



Friday, 19 February 2016

Special Review Second Draft Report – Australia's Climate Policy Options
Climate Change Authority
GPO Box 1944
Melbourne VIC 3001

Dear Sir / Madam

Submission to the Special Review - Australia's Climate Policy Options

The EUAA after attending various departmental forums and a series of consultations with its members from the large commercial and industrial sector is pleased to make a submission to the Special Review - Australia's Climate Policy Options.

The EUAA is the peak industry body for Australia's energy users including manufacturers, retailers and resource-based industries. Our members seek competitive, reliable and sustainable energy supply as a means of running their operations. We are the only organisation singularly focused on representing the needs of large energy users both in rapidly evolving and volatile energy markets (electricity, gas, renewables), and on climate change and energy efficiency policy issues.

The EUAA welcomes discussion on any aspects of this report.

Regards

A handwritten signature in blue ink that reads "Phil Barresi".

Phil Barresi
Chief Executive Officer

Special Review - Australia's Climate Policy Options

Overview

Climate Change Policy Objective

The fundamental objective of a climate change policy should be to limit global greenhouse gas emissions to a level that will avoid catastrophic effects of climate change. Parties to the U.N. Framework Convention on Climate Change (UNFCCC) reached an agreement on December 12, 2015 to limit global temperature increase well below 2°C, and more recently, the Paris climate talks reinforced this goal while urging efforts to limit the increase to 1.5°C. There is broad international consensus to adopt this as the objective of climate change policies. Australia's policy should adopt this limit as the fundamental objective of its climate change policy in the first instance and should adjust to match international consensus of this limit as it changes over time.

Federal Policy Across All Sectors

Australia's climate change policy should be implemented at the federal level. This means that in the presence of an effective national policy, state-based schemes such as emissions trading or energy efficiency are redundant and should be disbanded. The policy should be broad reaching and include all sectors within the economy.

Bi-partisan Support

Irrespective of the specific policy or mechanism employed, it should have bi-partisan support in order to provide the long-term certainty required for it to be effective. Without bi-partisan support, businesses will not have the confidence to make the long-term investment decisions required to meet the objective of the policy.

Clear, Long-term and Binding Targets

In order to meet the objective of a 2°C temperature rise, this needs to be translated into emissions targets for Australia as a whole. It is not the intention of this submission to stipulate the targets required, however, any targets set should be clear, long-term and binding. Australia's target should be proportionate in the international context. This may not create certainty, however, will create predictability which is essential for businesses to make long-term investments.

Least-Cost: Market-Based

The mechanism used to achieve Australia's emissions targets should be market-based. Market-based instruments allow businesses greater flexibility in meeting their objectives at least-cost. Policy should be technology neutral in order to avoid picking winners and potentially shifting away from the least-cost solution, and care should be taken when designing policy to consider the costs of compliance and assurance.

The market-based mechanism should be equitable, efficient, effective, transparent and flexible so that it may integrate with international schemes.

An important feature of a market based policy should be an international carbon price linkage. Climate change is a global problem that can only be met by a global solution, hence, location of carbon mitigation is irrelevant. Verifiable international credits should be permitted to achieve Australia's targets in order to provide the least-cost solution.

Emissions-Intensive-Trade-Exposed (EITE) Industries

Any policy needs to consider and address the risk of carbon leakage. This continues to be a real risk, despite the success at the COP21. Carbon leakage is a complex issue and detailed examination is required to understand where and how carbon leakage can occur.

Supplementary Schemes

In the presence of an effective national climate change policy, supplementary schemes at both federal and state levels are unnecessary and increase regulatory costs. Schemes such as the Renewable Energy Target (RET) and Energy Efficiency Schemes should be reviewed and a long-term course set in place to repeal over time. The aim would be to provide the least-cost solution whilst avoiding sovereign risk created with these existing schemes. Considering Energy and Sustainability policies in isolation will only result in unintended consequences.

Principles for Assessing Policies

The EUAA accepts that the three principles proposed are appropriate and all-encompassing on the proviso that:

- Cost effectiveness includes the cost of implementation both directly in corporations meeting their obligations and indirectly through tax payer's costs to run the scheme. For example, complex baseline and credit schemes will impose significant compliance costs on business in trying to meet their obligations.
- Environmental effectiveness includes achieving a real reduction in global emissions.
- Equity includes the ability to communicate the policy to participants in order to facilitate its uptake. For example, if a carbon tax revenue is utilised to provide compensation for low-income households, appropriate communication is required in order for the general public to understand this function.
- Each principal considers the consequence upon international competitiveness of Australian businesses and industry.

