



Investor Group on
Climate Change

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Re: Clean Energy Legislation (Carbon Tax Repeal) Bill 2013

IGCC thanks the Government for the opportunity to comment on the Clean Energy Legislation (Carbon Tax Repeal) Bill 2013.

The IGCC represents Australian institutional investors with over \$1 trillion of funds under management and other members of the investment community. IGCC members are invested across the Australian economy and are part owners of most of Australia's large companies. Members also hold substantial direct investments in infrastructure and property assets in Australia and around the world. As managers of retirement savings and pooled investments we are concerned with the long-term impacts of climate change on the global and Australian economies and future investment returns.

Summary

The IGCC supports robust, investment-grade policies to reduce emissions. We have long supported putting a price on emissions as the most effective and efficient way to provide a long-term, transparent and certain regulatory framework to address carbon risks in investment portfolios. In 2011, we welcomed the passage of the Clean Energy Future legislation and said that 'it is in the interests of investors that **it remain in place** to maintain a certain regulatory environment.'

Reducing Australia's emissions is a long-term project. It requires a policy framework that is stable and that is capable of being scaled up to deliver more ambitious reductions over time. Australia's economy is among the most emissions intensive in the world and emissions reductions from current levels will need to be significant. Australia should therefore adopt policies that cut emissions at the lowest possible cost.

Consistent with these views, in its October 2013 report, *Climate and Carbon – Aligning Prices and Policies*, the OCED said:

'If governments are serious in their fight against climate change, the core message of this reform must be that the cost of CO₂ emissions will gradually increase, creating a strong economic incentive to reduce the carbon entanglement and to shift towards a zero carbon trajectory. A central feature of such an approach is placing a price on carbon.'

In the absence of an alternative policy proposal that is likely to be at least as effective and efficient as the current carbon pricing framework, IGCC does not support repealing Australia's carbon legislation and recommends that the repeal bill not proceed.

An internationally linked carbon market allows emissions reductions to occur where the cost is lowest. For that reason, IGCC supports moving to a floating carbon price linked to the European Union emissions trading scheme from 1 July 2014.

Strengths of the existing policy framework

The current carbon pricing framework has several elements that are important features of a long term, investment grade, emissions reduction policy, including:

- a scheme cap that reflects an emissions reduction objective;
- broad coverage of sources of emissions in the economy, not only the electricity sector;
- transitional assistance arrangements for trade exposed sectors;
- the ability to access international permits to achieve lowest cost abatement;
- the capacity to respond to deeper reduction targets as necessary without undue policy disruption or economic cost.

The proposed repeal bill would remove these fundamentally important policy elements for Australia's policy framework. Each element is discussed below:

Scheme cap

A scheme cap based on a pre-determined emissions outcome facilitates a known contribution to Australia's emission reductions. Net emissions reductions have traditionally been required for developed economies under international climate change conventions. A scheme cap is required for any price based policy to be effective, including baseline and credit style schemes.

Broad coverage

Broad coverage of the sources of emissions in the economy spreads the burden of emission reduction efforts while increasing the opportunities for low cost domestic abatement. For universal investors, it also means that most sectors are required to address and reduce emissions risks earlier rather than later.

Transitional assistance

The transitional assistance framework incorporates important industrial activity baselines and a regime to address cost differentials with trading partners. As emission reduction policies will vary around the world, any scheme that requires emissions reductions will require the capacity to shield domestic industry from transitional cost disadvantages with trade competitors.

International access

As a developed, emissions intensive economy, it is in Australia's economic interest to be able to maximise the use of existing industrial assets and trade out of our emissions intensive position over time. Access to verified international permits supports our emission reduction objectives, reduces abatement costs and supports low carbon technologies internationally.

Deeper reductions

Australia and all nations will have to reduce their emissions by over 80% by 2050 to limit warming to 2 degrees or less. The trajectory of reductions may vary, but steep reductions will be required regardless. A policy framework that can respond to deeper targets, at relatively low cost is a fundamental requirement of any long term policy framework.

If removed, these policy elements are likely to be re-introduced in Australia to accommodate deep emissions reductions in future. It is difficult to see the benefit for investors and the economy generally of removing these elements and then reintroducing them sometime after 2015.

The carbon price has been effective

Despite public concerns about carbon pricing, the scheme has been relatively effective at sending an emissions reduction signal to the market. Further, from investor analyses, the perceived impact of the carbon price does not match the evidence.

The current carbon price is a price on emissions from industrial processes, from parts of transport, agriculture and waste, and on non-electricity stationary energy as well as on carbon-intensive electricity generation. While data is limited for many sectors at this stage, emissions in the electricity sector have fallen, in part attributable to the carbon price.¹

Australia's domestic emissions are expected to rise over time, but they would rise by less than they would have in the absence of the carbon price, and our net impact on global emissions falls because companies purchase cheaper abatement offshore. Net emissions is the globally accepted measure that underpins the Kyoto Protocol. Because the cost of reducing emissions may be lower internationally, this is a significantly cheaper way to reduce emissions than if all the effort occurred domestically.

