



Investor Group on
Climate Change

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Committee Secretary
Select Committee on the Scrutiny of New Taxes
PO Box 6100 Parliament House
CANBERRA ACT 2600

16th August 2011

Dear Committee Secretary,

Thank you for your invitation to make a submission to the *Senate Select Committee on the Scrutiny of New Taxes* Inquiry into Carbon Tax Pricing Mechanisms.

The Investor Group on Climate Change (IGCC) represents Australian institutional investors (superannuation funds and investment managers), with funds under management of over \$600 billion, and other key participants in the investment community. We are managers of retirement savings and investments, concerned with the long-term stability of the economy and the impacts of climate change. We invest in all sectors of the economy, emissions-intensive and low-emission alike, and are part owners of many Australian companies.

IGCC accepts the science of climate change as assessed by Australian and international scientific institutions¹ and accepts that if unabated, climate change will continue to present material risks to economic development and investment performance. IGCC also accepts that national and international policy responses to addressing climate change must be substantial and occur within the current decade if temperature rises this century are to be limited to the vicinity of two degrees celsius.

We believe that the emerging international framework under the Cancun Agreements is one in which each nation must determine the most appropriate and cost effective policy framework to meet their own emission reduction targets. This may lead to differences in national policies based on national circumstances and does not mean that national action to reduce emissions should be delayed.

Finally we believe that addressing the risks of climate change and making adjustments to emissions intensive industry are long term economic issues and policy action should not be delayed because of short term financial volatility.

IGCC wishes to take up three areas of the committee's inquiry. The table on page 2 below summarises our response.

¹ CSIRO, Bureau of Meteorology, NASA, The Royal Society, The Potsdam Institute and others



IGCC response in summary

Committee question	IGCC response
<p><i>(b) the short and long term impact of those new taxes on the economy, industry, trade, jobs, investment, the cost of living, electricity prices and the Federation;</i></p>	<p>The short term and long term implications of delaying a carbon price are higher costs for investors and energy users.</p> <p>Research conducted for IGCC by SKM/MMA found that delaying only four years from 2012 to 2016 would:</p> <ul style="list-style-type: none"> • delay the switch from coal to gas; • lock in \$2.5bn of additional costs to 2030; • cause wholesale electricity prices to reach 19% or \$13/MWh higher than necessary and average \$6/MWh per annum higher in the period 2016 to 2030;²
<p><i>(f) an international comparison of relevant taxation arrangements;</i></p>	<p>The parameters on which international policy arrangements should be compared are:</p> <ul style="list-style-type: none"> • Transparency, longevity and certainty of the policy framework • Likely emission abatement outcomes • Cost of achieving emission abatement outcomes <p>Australia's proposed policy framework will compare favourably to trade partners and competitors on these criteria providing a certain, long term policy framework and relatively low cost emission abatement.</p>
<p><i>(g) alternatives to any proposed new taxes, including direct action alternatives;</i></p>	<p>Investors consider direct action policies to be relatively costly and in isolation, unviable for capping national emissions. As a consequence, direct action policies may be temporary in nature and may not meet investors' needs for policy longevity and certainty. They are better implemented as complementary measures to address non-price barriers to achieving emissions reductions.</p>

² *Impacts on electricity markets of delaying an emissions trading scheme*, SKM/MMA, June 2011 (Paper included with this submission)



IGCC response in detail

(b) the short and long term impact of those new taxes on the economy, industry, trade, jobs, investment, the cost of living, electricity prices and the Federation;

IGCC is interested in both the overall economic impacts of the carbon pricing scheme and the impact on companies in which we are part owners. IGCC considers that:

- the short term impact of the carbon pricing scheme on the economy is modest and smaller than if substantial action to reduce national emissions is delayed;
- the impact of the proposed carbon price on ASX200 listed companies is generally low, being less than 1% of earnings for all but a few listed companies.

The greater cost is from delay

Research conducted for the Investor Group on Climate Change and Catholic Super by economic modelling firm SKM / MMA has found that delaying the start of a carbon price in Australia would cost investors and electricity users more than under a 2012 start.

The research, which focussed on costs of delay in electricity markets, showed that delaying the start of a carbon price in Australia by only four years from 2012 to 2016 would lock in additional costs of over \$2.5bn in the period to 2030 and specifically:

- delay the switch from coal to gas for base load electricity;
- result in less efficient electricity plant build, locking in additional economic costs of around \$500m to 2030 (\$1bn to 2050) ;
- incur \$2bn in additional emission costs for the economy to 2030 (\$2.8bn to 2050);
- cause wholesale electricity price increases to reach 19% or \$13/MWh more than necessary and average \$6/MWh per annum higher in the period 2016 to 2030.

The main reasons for the additional economic cost are the building of inefficient electricity generation plant which may have slightly lower cost in the short term but lead to much higher cost in the long term, and the higher cost of replacing unprofitable, emissions intensive plant after 2016 including likely labour shortages that result.

