

# AIGN Response to Climate Change Authority's *Caps and Targets Review Issues Paper* (April 2013)

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# 1 INTRODUCTION

The Australian Industry Greenhouse Network (AIGN) is making this submission in response to the Climate Change Authority's (CCA) invitation to provide input to its proposed approach to the Caps and Targets Review, and the issues identified in its Issues Paper in the review.

In offering a response to this paper the CCA should note AIGN's broad range of members, and resultant wide diversity of views on greenhouse and energy policy. This response accords with the views of our members in general; however at times there are variations in the positions of individual members on specific issues. It is therefore important that the CCA considers AIGN's feedback alongside any responses made to the issues paper by our members.

## 1.1 Background

In participating in the climate change policy debate, AIGN has a reliable history of basing all input on our policy principles (outlined in Attachment 1), which detail the manner in which we believe Australia's commitments and actions in relation to addressing greenhouse gas emissions should be shaped.

AIGN acknowledges that the prosperity, improved living standards and social conditions that industrial economies have experienced over the last 200 years has been as a result of activities that we now understand have had an impact on the global climate through increased atmospheric levels of greenhouse gases.

This link between economic prosperity and activities that generate greenhouse gases dictates that improved environmental outcomes must be achieved at the lowest possible cost to the community. To do otherwise will impact unnecessarily upon social conditions, in particular on those economies that are more vulnerable to the impacts of climate change.

Notwithstanding some ongoing debate within certain sections of the scientific community, AIGN recognises the consensus that indicates that the global climate system is warming with potential serious adverse impacts. AIGN has consistently advocated Australia should make an equitable contribution, in accordance with its differentiated responsibilities and respective capability, to global action to reduce greenhouse gas emissions and to adapt to the impacts of climate change.

However Australia's contributions to global emissions reductions need to be sensible of the global situation, and sensible of our trading performance noting Australia's industry structure.

## 1.2 Objectives of climate policy development

Climate change policy development is complex for many reasons, for example the difficulties involved in constructing policy instruments against the backdrop of (sometimes shifting) scientific evidence on what needs to be achieved, and by when. A major issue that can complicate this task is the mixture of objectives that need to be kept in mind when developing policy that responds fittingly to the conditions. Obviously the overarching goal is to reduce the atmospheric concentration of greenhouse gases, but beyond this there are three objectives that require consideration in shaping our policy response: providing certainty to the market, influencing other countries, and managing the impact of climate policies on the Australian economy, ensuring the burden we are bearing is commensurate with the economic impact on other nations. Different stakeholders deem these objectives with varying levels of importance; AIGN contends that the CCA could play a crucial role in emphasising the need for balancing the three objectives equally, as all have their place in shaping Australia's policy response to climate change.

Indeed, the Government has given every indication of understanding the significance of balancing these objectives, as can be seen in Box 3 of the issues paper. Box 3 outlines the conditions the

Government has put in place for reducing Australia's emissions reduction target lower than the unilateral -5% on 2000 levels by 2020. Attaching suitable conditions to increasingly ambitious targets allows for a level of flexibility in setting national emissions reduction goals that is necessary in the uncertain and shifting global climate change policy landscape.

It is our understanding that these conditions are consequential of the Government seeking to balance the objectives of reducing uncertainty, influencing other countries, and minimising the economic impact of Australia taking on emissions reduction targets. At this point in time, for example, AIGN members assessing policy action around the world would conclude that – because global ambition is modest, because the credibility of domestic action in the US, China and India is not established through a robust global agreement, because there is no international agreement in which major developing economies commit to restraining emissions substantially, because we still lack clarity on the assumptions for emissions accounting and access to markets – there is no case for moving beyond the -5% target. When international commitments begin to fulfil these conditions, we would have some capacity to calculate the expected changes to Australia's target, and its impact on business operations.