In terms of scheme costs the carbon price is assessed to have increased prices less than the 0.7% forecast by the Treasury before the start of the scheme. The Reserve Bank of Australia said, 'The carbon price accounted for a little less than half of the total increase in utilities prices over the past year (Q3, 2012), with this effect on utilities prices contributing around ¼ percentage point to headline inflation.'² Market economists have estimated around a 0.3% - 0.4% CPI increase attributable to carbon pricing across the economy.³ For trade exposed businesses, investors see the relative impact of a high Australian dollar as a factor that is material to trade competitiveness, but for emissions-intensive trade-exposed sectors the carbon price is not.

'Explicit carbon pricing mechanisms, such as carbon taxes and emissions trading systems, are generally more cost effective than most alternative policy options in creating the incentive for economies to transition towards zero carbon trajectories. The use of these mechanisms is expanding in developed, emerging and developing economies, but there is considerable scope for further uptake by governments.' OECD, October, 2013.⁴

This evidence is consistent with the performance of price based schemes around the world. A second recent OECD report found that market-based approaches like taxes and trading systems consistently reduced CO₂ at a lower cost than other instruments. Capital subsidies were among the most expensive ways of reducing emissions.⁵ The study examined the costs of reducing emissions in 15 countries using a range of policy instruments in five of the sectors that generate most emissions: electricity generation, road transport, pulp & paper and cement, as well as households' domestic energy use.

¹ Pitt & Sherry, *Electricity emissions update – data to 30 June 2013*, www.pittsh.com.au/cedex

² Reserve Bank of Australia, *Statement on Monetary Policy*, November 2012
www.rba.gov.au/publications/smp/boxes/2012/nov/d.pdf

³ Commonwealth Bank, *Economics: Update*, 23 October 2013
www.commbank.com.au/content/dam/commbank/corporate/research/publications/economics/economic-update/2013/231013-CPI.pdf

⁴ OECD, *Climate and Carbon: Aligning Prices and Policies*, OECD Publishing, October 2013, p 4.

www.oecd-ilibrary.org/environment-and-sustainable-development/climate-and-carbon_5k3z11hjj6r7-en

⁵ OECD, *Effective Carbon Prices*, November 2013, www.oecd-ilibrary.org/environment/effective-carbon-prices_9789264196964-en

Further, depending on the global carbon price path, the impact of the carbon price on electricity bills could actually fall in future as the energy mix changes towards lower carbon sources. In any case, the carbon price makes up around 7% of retail electricity prices, compared with 43% for transmission and distribution charges.⁶

Despite the evidence of price impacts and emission reductions, if concerns about relatively high domestic carbon prices persist, they can be addressed via limited international linking. The difference between the current fixed price of \$23 compared to the current EU price of \$7 is significant and would be expected to contribute to a small reduction in electricity prices while still achieving Australia's emissions reduction objectives.

For these reasons, repealing the carbon price is not justified in the absence of a more efficient or effective, long-term emissions reduction framework.

Moving to emissions trading from July 1, 2014

IGCC has long supported a cap and trade emissions trading scheme as the basis for emissions reductions policy in Australia. For this reason we support a move to a floating price ETS from 1 July 2014, with linkages to other international markets over time.

At the time the planned linkage to the European Union ETS scheme was announced in 2012, we said that 'linking with the EU ETS will provide a more predictable, longer dated price curve, which is an important input for investment decisions.' This continues to be the case.

A carbon price trajectory that encourages low carbon investment relative to emissions intensive investment is necessary for low carbon investment to occur at scale. But a relatively higher, short-term fixed price does little in practice to make long-term investment opportunities more attractive. Given that the purpose of linking the cap and trade scheme to international markets is to provide access to lower cost abatement, and that maintaining a higher price for one further year makes little difference to long-term investment decisions, IGCC supports the early commencement of emissions trading with a link to the EU ETS.

Planning for deeper emissions reductions targets

The Climate Change Authority's draft Caps and Targets Review report indicates the substantial emission reductions that Australia will have to achieve in coming decades. Cuts of 15% to 50% below 2000 levels in the period 2020 to 2030 are significant and will require a policy framework that supports deeper targets efficiently.

Investors' priority is the policy framework that will deliver emission reduction beyond 2020 and not just for the next few years. Australia's 2020 emissions reductions target is currently a relatively modest, interim step on a long-term emissions reductions path.

The current carbon pricing framework is designed to accommodate deeper emission reduction targets while still providing access to least cost abatement internationally. Without an alternative policy framework capable of accommodating deeper emissions reductions, repeal of the cap and trade framework is unwarranted.

⁶ Productivity Commission, *Electricity Network Regulatory Frameworks*, June 2013, p.109

Conclusion

In the absence of an equally efficient, long-term policy framework being proposed, IGCC does not support repeal of the carbon price and recommends that the repeal bill does not proceed.

Yours faithfully,

A handwritten signature in black ink, appearing to read "Nathan Fabian". The signature is written in a cursive style with a prominent loop at the end.

Nathan Fabian
Chief Executive
Investor Group on Climate Change