Mandatory Carbon Pricing

The last time Australia introduced mandatory pricing, in the first nine months emissions were 11.44 million tonnes CO₂-e.equivalent (7.4%) lower than the comparable prior period. Prima facie this suggests that pricing emissions has had the intended effect. Further inspection seems to undermine this conclusion. In particular, lower demand, shifting of hydro production from one period to the next and the commissioning of a new gas generator explain the emission reductions. A number of highly publicised generating plant closures actually had a minor impact on principles (because they produced little in the period before emission prices were introduced). For these reasons we suggest that it cannot be said that pricing emissions has reduced emissions in stationary energy to any meaningful extent. Indeed, this seems consistent with the expectations of all market modellers and industry analysts of the outcomes that were likely in the period shortly after emissions were priced.

Our 2013 Report on the impact of emission prices on wholesale electricity prices in the National Electricity Market (NEM)¹ highlighted the extent to which producers and consumers have borne the cost of the then Government's emission reduction policy. In the first nine months since emissions were priced, fossil-fuel fired electricity generators in the NEM paid around \$3.3bn for emission permits. The acquisition of these permits roughly tripled the (fuel) operating cost of brown coal generators and doubled the (fuel) operating cost of black coal generators.

The report reached conclusions on implied rates of emission pass-through for the first nine months that the emission price was in operation, compared to the corresponding prior nine months. The government of the day and the regulators failed to monitor pass through rates. In some cases we saw pass through rates of NEM-wide average of 115%. While the government of the day refrained from commercial considerations going into the carbon tax regime, such an oversight cannot be allowed to happen this time around.

As the EUAA stated at the time, "the decision to provide extraordinary generous compensation (\$5.5 billion according to the Government) to brown coal generators suggests that the Government had believed the pass-through rates would be much lower". Consequently, the EUAA urges the CCA to ensure that no exemption from price monitoring be extended to wholesale energy pricing.

Also, large energy users should be informed with enough time to prepare for changing legislation. When the Carbon Tax Repeal Bill was being introduced back in 2013 the ACCC stated that they intended to release guidance papers for consumers after it had been passed. Energy users need information in a timely manner. The EUAA request that the Minister clearly provides guidance to the industry as to his expectation of the market power behaviour of all energy industry stakeholders if a delay is expected which will lead to commercial contractual uncertainty.

Voluntary Carbon Pricing

While voluntary carbon pricing schemes such as offset schemes arguably have a part to play in the broader context of Australia's climate policy, their scope should be limited. Internationally recognised standards such as the CDM should be accessible to those who wish to voluntarily offset their emissions. However, Government purchase of emissions reductions (such as the ERF) are costly (both in terms of direct participation and government administration), have questionable additional issues, and are limited in their scope and ability to cover all sectors (costly to scale-up and accessible by only large participants).

¹ EUAA "The Impact of emission prices on electricity in the National Electricity Market" EUAA June 2013

Other Mandatory Price-based Policies

There is a need to consider energy and sustainability policies as a whole and not in isolation from one another. Failure to do so will result in unintended consequences such as the RET which has led to reducing output of black-coal power stations whilst maintaining brown-coal power stations.

We are sceptical that the large scale renewable industry (whether large scale solar thermal, PV or wind) will be able to develop capacity at the rate needed to meet the RET targets by 2020. We have held this view for some time and have yet to be persuaded by any evidence to the contrary. Should our scepticism be valid, energy users may face a significant impost to meet undeliverable targets impacting on both cost and environmental effectiveness. The EUAA considers energy efficiency should be a business decision not an impost of state governments. The energy investment decision making processes involve dynamic considerations of the business arena and levels of competitiveness within it. The only way to reach a level playing field is to base policy approaches on market measures.

The continuation of the uncapped subsidy of small-scale renewable electricity systems and water heaters, is a major area of concern to EUAA members. Subsidies to rooftop PV in particular have been the main reason for significantly higher RET impacts on energy users than was anticipated by policy makers. This small scale scheme needs to be reconsidered and we encourage the Review to take account of the considerable subsidies already paid under this scheme in considering future changes to the RET.

Much of the modelling that we have seen (for the CCA, for the Clean Energy Council and for some unnamed energy users) seems to conclude that the RET will deliver lower electricity prices. This is possible but we think implausible. The RET is a government intervention and the track record of government intervention in markets, in serving the interests of consumers, is not good. Certainly if we look back on the last 10 years of the RET, some consumers (households with rooftop PV) have benefitted from the RET, but it seems difficult to conclude that consumers in general are better off. To the contrary, large energy users that do not have partial exemption under the emission intensive trade exposed arrangements have had to bear a significant burden to subsidise renewable electricity.

Policy support for renewable generation may be needed to achieve this. It is important to note that emission reduction policy is public policy and not energy policy and in line with the Government's policy approach, it is the Government and not energy users that should pay for the delivery of this policy.

It is imperative that the federal and state governments agree to co-ordinate a national approach to climate change otherwise economic activity could be further stymied forcing further closures within an already stressed domestic manufacturing sector. By duplicating similar policies there will be multiple costs on activities concerning climate change. More compliance and red tape will stretch valuable resources that could otherwise be used effectively for reducing emissions under a well considered national climate policy. The role of the state governments should be limited to advocating and supporting the national approach.

