they serve to illustrate the adverse impacts of current restrictions in the self-generation eligibility provisions on optimal project design, project viability and emissions outcomes.

The COAG review's report, *Renewable Energy Sub Group Report to the Council of Australian Governments' Select Council on Climate Change COAG Review of Specific RET Issues*<sup>4</sup>, while largely endorsing many of APPEA's observations, made a majority recommendation for retention of the existing arrangements. Western Australia, the home of many of the relevant developments, endorsed APPEA's position and recommended changes in line with those recommended by APPEA.

APPEA would welcome the opportunity to discuss these issues further with you. Please feel free to contact Mr Damian Dwyer, Director – Economics, via telephone on (02) 6267 0902 or via e-mail at [ddwyer@appea.com.au](mailto:ddwyer@appea.com.au) if you have any queries.

Yours sincerely



David Byers  
**CHIEF EXECUTIVE**

Enc.

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<sup>4</sup> Available at [www.climatechangeauthority.gov.au/sites/climatechangeauthority.gov.au/files/COAG-RET-review-report.pdf](http://www.climatechangeauthority.gov.au/sites/climatechangeauthority.gov.au/files/COAG-RET-review-report.pdf).



# Implications of the RET for the Australian economy

A report for APPEA

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## Executive summary

This paper examines the implications for the Australian economy of the renewable energy target (RET). The RET requires 45 000 GWh of electricity generation to be sourced from renewable energy resources by 2020. Under current policy settings, the RET operates in parallel with the Carbon Pricing Mechanism, an emissions trading scheme (ETS).

The economic implications of four policy options have been assessed relative to a reference case in which no climate change policies are adopted:

- a domestic ETS policy scenario versus a domestic combined ETS + RET policy scenario; and
- an ETS policy scenario versus a combined ETS + RET policy scenario, in which the Australian ETS is linked to the European Union ETS (ETS\_EU).

The analysis shows that the combination of the ETS with the RET is significantly **less** efficient than an unadulterated ETS in achieving a given level of emissions abatement.

The modelling shows that to reach the emission target of five per cent below 2000 levels in 2020, the combined ETS + RET policy:

- costs Australia \$3.5 billion in today's dollars more than the ETS in output (GDP) losses in 2020; and
- causes substantial switching away from gas fired generation compared with an ETS, by 3 824 GWh in 2020.

A mandated renewable energy target such as the RET is less efficient at achieving a given environmental outcome because it forces higher cost renewable energy into the electricity generation mix at the expense of exploiting lower cost emissions abatement opportunities from gas generation and elsewhere in the economy.

Similar effects arise when the Australian ETS is linked with the European ETS. A combined ETS\_EU + RET policy:

- reduces Australian GDP by \$6.5 billion in today's dollars more than the unadulterated ETS\_EU in 2020; and
- reduces gas fired generation compared with the ETS\_EU by 2 313 GWh in 2020.

However, linking the Australian ETS with the EU ETS also implies that the Government's 2020 domestic emissions reductions target will be partly met by additional abatement in Europe. In these circumstances, Australia will be a net permit buyer before 2020 and the domestic carbon price will instead be set by the price of EU emissions allowances. Lower prices for EU allowances then translate into lower domestic carbon prices, and lower levels of domestic abatement and a transfer of income from Australia to the European Union.



# 1. Introduction

## 1.1. Policy context

The RET has its origins in the 2001 Mandatory Renewable Energy Target (MRET), which required that 9 500 GWh of electricity be generated from renewable energy sources from 2010 to 2020. The scheme obliges electricity retailers to purchase electricity from renewable energy sources. Retailers are required to surrender Renewable Energy Certificates (RECs), corresponding to one MWh of eligible renewable energy, purchased from accredited renewable energy generators, or alternatively pay a penalty. The costs of sourcing RECs are recovered from customers.

In June 2009, the then Rudd government legislated to raise the target to 45 000 GWh by 2020 (extending to 2030), corresponding to what was then estimated to be a 20 per cent share of renewables. In January 2011, the RET was split into a ‘Large-scale Renewable Energy Target’ (LRET) with a target of 41 000 GWh by 2020, and a ‘Small-scale Renewable Energy Scheme’ (SRES) with an implicit target of 4 000 GWh. The LRET created a financial incentive for large-scale renewable power stations such as wind and commercial solar, while the SRES encouraged retailers to support small scale technologies such as solar photovoltaic (PV) panels and solar hot water heaters. All aspects of the RET, including the LRET, the SRES, the associated liability and eligibility provisions and the impact of the RET on the electricity market are currently the subject of a review by the Climate Change Authority.

## 1.2. Scope of this study

The Australian Petroleum Production and Exploration Association (APPEA) has commissioned BAEconomics to undertake a quantitative assessment of the implications for the Australian economy of the RET, and to compare alternative policy options for reducing Australian emissions:

- through the combination of the Carbon Pricing Mechanism, an emissions trading scheme (ETS), and the RET; or
- by relying solely on an ETS.

These policy options are examined for their impacts on gross domestic product (GDP), real wages, electricity prices, Australian emissions and implications for electricity generation.

## 1.3. Structure of this report

This report is structured as follows:

- Section 2 describes the analytical and modelling framework used;
- Section 3 describes the modelling results; and
- Section 4 sets out the policy conclusions.



## 2. Analytical and modelling framework

The following describes BAEconomics' general equilibrium model BAEGEM, the reference case and policy scenarios that have been modelled and key model assumptions.

### 2.1. BAEGEM model description

The modelling simulations undertaken for this project were performed using BAEconomics' general equilibrium model, BAEGEM. General equilibrium models are a tool for determining the direct and indirect macroeconomic impacts of government policies by projecting changes in macroeconomic aggregates such as GDP, real wages, investment and private consumption in response to changed policy settings.

#### 2.1.1. Structure of BAEGEM

BAEGEM is a general equilibrium model of the world economy. The core model code of BAEGEM is based on the concepts of the Global Trade Analysis Project (GTAP) model, which relies on a global social accounting matrix to establish linkages between industries and countries. The model incorporates four interlinked modules: a government module, a GHG emission module, a technology mix module, and an energy module. For each year, BAEGEM simulates the interactions and feedbacks across these modules.