The additional emission costs are incurred through permit purchases and are in lieu of even greater economic costs that would be incurred if emissions in the domestic electricity market were forced to reduce by 5%. Forcing the electricity market to achieve a 5% emission reduction would result in higher economic costs than the permit prices included in the results. The additional costs result from the fact that emissions would be 90 million tonnes higher under the delayed start scenario than they would be in the 2012 start scenario.

Starting a carbon price in 2012, with or without a fixed price period in the first few years, would fully avoid these increased costs to investors and electricity users.

These costs can be avoided regardless of the speed at which other countries formalise their carbon pricing arrangements.

A -5% emission reduction below 2000 levels by 2020 was assumed in this research. If Australia's 2020 emission reduction target became deeper than -5%, the economic cost of delay would be higher than the results of this research indicate.

As this research modelled the cost of delay in the electricity market only, it does not include additional costs associated with delaying the start of carbon price, mainly from higher electricity prices, in other sectors of the economy.

The research does not attempt to capture any costs associated with the physical impacts of climate change or competitiveness impacts for Australia from delayed transition to a lower carbon economy.

On the basis of this analysis, IGCC considers that rather than costing the economy more, introducing carbon pricing in 2012 will cost the economy relatively less if the 5% emission reduction target is to remain a minimum target for 2020.

The full SKM / MMA modelling and summary report by IGCC and Catholic Super are attached as Appendix A and B.

Impacts on companies

Research by IGCC member organisations shows that after transitional support is paid to companies, the short term financial impact of the carbon price on Australian listed companies is marginal. 188 companies in the S&P/ASX200 have earnings impacts of less than 1% associated with the carbon price and a further seven companies have impacts of less than 5%. Only five companies have earnings impacts of greater than 5% in 2012/13 and some of these will receive specific shielding from the impacts of carbon pricing through related policies, e.g. Steel sector adjustment package.³

IGCC considers that the transitional assistance offered to emissions intensive trade exposed companies, and sector adjustment packages offered to industrial and manufacturing sectors make the financial impacts of the scheme marginal at most in the early years. As investors and part owners of impacted companies, we consider the cost impacts are generally not material to our investment decisions over the medium term.

The relatively small cost implications for large companies confirm our view that there is no economic cost based argument for delaying the introduction of a carbon price.

³ *Carbon price to start at \$23/t*, Deutsche Bank, Breaking News, Tim King & Tim Jordan, July 11th 2011

(f) an international comparison of relevant taxation arrangements;

The Cancun Agreements require that countries pledge emissions reduction targets and then develop their own policy regimes to meet those pledges. Pricing greenhouse gas emissions is one of the policy tools that countries may select in order to reduce their emissions, along with renewable energy targets, feed-in-tariffs, energy efficiency schemes, green or clean energy investment vehicles and government grant programmes. Each has a cost for national budgets and achieves varying levels of emission abatement and governments will select those policies that make sense for national circumstances.

IGCC does not consider a narrow interpretation of Australia's proposed policy framework, which transitions to an emissions trading scheme, as a simple 'tax' to be conducive to interpreting its likely cost and effect. 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.

Against these criteria, Australia's already implemented policies fall short of investor expectations and short of the policy frameworks in trade partner countries. For example, European countries have a transparent and long term carbon pricing framework; Germany has transparent and long term renewable technology financing arrangements; and California has established research and development and new venture support structures. In addition many countries have comparable policy arrangements such as renewable energy targets in Brazil and Mexico.⁴ It is evident to investors that other nations are implementing policies to meet their emissions reduction pledges.

Australia's proposed 'Clean Energy Future' policy framework improves Australia's relative position on each of these parameters; specifically by:

- *Transparency, longevity and certainty of the policy framework:* Providing a carbon price framework with a clear, legislated transition from fixed to floating pricing; a 2050 reduction target in line with scientific recommendations; and, an independent Climate Change Authority to report on the trajectory to meet the 2050 target and provide transparent institutional arrangements going forward;
- *Likely emission abatement outcomes:* The purpose of an emissions trading scheme is to allow a national emission reduction target to be met, where the price varies in response to demand. Alternative policies, such as carbon taxes and direct action approaches do not prioritise or ensure the meeting of national targets and therefore provide little certainty over emission growth in the economy.

⁴ *Global Climate Change Policy Tracker – Winners and Losers*, DB Climate Change Advisors, Deutsche Bank Group, pp 10-14 www.dbcca.com/dbcca/EN/investment-research/investment_research_2375.jsp



- *Cost of achieving emission abatement outcomes:* According to the Productivity Commission Report, *Emission Reduction Policies and Carbon Prices in Key Economies*, evidence suggests that explicit carbon pricing frameworks achieve relatively low cost emission abatement outcomes.⁵ The overall cost of emission abatement outcomes for Australia will therefore be lower than if no carbon price were introduced.

Investors consider that once the 'Clean Energy Future' package commences in July 2012, Australia will move up into the second tier of nations (behind Germany, China and the United Kingdom) including Denmark, France and Brazil, in terms of the strength of its climate change policy framework and ahead of other nations and states with emissions intensive economic profiles (such as India, New Jersey and Canada). We base these conclusions on the analysis of member organisations that invest capital internationally.