The balance needs to be struck between the liquidity of the scheme and the business efficiency case to minimise the admin and red tape impost on liable entities. If implemented appropriately, introducing project based assessments will result in a significant increase in participation of the scheme by commercial and industrial users.

The EUAA calls for a policy framework that does not reduce the competitiveness of Australian operations. As an example of the difficulty imposed on state based manufacturers, several EUAA members have invested significant amounts of capital into energy efficiency projects. Yet despite this investment, they were not able to benefit (such as by creating a certificate in VEEC) due to the very restrictive and prescriptive nature of the scheme- this outcome runs counter to all three principles.

Regulation

The EUAA believes that regulation has a part to play in some sectors, however, its scope should be limited. Areas where regulation is effective includes:

- energy efficiency standards for appliances, equipment and buildings; and
- emissions standards for vehicles.

Information and Innovation

Information programs are essential to the successful implementation of all climate policies and the long-term reduction in emissions across all sectors. In particular, social media programs such as “Sustain Me” app and the Brisbane City Council apps result in successful uptake of emission reduction activities. These information programs should cover the full spectrum of the supply chain whether it be energy or household’s products. This is particularly important for educating low-income households in how they can/should respond to the policy being introduced. This is essential to maintain the third principle of equity against which the policies are being compared.

The EUAA acknowledges that governments can play a role as enabler of R&D, innovation and adoption of technology. An example of this is ARENA’s dedicated R&D funding program to industry partners that helps expand options for large users to reduce energy cost. Ultimately, both information and innovation programs are necessary complements to an over-arching climate policy.

Sectors and Policies

The EUAA believes that the least-cost approach to climate policy is a market-based mechanism that covers the entire economy. However, it is understood that in sectors such as agriculture and land-use that the complexity of the measurement and monitoring process could mean that these sectors are better-off being excluded from the scheme at first and permitted to participate in voluntary offset schemes. Furthermore, the Transport sector (due to the large number of small players), could be better-off commencing with regulation before phasing into a market based scheme (such as they are doing in California).

International Competitiveness

Institutional stability is important for Australia's competitive position. If we want to encourage investment flow from less stable operating environments to Australia then we need to offer consistent, long-term policy that prices carbon in a predictable manner. To achieve the most effectiveness, international permits must be allowed. As the EUAA has always stressed, policy should reflect a global effort. We agree with CCA that allowing access to international abatement opportunities will be more cost and environmental effective than achieving abatement solely through domestic means. It is important that any climate policy addresses the issue of international competitiveness.

As has been recognised in previous policy development, there is a real risk to Australian businesses and industry through imposing climate policy that puts them at a disadvantage to their competitors. Reduced cost competitiveness makes Australian businesses and industries more vulnerable during an economic downturn, and makes it more difficult to justify growth and expansion; to the detriment of the Australian economy. Many of the EUAA’s large energy users are trade exposed as they compete in international

markets for the supply of goods and they compete on a cost of production basis. Any increase in direct and indirect costs relative to their overseas competitors will determine if Australian firms are at a disadvantage.

The COP21 Paris talks were the most recent in a long line of global meetings to reduce climate change. As successful as the talks were, COP21 does not represent the end of the journey, rather it is a significant step taken and there will need to be further steps to match the levels of ambition. The pledges given by countries, in the form of INDC's, are varied in respect of the level of commitment and the timing of those commitments. In many cases there is little detail on how those commitments will be delivered and therefore the impact that those commitments will have on domestic businesses and industry. It is therefore too early to ascertain the impact of such commitments on the competitiveness of Australian businesses and industry and the potential for carbon-leakage. More detailed analysis is required before any conclusion about the impacts upon competitiveness can be understood and addressed in Australia's climate change policy.

The complex effort of decarbonisation, as said above, cannot be successful without a global effort and the record number of countries making pledges at Paris was a positive sign. However, the EUAA finds it difficult to agree that this "broad international commitmentgreatly reduces the risk of carbon leakage" with the same level of confidence as the CCA. In the Australian context there is the risk of carbon leakage from Australian Emissions Intensive-Trade-Exposed (EITE) Industries. This would result in emission heavy industries within Australia being shut-down only to be re-opened overseas with equal or greater emissions in jurisdictions where there are less severe climate policies in place. In such instances there is no positive improvement in the three principles of cost effectiveness, environmental effectiveness and equity- only a significant negative impact to the Australian economy.

Consequently, the EUAA believes that assistance should be provided to Australia's EITE industries. The EITE provisions allowed for in the Clean Energy Legislation (Jobs and Competitiveness Package) provides a sound basis for minimising the impact on international competitiveness and the risk of carbon leakage. This involves administration by the Productivity Commission on a periodic basis.