The technology mix module has been constructed specifically for the electricity and transport sectors. In the technology mix module, electricity is generated from a combination of twelve technologies: brown coal, black coal, gas, oil, hydro power, nuclear, wind, solar, biomass, waste, geothermal and other renewables. Under this setting, electricity generators are allowed to choose their mix of technologies in response to changes in relative capital and operating costs in the model. This modelling feature is of central importance for evaluating climate change policies as operating costs of non-zero emission technologies will change after a carbon pricing mechanism is put in place. Capital and operating costs for each technology are fully represented in BAEGEM.

#### 2.1.2. Data

The BAEGEM database is based on a number of sources. The global social accounting matrix (SAM) is based on the GTAP v8 database with a base year of 2007. The GTAP v8 database covers 129 countries/regions across the world and 57 commodity groups. To better represent the energy and mining sectors, the commodity groups in BAEGEM have been expanded to 70.

The emissions database is sourced from International Energy Agency (IEA), the United National Framework Convention on Climate Change (UNFCCC) and the US Environmental Protection Agency (EPA), and covers around 99 per cent of the global greenhouse gas emissions in 2007. The data in the technology mix and energy modules are sourced from IEA and the World Bank.

For the purpose of the modelling undertaken in this report, the BAEGEM database was aggregated into 14 regional/national economies and 23 production sectors as not all regions and sectors are relevant to this simulation exercise. Electricity technologies were also aggregated to increase the modelling efficiency (Table 2-1).

**Table 2-1. Regions, sectors and technology**

Regional / national economies	Production sectors	Electricity technologies
Australia	Crops	Brown Coal
EU27	Livestock	Black Coal
United States	Forestry	Oil
Canada	Fishing	Gas
Russia	Black coal	Nuclear
Rest of Europe	Brown coal	Hydro Power
China	Metallurgical coal	Wind
India	Oil	Solar
Indonesia	Gas	Other Renewables
Japan, Korea and Taiwan	Coke	
Rest of Asia	Nuclear Fuel	
Central and South America	Petroleum products	
Middle East and North Africa	Iron Ore	
Sub-Saharan Africa	Other minerals	
	Food	
	Chemicals, rubber and plastics	
	Non-metallic minerals	
	Manufacturing	
	Iron and Steel	
	Non-ferrous metal	
	Electricity	
	Heat	
	Services	
	Road transport	
	Water and air transport	

Source: BAEGEM



An important feature of the simulation exercise is the specification of the carbon content in all economic activities and of the economic environment in which the strategic developments are assumed to take place. In the simulations it is assumed that consumers choose their bundle of consumption goods based on utility maximisation. Likewise, producers choose their mix of inputs and technologies based on cost minimisation. Under a carbon mitigation policy, consumers and producers will gradually move away from carbon-intensive goods and carbon-intensive technologies to less carbon intensive products and lower or zero emission technologies.

## 2.2. Reference case and policy scenarios

BAEGEM is a recursively dynamic model that solves year-on-year over a specified timeframe. The model is then used to project the relationship between variables under different scenarios over a predefined period. A typical modelling analysis is comprised of a reference case projection that forms the basis of the analysis. Set against this reference case are the one or more policy scenarios under consideration. The impacts of the policy change (the achievement of the strategic targets) are measured by differences between the reference case and policy scenarios at given points in time.

For the purpose of the modelling analysis in this paper, the reference case assumes that there is no emissions reductions target, and that there is no ETS and no RET. The reference case thus represents a benchmark against which the outcomes under the policy scenarios can be quantified and assessed.

In addition to the reference case, four policy scenarios have been modelled in this report, reflecting various government policy announcements:

- The Australian Government has made an unconditional commitment that Australia will reduce its emissions by 5 per cent compared with 2000 levels by 2020. Accordingly, two policy options for achieving this emissions reductions target have been modelled:
  - ETS + RET scenario. In this scenario, the RET operates in parallel to an ETS, with the ETS operating from 2012-13 onwards.
  - ETS scenario. In this scenario, emissions reductions are solely achieved through the application of a carbon price (i.e. the RET is abolished).

The above policy scenarios have been designed to achieve an emissions reduction target of 5 per cent below 2000 levels by 2020, and 15 per cent below 2000 levels by 2030. This corresponds to total Australian emissions of around 470 Mt by 2020 and around 420 Mt by 2030, excluding emissions from Land Use, Land Use change and Forestry (LULUCF). In these scenarios, it is assumed that a limited number of domestic emissions permits are issued, corresponding to the Government's emissions reductions target. The domestic carbon price therefore adjusts to balance domestic supply and demand. International trading of emissions permits is not permitted under these scenarios.

- On August 28, the Minister for Climate Change and Energy Efficiency announced that the Australian ETS would be linked with the European Union Emissions Trading System (EU ETS),



so that Australian liable entities would have access to EU allowances. The following additional policy options have therefore been modelled:

- ETS\_EU + RET scenario. In this scenario, the RET operates in parallel to a domestic (Australian) ETS that is linked with the EU ETS from 2015 onwards.
- ETS\_EU scenario. In this scenario, emissions reductions are solely achieved through the operation of the Australian ETS, which is linked with the EU ETS.

In the above EU linkage scenarios, the price of Australian domestic emissions permits is determined by the supply and demand of emission permits in the two markets.

All scenarios, that is, the reference case and the four policy scenarios are modelled over the period from 2007 to 2030.

## 2.3. Key modelling assumptions

### 2.3.1. Renewable energy target

The two RET scenarios modelled (i.e. ETS + RET and ETS\_EU + RET) assume that the overall renewable energy target of 45,000 GWh will be met by 2020. The future GWh contribution of the SRES to the RET target is uncertain, since it depends on the number of small-scale renewable installations taken up by household in response to state and Commonwealth policies. It is clear, however, that, in aggregate, the Government expects the combined LRET and SRES to achieve the overall RET target.<sup>1</sup>

### 2.3.2. Macroeconomic assumptions

Key macroeconomic assumptions for the reference case are shown in Table 2-2. GDP growth in policy scenarios is determined in the course of the general equilibrium modelling.

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<sup>1</sup> As set out in the Government's 2010 discussion paper (p. 7): 'The LRET's 41,000 GWh target for 2020 has been set to achieve a level of large-scale renewable electricity generation above what was expected under the existing Renewable Energy Target. The LRET portion of the target will be increased to ensure the 45,000 GWh target is still met in 2020 if the uptake of small scale technologies is lower than anticipated, but the annual LRET targets will not be reduced if uptake of small-scale technologies is greater than anticipated.' Australian Government 2010. Enhancing the Renewable Energy Target – Discussion Paper, March.