In other words, the conditions are a public statement of what has to happen before the target will be changed, and what a new target would be. Therefore they influence business behaviour; it is the certainty that the Government's design affords Australian entities. AIGN commends the latter point to the CCA's particular notice due to its importance to our members' commercial activities. In all things AIGN strongly promotes the reduction of uncertainty in the form of stable policy and decision-making frameworks (we also note the CCA's emphasis on reducing uncertainty, most recently demonstrated in its review of the Renewable Energy Target Scheme). Should recommendations for targets outside the framework represented by Box 3 be made, it would begin to unravel this certainty, as well as casting doubt on the certainty of any new target.

## 2 FEEDBACK ON SPECIFIC QUESTIONS FROM ISSUES PAPER

### 2.1 Making recommendations beyond 2020

AIGN supports the CCA's intention to look beyond 2020 within this review; policy frameworks considering the next 20 years or more are useful in providing institutional certainty to investors and businesses when assessing the viability and potential economic benefit of making investments (not only in abatement or clean technology projects, but in terms of investment choices more generally).

In terms of the merits of different approaches, AIGN has no strong view on this, except to state that the future global policy environment is extremely difficult to predict. As the CCA itself has pointed out in this paper, the reality of policy measures in different countries could be both better and worse than their international pledges indicate. In this context the main point AIGN makes is that the CCA should consider a range of future scenarios, including what Australia's fair and defensible share of the global effort would be should the international effort fall short of the aspirational goal of limiting global warming to 2°C.

While AIGN agrees that "...it is in Australia's interests to support global emissions reductions to limit global average warming to 2 degrees Celsius or less,"<sup>1</sup> the insufficiency of the sum of country pledges to reach this goal is fact.<sup>2</sup> It is therefore necessary for the CCA's proposed 'starting point' scenario (which cites Australia's target of 80% reduction on 2000 levels by 2050) to be one of several if the review is to have relevance in the event,

<sup>1</sup> Issues Paper, page vii

<sup>2</sup> <http://unfccc.int/bodies/awg/items/7398.php>

which is a possibility, of the 2°C goal not being reached.

## 2.2 Alignment with Kyoto Protocol commitments

AIGN agrees that Australia's emissions reduction goals should be consistent with the Kyoto Protocol rules in terms of coverage and scope, since this will facilitate an easier comparison with other countries operating under these rules. Conversely, it should be noted that only 37 countries accepted binding targets under the second commitment period of the Kyoto Protocol, which does not include the emissions of major economies like the US and China, or many of our trade competitors.

An increasing number of countries are considering implementing some form of regulated carbon pricing, and/or are trialling carbon pricing (China, South Korea, South Africa, Kazakhstan, etc). Furthermore, those Annex I countries that have not signed up to the second commitment period of the Kyoto Protocol are retaining their flexibility in terms of their future emissions reduction commitments (e.g. US, Canada, Japan, New Zealand). In this environment AIGN does not consider it viable to work on the basis of only one emissions reduction target in this review; a range of scenarios with differing degrees of probability should be assessed.

## 2.3 Framing targets, trajectories, budgets and caps to help reduce uncertainty

AIGN agrees with the CCA that limiting uncertainty is a sound guiding principle in shaping emissions reduction efforts and climate change policy in general, along with managing the economic impact on Australia and encouraging other countries to commit to quantitative emissions reductions. Having said that, the highest possible certainty is not necessarily achieved by announcing fixed targets or carbon prices, etc. Sometimes this creates more uncertainty. The best way to achieve maximum certainty is to ensure institutional stability within the particular policy environment. This means, for

example, a circumspect approach to changing the rules of a policy to manipulate the outcome, even when it is achieving its objective. In terms of setting targets, uncertainty can be minimised by fixing the conditions on which levels of ambition depend; this allows entities to make their own judgements on the likelihood or otherwise of a scenario and its implications for their operations.

With respect to trajectories, AIGN considers this to be principally a policy question. How the carbon budget will be distributed over time depends on the policy instrument/s used to achieve the target, levels of integration with other jurisdictions' policy instruments, access to international secondary markets, etc. These issues will be decided by the Government, and may be based on a variety of factors such as Australia's economic situation, political will, expected technological developments and the economic impact of various trajectories. On the latter two factors the CCA could provide useful guidance to the Government; AIGN considers this to be preferable to recommending a single trajectory. This approach would be consistent with the range of conditional targets that Australia has announced, which also recognise the fluidity of the environment in which decisions on climate policy are being made.