IGCC's view is that a carbon price with appropriate complementary policies remains the most transparent, effective and relatively low cost policy framework for Australia.

(g) alternatives to any proposed new taxes, including direct action alternatives;

As indicated above, IGCC assesses the merits of policies to reduce emissions in terms of their: transparency, longevity and certainty to investors; whether they are likely to achieve targeted emission abatement outcomes; and the relative cost of the emission abatement outcomes achieved. Investors consider that direct action policies are unable to meet these criteria in isolation of carbon pricing.

Longevity and certainty

Investors consider direct action policies to be relatively costly and in isolation unviable for capping national emissions. As a consequence, any policy framework that relies solely on direct government measures is likely to be subject to change and unable to meet investors' preference for policy certainty and longevity.

Direct action policies are constrained in a number of ways, including:

- capping total emissions may be more difficult as there is no incentive for companies to reduce emissions if they do not qualify for financial support to do so;
- there is no transparent investment signal in the market as decisions about emission reductions are subject to government priorities and budgetary constraints;

⁵ *Emission Reduction Policies and Carbon Prices in Key Economies*, Productivity Commission, June 2011



- when governments directly regulate or choose and fund abatement opportunities, they are unlikely to be achieved at relatively low cost, given that there is no competitive pressure to avoid or reduce emissions in the market.

Given these material limitations, investors consider that direct action policies are unlikely to be viable in isolation from carbon pricing as a long term policy response to reducing Australia's emissions.

Given that carbon pricing has been shown to be a low cost policy framework, IGCC assumes that even if a carbon price were not introduced in the short term, that a future government would eventually introduce such a scheme in Australia. There is sufficient evidence of national and sub-national regions implementing or trialling carbon price frameworks to suggest that the benefits of market based mechanisms are understood by Governments even if the short term politics to implement them are problematic.

Institutional investors have a long term investment outlook and many investments undertaken over twenty years or more. With this in mind, investors would strongly prefer a policy framework in which the rules were clear, and elements such as emission reduction targets and therefore prices can adjust as necessary. Changing policies from one in which governments regulate or pay companies to reduce emissions to one in which companies must pay for their own emissions would be a material change in the rules of the game and potentially lead to very different outcomes for investors.

Assuming that a carbon price would eventually be introduced in Australia because of its benefits in terms of low cost abatement and certainty over emission reductions, direct action policies are better implemented as complementary policies to address non-price barriers to reducing emissions.

Effectiveness

In addition to limitations around achieving national emission reduction targets, IGCC has concerns about the capacity of the current Opposition policy to achieve a minimum of 160 million tonnes of abatement annually in 2020. These relate the level of domestic abatement that can be achieved through soil carbon and the price for which it can be achieved.

A recent study by Citi concluded that achieving Opposition estimates of 85 million tonnes of soil carbon abatement at a price of \$8 - \$10 per tonne was very unlikely given: Department of Climate Change and Energy Efficiency estimates that approximately 2.5mt of soil carbon abatement was possible, each year by 2020; that soil carbon abatement is restricted from contributing to Australia's international emission reduction obligations and so is unlikely to count towards future targets; and, the fact that there is no certainty over methods that are able to achieve large scale abatement at a price of \$8 - \$10 per tonne.⁶

⁶ *Australian Carbon Politics*, Elaine Prior, Citi Australia / New Zealand, 26th July, 2011, Page 1.



Doubts about the capacity of the Direct Action policy to meet the stated emission reduction objectives confirm our view that the policy would be temporary. This introduces significant risk for investors, including the possibility that more stringent and costly policies would be required at a later date to reduce emissions in Australia.

Concluding comments

If Australia is to reduce its emissions by at least -5% over 2000 levels by 2020, IGCC considers that there is greater economic risk and cost for investors and energy users associated with delaying the introduction of a carbon price in Australia, than with commencing in 2012. Commencing a carbon price and related policies in 2012 reduces risk that the target will be missed and / or that more stringent regulatory responses are needed to deliver the emission reduction outcome later. This also reduces risk for our investments.

The proposed carbon pricing framework compares favourably with those of trading partners and competitors on key criteria including the transparency, longevity and certainty in scheme design, the capacity to meet targeted emission reductions and the relative cost of achieving those emissions reductions.

Finally we consider that policy approaches, which rely solely on direct government action, do not meet our expectations for a long term, cost effective policy framework. We therefore urge the Parliament not to pursue such an approach.

IGCC has been actively involved in the policy discussion on carbon pricing in Australia since 2005 and we consider that it is now time to commence this critical policy for Australia.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Nathan Fabian'.

Nathan Fabian
Chief Executive

Attachments:

- 1) An introductory report to research conducted for IGCC and Catholic Super on costs of delaying an emissions trading scheme, June 2011
- 2) Impacts on electricity markets of delaying an emissions trading scheme, SKM/MMA, June 2011