**Table 2-2. Key macroeconomic assumptions**

	Average annual growth 2011 to 2020 (per cent)	Average annual growth 2021 to 2030 (per cent)
<b>Australia</b>		
Gross domestic product (GDP)	2.6	2.4
Population	1.3	1.0
<b>Rest of the world (GDP)</b>		
China	7.5	5.1
India	7.6	6.5
Japan, Korean and Taiwan	2.0	1.6
EU-27	1.6	1.7

Source: IMF, UN and BAEconomics' estimates.

### 2.3.3. Technologies

It is assumed that no new large-scale hydropower project will be built by 2030. Electricity generation from hydropower is counted towards the RET baseline. Further, it is assumed that carbon capture and storage technology is not commercially viable before 2030, and that the average lead time from planning to completion of a commercial renewable project is four years.

### 2.3.4. Electricity generation

Table 2-3 presents the Australian electricity generation mix in 2010.

**Table 2-3. Electricity generation and share of electricity generated by technology (2010)**

Generation technology	Energy generated (GWh)	Share of energy generated (per cent)
Black Coal	123 463	51.5
Brown coal	55 611	23.2
Oil fired	3 284	1.4
Natural gas	35 927	15.0
Nuclear	0	0
Hydropower	12 367	5.2
Wind	4 759	2.0
Solar	275	0.1
Other renewable	274	1.6
Total	549	100.0

Source: IEA



## 3. Results

The results of the modelling analysis are presented in the following. We consider, in turn, the implications of the four policy options for:

- the carbon price;
- growth in real GDP;
- growth in real wages;
- Australian greenhouse gas emissions; and
- the Australian electricity sector, including for aggregate electricity generation, electricity prices, and for generation from different technologies including gas and renewables.

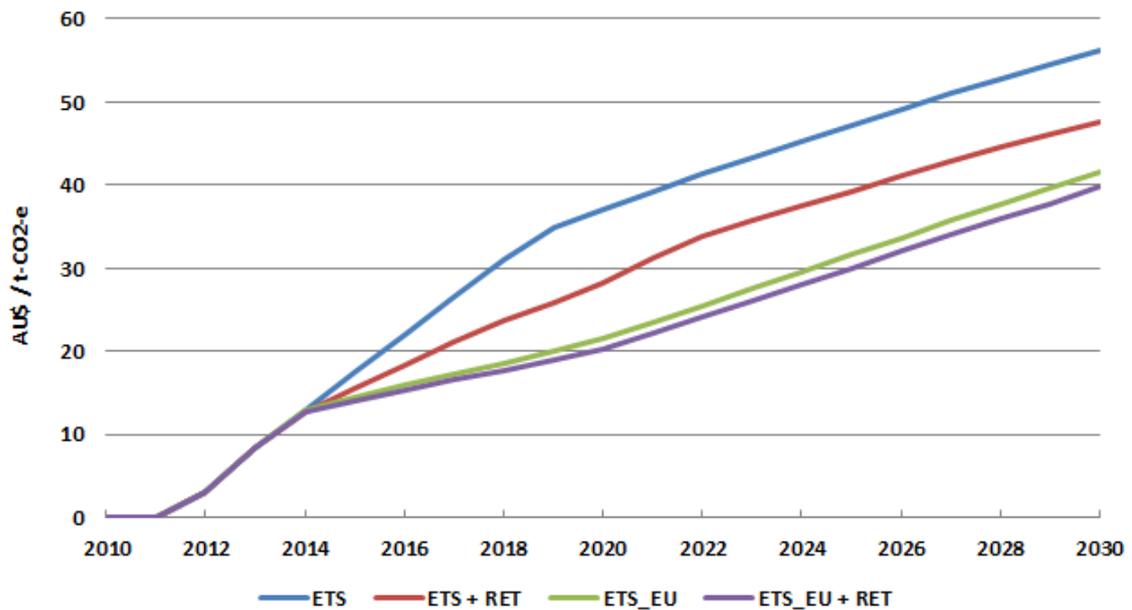
### 3.1. Policy implications for carbon prices

Figure 3-1 shows the evolution of carbon prices under the four policy scenarios considered in this analysis:

- Under the ETS and the ETS + RET scenarios, the domestic carbon price is projected to increase considerably to meet the Government's emissions reductions objective. In the ETS scenario, the carbon price rises to around A\$ 37/t-CO<sub>2</sub>-e in 2020 and to A\$ 56/t-CO<sub>2</sub>-e in 2030. In the combined ETS + RET scenario, the carbon price increases to A\$ 28/t-CO<sub>2</sub>-e in 2020 and to A\$ 48/t-CO<sub>2</sub>-e in 2030.
- The domestic carbon price is projected to be considerably lower in the EU linkage scenarios, given that it will be largely determined by the price of EU allowances. Australia will become a net permit buyer before 2020. The price of EU allowances is projected to be below A\$20/t-CO<sub>2</sub>-e before 2020, but will increase slightly to around A\$22/t-CO<sub>2</sub>-e after the Australian and EU ETS' are linked. In the ETS\_EU scenario, the carbon price then increases to A\$22/t-CO<sub>2</sub>-e in 2020 and to A\$42/t-CO<sub>2</sub>-e in 2030. In the ETS\_EU + RET scenario, the price increases to A\$20/t-CO<sub>2</sub>-e in 2020 and to A\$40 in 2030.

Irrespective of whether a stand-alone domestic ETS or a domestic ETS linked to the EU ETS is modelled, the combination of an ETS and the RET tends to lower the carbon price. This is because the RET imposes a technological mandate on liable entities and, thus artificially reduces the demand for emission permits.

Figure 3-1. Evolution of the domestic carbon price (A\$/t-CO<sub>2</sub>-e )



Source: BAEGEM.