Lastly, on the subject of caps, AIGN wishes to note that to date, no targeted national emissions reduction policies have been introduced for uncovered sectors since the carbon pricing mechanism came into force on 1 July 2012 (through the Carbon Farming Initiative, emissions reductions in uncovered sectors are not treated equitably to emissions reductions in covered sectors, and uncovered sectors participate voluntarily). This creates the risk that the emissions reduction burden is not borne equally across the whole economy. In setting scheme caps the abatement task should be divided fairly between the covered and uncovered sectors. This requires targeted policies for uncovered sectors to achieve their share of abatement, so that the cost of emissions reductions in uncovered sectors (not to mention the risks and cost of failure to do so) is not borne by covered sectors.

## 2.4 Global emissions budget

As stated above, AIGN supports an approach in which the CCA considers a range of viable global budgets reflecting a range of international ambition, rather than focusing exclusively on the 80% reduction target out to 2050. It should also be noted that, when assessing ranges of ambition from other countries, the CCA should distinguish between actual measures to reduce emissions, and aspirations to do so. Consideration should be given to whether targets are aspirational or legislated, how realistic they are and level of confidence in their enforcement, quality and reliability of monitoring, reporting and verification (MRV), and whether the economic costs of reaching these targets is comparable to Australia's economic costs of reaching our target. These considerations would be a useful addition to Table 2 in the issues paper.

## 2.5 Comparing Australia to other countries

Comparisons to other OECD countries (e.g. the US, Canada, Japan, the EU) remain relevant, however comparing the ambition of our targets with these countries is not as pertinent as comparing the economic cost of reaching our targets. Due to our similar wealth and standards of living, it is reasonable for Australians to bear a similar economic burden to these countries – however because of differences in the structure of our economies, what we achieve for a similar cost is not necessarily appropriate to be compared. Due to our natural resources advantage, Australia is home to a large share of emissions-intensive mining and production; this is arguably an economically and environmentally efficient outcome from a global perspective, and will continue to be so in the future. Comparisons to other countries should not limit Australia to doing the same things as other countries, but to contributing to a globally efficient outcome (which is likely to require different action in different countries).

Given the accepted, though unofficial, common method of evaluating the economic costs of certain targets which countries have generally adopted in

international negotiations – and moreover due to the economic realities of climate change policy which is publicly acknowledged through the Jobs and Competitiveness Program within the CPM – it is imperative to compare Australia with global trading partners (many of whom are not OECD countries). Most do not have quantitative targets under the Kyoto Protocol and many are not 'major' economies but are nevertheless major competitors of particular Australian industry sectors.

## 2.6 Global budget sharing

When it comes to sharing the global emissions budget, the consensus approach of the UN requires voluntary commitments, which all nations ultimately have no choice but to accept from one another. Nations historically nominate their preferred contribution to the emissions reduction effort based primarily on self-interest (in other words, what is affordable with minimal wealth leakage, i.e. adverse community impacts). Australia's unique circumstance as an advanced economy with a rich resources endowment creates complexities that many other nations (especially, advanced economies) would have little experience with. Of the approaches to budget sharing outlined in Table 4, none is optimised to deal effectively with a situation where the production of emissions outstrips consumption on a per-capita basis, as is the case in Australia. Neither do they address the reality that national commitments are made based on economic impact. This is an important concern that must be taken into account in setting targets for Australia. The CCA should consider reframing this discussion in terms of the relative economic burden of making emissions reductions, since such a metric more closely reflects the working reality that Australia must operate within in international negotiations.

## 2.7 Domestic budget sharing

On the questions of how to divide an emissions budget across individuals, sectors and generations, and how to achieve the required reductions to remain within one's budget, AIGN contends that these are matters of policy that should be left to the

Government of the day. It is more appropriate for the CCA to provide what guidance it can on the economic impacts of a range of potential options, than to make judgements on policy issues.

