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IGCC Submission on the Emissions Reduction Fund

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The Investor Group on Climate Change (IGCC) welcomes the opportunity to make a submission to the Government in design stages of the Emissions Reduction Fund (ERF).

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. We are supportive of robust, long-term, investment-grade policies to reduce emissions.

In this submission we describe the policy principles that have informed investor contributions on climate change policy development in Australia and around the world. IGCC applies these principles to all climate related policies and believe they could be of assistance in the Government's policy development.

Policy Principles

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. IGCC has consistently argued for long-term climate polices that can provide transparency, longevity and certainty to investors. For example in our Senate Select Committee on the Scrutiny of New Taxes inquiry submission from August 2011 we said:

> *The policies that each national government selects should in our view be based on the circumstances within each country and should be evaluated in terms of the extent to which they:*
> - *provide transparency, longevity and certainty to investors;*
> - *achieve targeted emissions abatement outcomes;*
> - *ensure low costs for emissions abatement outcomes.*

In this submission we comment on these principles in respect of the proposed ERF and identify key elements of a long-term policy framework that address them.

Provide transparency, longevity and certainty to investors

Investors seek stable policy frameworks so investment decisions on long-lived assets can be undertaken with confidence. In our June 2006 submission to the National Emissions Trading Taskforce, we identified 20 years as the preferred time frame for investors to have certainty over emissions reduction scheme design. If policy frameworks are expected to change in their design, there is a strong disincentive to invest. Defining how the ERF and or Direct Action Policy may change after the early years and meet deep and necessary emissions reductions in the period 2020 – 2030 and beyond is a more relevant policy question for investors than how the first three years of ERF funding will be spent. While the Government has indicated that it will return to the question of ambition for deeper reductions after 2015, it is not yet clear how the ERF or aspects of it would evolve to address deeper emission reductions in future.

If the ERF primarily targets domestic abatement in the short term, without a clear path to respond to deeper reductions later, it would not appear to provide a framework for long term investment. IGCC would welcome a discussion of the Government's long term policy intentions, in the Government's future Green Paper and White Paper consultation documents.

Achieve targeted emissions abatement outcomes

The ERF, as we understand from the Minister's public statements, will be a voluntary carbon market where companies create project-based offsets and sell them to the government. Australia's earlier attempt at a government-funded emissions reduction contracting program, the Greenhouse Gas Abatement Program, did not achieve its emission reduction objectives. The Audit Office found that 'the level of greenhouse gas abatement achieved was significantly less than anticipated even though abatement was the key criterion for selecting projects' (ANAO Audit Report No.26 2009-10, p.84). Nine of the twenty-three approved projects were terminated because of failure to meet contractual obligations or operational difficulties, and the program achieved only 30 per cent of the intended abatement. We have found no international evidence that a government-funded offset purchase program is capable of delivering significant abatement at reasonable cost.

We understand from the Minister's public comments that the Emissions Reduction Fund will have a fixed budget with no prospect of additional allocations if emitters are unwilling to offer enough abatement at the offered price. A capped budget for purchasing emissions means that Australia's emissions reduction effort cannot be scaled up to meet a more ambitious carbon reduction target. We note that the Climate Change Authority has indicated that Australia's fair share of the global effort to reduce emissions is greater than our current national committed reduction target.

The capacity of the ERF to deliver a targeted emissions abatement outcome that contributes to Australia's long term emission reduction objectives is at risk with these design constraints. The long term prospects for the policy are not clear at this stage and a more detailed discussion of these issues would be welcomed by investors.

Ensure low costs for emissions abatement outcomes

As the OECD said last month[1], a central feature of any serious approach to reducing emissions must be imposing a rising cost on every tonne of carbon emitted. An explicit carbon price provides an ongoing incentive to improve energy efficiency and find lower-carbon ways of doing business. A voluntary carbon market is less likely to elicit emissions reductions as cost-effectively as a mandatory carbon price for two main reasons:

(i) Decision-makers' well-understood tendency to prefer avoiding losses to acquiring gains - so-called 'loss aversion' - means that reducing emissions to avoid a carbon cost is more likely than taking up an opportunity for a gain by negotiating with the government for an emissions reduction grant. Because emissions face no mandatory cost under the ERF, projects to cut carbon will receive less management attention than they would under a mandatory carbon price, reducing the total quantity of expected emissions reductions across the economy. Overcoming that problem would require a significantly higher effective carbon price.

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[1] OECD, Climate and Carbon: Aligning Prices and Policies , OECD Publishing, October 2013.http://www.oecdlibrary.org/docserver/download/5k3z11hjg6r7.pdf?expires=1384760018&id=id&accname=guest&checksum=BB1E3BA251E76540C93A647508A9D0B1

(ii) Facing a mandatory carbon price, a company reduces its emissions where it is cheapest to do so. Where a company is required to prepare an application and negotiate a contract with the government, it faces higher costs, which means that it will require a higher effective carbon price to achieve the same emissions reductions as a mandatory price.

In addition, unless a contract includes penalties for failing to deliver offsets, there are only weak incentives to continue with an emissions-reducing project that faces operational difficulties.

Addressing these considerations would be necessary to establish a long term emissions reduction policy framework.

We also understand from the Minister's public comments that the Emissions Reduction Fund will not involve international trade in allowances. IGCC has strongly supported access to the international carbon market because international emission trading allows reductions to be made wherever they are cheapest. If reducing emissions is cheaper overseas, the cost to Australia of meeting the same environmental target will be lower with international emissions trading than without it.

Considering the constraints outlined above, it is not clear that the ERF would be superior to Australia's current carbon pricing framework in addressing investors' policy principles or meeting the stated policy objectives. The IGCC would welcome Government consideration of these issues in the upcoming stages of its policy consultation.

Policy design elements

Policy principles need to be tested for their relevance in practice. The following policy design elements are positive practical design elements for a long term policy framework for Australia. We encourage the Government to consider how and when these elements may be delivered as part of the ERF or subsequent to that in the Direct Action framework. They include:

- 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.

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 over time would 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.

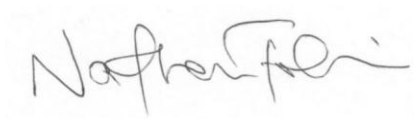
Capacity to support deeper emission reductions

According to the IPCC, 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.

Conclusion

The IGCC has consistently stated that a long term policy framework is needed to give confidence to investors for low carbon investments. We encourage the Government to specify in the design of the ERF how it will support these aims or clarify through what other mechanism, over what timeframe such a policy framework will be developed.

Yours faithfully,



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