### 3.2. Policy implications for real GDP

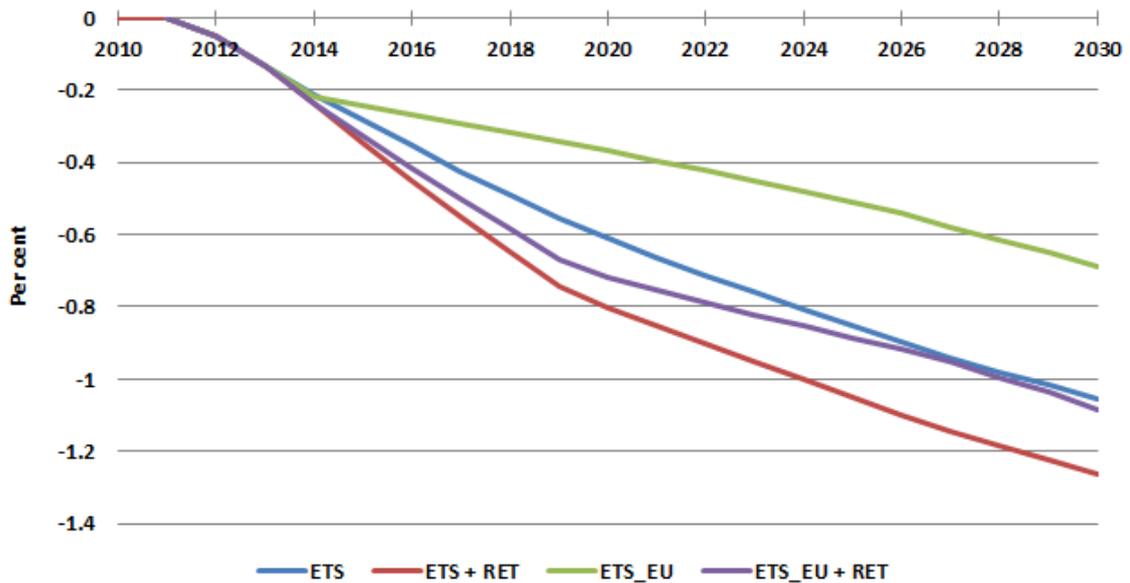
Figure 3-2 shows the deviations in real GDP levels under the policy scenarios relative to the reference case:

- relative to the reference case which does not incorporate climate change policies, real GDP is reduced in all policy scenarios; however,
- the combination of an ETS *and* the RET reduces GDP (significantly) more than a stand-alone ETS, irrespective of whether a purely domestic ETS or an ETS with EU linkages is modelled.

The larger reduction in GDP as a result of the RET is a consequence of the design of the scheme. The RET is a prescriptive technological mandate that requires renewable generation facilities to be commissioned, irrespective of whether lower cost alternatives (such as gas technologies) are available to meet the emissions objective. This is in contrast to a market based carbon price mechanism, which supports economy-wide least-cost abatement. It is therefore more efficient and less economically damaging to employ a pure ETS policy strategy to achieve a given level of emissions abatement than it is to adopt a combined (ETS and RET) policy approach.

The negative GDP impacts modelled in this report are likely to be conservative. This is because a significant portion of the RET target will be met from high cost, small-scale domestic installations, such as rooftop solar PV and solar hot water installations, which are not explicitly modelled in this exercise. Furthermore, a high reliance on renewable generation, particularly on intermittent technologies such as wind, imposes significant additional costs on the electricity system, for instance in terms of additional stand-by capacity required.

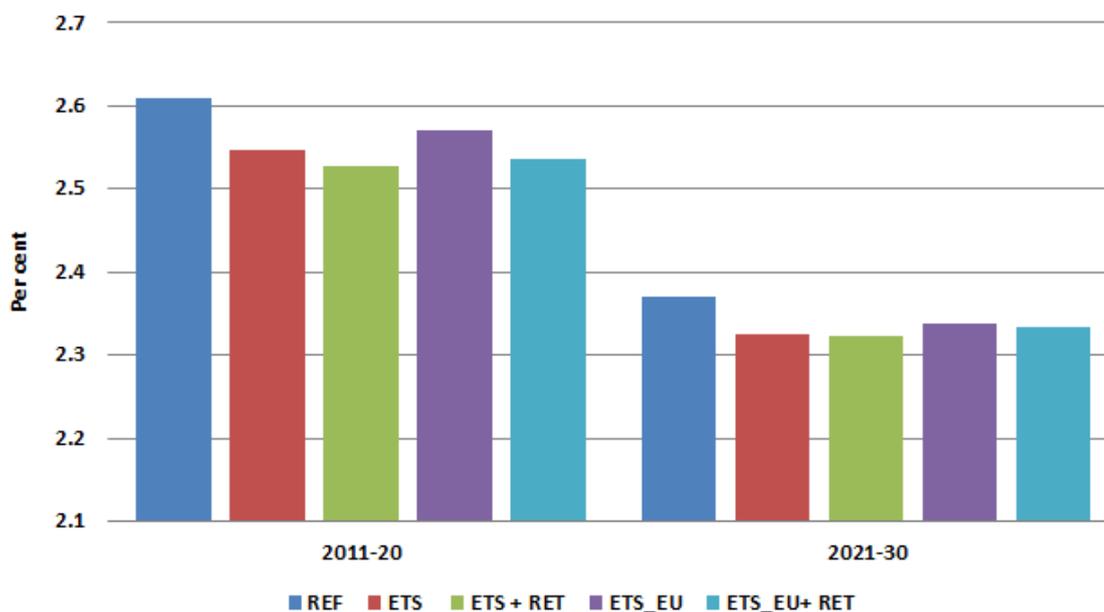
Figure 3-2. Real Australian GDP, deviation from the reference case



Source: BAEGEM.

Figure 3-3 shows average annual real GDP growth rates between 2011 and 2020, and between 2021 and 2030, respectively, for the reference case and the four policy scenarios. In all policy scenarios average real GDP growth is reduced relative to the reference case, but the existence of the RET depresses economic growth further. The reduction in average real GDP growth is less in the EU linkage scenarios (ETS\_EU and ETS\_EU + RET), given that electricity prices are projected to be lower in these scenarios (see Section 3.5.2).