## 2.8 Influencing other countries

In assessing whether – and to what extent – Australia's actions might influence other countries, it is useful to look at past experiences. As the CCA notes in its paper, international action (in the sense of collective action) can have a positive effect on individual country action; however the question of whether Australia's action in particular (i.e. in isolation from the context of collective action) has any global impact cannot be deduced from this fact. This is best determined by looking at past instances of Australian leadership and its results. For example, Australia's influence before and after ratifying the Kyoto Protocol, or its decision at the Doha meeting of 2012 to declare its QELRO to 2020 (which has yet to instigate similar declarations from other countries).

Australia has previously evaluated itself as a middle power that can contribute to maintaining the momentum of collective international action. It is a position acknowledged repeatedly by the Government since announcing its emissions reduction target ranges in May 2009, to do 'no more and no less than the rest of the world'; it is exemplified in the conditions attached to moving from the unconditional -5% target to a more ambitious goal. In seeking to influence other countries, decision makers should not lose sight of the other two objectives in setting our targets: reducing uncertainty and managing the economic impact of achieving targets. These facts are a useful starting point in understanding and measuring the effect of Australia's influence on international action.

## 2.9 Carry-over of units from KPI to KPII

On the issue of carry-over of emissions units between periods, AIGN refers the CCA to our support for the principle of certainty and stability in

policy. The terms of the Kyoto Protocol allow for carry-over, which is consistent with the concept of a global emissions budget (in this case, the savings realised in the past are of benefit in the future while remaining within Australia's overall emissions budget over time). AIGN supports the position advocated by the Business Council of Australia (BCA), that the credits carried over from the first commitment period should be proportionately allocated between the cap on covered sectors via the carbon pricing mechanism (to be sold into the market), and uncovered emissions (to be reserved for meeting our undertaking for the second commitment period). Options to use the carry-over to tighten our past or future QELROs are not consistent with the principles of emissions budgets and policy stability, while holding them as insurance to manage risk in uncovered sectors exacerbates an already compromised situation in which the policy construct lends itself to disproportionately burdening covered sectors with reducing emissions for the whole economy.

## 2.10 Impact of emissions reduction goals on carbon price, economic and social conditions

AIGN suggests that the impact of Australia's emissions reduction goals on the Australian carbon price, economic and social conditions, will not be determined by our level of ambition so much as by the level of integration with the international effort to reduce emissions. For example, prohibiting the import of international credits into Australia would do far more to raise the carbon price (or other cost of abatement) than the goal – though naturally the stringency of the goal will have a greater impact in this scenario. Similarly, should Australia's emissions reduction policies be linked to measures in other countries – especially large economies (e.g. the planned link between the CPM and EUEETS) – then significant policy changes in other jurisdictions have the potential to affect Australia's cost of abatement quite considerably. Economic and social conditions are causally linked to the level of the carbon price in relation to our trade competitors, so that estimating

the impact of emissions reduction goals on these factors in such a complex environment of uneven policy development and implementation is an immense task indeed.

AIGN also notes that, in assessing Australia's emissions reduction opportunities (p 28), the issues paper lists low-emissions technologies, energy efficiency improvements, changing production processes and materials, and shifting consumer preferences. AIGN agrees that these are legitimate opportunities, and adds another to the list: reduced production. Policies that put a price on emissions are designed to allow market forces to select the cheapest way to meet the cap, and as long as emissions reduction targets are based on production, this is as logical an option as any other.

## 2.11 Setting caps

In view of the Government's stated objective of reducing emissions at least cost, an important consideration for the CCA in setting caps should be to ensure that the task of reducing emissions is shared equitably across the economy. In a situation where every sector is a covered sector, and therefore subject to specific, enforceable annual constraints, setting caps is as simple as linking them to Australia's emissions reduction commitments under the Kyoto Protocol or any future international agreement.

However, with a price on carbon that does not apply to the entire economy, the cost of reducing emissions should be divided fairly between covered and uncovered sectors based on projected business-as-usual emissions over the relevant period. While this may not deliver the least-cost outcome possible (it cannot be known to a certainty in which sector/s the lowest-cost opportunities are located before the carbon price encourages innovation and savings), it will at least share the burden of reducing emissions equitably.