Figure 3-3. Real Australian GDP, average annual growth rates



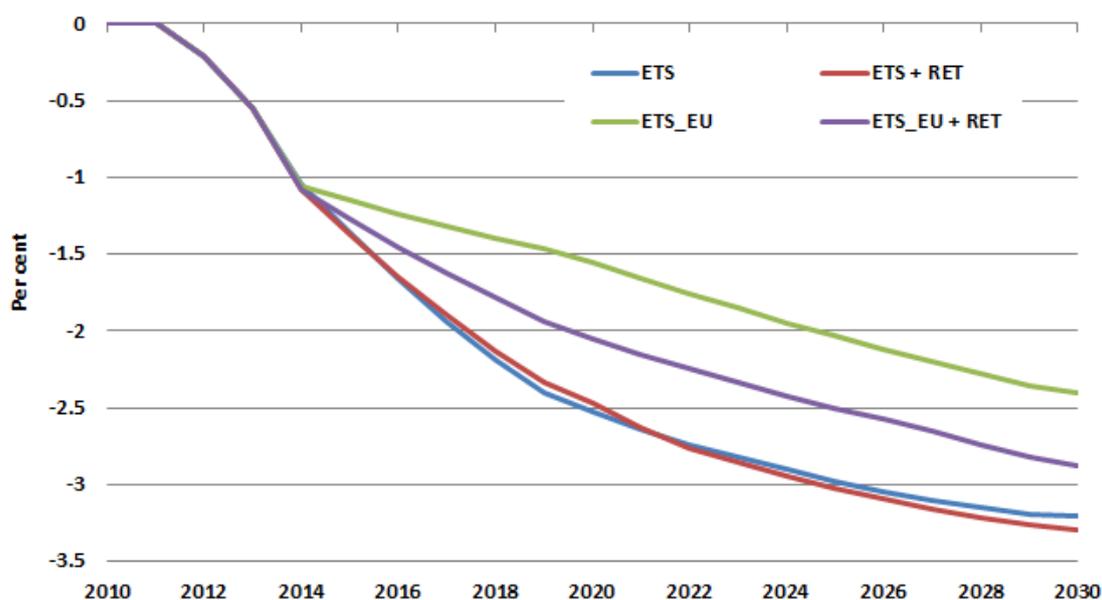
Source: BAEGEM.

### 3.3. Policy implications for real wages

Figure 3-4 highlights changes in real wages relative to the reference case in the four policy scenarios. All the climate change policies modelled here depress real wages relative to the reference case, but there are some differences depending on whether the domestic ETS is linked to the EU ETS or not:

- The reduction in real wages is very similar in the ETS scenario and the ETS + RET scenario. Real wages are reduced by around 2.5 per cent in 2020, and by around 3.3 per cent in 2030. This effect arises because the RET requirement to install additional renewable electricity capacity by 2020 temporarily places upward pressure on wages. This upward pressure largely compensates for the downward pressure on wages arising from lower GDP growth and higher electricity prices.
- This wage effect does not occur in the two scenarios in which the domestic ETS is linked with the EU ETS (ETS\_EU and ETS\_EU + RET). In these scenarios, the decline in real wages is significantly less than in the non-linkage scenarios. The temporary upward pressure from installing additional renewable electricity capacity is not enough to compensate for the downward pressure arising from lower GDP growth and higher electricity prices.

Figure 3-4. Real wages, deviation from the reference case



Source: BAEGEM.

### 3.4. Policy implications for greenhouse gas emissions

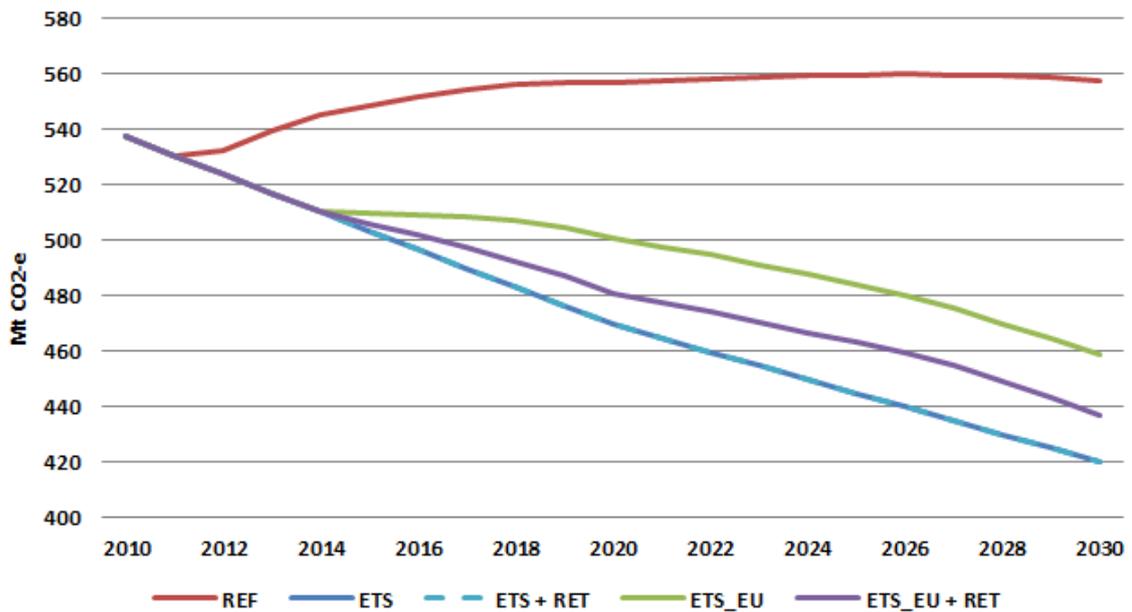
Figure 3-5 shows total Australian greenhouse gas (GHG) emissions, excluding emissions from LULUCF under the reference case and the policy scenarios. In the reference case scenario no GHG abatement measures are taken. Aggregate Australian GHG emissions increase from around 538 Mt CO<sub>2</sub>-e in 2010 to around 558 Mt CO<sub>2</sub>-e in 2020. Emissions level off at around 560 Mt CO<sub>2</sub>-e from 2023 onwards and then begin to decline to around 558 Mt CO<sub>2</sub>-e in 2030. This is a far lower level of emissions than assumed in Treasury modelling to date.

In the scenarios where the domestic ETS is not linked to the EU ETS, the carbon price pathway to 2030 is solely determined by the Government's emissions target. The ETS and the ETS + RET scenarios therefore generate the same levels of domestic emissions abatement; GHG emissions fall to 470 Mt CO<sub>2</sub>-e in 2020 and to 420 Mt CO<sub>2</sub>-e in 2030.

In the EU linkage scenarios, domestic carbon prices are determined by the prices of EU allowances, which reflect the EU emissions target and are projected to be relatively low over the forecasting horizon, and by the Government's domestic emissions target. Domestic carbon prices are projected to be lower than those in the scenarios without EU linkage because Australian firms can access cheaper permits from Europe (Figure 3-1). A lower domestic carbon price implies that the Government's emissions targets will be partly met by additional abatement in the EU:

- in the ETS\_EU + RET scenario, Australian emissions fall to 481 Mt CO<sub>2</sub>-e in 2020 (2.3 per cent above the 2020 target), and to 437 Mt CO<sub>2</sub>-e in 2030; while
- in the ETS\_EU scenario, Australian emissions fall to 501 Mt CO<sub>2</sub>-e in 2020 (6.6 per cent above the 2020 target), and to 459 Mt CO<sub>2</sub>-e in 2030.

Figure 3-5. Total Australian emissions (excluding LULUCF)



Source: BAEGEM.

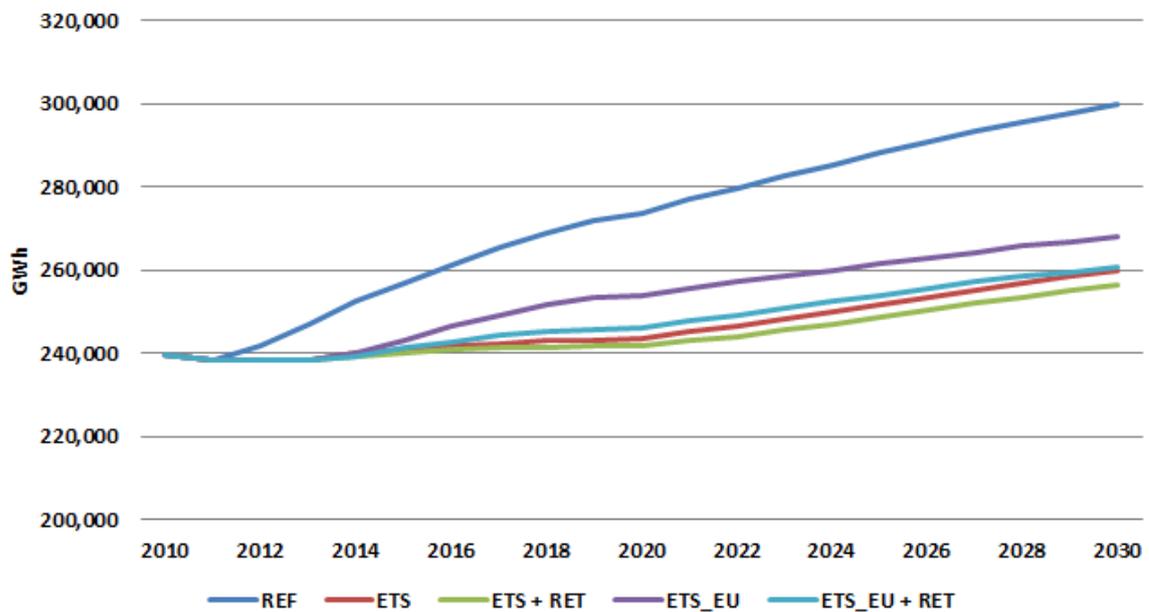
### 3.5. Policy implications for the electricity sector

#### 3.5.1. Aggregate electricity generation

The effects of the different climate change policies on electricity generation are shown in Figure 3-6. Aggregate electricity generation, excluding small scale generation, falls significantly relative to the reference case in all policy scenarios, although this effect is least pronounced in the ETS\_EU scenario. In the ETS policy scenario, aggregate electricity generation falls to around 244 TWh by 2020, a reduction of 11.1 per cent from electricity generation of 274 TWh in the reference case. In the ETS + RET policy scenario electricity generation falls to 242 TWh by 2020, an 11.7 per cent reduction. In the EU linkage scenarios, electricity generation in the ETS\_EU + RET scenario is projected to be 246 TWh in 2020 (a 10.1 per cent reduction), and in the ETS\_EU scenario electricity generation is 254 TWh (a 7.2 per cent reduction).

Irrespective of whether a stand-alone domestic ETS or a domestic ETS linked to the EU ETS is modelled, the overall effect on electricity generation is less under an ETS than it is under an ETS combined with the RET. This is because the abatement task is spread more evenly across the economy under an ETS and electricity prices are relatively lower. With a mandated renewables target, the electricity sector takes on a disproportionate abatement burden (given the marginal cost of abatement in the sector compared with marginal costs elsewhere in the economy) for a given abatement task.

Figure 3-6. Aggregate electricity generation in Australia (GWh)

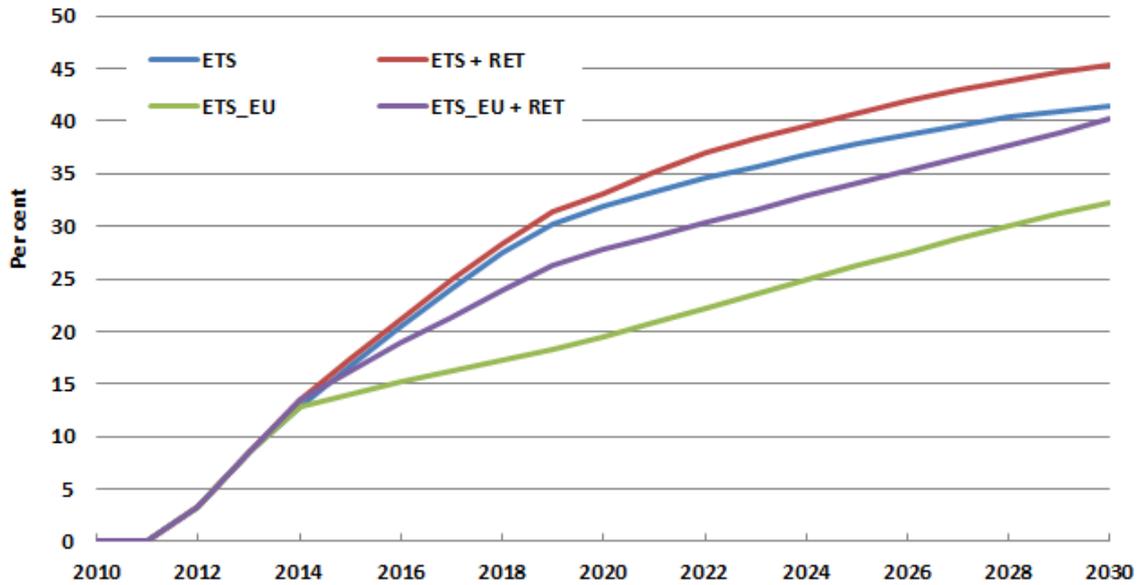


Source: BAEGEM.

### 3.5.2. Wholesale electricity

Figure 3-7 shows increases in average annual electricity wholesale prices relative to the reference case. By 2020, electricity prices will be 33.1 per cent higher in the ETS + RET scenarios, and 31.8 per cent higher in the ETS scenario. Wholesale electricity price increases are lower in the EU linkage scenarios; prices in 2020 will be 27.8 per cent higher in the ETS\_EU + RET scenario, and 19.5 per cent higher in the ETS\_EU scenario. The relatively smaller price increase in the ETS\_EU scenario is a reflection of the lower carbon price in this scenario, which is in turn a function of lower prices for EU allowances.