The concept of tightening caps to transfer the risk of uncovered sectors not reducing emissions sufficiently onto covered sectors (a definite likelihood in the absence of targeted emissions reduction policies in these sectors) is not supported

by AIGN. It is simply another method of distributing the burden to reduce emissions inequitably across the economy, allowing uncovered sectors the option of free-riding while covered sectors must bear the entire cost of meeting Australia's target.

## 2.12 Relationship between emissions caps and national trajectory

As mentioned elsewhere in this submission, AIGN sees the issue of setting the trajectory for meeting an emissions target as a matter for the Government of the day to determine. Information on the economic impacts associated with a variety of trajectories (taking into account such matters as expected technological developments and international progress on emissions reductions) may be useful in assisting the Government to choose a trajectory; however the unpredictable nature of future developments speaks against the recommendation of a single, fixed trajectory. Therefore, taking into consideration that the caps will bear some relationship to the trajectory (i.e. either follow or diverge from it), the CCA could examine whether there would be any benefits to diverging from a given trajectory. An alternative approach the CCA could adopt is to base its recommendation on caps on Government guidance regarding the trajectory.

## 2.13 Progress on reducing emissions

AIGN supports exploration of the factors that have influenced emissions abatement in Australia (e.g. exchange rates, climate change policies, commodity price movements, economic growth rates). This should occur alongside evaluation of the efficiency of the various climate change policy measures operating in Australia. Such analysis can then be used to track potential key drivers in meeting future emissions reduction targets (such as Australia's 2020 target). This retrospective approach should be a regular feature of climate policy analysis to inform future decisions regarding appropriate targets for Australia to commit to.

### 3 CONCLUSION & CONTACTS

Thank you for the opportunity to provide input into this process. AIGN is committed to engaging constructively with the Climate Change Authority in this review by providing feedback to assist the CCA in understanding the way in which our members are affected by significant national policy decisions.

If we can be of further assistance, please do not hesitate to contact Alex Gosman on 02 6295 2166, or by emailing [alex.gosman@aign.net.au](mailto:alex.gosman@aign.net.au).

## 4 ATTACHMENT 1 – AIGN CLIMATE CHANGE POLICY PRINCIPLES

The Australian Industry Greenhouse Network's position on climate change is informed by the following principles.

Australia should make an equitable contribution, in accordance with its differentiated responsibilities and respective capability<sup>1</sup>, to global action to reduce greenhouse gas emissions and to adapt to impacts of climate change.

Australia should engage the international community in pursuing identified and beneficial environmental outcomes through greenhouse gas emissions reduction action which:

- allows for differentiated national approaches;
- promotes international cooperation;
- minimises the costs and distributes the burden equitably across the international community;
- is comprehensive in its coverage of countries, greenhouse gases, sources and sinks;
- recognises the economic and social circumstances and aspirations of all societies; and
- is underpinned by streamlined, efficient and effective administrative, reporting and compliance arrangements.

In this global context, Australia should develop a strategic national approach to responding to climate change which:

- is consistent with the principles of sustainable development;
- is consistent with other national policies including on economic growth, population growth, international trade, energy supply and demand, and environmental and social responsibility;
- takes a long term perspective;
- maintains the competitiveness of Australian export and import competing industries;
- distributes the cost burden equitably across the community;
- adopts a consultative approach to the development of new policies; and
- is consistent and effectively co-ordinated across all jurisdictions throughout Australia.

Australia's future greenhouse policy measures should:

- be consistent with the strategic national approach;
- be trade and investment neutral, in a way that does not expose Australian industry to costs its competitors do not face;
- not discriminate against new entrants to Australian industry nor disadvantage "early movers" in Australian industry who have previously implemented greenhouse gas abatement measures;
- take account of the differing sectoral circumstances;
- be based as far as is practicable on market measures;
- address all greenhouse gases;
- address all emission sources and sinks; and
- balance, in a cost-effective way, abatement and adaptation strategies – both of which should be based on sound science and risk management.

1. Australia's contribution to the global climate change effort as set out here reflects the principle in Article 3.1 of the United Nations Framework Convention on Climate Change. Differentiated responsibilities and respective capabilities could take account of such matters as a country's economic growth and structure, population growth, energy production and use etc.