Figure 3-7. Electricity price deviations relative to the reference case

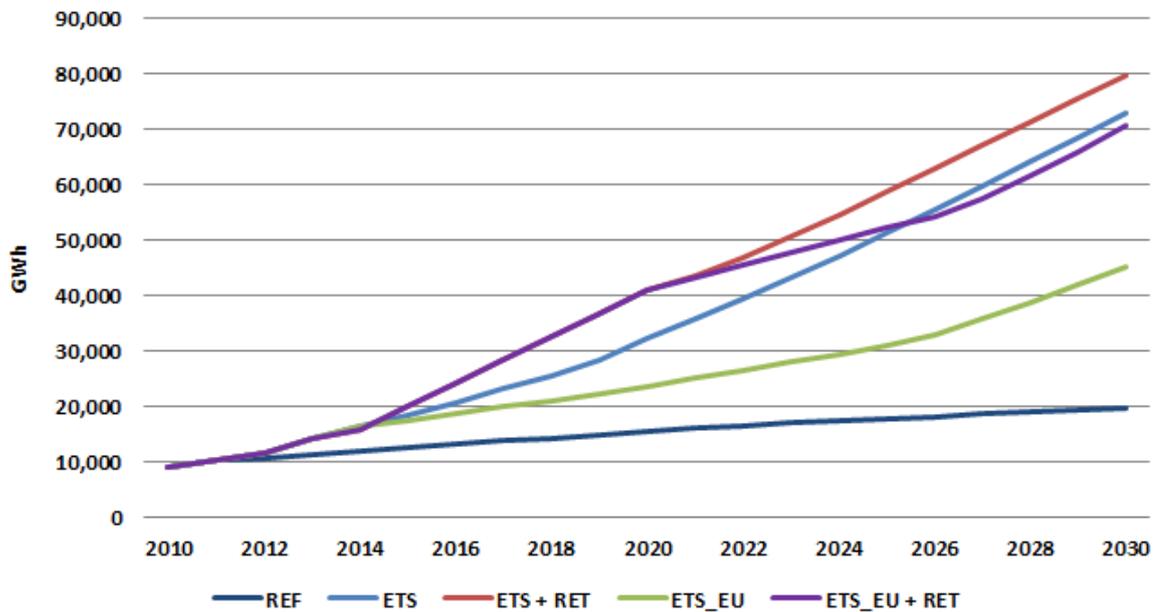


Source: BAEGEM.

### 3.5.3. Electricity generation by fuel source

Figure 3-8 shows electricity generation from renewable energy sources. Generation from renewables is higher under either of the RET scenarios (ETS + RET and ETS\_EU + RET), given that this policy mandates the amount of renewable electricity generated in each year. Under either of the non-RET scenarios (ETS and ETS\_EU), the amount of electricity generated from renewable energy sources is considerably lower. This result arises because, for a given abatement target, a sole reliance on renewable generation is not the least cost solution.

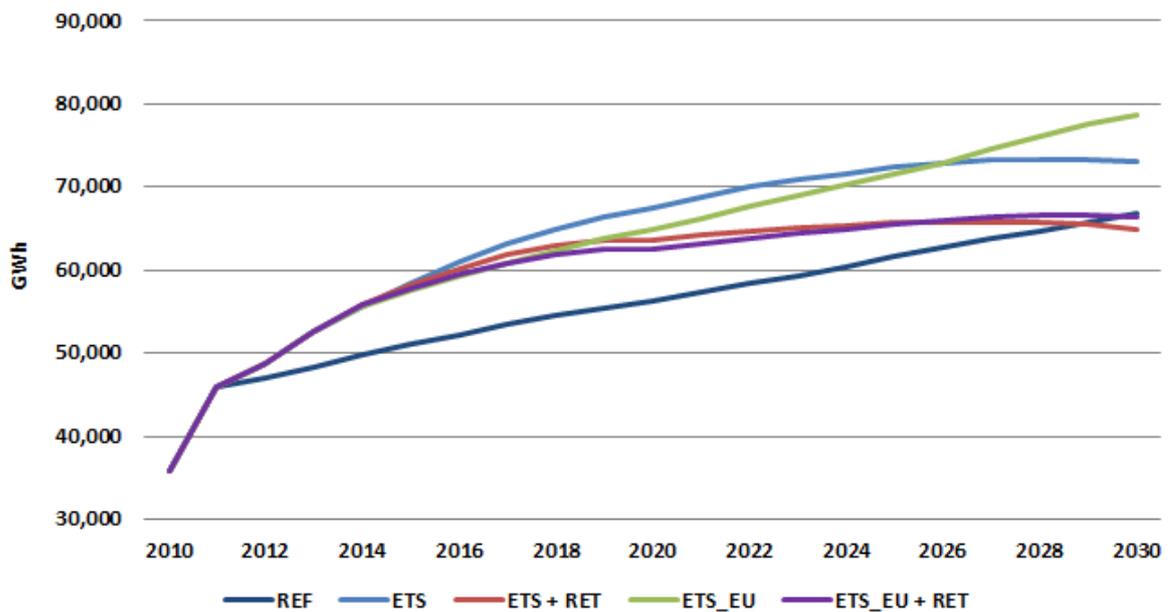
Figure 3-8. Electricity generation from renewable energy sources (excluding hydro)



Source: BAEGEM.

Figure 3-9 shows projections of electricity generation from natural gas for the reference case and the policy scenarios. Electricity generation from natural gas is higher than in the reference case for all policy scenarios, and is highest in the ETS scenarios (ETS and ETS\_EU). In these scenarios, the existence of a carbon price allows the emissions abatement objective to be achieved at least cost, by increasing the amount of generation from gas, which is less emission-intensive than coal. The renewable energy mandate of the RET, in contrast, forces more generation from (more costly) renewable energy sources.

Figure 3-9. Electricity generation from natural gas

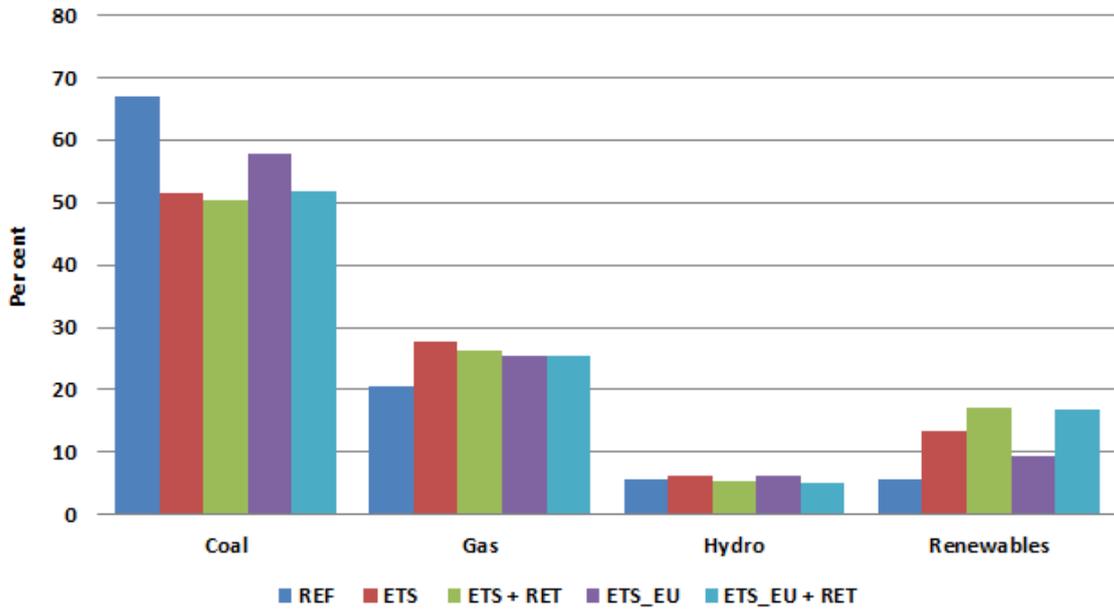


Source: BAEGEM.

Figure 3-10 and Figure 3-11 show the projected generation mix in 2020 and 2030. In all policy scenarios, coal-fired generation is reduced while generation from gas and renewables increases; these effects become more pronounced in 2030.

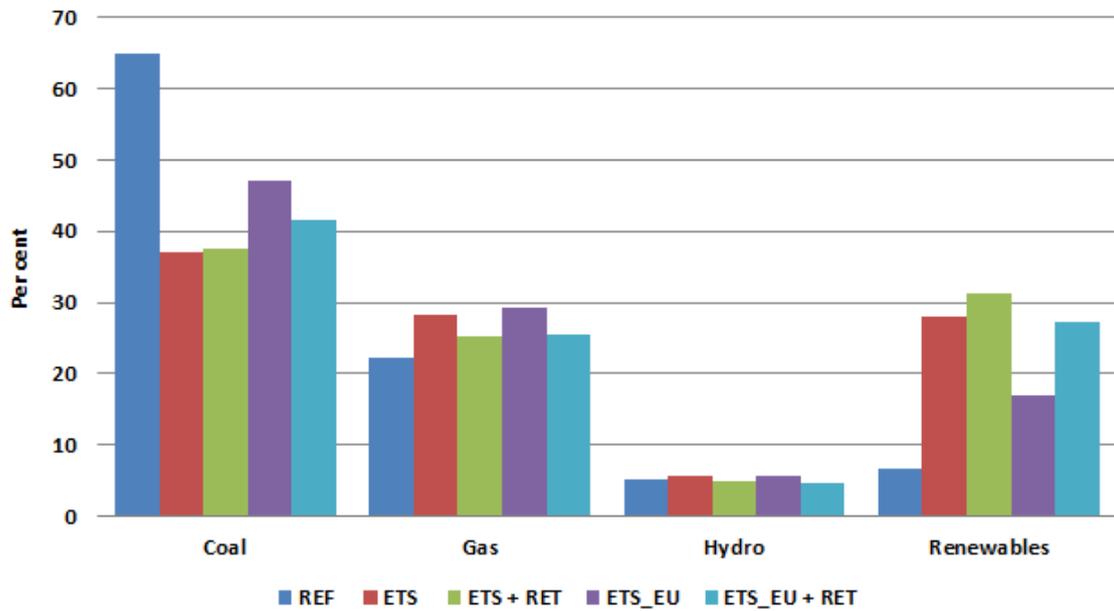
The share of generation from gas is always higher in the stand-alone ETS scenarios (ETS and ETS\_EU), than in the RET scenarios (ETS + RET and ETS\_EU + RET). A stand-alone ETS provides a least-cost solution to emission abatement through a market-based mechanism resulting in greater reliance on gas. To achieve an efficient outcome, it is crucial that the scheme includes a broad range of sectors across the economy. The RET, on the other hand, requires a disproportionate amount of abatement to be obtained from the electricity generation sector and, moreover, from more expensive sources.

Figure 3-10. Electricity generation mix in 2020



Source: BAEGEM.

Figure 3-11. Electricity generation mix in 2030



Source: BAEGEM.

## 4. Policy conclusions

The key economic effects of the four climate change policies analysed in this report are shown in Table 4-1. The combination of an ETS with the RET is (significantly) less efficient than a ‘pure’ ETS policy, irrespective of whether the ETS is purely domestic in scope or whether it is linked with the EU (Table 4-1):

- For the same level of abatement, the combined ETS + RET policy requires that the share of generation from expensive renewables is more than doubled, at the expense of generation from lower cost natural gas and adjustments in other sectors. In 2020, Australian GDP under the ETS + RET policy option is \$3.5 billion lower in today’s dollars, as compared to GDP under the ETS policy option;
- Linkage of the Australian ETS to the EU ETS somewhat reduces the negative impact on GDP growth that would arise under a purely domestic ETS. The operation of the RET in parallel to the ETS has a similarly depressing effect on economic growth.

**Table 4-1. Comparison of economic effects under alternative climate change policies (2020, percentage differences from the reference case)**

	ETS (per cent)	ETS + RET (per cent)	ETS_EU (per cent)	ETS_EU + RET (per cent)
Real GDP (Australia)	-0.6%	-0.8%	-0.4%	-0.7%
Wages	-2.5%	-2.5%	-1.6%	-2.1%
Emissions	-15.6%	-15.6%	-10.0%	-13.6%
Electricity generation	-11.1%	-11.7%	-7.2%	-10.1%
Electricity wholesale prices	31.8%	33.1%	19.5%	27.8%
Generation from renewables	107%	164%	53%	164%
Generation from gas	19.9%	13.1%	15.2%	11.1%

Source: BAEGEM.